Study H-821 February 1, 2008

Memorandum 2008-9

Mechanics Lien Law: Discussion of Issues

The Commission has provisionally approved a final recommendation on mechanics lien law.

This memorandum will address remaining outstanding issues relating to the proposed law, including issues noted by the staff.

We have received the following comments on the proposed law, attached as an Exhibit:

Comments that suggest the proposed law fails to accurately continue an aspect of existing law, or creates a problem that did not previously exist, are analyzed in this memorandum.

Comments that suggest an improvement to existing law, or renew an earlier suggestion that the Commission has considered and declined to adopt, are not addressed in this memorandum. These suggestions have been noted for possible future study by the Commission.

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

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

Sections of the proposed law reprinted in this memorandum are the latest draft versions of the section, incorporating all revisions approved by the

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

Commission at previous meetings and any non-substantive technical corrections made by the staff.

DEFINITIONAL ISSUES

☞ **"Commencement"**

Mr. Charles Philipps, a Corte Madera attorney, suggests that the proposed definition of "commencement" may not adequately describe commencement of a *site* improvement. Exhibit p. 3.

(A site improvement is a work of improvement that improves only the ground on which a structure may be built. See proposed Civ. Code § 8042.)

Proposed Section 8004 provides:

> 8004. A work of improvement "commences" on either of the following events:
> (a) Delivery to the site of material or supplies that are thereafter used, consumed, or incorporated in the work of improvement.
> (b) Visible work of a permanent nature on the site.

Mr. Philipps asserts that a site improvement can "commence" with the placing of survey stakes or the delivery of construction rental equipment, and that neither event is sufficiently described by proposed Section 8004.

Importance of "Commencement"

Identifying precisely when a work of improvement (whether a site improvement or otherwise) "commences" is most important for determining the priority of security interests in the improved property.

A construction lender that loans money for a construction project will generally secure the loan by obtaining a deed of trust on the property. However, unless the lender records this deed of trust before "commencement" of the work of improvement, the lender's security interest will be have a lower priority than any mechanics lien recorded on the work of improvement, as all mechanics liens are deemed to "relate back" to the commencement of the work of improvement. See Civ. Code §§ 3134, 3137.

A deviation from this "relation back" rule occurs when the owner arranges for site improvement in a contract separate from the contract for the remainder of the work of improvement. In this case, all *site improvement* work will "relate back" to the commencement of the *site improvement*; all other work will "relate

back" to the commencement of the remainder of the work of improvement. See Civ. Code § 3135.

Regardless of which "relation back" rule applies, it is important for a lender to be able to verify that *no* work of improvement (site improvement or otherwise) has "commenced," before issuing a loan. To this end, before issuing a loan a lender will typically inspect the site on which the work of improvement is planned, to make sure that "commencement" has not yet occurred.

Commencement Under Existing Law

The existing mechanics lien statute contains no provision defining when a work of improvement commences. The Commission added a statutory definition of the term to clarify the issue for practitioners and courts. This definition, which was adopted from the holdings of two relatively recent appellate court opinions that analyze the issue, was discussed at some length by the Commission. See CLRC Memorandum 2006-43, pp. 9-11; Meeting Minutes (October 2006), p. 6.

Section 8004 appears to be clearly correct as far as it goes, but its language may not cover every possible fact pattern that might arise relating to a work of improvement. Mr. Philipps has offered two fact patterns relating to commencement of a site improvement that may or may not be addressed by the proposed law's definition.

Placement of Survey Stakes

The placement of survey stakes at a site appears to constitute commencement of a site improvement under existing law. See *Tracy Price Associates v. Hebard*, 266 Cal. App. 2d 778, 72 Cal. Rptr. 600 (1968) and *Nolte v. Smith*, 189 Cal. App. 2d 140, 11 Cal. Rptr. 261 (1961) (placement of "permanent" boundary markers in ground in conjunction with pre-construction engineering services constitutes commencement of site improvement).

However, the staff believes that the language of proposed Section 8004 is broad enough to allow for the same result under the proposed law. The placement of stakes could be seen as either "delivery to the site of material" (Section 8004(a)), or "visible work of a permanent nature" (Section 8004(b)).

Thus, to the extent that placement of survey stakes at a site constitutes commencement of a site improvement under existing law, that event appears to be adequately covered by the proposed law's definition of "commencement."

The staff therefore recommends **no change to proposed Section 8004 to incorporate the placement of survey stakes.**

Delivery of Rental Equipment

A person that provides rental equipment to a site may claim a lien for that service, at least if the equipment is used in the work of improvement. See Civ. Code § 3110, *Rich-Lee Equipment Rentals, Inc. v. Intermountain Constr. Co.*, 79 Cal. App. 3d 581, 145 Cal. Rptr. 106 (1978). (The equipment has to be *rental* equipment — a *vendor* of equipment that is used in a work of improvement is *not* entitled to a lien. See *Davies Machinery Co. v. Pine Mountain Club, Inc.*, 39 Cal. App. 3d 18, 24, 113 Cal. Rptr. 784 (1974).)

However, whether the mere delivery to a site of as yet unused rental equipment constitutes "commencement" of the work of improvement is a different question, which appears to be unresolved. The staff has located no appellate opinion addressing the issue.

As indicated in the proposed law's definition of commencement, the delivery to a site of *material* constitutes commencement of a work of improvement, if the material is thereafter used in the work of improvement. The provision of rental equipment on a work of improvement is similar to the provision of material, in that both are non-labor items integral to the overall construction project, whose use is easily verifiable and quantifiable. The staff surmises that a court, if called upon to rule on the issue, would likely hold that material and equipment are sufficiently similar that the rule of commencement relating to the delivery of material to a job site also applies to the delivery of rental equipment.

However, that principle does not appear to be adequately expressed in the proposed law.

Delivery of rental equipment would probably *not* be considered "delivery to the site of material," as set forth in proposed Section 8004(a). The existing mechanics lien statute consistently refers to "equipment" as an item separate and distinguishable from "material." (See e.g., Civ. Code §§ 3084, 3097, 3123, 3124, 3138.) A codification of the definition of "commencement" that references only the delivery of "material" would therefore likely be read as implicitly *excluding* the delivery of "equipment."

To avoid that conclusion, the staff recommends **revising proposed Section 8004 to expressly recognize the delivery of rental equipment to a job site:**

8004. A work of improvement "commences" on either of the following events:

(a) Delivery to the site of rental equipment, material or supplies that are thereafter used, consumed, or incorporated in the work of improvement.

(b) Visible work of a permanent nature on the site.

"Contract[or]" and "Direct Contract[or]"

The proposed law draws a distinction between a "contract" and a "direct contract," and a contractor and a "direct contractor."

A "contract" is defined by the proposed law as "an agreement that provides for all or part of a work of improvement." Proposed Civ. Code § 8013. A "direct contract" is defined more narrowly as "a contract *between an owner and a direct contractor* that provides for all or part of a work of improvement." Proposed Civ. Code § 8014 (emphasis added).

Similarly, a "direct contractor" is defined as "a contractor that has a direct contractual relationship with an owner." Proposed Civ. Code § 8013.

The Commission has already revised references to these terms in several sections of the proposed law to more precisely clarify the intended usage. However, one section of the proposed law may still require revision in order to accurately continue existing law.

Defense of Lien Enforcement Action

Proposed Civil Code Section 8470 sets forth rights and responsibilities of both a "contractor" and a "direct contractor" on a work of improvement, when a claimant seeks to enforce a lien claim:

8470. In an action to enforce a lien for work provided to a *contractor*:

(a) The *contractor* shall defend the action at the *contractor's* own expense. During the pendency of the action the owner may withhold from the *direct contractor* the amount of the lien claim.

(b) If the judgment in the action is against the owner or the owner's property, the owner may deduct the amount of the judgment and costs from any amount owed to the *direct contractor*. If the amount of the judgment and costs exceeds the amount owed to the *direct contractor*, or if the owner has settled with the *direct contractor* in full, the owner may recover from the ***contractor***, or the sureties on a bond given by the ***contractor*** for faithful performance of ***the contract***, the amount of the judgment and costs that exceed

the contract price and for which the ***contractor*** was originally liable.

(Emphasis added.)

Existing law uses the term "*original* contractor" instead of "contractor" in the three instances indicated in bold above, and "*his* contract" instead of "the contract." See Civ. Code § 3153.

Changing those references in the proposed law to "contractor" and "the contract" would expand the references, and the application of the provisions, to include both direct contractors and *subcontractors*.

It does not appear that such changes were intended by the Commission, as the staff finds no discussion of the issue in previous memoranda.

The staff therefore recommends that **Section 8470 be revised to more precisely conform to the language of existing Section 3153**:

8470. In an action to enforce a lien for work provided to a contractor:

(a) The contractor shall defend the action at the contractor's own expense. During the pendency of the action the owner may withhold from the direct contractor the amount of the lien claim.

(b) If the judgment in the action is against the owner or the owner's property, the owner may deduct the amount of the judgment and costs from any amount owed to the direct contractor. If the amount of the judgment and costs exceeds the amount owed to the direct contractor, or if the owner has settled with the direct contractor in full, the owner may recover from the direct contractor, or the sureties on a bond given by the direct contractor for faithful performance of the direct contract, the amount of the judgment and costs that exceed the contract price and for which the direct contractor was originally liable.

"Laborer"

Mr. Philipps suggests that the Commission previously decided to make the following revision to the definition of "laborer" presented in the tentative recommendation, but has not incorporated the revision in the proposed law:

8020. (a) "Laborer" means a person who, acting as an employee, performs labor, or bestows skill or other necessary services, ~~on~~ upon a work of improvement.

….

Comment. Subdivision (a) of Section 8020 continues former Section 3089(a) without substantive change.

Exhibit pp. 3-4.

Mr. Philipps argues that if this revision is not made, persons working offsite or employees performing only clerical or administrative duties would arguably have a right to pursue a mechanics lien remedy.

The definition of "laborer" in existing Civil Code Section 3089 uses both "on" *and* "upon":

> 3089. (a) "Laborer" means any person who, acting as an employee, performs labor *upon* or bestows skill or other necessary services *on* any work of improvement.

(Emphasis added.) It isn't clear whether the use of the two different prepositions was intentional.

Difference Between "Upon" and "On"

Mr. Philipps's suggestion seems to be based on the notion that the word "upon" implies a more immediate physical connection than the word "on."

The staff has reviewed various dictionary definitions of the two words as well as usage notes, but found no definitive authority on the issue. Each word has multiple definitions, and it is impossible to know which two the Legislature had in mind in enacting Section 3089. Some of these definitions are common to both words (suggesting the words would be interchangeable), but some definitions apply to only one of the two.

For example, the words "on" and "upon" are generally recognized as interchangeable when indicating a direct physical connection between an action and an endpoint (e.g., the bird alighted on *(or upon*) a tree branch). However, the word "on" *can* also be used to convey a more general relationship than the word "upon" (e.g., she did work on (*not upon*) the project). This latter interpretation of the two words could support Mr. Philipps's contention that in the context of Section 3089, the words have different meaning.

Somewhat surprisingly, the staff has found no authority in either treatise or appellate decision that definitively states whether a laborer's work must necessarily occur *on the site* of a work of improvement, in order to be lienable. **The staff welcomes any input from any practitioner on this issue.**

The best the staff was able to come up with is an excerpt from a rather seasoned opinion of the California Supreme Court, holding that a person that cooked for workers on a job site was *not* entitled to a lien. The court's rationale is instructive:

> If any lien exists, *it arises not from the place where the cooking was done, but from the nature of the services and its relation to the work which was being constructed*. If the plaintiff can assert a lien on the facts proved, he could as well have done so if the cooking had been performed at any other place; and if the mere fact that a person is employed to cook for the laborers engaged in erecting a building entitled him to a lien, the same result would follow if he had furnished the provisions also. On the same theory a blacksmith who shod the horses, or a grain dealer who furnished them forage whilst employed on the work, or a wagon maker who repaired the carts of the contractor, would be entitled to a lien on the building. And if every one who contributed indirectly and remotely to the work is entitled to a lien, no reason is perceived why a surgeon called to set a broken limb of one of the laborers, whereby he will be enabled at an early day to resume work on the building, might not assert a lien; *but services of this character, not performed on the building, are not within the province of the statute.*

McCormick v. Los Angeles City Water Co., 40 Cal. 185, 187-88 (1870) (emphasis added).

The staff's ultimate conclusion on this issue is that, under existing law, the determination of whether a person is a "laborer" for purposes of asserting mechanics lien rights is not the *location* where a laborer performs work, per se, but rather the *character* of the work the person performs. See also *Primo Team, Inc. v. Blake Construction Co.*, 3 Cal. App. 4th 801, 4 Cal. Rptr. 2d 701 (1992) (a person that provides purely administrative services has no right to a mechanics lien remedy).

The use of the word "on" in proposed Section 8020 rather than "upon" would not contradict that principle. Moreover, the Comment to the proposed section confirms that the section is intended to continue existing law without substantive change.

The staff recommends against revising proposed Section 8020.

"Laborer" (Public Work)

Mr. Philipps also advocates adding the following language to the definition of "laborer" in the public work provisions of the proposed law:

> 41070. (a) "Laborer" means a person who, acting as an employee, performs labor, or bestows skill or other necessary services <u>on a work of improvement</u>, pursuant to a public works contract.

Exhibit p. 6.

The proposed law defines the "public works contract" referenced in Section 41070 as "an agreement for the erection, construction, alteration, repair, or improvement of any public structure, building, road, or other public improvement of any kind." Proposed Pub. Cont. Code § 41120, Pub. Cont. Code § 1101. This language would appear to make the additional language suggested by Mr. Philipps unnecessary.

The staff **recommends against revising proposed Public Contract Code Section 41070**.

☞ CONSTRUCTION OF BOND

Mr. Philipps contends that proposed Section 8144, which continues general rules governing how a bond is to be construed, does not accurately continue existing law. Exhibit pp. 4-5.

Section 8144 provides:

> 8144. (a) A bond given under this part shall be construed most strongly against the surety and in favor of the beneficiary.
>
> (b) A surety is not released from liability to the beneficiary by reason of a breach of the direct contract *or on the part of the beneficiary*.
>
> (c) Except as otherwise provided by statute, *the sole conditions of recovery* on the bond are that the beneficiary is a person described in Article 1 (commencing with Section 8400) of Chapter 4 and has not been paid the full amount of the claim.
>
> **Comment.** Section 8144 restates former Section 3226 without substantive change. ….

(Emphasis added.)

Mr. Philipps challenges the italicized portion of Section 8144(b), which states that a surety is not released from liability to a beneficiary of the bond by reason of a breach of contract on the part of the beneficiary. Mr. Philipps argues that under existing law, a surety *would* be released from liability on a bond to a beneficiary that had breached its contract. He notes that the corresponding provision in existing law, rather than referencing a breach by "the beneficiary," references a breach by the "obligee named in such bond."

Mr. Philipps contends that the "obligee" on a bond is a named party to the bond, and is a different person than the "beneficiary" of the bond. Mr. Philipps states that the "obligee" on a bond is typically an owner, but could be another person owed an obligation on a work of improvement, such as a lender.

Mr. Philipps argues that Section 8144(b) as drafted would allow a claimant to breach its own contractual obligation on a job, and still collect on a payment bond claim. He asserts this is contrary to existing law, noting that the court in *Flickinger v. Swedlow Engineering Co.*, 45 Cal. 2d 388, 289 P.2d 214 (1955) held that a surety may use any defense available to its principal (such as a breach of contract) to defeat a claim on the bond.

Existing Law

Civil Code Section 3226, the provision of existing law corresponding to Section 8144(b), does provide that a surety may not be released from liability on a bond by reason of a breach by the "obligee named in such bond":

> 3226. Any bond given pursuant to the provisions of this title will be construed most strongly against the surety and in favor of all persons for whose benefit such bond is given, and under no circumstances shall a surety be released from liability to those for whose benefit such bond has been given, *by reason of any breach of contract* between the owner and original contractor or *on the part of any obligee named in such bond*, but the sole conditions of recovery shall be that claimant is a person described in Section 3110, 3111, or 3112, and has not been paid the full amount of his claim.

(Emphasis added.)

However, there seems to be something of a conflict under existing law as to exactly who an "obligee" is, in the context of a bond. There appears to be no appellate opinion interpreting the term as used in Section 3226.

"Obligee" Means "Beneficiary"

Under the Bond and Undertaking Law (Code Civ. Proc. § 995.010 et seq), the term "obligee" means the beneficiary on the bond:

> 995.130. (a) ….
> (c) For the purpose of application of this chapter [the Bond and Undertaking Law] to a bond given pursuant to any statute of this state, the terms "beneficiary," "obligee," and comparable terms used in the statute mean "beneficiary" as defined in this section.

Section 995.130 is applicable to all bonds given as security pursuant to any statute, "except to the extent the statute prescribes a different rule or is inconsistent." Code Civ. Proc. § 995.020.

Several appellate decisions interpret the term "obligee" in the same way. See *State Farm General Ins. Co. v. Wells Fargo Bank, N.A.*, 143 Cal. App. 4th 1098, 1107

n.6, 49 Cal. Rptr. 3d 785 (2006) ("All surety bonds involve a tripartite relationship: 1) a principal (promisor, debtor, or obligor), 2) an obligee (promisee, creditor, or beneficiary), and 3) a surety."); *Department of Indus. Relations, Div. of Labor Standards Enforcement v. Fidelity Roof Co.,* 60 Cal. App. 4th 411, 423, 70 Cal. Rptr. 2d 465 (1997), discussing "the law pertaining to payment bonds":

> In general, by virtue of the agreement between the surety and the principal, the surety guarantees the performance by the principal of some obligation to a third party, or obligee. Thus, unlike an ordinary insurance contract, the agreement is not for the benefit of the principal but for the benefit of *the obligee who is not party to the agreement*. The surety's obligation to the obligee derives from, but is independent of, the principal's obligation. …. However, in the context of public works, *the surety is liable to an obligee* even if the principal is not. That is, *the payment bond surety is liable to any laborer who supplied work on the public project*. This liability exists even though the laborer has no contractual relationship with or any right of action against the general contractor.

(Emphasis added; internal citations omitted.)

Proposed Section 8144 is consistent with this understanding of the term "obligee." It uses the term "beneficiary" as a more understandable synonym for "obligee."

"Obligee" Does Not Mean "Beneficiary"

However, other appellate opinions imply the "obligee" on a payment bond may be a person distinct from the beneficiary on the bond (i.e., a person eligible to make a claim against the bond). See e.g., *Department of Industrial Relations v. Nielsen Construction Co.*, 51 Cal. App. 4th 1016, 1021, 59 Cal. Rptr. 2d 785 (1996):

> In February 1993, Nielsen Construction Company (Nielsen) entered into a contract with the San Diego Unified School District Public School Building Corporation (Building Corp.) for the construction of a public elementary school. As part of its statutory obligation under the public works contract, Nielsen purchased a performance and payment bond from Federal Insurance Company (Federal), *naming Building Corp. as obligee*.

(Emphasis added.)

Construction of Existing Statute

There appears to be some support for either interpretation of the term "obligee" as used in Civil Code Section 3226.

Section 3226 opens with a provision indicating that a mechanics lien bond is to be construed most strongly in favor of all persons for whose benefit such bond is given. Given that legislative mandate, a construction of the section requiring a surety to remain liable to a beneficiary on the bond, even if the beneficiary *is* in breach of the beneficiary's own contract, is not inherently unreasonable.

Why? Because the final provision of Section 3226 states that "the sole conditions of recovery [on the bond] shall be that a claimant is a person [authorized to pursue a mechanics lien claim] and has not been paid the full amount of his claim. (Emphasis added.) Read in combination, the provisions of Section 3226 could be reasonably interpreted to mean that a claimant that works on a project and is unpaid may make a claim against a bond for that unpaid work, even if the claimant breached some contractual obligation in the course of providing that work. Such a result seems consistent with the apparent intent of the Legislature to provide liberal financial protection to claimants on a work of improvement.

On the other hand, if the Legislature intended the reference to "any obligee named in such bond" in Section 3226 to mean all beneficiaries on the bond, why did the Legislature twice elsewhere in Section 3226 refer to beneficiaries on the bond as "all persons for whose benefit such bond is given"?

Moreover, the reference in the section to persons "named in" the bond would not seem to apply to beneficiaries on a bond. The beneficiaries on a bond are not normally "named" in the bond — on a large job, the identity of many beneficiaries would likely be unknown to both the surety and the person procuring the bond.

Given the ambiguity of the term "obligee" as used in Section 3226, rather than risk an unintended substantive change in the meaning of the section, the staff recommends that **the Commission reinstate the language of existing law**:

> 8144. (a) A bond given under this part shall be construed most strongly against the surety and in favor of the beneficiary.
>
> (b) A surety is not released from liability to the beneficiary by reason of a breach of the direct contract or on the part of ~~the beneficiary~~ any obligee named in the bond.
>
> (c) Except as otherwise provided by statute, the sole conditions of recovery on the bond are that the beneficiary is a person described in Article 1 (commencing with Section 8400) of Chapter 4 and has not been paid the full amount of the claim.

Possibly Redundant Language

Mr. Philipps also argues that the term "sole conditions" as used in Section 8144(c) is an oxymoron, and should instead simply read "conditions."

The staff disagrees. While use of the word "sole" may be unnecessary in a strict linguistic sense, it emphasizes the fact that there are no other conditions for recovery on a bond, and that the specified conditions are exclusive.

The staff recommends that the word "sole" be retained.

NOTICE ISSUES

Address for Notice

At the January 2007 meeting, the Commission directed the staff to revise proposed Civil Code Section 8108 to make clear that addresses specified in the proposed law for giving notice are alternatives, and that none of the subdivisions in the section state an exclusive rule. Meeting Minutes (January 2007), p. 3.

The staff has drafted a revision to Section 8108, but as noted by Dick Nash, from the Building Industry Credit Association (Exhibit p. 1), the staff failed to include the revision in the proposed legislation presented to the Commission for approval at the December 2007 meeting.

The staff therefore recommends that **proposed Civil Code Section 8108 be revised as follows:**

> 8108. Except as otherwise provided by this part, notice under this part shall be given to the person to be notified at ~~any of the following addresses:~~ the person's residence, the person's place of business, or at any of the following addresses:
>
> ~~(a) The person's residence.~~
>
> ~~(b) The person's place of business.~~
>
> ~~(c)~~ (a) If the person to be notified is an owner, at the owner's address shown on the direct contract, the building permit, or a construction trust deed.
>
> ~~(d)~~ (b) 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.
>
> ~~(e)~~ (c) 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, or on the records of the Contractors' State License Board.
>
> ~~(f)~~ (d) If the person to be notified is a claimant, at the claimant's address shown on the claimant's contract, preliminary notice, claim

of lien, stop payment notice, or claim against a payment bond, or on the records of the Contractors' State License Board.

~~(g)~~ (e) If the person to be notified is a surety on a bond, at the surety's address shown on the bond for service of notices, papers, and other documents, or on the records of the Department of Insurance.

Proof of Notice

Proposed Civil Code Section 8118 and Public Contract Code Section 42190 provide that proof of notice given by an express service carrier may be established by either of the following records:

- Documentation provided by an express service carrier showing that payment was made to send the notice using an overnight delivery service, or
- A tracking record or other documentation provided by an express service carrier showing delivery or attempted delivery of the notice.

The Insolvency Committee of the Business Law Section of the State Bar of California (hereinafter, "Insolvency Committee"), seems to advocate that only proof of actual *delivery* by an express service carrier should constitute sufficient proof of this notice. Exhibit p. 10.

The Insolvency Committee also advocates that the proposed law provide more detail as to how notice in general is proved, and that it should adopt a "rule of reason" as to when attempted delivery may constitute proof of delivery. Exhibit p. 11.

The Commission has previously considered these issues, and the Insolvency Committee has not offered any new information or arguments that would require revisiting the Commission's prior decisions.

The staff recommends **no change to proposed Civil Code Section 8518 or Public Contract Code Section 42190.**

☞ **Notice by Electronic Communication**

Proposed Civil Code Section 8112 and Public Contract Code Section 42170 provide that notice may be given by an electronic communication, if the person receiving the notice has agreed to receive notice in the form of an electronic communication. The proposed law does not specify any manner of agreement.

The Insolvency Committee suggests the proposed law require that the agreement be memorialized in a writing signed by the receiving party. Exhibit p. 10.

The staff believes this suggestion has some merit. Several important rights of both claimants and owners turn on the receipt of various notices. The proposed law allows all such notices to be given by electronic communication, but only if the receiving party "agrees" to receive the notice in that manner. The proof of such an agreement could therefore determine whether an electronically given notice was valid. A requirement that the agreement be in writing would help to avoid litigation over that issue.

However, requiring this writing to also be *signed* would effectively conflict with federal law relating to the sending of electronic records to a "consumer" (a defined term under federal law that could include an owner of certain works of improvement). Under that law, a consumer's consent to receive electronic records must be given in a manner that "reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." 15 U.S.C. § 7001(c)(1)(C)(ii) (e.g., consent to receive notice by email would be given by email).

This requirement has been expressly incorporated into the proposed law. See proposed Civ. Code § 8112, proposed Pub. Cont. Code § 42170(c). A signature requirement in the proposed law would conflict with the federal provision in some cases.

The staff therefore recommends **the following revisions in response to the Insolvency Committee's suggestion**:

> 8112. (a) As used in this section, "electronic record" has the meaning provided in Section 1633.2.
>
> (b) A notice under this part may be given to a person in the form of an electronic record if the person has agreed <u>in writing</u> to receive the notice in the form of an electronic record.
>
> (c) If a person that has agreed to receive a notice in the form of an electronic record is a consumer within the meaning of Section 7006 of Title 15 of the United States Code, the person's agreement shall satisfy the requirements of Section 7001 of Title 15 of the United States Code relating to consumer consent to an electronic record.
>
> 42170. (a) As used in this section, "electronic record" has the meaning provided in Civil Code Section 1633.2.

(b) A notice under this part may be given to a person in the form of an electronic record if the person has agreed in writing to receive the notice in the form of an electronic record.

(c) If a person that has agreed to receive a notice in the form of an electronic record is a consumer within the meaning of Section 7006 of Title 15 of the United States Code, the person's agreement shall satisfy the requirements of Section 7001 of Title 15 of the United States Code relating to consumer consent to an electronic record.

It would also make sense to require a copy of the written agreement to be attached to the proof of notice declaration for notices sent electronically. Such a requirement would expediently confirm the existence of the written agreement, and would also serve as a reminder that such writing was required. Since a proof of notice normally need only be generated when certain documents are recorded or in the course of litigation, this additional requirement should create little additional burden.

The staff therefore recommends **the following revisions to the proof of notice provisions in the proposed law**:

8118. (a) Proof that notice was given to a person in the manner required by this part shall be made by a proof of notice declaration that states all of the following:

….

(b) If the notice is given by mail, the declaration shall be accompanied by one of the following:

(1) Documentation provided by the United States Post Office showing that payment was made to mail the notice using registered or certified mail.

….

(c) If notice is given in the form of an electronic record, the declaration shall also state that the document was served electronically and that no notice of non-transmission was received, and shall be accompanied by the recipient's written agreement to receive the notice in the form of an electronic record.

42190. (a) Proof that notice was given to a person in the manner required by this part shall be made by a proof of notice declaration that states all of the following:

….

(c) If notice is given in the form of an electronic record, the declaration shall also state that the document was served electronically and that no notice of non-transmission was received, and shall be accompanied by the recipient's written agreement to receive the notice in the form of an electronic record.

Notification of Contract Change

Existing law requires an owner to notify the direct contractor and construction lender of a contract change that increases the price of the original contract by 5% or more. Civ. Code § 3123(c). The purpose of this requirement is unclear, as existing law provides no consequence if an owner does not comply with the provision. The Commission has been informed that in practice owners rarely do comply.

The proposed law deletes the requirement.

The Insolvency Committee suggests that the notice requirement be retained, with modifications. Exhibit pp. 12-13.

The staff does not understand the Insolvency Committee's suggested modifications. The staff will ask the Insolvency Committee for clarification, and will update the Commission on the issue at the upcoming meeting.

Notice of Claim of Lien

The proposed law would add a requirement that a claimant provide an owner with notice before recording a claim of lien. Proposed Civ. Code § 8418. Proof of such notice must be provided to the county recorder as a prerequisite to recording a claim of lien. Proposed Civ. Code § 8420.

The Insolvency Committee suggests that the proposed law provide a remedy for situations in which "all parties (such as the construction lender)" are not properly served with this new notice, or in which the owner has provided an incorrect address for service of notice. Exhibit p. 13.

It appears the Insolvency Committee may misunderstand the requirements of proposed Sections 8418 and 8420, as the proposed law already addresses these issues.

First, Section 8418 does not require that notice of the recordation of a lien be given to a construction lender. Rather, the section requires only that notice of the lien claim be served on the owner of the work of improvement, so there is no other party that could be improperly served.

Second, the fact that an owner has provided an incorrect address for notices is not a ground for invalidating the lien claim under either Section 8418 or 8420.

The staff recommends **no change to proposed Civil Code Sections 8418 or 8420.**

Recordation of Notice of Completion

Proposed Civil Code Section 8152 and Public Contract Code Section 42230 provide that an owner or public entity may record a notice of completion within *15* days of completion. This would be a minor change from existing law, which requires the notice of completion to be recorded within *10* days of completion.

The Insolvency Committee suggests that an owner or public entity should be allowed only 10 or even five days after completion to record a notice of completion. Exhibit pp. 11-12. The Committee's rationale is that the recordation of a notice of completion shortens the time period for most claimants to pursue a remedy to 30 days. The Committee argues that if owners are allowed 15 days to record a notice of completion, that will leave claimants only 15 days to take steps necessary to pursue a remedy.

The Committee may misunderstand the applicable statutory provisions. While the recordation of a notice of completion does shorten the applicable time period for most claimants to pursue a remedy to 30 days, that 30 days is measured from the date of *recordation*, not from the date of *completion*. Proposed Civ. Code § 8414(a)(2), Pub. Cont. Code § 44140(b). Allowing additional time to record the notice would not reduce the 30 days that a claimant has to pursue a remedy.

The staff recommends **no change to proposed Civil Code Section 8152 or Public Contract Code Section 42230.**

Providing Copy of Notice of Completion or Cessation

Mr. Philipps suggests that proposed Civil Code Section 8156(a) may contain an ambiguity. Exhibit p. 6.

Section 8156(a) provides:

> 8156. (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:
>
> ….

(Emphasis added.)

Mr. Philipps wonders whether the italicized language will be read as requiring that an owner give claimants a photocopy of the notice *that is actually*

recorded. That could be problematic, as it often takes substantial time to get a stamped copy of a recorded document back from a county recorder's office.

That was not the Commission's intention. To clarify, the staff recommends **revising the Comment to Section 8156 as follows:**

> **Comment.** Section 8156 restates former Section 3259.5, replacing the notice of recordation with a copy of the ~~recorded~~ notice that the owner files for recordation, and expanding the manner of notice. See Section 8106 (manner of giving notice). This provision is limited to a private work. See Section 8052 (application of part).

The staff recommends against any revision to the text of Section 8156.

PRELIMINARY NOTICE ISSUES

Content of Preliminary Notice

Proposed Civil Code Section 8202(c) would provide that some of the information required in a preliminary notice may be provided by giving a copy of an invoice for material or certified payroll:

> 8202. (a) The preliminary notice shall comply with the requirements of Section 8102, and shall also include:
>
> ….
>
> (c) If an invoice for material or certified payroll contains the information required by this section and Section 8102, a copy of the invoice or payroll, given in compliance with the requirements of Article 3 (commencing with Section 8100) of Chapter 1, is sufficient.

That option is a part of existing law. See Civ. Code § 3097(c)(6).

The California State Council of Laborers Legislative Department and Construction Laborers Trust Funds for Southern California (hereafter, "Laborers Group") asserts that privacy rights may be violated if a copy of a certified payroll (which may contain home addresses and social security numbers) is given as part of a preliminary notice. Exhibit p. 18. Laborers Group suggests that redaction may be required by various sections of other codes before this information is published, and that proposed Section 8202 or its Comment should reference this possible need for redaction.

The issue raised by Laborers Group is a concern about existing law. It is not created or worsened by the proposed law.

The staff recommends **that the issue be noted for possible future study.**

Lien Claim by Material Supplier

Under the proposed law, a material supplier must record a claim of lien within 30 days after an owner records a notice of completion or cessation. Mr. Philipps questions whether the Commission intended this 30 day time period to apply to material suppliers that contract directly with an owner. Exhibit p. 5.

It is the staff's belief that the application of the 30 day time limit to material suppliers that contract directly with an owner is existing law, as indicated by the court in *Vaughn Materials Co. v. Security Pacific National Bank*, 170 Cal. App. 3d 908, 216 Cal. Rptr. 605 (1985). That is the approach followed in the proposed law. See proposed Civ. Code §§ 8014, 8416.

If any practitioner has a contrary view, the staff would welcome comment on the point.

Notice of Recorded Lien Claim

Proposed Civil Code Section 8418 provides:

> 8418. (a) Before recording a claim of lien, the claimant shall give notice of the intended recording to the owner or reputed owner of property subject to the claim of lien, if known. The notice shall comply with the requirements of Article 3 (commencing with Section 8100) of Chapter 1.
>
> (b) Notice of the intended recording of a claim of lien shall include a copy of the claim of lien.

Mr. Philipps asserts that the requirement in subdivision (b) that the lien claimant send a copy of the lien claim to the owner is redundant and unnecessary, since the notice required under subdivision (a) will contain all the information that would be stated in the lien claim. Exhibit p. 6.

The staff agrees that the content of the notice and the lien claim will overlap. However, expressly requiring that a copy of the lien claim be provided will ensure that the owner has all of the relevant information. Without that requirement, a claimant might misunderstand proposed Section 8418(a), and send a notice that does nothing more than inform the owner that a claim has been recorded. In addition, it would be helpful to the owner to have in hand an exact copy of the document that asserts the claimant's actual lien claim.

The staff recommends against the suggested change.

Effect of Court Order Granting Lien Release Petition

The proposed law would impose a 20 day "hold" on a court order releasing a lien claim, in order to allow a claimant time to appeal before the lien is released. Proposed Civ. Code § 8490(c).

In revising the proposed law to implement this change, the staff noted some fragmentation in the provisions relating to the effect of a court order granting a lien release petition. A non-substantive consolidation of these provisions would allow the proposed law to read more smoothly.

The staff recommends **the following revisions to accomplish this consolidation:**

> 8490. (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 equivalent to cancellation of the claim of lien and its removal from the record.
>
> (c) 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)~~ (d) 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.
>
> (e) This section does not apply to a court order dismissing an action to enforce a lien that is expressly stated to be without prejudice.
>
> ~~8492. (a) A court order or judgment under Section 8490 is equivalent to cancellation of the claim of lien and its removal from the record.~~
>
> ~~(b) This section does not apply to a court order dismissing an action to enforce a lien that is expressly stated to be without prejudice.~~

STOP PAYMENT NOTICE ISSUES

A stop payment notice is a notice given by a claimant to a holder of a construction fund (an owner, a public entity, or a construction lender),

demanding that an amount be withheld from the fund to pay the claimant for unpaid work.

Claims Against Construction Fund

Proposed Civil Code Section 8500 and proposed Public Contract Code Section 44110 protect a construction fund from claims against it, except under certain specified circumstances.

Both sections provide:

> 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 written contract between such person and the person holding the fund, except pursuant to the provisions of this chapter.

(Emphasis added.)

At the December 2007 meeting, the staff was directed to examine whether the introductory reference in Section 8500 to "persons furnishing work for any work of improvement" should be revised to instead read "claimant."

As presently worded, the first two clauses of Section 8500 read together are subject to two different interpretations.

One interpretation is that the first clause of the section applies only to claimants on a work of improvement, while the second clause applies to *all* persons (claimants or not). An alternative interpretation of the two clauses — based substantially on the dual usage of the word "person" — is that the second clause only emphasizes the first clause, with both applying to the *same* group of "persons" (i.e., claimants on a work of improvement). There is no clear appellate authority indicating which interpretation is correct.

If the word "person" in the first clause of Section 8500 is changed to "claimant," this second interpretation of the section would lose its linguistic support, possibly resulting in a substantively different understanding of the provision of law.

The staff does not recommend the suggested change.

Content of Stop Payment Notice

At the December 2007 meeting, the Commission revised certain stop payment notice provisions to distinguish between general *information* that is to be included in a notice, and the dollar amount a claimant demands be *withheld* based on the notice. See CLRC Memorandum 2007-57, pp. 28-30, Meeting Minutes (December 2007), pp. 5-6.

To implement this clarification, the term "demand for withholding" was used in two sections specifying the content of a stop payment notice. See proposed Civ. Code § 8502, proposed Public Cont. Code § 44120. The same term was also substituted for the term "claim" used in two sections that specify the duties of a fund holder upon receipt of a stop payment notice. See proposed Civ. Code § 8536 (duty of construction lender), proposed Pub. Cont. Code § 44150 (duty to withhold funds).

The term "demand" was used to correspond to the usage of that term in general notice provisions relating to content of notice:

> 8102. (a) Notice under this part shall, in addition to any other information required by statute for that type of notice, include all of the following information to the extent known to the person giving the notice:
>
> ….
>
> (6) If the person giving the notice is a claimant:
>
> ….
>
> (iii) *A statement or estimate of the claimant's demand*, if any, after deducting all just credits and offsets.
>
> ….
>
> 42120. (a) Notice under this part shall, in addition to any other information required by statute for that type of notice, include all of the following information to the extent known to the person giving the notice:
>
> ….
>
> (5) If the person giving the notice is a claimant:
>
> ….
>
> (iii) *A statement or estimate of the claimant's demand*, if any, after deducting all just credits and offsets.

Proposed Civ. Code § 8102, proposed Pub. Cont. Code § 42120 (emphasis added).

However, the staff has since noted that the term "claim" appears in several other stop payment notice provisions in the proposed law. Based on the somewhat involved wording of some of these other provisions, a replacement of the term "claim" in each of these provisions with the term "demand for

withholding" would be difficult, and could introduce unintended changes in meaning.

The staff believes consistency in usage of the term "claim" throughout the proposed law is more important than the minor increase in clarity achieved by use of the term "demand for withholding." At this point, that consistency can be best achieved by backing out the use of the term "demand for withholding" in the four recently revised sections, and relying instead on added Comment language in proposed Civil Code Section 8502 and Public Contract Code Section 44120 to reference the "demand" specified in the general notice provisions.

The staff therefore recommends that **the four recently revised sections (and the Comments to proposed Civil Code Section 8502 and proposed Public Contract Code Section 44120) be revised to read as follows**:

> 8502. (a) A stop payment notice shall comply with the requirements of Section 8102, 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 amount in value of the work to be provided.
>
> (c) The claimant's ~~demand for withholding~~ amount claimed in the notice may include only the amount due the claimant for work provided through the date of the notice.
>
> (d) 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.
>
> **Comment.** Subdivisions (a) through (c) of Section 8502 supersede subdivisions (a) through (d) of former Section 3103. See also Sections 8100-8118 (notice). A stop payment notice may be executed by the claimant's agent. See Section 8064 (agency).
>
> Subdivision (c) provides a special rule that supplements the requirement of Section 8102(a)(6)(iii) (demand of claimant).
>
> This section does not preclude the claimant from including in a stop payment notice an amount due for work provided pursuant to a contract change. See Section 8008 ("contract").
>
> Subdivision (d) applies provisions applicable to a claim of lien to the stop payment notice. *Cf.* Section 8430 (amount of lien).
>
> See also Sections 8002 ("claimant"), 8006 ("construction lender"), 8008 ("contract"), 8032 ("person"), 8044 ("stop payment notice"), 8048 ("work").

44120. (a) A stop payment notice shall comply with the requirements of Section 42120, 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 amount in value of the work to be provided.

(c) The claimant's ~~demand for withholding~~ amount claimed in the notice may include only the amount due the claimant for work provided through the date of the notice.

(d) 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.

Comment. Subdivisions (a) through (c) of Section 44120 supersede subdivisions (a) through (d) of former Section 3103. See also Sections 42110-42190 (notice). A stop payment notice may be executed by the claimant's agent. See Section 42090 (agency).

Subdivision (c) provides a special rule that supplements the requirement of Section 42120(a)(5)(iii) (demand of claimant).

Subdivision (d) is similar to former Civil Code Section 3123(b).

See also Sections 41020 ("claimant"), 41160 ("work").

8536. (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 ~~claimant's demand for withholding~~ claim stated in the notice.

44150. (a) The public entity shall, on receipt of a stop payment notice, withhold from the direct contractor sufficient funds due or to become due to the direct contractor to pay the ~~claimant's demand for withholding~~ claim stated in the stop payment notice and to provide for the public entity's reasonable cost of any litigation pursuant to the stop payment notice.

Stop Payment Notice Release Bond

Proposed Civil Code Section 8510 sets forth provisions relating to a stop payment notice release bond:

8510. (a) A person may obtain release of funds withheld pursuant to a stop payment notice by giving the person withholding the funds a release bond.

> (b) A release bond shall be given by an admitted surety insurer and shall be conditioned for payment of any amount not exceeding the penal obligation of the bond that the claimant recovers on the claim, together with costs of suit awarded in the action. The bond shall be in an amount equal to 125 percent of the amount claimed in the stop payment notice.
>
> (c) On receipt of a release bond, the person withholding funds pursuant to the stop payment notice shall release them.

Mr. Philipps suggests this section as well as the similarly worded public work provision (proposed Public Contract Code Section 44180) could be challenged for vagueness, as the sections do not identify who the *obligee* on the bond must be. Exhibit pp. 6, 7. Mr. Philipps points out that the obligee could be either the fund holder that releases the stop payment notice, or the claimant that gave the notice that was released. Mr. Philipps cites by analogy to *Schweitzer v. Westminster Investments*, 157 Cal. App. 4th 1195, 69 Cal. Rptr. 3d 472 (2007), a recent opinion declaring a bonding requirement unrelated to mechanics lien law void for vagueness.

As previously discussed in this memorandum, there is some question as to the meaning of the term "obligee" in conjunction with a bond. However, regardless of the meaning of the term, neither of the sections of existing law continued by proposed Civil Code Section 8510 and Public Contract Code Section 44180 specify who the obligee on a stop payment notice release bond must be. See Civ. Code §§ 3171, 3196. Thus, Mr. Philipps appears to be identifying what he perceives to be a problem with existing law.

Further, it is the staff's belief that the constitutional infirmity found in *Schweitzer* does not exist in the two sections in the proposed law. The court in *Schweitzer* found an employment bonding requirement unconstitutionally vague, because the provision contained virtually *no* detail specifying the nature of the required bond.

By contrast, the bond provisions in proposed Civil Code Section 8510 and proposed Public Contract Code Section 44180 provide the procurer of the bond with sufficient procedural detail as to the nature of bond required. The sections provide the same level of detail as the other mechanics lien bond provisions. To the staff's knowledge, no treatise or appellate opinion has ever even questioned the constitutionality of any of the provisions.

The staff recommends that **the proposed law retain proposed Civil Code Section 8510 and proposed Public Contract Code Section 44180 as drafted.**

Stop Payment Notice by a Material Supplier on a Public Work

On a public work, Civil Code Section 3181 authorizes a stop payment notice by the following persons:

> 3181. Except for an original contractor, any person mentioned in Section 3110, 3111, or 3112, or in Section 4107.7 of the Public Contract Code, *or furnishing provisions, provender, or other supplies*, may serve a stop notice upon the public entity responsible for the public work in accordance with this chapter.

(Emphasis added.) The provision in Section 3181 allowing a stop payment notice by persons "furnishing provisions, provender, or other supplies" has not been continued in proposed Public Contract Code Section 42030.

The staff previously noted this omission, and indicated it would look for authority providing justification for the provision. See CLRC Memorandum 2007-25, pp. 37-38. The staff.

The staff has been unable to find any legislative history relating to the inclusion of this provision in existing law. Based on the inclusion in the reference of the word "provender" (a relatively archaic term meaning food, particularly for animals), the staff's best interpretation of the language is that it is an antiquated reference to persons that provided food and other supplies to workers and draft animals on a public work.

The staff recommends that **Public Contract Code Section 42030 be retained as drafted, without the provision allowing a stop payment notice by persons "furnishing provisions, provender, or other supplies."**

Notice to Stop Payment Notice Claimant on Public Work

On the occurrence of certain events that affect the time for enforcing a stop payment notice, a public entity is required to give notice to stop payment notice claimants who requested such notice and paid a fee:

> 44170. (a) Not later than 10 days after each of the following events, the public entity shall give notice to each claimant that has given a stop payment notice *of the time within which payment of the claim stated in a stop payment notice must be enforced*:
>
> (1) Completion of a public works contract, whether by acceptance or cessation.
>
> (2) Recordation of a notice of cessation or completion.
>
> (b) The notice shall comply with the requirements of Article 2 (commencing with Section 42110) of Chapter 2.

(c) A public entity need not give notice under this section unless the claimant has paid the public entity ten dollars ($10) at the time of giving the stop payment notice.

Proposed Pub. Cont. Code § 44170 (emphasis added).

The reference to the time "within which payment of the claim stated in a stop payment notice must be enforced" may be unclear. A reader might think the reference is to the time within which a judgment must be recovered (i.e., payment "enforced"), rather than the time within which an enforcement action must be commenced.

The staff recommends that **proposed Section 44170 be clarified as follows**:

44170. (a) Not later than 10 days after each of the following events, the public entity shall give notice to ~~each~~ a claimant that has given a stop payment notice of the time within which an action to enforce payment of the claim stated in ~~a~~ the stop payment notice must be ~~enforced~~ commenced:

(1) Completion of a public works contract, whether by acceptance or cessation.

(2) Recordation of a notice of cessation or completion.

(b) The notice shall comply with the requirements of Article 2 (commencing with Section 42110) of Chapter 2.

(c) A public entity need not give notice under this section unless the claimant has paid the public entity ten dollars ($10) at the time of giving the stop payment notice.

MISCELLANEOUS ISSUES

Subdivision Map Act

Mr. Philipps suggests that a few words may be missing from proposed Civil Code Section 8066(b) and proposed Public Contract Code Section 42020(b), new (and identical) provisions relating to the interrelationship between the proposed law and the Subdivision Map Act. Exhibit p. 4. He offers the following revision:

(b) This part does not apply to or change the remedies applicable to, the improvement security under the Subdivision Map Act, Division 2 (commencing with Section 66410) of Title 7 of the Government Code.

The staff believes the suggested revision could narrow the scope of the disclaimer, as there may be aspects of improvement security under the Subdivision Map Act *other than remedies* that might be affected by the proposed law.

The staff recommends that **Civil Code Section 8066(b) and proposed Public Contract Code Section 42020(b) be retained as drafted**.

Impairment of Claimant Rights

Proposed Civil Code Section 8160, continuing existing law, provides:

> 8160. An owner or direct contractor may not, by contract or otherwise, waive, affect, or impair 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.

Several months ago, a commenter inquired why this section should not be extended to also preclude *subcontractors* from impairing claimant rights. See CLRC Memorandum 2006-48, p. 26. The staff tentatively recommended the suggested extension.

When the issue was presented at a Commission meeting however, the Commission indicated that before deciding the issue it first wished to resolve an unrelated ambiguity in the proposed section, and directed the staff to report back after analyzing that ambiguity.

The staff reported back, noting that the ambiguity that concerned the Commission had been resolved by cleanup legislation enacted by the Legislature. Unfortunately, the staff neglected to again raise whether the section should be made applicable to subcontractors.

The staff continues to believe, as suggested by the previous commenter, that subcontractors should also be required to comply with the provisions of the section.

The staff again solicits input from practitioners as to whether there is any practical reason to exclude subcontractors from the application of this provision. If not, the staff again recommends that **the section be generalized as follows**:

> 8160. An owner ~~or~~ , direct contractor, or subcontractor may not, by contract or otherwise, waive, affect, or impair 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.

Transitional Provision of Proposed Law

A transitional provision of the proposed law provides as follows:

> SEC. ____. (a) This act is operative January 1, 2010.
> (b) Except as otherwise provided in this section, this act applies to a contract for a work of improvement executed before, on, or after the operative date.
> (c) The effectiveness of a notice given, or other action taken, before the operative date is governed by the applicable law in effect before the operative date and not by this act.

The Insolvency Committee suggests that this provision should instead state that the proposed law applies only to contracts effective as of the operative date of the proposed law. Exhibit p. 9. The committee's argument is that otherwise, participants on a work of improvement commencing before the operative date will have to change procedures mid-stream, and mistakes will inevitably be made.

While this will likely be true, the staff believes that implementing the Insolvency Committee's suggestion would be even more problematic. Other than the owner (or public entity) and the direct contractor on a work of improvement, most participants on a project have no way to know when the contract for the project was executed. Under the Insolvency Committee's proposal, it could be years after the effective date of the proposed law before participants on a work of improvement would know with certainty whether the project they were working on was governed by the new law. Moreover, implementation of the Insolvency Committee's suggestion would require contractors working on multiple jobs simultaneously to comply with different statutory requirements on each job, leading not only to confusion, but also to greatly increased inefficiency.

The staff does not recommend the change suggested by the Insolvency Committee.

Conforming Revision

Laborers Group advocates a "conforming revision" to Business and Professions Code Section 7115, which governs contractor disciplinary proceedings. Exhibit p. 22.

Section 7715 provides:

> 7115. Failure in any material respect to comply with the provisions of this chapter, or any rule or regulation adopted pursuant to this chapter, or to comply with the provisions of

> Section 7106 of the Public Contract Code, constitutes a cause for disciplinary action.

Laborers Group suggests adding to Section 7115 references to two new disciplinary provisions in the proposed law, proposed Civil Code Section 8104 and Public Contract Code Section 42130.

However, the addition suggested by Laborers Group would not constitute a conforming revision, because Business and Professions Code Section 7115 does not currently reference the sections continued by proposed Civil Code Section 8104 or Public Contract Code Section 42130. Instead, implementing the suggestion of Laborers Group would be a substantive change to Section 7515, expanding its scope.

The staff does not recommend the suggested revision.

TECHNICAL CORRECTIONS TO DRAFT

The staff has made the following technical corrections to the draft of the proposed law.

Proposed Civil Code Section 8816

The Commission previously decided to clarify the various references throughout the proposed law to the term "contract" so as to distinguish between *any* contract for a work of improvement, and a contract directly with the owner of the work of improvement. See CLRC Memorandum 2007-11, pp. 4-9; Meeting Minutes (December 2007), pp. 4-5. This latter type of contract is now defined and referred to in the proposed law as a "direct contract."

The staff erroneously recommended making that change in proposed Civil Code Section 8816. The change in that section could substantively change the meaning of the provision in which the reference appears.

The staff will restore the general term "contract" in proposed Section 8816.

Notice of Completion and Cessation

The Commission previously decided that the proposed law should continue to provide for a notice of cessation, as in existing law. CLRC Memorandum 2007-57, pp. 10-13; Meeting Minutes (December 2007), p. 4. The Commission had previously merged the notice of cessation with a notice of completion.

In implementing that decision, two provisions of existing law relating solely to a notice of cessation were inadvertently left in proposed Civil Code Section 8152, a section of the proposed law that now relates only to a notice of completion.

The staff will correct that problem by deleting proposed Civil Code Section 8152(c)(5) and (6).

Notice of Completion of Portion of Public Work

Existing law allows an owner on a private work to record a notice of completion for only a part of a work of improvement, if there is more than one direct contract on the work of improvement, and all work on one of the contracts is complete. See Civ. Code § 3117, proposed Civ. Code § 8154.

The proposed law would add a corresponding provision for public works. See proposed Pub. Cont. § 42240. However, the provision added is not completely parallel to the private work provision.

If an owner on a private work records a notice of completion under proposed Section 8154, the owner is required to identify the portion of the work that has been completed. Proposed Civ. Code § 8152(c)(1).

The staff will add a corresponding requirement to proposed Pub. Cont. Code § 42230(c)(2).

Preliminary Notice Given by Design Professional

Proposed Civil Code Section 8204(b), governing a preliminary notice on a private work, substitutes the term "design professional" for the phrase used in existing law, "certificated architect, registered engineer, or licensed land surveyor who has furnished services for the design of the work of improvement." See Civ. Code § 3097. That substitution slightly narrows the application of the preliminary notice provision, as the proposed law defines a "design professional" as an architect, engineer, or land surveyor that provides design services "*pursuant to a written contract with a landowner*." Proposed Civ. Code § 8012 (emphasis added).

Thus, use of the term "design professional" would include those who provide design professional services as a *subcontractor*. That substantive change was not intended.

The staff will restore the language used in existing law.

Although the primary goal of this study has been a reorganization and modernization of existing law, the proposed law would also make some substantive changes to existing law. In light of these changes, the Commission has expressed a desire that the proposed law as a whole consist of a balanced package of reform. See, e.g., Tentative Recommendation, Staff Note to proposed Civil Code Section 7026.

It is the staff's view that the proposed law achieves the Commission's goal. The bulk of the proposed law serves only to clarify and modernize existing law, providing systemic improvement that benefits *all* interest groups.

As for the substantive changes the proposed law would make to existing law, most are minor. As examples, notice requirements would be made more uniform, a few deadlines would be slightly expanded, and the definition and application of some terms would be clarified.

The most notable substantive changes effected by the proposed law assist owners in learning about and addressing lien claims recorded against their property. While those changes would provide a significant benefit to owners, they would not significantly disadvantage lien claimants. They are briefly discussed below:

Notice of Prospective Lien Claim

The proposed law would require that a lien claimant notify a property owner before recording a lien claim. See proposed Civ. Code §§ 8418, 8420. This notice would add a minor procedural burden for claimants, but would be much fairer to owners. Without the notice, an owner may not realize that property has been liened until the owner tries to sell or encumber the property.

Expanded Lien Release Proceeding

The proposed law would also slightly expand the scope of an existing judicial lien release proceeding. See proposed Civ. Code §§ 8480-8492. The proposed law would add limited and unambiguous grounds that an owner may allege as a basis for a release petition, grounds that already bar enforcement of a lien claim if an enforcement action was brought.

That would help an owner to release a plainly unmeritorious lien claim.

Lis Pendens Requirement

The proposed law would also require a lien claimant that brings an enforcement action to also record a lis pendens relating to the action. That would allow title insurers to determine whether a lien claim had expired for lack of enforcement. See proposed Civ. Code § 8460.

This requirement would add a minimal procedural burden for lien claimants that have filed an enforcement action, but would cure an existing problem that causes title insurers to be unwilling to insure upon discovery of a recorded lien claim.

☞ INTRODUCTION OF BILL

The last day a bill may be introduced for consideration in the 2007-2008 legislative session is Friday, February 22, 2008.

It remains possible to introduce a bill in this matter by that date, and the Commission has indicated it wishes to attempt to do so, if reasonably possible. The alternative would be to delay introduction of a bill in this matter until next year.

Once the Commission has made decisions on all issues presented in this memorandum, the Commission will need to decide whether it is ready to adopt a final recommendation for possible introduction in 2008.

Respectfully submitted,

Steve Cohen
Staff Counsel

EMAIL FROM DICK NASH
(DECEMBER 21, 2007)

Steve Cohen
Staff Counsel
California Law Revision Commission

Dear Mr. Cohen:

First I would like correct a statement I made at the December 14, 2007 CLRC meeting in Burbank during the discussion of Memo 2007-57 on the topic "Notice Required Prior To Payment Bond Claim" (Section 7612). I mentioned that there was a 2 year bill in the current legislature attempting to eliminate the second notice which can presently be given at the end of the public works job. I was correct about there being a 2 year bill but wrong about the time of this legislation. The bill was introduced as AB 411 in February 2005 and came out of the Senate Committee without further action on November 30, 2006.

Below is a listing of the sections we discussed:

Section 8108 – In the minutes of January 25, 2007 the Commission directed the staff to revise proposed Section 7106 (now Section 8108) to make clear that the listed addresses for notice are alternatives and that none of the subdivisions state an exclusive rule. You revised that language and sent me a copy of the revised language in an email dated February 9, 2007- a copy of which is attached. Should the revised language from your email appear in Section 8108?

Section 8200 – Should the language for 8200 reflect the revision which appears to have been approved by the Commission in minutes dated June 28, 2007 on page 4?

Section 8460 – Should the language for 8460 reflect the revision shown in Memo 2006-48 page 71 which appears to have been approved by the Commission in minutes dated January 25, 2007 page 3?

Sections 8492, 8494, 8496 and 8498– these sections do not appear in Memo 2007-58. Should proposed revised language for 8492, 8494, 8496 and the suggested language (though not proposed) for 8496 in Memo 2006-48 on pages 88 - 90 and which appears to have been approved by the Commission in minutes dated January 25, 2007 on page 3 appear in the draft?

Section 43010 – Should the language for 43010 reflect the revision which appears to have been approved by the Commission in minutes dated June 28, 2007 on page 3?

Section 43020 – Should this section be deleted in accordance with Memo 2007-25 on page 9 which appears to have been approved by the Commission in minutes dated June 28, 2007?

Section 44110 – Should this section reflect the revised comment language which appears to have been approved by the Commission in the minutes dated October 26, 2007 on page 3?

Section 44170 – Should this section reflect the revised language for 44170 which appears to have been approved by the Commission in the minutes dated October 26, 2007, page 3?

Have a great holiday and will see you in January.

Dick Nash
Vice President
Building Industry Credit Association
213-251-1179

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OUR FILE NO. 00001

January 2, 2008

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

Att: Steven Cohen, Staff Counsel

Re: California Law Revision Commission - Mechanic's Liens
Study H-821

Dear Mr. Cohen:

The following comments relate to Memorandum 2007-58 which I understand is the current state of the proposed legislation through the meeting of October 26, 2007.

PRIVATE WORKS

The current and proposed law contain sections which only apply to site improvements which are separately defined in §8042 even though site improvements are included in the definition of "work of improvement" in § 8050. While proposed §8004 defines the commencement of a work of improvement, the commencement definition appears to apply only to a permanent structure and not to a site improvement which could commence with placing of survey stakes or the delivery of construction rental equipment. Rental equipment is not clearly included within the definition of "Material Supplier" in §8026. The date of commencement of a site improvement is just as important for priority issues as it is for permanent improvements. Is there a need for a definition of commencement of a site improvement or the inclusion in §8004 of other criteria to act as commencement?

The word "upon" may have been dropped from §8020. According to my notes of the meeting of October 27, 2006, the word "upon" was added so that the section would read:

> "Laborer" means a person who, acting as an employee, performs labor ***upon,*** or bestows skill or other necessary services, on a work of improvement.

Otherwise, persons offsite or employees which only perform clerical or administrative duties would arguably have a right to a mechanic's lien, stop payment notice or claim on the payment bond.

My notes of the Commission meeting of October 27, 2006 also indicate that subsection (b) of §8026 was adopted by the Commission "pending further consideration of whether this change in the law as a whole strikes a fair balance among all participants in the construction process" as it is a 180 degree change in the law. I am not aware of whether this "fair balance" was ever revisited.

There seems to be a word or two missing in subsection (b) of §8066. Perhaps, it should read: "This part does not apply to, or change ***the remedies applicable to, the*** improvement security. . ."

Subsection (c) of §8132 seems awkward. The addition of several commas and the article "a" would be helpful so that it reads: " Failure of the applicant to indicate the name and address of the construction lender on the application does not relieve a person, who is required to give the construction lender a preliminary notice, from that duty."

Somewhere in transition, subsection (b) of §8144 was changed, as it is not a simple restatement of the existing statute. I assume that this occurred due to the reference to the Bond and Undertaking Law and the intent to use the definition of beneficiary in that statutory scheme. Thus, the word "obligee" in the exiting statute was changed to "beneficiary" and the words "named is such bond" were deleted.

There is a significant distinction between an obligee and a beneficiary on a bond. On a payment bond, the obligee is usually the owner, a party to the bond, but the beneficiaries [third parties] of the bond are the claimants who have not been paid. Each has distinct and separate right *vis a vis* the payment bond. Due to the proposed change in the statutory language, a beneficiary, i.e., a claimant could be in breach of its own obligation and that breach would not be a defense to the surety on the payment bond. This is not the result under the current statute which allows a surety to defend against the claimant on the basis of the claimant's breach of its own obligation, as the surety may use any defense available to its principal to defeat a claim on the bond. [*Flickinger vs. Swedlow Engineering Co.* (1955) 45 Cal. 2d 388,394]. However, the current law does not allow the payment bond surety to defend against a payment bond beneficiary [claimant] on the basis that there has been a breach of contract by the owner, direct contractor or ***obligee named in such bond***. Thus, the words "***obligee named in such bond***" should be continued. In other words, under current law the fact that the owner or lender, which might also be an obligee, has not paid the direct contractor is not a defense against a payment bond claim by an unpaid subcontractor or supplier. This is acceptable, However, to allow a claimant, in breach of its own obligation, to recover on the payment bond appears to be an unintended result. The same result would occur

under the proposed law on a release of lien or release of stop notice bond. Thus, the language should revert to that of the existing statute.

In subsection (c) of §8144, there is the continuation of an oxymoron, i.e., "sole conditions". This should simply be "conditions".

Although a recordable document titled "notice of cessation" was continued under the public works portion of the law [§42220], there is no similar provision under the private works section. Was this an oversight?

Under §8154(a), a notice of completion for a portion of the work creates several "presumptions" regarding completion and cessation to start the lien period. These same "presumptions" are not provided for when the notice of completion is for the entire project. I assume that there is a valid reason for this different treatment.

Section 8156(a) provides that a copy of the notice of completion be served on various persons. Although the statute is not clear that the copy to be served is the recorded document, the comment indicates that it is the recorded copy. As has been discussed at various times during the meetings, it is extremely difficult to obtain a copy of the recorded document from the county recorder within the time period set forth in the statute, i.e., ten days. Therefore, I suggest that rather than a copy of the recorded document, that the statute be modified to state, " . . . copy of the notice containing the recording information to all . . ."

Subsections (c) (3) and (4) of §8166 should be combined into one subsection. ". . . that is timely and proper, but only for the value of the work not encompassed within a previous release of stop payment notice or partial release of stop payment notice."

Section 8602(b). What if the claimant has a contract with the direct contractor and a subcontractor? How many preliminary notices must be given? As section (b) only deals with contracts with subcontractors, the scenario of a contract with the direct contractor and a subcontractor does not appear to be covered. Thus, the suggested change is (b): " . . .pursuant to contracts with the direct contractor and one or more subcontractors, the claimant shall give a separate preliminary notice with respect to work provided under each contract."

The comment in §8410 that a direct contractor is not required to give a preliminary notice is not correct in view of the need to do so if there is a lender. See § 8200(c)(2).

Was it intentional that a supplier dealing directly with an owner is allowed a lesser period of time to record a mechanic's lien than a direct contractor? § 8414 seems to place a supplier with a direct contract with the owner on the same footing as a subcontractor or material supplier to the direct contractor or a subcontractor.

Section 8418 seems to contain a redundancy. The notice under (a) contains all of the information required under §8102 which is the same information to be supplied on a mechanic's lien. [§8416]
Sending a copy of the proposed lien would seem to be redundant, thus unnecessary.

Section 8430(c). The first sentence of this section should be deleted. How does a claimant perform work as a result of rescission, abandonment or breach of contract?

Is there any valid reason why the bond under §8452 is 75% of the mortgage and the bond under §8458 is 50% of the mortgage?

Section 8500. As all "persons furnishing work for any work of improvement" are by definition "claimants", why not use the defined word in place of the phrase?

Section 8502(c). The first sentence of this section should be deleted. How does a claimant perform work as a result of rescission, abandonment or breach of contract?

Section 8510 could possibly be challenged for vagueness. Who is the obligee on the bond? Does the bond protect the fund holder or the claimant? See recent decision *Schweitzer vs. Westminister Investments* (2007) 2007 DJDAR 18411; D049589, D049616 on vagueness. Most release of stop notice bonds name the holder of the fund as the obligee as this is the person to whom the bond is delivered. See *California Mechanics' Liens and Related Construction Remedies*, Third Ed. CEB, §9.60*f*. If the claimant is named as the obligee, the issue discussed under §8144(b) arises, in which a literal reading of the statute allows a claimant in breach of its own obligation to recover on the bond.

Section 8520, literally read, gives a design professional a stop notice. Was this intended?

Section 8552 retains the current law regarding consolidation and joinder, but the similar statute applying to mechanic's liens was removed [C. C. §3149]. Is there a basis for this difference? Practitioners appreciate a specific statute on joinder and consolidation rather than the generic statute in the C.C.P.

PUBLIC WORKS

Section 41070(a). See comment above under §8020 with the necessary addition of the words " on a work of improvement" after the word "services".

Section 42020(b). See comment above under §8066.

Section 42030(a)(3). What is the reference to 4107.7? Should it be 41070?

Section 42240(a). There appears to be an inadvertent inclusion of the words " with the public entity" in line 3.

Section 42250(b). Was "notice of cessation" inadvertently not included in the last line?

Section 42340(c)(3)& (4). See comment above under §8166.

Section 44110. See comment above under §8500.

Section 44120(c). See comment above under §8502(c).

Section 44180. See comments above under §8510.

Although § 45010(c) is taken from existing law, if read literally, it could make the payment bond surety and the contractor which provided the bond for the original work liable for debts of a new contractor on a public work project that "supplements" the original contract. Just what "supplements" is, is rather vague. This may not be the intended result, but a literal reading could justify this result. Note also that this section would appear to give public agencies *carte blanc* to add unrestricted additional work without the need to call for competitive bids and, thus, it may conflict with the general policy of competitive bids on public works. The suggested change, which will also remove the need for the comment, is: ". . . coverage for supplemental work pursuant to a subsequent public works contract with the existing direct contractor which supplements the original contract with the existing direct contractor . . ."

Section 45040(b)& (c). See comments above under §8144.

Very truly yours,

LAW OFFICES OF CHARLES J. PHILIPPS

s/Charles J. Philipps
Charles J. Philipps
CJP/hs

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BUSINESS LAW SECTION

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January 8, 2008

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

RE: Mechanics Lien Law Set Forth in the Commission's Tentative Recommendation Dated June 2006

Commissioners:

The Insolvency Law Committee of the Business Law Section of the State Bar of California (the "Committee") welcomes this opportunity to comment upon the California Law Review Commission's (the "Commission") revisions to the Mechanics Lien Law set forth in the Commission's Tentative Recommendation dated June 2006, as modified in the December 2007 draft. In summary, the Committee believes that many of the proposed revisions both clarify the law and strike an appropriate balance between the competing interests of the many participants.

The Committee believes that the Tentative Recommendation remains consistent with the spirit and intent of the Mechanics Lien Law and avoids making major policy shifts that could disrupt the negotiated balance of rights, remedies and restrictions among the parties. Recognizing that the judicial policy has always been to "liberally construe" the Mechanics Lien Law to ensure maximum protection of the lien claimant, the Committee applauds the Commission for rarely recommending a change that significantly favors another of the parties in this area. In addition to the comments on the Tentative Recommendation set forth below, the Committee recommends that the Commission revisit one particular notice issue and adopt a recommendation concerning same, as set forth in section C (12) below. Finally, if not addressed herein, the Committee takes no position on the remaining provisions of the Tentative Recommendation.

Comments

A. Public Works. The Committee supports the Commission's proposed revision to remove altogether the public works provisions from the Civil Code and relocate it to the Public Contract Code.

B. Design Professionals Lien. The Design Professionals Lien ("DPL") was enacted in 1990 to provide a specific remedy for the Design Professional who prepared drawings and engineering for a project that led to the issuance of a construction permit, but for which no construction actually commenced. Current law is confusing in that it provides that the DPL is

"cumulative" of the mechanics lien law. The proposed law states clearly that the DPL ends when construction begins, and at that point the Design Professional's remedy is a mechanics lien. The Committee supports this proposed modification, as it clarifies an ambiguity in the current law. Additionally, the Committee supports the proposed law's elimination of the separateness of the DPL remedies and relocation of the DPL provisions within the Mechanics Lien Law, given the conceptual modification that there is not a truly overlapping cumulative remedy.

C. Mechanics Lien Law – General Provisions. The Committee makes the following comments to the proposed revisions:

1. The name "Mechanics Lien." Although the name does not really fit the description, this term is one that the Commission wisely chose not to change. Because there is clearly a common understanding of the meaning of the term in the industry, the Committee strongly suggests no modification.

2. Original Contractor. Current law distinguishes between the term "original contractor" – one who contracts directly with the owner – and other contractors such as a subcontractor, who does not contract directly with the owner. The proposed law substitutes the term "direct contractor" for "original contractor" which is more descriptive of the situation that the direct contractor is in privity with the owner. The Commission could have used the commonly understood term "prime contractor" rather that "direct contractor" which would likely be preferred by the trade; nevertheless, the Committee supports the use of the new term "direct" instead of "original."

3. Operative Date. The proposed law would apply to existing as well as new contracts, with any notice given or action taken before the operative date of the new law to be governed by the applicable law in effect at that time and not the new law. The Committee believes the new law should be operative only for contracts entered into and effective as of the effective date of the new law, because it is self-evident that the cross-over of the old and new as applied to the same contract or job will clearly create confusion. With changes in notice requirements and methods, there is little doubt that claimants will be prone to make perhaps fatal mistakes. The Committee recommends that the Commission adopt an effective date similar to that found with reference to imputed interest in an otherwise silent contract as set forth in Civil Code section 3289(b), with clear language – perhaps as simple as the following: "the new law applies to contracts entered into on or after DATE." Since the goal of a statutory revision is simplification, a bright line regarding application is most appropriate.

4. Terminology. A common problem for the participants in the construction area is the ability to actually discover or obtain necessary information. There are provisions of the law that remain untouched which require certain contact and other identifying information to be provided, but provide neither an effective nor adequate remedy for failure to provide that information. Because the proposed law codifies an objective standard of knowledge – making a requirement to provide notice of specific information that the person "knows or should have known," the Committee recommends in section C (12) below that the Commission consider

some consequence to those who do not provide the information known to them to those who ask; e.g., the "direct contractor" who fails to identify the existence of a construction lender, much less the address for service of same.

5. Content of Notice. The proposed law prescribes standard contents applicable to all notices required to be given under the statute. This is a great improvement, as one technique frequently used to oppose a claim of lien is the "inadequate content" defense.

6. Manner of Notice. The proposed law standardizes the approved methods of service for all notices, and provides that any notice required to be given may be given by personal delivery, mail, or by leaving the notice for the person and mailing a copy in the manner provided for service of summons in a civil action. The Committee supports this streamlining.

7. Mail Service. For mail service, the new law proposes that the mailing must be first class registered or certified mail. The proposed law also authorizes express mail or another method of delivery providing for overnight delivery. The Commission particularly solicits comment on the "overnight delivery" concept. The Committee supports expanding the universe of reliable and economical delivery, and welcomes this change. The Committee supports the concept that, if such overnight service is to be used, the person providing such notice provide more than just a proof of mailing, such as proof of delivery.

8. Recorded Notice. A notable "no change" in the proposed law is that notary acknowledgement remains unnecessary to permit the recordation of the mechanics lien and related documents at the County Recorder's office. For years, those trying to make prosecution of claims more costly on claimants have demanded notary acknowledgment on such documents. The Committee supports this "no change," as the Committee believes no change is warranted.

9. Electronic Notice. The proposed law would permit electronic notification only when the party to be notified agrees to receive notice by electronic means. The Commission believes that we should move slowly to introduce this "paper" industry to the concept of electronic notice. The Committee believes that concern to be appropriate and that this provision is appropriate at this time. However, the Committee recommends that the Commission go one step further to provide that the agreement to accept electronic notification must be both in writing and signed by the party agreeing to accept electronic notice.

10. Proof of Mailing. Taking into account the various issues between a "proof of mailing" and a "proof of receipt," the proposed law adopts alternative ways to prove mailing:

> Under the proposed law, proof of mailing may be made by:
>
> (1) A return receipt, delivery confirmation, signature confirmation, or other proof of delivery or attempted delivery provided by the United States Postal Service.

(2) A proof of mailing certified by the United States Postal Service.

(3) A tracking record certified by an express service showing delivery or attempted delivery.

The Commission expressly seeks comment of the reliability of the United States Postal Service, and whether "proof of mailing" should remain sufficient or whether "proof of receipt" may be a more appropriate standard. The Committee recommends that the Commission adopt the protocol of "proof of delivery" and specifically identify and define what it means that a "tracking record be certified" and further adopt a rule of reason for when attempted delivery, coupled with a recipient's refusal to accept said delivery, may constitute "proof of delivery."

11. Proof of Personal Delivery. This is an improvement over current law, which was silent on what constitutes proof of personal delivery. The proposed revision models an acceptable proof from that used in other contexts, such as litigation, which sets forth the content of notice and a method for tracking the person signing the proof. The Committee believes this is an improvement and supports this modification.

12. Address Issues/Consequences of Failure to Provide Address Information. While the industry covered by the Mechanics Lien Law is one of precision, its paperwork is too often imprecise. The statute goes far to provide what is the appropriate address to list for each of the relevant parties. In an industry where the folks closest to the money want the weakest rights for claimants, the problem is not providing what addresses to use, but providing some remedy against those who know, and refuse to provide, said information to the claimant. The Committee encourages the Commission to prescribe a remedy to the claimant who requests, and is not provided, the information required pursuant to current Cal. Civ. Code § 3097(m). The Committee believes this deceptive practice of misinformation would change if there were a strong remedy available to the claimant that is denied essential information.

13. Completion of Notice. These provisions essentially codify and standardize several old judicial opinions on when notice is complete. The Committee sees no controversy here.

D. Commencement and Completion.

1. Commencement. The Committee supports the proposed revisions, which codify the judicial case law concerning the concept of commencement of the work of improvement.

2. Completion.

(i) Notice of Completion and Notice of Cessation. The proposed revisions combine notice of completion with notice of cessation. The Committee does not object to that combination. However, the time for recording a notice of completion, now required to be

10 days from actual completion, is amended to become within 15 days of actual completion. This modification favors the non-claimants. Under current law, the notice of completion is used to shorten the time period to record a lien from 90 to either 60 or 30 (and 30 for most parties). The recordation is valid, and shortens the time to 60 or 30 from recordation, if actual completion occurs within 10 days of recordation. Current law thus gives the claimants, many of whom do not get good information from the others, 20 days to record their lien. Under the proposed revisions, claimants would have 15 days. The Committee does not see manifest justification for such a drastic shortening of this time period. The Committee encourages the Commission to revisit this issue, to determine if a shorter effective notice of completion recordation date, such as 5 days, might be more appropriate to provide sufficient time for claimants to record their lien. If not, the Committee recommends no change to this provision.

(ii) Notice of Recordation. Under current law, an owner is required to notify a claimant of the recording of a notice of completion, and the remedy for failure to do so is the extension of the time period within which the claimant must file the lien. Under the proposed revisions, the owner must send a copy of the notice of completion, not just a notice about it. The Committee supports this change, and requests that the Commission adopt the same "proof of delivery" concept for the notice of completion, discussed above.

(iii) Notice to County Recorder. Under existing law, a claimant who records its 20-day notice with the County Recorder is to receive a copy of any notice of completion that is recorded. There is no consequence for failure to comply with this provision, and the Commission notes that most recorders do not actually give the notice. The proposed revisions eliminate this alternative. In light of the changes regarding the notice of recordation of the notice of completion discussed above, the Committee does not oppose this change.

(iv) Waiver and Release. Existing law requires the use of specific waiver and release forms to affect an enforceable waiver of lien rights. The proposed law corrects ambiguities and streamlines the forms to make them easier to understand. The Committee supports these proposed changes.

(v) Contract Change. Current law requires an owner to notify the original contractor and the construction lender of a change in the original contract if the change increases the contract price by 5% or more. In practice, owners rarely comply; indeed, the case law is replete with cases in which owners have demanded changes and never actually sign the change order to be able to argue later it was not approved. The Commission, accepting that owners rarely give this notice, asks for comment on its elimination. The Committee suggests that the provision not be eliminated. Instead, the Committee recommends that the law should require all parties to give a notice when the contract changes by more than 10%, and further that the lien amount set forth in the preliminary notice becomes a "maximum amount" if there is no subsequent notice given to the appropriate parties when there is such a change. Such notice should be given according to the "proof of delivery" concept discussed above. Moreover, the Committee suggests that the Commission consider codifying this provision as an acceptable alternative to any contractual provision requiring any such change to be signed by the party

proposed to accept the change, to eliminate a constant cause of expensive and often frivolous litigation between the parties over whether such change was "proper" or "approved." Upon receipt of such notice of change, owners and contractors have sufficient remedies available to protect themselves, including cessation of work until the issue can be resolved

(vi) Use of Material in Structure. One of the most hotly contested areas of this law is the ability of the material supplier, who delivers material to the job site, to prove that their material is indeed incorporated into the structure. For the benefit of claimants and taking into account the practical work site, under the proposed revisions, delivery of materials to the jobsite would create a rebuttable presumption that the materials were used in the construction. The Committee supports this proposed revision.

(vii) Notice of Claim of Lien. Today, there is no requirement that a claim of lien be served on the owner, and until the owner attempts to sell or refinance, it may never learn of it. The proposed revisions do not to permit a lien to be recorded without a proof of service. This change places a greater burden on the claimant to get the "proof" right and for the recorder's clerk to determine if the proof is adequate. While the Committee generally supports this change, we suggest that the Commission adopt some additional remedy for the situation when a notice is deemed ineffective for failure to serve all parties (such as the construction lender) and the facts demonstrate that the owner failed to provide the correct address for service of such person, as discussed above. Moreover, the Committee recommends that the entire notice should not be invalidated as to parties properly served on account of having missed a party to be served. For example, the notice should remain effective as against a properly served owner notwithstanding failure to serve the construction lender.

(viii) Lien Release Bond/Attorneys' Fees. A Mechanics' Lien Release Bond is required to be 1.5 times the amount of the claim; a stop notice release bond only 1.25. The proposed revisions standardize both at 1.25. The Committee supports this change.

(ix) Expedited Release. The proposed revisions provide a much quicker procedure for releasing a recorded mechanics' lien when no enforcement action is brought to timely enforce it. The Committee supports these changes.

(x) Attorneys' Fees. A mechanics' lien claimant is not entitled to claim attorneys' fees pursuant to statute; yet, a stop notice claimant can. The Committee recommends that the successful lien claimant be statutorily entitled to collect attorneys' fees for the successful prosecution in the same way that stop notice claimants are so afforded under Civil Code section 3176.

(xi) Extension of Credit. Under current law, the time period for enforcing a recorded lien can be extended up to one year by the recordation of an extension of credit. Under the proposed law, only the owner can so agree to such an extension. The Committee supports this change.

E. Stop Payment.

1. **The Name "Stop Notice."** The proposed revisions change the term "Stop Notice" to "Stop Payment Notice." The Committee supports this change.

2. **Amount of Claim.** Removing arcane language, the proposed revisions require that the stop payment notice state the claimant's demand after deducting all just credits and offsets, and clarifies that the demand may include amounts due based on breach of contract and other items similarly in the mechanics' lien. The Committee does not oppose this change.

The Commission requests comment on whether the new code section 3262, which provides that the waiver and release forms are ineffective to release stop payment notice rights, should be modified or eliminated. The Committee suggests that the Commission adopt and approve a separate form of release that must be used in order to release stop payment notice rights, since they are often most valuable

3. **Amount of Withholding.** Existing law provides that the amount withheld must be both for the amount of the stop notice and in addition any amount asserted in any claim of lien. The Committee would support the Tentative Recommendation to eliminate the duplicative withholding amount.

4. **Notice of Enforcement Action.** Existing law requires a stop notice claimant to give notice of commencement of an action to enforce the stop payment within 5 days of commencement. The law is not clear on what happens if the notice is not given. The Commission invites comment on whether clarifying that failure to give the notice of commencement invalidates the claim would be appropriate. The Committee supports such a provision

5. **Payment Bond.** Current law provides a six month statute of limitations for an action against a surety on a payment bond that is itself recorded before completion of a work of improvement. The Commission is considering, but has not yet adopted, a requirement that an owner be required to provide a copy of the payment bond to anyone that has given a preliminary notice, and that failure to do so tolls the statute of limitations for enforcement of a recorded bond until a copy is served. The Committee supports this concept, and recommends that it extend to any potential claimant, including the direct contractor, who is not required to give a preliminary notice.

F. Public Works.

1. **Completion.** In private works, a cessation of labor is not deemed to be "completion" unless 60 days have elapsed; in public works, it is 30 days. The Commission invites comment on whether these provisions should be harmonized. The Committee supports standardization of both time periods to 60 days

2. **Preliminary Notice.** Under existing law, if the amount to be paid to a licensed subcontractor exceeds $400, and the subcontractor fails to give a preliminary notice, the subcontractor faces a $400 fine as a disciplinary action. The proposed law eliminates this

provision, and instead provides for disciplinary action only if the failure to serve results in loss to laborers. The Commission seeks comment, and the Committee supports this proposed change.

Conclusion

The Committee believes that its members have the special knowledge, training, experience and technical expertise to provide helpful comments on the Tentative Recommendation and that the positions advocated herein are in the best interests of users of the Mechanics' Lien Law and the constituents that the Committee serves.

This statement is only of the Insolvency Law Committee of the Business Law Section of the State Bar of California. The positions expressed herein have not been adopted by the Business Law Section or its overall membership or by the State Bar's Board of Governors or its overall membership, and are not to be construed as representing the position of the State Bar of California. There are currently more than 8,800 members of the Business Law Section. Membership in the Business Law Section is voluntary and funding for Section activities, including all legislative activities, is obtained entirely from voluntary sources.

Once again, we thank you for the opportunity to comment on the Commission's outstanding work, and please feel free to contact us if you have any questions regarding our comments. Questions regarding this letter should be directed to Christopher Celentino, who can be reached at (619) 744-2246, or at ccelentino@duanemorris.com. I can be reached at (916) 449-1440, or at donna@parkinsonphinney.com.

Very truly yours,

Donna Parkinson

Donna Parkinson, Chair
Insolvency Law Committee, Business
Law Section of the State Bar of California

cc: Christopher Celentino
Insolvency Law Committee Co-Vice Chair
Saul Bercovitch
Office of Governmental Affairs
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January 10, 2008

Via E-Mail and U.S. Mail

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

Comments from California State Council of Laborers Legislative Dept. and Construction Laborers Trust Funds for Southern California on Public Works - Memorandum 2007- 58

Dear Members of the Commission:

On behalf of the California State Council of Laborers Legislative Department (Laborers), and the Construction Laborers Trust Funds for Southern California (Laborers Funds), we present the following comments to Memorandum 2007-58. We understand this Memorandum to be the final version of the complete recommendation to be sent to the Legislature, with changes up to the December 2007 meeting.

Our comments here are therefore limited to issues we have spotted, which have not been addressed before (although some relate to prior issues). While these are mostly miscellaneous technical issues, we have spotted another major problem with the "exclusive remedy" provision of proposed Public Contracts Code § 44110. We ask that this be given special attention, since it could result in a change in the law adverse to our interests.

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@rac-law.com

Thank you for your consideration.

Sincerely,

J. David Sackman, of
Reich, Adell & Cvitan

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

cc: Mike Quevedo, Southern California District Council of Laborers
Jose Mejia, Cal. State Council of Laborers
Ric Quevedo, Construction Laborers Trust Funds for Southern California
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1. Private Works Provisions (Civil Code)

§ 8104. Notice of Overdue Laborer Compensation

This section requires certain notice to be given by contractors. The failure to do so "constitutes grounds for disciplinary action under the Contractors' State License Law." There should be a conforming provision in the Business & Professions Code referring back to this section. Suggested language is provide below. *See also* the equivalent provision Public Contracts Code § 42130.

§ 8202. Contents of Preliminary Notice

A contractor, under certain circumstances, is required to include in the Preliminary Notice certain information, which, under subsection (c), may be satisfied by copies of "an invoice for material or certified payroll." We were the ones who suggested this alternative. We now realize that privacy rights may be implicated by publishing this material. Some of the private information (such as address and social security numbers) is governed generally by the Information Practices Act of 1977, Civil Code § 1798 et. seq., and certified payroll is specifically governed by Labor Code § 1776(e).

This does not mean that the information should not be provided, or certified payrolls not be used. However, they may have to be redacted in compliance with those provisions. We suggest a reference to these two statutes be made in either the text or comment, clarifying that these privacy protections still apply to the publication of this information.

§ 8208 - Direct contractors obligation to give information to claimants.

Direct contractors are required to give certain information to claimants. Conspicuously absent from the list of information to be provided is information on the bonds (payment bond or release bond) which may have been posted by the direct contractor. We believe the direct contractor should be required to provide this necessary information, which will help foster the purposes of those bonds by shifting the liability away from the owner.

§ 8608(a) Limitation on Part (for payment bonds).

This subsection merely restates the scope of a payment bond. It seems redundant of other provisions defining who is a "claimant" and what they may claim under payment bonds and the entire Part. See Proposed §§ 8002, 8144, 8400, 8404, 8430 and 8432. The Commission should consider deleting it as an unnecessary redundancy which can only cause confusion.

2. Public Works Provisions (Public Contracts Code)

§ 41050 "Funds" Defined

This is a new provision, which is innocuous in itself, but creates problems when referenced in § 44110 (Stop payment notice exclusive remedy to reach construction funds). By defining "Funds" differently from that meant when the basis for § 44110 (current Civil Code § 3264) was adopted, it changes the meaning of that section. This is discussed more fully under that Section, below.

§ 42010 Application of Part.

This section excludes from coverage a "transaction governed by Sections 20457 to 20464," which is street work covered by the Improvement Act of 1911. Those provisions provide essentially the same procedure for filing a Payment Bond and withholding funds if not paid by the bond. Why not eliminate those sections and make such work subject to the new Code?

§ 42120 Contents of Notice

This provision repeats the private works requirement of giving the street address of a work of improvement. We believe that the project name and number of the public entity is more important in identifying the job on a public work.

§ 42130 Notice of Overdue Laborer Compensation

This section requires certain notice to be given by contractors. The failure to do so "constitutes grounds for disciplinary action under the Contractors' State License Law." There should be a conforming provision in the Business & Professions Code referring back to this section. Suggested language is provide below. *See also* the equivalent provision in proposed Civil Code § 8104.

§ 42240 Notice of Completion of contract for portion of work of improvement.

This is a new provision allowing a notice of completion for one or more of several contracts on the same site. If a notice if completion is to be allowed under such circumstance, shouldn't it require that Notice specify which contract is completed, and which remain uncompleted?

§§ 42360 through 42390 Release Forms

The Forms should show the project name and/or number, as identified by the public entity, and if possible, the identity of the general contractor.

§ 43020. Persons to be given preliminary notice

We suggest this provision be modified to be consistent with similar provisions referring to the preliminary notice requirement, keeping in mind that laborers are not required to give preliminary notice. We suggest the following change:

> 43020. Before giving a stop payment notice or asserting a claim against a payment bond, a claimant shall give preliminary notice (to the extent required by § 43010) to the public entity and the direct contractor.

§ 44110. Stop payment notice exclusive remedy to reach construction funds

We previously objected to this provision, which carries over into public works a provision (currently in Civil Code § 3264) not meant to apply to public funds, and contradictory to several statutory provisions providing otherwise. The Commission adopted a compromise, inserting language into the Comment to clarify that this did not supercede these provisions:

> *There may be specific statutory provisions that authorize payment by a public entity from a fund designated for a public work, notwithstanding the provisions of Section 44110. See, e.g., Code Civ. Proc. § 708.760 (satisfaction of judgment against direct contractor on public work), Labor Code § 1727 (public entity to withhold amounts needed to satisfy prevailing wage violations from funds due direct contractor on public work). This section is not intended to change existing law with respect to such provisions.*[1/]

1/ We now note that the Comment should also reference the proposed new Public Contracts Code § 44340 regarding garnishments.

We have now noticed an additional problem, regarding the reference to Section 41050,[2/] defining "Funds" which only exacerbates the problem we originally pointed out. Both current Civil Code § 3264[3/] and proposed Public Contract Code § 44110 refer to a "fund for the payment of construction costs." A "Fund" is not currently defined. The proposed Public Contracts Code § 41050 would define "Funds" as a "*warrant, check, money, or bonds (if bonds are to be issued in payment of the public works contract).*" While innocuous in itself, when referenced in Section 44110, it changes the meaning of the statute.

A "fund for the payment of construction costs," was not meant to and should not be changed to refer to a "warrant, check, money, or bonds" from a public agency. This is far from the original purpose of the statute. "The enactment of Civil Code section 3264 in 1969 abolished the nonstatutory equitable lien." *Connolly Development, Inc. v. Superior Court*, 17 Cal.3d 803, 827, 132 Cal.Rptr. 477, 553 P.2d 637 (1976), *citing Boyd & Lovesee Lumber Co. v. Western Pacific Financial Corp.*, 44 Cal.App.3d 460, 465, 118 Cal.Rptr. 699 (Cal.App. 1975). All of the cases we have found discussing this involve a special construction fund on private works. While a special "escrow" account sometimes established by public entities for construction projects might theoretically qualify as a "fund for the payment of construction costs," it does not, and should not, reach any "warrant, check, money, or bonds" from a public agency.

The meaning of a "fund for the payment of construction costs" was discussed in the bankruptcy case of *In re Flooring Concepts, Inc.*, 37 B.R. 957 (9th Cir. BAP 1984). Section 3264 of the Civil Code was considered in determining whether a payment from the general contractor to a material supplier of the bankrupt subcontractor was a voidable preference under Bankruptcy Code, 11 U.S.C. § 547(b). The Trustee argued that it was, because Civil Code § 3264 wiped out any other claim the material supplier had. The Ninth Circuit Bankruptcy Appellate Panel disagreed:

> "The amount owed by Konwiser [the general contractor] was not a "fund for the payment of construction costs", as contemplated by § 3264, which was designed to protect construction lenders from claims of equitable liens. The payments made to Shaw [the material supplier] were not made out of the construction loan fund, per se. They were payments made by the general contractor from its own funds to another creditor who, in effect displaced the insolvent subcontractor." 37 B.R. 957, 962.

2/ The Comment incorrectly refers to § 41060, but states that it means "funds" defined.

3/ Section 3264 was carried over, in 1969, from former Code Civ. P. § 1190.1(n), adopted in 1967. Stats.1967, c. 789, p. 2177, § 1, Stats.1969, c. 1362, p. 2780, § 2.

A "fund for the payment of construction costs" was not meant to include the money owed by a public entity to the general contractor, or the general contractor to subcontractors. By adding a section specifically referring to public works *and* adding a new definition for "funds" which is specifically referenced, a significant and deleterious change in the law would be made.

We still believe that this section should be deleted entirely from the proposed Public Contract Code provisions. If it is not, then **at least the reference to the definition of "funds" should be deleted, and a comment added instead, to the effect that a "fund for the payment of construction costs" is meant to have the same meaning as when that language was originally adopted in 1967 (Stats.1967, c. 789, p. 2177, § 1), and not the meaning of a "fund" defined in proposed Public Contracts Code § 41050. A reference could also be made to the purpose of the section, as enunciated by the California Supreme Court in *Connolly Development, Inc. v. Superior Court*, 17 Cal.3d 803, 827, 132 Cal.Rptr. 477, 553 P.2d 637 (1976): "The enactment of Civil Code section 3264 in 1969 abolished the nonstatutory equitable lien." *See also*, *Boyd & Lovesee Lumber Co. v. Western Pacific Financial Corp.*, 44 Cal.App.3d 460, 465, 118 Cal.Rptr. 699 (Cal.App. 1975).**

We note that the proposed revisions to Private Works does not add any definition of "Fund" so that this problem does not occur in the parallel provision of proposed Civil Code § 8500. This problem has been created by the addition of a definition of "Fund" to the Public Contracts Code.

3. Conforming Revisions to Business & Professional Code

As described above, we suggest a conforming provision to refer to the grounds for discipline established in Civil Code § 8104 & Public Contracts Code § 4213. We suggest modifying Business & Professions Code § 7115 as follows:

> § 7115 Failure in any material respect to comply with the provisions of this chapter, or any rule or regulation adopted pursuant to this chapter, or to comply with the provisions of Section 8104 of the Civil Code or Sections 4213 or 7106 of the Public Contract Code, constitutes a cause for disciplinary action.

We thank you for your consideration.