

Memorandum 2007-57

**Mechanics Lien Law: Deferred Issues  
(Analysis of Comments on Tentative Recommendation)**

This memorandum concludes discussion of all significant outstanding issues relating to the Commission’s tentative recommendation on *Mechanics Lien Law* (June 2006).

The issues discussed in this memorandum have either been previously deferred by the Commission for later consideration, address comments submitted after the deadline for comment on the tentative recommendation, or were identified by the staff during the staff’s continuing review of the proposed law.

**Except as otherwise noted, all issues discussed in this memorandum relate to private works of improvement.**

Most comments analyzed in this memorandum were attached as an exhibit to previous CLRC memoranda. The relevant portions of those comments are summarized and discussed in this memorandum, but the comments have not been republished.

The following new comments are attached to this memorandum:

*Exhibit p.*

- California State Council of Laborers Legislative Department and Construction Laborers Trust Funds for Southern California, Los Angeles (11/29/06) ..... 1
- Sylvia Contreras, Long Beach (9/21/07) ..... 16
- Gibbs, Giden, Locher & Turner, Los Angeles (2/23/07) ..... 10
- Rodney Moss, Los Angeles (4/24/07) ..... 13
- Lori Nord, San Francisco (12/26/06) ..... 9

Comments supportive of a provision of the proposed law are not discussed in this memorandum, except when comments questioning the same provision have been received, or when the Commission has specifically solicited comment on the provision.

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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](http://www.clrc.ca.gov)). Other materials can be obtained by contacting the Commission’s staff, through the website or otherwise.

Issues in this memorandum that clearly require discussion have been marked with the following symbol: ☞.

All other issues in this memorandum are presumed to be noncontroversial “consent” issues. The staff does not intend to discuss any consent issue, unless a Commission member or member of the public expresses a question or concern about the issue.

All references to code sections in this memorandum are to the Civil Code, unless otherwise specified.

Sections of the proposed law reprinted in this memorandum are the latest draft versions of the section, incorporating any revisions approved by the Commission at previous meetings and any non-substantive technical corrections made by the staff.

#### DEFINITIONAL ISSUES

##### **“Trust Deed,” “Mortgage,” and “Deed of Trust”**

The Commission previously directed the staff to examine references in the proposed law to the terms “trust deed,” “mortgage,” and “deed of trust,” and to consider whether they can be made uniform. CLRC Minutes (December 2006), p. 3.

Each usage of these terms in the proposed law is a continuation of the language used in existing law.

##### *“Trust Deed”*

The term “trust deed” is used in the proposed law only as part of the term “construction trust deed,” which itself is used in only two sections in the proposed law. See proposed Sections 7106, 7134.

The term “construction trust deed” is effectively defined by proposed Section 7134, which provides that the words “Construction Trust Deed” must appear on certain documents:

7134. (a) A mortgage, deed of trust, or other instrument securing a loan, any of the proceeds of which may be used for a work of improvement, shall bear the designation “Construction Trust Deed” prominently on its face and shall state all of the following:

....

The term is also referenced twice in proposed Section 7106, one of the general notice provisions of the proposed law (emphasis added):

**§ 7106. Address at which notice is given**

7106. Notice under this part shall be given to the person to be notified at any of the following addresses:

....

(c) If the person to be notified is an owner, at the owner's address shown on the contract, the building permit, *or a construction trust deed*.

(d) If the person to be notified is a construction lender, at the construction lender's address shown on the construction loan agreement *or construction trust deed*.

....

(Emphasis added.)

Because the term "construction trust deed" has a specific meaning distinguishable from the more general terms "deed of trust" and "mortgage," the staff recommends that **the term "construction trust deed" continue to be used in proposed Sections 7106 and 7134.**

*"Mortgage" and "Deed of Trust"*

The terms "mortgage" and "deed of trust" both refer to similar types of security interests in property. But the terms are not synonymous, as technical differences exist between the two. See 4 B. Witkin, Summary of California Law, Chapter 8, § 5 (10th ed. 2005).

A mortgage involves an arrangement solely between a debtor and a creditor, in which the debtor (mortgagor) gives the creditor (mortgagee) a lien on property the debtor acquires or retains title to, as security for an obligation owed. A deed of trust involves a third party trustee (usually an escrow or title insurance company), that both parties agree will hold title to property serving as security, until the obligation of the debtor (trustor) to the creditor (beneficiary) is fulfilled.

In the event of debtor default, the remedies available to the creditor in each of the two scenarios may also be slightly different. See 4 B. Witkin, Summary of California Law, Chapter 8, § 5 (10th ed. 2005).

In the proposed law, the terms "mortgage" and "deed of trust" usually appear together, typically as two items in a list of referenced items. See e.g., proposed Sections 7004, 7134, 7450, 7452, and 7458. Since there are technical differences between the two terms, this usage appears appropriate.

There is one instance in the proposed law in which the term “mortgage” appears, *without* a reference to a deed of trust:

7472. If there is a deficiency of proceeds from the sale of property on a judgment for enforcement of a lien, a deficiency judgment may be entered against a party personally liable for the deficiency in the same manner and with the same effect as in an action to *foreclose a mortgage*.

Proposed Section 7472 (emphasis added). But because there can be technical differences between an action to foreclose a mortgage and an action to foreclose a deed of trust, this reference to only one of the two security interests draws a substantive distinction. It should not be changed.

The staff recommends that **the use of the terms “mortgage” and “deed of trust” be continued without any change.**

### **“Contract”**

The Commission previously directed the staff to evaluate each use of the term “contract” in the proposed law to determine whether the definition provided in proposed Section 7006 is appropriate. CLRC Minutes (October 2006), p. 6.

Proposed Section 7006 provides:

7006. “Contract” means an agreement between an owner and a direct contractor that provides for all or part of a work of improvement. The term includes a contract change.

#### **Comment. ....**

There are instances in this part where the term is not used in its defined sense. See, e.g., Sections 7028 (contract of purchase), 7130 (subcontract). See also Section 7000 (application of definitions).

....

The definition of the term “contract” in proposed Section 7006 is consistent with the definition of “contract” provided by existing law. See Section 3088. Notwithstanding this statutory definition, the proposed law would use the term to refer to three distinct types of contracts — (1) a contract between an owner and a direct contractor on a work of improvement (the statutory definition), (2) *any* contract to contribute to a work of improvement (including contracts between a direct contractor, subcontractor, material supplier, or laborer), and (3) any contract *at all*, whether related to a work of improvement or not (e.g., a “contract of purchase”).

In many instances, the intended meaning of the term is easily understood from context. In more than a few instances however, as will be outlined below, the use of the term may be confusing.

The confusion arises in sections that use the term with an apparent intent to reference *any* contract on a work of improvement, rather than only a contract between an owner and a direct contractor (all sections shown with emphasis added):

**§ 7106. Address at which notice is given**

7106. Notice under this part shall be given to the person to be notified at any of the following addresses:

....

(e) If the person to be notified is a direct contractor or a subcontractor, at the contractor's address shown on the building permit, on the contractor's *contract*....

**§ 7130. Contract forms**

7130. ....

(b) A written *contract* entered into between a direct contractor and subcontractor, or between subcontractors, shall provide a space for the name and address of the owner, direct contractor, and construction lender if any.

**§ 7142. No release of surety from liability**

7142. None of the following releases a surety from liability on a bond given under this part:

(a) A change to a *contract*, plan, specification, or agreement for a work of improvement or for work provided for a work of improvement.

....

(c) A rescission or attempted rescission of a *contract*, agreement, or bond.

(d) A condition precedent or subsequent in the bond purporting to limit the right of recovery of a claimant otherwise entitled to recover pursuant to a *contract*, agreement, or bond.

....

**§ 7160. Terms of contract**

7160. An owner or direct contractor may not, by *contract* or otherwise, waive, affect, or impair a claimant's rights under this part, whether with or without notice, and any term of a *contract* that purports to do so is void and unenforceable unless and until the claimant executes and delivers a waiver and release under this article.

**§ 7170. Conditional waiver and release on progress payment**

7170. ....

This document does not affect *contract* rights, including (i) a right based on rescission, abandonment, or breach of *contract*, and (ii) the right to recover compensation for work not compensated by the payment.

**§ 7434. Amount of recovery**

7434. A direct contractor or a subcontractor may enforce a lien only for the amount due pursuant to that contractor's *contract* after deducting all claims of other claimants for work provided and embraced within that *contract*.

**§ 7446. Multiple works of improvement**

7446. A claimant may record one claim of lien on two or more works of improvement, subject to the following conditions:

....

(b) The claimant in the claim of lien designates the amount due for each work of improvement. If the claimant contracted for a lump sum payment for work provided for the works of improvement and the *contract* does not segregate the amount due for each work of improvement separately, the claimant may estimate an equitable distribution of the amount due for each work of improvement based on the proportionate amount of work provided for each.

....

**§ 7502. Contents of stop payment notice**

7502. ....

(c) The claimant may include in a stop payment notice an amount due for work performed as a result of rescission, abandonment, or breach of the *contract*. If there is a rescission, abandonment, or breach of the *contract*, the amount of the stop payment notice may not exceed the reasonable value of the work provided by the claimant.

**§ 7714. Security not waivable**

7714. It is against public policy by *contract* to waive the provisions of this chapter.

**§ 7820. Waiver against public policy**

7820. It is against public policy by *contract* to waive the provisions of this article.

**§ 7846. Waiver against public policy**

7846. It is against public policy by *contract* to waive the provisions of this article.

**§ 7848. Application of article**

7848. (a) This article applies to a *contract* entered into on or after January 1, 1999.

Given the number of non-conforming uses, the staff believes it would be helpful to practitioners to distinguish between a “direct contract” between an owner and a direct contractor, and *any* contract relating to a work of improvement.

The staff recommends **the following changes**:

First, **the statutory definition of the term “contract” in proposed Section 7006 should be revised to define the term as *any* contract on a work of improvement.** Not only does this appear to be the more frequently intended usage of the term, but it is also the definition most likely to be assumed by readers coming across the term in the proposed law.

**Proposed Section 7006 would be revised as follows:**

**§ 7006. Contract**

7006. “Contract” means an agreement ~~between an owner and a direct contractor~~ that provides for all or part of a work of improvement. The term includes a contract change.

**Comment.** Section 7006 ~~continues~~ broadens the definition of “contract” in former Section 3088 and adds a reference to a contract change. The term “contract change” replaces “written modification of the contract” as used in former Section 3123. This codifies the effect of *Basic Modular Facilities, Inc. v. Ehsanipour*, 70 Cal. App. 4th 1480, 83 Cal. Rptr. 2d 462 (1990).

There are instances in this part where the term is not used in its defined sense. See, e.g., Sections 7028 (contract of purchase), ~~7130 (subcontract)~~. See also Section 7000 (application of definitions).

An agreement between an owner and a direct contractor that provides for all or part of a work of improvement is a “direct contract.” See Section 7011.

See also ~~Sections 7012 (“direct contractor” defined), 7028 (“owner” defined),~~ Section 7046 (“work of improvement” defined).

**Second, a new definition should be added as follows:**

**§ 7011 (added). Direct contract**

7011. “Direct contract” means a contract between an owner and a direct contractor that provides for all or part of a work of improvement. The term includes a contract change.

**Comment.** Section 7011 continues the substance of former Section 3088, but adds a reference to a contract change. The term “contract change” replaces “written modification of the contract” as

used in former Section 3123. This codifies the effect of *Basic Modular Facilities, Inc. v. Ehsanipour*, 70 Cal. App. 4th 1480, 83 Cal. Rptr. 2d 462 (1990).

See also Sections 7006 (“contract” defined), 7012 (“direct contractor” defined), 7028 (“owner” defined), 7046 (“work of improvement” defined).

**Third, sections in the proposed law that reference a contract between an owner and a direct contractor should be revised to use the new term:**

**§ 7008. Contract price**

7008. “Contract price” means the price agreed to in a direct contract for a work of improvement, including a contract change. If the parties have not agreed to a price for the work of improvement, the contract price is the reasonable value of the work provided for the work of improvement.

**§ 7154. Notice of completion of contract for portion of work of improvement**

7154. If a work of improvement is made pursuant to two or more direct contracts, each covering a portion of the work of improvement:

(a) The owner may record a notice of completion of a direct contract for a portion of the work of improvement. On recordation of the notice of completion, for the purpose of Sections 7412 and 7414 a direct contractor is deemed to have completed the contract for which the notice of completion is recorded ....

**§ 7412. Time for claim of lien by direct contractor**

7412. A direct contractor may not enforce a lien unless the contractor records a claim of lien after the contractor completes the direct contract, and before the earlier of the following times:

....

**§ 7432. Lien limited to work included in contract or modification**

7432. (a) A lien does not extend to work authorized by a direct contractor or subcontractor, if the work was not included in a direct contract ~~between the owner and direct contractor~~, and the claimant had actual knowledge or constructive notice of the provisions of that contract before providing the work.

....

**§ 7454. Separate contract for site improvement**

7454. If a site improvement is provided for in a direct contract separate from the direct contract for the remainder of the work of improvement, the site improvement is deemed a separate work of improvement and commencement of the site improvement is not commencement of the remainder of the work of improvement.



**§ 7600. Public policy of payment bond**

7600. An owner may require a performance bond, payment bond, or other security as protection against a direct contractor's failure to perform the direct contract or to make full payment for all work provided pursuant to the contract.

**§ 7602. Limitation of owner's liability**

7602. (a) This section applies if, before the commencement of work, the owner in good faith files ~~the~~ a direct contract with the county recorder and records a payment bond of the direct contractor in an amount not less than 50 percent of the contract price.

....

**§ 7816. Payment for disputed work**

7816. (a) If the direct contractor gives the owner, or a subcontractor gives the direct contractor, notice that work in dispute has been completed in accordance with the direct contract, the owner or direct contractor shall within 10 days give notice advising the notifying party of the acceptance or rejection of the disputed work. Both notices shall comply with the requirements of Article 4 (commencing with Section 7100).

....

Finally, **proposed Section 7500, which refers to a "direct written contract" in another sense, should be clarified:**

**§ 7500. Stop payment notice exclusive remedy to reach construction funds**

The rights of all persons furnishing work for any work of improvement, with respect to any fund for payment of construction costs, are governed exclusively by this chapter, and no person may assert any legal or equitable right with respect to such fund, other than a right created by ~~direct~~ a written contract between such person and the person holding the fund, except pursuant to the provisions of this chapter.

**Comment.** Section 7500 continues Section 3264 without substantive change, except that it is limited to a private work. See Section 7050 (application of part). For a comparable provision applicable to a public work, see Pub. Cont. Code § 44110 (stop payment notice exclusive remedy to reach construction funds).

The reference to a "direct" written contract has been revised to avoid confusion with the term "direct contract." See Section 7011. The revision is non-substantive.

This section is not intended to either ratify or abrogate the holding of *Nibbi Brothers, Inc. v. Home Fed. Sav. & Loan Ass'n*, 205 Cal. App. 3d 1415, 253 Cal. Rptr. 289 (1988), that in an appropriate

case a person providing labor or materials may recover from a construction lender on a theory of unjust enrichment.

See also Sections 7032 (“person” defined), 7045 (“work” defined).

#### MANNER OF GIVING NOTICE

The staff has noted that proposed Section 7104, which specifies the *manner* of giving notice under the proposed law, deviates from existing law by using permissive rather than mandatory language:

7104. Except as otherwise provided by statute, notice under this part *may* be given by any of the following means:

....

Existing law consistently uses “shall” when describing how notice is to be given. See e.g., Sections 3097 (giving of preliminary notice), 3144.5 (notice of lien release bond), 3154 (notice of hearing on lien release petition). Changing “shall” to “may” could cause a problem, as the change could be interpreted as making a mandatory requirement optional.

The staff recommends that **proposed Section 7104 be revised as follows:**

#### **§ 7104. Manner of giving notice**

7104. Except as otherwise provided by statute, notice under this part ~~may~~ shall be given by any of the following means:

- (a) Personal delivery.
- (b) Mail in the manner provided in Section 7108.
- (c) Leaving the notice and mailing a copy in the manner provided in Section 415.20 of the Code of Civil Procedure for service of summons and complaint in a civil action.

The staff also recommends that the same **change be made to proposed Public Contract Code Section 42104, specifying the manner of giving notice in a public work.**

#### COMPLETION ISSUES

##### **Notice of Cessation**

Existing law provides that an owner (a private owner or a public entity) may record a “notice of cessation” after 30 continuous days of cessation of labor. Section 3092. Under existing law, this recordation is one of several events that trigger the running of a time limit to pursue the various remedies available under the mechanics lien law.

In the tentative recommendation, the Commission merged the notice of cessation with the notice of completion, as the two types of notices seemed to have identical effect. Tentative Recommendation on *Mechanics Lien Law* (June 2006), p. 26.

After receiving comment on the proposed change however, the Commission decided to restore the notice of cessation in the public work part of the proposed law. See CLRC Memorandum 2007-34, pp. 26-30; CLRC Minutes (August 2007), p. 3.

According to commenters, recordation of a notice of completion is used to mark the *end* of a project, and various obligations are keyed on that event. A recordation of a notice of cessation is used in the *middle* of a project — typically when the direct contractor defaults — to identify all outstanding amounts owed to any contributor at that point (by triggering the applicable statute of limitation for making such claim). The Commission was advised that using the recordation of a notice of completion to accomplish this latter purpose would be unacceptable to public entities.

The staff indicated it would analyze and present at a later time whether the notice should also be restored on a private work.

The staff believes the considerations discussed above apply equally to a private work. Moreover, if the proposed law continues the notice of cessation on a public work, the failure to continue the concept on a private work may be more confusing than helpful. This would be particularly true for practitioners that do work in both arenas.

The staff recommends **restoring the notice of cessation in existing law to the private work part of the proposed law, as follows:**

**§ 7155 (added). Notice of cessation**

7155. (a) An owner may record a notice of cessation if there has been a continuous cessation of labor on a work of improvement for at least 30 days prior to the recordation that continues through the date of the recordation.

(b) The notice shall be signed and verified by the owner.

(c) The notice shall comply with the requirements of Article 4 (commencing with Section 7100), and shall also include all of the following information:

(1) The date on or about which work ceased.

(2) A statement that the cessation has continued until the recordation of the notice.

**Comment.** Section 7155 continues former Civil Code Section 3092 (notice of cessation). For the effect of recordation of a notice of

cessation, see Sections 7412 and 7414 (time for recording lien claim) and 7508(b) (time for giving stop payment notice).

The notice of cessation may be recorded by an agent of the owner to the extent the act is within the scope of the agent's authority. See Section 7060 (agency).

A notice of cessation is recorded in the office of the county recorder of the county in which the work of improvement or part of it is performed. Section 7056(a) (recordation of notice). A notice of cessation is recorded when it is filed for record. Section 7056(b) (recordation of notice).

As used in this section, the owner is the person that causes a building, improvement, or structure, to be constructed, altered, or repaired (or the owner's successor in interest at the date of a notice of cessation is recorded) whether the interest or estate of the owner is in fee, as vendee under a contract of purchase, as lessee, or other interest or estate less than the fee, and includes a cotenant. See Sections 7028 ("owner" defined), 7058 (co-owners).

See also Section 7045 ("work" defined).

The staff also recommends **the following revisions, to restore existing law relating to the recordation of a notice of cessation on a private work:**

#### **§ 7150. Completion**

7150. (a) For the purpose of this part, completion of a work of improvement occurs at the earliest of the following times:

....

(4) Recordation of a notice of ~~completion~~ cessation after cessation of labor for a continuous period of 30 days.

#### **§ 7156. Notice of recordation by owner**

7156. (a) An owner that records a notice of completion or cessation shall, within 10 days of the date the notice of completion or cessation is filed for record, give a copy of the notice to all of the following persons:

(1) A direct contractor.

(2) A claimant that has given the owner preliminary notice.

(b) The copy of the notice shall be given in compliance with the requirements of Article 4 (commencing with Section 7100).

(c) If the owner fails to give notice to a person as required by subdivision (a), the notice of ~~completion~~ is ineffective to shorten the time within which that person may record a claim of lien under Sections 7412 and 7414. The ineffectiveness of the notice of ~~completion~~ is the sole liability of the owner for failure to give notice to a person under subdivision (a).

....

**§ 7412. Time for claim of lien by direct contractor**

7412. A direct contractor may not enforce a lien unless the contractor records a claim of lien after the contractor completes the contract, and before the earlier of the following times:

- (a) Ninety days after completion of the work of improvement.
- (b) Sixty days after the owner records a notice of completion or cessation.

**Comment.** Section 7412 ~~restates~~ continues former Section 3115. A contract is complete within the meaning of this section when the contractor’s obligations under it are substantially performed, excused, or otherwise discharged. See Howard S. Wright Construction Co. v. BBIC Investors, LLC, 136 Cal. App. 4th 228, 38 Cal. Rptr. 3d 769 (2006).

For “completion” of a work of improvement, see Section 7150. For recordation of a notice of completion, see Section 7152 (notice of completion). ~~The notice of completion includes notice of cessation.~~ For recordation of a notice of cessation, see Section 7155 (notice of cessation).

....

**§ 7414. Time for claim of lien by claimant other than direct contractor**

7414. A claimant other than a direct contractor may not enforce a lien unless the claimant records a claim of lien within the following times:

- (a) After the claimant ceases to provide work.
- (b) Before the earlier of the following times:
  - (1) Ninety days after completion of the work of improvement.
  - (2) Thirty days after the owner records a notice of completion or cessation.

**Comment.** Section 7414 ~~restates~~ continues former Section 3116. For “completion” of a work of improvement, see Section 7150. For recordation of a notice of completion, see Section 7152 (notice of completion). ~~The notice of completion includes notice of cessation.~~ For recordation of a notice of cessation, see Section 7155 (notice of cessation).

....

 **Work Performed After “Completion” of a Work of Improvement**

*Background*

“Completion” of a private work of improvement is an event that can trigger a time limit for pursuing a claim of lien, stop payment notice, or payment bond claim. Proposed Sections 7412(b)(1), 7414(b)(1), 7416, 7508(b), 7612(b). Under each of these sections, a claimant has at most 90 days from the date of completion

(and may have less) to take specified action. Once the deadline passes, a claimant may not take that action.

On a private work of improvement, the proposed law would define “completion” as follows:

7150. (a) For the purpose of this part, completion of a work of improvement occurs at the earliest of the following times:

- (1) Substantial completion of the work of improvement.
- (2) Occupation or use by the owner accompanied by cessation of labor.
- (3) Cessation of labor for a continuous period of 60 days.
- (4) Recordation of a notice of completion after cessation of labor for a continuous period of 30 days.

(b) Notwithstanding subdivision (a), if a work of improvement is subject to acceptance by a public entity, completion occurs on acceptance.

#### *Work Performed After “Completion”*

In some cases work may continue to be done *after* completion.

For example, the California State Council of Laborers Legislative Department and the Construction Laborers Trust Funds for Southern California (collectively, “Laborers Group”) reports several cases in which laborers provide landscape work after “completion” of a work of improvement. Exhibit pp. 7-8. That could happen if the landscaping is done after the owner occupies or uses the property, or after a cessation of work for at least 60 days (perhaps due to weather), prior to the commencement of the landscaping work. Proposed Sections 7150(a)(2), (3). Another example of post-completion work would be the “punchlist” finishing work that occurs after “substantial completion” of the work of improvement. Proposed Section 7150(a)(1).

Post-completion work creates a problem. Given that *all* claimants on a work of improvement are required to pursue remedies no more than 90 days after “completion,” what happens to a claimant that is still doing work more than 90 days after completion?

At minimum, this claimant would not be able to pursue a claim for any work performed after the applicable deadline.

Furthermore, a lien claim may not be recorded until after a claimant has ceased *all* work on a work of improvement. Sections 3115, 3116, proposed Sections 7412, 7414(a). That means that a claimant still providing work more than 90 days after completion may not record a lien claim until after the deadline for doing so.

The staff has located no appellate opinion governing this issue, nor do the leading treatises address the issue.

The staff suggests two ways the Commission might address this existing problem. **It makes no recommendation as to which of the two options the Commission should adopt.**

#### *No Further Revision to Proposed Law*

First, the Commission could decide to make no change to existing law on the issue. This would continue the problem to the extent it exists at the present time, but would also allow for the continuation of whatever practical solutions to the problem have been developed over the years by practitioners and courts.

A possible drawback to this alternative, as suggested by Gibbs, Giden, Locher & Turner (“GGLT”), a Los Angeles law firm, is that the explicit recognition of “substantial completion” as a basis for completion under the proposed law could exacerbate the problem. Exhibit p. 10-12. Under existing law, a claimant may at least be able to *argue* that “actual completion” includes post-completion work (even though the weight of authority on the issue is to the contrary). Under the proposed law, that argument would be foreclosed.

#### *Extension of Time to Make Claims*

Alternatively, the Commission could extend the time to pursue statutory remedies for a claimant providing work after completion, to some specified date after the claimant finishes work. While this approach would mean that an owner would not be able to rely on the event of completion to close out *all* outstanding claims, any post-completion claim exposure should be relatively minor and obvious (e.g., post occupation landscaping). It may be better policy to require owners to face this limited extension of claim exposure, than to cut off claims for post-completion work.

#### *Special Problem: Stop Payment Notices*

An extension of time would probably not work for one of the three remedies available under the law, the stop payment notice.

All stop payment notice claims are made against a fixed pool of money, which is sometimes not enough to cover all claims. If that happens, a pro rata distribution is sometimes required. Proposed Section 7540.

A pro rata distribution necessarily requires a calculation of the total of all stop payment notice claims, *as of the date when the fund holder knows no more stop payment notices can be given*. Extending this date to accommodate a claimant doing work on a project after completion would delay payment to every other stop payment notice claimant.

#### *Implementing an Extension of Time*

The proposed law could still provide more protection for claimants doing post-completion work than such claimants have now, by adding an extension of time to either record a lien claim or make a claim against a payment bond. The extension could be for any length of time the Commission felt appropriate. The staff suggests 30 days from the date the claimant stops providing work.

That approach would be supported in part by the Laborers Group. Exhibit p. 8. It would also be supported in part by Lori Nord, a San Francisco attorney who generally concurs in the comment of the Laborers Group. Exhibit p. 9.

**The reform would be implemented by adding a new section and revising proposed Section 7612, as follows:**

#### **§ 7415 (added). Time for claim of lien by claimant doing work after completion**

7415. A claimant that provides work after completion of the work of improvement may enforce a lien, if the claimant records a claim of lien within the following times:

- (a) After the claimant ceases to provide work.
- (b) Before the later of the following times:
  - (1) The time within which a claim of lien must be recorded under Section 7412 or 7414.
  - (2) Thirty days after the claimant ceases to provide work.

#### **§ 7612. Notice prerequisite to enforcement**

7612. (a) In order to enforce a claim against a payment bond under this part, a claimant shall give the preliminary notice provided in Chapter 2 (commencing with Section 7200).

(b) If preliminary notice was not given as provided in Chapter 2 (commencing with Section 7200), a claimant may enforce a claim by giving written notice to the surety and the bond principal within 15 days after recordation of a notice of completion, or 30 days after the claimant ceases providing work, whichever is later. If no notice of completion has been recorded, the time for giving written notice to the surety and the bond principal is extended to 75 days after completion of the work of improvement, or 30 days after the claimant ceases providing work, whichever is later.



To avoid impeding other claimants' stop payment notice rights, **the reform would also need to provide that the new extension of time was *not* applicable to a stop payment notice claim under proposed Section 7508:**

**§ 7508. Requirements for valid stop payment notice**

7508. A stop payment notice is not valid unless both of the following conditions are satisfied:

(a) The claimant gave preliminary notice to the extent required by Chapter 2 (commencing with Section 7200).

(b) The claimant gave the stop payment notice before expiration of the time within which a claim of lien must be recorded under ~~Chapter 4 (commencing with Section 7400)~~ Section 7412 or 7414.

Finally, if the Commission decides to revise the private work part of the proposed law to address this issue, the staff also recommends **the following revision to the provision in the proposed law governing notice on a public work payment bond:**

**§ 45060. Notice required**

45060. (a) In order to enforce a claim against a payment bond, a claimant shall give the preliminary notice provided in Chapter 3 (commencing with Section 43010).

(b) If preliminary notice was not given as provided in Chapter 3 (commencing with Section 43010), a claimant may enforce a claim by giving written notice to the surety and the bond principal within 15 days after recordation of a notice of completion, or 30 days after the claimant ceases providing work, whichever is later. If no notice of completion has been recorded, the time for giving written notice to the surety and the bond principal is extended to 75 days after completion of the work of improvement, or 30 days after the claimant ceases providing work, whichever is later.

WAIVER OF CLAIMANT RIGHTS

Proposed Section 7160 restricts the ability of an owner or a direct contractor to obtain a waiver of a claimant's mechanics lien rights:

7160. An owner or direct contractor may not, by contract or otherwise, waive, affect, or impair a claimant's rights under this part, whether with or without notice, and any term of a contract that purports to do so is void and unenforceable unless and until the claimant executes and delivers a waiver and release under this article.

Proposed Section 7160 continues Section 3262. The Commission previously directed the staff to analyze an ambiguous reference in Section 3262, to make sure proposed Section 7160 accurately continued existing law. CLRC Minutes (December 2006), p. 5. The ambiguity related to whether Section 3262 applied *only* to a contract between an owner and a direct contractor, or whether it applied to all contracts entered into between an owner or direct contractor and a third party.

The Legislature amended the ambiguity out of Section 3262, effective January 1, 2007, as part of a maintenance of the codes bill. 2006 Cal. Stat. ch. 538. The amendment confirms that proposed Section 7160 as worded accurately continues this aspect of Section 3262.

However, the staff has noted another aspect of Section 3262 that proposed Section 7160 fails to continue. Section 3262 now provides:

3262. (a) Neither the owner nor original contractor by any term of a contract, or otherwise, shall waive, affect, or impair the claims and liens of other persons whether with or without notice except by their written consent, and any term of the contract to that effect shall be null and void....

As the above language indicates, Section 3262 precludes either an owner or a direct contractor from waiving, affecting, or impairing the claims and liens of *other persons*, except as provided in the section. The section does *not* restrict a direct contractor — who may also be a claimant — from waiving the direct contractor's *own* rights, in whatever manner the contractor wishes. An appellate opinion confirms this construction of Section 3262. *Santa Clara Land Title Co. v. Nowack & Associates, Inc.*, 226 Cal. App. 3d 1558, 277 Cal. Rptr. 497 (1991).

To accurately continue Section 3262, the staff recommends that **proposed Section 7160 be revised as follows:**

**§ 7160. Terms of contract**

7160. An owner or direct contractor may not, by contract or otherwise, waive, affect, or impair a any other claimant's rights under this part, whether with or without notice, and any term of a contract that purports to do so is void and unenforceable unless and until the claimant executes and delivers a waiver and release under this article.

## PRELIMINARY NOTICE ISSUES

### Content of Preliminary Notice

Proposed Section 7204, in specifying the content of a preliminary notice, incorporates the requirements of proposed Section 7102, a new provision generalizing and standardizing notice provisions found throughout existing law. Proposed Section 7102 provides that a notice given by a claimant (such as a preliminary notice) must include:

- (i) A general statement of *the work provided*.
- (ii) The name of the person to or for which the work is provided.
- (iii) A statement or estimate of the claimant's demand, if any, after deducting all just credits and offsets.

(Emphasis added).

The staff has noted that this provision fails to continue a significant aspect of the existing preliminary notice provision. Under existing law, a preliminary notice is also required to include "a general description of the labor, service, equipment, or materials ... *to be furnished*," as well as *an estimate of the total price thereof*." Section 3097(c)(1) (emphasis added).

The failure to require a preliminary notice to disclose this information would represent a significant change in existing law. In *Rental Equipment, Inc. v. McDaniel Builders, Inc.*, 91 Cal. App. 4th 445, 109 Cal. Rptr. 2d 922 (2001), a preliminary notice was held invalid, thereby invalidating the claimant's lien claim, in part because the preliminary notice failed to identify work to be provided in the future, or estimate the price of that future work.

Because all notices given by a claimant need not include these disclosures, the staff recommends, **rather than revising proposed Section 7102, that proposed Section 7204 be revised as follows:**

7204. (a) ~~In addition to~~ The preliminary notice shall comply with the requirements of Section 7102, and shall also include:

- (1) A general description of the work to be provided.
- (2) An estimate of the total price of the work provided and to be provided.
- ~~(3) The preliminary notice shall include the following statement in boldface type: ....~~

## Work on Multiple Contracts

Both existing and the proposed law require certain claimants to give a preliminary notice of work performed, as a prerequisite to pursuing a remedy under the mechanics lien law.

Proposed Section 7208 addresses the preliminary notice obligations of a claimant that provides work pursuant to contracts with more than one subcontractor:

7208. (a) Except as provided in subdivision (b), a claimant need give only one preliminary notice to each person to which notice must be given under this chapter with respect to all work provided by the claimant for a work of improvement.

(b) If a claimant provides work pursuant to contracts with more than one subcontractor, the claimant shall give a separate preliminary notice with respect to work provided to each contractor.

....

The Commission directed the staff to revise subdivision (b) to clarify that, as provided by existing law, the subdivision addresses only the number of *notices* that must be given when a person provides work pursuant to multiple subcontracts, not the number of *persons* entitled to receive preliminary notice. CLRC Minutes (January 2007), p. 4. As drafted, the subdivision could be misread as adding a requirement that a claimant give preliminary notices to each of the subcontractors to whom the claimant has provided work (i.e., the claimant shall give a separate preliminary notice with respect to work provided, *to each contractor*).

The staff recommends that **proposed Section 7208 be revised as follows:**

7208. (a) Except as provided in subdivision (b), a claimant need give only one preliminary notice to each person to which notice must be given under this chapter with respect to all work provided by the claimant for a work of improvement.

(b) If a claimant provides work pursuant to contracts with more than one subcontractor, the claimant shall give a separate preliminary notice with respect to work provided ~~to each contractor~~ pursuant to each contract.

....



## Mechanics Lien Release Bond

Proposed Section 7428 allows designated persons to release property from a recorded lien claim by obtaining and recording a lien release bond:

7428. (a) An owner of property subject to a recorded claim of lien or a direct contractor or subcontractor affected by the claim of lien that disputes the correctness or validity of the claim may obtain release of the property from the claim of lien by recording a lien release bond. The principal on the bond may be the owner of the property or the contractor or subcontractor.

(b) The bond shall be conditioned on payment of any judgment and costs the claimant recovers on the lien. The bond shall be in an amount equal to 125 percent of the amount of the claim of lien or 125 percent of the amount allocated in the claim of lien to the property to be released. The bond shall be executed by an admitted surety insurer.

....

**Comment.** Subdivisions (a)-(c) of Section 7428 continue former Section 3143. The amount of the release bond is reduced to 125 percent of the amount of the claim of lien, consistent with the stop payment notice release bond. See Section 7510 (release bond).

....

The release bond serves as a substitute for the recorded lien claim. A claimant seeking to enforce the recorded lien claim in court must instead bring the action against the surety and principal on the bond.

The American Insurance Association, National Association of Surety Bond Producers, and Surety & Fidelity Association of America (hereafter, “joint surety commenters”) argue that language should be added to proposed Section 7428 providing that the maximum recovery by a claimant in any such action must be limited to the penal amount (stated amount) of the bond. CLRC Memorandum 2006-39, Exhibit p. 98. The group’s concern is that otherwise, the surety could be held personally responsible for a judgment in excess of the bond amount. The language requested by the joint surety commenters does not appear in existing law.

### *Amount of Recovery on Lien Claim*

Since the release bond is intended to provide a substitute source of recovery for a lien claim, it is appropriate to consider what recovery is statutorily available to a claimant that seeks to directly enforce a lien claim.

In an action to enforce a lien claim, a claimant may recover the amount of the claim, litigation costs, and in some cases pre-judgment interest. Section 3150; Miller & Starr, California Real Estate § 28:73, fn. 1 (3d ed. 2007) (cases cited). However, attorney fees in such an action are *not* recoverable. *Wilson's Heating & Air Conditioning v. Wells Fargo Bank*, 202 Cal. App. 3d 1326, 249 Cal. Rptr. 553 (1988).

#### *Amount of Recovery Against Release Bond*

Proposed Section 7428(b) requires a lien claim release bond to be 125% of the amount stated in the claim of lien. As attorney fees are also not recoverable in an action against the release bond (see *Royster Construction Co. v. Urban West Communities*, 40 Cal. App. 4th 1158, 47 Cal. Rptr. 2d 684 (1995)), this 125% “cushion” would seem to be sufficient to cover court costs and interest without exposing a surety to any excess judgment.

However, the lien claim release bond provision in existing law provides for an even larger cushion, requiring the bond amount to be 150% of the amount stated in the lien claim. Section 3143. The rationale for this amount of excess coverage is unclear, but it may be because the Legislature intentionally provided such a large cushion as an *alternative* to the limitation now sought by the joint surety commenters.

Since the right to a mechanics lien is grounded in the state constitution, the Legislature may have decided that a lien claimant forced to seek recovery against a substitute release bond should never be prevented from recovering whatever amount the claimant could have recovered if the claimant had been able to directly enforce the lien claim. Therefore, rather than limit the dollar amount of a claimant's recovery against a release bond (i.e., to the amount of the bond), the Legislature may have instead decided to require a bond that far exceeds the amount of the claim.

#### *Comparison to Stop Payment Notice Release Bond*

The proposed law would reduce the 150% amount for a lien claim release bond to 125%. The rationale for the change was to achieve consistency with the provision that governs a stop payment notice release bond, a bond seen as serving a similar function. CLRC Memorandum 2006-20, p. 94. The amount of a stop payment notice release bond is required to be only 125% of the stop payment notice claim. See Section 3171.

However, while Section 3171 does require a bond in a lower amount, it also expressly provides the limitation the joint surety commenters request for the lien claim release bond:

If the owner, construction lender or any original contractor or subcontractor disputes the correctness or validity of any stop notice or bonded stop notice, he may file with the person upon whom such notice was served a bond executed by good and sufficient sureties in a penal sum equal to 1 1/4 times the amount stated in such notice, *conditioned for the payment of any sum not exceeding the penal obligation of the bond ....*

(Emphasis added).

That provision protects a surety from any liability beyond the penal amount of the bond, even if the bond is insufficient to pay the claimant fully.

So, under existing law, both the lien claim release bond provision and the stop payment notice release bond provision protect a surety, but in different ways. Section 3143 requires the lien claim release bond to be very large (150% of the amount claimed), making it very unlikely a surety would ever have any liability beyond the bond amount. Section 3171 provides that the stop payment notice release bond may be smaller (only 125% of the amount claimed), but expressly limits the surety's liability to the amount of the bond.

But proposed Section 7420 offers neither protection to sureties. The proposed section would provide for a smaller bond, without any express limit on surety liability.

#### *Recommendation*

The most conservative way to provide protection to sureties issuing a mechanics lien release bond would be to restore the 150% bond amount required by existing law.

The staff recommends that **proposed Section 7428 be revised as follows:**

7428. (a) An owner of property subject to a recorded claim of lien or a direct contractor or subcontractor affected by the claim of lien that disputes the correctness or validity of the claim may obtain release of the property from the claim of lien by recording a lien release bond. The principal on the bond may be the owner of the property or the contractor or subcontractor.

(b) The bond shall be conditioned on payment of any judgment and costs the claimant recovers on the lien. The bond shall be in an amount equal to ~~125~~ 150 percent of the amount of the claim of lien or ~~125~~ 150 percent of the amount allocated in the claim of lien to the

property to be released. The bond shall be executed by an admitted surety insurer.

....

**Comment.** Subdivisions (a)-(c) of Section 7428 continue former Section 3143. ~~The amount of the release bond is reduced to 125 percent of the amount of the claim of lien, consistent with the stop payment notice release bond. See Section 7510 (release bond) without substantive change.~~

## **Lien Claim Release Procedure**

The proposed law expands the grounds on which an owner may petition a court, on an expedited basis, for release of a recorded lien claim. See proposed Sections 7480-7488. Under existing law, such a petition may be made only if a claimant has failed to bring an action to enforce the recorded lien claim within 90 days of its recordation. Section 3154.

### *Ground for Release Petition*

Proposed Section 7480(a) lists the grounds on which an expedited petition to release a lien claim may be brought under the proposed law. One ground is stated in proposed Section 7480(a)(2):

7480. (a) The owner of property subject to a claim of lien may petition the court for an order to release the property from the claim of lien for any of the following causes:

....

(2) The claimant's demand stated in the claim of lien has been paid to the claimant in full.

....

The Commission directed the staff to determine whether proposed Section 7480(a)(2) should also reference payment in full *to a claimant's assignee*. CLRC Minutes (January 2007), p. 4.

There would seem to be little dispute that a payment in full to a claimant's assignee would satisfy the requirements of subdivision (a)(2). But an express reference to an assignee in the text of this subdivision could create a negative implication relating to other "claimant" references in the proposed law that do *not* expressly include a claimant's assignee.

The staff instead recommends that **the Comment to proposed Section 7480 include the following new sentence:**

Subdivision (a)(2) includes payment in full to an assignee of the claimant.



### *Homeowner Complaint*

Sylvia Contreras, a homeowner, has commented on a long-standing dispute she is having with a contractor that recorded what she believes to be an invalid lien on her property. Exhibit p. 16. Ms. Contreras expresses a number of concerns about existing mechanics lien law.

The expanded lien claim release procedure in the proposed law appears to address each of Ms. Contreras' concerns, save one. Ms. Contreras would like the proposed law to impose civil liability for the recordation of a fraudulent lien claim, an issue that has already been discussed at length by the Commission and ultimately rejected.



### *Appeal of Order Releasing Lien Claim*

The Commission directed the staff to consider the ramifications of an appeal from an order releasing a lien claim. CLRC Minutes (January, 2007), p. 5. The concern was whether the proposed law should delay the effective date of the release to allow the claimant time to seek appellate relief, and if so for how long.

It makes sense for the proposed law to provide a brief hold time on the release, in order to allow a losing lien claimant to seek appellate relief. Without a hold period, the release order could be recorded and the property sold to a bona fide purchaser before the claimant could appeal and obtain a stay. The claimant could forever lose a constitutionally protected lien claim, even if the release order was eventually reversed.

How long should this hold period be? One possibility the Commission considered was to wait until the deadline for seeking appellate relief from the order had passed.

The nature of appellate relief from a release order is unclear. Possibilities might include a direct appeal (see, e.g., Code Civ. Proc. § 904.1(a)(8), allowing an appeal from an order “entered in an action to redeem real or personal property from ... a lien thereon”), a petition for a writ of mandate, or a petition for a writ of supersedeas. No appellate decision has addressed this precise issue.

A direct appeal need only be filed within 60 days of the entry of the lower court order (Cal. R. Ct. 8.104), and there is no general statutory deadline for filing a petition for a writ. See Moore & Thomas, *California Civil Practice Procedure*, § 31:8 (2007) (no statutory time period for the filing of a writ of mandate), Witkin, *California Procedure*, § 314 (4th ed. 1997) (no statutory time period for seeking a writ of supersedeas). There are, however, some special deadlines for filing a writ

petition in a particular type of case, with automatic “holds” on the trial court order. See, e.g. Code Civ. Proc. §§ 405.35, 405.39 (20 days to petition for writ of mandate challenging court order expunging lis pendens, during which time expungement order is not effective or recordable).

A 60 day hold period following an order releasing a lien claim would be impractical. The hold period needs to be just long enough to allow a losing claimant some reasonable opportunity to seek a stay in an appellate court. Any longer and the purpose of the expanded lien claim release procedure — offering an owner a vehicle to clear a lien claim without having to wait 90 days for the claim to expire by operation of law — would be undermined.

The 20 days provided in existing law for challenging a lis pendens expungement order might be a workable hold period following an order releasing a lien claim. In fact, the two situations are somewhat similar. In both scenarios, the desire of the property owner for clear title at the earliest possible time must be balanced against the due process rights of the person seeking to preserve a claim against that title.

The staff recommends **revising proposed Section 7490 to borrow the hold period from existing lis pendens procedure (with additional revisions to include inadvertently omitted references to a “judgment”):**

**§ 7490. Court order**

7490. (a) A court order dismissing a cause of action to enforce a lien or releasing property from a claim of lien, or a judgment that no lien exists, shall include all of the following information:

...

(b) A court order or judgment under this section is a recordable instrument. On recordation of a certified copy of the court order or judgment, the property described in the order or judgment is released from the claim of lien.

(c) A court order or judgment under this section is not effective, and may not be recorded, until 20 days after service by the court or any party of notice of the entry of the order or judgment.

**Comment.** Subdivision (a) of Section 7490 generalizes a portion of former Section 3154(f). ....

Subdivision (b) generalizes the second sentence of former Section 3154(f)(4).

Subdivision (c) is new. It is intended to allow a losing claimant time to seek appellate relief and a stay of the court order or judgment. See California Rules of Court 8.112, 8.116 (request for stay).

See also Section 7024 (“lien” defined), 7056 (filing and recording of papers).

## STOP PAYMENT NOTICE ISSUES

A stop payment notice (known as a “stop notice” under existing law) is a notice given by a claimant to the holder of a construction fund (usually a construction lender, occasionally an owner), demanding that an amount owed the claimant be withheld from distribution to the direct contractor. The notice serves to reserve a portion of the construction fund as compensation for the claimant, in the event the claimant is not eventually paid by other means.

### **Manner of Giving Stop Payment Notice**

Proposed Section 7506 provides:

7506. (a) A stop payment notice to an owner shall be given to the owner or to the owner’s architect, if any.

(b) A stop payment notice to a construction lender holding construction funds shall be given to the manager or other responsible officer or person at the office or branch of the lender administering or holding the construction funds.

(c) A stop payment notice shall comply with the requirements of Article 4 (commencing with Section 7100).

**Comment.** Subdivisions (a) and (b) of Section 7506 restate a portion of the second paragraph of former Section 3103 and the last two sentences of former Section 3083.

....

Section 3103 expressly provides that a stop payment notice to a construction lender “shall not be effective” unless it is given in the manner specified in proposed Section 7506(b). This quoted language is not a part of any other provision of existing law relating to the giving of notice.

At a Commission meeting, it was suggested that the staff consider whether the absence of this quoted language in Section 7506(b) would change existing law (i.e., by implying that non-compliance with proposed Section 7506(b) would *not* necessarily make the notice ineffective).

The proposed section could be read that way.

The staff therefore recommends **restoring the missing language to proposed Section 7506, along with a revision to the Comment:**

7506. (a) A stop payment notice to an owner shall be given to the owner or to the owner’s architect, if any.

(b) A stop payment notice to a construction lender holding construction funds shall be not be effective unless given to the manager or other responsible officer or person at the office or

branch of the lender administering or holding the construction funds.

(c) A stop payment notice shall comply with the requirements of Article 4 (commencing with Section 7100).

**Comment.** Subdivisions (a) and (b) of Section 7506 ~~restate~~ continue a portion of the second paragraph of former Section 3103 and the last two sentences of former Section 3083 without substantive change.

....



### Notice for Future Work

The Commission has previously decided, after reviewing arguably conflicting language in existing law, that a stop payment notice claim may be made only for work already performed (as contrasted with work *to be performed*). CLRC Memorandum 2007-08, pp. 12-14. The Commission's decision was based in large part on the consensus opinion of practitioners, as well as language in Section 3159, which provides that a stop payment notice to a construction lender "may only be given for materials, equipment, or services furnished, or labor performed."

The Commission revised proposed Section 7502 to read as follows:

7502. (a) A stop payment notice shall comply with the requirements of Section 7102, and shall be signed and verified by the claimant.

(b) The notice may only be given for the amount due the claimant for work provided.

....

While approving this revision, the Commission directed the staff to research the purpose of two possibly conflicting provisions in Section 3103, which states:

3103. "Stop notice" means a written notice, signed and verified by the claimant or his or her agent, stating in general terms all of the following:

(a) The kind of labor, services, equipment, or materials furnished or agreed *to be furnished* by such claimant.

....

(c) The amount in value, as near as may be, of that already done or furnished *and of the whole agreed to be done or furnished*.

....

(Emphasis added).

The staff has not located any legislative history shedding any light on why the italicized language above was included in Section 3103. Nevertheless, the staff believes the discrepancy in language between Sections 3103 and 3159 can be

reconciled by focusing on the distinction between two separate concepts — (1) *general information* to be included in a stop payment notice, and (2) the dollar amount a stop payment notice claim demands to be *withheld from a construction fund*.

As the Commission has discussed, there are strong policy reasons why an owner or lender should not be required to withhold from a construction fund amounts claimed for work that has not yet been performed. But there appears to be *no* good policy reason why a stop payment notice should not or cannot disclose — separate from the amount to be withheld — general information about the work expected to be provided in the future. Quite to the contrary, this information likely has been and will continue to prove helpful to construction fund holders in budgeting for the remainder of the project.

This same argument has been raised by the Associated General Contractors of California (hereafter, “AGC”), which strongly urges the Commission not to change the required informational content of a stop payment notice. Third Supplement to CLRC Memorandum 2006-48, Exhibit pp. 23-24.

In order to continue and reconcile the notice provisions of existing law, the staff recommends **the following additional revisions, which would clarify the distinction between information to be included in a stop payment notice, and amounts to be withheld upon receipt of a stop payment notice:**

**§ 7502. Content of stop payment notice**

7502. (a) A stop payment notice shall comply with the requirements of Section 7102, and shall be signed and verified by the claimant.

(b) The notice shall include a general description of work to be provided, and an estimate of the total price of the work to be provided.

(c) The ~~notice~~ claimant’s demand for withholding may include only ~~be given for~~ the amount due the claimant for work provided through the date of the notice.

....

**§ 7536. Duty of construction lender**

7536. (a) Except as provided in subdivision (b), on receipt of a stop payment notice a construction lender shall withhold from the borrower or other person to which the lender or the owner is obligated to make payments or advancement out of the construction fund sufficient funds to pay the ~~claim~~ claimant’s demand for withholding.

....

Proposed Section 7504 needs to be further revised to eliminate language (not a part of existing law) that seems to imply a claimant *can* give a stop payment notice for work that has only been “agreed to be provided,” as opposed to actually provided:

**§ 7504. False stop payment notice**

7504. A claimant that willfully gives a false stop payment notice or that willfully includes in the notice a demand to withhold for work that has not been provided ~~or agreed to be provided to or for the person named in the notice~~ forfeits all right to participate in the distribution of the funds withheld and all right to a lien under Chapter 4 (commencing with Section 7400).

**Owner’s Demand for Stop Payment Notice**

Proposed Section 7520 provides that an owner may *demand* a stop payment notice from a claimant. An owner would presumably do this to allow the owner to withhold from the direct contractor any amount owed to the claimant, so as to avoid a lien claim by the claimant. A claimant who does not comply with the demand loses lien rights:

7520. (a) A person that has a lien right under Chapter 4 (commencing with Section 7400), other than a direct contractor, may give the owner a stop payment notice.

(b) The owner may give notice demanding that a person that has a lien right under Chapter 4 (commencing with Section 7400) give the owner a stop payment notice. The notice given by the owner shall comply with the requirements of Article 4 (commencing with Section 7100). If the person fails to give the owner a bonded or unbonded stop payment notice, the person forfeits the right to a lien under Chapter 4 (commencing with Section 7400).

AGC correctly notes that proposed Section 7520, which accurately continues existing law, provides no time limit within which a claimant must comply with the section. Third Supplement to CLRC Memorandum 2006-48, Exhibit p. 24. AGC suggests allowing the claimant 30 days to give the demanded notice.

In light of the substantial penalty for non-compliance, adding a deadline for compliance is not a simple matter. The issue does not appear to have been considered in any appellate opinion or treatise.

Adding a short deadline could be problematic. It might be difficult for a claimant to review all billing and payment records in time to meet the applicable deadline. Further, if a claimant submitted a stop payment notice that failed to

account for all unpaid work, proposed Section 7520 could result in forfeiture of lien rights for any work that was omitted.

Given this potential consequence, the omission of a deadline for compliance may have been an intentional political choice. A hard deadline for response might have been seen as too likely to result in the loss of lien rights by unsophisticated claimants.

The staff believes AGC's suggestion has some merit, and the creation of a deadline may be in order at some future time. However, in the context of this study, the staff recommends that **proposed Section 7520 be retained as drafted**.

### **Bonded Stop Payment Notice**

A stop payment notice given to a construction lender on a private work must be accompanied by a bond in order to compel the withholding of funds. Proposed Section 7536(b)(1).

If an action is commenced in court to enforce the stop payment notice or to enforce a lien claim, the bond guarantees payment to a defendant owner, direct contractor, or lender of costs awarded or damages sustained based on the stop payment notice or lien.

Proposed Section 7532 provides detail as to how the bond accompanying the stop payment notice is to be "conditioned":

7532. A claimant may give a construction lender a stop payment notice accompanied by a bond in an amount equal to 125 percent of the amount of the claim. The bond shall be conditioned that if the defendant recovers judgment in an action to enforce payment of the claim stated in the stop payment notice or to enforce a claim of lien recorded by the claimant, the claimant will pay all costs that are awarded the owner, direct contractor, or construction lender, and all damages to the owner, direct contractor, or construction lender that result from the stop payment notice or recordation of the claim of lien, *not exceeding the amount of the bond*.

**Comment.** Section 7532 restates the first sentence of former Section 3083 without substantive change. ....

(Emphasis added).

The joint surety commenters argue that proposed Section 7532 should state more clearly that the liability of the surety on the bond is limited to the penal limit of the bond. CLRC Memorandum 2006-39, Exhibit p. 99.

Proposed Section 7532 continues nearly verbatim the language used in Section 3083 relating to the conditioning of a stop payment notice bond. And in fact, the limiting language sought by the joint surety commenters appears at the

end of proposed Section 7532. However, the somewhat awkward wording of the section makes the intended application of that limiting language unclear.

Generally speaking, a bond is a guarantee of the performance of an act by a third person, backed up by a promise from a surety to pay a specified sum of money, if the act is *not* performed. Language in a statutory bond provision along the lines of “not exceeding the amount of the bond” would thus logically seem to refer to this promised payment by the surety. If the Legislature intended that reference in Section 3083, the meaning of the provision could be made more clear with the following revision:

7532. A claimant may give a construction lender a stop payment notice accompanied by a bond in an amount equal to 125 percent of the amount of the claim. The bond shall be conditioned that if the defendant recovers judgment in an action to enforce payment of the claim stated in the stop payment notice or to enforce a claim of lien recorded by the claimant, the claimant will pay all costs that are awarded the owner, direct contractor, or construction lender, and all damages to the owner, direct contractor, or construction lender that result from the stop payment notice or recordation of the claim of lien, ~~not exceeding~~ . Payment under the bond shall not exceed the penal amount of the bond.

But it is possible the Legislature did not intend that meaning. Another possible interpretation of the provision is that it was intended to limit the *claimant's* liability, in the event the notice was found to be invalid. Although it seems odd to bury a limitation on a *principal's* overall liability within a section describing the conditioning of a bond, there are bond provisions in other code sections that expressly limit the principal's liability. See, e.g., Code Civ. Proc. §§ 490.020, 1110a.

The staff has not located a discussion of this aspect of Section 3083 in any appellate decision, nor in any treatise.

The staff believes that, without more certainty as to the intended meaning of the limiting language in Section 3083, any attempt at clarification might result in a substantive change in this provision.

**The staff recommends against making any clarifying change to proposed Section 7732.**





## EFFECT OF CONTRACT CHANGE ON PAYMENT BOND

### Background

Proposed Section 7602, which generally continues Section 3235, provides that an owner may limit lien claim liability on a project to the amount owed to the direct contractor, if the owner records both the contract and a payment bond of at least 50% of the contract price, prior to commencement of work:

7602. (a) This section applies if, before the commencement of work, the owner in good faith files the contract with the county recorder and records a payment bond of the direct contractor in an amount not less than 50 percent of the contract price.

(b) If the conditions of subdivision (a) are satisfied, the court shall restrict lien enforcement under this part to the aggregate amount due from the owner to the direct contractor and shall enter judgment against the direct contractor and surety on the bond for any deficiency that remains between the amount due to the direct contractor and the whole amount due to claimants.

If the requirements of proposed Section 7602 are satisfied, an owner's lien liability is limited to whatever amount is due the direct contractor. If the owner pays the direct contractor in full, the owner has no lien liability to any claimants on the project, even those claimants that are not paid by the direct contractor. Claimants can make claims against the payment bond for any amounts they are owed.

It is unclear under existing law how this provision is intended to operate, when a contract change occurs after recordation of a bond based on the original contract. This ambiguity is not resolved by the language of proposed Section 7602.

As an example, assume an owner and a direct contractor enter into a contract for \$100,000 worth of work on a home. Prior to commencement of the project, the owner records this contract, along with a bond for \$50,000, thereby satisfying the requirements of proposed Section 7602.

However, after the bond is recorded and the project commences, the owner and direct contractor agree to a contract change, which increases the amount of the total contract price on the work of improvement to \$200,000. Under the language of proposed Section 7602, the owner continues to have full lien claim protection, which now expands to cover all work on a project that has doubled in value. At the same time, the claimants on this project that are now contributing twice as much work still have to share in the same \$50,000 payment bond as a

substitute for all of their lien claims. The risk that the bond will be insufficient to pay all claims has effectively doubled.

The Commission has deferred consideration of this rather thorny problem. CLRC Minutes (April 2007), p. 3.

The staff has located no authority indicating how existing law addresses this issue. However, it is quite possible that the problem is avoided by an equitable limitation in the existing bond provision, which was not continued in the proposed law:

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

Section 3235 (emphasis added).

Under that provision, a claimant who is unable to recover on a payment bond because a contract change rendered the bond insufficient to cover all claims could argue it would be inequitable to preclude the claimant from recording a lien claim.

### **Proposed Solutions**

After considering several different options, the staff offers two ways the Commission might revise proposed Section 7602 to better account for contract changes. **The staff makes no recommendation as to which option would be best, but does recommend that one of the two changes be made.**

#### *Restore Existing Law*

The first alternative would be to restore the equitable qualification language of Section 3235.

This alternative would be faithful to existing law, and would restore a basis for protection of claimant lien rights that is not contained in proposed Section 7602. As contrasted with the absolute bar against lien claims in proposed Section

7602, this alternative would explicitly protect a claimant's right to argue that barring a lien claim would be inequitable if the payment bond was insufficient to pay the claimant.

The main drawback to this approach is the uncertainty of its application. Despite the inclusion of the equitable exception, a claimant would have no guarantee of payment from either the bond *or* from a lien claim. At the same time, the owner would not be guaranteed absolute protection against lien claims (the likely consideration for purchasing the bond). What's more, the equitable limitation encourages litigation to resolve the matter, which would add expense for both claimants and owners.

To implement this alternative, the staff would recommend **the following revision:**

**§ 7602. Limitation of owner's liability**

7602. (a) This section applies if, before the commencement of work, the owner in good faith files ~~the~~ a direct contract with the county recorder, and records a payment bond of the direct contractor in an amount not less than 50 percent of the ~~contract~~ price stated in the recorded contract.

(b) If the conditions of subdivision (a) are satisfied, the court shall, where equitable to do so, restrict lien enforcement under this part to the aggregate amount due from the owner to the direct contractor and shall enter judgment against the direct contractor and surety on the bond for any deficiency that remains between the amount due to the direct contractor and the whole amount due to claimants.

(The changes to subdivision (a) are needed to clarify two points. First, the contract recorded must be the contract between the owner and the direct contractor. See discussion earlier in this memorandum recommending adding the new term "direct contract" to the proposed law. Second, the amount of the bond is to be calculated based on the price stated in the recorded contract, regardless of any subsequent contract changes. This clarification is needed because the proposed law defines the term "contract price" to include contract changes. Proposed Section 7008.)

*Increase Bond Amount*

An alternative way to address the issue would be to keep the equitable qualification language out of the provision, but increase the required penal

amount of the bond. By increasing the coverage of the bond, the risk that it would be insufficient to pay all claims would be significantly reduced.

Under this scenario, an owner who pays the direct contractor in full would be certain of no lien claim exposure. Claimants, while still having not having a *guarantee* of a payment bond recovery, would nevertheless be provided much greater assurance that the bond would be sufficient to pay any amounts owed. There would also be no need for either party to litigate any equitable considerations.

This alternative could be implemented by raising the bond amount to 100% of the price stated in the original contract between the owner and the direct contractor.

Owners and direct contractors might oppose that change, based on a perception that the bond would be significantly more expensive. However, the Commission has been informed by sureties that such would not be the case. See CLRC Memorandum 2007-11, pp. 13-14, CLRC Memorandum 2007-11, Exhibit pp. 1-3.

As explained by the joint surety commenters, it is standard industry practice to measure a surety's risk in issuing a bond, and calculate the premium for the bond, based on 100% of the *contract price* of the contract guaranteed by the bond. Reportedly, the premium for a payment bond is based mostly on underwriting and processing costs, rather than the penal amount. If the premium for a payment bond is *already* based on 100% of contract price, increasing the statutory bond requirement to 100% should have little or no effect on the bond's cost.

The main drawback to this alternative is that in the event of significant contract changes, it is still *possible* the bond could be insufficient to pay all claims, thereby theoretically leaving some claimants without recourse to either a payment bond or a lien claim. However, that should be rare.

For that to happen, the aggregate amount owed to claimants would need to exceed 100% of the original contract price (otherwise, all claims could be paid from the bond). Even in that unlikely event, lien claims would only be completely barred if the owner had already paid the direct contractor the full amount of the original contract price. Thus, for a claimant to have neither a payment bond nor a lien claim remedy, there would need to be the rare convergence of contributors on a job being owed an amount greater than the original contract price, despite the direct contractor having been paid that entire amount by the owner.

The risk of such an occurrence is significantly reduced by the fact that direct contractors on a project are generally paid in progress payments. It is quite unlikely an owner would continue making these progress payments, if the direct contractor (or the direct contractor's subcontractors) were defaulting on payments to other contributors at a rate by which the total amount owed to contributors was approaching 100% of the original contract price.

The risk is further reduced by statutory requirements mandating prompt payment. Unless otherwise agreed to in writing, a contractor is required to pay subcontractors within 10 days after receipt of a payment, or face both disciplinary action and a statutory penalty. Bus. & Prof. Code § 7108.5.

The staff believes that a 100% bond requirement, though imperfect, would be a significant improvement over proposed Section 7602. In most cases, a bond of this amount should be sufficient to pay all claims.

To implement this alternative, the staff would recommend **the following revision:**

**§ 7602. Limitation of owner's liability**

7602. (a) This section applies if, before the commencement of work, the owner in good faith files ~~the~~ a direct contract with the county recorder, and records a payment bond of the direct contractor in an amount not less than ~~50~~ 100 percent of the ~~contract~~ price of the recorded contract.

(b) If the conditions of subdivision (a) are satisfied, the court shall restrict lien enforcement under this part to the aggregate amount due from the owner to the direct contractor and shall enter judgment against the direct contractor and surety on the bond for any deficiency that remains between the amount due to the direct contractor and the whole amount due to claimants.



**NOTICE REQUIRED PRIOR TO PAYMENT BOND CLAIM**

Proposed Section 7612, which continues the language of Section 3242, specifies the notice a claimant must give as a prerequisite to asserting a claim against a payment bond:

7612. (a) In order to enforce a claim against a payment bond under this part, a claimant shall give the preliminary notice provided in Chapter 2 (commencing with Section 7200).

(b) If preliminary notice was not given as provided in Chapter 2 (commencing with Section 7200), a claimant may enforce a claim by giving written notice to the surety and the bond principal within 15 days after recordation of a notice of completion. If no notice of

completion has been recorded, the time for giving written notice to the surety and the bond principal is extended to 75 days after completion of the work of improvement.

**Comment.** Section 7612 restates former Section 3242 without substantive change. ....

The proposed law provides (as does Section 3242) that a claimant may satisfy this requirement by (1) giving preliminary notice, or (2) if preliminary notice was *not* given, by giving what is commonly known as the “second chance” notice to the bond surety and principal, within a specified number of days after completion or recordation of a notice of completion.

The Commission has directed the staff to analyze how this notice provision is intended to operate, when a *late* preliminary notice is given (as opposed to no preliminary notice at all).

Under both existing law and the proposed law, a claimant giving a preliminary notice more than 20 days after commencing work may not enforce a payment bond claim for work performed more than 20 days prior to giving the preliminary notice. Section 3097(d), proposed Section 7206(a).

However, there is nothing in the “second chance” payment bond notice provision that limits the work that may be claimed against the bond. That leads to the perverse result that a claimant giving a “*late*” preliminary notice (i.e., one given more than 20 days after the claimant commences work) would be worse off than a claimant that gives no preliminary notice *at all*.

In *American Buildings Co. v. Bay Commercial Construction, Inc.*, 99 Cal. App. 4th 1193, 121 Cal. Rptr. 2d 539 (2002), the court analyzed this issue in the context of a public work payment bond, a bond governed by provisions containing the same substantive language as the provisions governing notice on a private work payment bond. See Sections 3098(d), 3252. The court, after analyzing the legislative history of Section 3252, concluded that the Legislature did *not* intend a late preliminary notice to limit a claimant from making a full claim against a payment bond.

That result makes sense to the staff. If a “second chance” notice is sufficient by itself to allow a full claim against a payment bond, there seems to be no logical reason to limit the claims of a claimant that gives a late preliminary notice instead.

The only substantive difference in this context between a late preliminary notice and a second chance notice is that a preliminary notice does not have to be given to the surety on the bond. However, the staff does not see why that

distinction relates to or should affect a surety's obligation under the bond. If a claimant gives a "timely" preliminary notice (i.e., within 20 days after starting work), the bond covers all work provided, even though the surety did not receive *that* preliminary notice. If this same preliminary notice is instead given later, what is the rationale for limiting claims against the bond? No obvious purpose is served by such limitation.

At one time, the 20 day limitation may have served as an incentive to give preliminary notices promptly upon starting work. But with regard to payment bond claims, that purpose has now been defeated by the second chance notice, which allows a full payment bond claim without *any* preliminary notice having been given.

The staff recommends that a claimant giving a "late" preliminary notice have the same payment bond rights as a claimant giving the "second chance" notice. To that end, **proposed Sections 7206 and 7612 should be revised as follows:**

**§ 7206. Effect of preliminary notice**

7206. (a) A claimant may record a claim of lien, or file a stop payment notice, ~~or assert a claim against a payment bond~~ only for work provided within 20 days before giving preliminary notice or at any time thereafter.

(b) Notwithstanding subdivision (a), a design professional may record a claim of lien, file a stop payment notice, or assert a claim against a payment bond for design professional services provided for the design of the work of improvement if the design professional gives preliminary notice not later than 20 days after the work of improvement has commenced.

(The staff is unsure why subdivision (b), which continues existing law, limits a design professional's claim against a payment bond. A "design professional" is by definition a direct contractor, and therefore should not be asserting a claim against a payment bond. Nevertheless, in an excess of caution, the staff recommends leaving subdivision (b) unchanged.)

**§ 7612. Notice prerequisite to enforcement**

7612. ~~(a)~~ In order to enforce a claim against a payment bond under this part, a claimant shall give either of the following notices no later than 15 days after recordation of a notice of completion, or if no notice of completion has been recorded, no later than 75 days after completion of the work of improvement:

(a) the The preliminary notice provided in Chapter 2 (commencing with Section 7200).

~~(b) If preliminary notice was not given as provided in Chapter 2 (commencing with Section 7200), a claimant may enforce a claim by giving written Written notice of the claim to the surety and the bond principal within 15 days after recordation of a notice of completion. If no notice of completion has been recorded, the time for giving written notice to the surety and the bond principal is extended to 75 days after completion of the work of improvement.~~

The staff also recommends that **similar revisions be made to proposed Public Contract Code Sections 43050 and 45060, governing claims against a public work payment bond, as the same analysis applies.**

#### STOP WORK NOTICE ISSUES

##### **Additional Notice in Conjunction with Stop Work Notice**

A stop work notice is given by a direct contractor to inform an owner that work will stop on a job unless money owed to the direct contractor is paid. Proposed Sections 7830-7848. If work does stop, and the payment dispute is thereafter resolved, the direct contractor is required to give notice of the resumption of work to the direct contractor's subcontractors. Proposed Section 7840.

Sam Abdulaziz, an attorney in North Hollywood, has suggested that these subcontractors be required to relay the notice of resumption of work to their own subcontractors and suppliers. CLRC Memorandum 2006-39, Exhibit p. 19; CLRC Memorandum 2007-11, pp. 36-37.

The Commission directed the staff to analyze whether a stop work notice and notice of resumption of work should be given to all claimants that have given the direct contractor a preliminary notice. CLRC Minutes (April 2007), p. 4.

The one commenter that submitted a comment addressing this suggestion is against it. Rodney Moss, an attorney in Los Angeles, believes the benefit that might obtain from the additional notices does not warrant the burden and additional complexity that the new requirement would generate. Exhibit p. 14.

After further analysis, the staff agrees. While there would clearly be some utility in providing notice of both a work stoppage and the resumption of work to all contributors on a job, implementation of such notice could cause unexpected consequences. If someone was obligated by statute to provide one of these notices to a contributor, and did not, would that give rise to some liability? What if *inaccurate* notice was given, and relied upon by the contributor to the contributor's detriment?



These issues may exist to a lesser extent under existing law, since a direct contractor presently has a limited notice obligation to the direct contractor's subcontractors. However, as these parties have a direct contractual relationship, the issues may be resolved either informally or by contract.

**The staff does not recommend that any new notice obligations be added to the proposed law relating to stop work notices.**

### **Venue Provision**

The tentative recommendation added a new general venue provision to the proposed law that allowed the deletion of a special venue provision in existing law applicable only to a stop work notice dispute. Tentative Recommendation on *Mechanics Lien Law* (June 2006), pp. 75, 139.

However, the Commission later deleted the new venue provision from the proposed law, finding that the provision conflicted with other general venue provisions applicable to mechanics lien law claims. CLRC Memorandum 2007-25, pp. 39-40; CLRC Minutes (June 2007), p. 3.

Now that the general venue provision has been deleted, the special venue provision governing action on a stop work notice needs to be restored.

The staff thus recommends **the following revision to proposed Section 7844:**

7844. If payment of the amount claimed is not made within 10 days after a stop work notice is given, the direct contractor, the direct contractor's surety, or an owner may, in an expedited proceeding in the superior court in the county in which the private work of improvement is located, seek a judicial determination of liability for the amount due.

....

### PROMPT PAYMENT TO CONTRACTORS

Proposed Sections 7800 through 7822 continue existing rules for the prompt payment of funds owed to contractors.

Proposed Section 7800 governs a progress payment owed to a direct contractor:

7800. (a) Except as otherwise agreed in writing by the owner and direct contractor, the owner shall pay the direct contractor, within 30 days after notice demanding payment pursuant to the contract, any progress payment due as to which there is no good faith dispute between them. The notice given shall comply with the requirements of Article 4 (commencing with Section 7100).

(b) If there is a good faith dispute between the owner and direct contractor, the owner may withhold from the progress payment an amount not in excess of 150 percent of the disputed amount.

Proposed Section 7812 provides a similar rule with regard to a direct contractor's final retention payment:

7812. (a) If an owner withholds a retention from a direct contractor, the owner shall, within 45 days after completion of the work of improvement, pay the retention to the contractor.

(b) ....

(c) If there is a good faith dispute between the owner and direct contractor, the owner may withhold from final payment an amount not in excess of 150 percent of the disputed amount.

AGC argues that owners have been abusing the withholding provisions in existing law in two different ways. Third Supplement to CLRC Memorandum 2006-48, Exhibit pp. 31-32.

### **Amount of Withholding**

First, AGC asserts that the 150% withholding "cushion" is too generous. The group suggests that the withholding amount in the proposed law should be decreased to allow at most 125% of the amount in dispute to be withheld, consistent with the amount required for a stop payment notice or lien release bond. See Section 3171, proposed Section 7428. The rationale seems to be that in all of the scenarios, a specified dollar amount based on the amount of a disputed claim is also "reserved," while the parties negotiate or litigate the amount owed.

As previously discussed in this memorandum, existing law in fact provides that a mechanics lien release bond must be at least 150% of the amount of the lien claim. Although the proposed law would reduce this amount to 125%, elsewhere in this memorandum the staff has recommended restoring the percentage in existing law.

Whether or not this change is made, different considerations may be involved when a bond is mandated as security for resolution of a dispute. The cost of the bond that someone must bear, an amount likely based at least in part on the penal amount of the bond, may be a countervailing consideration in deciding how high a bond amount to require in a given circumstance.

In the context of this study, **the staff does not recommend a substantive change in the withholding percentages specified in these sections.**

## **Nature of Dispute Allowing for Withholding**

Second, AGC maintains that owners sometimes withhold payment due a direct contractor whenever *any* “dispute” arises between the owner and the direct contractor, including disputes that are unrelated to whether a progress or retention payment is owed. AGC explains that its members routinely succeed in challenging such withholding in court, but argue that the proposed law should clarify that such withholding is not allowed. The group also suggests statutory language it believes would achieve that result. Third Supplement to CLRC Memorandum 2006-48, Exhibit p. 32.

The staff sees no harm adding clarifying language.

**Proposed Sections 7800 and 7812 should be revised as follows:**

### **§ 7800. Progress payment between owner and direct contractor**

7800. (a) Except as otherwise agreed in writing by the owner and direct contractor, the owner shall pay the direct contractor, within 30 days after notice demanding payment pursuant to the contract, any progress payment due as to which there is no good faith dispute between them. The notice given shall comply with the requirements of Article 4 (commencing with Section 7100).

(b) If there is a good faith dispute between the owner and direct contractor as to a progress payment due, the owner may withhold from the progress payment an amount not in excess of 150 percent of the disputed amount.

### **§ 7812. Payment of retention by owner**

7812. (a) If an owner withholds a retention from a direct contractor, the owner shall, within 45 days after completion of the work of improvement, pay the retention to the contractor.

(b) If part of a work of improvement ultimately will become the property of a public entity, the owner may condition payment of a retention allocable to that part on acceptance of the part by the public entity.

(c) If there is a good faith dispute between the owner and direct contractor as to a retention payment due, the owner may withhold from final payment an amount not in excess of 150 percent of the disputed amount.

## CONDOMINIUM PROJECTS

AGC argues that many of the provisions of both existing mechanics lien law and the proposed law are problematic when applied to improvements to a condominium complex. Third Supplement to CLRC Memorandum 2006-48,

Exhibit pp. 32-33. AGC's concerns are generally applicable to any common interest development.

Among other problems, the group argues that the proposed law's definition of "owner" is unclear when work is performed in a condominium complex (i.e., does the term refer to the owner of an individual unit, to the homeowners' association, or both), that the proposed law does not clearly specify to what property a claimed lien attaches (i.e., individual privately owned property, common area, or the entire complex), nor who is supposed to get various notices (i.e., the association, owners of individual units directly affected by the work, or all owners), and whether special entities sometimes designated in condominium construction litigation to hold funds for post-litigation remedial work qualify as "construction lenders."

**The staff believes most of these specialized concerns are valid, but that all are beyond the scope of the current study.**

**The staff recommends against making any additional changes to the proposed law that would address the special concerns of condominium projects or other common interest developments.** That topic should be noted for possible study as part of the Commission's ongoing study of common interest development law.

#### ATTORNEY'S FEES

The proposed law, continuing existing law, provides for reasonable attorney's fees to be awarded in an action to enforce a bonded private work stop payment notice (proposed Section 7158), and in an action to enforce a claim against a public work payment bond (proposed Pub. Cont. Code § 45080).

The proposed law, also continuing existing law, does *not* provide for an award of attorney's fees in an action to enforce a mechanic's lien claim.

The tentative recommendation in this study solicited comment on this disparate treatment. Tentative Recommendation on *Mechanics Lien Law* (June 2006), p. 35.

**Most commenters favor continuing the status quo on this issue.**

Rodney Moss, a Los Angeles attorney, indicates that he would like to see consistency of treatment, but due to the long-standing prohibition against attorney's fees in lien enforcement actions, on balance would leave the law as it is. CLRC Memorandum 2006-39, Exhibit p. 1.

Graniterock, a material supplier and subcontractor, also urges that the attorney fee provisions remain as they are. CLRC Memorandum 2006-39, Exhibit pp. 8-9. It suggests a rational basis exists for the disparate treatment, in that mechanics lien claims are often asserted against unsophisticated homeowners already subject to the risk of double payment, whereas stop payment notice and payment bond remedies are typically asserted against commercial entities.

William Last, a San Mateo attorney, agrees that existing attorney fee provisions should not be changed. CLRC Memorandum 2006-39, Exhibit p. 86.

The Building Owners and Managers Association (“BOMA”) feels that the current arrangement is stable and workable. CLRC Memorandum 2006-39, Exhibit pp. 92-93.

AGC urges continuation of existing law. Third Supplement to CLRC Memorandum 2006-48, Exhibit pp. 18-19.

The Association of California Surety Companies also supports continuation of the existing law on this issue. CLRC Memorandum 2006-39, Exhibit pp. 124-125. The group argues that allowing attorney’s fees in a lien claim action may even be unconstitutional, as the constitution limits a lien to the value of work provided.

The joint surety commenters urge continuation of existing law on the issue. CLRC Memorandum 2006-39, Exhibit p. 89.

GGLT recognizes certain advantages that might be achieved if attorney’s fees were available in an action to enforce a lien claim, but takes no position on whether the law should be changed. CLRC Memorandum 2006-39, Exhibit pp. 132-133.

Mr. Melino, a San Jose attorney, generally favors continuing existing law as well. CLRC Memorandum 2006-39, Exhibit p. 112. However, Mr. Melino suggests the possibility of awarding a residential property owner attorney’s fees for successfully defeating the lien claim of an “unscrupulous contractor.”

**This last suggestion is at least partially addressed by the expanded lien claim release procedure, in which the prevailing party may be awarded a reasonable attorney’s fee.** See proposed Section 7488(c).

There is virtual consensus among commenters that existing law on attorney fee awards should be left as is. The staff recommends **no change to the proposed law on the issue.**

## CONFORMING REVISIONS

Laborers Group points out the need for conforming revisions to two sections of the Business and Professions Code. CLRC Memorandum 2006-39, Exhibit pp. 79-80. The revisions would conform to the Commission's previous revisions of references to an "express trust fund," intended to preclude a finding of ERISA preemption.

The staff recommends **the following conforming revisions:**

### **Bus. & Prof. Code § 7071.5 (amended). Contractor's bond**

SEC. \_\_\_\_\_. Section 7071.5 of the Business and Professions Code is amended to read:

7071.5. The contractor's bond required by this article shall be executed by an admitted surety in favor of the State of California, in a form acceptable to the registrar and filed with the registrar by the licensee or applicant. The contractor's bond shall be for the benefit of the following:

(a) Any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the licensee.

(b) Any person damaged as a result of a willful and deliberate violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

(c) Any employee of the licensee damaged by the licensee's failure to pay wages.

(d) Any person or entity, including ~~an express trust fund~~ a laborer described in subdivision (b) of Section 3111 7018 of the Civil Code or subdivision (b) of Section 41075 of the Public Contract Code, to whom a portion of the compensation of an employee of a licensee is paid by agreement with that employee or the collective bargaining agent of that employee, damaged as the result of the licensee's failure to pay fringe benefits for its employees, including, but not limited to, employer payments described in Section 1773.1 of the Labor Code and regulations thereunder (without regard to whether the work was performed on a private or public work). Damage to an express trust fund a person or entity under this subdivision is limited to actual employer payments required to be made on behalf of employees of the licensee, as part of the overall compensation of those employees, which the licensee fails to pay.

### **Bus. & Prof. Code § 7071.10 (amended). Qualifying individual's bond**

SEC. \_\_\_\_\_. Section 7071.10 of the Business and Professions Code is amended to read:

7071.10. (a) The qualifying individual's bond required by this article shall be executed by an admitted surety insurer in favor of the State of California, in a form acceptable to the registrar and filed

with the registrar by the qualifying individual. The qualifying individual's bond shall be for the benefit of the following persons:

(1) Any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the licensee.

(2) Any person damaged as a result of a willful and deliberate violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

(3) Any employee of the licensee damaged by the licensee's failure to pay wages.

(4) Any person or entity, including ~~an express trust fund~~ a laborer described in subdivision (b) of Section 3111 7018 of the Civil Code or subdivision (b) of Section 41075 of the Public Contract Code, to whom a portion of the compensation of an employee of a licensee is paid by agreement with that employee or the collective bargaining agent of that employee, that is damaged as the result of the licensee's failure to pay fringe benefits for its employees including, but not limited to, employer payments described in Section 1773.1 of the Labor Code and regulations adopted thereunder (without regard to whether the work was performed on a public or private work). Damage to an express trust fund a person or entity under this subdivision is limited to employer payments required to be made on behalf of employees of the licensee, as part of the overall compensation of those employees, which the licensee fails to pay.

(b) The qualifying individual's bond shall not be required in addition to the contractor's bond when the qualifying individual is himself or herself the proprietor under subdivision (a) or a general partner under subdivision (b) of Section 7068.

Respectfully submitted,

Steve Cohen  
Staff Counsel

**EMAIL FROM CALIFORNIA STATE COUNCIL OF LABORERS LEGISLATIVE  
DEPT. AND CONSTRUCTION LABORERS TRUST FUNDS FOR SOUTHERN  
CALIFORNIA  
(NOVEMBER 29, 2006)**

Comments from California State Council of Laborers Legislative Dept. and  
Construction Laborers Trust Funds for Southern California  
on Tentative Recommendation for Mechanics Lien Law

Dear Members of the Commission:

At the last Commission Meeting, you directed your staff counsel, Steve Cohen, to review with me the drafting issues regarding ERISA preemption and "Laborers Benefit Funds." We have done so, and Mr. Cohen has issued a draft proposal as to these sections which reflect this discussion. A copy (labor2.doc) is attached, for reference.

Mr. Cohen has done an excellent job of simplifying the Code, while retaining its substance, and avoiding the preemption problem. The basic idea is that laborer benefit funds are included (among others) within the definition of "laborers" and given the same standing to assert claims, consistent with the stated legislative purpose in the 1999 amendments "to clarify that the protections offered in this title are meant to cover the entire compensation package of employees, and not to single out or treat differently any particular form of compensation." Stats 1999, ch. 795 § 9. We recommend adoption of these changes, subject to the comments below.

There remain four areas which we ask be put forth for further comment. These may go beyond drafting issues to policy issues. They are:

Standing of Agent §§ 7018(c) and 7060

We support the changes.

Disciplinary Action § 7216

We ask that § 7216 be modified to avoid ERISA preemption.

Standing of Assignees § 7400

We propose that assignees of all claimants be given standing, and ask that public comments be solicited on this issue.

Completion §§ 7414 and 7416

We ask that § 7416 be deleted as preempted by ERISA. We propose that liens be explicitly allowed for labor and materials supplied after completion, and ask that public comments be solicited on this issue.

Our comments on these sections is attached (MLnotes2.doc). 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](mailto:jds@racclaw.com)



Thank you for your consideration.

Sincerely,

J. David Sackman  
of Reich, Adell, Crost & Cvitan

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  
John Miller, Cox Castle & Nicholson  
Alexander Cvitan, Reich, Adell, Crost & Cvitan

Comments from California State Council of Laborers Legislative Department  
and Construction Laborers Trust Funds for Southern California  
on Tentative Recommendation for Mechanics Lien Law

Standing of Agent §§ 7018(c) and 7060

In the 1999 amendments to Civil Code § 3089(b), it was meant that agents of laborers, such as their collective bargaining agent, have standing to file mechanic liens, to the extent of their agency. This is reflected in the language “*To the extent that a person or entity defined in this subdivision has standing under applicable law to maintain a direct legal action, in their own name or as an assignee, to collect any portion of compensation owed for a laborer, that person or entity shall have standing to enforce any rights under this title to the same extent as the laborer.*” However, the language may not have fully accomplished this.

This was raised in the *Betancourt v. Storke Housing Investors*, 31 Cal.4th 1157, 82 P.3d 286, 8 Cal.Rptr.3d 259 (2003) case. However, the Supreme Court avoided deciding the standing issue:

“Storke maintains that plaintiffs also lack standing to bring an action to recover funds owed directly to the employee trust fund: “The Union's trust funds are the actual and only entities entitled to recover the delinquent contributions due under the collective bargaining agreement between the Union and R.P. Richards.” (Fn.omitted.) Plaintiffs counter that under “the plain meaning of Section 3110, there can be no doubt that the laborers or Individual Plaintiffs have standing to enforce their mechanics' lien rights. In fact, both the laborers and their representative, the Union, have standing under Sections 3089 and 3110.” We need not determine this issue because it does not directly bear on the issue presented in this case, i.e., whether ERISA preempts a section 3110 action. (See *Rush Prudential, supra*, 536 U.S. at p. 363, fn. 3, 122 S.Ct. 2151 [defendant's “true status ... is immaterial to our holding”].)” 31 Cal.4th 1157, 1169 n. 7.

It was pointed out to us that proposed Section 7060 may address this issue:

*7060. An act that may be done by or to a person under this part may be done by or to the person's agent to the extent the act is within the scope of the agent's authority.*

**We therefore support the addition of this section.** Just as contractors and suppliers use agents, including attorneys, to file liens and perform other duties for them, so laborers should be able to have their collective bargaining agent perform these functions for them. Individual laborers usually do not have the skill, knowledge, or time, to file their own liens. Allowing their agent to perform this function enables them to use the remedy which was designed for their benefit in the first place.

## Disciplinary Action § 7216

This section, based on current § 3097(h), refers back to the notice required in proposed § 7204(b), which in turn is based on Civil Code § 3097(c)(6). We concur with the most recent proposed § 7204(b):

*“If preliminary notice is given by a subcontractor that has not paid all compensation due to a laborer, the notice shall include the name and address of the laborer and any person or entity described in subdivision (b) of Section 7018 to which payments are due.”*

Proposed § 7216 allows disciplinary action to be imposed if a subcontractor fails to give this notice AND *“The subcontractors failure results in a person or entity described in subdivision (b) of Section 7018 recording a claim of lien, filing a stop payment notice, or asserting a claim against a payment bond”* AND *“The amount due the person or entity described in subdivision (b) of Section 7018 is not paid.”*

Thus, special notice is required for ANY failure to pay laborers, whether wages or benefits, but discipline can only be imposed if the BENEFITS remain unpaid and result in a lien. If WAGES are unpaid and result in a lien, no discipline can be imposed. It would appear that this provision “singles out ERISA employee welfare benefit plans for different treatment” and thus may be preempted. *Mackey v. Lanier Collections Agency & Service, Inc.*, 486 U.S. 825, 830, 108 S.Ct. 2182, 100 L.Ed.2d 836 (1988). This is unlike the other provisions of the lien law, as amended in 1999, which the California Supreme Court concluded were not “specifically designed to affect employee benefit plans” and thus not preempted. *Betancourt v. Storke Housing Investors*, 31 Cal.4th 1157, 1166-6782 P.3d 286, 8 Cal.Rptr.3d 259 (2003), quoting *Mackey*, *supra*.

We note that the purpose of these sections is to protect the owner. Section 7204 requires the owner to be notified of possible liens for the failure to pay laborers. Section 7216 gives the owner a remedy if it is not provided the notice, resulting in a lien and a “double payment” by the owner.

We propose, then, that Section 7216 (b) and (c) be modified to read as follows:

*(b) The subcontractor’s failure results in **any laborer** recording a claim of lien, filing a stop payment notice, or asserting a claim against the payment bond.*

*(c) The amount due **the laborer** is not paid.*

This will provide the owner with some protection against surprise liens, without risking ERISA preemption. It places no extra burden on contractors, since they are already required by § 7204 to provide notice as to all labor claims. We note that a contractor is already subject to the much harsher and *mandatory* consequence of license suspension if the failure to pay a laborer, supplier, subcontractor or consumer results in an unpaid court judgment. Bus. & P. Code § 7071.17.

## Standing of Assignees § 7400

Proposed § 7400 (based loosely on current § 3110) defines the “Persons entitled to lien” (i.e. standing) as “*A person that provides labor, service, equipment, or material authorized for a work of improvement, including but not limited [to] the following persons, has a lien right under this chapter: . . . (e) Laborer.*”

This would seem to limit the persons who have standing to one who themselves “provides labor” and not assignees, such as laborers benefit funds. On the other hand, proposed § 7018(c) (based on current § 3089(b)) specifically provides that:

*“A person or entity described in subdivision (b) [laborers benefit funds] that has standing under applicable law to maintain a direct legal action, in their own name or as an assignee, to collect any portion of compensation owed for a laborer for a work of improvement, shall have standing to enforce any rights or claims of the laborer under this part, to the extent of the compensation agreed to be paid to the person or entity for labor on that improvement.”*

The apparent contradiction between §§ 7400 (giving standing only to those who themselves provide labor) and § 7018(c) (giving standing to assignees of laborers) is resolved by a proposed comment to § 7018:

*“A person or entity described in Section 7018(b) has the same lien right as the laborer in subdivision (e), to the extent of the laborer’s compensation agreed to be paid to the person or entity for labor on the improvement. See Section 7018 (“laborer”) defined.”*

**We support this comment to clarify the law.** One of the purposes of the 1999 amendments was to make clear that all assignees of laborers be given standing to assert lien claims “to clarify that the protections offered in this title are meant to cover the entire compensation package of employees, and not to single out or treat differently any particular form of compensation.” Stats 1999, ch. 795 § 9.

This raises the issue, however, of whether laborers benefit funds are the only assignees who have standing to assert claims under proposed § 7400. If so, this may “single out” and “treat differently” laborers benefit funds, which could raise ERISA preemption issues. **We propose that § 7400 be modified to clarify that all assignees have standing to assert lien claims. We believe that this is the current state of the law.**

Section 1084 of the Civil Code provides that “The transfer of a thing transfers also all its incidents, unless not expressly excepted; but the transfer of an incident to a thing does not transfer the thing itself.” Based upon this statute, courts have long held that an assignment of the underlying claim for labor or materials transfers with it the right to assert mechanic lien or other claims under this Title. See Union Supply Co. v. Morris,

220 Cal. 331, 339, 30 P.2d 394 (1934) (supplier who received assignment of claims from other suppliers and subcontractors had standing to file lien for combined claims); *Koudmani v. Ogle Enterprises, Inc.*, 47 Cal.App.4th 1650, 1659, 55 Cal.Rptr.2d 330 (1996) (assignee of lien rights does not have to give separate preliminary notice); *Dept. Ind. Rel. v. Fidelity Roof Co.*, 60 Cal.App.4th 411, 426-27, 70 Cal.Rptr.2d 465 (1997) (statutory assignment to Labor Commissioner allowed it to bring stop notice and bond claims); *Bernard v. Indemnity Ins. Co.*, 162 Cal.App.2d 479, 487, 329 P.2d 57 (1958) (laborers benefit funds are effectively assignees of laborers payment bond claim on public works, entitled to assert those rights). Thus, “the lien is an incident of the debt and passes with it by operation of law.” *Union Supply*, 220 Cal. 331, 339. An assignee thus “stands in the shoes of his or her assignor” and should have the same standing, and be subject to the same procedures, as their assignor. 7 Cal.Jur.3d Assignments § 31 at 57 (1989). “It is well settled that an assignee of a chose in action does not sue in his own right but stands in the shoes of the assignor.” *Koudmani*, 47 Cal.App.4<sup>th</sup> 1650, 1660, quoting *Bush v. Superior Court*, 10 Cal.App.4<sup>th</sup> 1374, 1380, 13 Cal.Rptr.2d 382 (1992).

However, there are some old cases to the contrary. In *Mills v. LaVerne Land Co.*, 97 Cal. 254, 32 P. 169 (1893) it was held that the right to record a mechanic lien (as opposed to the recorded lien itself) is personal and can only be asserted by the one actually providing labor or materials. See also *Willett v. Peppers Cotton Lumber Co.*, 91 Cal.App. 798, 266 P. 1028 (1928) (same); *Burr v. Peppers Cotton Lumber Co.*, 91 Cal.App. 268, 266 P. 1025 (1928) (same). It would seem that *Union Supply* is in direct contradiction to the earlier decision of *Mills* and its progeny. Yet *Mills* has never been expressly overruled.

We suggest that this contradiction be clarified by expressly allowing any valid assignee to assert claims under the mechanic lien law, to the extent of their assignment. There is no cogent reason to limit standing to those who, themselves, provide labor and material. There is no reason why Civil Code § 1084 should apply to every other “incident” of a debt, but not mechanic liens. As in *Union Supply*, it is common for smaller claimants to sell and assign their claims to another, who is in a better position to enforce it.

**The Laborers support the idea of extending standing to all other assignees, because it would lessen the possibility of ERISA preemption. We believe this is the current status of the law, and is good public policy. We therefore request that this idea be put forth for public comment.**

## Completion §§ 7414 and 7416

There is one more issue I would like to raise; determining the time of completion for purpose of calculating the time to file a lien. In my prior review, I missed the reference to an “express trust fund” in proposed § 7416:

*“Notwithstanding any other provision of this chapter, completion of a residential structure containing multiple condominium units, together with any common area, garage, or other appurtenant improvements, does not operate in any manner to impair the lien right of an express trust fund under Section 7402 if the claim of lien is recorded within 120 days after completion of the residential structure.”*

This is based on the last sentence of current § 3131. While we would appreciate the longer period to file a lien, this section clearly “singles out” benefit funds for special treatment. **It should be deleted, since it would likely be preempted by ERISA.**

This brings up a broader issue of the definition of “completion” and the time to file a lien. Proposed § 7414 restates current § 3116:

*A claimant other than a direct contractor may not enforce a lien unless the claimant records a claim of lien within the following times:*

- (a) After the claimant ceases to provide labor, service, equipment, or material.*
- (b) Before the earlier of the following times:*
  - (1) Ninety days after completion of the work of improvement.*
  - (2) Thirty days after the owner records a notice of completion.*

What would happen if labor or materials are provided, and unpaid, *after* the deadline to file a lien? This is not a hypothetical situation. Completion can occur, not only upon “actual” completion, or a Notice of Occupancy, but upon “substantial completion.” See *Hammond Lumber Co. v. Yeager*, 185 Cal.355, 197 P. 111 (1921); *Mott v. Wright*, 43 Cal.App.21, 184 P. 517 (1919); see also *In Re Showplace Square Loft Co.*, 289 B.R. 403, 409-410 (B.C. N.D. Cal. 2003) (material issue of fact when completion occurred, and whether lien for work on “punch list” was timely).

This may often occur with landscaping work, which is expressly included as part of a “work of improvement.” Civil Code § 3106, Proposed § 7046. Landscaping is often not even begun until *after* the building structure is completed, and may go on even after the building is occupied. I currently have several cases with such facts, involving landscape labor.

If a work of improvement is considered complete by the fact of occupancy, or by virtue of the doctrine of “substantial completion,” before the landscape work is actually completed, then it would be physically impossible for anyone providing labor or materials on that job to assert a lien. They cannot assert a lien until after the work is

complete, which may be beyond the deadline, calculated by the current definition of completion.

I have not found any cases addressing this precise issue, but it seems such a construction would be contrary to the Constitutional mandate that laborers "shall have a lien upon the property upon which they have bestowed labor . . . for the value of such labor done . . ." Cal. Const. Art. 14 § 3. If the statute is construed to make it impossible to assert a lien for work actually done and unpaid, then the Legislature has failed its mandate to "provide, by law, for the speedy and efficient enforcement of such liens." Id. This is now the opportunity for the Legislature to fulfill its Constitutional mandate.

We suggest that proposed § 7414 be rewritten as follows:

A claimant other than a direct contractor may not enforce a lien unless the claimant records a claim of lien within the following times:

- (a) After the claimant ceases to provide labor, service, equipment, or material.
- (b) Before the earlier of the following times:
  - (1) Ninety days after completion of the work of improvement, **or the last labor, service, equipment or material provided by that claimant, whichever is later.**
  - (2) Thirty days after the owner records a notice of completion improvement, **or the last labor, service, equipment or material provided by that claimant, whichever is later.**

A similar suggestion has been made by a commentator who has more thoroughly analyzed the issue. Craig Penner Bronstein, TRIVIAL (?) IMPERFECTIONS: THE CALIFORNIA MECHANICS' LIEN RECORDING STATUTES, 27 Loy. L.A. L. Rev. 735 (Jan. 1994). We would recommend that Article, and suggest that comments be solicited as to this issue.

**EMAIL FROM LORI NORD**  
**(DECEMBER 26, 2006)**

As you may recall I have represented construction industry trust funds for 27 years and a significant part of my practice has been in the area of mechanics' liens, stop notices and payment bond remedies. I have the following additional comments:

- 1) I agree with Mr. Sackman's request that section 7414 be rewritten as he proposes for the same reasons he proposed it (EX 7 & 8 of his 11/29 comments). I too represent workers who have been employed in landscaping and punch list type work which should be covered by the mechanics lien laws. His suggested changes make this clear.
- 2) I support the addition of section 7060 regarding the standing of one's agent to exercise his/her lien rights.
- 3) I agree with you that section 7474 (a) (3) (b) should be left to judicial interpretation rather than to force a statutory crediting rule. I frequently have cases against a delinquent contractor for the full amount it owes my clients and several lien claims against third parties. If I collect some money from the contractor before I collect on one of the liens, I would argue that the money should first be applied to amounts that the contractor owes, but for which we have no claim against the third party. Then it may be appropriate to prorate among the remaining liens or it might be appropriate to apply to the earliest period first, depending on the particular case. Because facts vary, I believe that a general statutory rule is inappropriate.
- 4) I believe that section 7420 notice requirement would be better served and less ambiguous and less invasive to the mechanics lien right by stating that the lien claimant should attach a proof of service by mail to the claim of lien recorded in the County Recorder's office showing that the claim has been mailed to the owner on or before the date of recording. I am concerned that a County Recorder could otherwise refuse to record a valid lien. For instance, what is a "notice of intended recording"? Should a ministerial clerk be allowed to determine what that is?

Thank you for your consideration of these comments.

Lori A. Nord  
McCarthy, Johnson & Miller, Law Corporation  
595 Market Street, Suite 2200  
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REPLY TO LOS ANGELES OFFICE

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February 23, 2007

## VIA ELECTRONIC-MAIL AND U.S. MAIL

California Law Revision Commission  
4000 Middlefield Road, Room D-1  
Palo Alto, California 94303-1335  
Attn: Steve Cohen, Staff Counsel

Re: Supplemental Comments on Proposed Revisions to the California Mechanics Lien  
Law and Associated Construction Remedies

Dear Mr. Cohen:

My apologies for the lengthy hiatus between our last communication with the Commission and this letter; however, I believe it is important that Staff and the Commission be alerted to potential unintended consequences resulting from a recent proposed change to the language of Proposed Section 7150 (Completion). Specifically, I am concerned that the substitution of the concept of "substantial completion" for "actual completion" will have far-reaching consequences unless further radical modifications are made to other provisions of the proposed law.

It is my understanding that the proposal of modifying the contents of Proposed Section 7150 was first discussed in Staff's Memorandum 2006-43 dated October 19, 2006 (pgs. 54-59). The argument, at its core, was that the term "actual completion" is a meaningless term. Further, it was asserted that the concept of "substantial completion" is a term that is used quite regularly in the construction industry and is also a term, the definition of which, is widely known and understood. With this premise, I do not disagree. However, the concept of "substantial completion," as acknowledged in the discussion is not equivalent to final completion or full satisfaction of all performance obligations on the work of improvement. Indeed, after "substantial completion" has occurred, it is not uncommon, particularly on large projects, for "punch-list, remedial or pick-up work" to take weeks to complete. Establishing "substantial completion" as one possible milestone for determining the earliest date when "completion" occurs for purposes of lien and other statutory rights will, in my estimation, result in the unjust loss of lien rights by claimants otherwise entitled to such rights. The basis for my contention is

EX 10

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demonstrated by the example set forth in the following paragraphs – a scenario that I believe could occur with great frequency on projects in California should Proposed Section 7150 remain unchanged.

As it is presently constituted, Proposed Section 7150 provides that “completion” of a private work of improvement occurs “at the earliest” of several events, one of which is “[s]ubstantial completion of the work of improvement.” It is widely understood that at the time substantial completion occurs, work on the project (remedial, punch-list or pick-up work) still remains to be completed. Nevertheless, on or within fifteen (15) days of the “completion of a work of improvement,” Proposed Section 7152 permits the owner to record a notice of completion. As such, a notice of completion could be lawfully recorded despite the fact that all of the work under the contract has not been completely performed.

Pursuant to Proposed Section 7414, the effect of the notice of completion is to shorten the time period in which claimants, other than a direct contractor, can record liens to thirty (30) days after recordation. That same section specifically conditions the recording of a lien by a non-direct contractor claimant on the cessation of the performance or furnishing of labor, service, equipment or material by that claimant on the work of improvement. Therefore, until that claimant has ceased performing any further work on the project (i.e., its work has been fully performed, stopped or come to an end), that claimant cannot record a lien. This condition to recording a lien, I believe, is well settled in the law. The problem obviously occurs when the non-direct contractor is responsible for performing some or all of the punch-list, remedial or pick-up work which is not completed within thirty (30) days of the recordation of a notice of completion that is recorded because “substantial completion” has been achieved. That non-direct contractor claimant would then be faced with the difficult decision of ceasing the continued performance of the remedial, punch-list or pick-up work (likely resulting in a claim of breach by the other contracting party) or, equally unappetizing, the prospect of losing its lien rights because it can’t record a lien within the 30-day recording window since it’s work has not ceased.

The scenario discussed above is not theoretical, it is realistic and a scenario that will play out on countless projects if Proposed Section 7150 is adopted as it has been revised. Moreover, the aforementioned scenario relating to lien claims could occur with respect to other statutory rights or obligations that are triggered by “completion” and, which are accelerated unnecessarily by the use of “substantial completion” as a determiner of “completion.” (See, Proposed Section 7812 – Payment of retention by owner; Proposed Section 7508(b) – Requirements for valid stop payment notice).

Under the present scheme, although the concept of “actual completion” may indeed be somewhat ambiguous, it does nonetheless connote the full satisfaction or full completion of the work of improvement – something I believe is firmly understood in the industry. Further, it protects potential claimants, whose lien rights are derived from the California Constitution and

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protected under current law, from losing those rights by virtue of a determination of “completion” that is earlier than the time that “completion” actually occurs.

Although I have other comments as to a variety of the other issues about which the Commission has sought comment, those other comments will be sent under separate cover. Because the Commission is planning a meeting on March 1<sup>st</sup>, I thought it best to alert you and the Commission as to the potential problem that I believe exists as to Proposed Section 7150 so that it might be possible, should Staff or the Commission choose, to conduct a further review and analysis of this issue.

Again, thank you for this opportunity to provide comments and I look forward to making future comments on the proposed revisions of the mechanics lien law and associated construction remedies. As was stated in our earlier Memorandum, we stand ready to assist the Commission in this highly important task and we look forward to a further opportunity to review the proposed legislation before it is forwarded to the Legislature for its consideration. In the interim, should you desire any further comment or discussion on any of our comments, please do not hesitate to contact me.

Very truly yours,



John F. Heuer, Jr.

of GIBBS, GIDEN, LOCHER & TURNER LLP

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April 24, 2007

Law Revision Commission  
REC'D

APR 26 2007

File: H-821

California Law Revision Commission  
Attention: Steve Cohen, Staff Counsel  
3200 5<sup>th</sup> Avenue  
Sacramento, CA 95817

Re: Law Revision Commission Study of  
Mechanic's Lien Law

Dear Mr. Cohen:

I am in receipt of Memorandum 2007-11 in connection with the above-entitled matter. You have asked for comments from practitioners on various points and I will attempt to address your questions in this correspondence.

In your introductory statement on payment bonds, you indicate that an owner may require a direct contractor to obtain a payment bond as a term of a construction contract. What you do not say is that a general contractor may require a subcontractor to obtain a payment bond as a term of the construction project or that a subcontractor may require of his subcontractor or material supplier a payment bond as a term of a construction project. Although your comments are not directly part of the proposed sections, I believe the issue is sufficiently important to warrant comment.

You have requested comment with regard to Section 3235 as to whether the payment bond and contract must be recorded simultaneously to obtain the benefits of Section 3235. I cannot see any reason why simultaneous recordation would be necessary where the contract and the bond are both recorded prior to work commencing as required by this section. Additionally, you question whether it is appropriate to continue to require that both the contract and the payment bond be recorded prior to commencement. I would think not. A claimant will typically look for a bond on a private work of improvement through the recording statutes sometime later in the job but when a claim arises. I would think that at least 30 days from commencement of work should be given to the owner or his agent to comply with proposed Section 7602.

With regard to proposed Section 7610, my interpretation of present 3239 arises out of the statement that the payment bond surety may not shorten the statute of limitations to less than six months and therefore, by implication, if the surety does not do so, the statute of limitations will be four years or whatever other time the surety sets forth

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in the bond greater than six months from completion. I realize that the language is not absolutely clear in 3239 and therefore your interpretation may well be valid. I do not see a problem in your new section which simply takes the position that if the bond is recorded prior to completion, the statute of limitations on the bond will be six months.

With regard to proposed Section 7612, I believe your revision is appropriate. Much of my practice has occurred during a time in which there was no preliminary notice requirement to make a claim on a bond on a private work of improvement. The 1995 revision to 3242 changed those circumstances. Practitioners are now aware that a preliminary notice must be given in connection with a bond on a private work of improvement and I believe that the extensions given by Sections A and B of both the existing statute and the proposed statute are a desirable protection to bond claimants.

With regard to proposed 7004 and 7726, I agree that an escrow holder functions as a construction lender because it holds construction funds.

With regard to proposed 7804, I agree with the staff recommendation since it is not clear at what point a surety may be responsible for prompt payment.

With regard to proposed 7830, I do not believe that the term "stop work notice" is confusing and therefore the proposed section seems appropriate.

With regard to proposed Section 7838(b), I agree with the staff's recommendation since present 3260.2(c) is definitely confusing.

With regard to proposed 7834, I do not think that additional notices should be required before giving a stop work notice. This would be an additional burden on the direct contractor which does not presently exist and I do not believe that any contemplated benefit would warrant the additional complexity.

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With regard to proposed 7844, I strongly believe that an owner should have a reciprocal right to an expedited proceeding to resolve the stoppage for purposes of mutuality and plain fairness.

Very truly yours,

MOSS, LEVITT & MANDELL

  
By Rodney Moss

RM:ll

**EMILIO AND SYLVIA CONTRERAS**  
**327 E. 57<sup>th</sup> Street**  
**Long Beach, CA 90805**  
**562-423-1145**

September 21, 2007

Steve Cohen  
California Law Revision Commission  
4000 Middle Field Road, Room D-1  
Palo Alto, California 94303-4739

Re: Comments to Tentative Recommendations  
Real and Current Ongoing Case of Mechanic's Lien Litigation

Dear Mr. Cohen,

I, Sylvia Contreras, recently discovered clrc's website with your contact information. I am very interested in how a mechanic's lien law operates. Us, the homeowners, have 11 contracts with a plumber totaling \$66K of which \$60K was paid, and much work not started, not completed, or incorrectly completed. Michael Carr, the direct contractor, was hired on Sept 2, 2006 (last year), had a temper tantrum and abandoned the job site (from owners' point of view). Carr filed an \$18.5K mechanic's lien lawsuit on Jan 22, 2007 and trial is set for January 2008.

I am not an attorney, I do not work for a law firm, and my legal background is nothing to brag about. I am a homeowner who is currently in litigation for what I believe to be fraudulent mechanic's lien. It seems, that even with a reputable attorney defending us, a direct contractor has all the benefits. Ironically, I just discovered today that my attorney provided the Commission with comments in August 2006. My attorney is Rodney Moss. My input to the commission is solely my own, and not brought to the commission by any discussion between Rodney and us, the homeowners.

It just so coincidentally happens that one homeowner contacted clrc, to find out more about the Mechanic's Lien Law and is providing comments. . It just so coincidentally happens that this homeowner's attorney provided comments to the Commission about the Tentative Recommendations. What are the odds for this to occur?

I reviewed portions of the California Law Revision Commission Tentative Recommendations. Some of the areas of the Tentative Recommendations were perplexing. I do not expect the Commission to change law, but hopefully, give serious thought as to how many homeowners may be caught in the same situation as us, and out of desperation of insufficient funds to continue litigation, give up the fight for what is right. And maybe the Commission will not simply file away my input, and keep it active as a reminder for possible future mechanic's lien reform. Also, I believe, that if my case does not make an impact on the Commission of a direct contractor's "wrongful"

CONTRERAS  
LONG BEACH, CA  
P. 2 of 8  
9/21/07

mechanic's lien going through the court system as a "rightful", then I feel homeowners have little to look for defense and a lot of attorney expenses. I think our case will give the Commission a lot to think about.

If there is anything the Commission would like to review further, i.e. supporting documentation, please feel free to ask. I will be happy to provide copies of requested documents.

Attached are questions I had before finding clrc's website, and questions that arose after reviewing the Tentative Recommendations. The questions are followed by a Contreras Summary of Mechanic's Lien Experience.

Sincerely,

Sylvia Contreras



### CONTRERAS QUESTIONS

1. Why didn't the direct contractor have to advise the owners of a forthcoming lien? Owners discovered mechanic's lien from attorney mailing solicitation of services for defense.
2. Why didn't the direct contractor have to advise the owners of how the forthcoming lien was calculated?
3. Why is it allowed that a direct contractor file an \$18,537.37 mechanic's lien when there were 11 separately signed contracts that totaled \$66,167.00, and owners paid \$60,063.30? And of this amount, owners paid \$13000 of a \$14000 contract for substantial work not performed.
4. Why can't the owner attain the description, itemized list, etc to support the \$18.5K lien? Consumers can request credit card copies of disputed charges to verify charge. Why shouldn't the owner, also a consumer, be provided with copies of HOW a huge mechanic's lien was calculated and its basis of creation? Contreras are owners going through months of litigation and still do not know how the direct contractor created the \$18.5K lien. It does not make sense at all. (One the flip side, owners are not sure how attorney arrived at very high amount of counter-suit).
5. How can a direct contractor file a lien when he did not complete his work and doesn't have to prove so until litigation is completed?
6. How can a direct contractor be allowed to retain a mechanic's lien if the direct contractor was paid, in good faith, for non-performance, and owners expecting the work to be done?
7. Why is a Petition Release Order have to be for contracts paid in full, if the direct contractor didn't complete the job? Should the owner pay all monies to the contractor, without completing the work, just to remove the lien? In my case, if I would have paid Carr Drain balance of \$6K, even though the work was far from complete, would I still have to go to court to remove the lien? Plus, as the owner, it is difficult to trust a direct contractor after the method of professionalism demonstrated is disagreeable.
8. How does a mechanic's lien law help the owner, in the situation that the owner paid 90% of the contracts, but work performed was less than 90%, and visible to the eye that work was performed incorrectly or not at all?
9. So, is the Commission NOT going to allow fraudulent claims be filed by owners? I got confused on this part of the revision.
10. What should prevent a direct contractor from creating a bogus invoice to cover underestimated expenses, and then attempt to collect under a mechanic's lien?
11. Why can't an owner file a fraudulent claim or frivolous lawsuit against a direct contractor who falsely filed a mechanic's lien?
12. What can an owner do, if the owner prevails judgement, besides wait?
13. Why can't owners be provided with all documentation from a bond company related to findings of work performed/not performed?
14. How far does a case have to go for the case to become case law? Trial?

## **CONTRERAS SUMMARY OF EXPERIENCE WITH MECHANIC'S LIEN LAW**

On 9/2/07 (Labor Day weekend), Emilio and Sylvia Contreras, owners, hired direct contractor, Michael Carr of Carr Drain Cleaning, a California licensed plumber. (Owners verified licensure and worker's compensation insurance from State License Board website.) There was a plumbing problem in owner's ¾ bathroom caused by tile contractors. Owners felt help was needed, called plumbers in yellow pages, and Carr was available over the holiday weekend to resolve the problem.

After litigation started, owners discovered that much of the work contracted was in violation of plumber contractor's license. Owners had been asking contractor if he could do the work, plumber convinced owners his license covered all work described in the 11 contracts. Violation of license was confirmed by the California State License Board. Further, owners also discovered Michael Carr had his license previously revoked.

Owners came to trust the direct contractor and ended up with 11 signed contracts for \$66,167 for the period of 9/2/06 through 10/27/06. Direct contractor found problems, and owners believed work needed to be done. Some problems, owners knew existed, but not how bad the problems were until direct contractor described possible future problems if problems not corrected.

Owners paid direct contractor \$60,063 with 34 "progress payment" checks during same timeframe. Most contracts were not completed (i.e. shower head not installed, shower not ever used since contractor left site), work not ever started (i.e. bathroom remodel), etc, etc. The contracts were for work to be performed at owner's residence, 327 E. 57<sup>th</sup> Street, and 329 E. 57<sup>th</sup> Street, Long Beach, CA 90805 (329 is a rental unit above a 3-car garage on same lot).

As an example of work NOT performed, Contract #1019 signed on 9/14/06 was \$14,000 for 327 remodel of full bathroom, and replacing hot water system underneath residence. Owners had no intentions of remodeling bathroom, did not know of any leak below the house, but direct contractor convinced owners of a major leak that required immediate attention. Owners signed the contract. Owners paid five "progress payments" totaling \$13,000.00. Direct contractor expected and accepted "progress payments" from Contract #1019, even though direct contractor was not performing work on Contract #1019.

On Friday, 10/27/06, direct contractor has a temper tantrum, when owner asks direct contractor to clean up plumbing debris from backyard before the weekend. (Direct contractor was leaving property daily in "little Beirut" environment.) Direct contractor removes his tools and materials, uses foul language, upsets owner, and states "I'll think about returning to back here" Further, on 10/27/07, just before direct contractor leaves, he shoves owner a contract for landscaping. The agreed amount was \$1,245 but direct contractor demands \$1,000 for first payment, or threatens landscaping will be cancelled. Direct contractor hired landscaper for the job. Owner felt pressured to pay more than the

10% (\$125) because owner did not want landscaping job cancelled. Front yard was bare and old grass torn off already when direct contractor installed sprinkler systems.

On Tuesday, Oct 31, 2006, direct contractor calls owner to discuss problem. Owner agrees that there are issues to be resolved, and to expect decision shortly. Owner faxed direct contractor a letter dated Nov 2, 2006 describing expectations to return to the job site. For example, pull the permit for work being performed on rental property 329 E. 57<sup>th</sup>. Owner had asked various times to get that done, to no avail. Provide owner with laborers names (direct contractor said on Sept 2, 2006, he had eight staff people to help him, but no such eight people were on the job site, and people seemed to be picked out of nowhere, and not seen again). Contractor did pull the permit for 329 E. 57<sup>th</sup> Street until Nov 6, 2006, after last day worked of Oct 27, 2006. Owner thought it was strange since direct contractor did not contact owner agreeing to owner's stipulations to return to the work site.

On Nov 28, 2006, owners file a Complaint with HCC Surety, the bond company. Owners provide extensive supporting documentation, including copies of all 34 cancelled checks issued to Carr Drain Cleaning. Owner, Sylvia, and claim rep, Vanessa, built an amicable and professional rapport.

In December, 2006, HCC Surety claim rep and owner held various discussions. It definitely appeared to owner that HCC Surety was willing to pay claim, but direct contractor vetoed payment. However, owner, for the next few months, after so many conversations with claim rep, believed \$10K claim would be paid.

Around Feb 6, 2007, owners received solicitation from an attorney Rodney Moss, about a mechanic's lien on our property. Owner contacted attorney to inquire about solicitation and asked how attorney knew about owner's mechanic's lien before owners? How can a direct contractor file a mechanic's lien for work not completed, and/or completed wrong that someone else will have to finish the job and/or redo the work? How can a direct contractor who was paid 90% of all contracts combined, but certainly did not perform or complete 90% of the all work combined? (i.e. 327's full bath remains in original form, but paid \$13000 out of good faith).

Early February 2007, HCC Surety hires Guardian Group to inspect the property site. Owner refused to allow direct contractor to return to property for inspection since mechanic lien is filed. Owner received copy of Guardian Group's March 13, 2007 inspection report. The report included a Cost Analysis Excel spreadsheet attachment that shows how Guardian Group arrived at \$15,000 of repairs remained to be done. Owner was not provided with the Cost Analysis even after several requests. Owner felt there was a problem with the Cost Analysis because of a few reasons: 1) owners provided HCC Surety with two estimates dated 11/1/06 from Mr. Rotor Rooter Plumbing to complete the plumbing work. The estimates totaled \$13,000 and 2) owners explained to inspector that owners paid \$13,000 of \$14,000 for Contract #1019 for 327 bathroom remodel, which most work was not performed, inspector was shown full bath, inspector

agreed and said, “nothing done here” and 3) the inspection report stated that owners did not show inspector “anything of consequence.” How did Guardian Group arrive to \$15,000 if the two estimates from Mr. Rotor Rooter Plumbing alone were \$13,000? What was the credit given to the direct contractor for Contract 1019? HCC Surety, to date, has not provided copy of the Cost Analysis. How could the inspector, who agreed visual to the eye, that 327 full bathroom remodel was not done. This was for Contract #1019 that owners paid five “progress” payments totaling \$13,000 of the \$14,000 contract. How can something so visual to the eye, with proof of “progress” payments (cancelled checks) of \$13,000 issued to direct contractor for work not performed not be considered as “anything of consequence”?

On March 8, 2007, owners file a Complaint with the State Contractor’s License Board. Owners provide about 1” thick of supporting documentation. On March 30, 2007, SCLB advises owner case is closed due to litigation, but if owner prevails, contact SCLB.

Owners receive a letter dated April 12, 2007 from HCC Surety that the claim was neither denied or accepted. The letter states the \$10K claim would be paid (but HCC could change their mind).

Around April 16, 2007, attorney contacts owner to advise settlement offer has been made for \$15,000. Owner thought the settlement offer may have been from Guardian Group’s original Cost Analysis, which owner felt was a wrong Cost Analysis. Owner wants copy of Cost Analysis. Owner believes attorney may have attempted to attain the Cost Analysis from opposing counsel. To owner’s knowledge, attorney does not have Cost Analysis. Owners reject settlement offer because Cost Analysis is probably wrong.

Early May 2007, in a verbal conversation, owner contacts HCC Surety to follow up on collection of the bond. Claim rep said, “didn’t you get my letter?” Owner asked, “what letter?” Claim rep said, “I sent a letter with a copy of the attorney’s letter (Carr’s attorney).” Owner asked, “What did the letter say? Are you trying to tell me HCC Surety is not paying the bond?” HCC Surety confirmed was not paying the \$10K bond because the claim is in litigation. Owner requested from HCC Surety, several times, for the copy of the letter supposedly sent stating why the bond was not being paid. HCC Surety did not respond to any of the requests.

In May, June... around this time frame, owners attorney makes settlement offer to opposing counsel, approx \$38K to settle. Opposing counsel refuses settlement. (Owner had estimate provided for remodel of bathroom and to complete other work paid to direct contractor, but which was incomplete.

Approximately late June 2007, owner asks attorney to approach opposing counsel. Owner wants opposing counsel to release mechanic’s lien, to refinance property and continue to complete work. Owner offers mechanic lien of \$18.5K paid into attorney’s trust account, and to be paid to prevailing party at end of case. (Owners strongly felt

owners would prevail – owners are telling the truth, how can owners not prevail?)  
Opposing counsel denies request to release mechanic's lien.

Approx July 2007, owners and direct contractors attempt resolution. However, owner requests copy of Guardian Group's Cost Analysis Excel Spreadsheet which direct contractor will not provide. Direct contractor will not settle beyond \$15,000, based on Guardian Groups inadequate inspection report analysis. Direct contractor informs owners that foreclosure of direct contractor's property was an issue prior to working on owner's property. Direct contractor mentions that contractor is filing bankruptcy (or will file).

Approx Aug 14, 2007, owners file a Motion to Remove Mechanic's Lien and Dismiss Summons and Complaint. Direct contractor responded to motion. Owner responds to direct contractor's response in preparation for Sept 18, 2007 hearing. On Sept 13, 2007, State Contractor's License Board provides a letter to owner stating direct contractor was in violation of Business Code. Owner misplaced March 30, 2007 letter from SCLB, but Sept 13, 2007 letter helps restate information of March 30, 2007 letter. Owner advised attorney of information, hoping it can be used verbally at Sept 18, 2007 hearing to remove mechanic's lien.

Owner's counsel provides defense via phone. Direct contractor's counsel appears in court. Direct contractor's counsel gives presentation. The judge favors direct contractor's counsel response. Motion to remove mechanic's lien was denied on Sept 18, 2007. Owner, present at hearing, is bewildered. Owner wanted to say, "Judge, you are being fooled." Owner wanted to contact judge directly and tell him why he was fooled, but owner's attorney said not to contact judge. And, now owners wonder that if the judge was fooled once, it can occur – these contracts are confusing each and every party associated with reviewing the case. Is there any chance for owner's recovery? Owner's property remains with work incomplete, with owner cleaning up where possible. Owner's wonder if the judge starts denying the process from the start, what are the chances of recovery and at what cost to clear up the fraudulent claim?

Owners have many, many, many pictures of the property during Carr's work performance. The intent of the pictures was to have record of the work done should the property ever be sold. It was for sales disclosure purposes only – simply a "before" and "after" effect. Maybe the pictures will help owners at mediation in October.

Since owner's attorney attain copy of direct contractor's license, owners discovered direct contractor's license was revoked in the past. However, State Contractor's License Board website did not state so such information.. In fact, there is a disciplinary action complaint on the website, and when asked, the State License Board reps will state the action is over 5 years old and no information is available as to what the action was about. The State reinstated a problem contractor. The State has proof that the same contractor acted against Business Code. Owners felt if the State Contractors License Board honored

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Carr a license, then the direct contractor must be reputable and the disciplinary action was trivial. Ha, what a joke on owners.