Study H-821 October 18, 2007

Third Supplement to Memorandum 2007-45

Mechanics Lien Law: Public Work of Improvement (Analysis of Comments on Tentative Recommendation)

This supplement analyzes comment on the proposed hybrid project payment bond remedy discussed in the First Supplement to CLRC Memorandum 2007-45, submitted by the California State Council of Laborers Legislative Department and Construction Laborers Trust Funds for Southern California (collectively, "Laborers Group"). The comment from Laborers Group is attached as an Exhibit to this memorandum.

REMEDY AS SEPARATE LEGISLATIVE ENACTMENT

In the First Supplement to CLRC Memorandum 2007-45, the staff has recommended, due to the complexity of the proposed remedy and the perceived need for additional comment from interested parties, that any recommendation from the Commission regarding the remedy be presented to the Legislature in a separate study.

Laborers Group agrees with that recommendation. Exhibit, p. 3.

If the Commission ultimately agrees to proceed in that manner, the remainder of the issues discussed in this memorandum will be analyzed in more detail at a future time, in conjunction with the separate study.

SCOPE OF APPLICATION OF REMEDY

Laborers Group disagrees with the staff recommendation that the new remedy should apply only to improved property in which a public entity holds a present fee simple interest. Exhibit, pp. 3-5.

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

Inapplicability of Remedy to Certain Hybrid Projects

Laborers Group points out that under the staff's proposed scope of application, the new proposed remedy would not be available on several types of hybrid projects:

- Public utility projects on easements that are regulated by state agencies.
- Projects improving property in which a public entity has an ownership interest less than a fee simple interest.
- "Build-Buy" projects on privately owned land, where ownership is to be transferred to a public entity on some future date.

Exhibit, p. 4.

Laborers Group contends that in each of these situations, the recording of a lien claim on the improved property would be precluded. (In the last example, the group contends lien claims would be precluded after the transfer to the public entity occurred.) Contributors to those projects would thus be left — as they are under existing law — with neither a lien claim right nor a payment bond remedy.

The staff agrees that the proposed new remedy, if based on a present fee simple ownership interest by a public entity, would not apply to the above described projects. However, whether the inapplicability of the remedy to these types of projects warrants changing the scope of application of the proposed remedy is a separate question.

Quantification of Problem

The staff has no information that would shed light on what percentage of hybrid projects fall into the above described categories. Laborers Group asserts that the gap in the coverage of the proposed remedy would be "substantial."

The staff believes that soliciting more input on this issue would be helpful to the Commission in evaluating this question.

Unavailability of Lien Claim

The only purpose of the new payment remedy is to serve as a substitute for a lien claim. The staff is unsure whether a lien would be precluded in the cases described by Laborers Group.

Nevertheless, the remedy recommended by the staff would likely be unavailable in at least *some* scenarios in which a lien claim is also unavailable. However, as indicated in the First Supplement to CLRC Memorandum 2007-45, the staff believes this gap in coverage to be unavoidable, if the remedy is to be understandable to those who must apply it.

Suggested Alternative Scope of Application

Laborers Group disagrees, and suggests making the remedy apply in either of two cases:

(1) When a present or future public ownership interest in the improved property would preclude a lien claim.

(2) When a project is paid for at least in part by a public utility or electrical provider subject to rate regulation by the Public Utilities Commission.
See Exhibit, p. 4.

Potential Problems with Alternative Suggestion

As the staff has suggested in the First Supplement to CLRC Memorandum 2007-45, the solution advocated by Laborers Group may create other problems.

Application of the proposed remedy in the first case described by Laborers Group would on each project require someone to reach a legal conclusion as to whether the particular public ownership interest at issue would preclude a lien claim. In most cases the answer to that question would be unsettled under California case law, and disputable even among attorneys practicing in the field. It would be unreasonable to expect lay people to make that determination, particularly when risking a potentially severe adverse consequence for an incorrect decision.

Application of the remedy in the second case described by Laborers Group requires further study. The staff is unclear why *every* work of improvement contracted for by a public utility — even work on property in which there is no public ownership interest at all — is not subject to a lien claim.

The staff recommends that **the Commission obtain more input from a variety of interested parties on both aspects of the suggested alternative proposed by Laborers Group, before any decision on the scope of application of the new remedy is made**.

OPERATIONAL PROVISIONS OF NEW REMEDY

Laborers Group agrees with the staff recommendation that most of the private work payment bond provisions in the proposed law should be made applicable to the new proposed payment bond remedy. Exhibit, p. 5.

However, the Laborers Group does not agree that the private owner/developer of the hybrid project should be responsible for obtaining the payment bond. Exhibit, p. 5. The group inquires why the new remedy should deviate from the traditional private and public work payment bond scenarios, in which the direct contractor is responsible for obtaining the bond.

The staff addresses this issue in the First Supplement to CLRC Memorandum 2007-45, at pages 9-10.

Laborers Group also suggests the staff recommendation contains an anomaly, because it places the burden for obtaining the payment bond on the "owner" of the property, which would include the public entity. Exhibit, p. 5.

However, the staff recommendation does not place this burden for obtaining the bond on the "owner" of the property, it places the burden on an "owner *that contracts for a work of improvement*." First Supplement to CLRC Memorandum 2007-45, p. 11. On a hybrid project, the public entity does not contract for the work of improvement. (If it does, the project would be governed by the public work payment bond provisions. Proposed Pub. Cont. Code §§ 41130, 42010, 45010.)

ENFORCEMENT PROVISIONS

Laborers Group also disagrees with the staff recommendation that the proposed law not specify a consequence for failure to obtain the newly required bond. Exhibit, p. 6.

The staff believes that the courts would address that issue, perhaps by paralleling the treatment of an offending public entity on a public work (by imposing tort liability). See *N.V. Heathorn, Inc. v. County of San Mateo*, 126 Cal. App. 4th 1526, 25 Cal. Rptr. 3d 400 (2005), *Walt Rankin & Associates, Inc. v. City of Murrieta*, 84 Cal. App. 4th 605, 101 Cal. Rptr. 2d 48 (2000).

Laborers Group is not convinced, and asserts the proposed law should contain an express liability provision. The group suggests that the proposed law, rather than provide for tort liability, should provide for liability in whatever amount would have been required to be paid under the missing payment bond.

Laborers Group also advocates a four year statute of limitation for enforcing this liability, an award of attorney fees to a prevailing claimant, and the availability of a writ of attachment against a developer mid-project if a developer failed to obtain or require a mandated bond.

All four of these suggestions would represent new law. The staff recommends that **time be allowed to solicit and analyze the views of practitioners on the underlying issues before the Commission makes any decision on these suggestions**.

MISCELLANEOUS

Laborers Group also asserts that the proposed law should make clear that a "public entity" does not include the United States of America, or its agencies. Exhibit, p. 4, fn. 1. The group notes that the State of California has no jurisdiction over federal land.

The proposed law makes clear that its public work provisions are inapplicable to federal public work projects. See proposed Pub. Cont. Code § 41120.

However, treatment of federal property ownership in a hybrid project may not be so straightforward.

As the proposed new payment bond remedy directly impacts only private parties, application of the remedy to a work of improvement in which a federal entity has only a limited type of ownership interest might not be precluded by federal law.

If the Commission decides the proposed remedy should be included in the pending study, the staff will work with Laborers Group to develop appropriate language addressing the issue.

Respectfully submitted,

Steve Cohen
Staff Counsel

REICH, ADELL & CVITAN
A PROFESSIONAL LAW CORPORATION

3550 WILSHIRE BOULEVARD, SUITE 2000
LOS ANGELES, CALIFORNIA 90010
TEL: (213) 386-3860 • FAX: (213) 386-5583
www.rac-law.com

HIRSCH ADELL
ALEXANDER B. CVITAN
MARIANNE REINHOLD
J. DAVID SACKMAN
LAURENCE S. ZAKSON
CARLOS R. PEREZ

MARSHA M. HAMASAKI
NEELAM CHANDNA
DEBRA S. GOLDBERG
ANDREW BIRNBAUM
WILLIAM Y. SHEH

OF COUNSEL
GEORGE A. PAPPY
STEVEN T. NUTTER

JULIUS MEL REICH
(1933 - 2000)

October 12, 2007

Via E-Mail and U.S. Mail

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

Comments from California State Council of Laborers Legislative Dept. and
Construction Laborers Trust Funds for Southern California
on Payment Bond Proposal for "Hybrid" Projects
Memorandum 2007- 45 Supplement 1

Dear Members of the Commission:

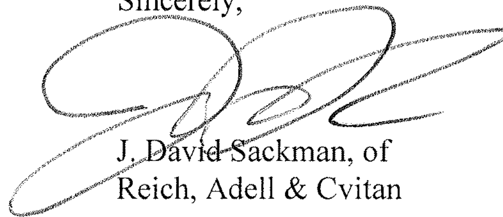
On behalf of the California State Council of Laborers Legislative Department (Laborers), and the Construction Laborers Trust Funds for Southern California (Laborers Funds), we present the following comments regarding the Payment Bond Proposal for "Hybrid" Projects, Memorandum 2007- 45 Supplement 1. We are separately submitting comments on other issues dealt with in Memorandum 2007-45.

I am available for questions, discussion or further input, at the address, phone and e-mail listed here. The best way to contact me is at this e-mail address: jds@racclaw.com

151907.1

Thank you for your consideration.

Sincerely,



J. David Sackman, of
Reich, Adell & Cvitan

following: Comments (attached as a separate files with e-mail).

cc: Mike Quevedo, Southern California District Council of Laborers
Jose Mejia, Cal. State Council of Laborers
Ric Quevedo, Construction Laborers Trust Funds for Southern California
Mark J. Rice, Cox Castle & Nicholson (Markjrice@aol.com)
John Miller, Cox Castle & Nicholson
Alexander Cvitan, Reich, Adell & Cvitan

LABORERS COMMENTS ON PAYMENT BOND PROPOSAL FOR "HYBRID" PROJECTS

We agree with the Staff that this proposal should be presented separately to the Legislature from the overall revisions to the Mechanic Lien law. We believe this proposal is mandated by the Califiornia Constitution. Article XIV § 3 provides that "**Legislature shall provide, by law, for the speedy and efficient enforcement of such liens**." By leaving holes in existing law, the Legislature has failed in its Constitutional mandate. It is therefore the mandate of this Commission, to make proposals to the Legislature on how it can fulfill its own Constitutional mandate. However, unlike the rest of the Revisions, this proposal *would be a change in existing law*. Therefore it should be considered separately.

1. Scope of Application

We disagree with the "conservative" approach taken by the Staff in framing the scope of this remedy. We see no problem in mandating "a payment bond on a project on which a court might ultimately determine that a lien claim is available." The very point of this provision is to fill a hole in existing law. The hole should be filled completely, even if there is some overflow. If there is any gap, that means that claimants will be left *without any remedy at all* for a failure to be paid for their labor or materials. On the other hand, if a bond is required on a project which turns out to be subject to a mechanic lien, nobody is deprived of a claim, and the owner receives the extra protection of a bond against a lien claim. We believe the Constitution mandates that this hole be filled completely.

The Staff Proposal is to apply the bond requirement only to projects over $25,000.00, where a public entity owns a "fee simple" interest in the real property. We agree that the monetary threshhold should be the same as that for the payment bond remedy on "public works." Limiting the remedy to this ownership interest, however, leaves several large holes in coverage. These holes include:

- Construction work by contractors for public utilities, which are not publicly owned (e.g. SBC, Sempra). The real property worked on is nothing but an easement. The land through which the easement lies may be public or private, or both. Because that easement is regulated by state and federal agencies, it cannot be bought and sold without their approval, and thus cannot be liened or foreclosed on, no matter who owns it. Because the entity contracting for the work is not a public entity, it is not considered a "public work." This is the subject of our bill - SB 935.

- "Build-Buy" projects where a private entity contracts for the work and then sells

the land and the structures to a public entity, upon completion. While a mechanic lien can be placed on the private property before it is transferred, the transfer may occur before the limitation period to file liens, thus cutting off the ability of some claimants to file a lien. Because the Staff proposal is specifically limited to a "present" interest in the property, it would not cover the "Build-Buy" situation.

- Projects in which a public entity[1/] owns something other than a "fee simple interest" but which would nevertheless be enough to block a mechanic lien. For example, real property is often granted to public entities with certain restrictions on its use. This may not be a "fee simple interest" but the property records would still show it as public land, and therefore not subject to a lien.

The above holes in the proposal are substantial. All of this work is unprotected under current law, and would remain unprotected under the Staff proposal. The Constitutional mandate would not be met by leaving such a gaping hole in the law.

We propose instead that the hole be filled completely. Our proposed statute is attached. As to the scope of coverage, we suggest that, in addition to meeting the monetary threshhold, any *one* of the following three situations be subject to the bond requirement:

(A) A public entity has an interest in the real property to be improved, so that a mechanic lien could not be filed on the property;

(B) The contract contemplates that an interest in the real property to be improved shall be transferred to a public entity, within one-hundred twenty (120) days after completion, so that a mechanic lien could not thereafter be filed on the property; or

(C) The work of improvement is to be done under contract and paid for, in whole or part, by a public utility, as defined in Section 216 of the Public Utilities Code, or any electrical provider, as defined in Section 218.3 of the Public Utilities Code, that is subject to rate regulation by the Public Utilities Commission.

1/ On a technical note, the statute should be clear that a "public entity" does not include the United States of America, or its agencies. The State of California, of course, has no jurisdiction over federal land. This is why federal law already provides a bond remedy for the equivalent of mechanic lien claims on federal land, through the Miller Act, 40 U.S.C. § 270a. The Miller Act was passed to protect laborers "in lieu of the protection [they] might receive under state statutes with respect to the construction of nonfederal buildings." United States v. Carter, 353 U.S. 210, 216 (1957).

Paragraph (C) is taken from SB 935. Paragraph (B) addresses the "Build-Buy" situation where a future interest may be granted to a public entity, rather than a present interest. Paragraph (A) is the catch-all provision to cover any other type of project which would not be subject to a mechanic lien. Together, these provisions should fill the entire hole left by existing law.

2. Operational Provisions

We do not see the potential conflict between public work payment bonds and private work payment bonds that the Staff fears. We note that, under existing law, public and private payment bonds share common provisions. For example, the "claimants" to both types of bonds are commonly described in Civil Code §§ 3110-3112. It is only because of the separation of private from public works provisions in the proposed revisions that there could be any conflict. Again this is why care should be taken to make sure that the private and public work provisions continue to be the same, to the extent they are in current law. Nevertheless, because we see no substantial difference between public or private bonds in this context, we have no objection to incorporating the private bond provisions in the Civil Code, rather than the provisions of the Public Contracts Code.

We also agree that the amount of the bond required should match the amount required on public works. This provision is designed to fill the hole left by the definition of public works, so the requirement should be similar.

We do object to the proposal to place the bond obligation on the "owner" or "developer" rather than on the direct contractor. It is the direct contractor who is currently required to post a bond on both public and private works, not the owner. We can find no provision currently requiring an owner to post a bond. Why change the current relationships regarding bonding? This proposal was originally brought up by the Associated General Contractors (AGC) who represent the direct contractors who would be required to post a bond, and supported by the Sureties, who would provide the bonds. As the Staff later notes, the only group which has not yet commented on this issue is the developers and owners. So why propose a new and unprecedented burden on the only group which has not been represented so far? In addition, the bond is for the benefit of the owner, as well as claimants, under Proposed § 7602.

The proposal, as written, also contains an anamoly. The scope is defined as projects where a public entity is the "owner." So requiring the "owner" to post a bond would mean requiring public entities to post a bond. This makes no sense. We suggest leaving the responsibility where it has been for at least a century under current law - with the direct contractor.

3. Enforcement Provisions

The Staff recommends that no provision be added to enforce the new bond requirement. This would leave the law as an empty exercise. The possibility of "tort liability" does not currently exist in the law, as there is no such requirement for a bond in private works. The referenced case of N.V. Heathorn, Inc. v. County of San Mateo, 126 Cal.App.4th 1526, 25 Cal.Rptr.3d 400 (2005) imposed tort liability only on public entities. It did so only by analogizing the duty of the public entity to post a bond to the liability created by mechanic lien law on private works. There is no guarantee that a similar remedy would be developed by the courts for this new law, especially if it was not included in the statute. This would allow the law to be completely ignored, leaving claimants again with no remedy at all.

We suggest instead that an express enforcement provision be added. Instead of tort liability, we propose that the bond liability be instead placed, by statute, on the party (or parties) who have failed to require or post the bond:

> *If a developer or person contracting for a work of improvement fails to require the posting of a payment bond, if required by subsection (a), then such developer or person contracting for the work of improvement shall be jointly and severally liable with the direct contractor, to any claimant, to the same extent as the payment bond which should have been posted. Any action to enforce this liability may be commenced within four years from the date on which the claim of the claimant arose, and a prevailing claimant shall be entitled to an award of fees and costs.*

In other words, the failure to post the required bond results in direct liability to the same extent as the bond. The four-year statute of limitations from written contract claims is used, because it may take some time before it is clear that the property cannot be liened, and no bond was posted. A claimant may try to file a lien, and it may take years before a court decides no lien is available. Also, a developer who fails to post the required bond should not be rewarded with a short limitation period. The fee award is taken from current Civil Code § 3252, for payment bonds.

We also propose making a provisional remedy available. Specifically, we propose adding this statutory liability to the list of claims for which a Writ of Attachment can be sought, in the Code of Civil Procedure. The effect of this would be to make a stop-payment type remedy available. For example, in a Build-Buy situation, in which the required bond was not posted, a claimant could file a court action, seek a writ of attachment, and then secure the claim against the contract price to be paid by the public entity to the developer. This; would give laborers and

suppliers on these "hybrid" projects protection similar to that on public works.

We thank you for your consideration. Our proposed statute follows.

PROPOSED "HYBRID" PAYMENT BOND PROVISIONS

1. Civil Code § 7603 is added:

(a) Any developer or person contracting for a work of improvement shall require the direct contractor to post a payment bond, described in Section 7606, in an amount of at least one hundred percent (100%) of the contract price of the work of improvement, if the conditions of (1) and (2) are met:

(1) The contract is for more than twenty-five thousand dollars ($25,000); and

(2) Any of the following conditions exist:

(A) A public entity has an interest in the real property to be improved, so that a mechanic lien could not be filed on the property;

(B) The contract contemplates that an interest in the real property to be improved shall be transferred to a public entity, within one-hundred twenty (120) days after completion, so that a mechanic lien could not thereafter be filed on the property; or

(C) The work of improvement is to be done under contract and paid for, in whole or part, by a public utility, as defined in Section 216 of the Public Utilities Code, or any electrical provider, as defined in Section 218.3 of the Public Utilities Code, that is subject to rate regulation by the Public Utilities Commission.

(b) If a developer or person contracting for a work of improvement fails to require the posting of a payment bond, if required by subsection (a), then such developer or person contracting for the work of improvement shall be jointly and severally liable with the direct contractor, to any claimant, to the same extent as the payment bond which should have been posted. Any action to enforce this liability may be commenced within four years from the date on which the claim of the claimant arose, and a prevailing claimant shall be entitled to an award of fees and costs.

2. Code of Civil Procedure § 483.010 is amended as follows:

483.010. (a) Except as otherwise provided by statute, an attachment may be issued only in an action on a claim or claims for money, each of which is based upon a contract, express or implied, where the total amount of the claim or claims is a fixed or readily ascertainable amount not less than five hundred dollars ($500) exclusive of costs, interest, and attorney's fees.

(b) An attachment may not be issued on a claim which is secured by any interest in real property arising from agreement, statute, or other rule of law (including any mortgage or deed of trust of realty and any statutory, common law, or equitable lien on real property, but excluding any security interest in fixtures subject to Division 9 (commencing with Section 9101) of the Commercial Code). However, an attachment may be issued where the claim was originally so secured but, without any act of the plaintiff or the person to whom the security was given, the security has become valueless or has decreased in value to less than the amount then owing on the claim, in which event the amount to be secured by the attachment shall not exceed the lesser of the amount of the decrease or the difference between the value of the security and the amount then owing on the claim.

(c) If the action is against a defendant who is a natural person, an attachment may be issued only on a claim which arises out of the conduct by the defendant of a trade, business, or profession. An attachment may not be issued on a claim against a defendant who is a natural person if the claim is based on the sale or lease of property, a license to use property, the furnishing of services, or the loan of money where the property sold or leased, or licensed for use, the services furnished, or the money loaned was used by the defendant primarily for personal, family, or household purposes.

(d) Notwithstanding subsections (a) through (c) above, an attachment may be issued in an action brought under Civil Code § 7603(b).

(~~d~~) **(e)** An attachment may be issued pursuant to this section whether or not other forms of relief are demanded.