

CALIFORNIA LAW REVISION COMMISSION

TENTATIVE RECOMMENDATION

The Double Payment Problem in Home Improvement Contracts

September 2001

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN November 15, 2001.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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SUMMARY OF TENTATIVE RECOMMENDATION

The Law Revision Commission recommends special protections for homeowners who face potential double liability for labor and materials under home improvement contracts. This problem arises where the owner pays the prime contractor under the terms of their contract, but the prime contractor does not pay amounts due to subcontractors and equipment and material suppliers, who can then enforce their claims against the owner's property or construction funds.

The Commission has studied a number of different approaches to this problem and settled on limited mandatory bonding, coupled with protection for good-faith payments, as the best balance between the interests of homeowners, subcontractors, and suppliers and the cost of the protections.

The proposed law would require that prime contractors on home improvement contracts obtain a payment bond from a surety insurer in the amount of 50% of the contract price to protect unpaid subcontractors and suppliers, thereby relieving the homeowner from double liability. The home improvement contract would be filed with the county recorder and the payment bond would be recorded before the home improvement job commences. In essence, this proposal would make the optional procedure in Civil Code Section 3235 mandatory for home improvement contracts.

The mandatory 50% bond would not be required for contracts under \$10,000, in view of the inefficiency of bonding on smaller jobs, but blanket payment bonds would be available in the smaller cases.

Under the \$10,000 contract level, and in any case where the prime contractor has failed to obtain the required bond, the homeowner would be protected from double liability to the extent that payments had been made in good faith under the contract. Subcontractors and suppliers would easily be able to determine whether the job is bonded by reference to the recorder's files or by checking with the surety company noted on the contract form.

The mechanic's lien and stop notice rights of subcontractors and suppliers would not be affected to the extent that the homeowner has not paid for labor, supplies, equipment, and materials. If a bond has been provided, subcontractors and suppliers would also have the additional remedy of enforcement against the bond.

The Commission is also soliciting comment on the desirability of an alternative scheme that would simply protect good-faith payments under home improvement contracts below \$10,000 (or other appropriate amount), *without* providing for a mandatory bond in all home improvement contracts.

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

THE DOUBLE PAYMENT PROBLEM IN HOME IMPROVEMENT CONTRACTS

THE PROBLEM

1 **Introduction**

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

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

20 The mechanic's lien law is unfairly balanced against the average consumer. It is
21 natural for the homeowner to rely on his or her relationship with the prime
22 contractor and to have confidence that payments under a home improvement
23 contract are directed to the subcontractors, material and equipment suppliers, and

1. This tentative recommendation is submitted as part of the Commission's fulfillment of a request from the Assembly Judiciary Committee to undertake a "comprehensive review of [mechanic's lien] law, making suggestions for possible areas of reform and aiding the review of such proposals in future legislative sessions." See Letter from Assembly Members Sheila James Kuehl (Chair) and Rod Pacheco (Vice Chair), June 28, 1999 (attached to Commission Staff Memorandum 99-85 (Nov. 16, 1999)). The Commission has long-standing authority from the Legislature to study mechanic's liens under its general authority to consider creditors' remedies, including liens, foreclosures, and enforcement of judgments, and its general authority to consider the law relating to real property. For the text of the most recent legislative authorization, see 2001 Cal. Stat. res. ch. 78.

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

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

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

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

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

12 **Significance of Problem**

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

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

30 COMMISSION'S TENTATIVE PROPOSAL

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

3. See Commission Staff Memorandum 2000-9 (Jan. 31, 2000), p. 2.

4. See, e.g., Hunt, *Report to Law Revision Commission Regarding Recommendations for Changes to the Mechanic's Lien Law* [Part 2] (February 2000) (attached to Commission Staff Memorandum 2000-9 (Jan. 31, 2000)).

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

1 Commission is proposing amendments of the mechanic's lien statute to provide
2 special rules applicable to home improvement contracts, with the following
3 features:⁶

- 4 (1) The proposed law would apply to all home improvement contracts, as
5 defined under the Contractors' State License Law.
- 6 (2) An owner who pays the prime contractor in good faith would not be
7 subject to further liability.
- 8 (3) Mechanic's liens and stop notices would apply only to the extent that the
9 owner had not paid the prime contractor in good faith.
- 10 (4) A surety bond in the amount of 50% of the contract price would be
11 required in all home improvement contracts over \$10,000.
- 12 (5) The bond would be obtained by the prime contractor, and would be
13 recorded with the county recorder, along with a filed copy of the contract
14 between the owner and prime contractor, as under existing law.
- 15 (6) Claims of subcontractors and suppliers would be made against the bond
16 or other liable parties, but could not be made against the owner to the
17 extent the owner has paid the prime contractor in good faith.
- 18 (7) Stop notice rights of all claimants would continue. A stop notice or claim
19 of lien served on the owner who has not paid the prime contractor would
20 prevent payment in good faith, but could not be served until payment to
21 the claimant was overdue. A direct payment notice could be served at any
22 time in order to redirect payments when they are due.
- 23 (8) The preliminary 20-day notice would not be required in home
24 improvement contracts and the restrictions on the rights of subcontractors
25 and suppliers in the existing preliminary notice scheme would not apply.
- 26 (9) For home improvement contracts under \$10,000, the owner would be
27 protected by the good-faith payment rule, claimants would not need to

the Mechanic's Lien Law — Part 1 (November 1999) (attached to Commission Staff Memorandum 99-85 (Nov. 16, 1999)) [hereinafter Hunt Report Part 1]; Hunt, *Report to Law Revision Commission Regarding Recommendations for Changes to the Mechanic's Lien Law — Part 2* (February 2000) (attached to Commission Staff Memorandum 2000-9 (Jan. 31, 2000)) [hereinafter Hunt Report Part 2]; Hunt, *Report to Law Revision Commission Regarding Current Proposals Pending Before the Commission Regarding Changes to the Mechanic's Lien Law* (August 2000) (attached to First Supplement to Commission Staff Memorandum 2000-63 (Sept. 29, 2000)) [hereinafter Hunt Report Part 3]. Mr. Acret and Mr. Honda have also submitted numerous written materials. See, e.g., Commission Staff Memorandums 2000-9 & Second Supplement, 2000-26 & Second Supplement, First Supplement to Memorandum 2000-63, 2000-78. A number of other interested persons, some of them representing stakeholders in the construction world, have provided important assistance to the Commission, including Sam K. Abdulaziz, Peter C. Freeman, Ellen Gallagher (CSLB), and Kenneth S. Grossbart. A complete list of persons attending Commission meetings relating to mechanic's liens can be compiled from the Minutes of the following meetings: November 1999; February, April, June, July, October, and December 2000; February, May, June, and September 2001. Written commentary can be found in the exhibits to Commission meeting materials, available at the Commission's website at <<http://www.clrc.ca.gov>>. For mechanic's liens materials, see <<ftp://clrc.ca.gov/pub/Study-H-RealProperty/H820-MechanicsLiens/>>.

6. The core provisions implementing the proposal are set out in a new article applicable to home improvement contracts. See proposed Civ. Code §§ 3244-3244.70, *infra* pp. 38-41.

1 give the preliminary notice, and stop payment and mechanic's lien rights
2 would continue to apply as to amounts not yet paid.

3 (10) Subcontractors and suppliers would be able to determine whether a
4 payment bond is in place before beginning work or furnishing materials
5 or equipment.

6 (11) Other protective options would still be available. Thus, a party would be
7 able to contract for additional notices or greater protections, such as
8 additional bonds or joint control, and the owner could use joint checks to
9 direct payment to subcontractors and suppliers.

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

13 These elements are discussed in more detail below.

14 **Scope of Special Protections — Home Improvement Contracts**

15 The proposed law would apply to all “home improvement contracts,” as defined
16 under the Contractors’ State License Law.⁷ Home improvement contracts are
17 appropriate for special treatment under the mechanic’s lien law because this class
18 of construction contracts has been the focus of special Legislative attention for
19 more than 30 years.⁸ Employing other classifications, such as single-family,

7. “Home improvement” is defined in Business and Professions Code Section 7151:

7151. “Home improvement” means the repairing, remodeling, altering, converting, or modernizing of, or adding to, residential property and shall include, but not be limited to, the construction, erection, replacement, or improvement of driveways, swimming pools, including spas and hot tubs, terraces, patios, awnings, storm windows, landscaping, fences, porches, garages, fallout shelters, basements, and other improvements of the structures or land which is adjacent to a dwelling house. “Home improvement” shall also mean the installation of home improvement goods or the furnishing of home improvement services.

For purposes of this chapter, “home improvement goods or services” means goods and services, as defined in Section 1689.5 of the Civil Code, which are bought in connection with the improvement of real property. Such home improvement goods and services include, but are not limited to, carpeting, texture coating, fencing, air conditioning or heating equipment, and termite extermination. Home improvement goods include goods which are to be so affixed to real property as to become a part of real property whether or not severable therefrom.

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

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

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

1 owner-occupied dwellings, may also be appropriate, but it should be more
2 straightforward to use an existing classification that is familiar to contractors and
3 suppliers. Since home improvement contracts are required to be executed in a
4 special form, it should be easy for those not in privity with the owner to determine
5 whether the job is subject to special rules in the Contractors' State License Law
6 and in the mechanic's lien law as revised in this proposal.

7 **Protection Against Liability for Double Payment**

8 An owner who pays the prime contractor in good faith would not be subject to
9 further liability. This is the basic protection afforded homeowners⁹ under the pro-
10 posed revisions of the mechanic's lien law. This rule is consistent with the com-
11 mon expectations of people who have not learned of the special rules applicable to
12 mechanic's liens in California since 1911.¹⁰ From the owner's perspective,
13 common sense and fairness dictate that payment to the contractor in good faith
14 under the contract should be the end of the owner's liability.

15 Accordingly, mechanic's liens and stop notices should apply only to the extent
16 that the owner has not paid the prime contractor in good faith. In general, subcon-
17 tractors and suppliers (as well as the prime contractor) would continue to have
18 their existing remedies against the property and funds of the owner for amounts
19 that are due but unpaid. If the owner has not paid in good faith, the existing reme-
20 dies would still be available.

21 **Mandatory Bonding**

22 In order to protect subcontractors and suppliers who would no longer have rights
23 against a good-faith homeowner, the proposed law would require prime contrac-
24 tors to obtain a payment bond, from an admitted surety insurer, in the amount of
25 50% of the contract price for all home improvement contracts over \$10,000. In the
26 interest of efficiency, the bonding requirement could be satisfied by blanket bonds
27 satisfying regulations of the Contractors' State License Board.

28 The 50% payment bond approach to addressing the double payment issue is
29 grounded in an existing remedy. Civil Code Section 3235, whose core provisions
30 date back to 1911, permits the owner to limit liability to the amount of the contract
31 remaining unpaid by filing the contract and recording a surety bond for 50% of the
32 contract amount, before work commences. The Section 3235 procedure does not
33 appear to have been used often enough to develop much case law or statutory
34 refinements, leaving a number of questions about the application of the section
35 unanswered.¹¹ Consequently, the proposed law provides a new implementation of

9. "Homeowner" will be used interchangeably with "owner" in this discussion, even though the owner may be a lessor and the home improvement project may be undertaken by the lessee.

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

11. E.g., what is the meaning of the clause in Section 3235 reading "the court must, *where it would be equitable so to do*, restrict the recovery" to the amount remaining due? (Emphasis added.) Is this a good

1 the 50% payment bond concept to protect homeowners from double liability and
2 to provide a fund for subcontractors and suppliers working on home improvement
3 projects.

4 Payment bonds, and other forms of surety bonds, are familiar in the construction
5 industry. Several types of bonding options exist: performance bonds, payment
6 bonds, release bonds, etc. A contractor can get a payment bond to cover payments
7 to subcontractors. Subcontractors can get a bond to guarantee payment to sub-
8 subcontractors and material suppliers. An owner can seek a bond to substitute for
9 the mechanic's lien remedy. But on small projects and in the home improvement
10 area, bonds are generally not a practical option. The cost of a bond can be 1-5% of
11 the contract amount, some contractors may have difficulty qualifying, and human
12 nature is to avoid the trouble and expense of a bond until it is too late.

13 Mandatory bonding would be a mixed blessing. The advantages of the security
14 provided for potential claimants, the protection against the owner's double liabil-
15 ity, and the potential for improving the financial soundness of the home improve-
16 ment industry, must be weighed against the added cost and burden of obtaining
17 bonds and the difficulty some worthy contractors may have in satisfying bond
18 underwriters.

19 **Advantages and Disadvantages of Payment Bonds**

20 Professor George Lefcoe has written:¹²

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

26 He believes that the recorded bonded contract option under Civil Code Section
27 3235 "offers the best protection for the owner, but is the least often used because
28 few owners know about it and, in any event, bonding is a costly and bureaucratic
29 exercise for the novice."¹³

30 The Nolo Press self-help guide says little about payment bonds, since they are
31 "not a viable option for most small property owners."¹⁴ Of course, under the
32 Commission's proposal, the prime contractor, who should have the necessary

faith payment rule that would not protect owners to the extent payments were not made in good faith? Or does it have a broader scope, giving the court authority to waive the protection from double liability on a determination that it would be unfair to subcontractors or suppliers?

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

13. *Id.* § 102.02(a)(2)(iv), at 562.

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

1 knowledge and experience, would obtain the bond, not the homeowner. As to the
2 recorded contract and 50% bond under Section 3235, the Nolo Guide says:¹⁵

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

10 These bond premiums appear high. The Commission is informed that the cost of
11 the proposed 50% payment bonds should be in the range of one-half to 3%.¹⁶
12 Other estimates range from 1-5% on the bond amount, which would be equivalent
13 to one-half to 2½% of the contract amount. The policy question for resolution in
14 the legislative process is whether this anticipated expense is justified by the
15 advantages of the mandatory 50% payment bond. Competition could reduce the
16 cost ultimately passed on to homeowners, in contrast to proposals that would
17 impose a percentage fee on every home improvement job, such as through the
18 building permit process. In addition, bond premiums will be lower for the more
19 reliable and creditworthy contractors, thereby reducing the overall cost.

20 In his report to the Commission, Gordon Hunt analyzed mandatory full payment
21 and performance bonds as follows:¹⁷

22 [A]nother alternative would be to make the furnishing of a payment and a per-
23 formance bond mandatory in the case of a single-family owner-occupied dwelling
24 that is the primary residence of the owner.... The cost of the bonding, of course, is
25 passed on to the owner and it would increase the cost of the project to the owner,
26 but it would provide the owner with ultimate protection from a defaulting original
27 contractor. It would completely serve to protect the owner from the failure of the
28 original contractor to pay subcontractors, laborers, and suppliers. It would like-
29 wise protect the owner from failure to complete by the original contractor. The
30 primary objection to any such statute would be claims by contractors that they
31 would be unable to obtain such bonds because they are not “bondable.” Those, of
32 course, are the very contractors that shouldn’t be in the home improvement busi-
33 ness to begin with. If such a provision were enacted, the marketplace would react
34 and surety companies would be willing to write such bonds and would find ways
35 in the underwriting process to protect their interests. Specifically, sureties would
36 take a more active participation in the projects that they bond for small contractors
37 to insure that the money flows down from the contractor to the subcontractors,
38 laborers, and suppliers. This would increase the cost of the bonds and thus the
39 cost to the owner, but would provide the owner with much greater protection from

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

16. Email from Andy Faust, American Contractors Indemnity Co. (June 27, 2001) (Second Supplement to Commission Staff Memorandum 2001-52 (June 28, 2001)).

17. Hunt Report Part 2, *supra* note 5, at 10; see also Hunt, *California Mechanics’ Lien Law: Need for Improvement*, 9 Santa Clara Law. 101, 107-09 (1968).

1 defaulting original contractors. The cost of the bond would be much less than
2 having to litigate and pay Mechanic's Liens.

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

8 **Duty to Obtain and Record Bond**

9 The prime contractor would have the duty under the proposal to obtain and
10 record the bond. Following the existing scheme, the home improvement contract
11 would be filed (as opposed to recorded) with the county recorder. This approach
12 should work well because it is familiar to contractors, subcontractors, suppliers,
13 and lenders, even if it may appear burdensome to someone outside the
14 construction industry. Further study may lead to cheaper and more efficient
15 substitutes, such as statewide filing with the Contractors' State License Board and
16 providing bond information on the Internet.

17 The Commission has considered providing alternatives to bonding, particularly
18 for contractors who cannot qualify for a bond, such as permitting cash deposits in
19 lieu of bond or employing a joint control agency, but the proposal sets out only the
20 50% payment bond of an admitted surety insurer since it would be less confusing
21 for persons relying on the security of the prime contractor. Providing a set of alter-
22 natives would make it more difficult for homeowners, subcontractors, and
23 suppliers to know which scheme was in place or whether any security had been
24 provided.

25 **Nature of Bond**

26 The best security is a bond issued by an admitted surety insurer. This standard is
27 adopted in the proposed legislation. A potential drawback is that surety companies
28 underwrite bonds based on the soundness of the bond principal. The argument is
29 always made against mandatory bonding that it will drive a number of contractors
30 out of business or into the underground economy and that it constitutes a barrier to
31 entry. On the other hand, bonding is required in public works. It has also been
32 suggested that smaller bonds will be readily available for entry-level general
33 contractors, and that bond qualification difficulties will only occur if the contractor
34 is trying to take on too many projects or projects that are too complicated in
35 relation to the contractor's experience.

36 The proposal also includes an amendment to the home improvement contract
37 form to provide a space for indicating the name and telephone number of the
38 surety on the bond so that owners, subcontractors, suppliers, and lenders can verify
39 the prime contractor's bond status. Education efforts can focus on obtaining and

1 verifying one sound form of security more effectively than offering a smorgasbord
2 of options, each with its own features and verification rules.

3 **Setting the Floor on Mandatory Bonding**

4 Under the Commission’s proposal, the mandatory payment bond would not
5 apply to home improvement contracts under \$10,000.¹⁸ Any such statutory thresh-
6 old is arbitrary, and can only reflect an estimation of the appropriate level deter-
7 mined by balancing a number of factors. Since the proposed mandatory bond is in
8 the amount of 50% of the contract price, the threshold may also be viewed as a
9 \$5,000 amount for the purposes of assessing efficiency of scale and the need for
10 the protection afforded by the bond.

11 A \$5,000 minimum bond amount is the same as the limitation on small claims
12 court jurisdiction,¹⁹ which may be taken as one measure of “smaller” contracts
13 where less formal rules are appropriate. Taking inflation into account, this amount
14 is also generally in line with a State Bar committee proposal from 40 years ago,
15 which would have set the floor amount for a full mandatory bond at \$1,000, which
16 would be equivalent to over \$5,700 today.²⁰

17 Although some different policies are involved, it is interesting to note that public
18 works are not required to be bonded in California below \$25,000.²¹

19 **Enforcement of Claims by Subcontractors and Suppliers**

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

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

30 (1) Stop notices and claims of lien that would put the homeowner on notice so as
31 to prevent further good-faith payments to the prime contractor could not be given
32 until payment was overdue to the subcontractor or supplier. Under existing law, a
33 claimant who has given a preliminary 20-day notice is free to record a claim of

18. If the prime contractor has a blanket payment bond, it would cover all home improvement contracts, not just those over \$10,000. This recognizes that a major reason for the floor amount is the relative inefficiency of obtaining a bond for each small job.

19. Code Civ. Proc. § 116.220.

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

21. Civ. Code § 3247.

1 lien after he or she has “ceased furnishing labor, services, equipment, or materi-
2 als”²² and does not need to wait until payment is overdue or the job is complete.
3 To permit routine use of stop notices and lien claims as soon as the subcontractor
4 or supplier has *finished* his or her part of the job would defeat the purpose of the
5 mandatory bond and the ability of homeowners to rely on their contract with the
6 prime contractor.

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

15 (3) Where subcontractors and suppliers anticipate that they may not be paid by
16 the prime contractor, they would have the alternative of giving the owner and
17 prime contractor a direct pay notice that would call for the owner to pay the sub-
18 contractor or supplier directly instead of through the prime contractor when the
19 prime contractor bills for their work or supplies. The direct pay notice could be
20 served for any work or supplies that had been furnished and would not have to
21 wait for payment to become overdue.

22 **Procedural Simplification**

23 Under existing law, subcontractors and suppliers are commonly advised to
24 routinely send out the preliminary 20-day notice as soon as they sign a contract or
25 start work on a job.²³ The preliminary notice relates back for 20 days, even if it is
26 given late, but it is generally a prerequisite to use of other remedies under the
27 mechanic’s lien statute, including stop notices and bond recovery.²⁴

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

34 **Protections Under Small Contracts**

35 Mandating 50% payment bonds, with the associated expense of filing the
36 contract and bond with the county recorder, becomes increasingly inefficient and

22. Civ. Code § 3116.

23. See S. Abdulaziz, *California Construction Law* 200-01, 204 (K. Grossbart ed. 2000); Nolo Guide, *supra* note 14, at 1/8, 2/2-2/3.

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

1 burdensome for smaller contracts. The risk exposure for the parties is also signifi-
2 cantly lower, the smaller the overall contract price. Accordingly, the floor applica-
3 ble to the mandatory bonding for home improvement contracts under the
4 Commission's proposal in the aggregate amount of \$10,000. But it is also ineffi-
5 cient to continue the burdensome and premature service of multiple copies of pre-
6 liminary 20-day notices on owners, prime contractors, and lenders. The proposal
7 dispenses with the need to give preliminary notices in home improvement con-
8 tracts under \$10,000, thereby saving this cost and paper-shuffling burden on the
9 parties.

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

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

29 Protecting homeowners under small contracts serves the fundamental purpose of
30 providing a meaningful degree of consumer protection without complicated forms
31 and technical deadlines. Setting a \$10,000 floor also recognizes that subcontractors
32 and suppliers will rarely pursue the mechanic's lien remedy under existing law for
33 smaller amounts because of the costs involved. The Commission is informed that
34 the lack of recoverable attorney's fees in mechanic's lien foreclosure makes it
35 impractical for subcontractor or supplier to pursue amounts under \$5,000 or
36 \$8,000 (depending on the assessment of the particular business). In most cases, an
37 individual subcontractor or supplier's portion of a home improvement contract
38 under \$10,000 would likely fall in the range of unforclosable liabilities.

39 **Market Principles**

40 A major defect that has been identified in the existing system is reliance on the
41 homeowner to sort through the various notices and correctly anticipate the best
42 remedy. As a general rule, homeowners are likely to initiate few home improve-

1 ment projects in a lifetime, whereas contractors and suppliers have daily experi-
2 ence in the business. This principle lies at the heart of consumer protection. Of
3 course, there may also be significant inequalities in business and legal sophistica-
4 tion, bargaining power, financial soundness, and risk aversion among prime
5 contractors, subcontractors, and suppliers. But as a class, those in the construction
6 business and trades should be expected to have greater knowledge and sophistica-
7 tion about how things work than homeowners.

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

16 Under the proposal, subcontractors and suppliers would be responsible for
17 determining whether an individual bond had been recorded on the contract or
18 whether a blanket payment bond is in force. Subcontractors and suppliers are the
19 direct beneficiaries of the payment bond and should be familiar with the
20 technicalities of obtaining information from county recorders, surety companies,
21 and the Contractors' State License Board. In the absence of a bond, their risk
22 exposure increases, so it makes business sense to know before entering a contract
23 or extending credit, by performing work or supplying equipment or materials,
24 whether the payment bond is in place.

25 **Simpler Alternative**

26 The Commission would like to receive comment on the desirability of an
27 alternative scheme of simply providing protection for good-faith payments under
28 home improvement contracts below the amount of \$10,000 (or other appropriate
29 amount), *without* providing for a mandatory bond in home improvement contracts
30 above that amount.

31 **Deferred Operative Date**

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

35 **CONSTITUTIONAL CONSIDERATIONS**

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

37 Mechanics, persons furnishing materials, artisans, and laborers of every class,
38 shall have a lien upon the property upon which they have bestowed labor or
39 furnished material for the value of such labor done and material furnished; and the

1 Legislature shall provide, by law, for the speedy and efficient enforcement of such
2 liens.²⁵

3 Any statute that qualifies or imposes conditions on this important right must pass
4 constitutional muster. The following discussion reviews the history of the
5 mechanic's lien statute and constitutional provision, and case law relevant to
6 determining the constitutionality of statutory reform.

7 **Background and History**

8 The history of the mechanic's lien law in California is relevant to an understand-
9 ing of the dimension of permissible legislation and the context of the law as
10 understood by the framers of the 1879 California Constitution.

11 The mechanic's lien law dates back to the first Legislature, which enacted a
12 rudimentary statute on April 12, 1850 — five days before defining property rights
13 of spouses.²⁶ The first mechanic's lien case reached the Supreme Court that same
14 year, when the court ruled that a lumber merchant did not have a lien on the
15 building under the mechanic's lien statute where he had failed to comply with the
16 60-day recording period following completion of construction.²⁷

17 The double payment problem appeared in the cases within the first decade. In
18 *Knowles v. Joost*²⁸ the Supreme Court ruled that, under the statute, an owner who
19 had paid the contractor in full was not liable to materialmen.²⁹

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

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

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

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

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

28. 13 Cal. 620 (1859).

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

1 In *McAlpin v. Duncan*³⁰ the court again addressed the double payment problem,
2 this time under the 1858 statute:

3 The question presented by the record is, whether the defendant, having paid the
4 contractor in full before notice of the claims of these parties, can be compelled to
5 pay a second time....

6 [The 1858 statute] is not a little confused and difficult of satisfactory construc-
7 tion. If it were designed to give to the sub-contractor and laborer a lien upon the
8 property of the owner for the entire amount of the last or sub-contract, without
9 any regard to the amount of the principal contract, a very curious anomaly would
10 exist, and the whole property of the owner might be placed at the discretion of the
11 contractor, to be encumbered by him as he chose. Such laws, as we have held in
12 this very class of cases, are to be strictly construed, as derogating from the
13 common law....

14 We think all that can be gathered from this act, is that material-men, sub-
15 contractors, etc., have a lien upon the property described in the act to the extent (if
16 so much is necessary) of the contract price of the principal contractor; that these
17 persons must give notice of their claims to the owner, or the mere existence of
18 such claims will not prevent the owner from paying the contractor, and thereby
19 discharging himself from the debt; that by giving notice, the owner becomes liable
20 to pay the sub-contractor, etc. (as on garnishment or assignment, etc.), *but that if*
21 *the owner pays according to his contract, in ignorance of such claims, the*
22 *payment is good.*

23 Unless this view is correct, the grossest absurdities appear. We have, in the first
24 place, a valid contract, with nothing appearing against it, which yet cannot be
25 enforced — a clear right of action on the part of the contractor, with no defense by
26 the defendant, and yet which cannot be enforced; *or* which the plaintiff may
27 enforce at law, and yet, if the defendant pays the money, with or without suit, he
28 must pay it again. Innumerable liens may be created, without the knowledge of
29 the owner, for which he might be held liable; while the owner could never pay
30 anything until after long delays, whatever the terms of the contract, or the contrac-
31 tor's necessity for money, unless payment were made at the expense, or at the risk
32 of the payor. Such a construction would lead to law suits and difficulties innum-
33 erable. By the other construction, no injustice is done or confusion wrought. These
34 sub-contractors, etc., have only to notify their claims to the owner, in order to
35 secure them. *If they, by their own laches, suffer the owner to pay over the money*
36 *according to the terms of his contract, they ought not to complain; for it was by*
37 *their own neglect of a very simple duty that the loss accrued; and it would be*
38 *unjust to make the owner pay a second time because of that neglect.*³¹

39 Cases such as *McAlpin* were decided before mechanic's liens were addressed in
40 the constitution, but *McAlpin* touches on several themes that remain relevant 140

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

30. 16 Cal. 126 (1860).

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

1 years later. The court was faced with a “confused” and “difficult” statute, and
2 balanced the interests of the parties by placing responsibility where it logically lay,
3 in order to avoid the injustice of liability for double payment.

4 These cases were the beginning of a long line of consistent rulings, even though
5 the statute changed in its details from time to time. Thus, in *Renton v. Conley*³² the
6 court ruled under the 1868 statute, as it had under the 1856 and 1858 statutes, that

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

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

18 Nevertheless, the line of contract-based cases continued through the period of
19 the Constitutional Convention in 1878-79 and thereafter, up until the “direct lien”
20 revision in 1911 (with a brief detour through an 1880 amendment). This case law
21 was reflected in the constitutional debates. In 1885 the statute was amended to
22 reflect the basic contract analysis of the cases, with some special rules applicable
23 where the contract was void or not completed. The strict limitations imposed by
24 the courts through the contract analysis resulted in hardship to subcontractors,
25 suppliers, and laborers employed by the contractor where no payments were due
26 because the contract was void or where the contractor abandoned the project.
27 Under the cases decided during this era, only the amount remaining due and
28 unpaid was available for claims of subcontractors, suppliers, and laborers not in
29 privity with the owner.³³

30 In 1885, however, the problem of the void contract was addressed, giving
31 claimants under the original contractor a direct lien for the value of their work, not
32 limited by the contract amount.³⁴ Reflecting the perspective of a century ago,
33 Counselor James in his treatise analyzed this rule as follows:

34 The effect of section 1200 is ... to charge the property of the owner with liens
35 of persons other than the owner to the extent in value of the work actually done or
36 of the materials actually furnished by them measured always by the standard of

32. 49 Cal. 185, 188 (1874).

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

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

1 the contract price. If the effect was to *charge the property of the owner with such*
2 *liens beyond the limit of the contract price, it would according to all of the*
3 *authorities, be unconstitutional.*³⁵

4 Clearly it was the expectation at the time, shortly after adoption of the constitu-
5 tional mechanic's lien provision, that the mechanic's lien right was subject to
6 overriding contract principles.

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

17 **End of the Contract Era**

18 The dominance of the law of contract — which had survived repeated legislative
19 adjustments in the 1850s through 1880, the Constitutional Convention of 1878-79,
20 and the more significant legislative revisions in 1885 and after — came to an end
21 with the revision of 1911.³⁶ Code of Civil Procedure Section 1183 was amended to
22 adopt the "direct lien" approach: "The liens in this chapter provided for shall be
23 direct liens, and shall not in the case of any claimants, other than the contractor be
24 limited, as to amount, by any contract price agreed upon between the contractor
25 and the owner except as hereinafter provided...."³⁷ The pre-1911 limitation on the
26 liability of the owner to amounts remaining due under the contract was now only
27 available through obtaining a payment bond in the amount of 50% of the contract
28 price. In general terms, the current statute is a direct descendent of the 1911
29 revisions.

30 The leading case of *Roystone Co. v. Darling*³⁸ gives a useful overview of the
31 1911 revision and the reasons for it, and places the statutory history in context
32 with the case law. *Roystone* also is significant for the fact that it reflects a broad
33 view of legislative power to implement the constitutional mandate:

34 [The 1911 statutory] revision made some radical changes in the law, and it
35 presents new questions for decision. It will aid in the understanding of the purpose
36 and meaning of this act if we call to mind, as briefly as may be, the history of the

35. James, *supra* note 33, § 310, at 329 (emphasis added).

36. 1911 Cal. Stat. ch. 678.

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

38. 171 Cal. 526, 530-34, 154 P. 15 (1915).

1 mechanic's lien laws in this state and the state of the law on the subject at the time
2 the amendments in question were enacted.

3 Prior to the adoption of the constitution of 1879 the lien of mechanics and mate-
4 rialmen for work done and materials furnished in the erection of buildings was
5 entirely a creature of the legislature. The former constitution contained no decla-
6 ration on the subject. Numerous decisions of the supreme court had declared that
7 all such liens were limited by the contract between the owner and the contractor,
8 and could not, in the aggregate, exceed the contract price. The doctrine that the
9 right of contract could not be invaded by legislative acts purporting to give liens
10 beyond the price fixed in the contract between the owner and the contractor, or
11 regardless of the fact that the price had been wholly or partially paid, was so thor-
12 oughly established that litigation involving it had virtually ended. Section 1183 of
13 the [Code of Civil Procedure], as amended in 1874, declared that every person
14 performing labor or furnishing materials to be used in the construction of any
15 building should have a lien upon the same for such work or material. It did not
16 limit the liens to the contract price. In this condition of the law the constitution of
17 1879 was adopted....

18

19 In 1880 section 1183 was again amended by inserting a direct declaration that
20 "the lien shall not be affected by the fact that no money is due, or to become due,
21 on any contract made by the owner with any other party." This amendment of
22 1880 first came before the supreme court for consideration in *Latson v. Nelson*, [2
23 Cal. Unrep. 199], ... a case not officially reported. The court in that case consid-
24 ered the power of the legislature to disregard the contract of the owner with the
25 contractor and give the laborer or materialman a lien for an amount in excess of
26 the money due thereon from the owner to the contractor. In effect, it declared that
27 section 15, article XX, of the constitution was not intended to impair the right to
28 contract respecting property guaranteed by section 1, article I, thereof, and that the
29 provisions of the code purporting to give a lien upon property in favor of third
30 persons, in disregard of and exceeding the obligations of the owner concerning
31 that property, was an invalid restriction of the liberty of contract.... In the mean-
32 time the legislature of 1885 ..., apparently recognizing and conceding the force of
33 the decision in *Latson v. Nelson*, undertook to secure and enforce the constitu-
34 tional lien by other means, that is, by regulating the mode of making and execut-
35 ing contracts, rather than by disregarding the right of contract. It amended sections
36 1183 and 1184 of the code by providing that in all building contracts the contract
37 price should be payable in installments at specified times after the beginning of
38 the work, that at least one-fourth thereof should be made payable not less than
39 thirty-five days after the completion of the work contracted for, that all such
40 contracts exceeding one thousand dollars should be in writing, subscribed by the
41 parties thereto, and should be filed in the office of the county recorder before the
42 work was begun thereunder, that if these regulations were followed, liens upon
43 the property for the erection of the structure should be confined to the unpaid por-
44 tion of the contract price, but that all contracts which did not conform thereto, or
45 which were not filed as provided, should be void, that in such case the contractor
46 should be deemed the agent of the owner, and the property should be subject to a
47 lien in favor of any person performing labor or furnishing material to the contrac-
48 tor upon the building for the value of such labor or material. This law, with some

1 amendments not material to our discussion, remained in force until the enactment
2 of the revision of 1911 aforesaid.

3 In the meantime the supreme court has followed the rule established by the
4 cases ... and has uniformly declared, with respect to such liens, that if there is a
5 valid contract, the contract price measures the limit of the amount of liens which
6 can be acquired against the property by laborers and materialmen. [Citations
7 omitted.] ... In addition to these express declarations there are many cases in
8 which the rights of the parties were adjudicated upon the assumption that this
9 proposition constituted the law of the state. Each one of the large number of deci-
10 sions regarding the priorities of liens in the unpaid portion of the contract price,
11 each decision respecting the right to reach payments made before maturity under
12 such contract, each decision as to the formal requisites of contracts under the
13 amendment of 1885, and each decision as to the apportionment under section
14 1200 of the Code of Civil Procedure, upon the failure of the contractor to com-
15 plete the work, constitutes an affirmance of the doctrine that the contract, legally
16 made, limits the liability of the owner to lien claimants. There has been scarcely a
17 session of this court since the enactment of that amendment at which one or more
18 cases have not been presented and decided which, in effect, amounted to a repeti-
19 tion of this doctrine....

20

21 We have shown that when [the 1911] act was passed it was the established doc-
22 trine of this state that the legislature cannot create mechanics' liens against real
23 property in excess of the contract price, where there is a valid contract, but that it
24 is within the legislative power, in order to protect and enforce the liens provided
25 for in the constitution, and so far as for that purpose may be necessary, to make
26 reasonable regulations of the mode of contracting, and even of the terms of such
27 contracts, and to declare that contracts shall be void if they do not conform to
28 such regulations....

29 The portions of the act of 1911 above quoted clearly show that the legislature
30 did not intend thereby to depart from this doctrine, but that, on the contrary, the
31 design was to follow it and to protect lienholders by means of regulations con-
32 cerning the mode of contracting and dealing with property for the purposes of
33 erecting improvements thereon. The first declaration on the subject is that the
34 liens provided in the chapter shall be "direct liens" (whatever that may mean), and
35 that persons, other than the contractor, shall not be limited by the contract price
36 "except as hereinafter provided." The proviso referred to is found in the following
37 declaration in the same section:

38 "It is the intent and purpose of this section to limit the owner's liability, in all
39 cases, to the measure of the contract price where he shall have filed or caused to
40 be filed in good faith with his original contract a valid bond with good and suffi-
41 cient sureties in the amount and upon the conditions as herein provided."

42 A plainer declaration of the intention to make the contract price the limit of the
43 owner's liability, where the bond and contract have been filed as required by this
44 section, could scarcely be made....

45 This lengthy quotation from *Roystone* provides a definitive exposition of the
46 issues at a critical time when the contract era was giving way to the "direct lien"
47 era resulting from the 1911 amendments — in other words, a balancing of inter-
48 ests, formerly thought unconstitutional, that permits owners to be charged twice

1 for the same work. There is not even a hint in this discussion that limiting liability
2 to the amount of the contract could be unconstitutional.

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

9 The court had occasion to reflect on the significance of *Roystone* with respect to
10 limitations on legislative power in *Pacific Portland Cement Co. v. Hopkins*.³⁹
11 Responding to the appellant supplier’s arguments, a three-judge department of the
12 full court wrote:

13 The final point made is that, since the Constitution gives a lien on property upon
14 which labor is bestowed or materials furnished (Const. art. XX, sec. 15), the legis-
15 lature has no power to enact a statute which shall limit the lien-claimant’s
16 recovery to the unpaid portion of the contract price. Whatever might be thought of
17 this as an original question, it is no longer open or debatable in this court. In the
18 recent case of *Roystone Co. v. Darling* ... we reviewed the long line of decisions
19 which had established in this state the soundness of the rule that “if there is a valid
20 contract, the contract price measures the limit of the amount of liens which can be
21 acquired against the property by laborers and materialmen.” In the present case,
22 the portion of the contract price applicable to the payment of liens was fixed in
23 accordance with the rule laid down in section 1200 of the Code of Civil Proce-
24 dure. That the specific method provided by this section is not in conflict with the
25 Constitution was expressly decided in *Hoffman Marks Co. v. Spires*, 154 Cal. 111,
26 115. The findings show that there was no unpaid portion of the contract price
27 applicable to the payment of claimants who had furnished labor or materials to the
28 original contractor. The conclusion of law that the defendant was entitled to
29 judgment necessarily follows.

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

37 **Scope of Legislative Authority**

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

39. 174 Cal. 251, 254-55, 162 P. 1016 (1917).

1 The constitutional language “shall have a lien” might appear to directly create a
2 mechanic’s lien, and courts have occasionally dealt with the argument that there is
3 a “constitutional lien,” somehow distinct from the statutory implementation. In an
4 early case, the court described it as follows:⁴⁰

5 This declaration of a right, like many others in our constitution, is inoperative
6 except as supplemented by legislative action.

7 So far as substantial benefits are concerned, the naked right, without the inter-
8 position of the legislature, is like the earth before the creation, “without form and
9 void,” or to put it in the usual form, the constitution in this respect is not self-
10 executing.

11 Cases have distinguished between the constitutional right to the lien and the
12 statutory lien itself.⁴¹ The constitutional provision is “not self-executing and is
13 inoperative except to the extent the Legislature has provided by statute for the
14 exercise of the right.”⁴² The court in the leading case of *Frank Curran Lumber Co.*
15 *v. Eleven Co.*⁴³ explained that the constitution is

16 inoperative except as supplemented by the Legislature through its power reason-
17 ably to regulate and to provide for the exercise of the right, the manner of its
18 exercise, the time when it attached, and the time within which and the persons
19 against whom it could be enforced. *The constitutional mandate is a two-way*
20 *street, requiring a balancing of the interests of both lien claimants and property*
21 *owners. In carrying out this constitutional mandate the Legislature has the duty of*
22 *balancing the interests of lien claimants and property owners.*⁴⁴

23 It is this balancing of interests that the Commission has sought in preparing its
24 recommendation, and that the Legislature must do whenever significant amend-
25 ments are made affecting right to a mechanic’s lien.

26 **Purpose and Justification of Lien**

27 The mechanic’s lien was unknown at common law. The early cases adopted the
28 traditional strict construction approach to the statute.⁴⁵ The lien is usually justified
29 on the ground that the lien claimant has increased the value of the owner’s prop-
30 erty through labor, services, or materials supplied, and it would unjustly enrich the
31 owner if the benefits could be enjoyed without payment.⁴⁶ Thus, it is fitting that

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

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

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

43. 271 Cal. App. 2d 175, 183, 76 Cal. Rptr. 753 (1969).

44. 271 Cal. App. 2d at 183 (emphasis added).

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

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

1 the laborer and supplier should follow the fruits of their activities into the building
2 (and some land) that has been enhanced.

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

10 **Original Intent of Constitutional Provision**

11 There is strong evidence that the constitutional language was not meant to permit
12 imposition of double liability on property owners. The language of the mechanic's
13 lien provision placed in Article XX, Section 15, was discussed in some detail, as
14 recorded in the Debates and Proceedings of the California Constitutional Conven-
15 tion of 1878-79.⁴⁷ The Convention soundly rejected proposed language to make
16 clear that "no payment by the owner ... shall work a discharge of a lien." This
17 rejection took place with the certain knowledge that the Supreme Court had
18 consistently held that liens were limited to the contract price under the statutes in
19 force at the time.

20 In reviewing the constitutional history, one analyst has concluded:

21 [T]he delegates clearly left the decision regarding the enforcement of liens for
22 the Legislature to determine by statute. In rejecting the amendment, the delegates
23 preserved the right of [the] Legislature to enact reasonable regulations limiting
24 mechanic's liens, including statutes that grant homeowners a defense based on
25 full payment. When viewed within the context of the Debates and Proceedings,
26 the very system that is now in place was in fact rejected by the delegates of the
27 Constitution Convention.⁴⁸

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

30 The delegates participating in the debate were obviously aware of the fact than
31 an earlier decision had construed mechanics' liens as limited to the amount found
32 due and owing to the contractor. The drafting committee reported out the provi-
33 sion in the form in which it was ultimately enacted.

34 A Mr. Barbour introduced an amended version which would have made the
35 liens unlimited and would also have made the owner personally liable for them.
36 There was some talk of revising the offered amendment to eliminate the feature of
37 personal liability while retaining unlimited lien liability. Such a revision was

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

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

1 never made, so the delegates never had the opportunity to vote on the simple issue
2 of limited versus unlimited liens. The proponents of the Barbour amendment indi-
3 cated that their primary interest was in aiding the laborer; materialmen were
4 included as potential lienors without any real reason for including them advanced.
5 No one contended that it was proper that an innocent homeowner should be sub-
6 jected to “double payment.” Instead, the proponents of the amendment assumed
7 that the honest owner would be fully aware of the law and be able to protect him-
8 self. The principal argument in support of the Barbour amendment was that it
9 would prevent “collusion” between “thieving contractors and scoundrelly owners
10 who connive to swindle the workman out of his wages.” ... The opponents of the
11 amendment used some rather strong language in asserting their position. One
12 called the amendment a “fraud” and “infirm in principle.” At all events, the
13 amendment was voted down. Since most of the speakers seemed to be of the
14 opinion that unlimited liens would not be permitted under the constitution unless
15 expressly authorized therein, the fact that the Barbour amendment was defeated
16 would seem to indicate an intention on the part of the delegates that unlimited
17 liens should not be allowed. This cannot be stated with certainty, however, since
18 one of the delegates was of the opinion that the provision as ultimately enacted
19 would leave the question of limited or unlimited liens up to the legislature. Thus,
20 there remains the possibility that the delegates adopted his view, and decided to
21 dump the question into the legislators’ laps. It can be stated categorically that,
22 since no one thought that innocent homeowners should be subjected to “double
23 payment,” the delegates did not give their stamp of approval in advance to the
24 present scheme of mechanics’ liens.⁴⁹

25 A contrary interpretation of the debates is possible, since the Legislature in 1880
26 amended Code of Civil Procedure Section 1183 to provide that the lien “shall not
27 be affected by the fact that no money is due, or to become due, on any contract
28 made by the owner with any other party.”⁵⁰ It is possible to conclude from the
29 transcript that the debate resulted in a stand-off, with the extent of the lien left to
30 later legislative determination. But even this interpretation of the original intent
31 does not provide support for the position that the Legislature is powerless to limit,
32 condition, or redirect certain mechanic’s lien rights as a result of balancing com-
33 peting interests. Both interpretations of the constitutional debates support the Leg-
34 islature’s power to limit liens for important policy reasons.

49. Comment, *The “Forgotten Man” of Mechanics’ Lien Laws — The Homeowner*, 16 *Hastings L.J.* 198, 217-18 (1964) [footnotes omitted]. Research has not revealed a single case, among nearly 900 mechanic’s lien cases reported since 1879, that refers to the constitutional *Debates and Proceedings*. Fewer than 10 cases have discussed the “double payment” problem, and none of them reviewed the original intent of the framers of the constitutional mechanic’s lien right.

50. 1880 Cal. Code Amends. ch. 67, § 1.

1 **Limits on Legislative Power**

2 Some authorities argue that restricting or eliminating the mechanic's lien right
3 where the owner has paid the contractor in full would be unconstitutional.⁵¹ Other
4 authorities disagree.⁵²

5 Since the particular question of limiting the homeowner's liability to amounts
6 remaining unpaid under the contract has not been decided in modern times, those
7 who believe this approach would be unconstitutional rely on quotations from the
8 cases concerning the special status of the mechanic's lien. Great reliance is placed
9 on two California Supreme Court cases decided in the last 25 years: *Connolly*
10 *Development, Inc. v. Superior Court*⁵³ and *Wm. R. Clarke Corp. v. Safeco Insur-*
11 *ance Co.*⁵⁴

12 *Connolly* was a 4-3 decision upholding the constitutionality of the mechanic's
13 lien statute against a challenge based on the claim that the imposition of the lien
14 constituted a taking without due process. Strikingly, however, *Connolly* is not rel-
15 evant to the question of whether a good-faith payment exception to double liability
16 for mechanic's lien claims would be constitutional — the constitutionality of the
17 mechanic's lien statute itself was the issue in the case. In upholding the statute,
18 *Connolly* employed a balancing of interests in determining whether the taking
19 without notice could withstand constitutional scrutiny. For the purposes of the
20 Commission's proposal, *Connolly* is of interest because it illustrates that balancing
21 of creditors' and debtors' rights must occur in considering mechanic's lien issues.
22 This case is not relevant to the issue of whether the Legislature can constitution-
23 ally balance the interests of homeowners and mechanic's lien claimants through a
24 rule protecting the owner from double payment liability.

25 In *Wm. R. Clarke Corp. v. Safeco* a divided court struck down pay-if-paid
26 clauses in contracts between contractors and subcontractors. *Clarke* involved *con-*
27 *tractual* waivers of an important constitutional right which were found to be
28 against *legislated* public policy. The analysis undertaken in *Clarke* is clearly dis-
29 tinct from that required to determine whether a new public policy established by
30 statute, in which the Legislature has balanced the competing interests, can properly
31 be balanced against the lien right. In *Clarke* the owner had not paid and the surety
32 company was trying to avoid paying. These equities differ markedly from the situ-
33 ation addressed in the this proposal, which would provide protection for owners
34 who have already paid in good faith.

51. See, e.g., Hunt Report Part 2, *supra* note 5; see also First Supplement to Commission Staff Memorandum 2000-26 (April 10, 2000); Abdulaziz memorandum (attached to First Supplement to Commission Staff Memorandum 2000-36 (June 15, 2000)).

52. See, e.g., Honda, *supra* note 48; Acret letter (Aug. 25, 1999) (quoted in Honda, *id.* at 2-5).

53. 17 Cal. 3d 803, 553 P.2d 637, 132 Cal. Rptr. 477 (1976) (upholding mechanic's lien statute against due process attack).

54. 15 Cal. 4th 882, 938 P.2d 372, 64 Cal. Rptr. 2d 578 (1997) (pay-if-paid contract provision held unconstitutional).

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

4 *Roystone*, quoted at length earlier, is probably the most significant decision
5 because it held the 1911 payment bond reform valid and attempted to harmonize
6 the new reforms with the contract rule that had prevailed for 60 years. Justice
7 Henshaw’s lone concurring opinion in *Roystone*⁵⁵ — to the effect that it is “wholly
8 beyond the power of the Legislature to destroy or even impair this lien” — was an
9 extreme minority opinion even then.

10 *Martin v. Becker*⁵⁶ describes the high status of the mechanic’s lien as follows:
11 “[T]he lien of the mechanic in this state ... is a lien of the highest possible dignity,
12 since it is secured not by legislative enactment but by the constitution.... Grave
13 reasons indeed must be shown in every case to justify a holding that such a lien is
14 lost or destroyed.” This language is directed toward the exercise of judicial
15 authority in a case where the court was called upon to determine whether the right
16 to a mechanic’s lien was lost when the claimant had also obtained security by way
17 of a mortgage. Although the court’s sentiments may be sound, they are irrelevant
18 to the standards for reviewing a legislative determination of the proper balance
19 between competing interests. Judicial recognition that the state has a “strong
20 policy” favoring laws giving laborers and materialmen security for their liens⁵⁷
21 addresses only one element in the Legislative balancing process and cannot
22 determine the validity of a legislative determination that homeowners need
23 protection from having to pay twice for the same home improvements.

24 In *English v. Olympic Auditorium*,⁵⁸ the court wrote: “Should the lien laws be so
25 interpreted as to destroy the liens because the leasehold interest has ceased to exist,
26 such interpretation would render such laws unconstitutional.” But in this case there

55. 171 Cal. at 544. Justice Henshaw appears to have believed that even the 50% bonding provision was suspect:

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

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

56. 169 Cal. 301, 316, 146 P. 665 (1915).

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

58. 217 Cal. 631, 20 P.2d 946 (1933).

1 was no double payment — there was not even a single payment. The court ruled
2 that mechanic’s liens remained on a structure built by the lessee whose lease had
3 terminated, notwithstanding the lease provision making any construction a fixture
4 inuring ultimately to the lessor’s benefit.

5 *Young v. Shriver*⁵⁹ has been cited for the language “we presume that no one will
6 say that the right to the remedy expressly authorized by the organic law can be frit-
7 tered away by any legislative action or enactment.” But this is a case where the
8 court rejected a mechanic’s lien claim for the labor of plowing agricultural land,
9 taking into account the technicalities of distinguishing between the first plowing
10 and later plowings. The court did not find plowing at any time to be an
11 “improvement” within the constitutional or statutory language.

12 *Hammond Lumber Co. v. Barth Investment Corp.*⁶⁰ repeats the *Martin v. Becker*
13 language in a case concerning a technical question of whether a building had actu-
14 ally been completed for purposes of a 90-day lien-filing period. The court wrote:
15 “The function of the legislature is to provide a system through which the rights of
16 mechanics and materialmen may be carried into effect, and this right cannot be
17 destroyed or defeated either by the legislature or courts, unless grave reasons be
18 shown therefor.” This case did not involve an issue of the scope of the Legisla-
19 ture’s power to “destroy or defeat” the lien upon a showing of grave reasons.

20 *Hammond v. Moore*⁶¹ resolved the issue whether the Land Title Law, enacted by
21 initiative, violated the mechanic’s lien provision in the constitution. The court
22 found that the lien recording requirement was not unduly burdensome, and in dicta
23 speculated that “the second sentence of section 93, by denying the creation of a
24 lien unless the notice is filed, violates the forepart of article XX, section 15, of the
25 Constitution, granting a lien.” But that issue was not before the court, and similar
26 procedural requirements have been accepted in the mechanic’s lien law for years
27 without challenge.

28 The source of some interesting language cited in a number of later cases is *Dia-*
29 *mond Match Co. v. Sanitary Fruit Co.*:⁶²

30 The right of mechanics, materialmen, etc., to a lien upon property upon which
31 they have bestowed labor, or in the improvement of which material which they
32 have furnished have been used, for the value of such labor or materials, is guaran-
33 teed by the Constitution, the mode and manner of the enforcement of such right
34 being committed to the Legislature.... Manifestly, the legislature is not thus
35 vested with arbitrary power or discretion in attending to this business. Indeed,
36 rather than power so vested in the legislature, it is a command addressed by the
37 constitution to the law-making body to establish a reasonably framed system for
38 enforcing the right which the organic law vouchsafes to the classes named.
39 Clearly, it is not within the right or province of the legislature, by a cumbersome

59. 56 Cal. App. 653, 655-66, 206 P. 99 (1922).

60. 202 Cal. 606, 610, 262 P. 31 (1927).

61. 104 Cal. App. 528, 286 P. 504 (1930).

62. 70 Cal. App. 695, 701-02, 234 P. 322 (1925).

1 or ultratechnical scheme designed for the enforcement of the right of lien, to
2 impair that right or unduly hamper its exercise. Every provision of the law which
3 the Legislature may enact for the enforcement of the liens ... must be subordinate
4 to and in consonance with that constitutional provision....

5 But, while all that has been said above is true, it will not be denied that it is no
6 less the duty of the legislature, in adopting means for the enforcement of the liens
7 referred to in the constitutional provision, to consider and protect the rights of
8 owners of property which may be affected by such liens than it is to consider and
9 protect the rights of those claiming the benefit of the lien laws. The liens which
10 are filed under the lien law against property, as a general rule, grow out of con-
11 tracts which are made by and between lien claimants and persons (contractors)
12 other than the owner of the property so affected, and such liens may be filed and
13 so become a charge against property without the owner having actual knowledge
14 thereof. The act of filing, as the law requires, constitutes constructive notice to the
15 owners and others that the property stands embarrassed with a charge which will
16 operate as a cloud upon the title thereof so long as the lien remains undischarged,
17 and that the property may be sold under foreclosure proceedings unless the debt to
18 secure which the lien was filed is otherwise sooner satisfied. The filing of the
19 claim in the recorder's office is intended to protect the owner of the property
20 against double payment to the contractor or payment for his services and the
21 materials he uses in the work of improvement in excess of what his contract calls
22 for. The notice is also intended for the protection of those who may, as to such
23 property, deal with the owner thereof — that is, third persons as purchasers or
24 mortgagees.

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

29 There is also a presumption in favor of the validity of statutes which may be
30 applied to uphold legislative balancing of different interests in the mechanic's lien
31 context. Legislative discretion was discussed in *Alta Building Material Co. v.*
32 *Cameron* as follows:⁶³

33 The following language in *Sacramento Municipal Utility Dist. v. Pacific Gas &*
34 *Elec. Co.*, 20 Cal. 2d 684, 693, [128 P.2d 529] is applicable: "The contention that
35 the section in question [Code Civ. Proc. § 526b] lacks uniformity, grants special
36 privileges and denies equal protection of the laws, is also without merit. None of
37 those constitutional principles is violated if the classification of persons or things
38 affected by the legislation is not arbitrary and is based upon some difference in the
39 classes having a substantial relation to the purpose for which the legislation was
40 designed. [Citations.] ... Wide discretion is vested in the Legislature in making
41 the classification and every presumption is in favor of the validity of the statute;
42 the decision of the Legislature as to what is a sufficient distinction to warrant the
43 classification will not be overthrown by the courts unless it is palpably arbitrary
44 and beyond rational doubt erroneous. [Citations.] A distinction in legislation is not

63. 202 Cal. App. 2d 299, 303-04, 20 Cal. Rptr. 713 (1962).

1 arbitrary if any set of facts reasonably can be conceived that would sustain it.”
2 [Citations omitted.]

3 While the essential purpose of the mechanics’ lien statutes is to protect those
4 who have performed labor or furnished material towards the improvement of the
5 property of another (*Nolte v. Smith*, 189 Cal. App. 2d 140, 144 [11 Cal. Rptr.
6 261], inherent in this concept is a recognition also of the rights of the owner of the
7 benefited property. It has been stated that the lien laws are for the protection of
8 property owners as well as lien claimants (*Shafer v. Los Serranos Co.*, 128 Cal.
9 App. 357, 362 [17 P.2d 1036]) and that our laws relating to mechanics’ liens
10 result from the desire of the Legislature to adjust the respective rights of lien
11 claimants with those of the owners of property improved by their labor and mate-
12 rial. (*Corbett v. Chambers*, 109 Cal. 178, 181 [41 P. 873].) ... [Quotation from
13 *Diamond Match Co.* omitted.]

14 Viewing section 1193 within the framework of these principles, we are unable
15 to state that the Legislature acted arbitrarily and unreasonably in making the clas-
16 sification which it did.

17 The section does not require a pre-lien notice by those under direct contract
18 with the owner or those who perform actual labor for wages on the property. The
19 logical reason for this distinction is that the owner would in the usual situation be
20 apprised of potential claims by way of lien in connection with those with whom
21 he contracts directly, as well as those who perform actual labor for wages upon
22 the property.

23 However, as to materials furnished or labor *supplied* by persons not under direct
24 contract with the owner, it may be difficult, if not impossible, for the owner to be
25 so apprised and the clear purpose of section 1193 is to give the owner 15 days’
26 notice in such a situation that his property is to be “embarrassed with a charge
27 which will operate as a cloud upon the title thereof so long as the lien remains
28 undischarged, and that the property may be sold under foreclosure proceedings
29 unless the debt to secure which the lien was filed is otherwise sooner satisfied.”
30 ...

31 The court in *Alta Building Material* distinguished the Supreme Court case of
32 *Miltimore v. Nofziger*,⁶⁴ a 4-3 decision holding unconstitutional a statutory rule
33 giving priority to laborers over material suppliers in satisfaction of mechanic’s lien
34 claims against the proceeds from the sale of the liened property.⁶⁵ Although *Milti-*
35 *more* is short on detail, the *Alta Building Material* court concluded that *Miltimore*
36 involved classifications “as to substantive matters,” whereas Section 1193 at issue
37 in *Alta Building Material* involved a procedural matter — “the right itself is not
38 denied or impaired.”

39 **Balancing Interests**

40 There have been a number of schemes implementing the constitutional direction
41 since 1879, and several statutory provisions have been challenged for being
42 unconstitutional as measured against the language of the constitution. Throughout

64. 150 Cal. 790, 90 P. 114 (1907).

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

1 the years, the courts have rejected most constitutional challenges to aspects of the
2 statutes, recognized a number of exceptions to the scope of the constitutional pro-
3 vision, and generally have deferred to the Legislature’s balancing of the interests.

4 In early cases, the fundamental property rights of the owner received frequent
5 judicial attention. For example, in the course of striking down the statute requiring
6 payment of construction contracts in money, the court in *Stimson Mill Co. v.*
7 *Braun*⁶⁶ explained:

8 The provision in the constitution respecting mechanics’ liens (art. XX 20, sec.
9 15) is subordinate to the Declaration of Rights in the same instrument, which
10 declares (art. I, sec. 1) that all men have the inalienable right of “acquiring,
11 possessing and protecting property,” and (in sec. 13) that no person shall be
12 deprived of property “without due process of law.” The right of property antedates
13 all constitutions, and the individual’s protection in the enjoyment of this right is
14 one of the chief objects of society.

15 In considering whether it was constitutionally permissible to make procedural
16 distinctions between different classes of lien claimants, the Supreme Court
17 explained in *Borchers Bros. v. Buckeye Incubator Co.*:⁶⁷

18 The problem is therefore presented whether the Legislature’s procedural dis-
19 tinction in section 1193 of the Code of Civil Procedure, requiring notice by a
20 materialman but not by a laborer, is so arbitrary and unreasonable that there is no
21 substantial relation to a legitimate legislative objective.

22 The constitutional mandate of article XX, section 15, is a two-way street,
23 requiring a balancing of the interests of both lien claimants and property owners.
24 First, this argument could appropriately be presented to the Legislature and not to
25 the courts. Second, in carrying out this constitutional mandate, the Legislature has
26 the duty of balancing the interests of lien claimants and property owners.

27 **Examples of “Balanced Interests”**

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

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

35 In each of these cases, the legislature has made a policy decision that the consti-
36 tutional right to a mechanics lien should yield to legitimate interests of property
37 owners.

38 In one case, the legislature decided that a property owner should be protected
39 against liens for work ordered by a tenant even though construction ordered by a
40 tenant is just as valuable as any other construction. In another case, the legislature

66. 136 Cal. 122, 125, 68 P. 481 (1902).

67. 59 Cal. 2d 234, 238, 379 P.2d 1, 28 Cal. Rptr. 697 (1963).

1 decided that it was more important to encourage construction financing by insti-
2 tutional lenders than to protect mechanics lien rights. In the last case, the legisla-
3 ture simply decided that public agencies should be exempt from mechanics lien
4 claims.⁶⁸

5 *Licensed Contractor Limitation*

6 Since 1931, unlicensed contractors have been precluded from recovering com-
7 pensation “in law or equity in any action,” including foreclosure of mechanic’s
8 liens.⁶⁹ In *Alvarado v. Davis*,⁷⁰ the court denied enforcement of a mechanic’s lien
9 by an unlicensed contractor based on the licensing requirement enacted in 1929,
10 even before the statute provided an explicit bar.⁷¹

11 The current rule is set out in Business and Professions Code Section 7031. The
12 courts have affirmed the intent of the Legislature “to enforce honest and efficient
13 construction standards” for the protection of the public.⁷² The severe penalty in the
14 nature of a forfeiture caused some unease when courts were faced with technical
15 violations of the licensing statute, giving rise to the substantial compliance doc-
16 trine.⁷³ The Legislature acted to rein in the substantial compliance doctrine by
17 amendments starting in 1991 restricting the doctrine to cases where the contractor
18 has been licensed in California and has acted reasonably and in good faith to main-
19 tain licensure, but did not know or reasonably should not have known of the
20 lapse.⁷⁴

21 In *Vallejo Development Co. v. Beck Development Co.*,⁷⁵ the court reaffirmed the
22 authority of the licensing rules:

23 California’s strict contractor licensing law reflects a strong public policy in
24 favor of protecting the public against unscrupulous and/or incompetent contract-
25 ing work. As the California Supreme Court recently reaffirmed, “The purpose of
26 the licensing law is to protect the public from incompetence and dishonesty in
27 those who provide building and construction services.... The licensing require-
28 ments provide minimal assurance that all persons offering such services in Cali-
29 fornia have the requisite skill and character, understand applicable local laws and
30 codes, and know the rudiments of administering a contracting business.”

31 The constitutional mechanic’s lien provision predates the licensing regime by 50
32 years. The decisions do not question the propriety of this major limitation on the

68. Acret Letter, *supra* note 52.

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

70. 115 Cal. App. Supp. 782, 783 (1931).

71. See 1929 Cal. Stat. ch. 791, § 1.

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

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

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

75. 24 Cal. App. 4th 929, 938, 29 Cal. Rptr. 2d 669 (1994).

1 constitutional lien. Even though a disfavored forfeiture can result from application
2 of the licensing rules, the mechanic's lien right bows before the policy of protect-
3 ing the public implemented in the licensing statute.⁷⁶

4 *Public Works*

5 The statutes make clear that the mechanic's lien is not available in public
6 works.⁷⁷ A "public work" is defined as "any work of improvement contracted for
7 by a public entity."⁷⁸ The constitutional mechanic's lien provision does not contain
8 this limitation.

9 The statutory rule appears first in 1969.⁷⁹ However, by 1891 the California
10 Supreme Court had ruled that the constitutional mechanic's lien provision could
11 not apply to public property as a matter of public policy. In *Mayrhofer v. Board of*
12 *Education*,⁸⁰ a supplier sought to foreclose a lien for materials furnished to a sub-
13 contractor for building a public schoolhouse. Although the constitutional provision
14 is unlimited in its use of "property" to which the lien attaches for labor or materi-
15 als furnished, the court found that "the state is not bound by general words in a
16 statute, which would operate to trench upon its sovereign rights, injuriously affects
17 its capacity to perform its functions, or establish a right of action against it."⁸¹ The
18 court termed it "misleading to say that this construction is adopted on the ground
19 of public policy," thus distinguishing this limitation on the scope of the mechan-
20 ic's lien from other balancing tests. Rather, the interpretation follows from the
21 original intent of the language to provide remedies for private individuals; it would
22 be an "unnatural inference" to conclude otherwise.⁸²

23 Constitutional provisions for the payment of state debts through taxation and
24 restrictions on suits against the state bolster the conclusion that general provisions
25 like the mechanic's lien statute and its implementing legislation do not apply to the
26 state and its subdivisions.⁸³

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

77. Civ. Code § 3109.

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

79. 1969 Cal. Stat. ch. 1362, § 2 (enacting Civ. Code § 3109).

80. 89 Cal. 110, 26 P. 646 (1891).

81. *Id.* at 112.

82. *Id.* at 113.

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

1 *Special Protections of Homeowner and Consumer Interests*

2 Modern California law provides a number of special protections for homeown-
3 ers.⁸⁴ This special treatment evidences legislative concern for this fundamental
4 class of property and suggests the propriety of balancing that interest with the
5 mechanic's lien right. This is not entirely a modern development. Just as the
6 mechanic's lien is the only creditor's remedy with constitutional status, the home-
7 stead exemption is also constitutionally protected.⁸⁵

8 The California codes are replete with consumer protection statutes that condition
9 the freedom of contract and other fundamental rights. Particularly relevant here is
10 the Contractors' State License Law,⁸⁶ which contains numerous provisions limit-
11 ing activities of contractors in the interest of consumer protection.

12 **Other Constitutional Rulings**

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

19 *Gibbs v. Tally*⁸⁷ invalidated the mandatory bond provision in Code of Civil
20 Procedure Section 1203, as enacted in 1893, as an unreasonable restraint on the
21 owner's property rights and an unreasonable and unnecessary restriction on the
22 power to make contracts.

23 *Stimson Mill Co. v. Braun*⁸⁸ held the requirement of payment in cash in the 1885
24 version of Code of Civil Procedure Section 1184 was unconstitutional as an inter-
25 ference with contract rights.

26 The allowance of attorney's fees as an incident to lien foreclosure under the
27 1885 version of Code of Civil Procedure 1195 was invalidated in *Builders' Supply*
28 *Depot v. O'Connor*.⁸⁹

29 The most relevant case is *Parsons Brinckerhoff Quade & Douglas, Inc. v. Kern*
30 *County Employees Retirement Ass'n*,⁹⁰ cited in a recent Legislative Counsel's

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

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

86. Bus. & Prof. Code §§ 7000-7191

87. 133 Cal. 373, 376-77, 65 P. 970 (1901) (distinguished in *Roystone*).

88. 136 Cal. 122, 125, 68 P. 481 (1902).

89. 150 Cal. 265, 88 P. 982 (1907).

90. 5 Cal. App. 4th 1264, 7 Cal. Rptr. 2d 456 (1992).

1 opinion.⁹¹ Assembly Member Mike Honda requested an opinion from the Legisla-
2 tive Counsel on the following question:

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

7 The Opinion concluded that such a statute would be unconstitutional. While it
8 cites a broad statement in the case law concerning the legislative power in relation
9 to the constitution,⁹² the Opinion does not mention the limitations on the constitu-
10 tional provision resulting from balancing competing policies, such as the contrac-
11 tor licensing rules, nor does it consider the constitutional history as reflected in the
12 *Debates and Proceedings*. The Opinion does not mention the early case law, nor
13 the statutes from 1885 to 1911, under which good-faith payment to the prime con-
14 tractor without notice of other claims acted as a shield against mechanic's liens.

15 Although the Opinion recognizes that the Legislature has "plenary power to rea-
16 sonably regulate and provide for the exercise of this right, the manner of its exer-
17 cise, the time when it attached, and the time within which and the persons against
18 whom it could be enforced" it concludes:

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

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

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

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

35 Probably the most meaningful point in the Opinion is the citation to *Parsons*
36 *Brinckerhoff Quade & Douglas, Inc. v. Kern County Employees Retirement*
37 *Ass'n*.⁹³ The Opinion cites this case for the proposition that "the Legislature, in

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

92. *Diamond Match Co.*, *supra* note 62.

93. 5 Cal. App. 4th 1264, 7 Cal. Rptr. 2d 456 (1992).

1 carrying out its constitutional mandate ... may not effectively deny a member of a
2 protected class the benefits of an otherwise valid lien by forbidding its enforce-
3 ment against the property of a preferred person or entity.” But *Parsons* involved
4 the conflict between a special debtor’s exemption statute and the mechanic’s lien
5 law. To uphold the exemption would mean that the fund would receive a windfall.
6 This is not the situation where the homeowner has paid in full under the contract
7 with the prime contractor. The proposal does not impose a categorical exemption
8 of homeowners from liability under home improvement contracts. In the absence
9 of such a proposal, *Parsons* is not on point.

10 **Constitutionality of Proposed Reforms — Conclusion**

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

19 Most judicial discourse on the nature of the mechanic’s lien provision in the
20 constitution, the role of the Legislature in implementing it, and other affirmations
21 of the status of the mechanic’s lien appear in cases involving technical issues or
22 establishing the basis for a liberal, remedial interpretation of the statute. By and
23 large, the cases do not demonstrate a judicial pattern of limiting legislative power
24 or rejecting legislative determinations of the proper balance of interests based on
25 larger policy concerns. Standard recitations pertaining to the force of the
26 constitutional language suggest a general inclination of the courts to honor the
27 protection of mechanics, suppliers, laborers, subcontractors, and contractors. But
28 at the same time, it must be recognized that the concrete results in these cases have
29 been largely to uphold statutory qualifications and policy balancing,
30 notwithstanding the breadth of the constitutional language.

PROPOSED LEGISLATION

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

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

1 CHAPTER 6. PAYMENT BOND FOR PRIVATE WORKS

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

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

4 3235. In case the original contract for a private work of improvement is filed in
5 the office of the county recorder of the county where the property is situated
6 before the work is commenced, and the payment bond of the original contractor in
7 an amount not less than 50 percent of the contract price named in such contract is
8 recorded in such office, then the court must, where it would be equitable so to do,
9 restrict the recovery under lien claims to an aggregate amount equal to the amount
10 found to be due from the owner to the original contractor and render judgment
11 against the original contractor and his sureties on such bond for any deficiency or
12 difference there may remain between such amount so found to be due to the
13 original contractor and the whole amount found to be due to claimants.

14 **Civ. Code § 3236 [unchanged]. Purpose, limitation on owner’s liability**

15 3236. It is the intent and purpose of Section 3235 to limit the owner’s liability, in
16 all cases, to the measure of the contract price where he shall have filed or caused
17 to be filed in good faith his original contract and recorded a payment bond as
18 therein provided. It shall be lawful for the owner to protect himself against any
19 failure of the original contractor to perform his contract and make full payment for
20 all work done and materials furnished thereunder by exacting such bond or other
21 security as he may deem necessary.

22 **Civ. Code § 3237 [unchanged]. Lender’s objection**

23 3237. When a lending institution requires that a payment bond be furnished as a
24 condition of lending money to finance a private work of improvement, and accepts
25 in writing as sufficient a payment bond posted in fulfillment of this requirement, it
26 may thereafter object to the borrower as to the validity of that payment bond or
27 refuse to make the loan based upon any objection to the payment bond only if the
28 bond underwriter was licensed by the Department of Insurance.

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

32 Article 2. Conditions to Action on Payment Bond

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

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

35 3239. (a) ~~No~~ A provision in any a payment bond given pursuant to ~~any of the~~
36 ~~provisions of this chapter~~ Article 1 (commencing with Section 3235) attempting

1 by contract to shorten the period prescribed in Section 337 of the Code of Civil
2 Procedure for the commencement of an action thereon shall be on the bond is not
3 valid if such provision ~~it~~ attempts to limit the time for commencement of an action
4 thereon on the bond to a shorter period than six months from the completion of
5 any the work of improvement, ~~nor shall any.~~

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

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

18 See also Sections 3096 (“payment bond” defined), 3106 (“work of improvement” defined).

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

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

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

24 3240. Notwithstanding Section 3239, if a surety on ~~any a~~ a payment bond given
25 pursuant to ~~this chapter~~ Article 1 (commencing with Section 3235), or a prime
26 contractor as principal on a home improvement payment bond given pursuant to
27 Article 3 (commencing with Section 3244), records the payment bond in the office
28 of the county recorder of the county in which the property is situated before the
29 work of improvement is completed, then any action ~~against the surety or sureties~~
30 on the bond shall be commenced not later than six months after the completion of
31 the work of improvement.

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

35 See also Sections 3096 (“payment bond” defined), [3097 (“prime contractor” defined),] 3106
36 (“work of improvement” defined).

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

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

39 3242. (a) With regard to a contract entered into on or after January 1, 1995, in
40 order to enforce a claim ~~upon any on a~~ on a payment bond given in connection with a
41 private work of improvement, a claimant shall give the preliminary 20-day ~~private~~
42 ~~work preliminary~~ notice (private work) provided in Section 3097.

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

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

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

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

17 **Civ. Code §§ 3244-3244.70 (added). Home improvement payment bonds**

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

20 Article 3. Home Improvement Payment Bonds

21 **§ 3244. Scope of article**

22 3244. Notwithstanding any other provision in this title, this article governs the
23 rights of claimants and the liabilities of owners under home improvement
24 contracts, as defined in Section 7151.2 of the Business and Professions Code.

25 **Comment.** Section 3244 makes clear that this article governs enforcement of claims by way of
26 mechanic’s liens, bond claims, and stop notices, and any other means, in the case of home
27 improvement contracts. Specific limitations have been amended into a number of other provisions
28 in this title, but the introductory clause is intended to make clear that this article governs home
29 improvement contracts in the case of a conflict with another provision. See, e.g., Sections
30 3097(q), 3123(a), 3159(a)(1)-(2), 3161(a), 3162(a)(1)-(2).

31 See also Sections 3085 (“claimant” defined), [3094 (“owner” defined)].

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

35 **§ 3244.10. Fifty percent payment bond**

36 3244.10. (a) Before work commences under a home improvement contract in the
37 amount of ten thousand dollars (\$10,000) or more, the prime contractor shall
38 obtain a payment bond in an amount not less than 50 percent of the contract price,
39 and shall file the home improvement contract and record the bond with the county
40 recorder of the county where the subject of the contract is situated.

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

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

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

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

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

20 See also Sections 3096 (“payment bond” defined), [3097 (“prime contractor” defined),] 3244
21 (incorporation of “home improvement contract” definition).

22  **Note.** The definition of “prime contractor” is in the general revision draft.

23 § 3244.20. Bond requirements

24 3244.20. (a) A payment bond under this article shall be executed by an admitted
25 surety insurer.

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

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

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

39 Subdivision (c) authorizes the use of a more efficient blanket payment bond, so long as the
40 blanket payment bond affords equivalent coverage to the 50% payment bond described in Section
41 3244.10. The determination of standards for blanket payment bonds is delegated to the
42 Contractors’ State License Board. See Section 3244.70 (CSLB regulatory authority).


43 See also Sections 3095 (“payment bond” defined), [3097 (“prime contractor” defined)].

1 § 3244.30. Limitation on owner’s liability

2 3244.30. Whether or not the home improvement contract is filed and a payment
3 bond is recorded as provided in Section 3244.10, the liability of an owner under a
4 home improvement contract is limited to the contract price. Payments made to the
5 prime contractor in good faith discharge the owner’s liability to all claimants to the
6 extent of the payments.

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

12 See also Sections 3084 (“claim of lien” defined), 3085 (“claimant” defined), 3088 (“contract”
13 defined), 3096 (“payment bond” defined), [3097 (“prime contractor” defined),] 3103 (“stop
14 notice” defined).

15  **Alternative Approach.** The Commission would like to receive comment on the desirability
16 of an alternative scheme of simply providing protection for good-faith payments under home
17 improvement contracts below the amount of \$10,000 (or other appropriate amount), *without*
18 providing for a mandatory bond. In this alternative, Section 3244.30 would read as follows:

19 3244.30 [alternative]. The liability of an owner under a home improvement contract in an
20 amount less than ten thousand dollars (\$10,000) is limited to the contract price. Payments made to
21 the prime contractor in good faith discharge the owner’s liability to all claimants to the extent of
22 the payments.

23 This alternative would eliminate the mandatory 50% bond for home improvement contracts over
24 \$10,000 provided in Sections 3244.10-3244.20

25 § 3244.40. Good faith payments

26 3244.40 (a) A payment is presumed to be made in good faith by the owner to the
27 prime contractor if both of the following requirements are satisfied:

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

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

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


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

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

42 Subdivision (b) delineates the meaning of a timely communication to the owner that can defeat
43 good-faith payments. Under this section, lien claims and stop notices do not affect the rights of

1 the owner unless given *after* payments to a claimant have become due and remain unpaid under
2 governing statute and contract rules.

3 See also Sections 3084 (“claim of lien” defined), 3085 (“claimant” defined), 3088 (“contract”
4 defined), 3096 (“payment bond” defined), [3097 (“prime contractor” defined),] 3103 (“stop
5 notice” defined).

6  **Note.** Additional detail will be needed to flesh out the “direct payment notice” listed in
7 subdivision (b). The purpose of the direct payment notice is to permit a subcontractor or supplier
8 to give notice to the owner so that debt-discharging payments cannot be made in good faith. The
9 owner would be able to pay the subcontractor or supplier directly as soon as the prime contractor
10 informs the owner that progress payments for the work done or material or equipment supplied.
11 Unlike mechanic’s lien claims and stop notices, the direct payment notice does not involve other
12 consequences such as tying up financing or starting the clock running on enforcement procedures.
13 The form and contents of the direct payment notice would be determined by Contractors’ State
14 License Board regulation under Section 3244.70(b).

15 **§ 3244.50. Enforcement of claims**

16 3244.50. Except as provided in Section 3244.30, the mechanic’s lien and stop
17 notice rights of claimants are not limited by this article, and claimants may enforce
18 payment by any remedy provided in this title, without the necessity of giving a
19 preliminary 20-day notice.

20 **Comment.** Section 3244.40 makes clear that the only limitation on the rights of claimants is the
21 rule protecting good-faith owners from being subject to double liability for payments made under
22 the contract. Thus, for example, subcontractors and suppliers may seek satisfaction from the
23 owner as to amounts not yet paid to the prime contractor or from the construction lender by way
24 of a stop notice. In addition, compensation may be sought from the payment bond. The final
25 clause of this section emphasizes that the preliminary 20-day notice should not be used with
26 regard to home improvement contracts. The notice is not necessary and serves no purpose in this
27 context, and it would be confusing to recipients. Sureties, lenders, and others may contract for
28 notice as desired.

29 See also Sections 3084 (“claim of lien” defined), 3085 (“claimant” defined), 3103 (“stop
30 notice” defined).

31 **§ 3244.60. Penalty for noncompliance with bonding requirement**

32 3244.60. The failure of a prime contractor to comply with the requirements of
33 this article is a cause for disciplinary action by the Contractors’ State License
34 Board.

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

37 See also Section [3097 (“prime contractor” defined)]; Bus. & Prof. Code § 7000 *et seq.*
38 (Contractors’ State License Law).

39 **§ 3244.70. Regulatory authority**

40 3244.70. (a) The Contractors’ State License Board shall, by regulation, provide
41 standard terms for payment bonds required by this article, and shall set standards
42 for blanket payment bonds satisfying the requirements of this article.

43 (b) The Contractors’ State License Board shall, by regulation, provide the
44 contents of the direct pay notice under Section 3244.40.

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

5 **Uncodified (added). Operative date**

6 SEC. _____. This act becomes operative on January 1, 2004, except that the
7 authority granted the Contractors’ State License Board to make regulations
8 governing forms and notices, and any related implementing regulations, becomes
9 operative on January 1, 2003.

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

1 CONFORMING REVISIONS

2 BUSINESS AND PROFESSIONS CODE

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

4 SEC. _____. Section 7018.5 of the Business and Professions Code Section is
5 amended to read:

6 7018.5. (a) The board, by regulation, shall prescribe ~~a form~~ forms entitled
7 “Notice to Owner (General)” and “Notice to Owner (Home Improvement)” or
8 other appropriate titles, which shall state: include the following information, in
9 plain, nontechnical language:

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

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

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

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

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

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

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

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

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

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

21 (4) Upon making payment on any completed phase of the project, and before
22 making any further payments, require your contractor to provide you with
23 unconditional "Waiver and Release" forms signed by each material supplier,
24 subcontractor, and laborer involved in that portion of the work for which payment
25 was made. The statutory lien releases are set forth in exact language in Section
26 3262 of the Civil Code. Most stationery stores will sell the "Waiver and Release"
27 forms if your contractor does not have them. The material suppliers,
28 subcontractors, and laborers that you obtain releases from are those persons or
29 entities who have filed preliminary notices with you. If you are not certain of the
30 material suppliers, subcontractors, and laborers working on your project, you may
31 obtain a list from your contractor. On projects involving improvements to a single-
32 family residence or a duplex owned by individuals, the persons signing these
33 releases lose the right to file a mechanics' lien claim against your property. In
34 other types of construction, this protection may still be important, but may not be
35 as complete.

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

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

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

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

12 SEC. _____. Section 7159 of the Business and Professions Code Section is
13 amended to read:

14 7159. (a) This section applies only to home improvement contracts, as defined in
15 Section 7151.2, between a contractor, whether a general contractor or a specialty
16 contractor, who is licensed or subject to be licensed pursuant to this chapter with
17 regard to the transaction and who contracts with an owner or tenant for work upon
18 a residential building or structure, or upon land adjacent thereto, for proposed
19 repairing, remodeling, altering, converting, modernizing, or adding to the
20 residential building or structure or land adjacent thereto, and where the aggregate
21 contract price specified in one or more improvement contracts, including all labor,
22 services, and materials to be furnished by the contractor, exceeds five hundred
23 dollars (\$500).

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

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

29 (a)

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

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

34 (b)

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

37 (c)

38 (4) A plan and scale drawing showing the shape, size, dimensions, and
39 construction and equipment specifications for a swimming pool and for other
40 home improvements, a description of the work to be done and description of the
41 materials to be used and the equipment to be used or installed, and the agreed
42 consideration for the work.

1 (d)

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

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

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

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

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

39 ~~(g) (7) The requirements set forth in subdivisions (d), (e), and (f) paragraphs (5)~~
40 ~~and (6) do not apply when the contract provides for the contractor to furnish a~~
41 ~~performance and payment bond, lien and completion bond, bond equivalent, or~~
42 ~~joint control approved by the registrar covering full performance and completion~~
43 ~~of the contract and the bonds or joint control is or are furnished by the contractor,~~

1 or when the parties agree for full payment to be made upon or for a schedule of
2 payments to commence after satisfactory completion of the project.

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

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

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

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

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

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

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

18 (h)

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

30 (i)

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

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

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

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

42 ~~(m)-~~

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

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

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

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

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

15 ~~For purposes of this section, the board shall, by regulation, determine what~~
16 ~~constitutes “without lawful excuse.”~~

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

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

25 ~~(n)~~

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

39 ~~(o)~~

40 (n)(1) An indictment or information against a person who is not licensed, but
41 who is required to be licensed under this chapter, shall be brought, or a criminal
42 complaint filed, for a violation of this section within four years from the date the
43 buyer signs the contract.

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

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

6 (o) For purposes of this section, the board shall, by regulation, determine what
7 constitutes “without lawful excuse.”

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

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

17 The reference in former subdivision (f) (now subdivision (c)(6)) to Civil Code Section 3114 has
18 been deleted because it was incorrect. Omitting this language has no effect on the substance of
19 this provision. When the cross-reference was enacted in 1979, it described a person, other than
20 the contractor, who was entitled under Civil Code Section 3114 to enforce a mechanic’s lien. See
21 former Bus. & Prof. Code § 7167, as enacted by 1979 Cal. Stat. ch. 747, § 2. The cross-reference
22 was incorporated into Section 7159 in 1991, but in a form that corrupted the original purpose. See
23 1991 Cal. Stat. ch. 1160, § 45 (amending Section 7159), § 50 (repealing former Section 7167).

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

25 SEC. _____. Section 7167 of the Business and Professions Code is amended to
26 read:

27 7167. Any A contract the whose primary purpose ~~of which~~ is the construction of
28 a swimming pool ~~which~~ and that does not substantially comply with the applicable
29 provisions of subdivisions (b), (c), (d), (e), (f), and (h) paragraphs (2), (4), (5), and
30 (6) of subdivision (c), and subdivision (f), of Section 7159, shall be is void and
31 unenforceable by the contractor as contrary to public policy.

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

34 CIVIL CODE

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

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

37 3097. “Preliminary 20-day notice (private work)” means a written notice from a
38 claimant that is given prior to the recording of a mechanic’s lien, prior to the filing
39 of a stop notice, and prior to asserting a claim against a payment bond, and is
40 required to be given under the following circumstances:

41 (a) Except one under direct contract with the owner or one performing actual
42 labor for wages as described in subdivision (a) of Section 3089, or a person or
43 entity to whom a portion of a laborer’s compensation is paid as described in

1 subdivision (b) of Section 3089, or as provided in subdivision (q), every person
2 who furnishes labor, service, equipment, or material for which a lien or payment
3 bond otherwise can be claimed under this title, or for which a notice to withhold
4 can otherwise be given under this title, shall, as a necessary prerequisite to the
5 validity of any claim of lien, payment bond, and of a notice to withhold, cause to
6 be given to the owner or reputed owner, to the original contractor, or reputed
7 contractor, and to the construction lender, if any, or to the reputed construction
8 lender, if any, a written preliminary notice as prescribed by this section.

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

20 [Note. Subdivisions (c)-(p) are unchanged and are not reproduced here.]

21 (q) This section does not apply to home improvement contracts, to the extent
22 provided in Chapter 6 (commencing with Section 3235).

23 **Comment.** Section 3097 is amended, and subdivision (q) is added, to recognize the exception
24 in Section 3244.40 (home improvement contracts) to the general rule making the giving of a
25 preliminary notice a precondition to enforcement of other remedies.

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

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

28 3114. A Except as provided in Section 3244.40, a claimant shall be is entitled to
29 enforce a lien only if ~~he has given the a~~ preliminary 20-day notice (private work)
30 has been given in accordance with the provisions of Section 3097, if required by
31 that section, and has made proof of service in accordance with ~~the provisions of~~
32 Section 3097.1.

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

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

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

38 3123. (a) The liens provided for in this chapter ~~shall be~~ are direct liens, and shall
39 be for the reasonable value of the labor, services, equipment, or materials
40 furnished or for the price agreed upon by the claimant and the person with whom
41 ~~he or she~~ the claimant contracted, whichever is less. The lien ~~shall is~~ not be limited
42 ~~in amount by the price stated in the contract, as defined in Section 3088~~ between

1 the owner and the original contractor, except as provided in Sections ~~3235 and~~
2 ~~3236 and in subdivision (c) of this section and in Chapter 6 (commencing with~~
3 ~~Section 3235).~~

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

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

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

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

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

19 3159. (a) ~~Any of the persons named~~ A claimant described in Sections ~~Section~~
20 ~~3110, 3111, and or 3112~~ may, prior to the expiration of the period within which
21 ~~his or her~~ the ~~claim of lien must is required to~~ be recorded under Chapter 2
22 (commencing with Section 3109), give to a construction lender a stop notice or a
23 bonded stop notice. The construction lender ~~shall be~~ is subject to the following
24 duties:

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

30 (2) The construction lender shall withhold funds pursuant to a bonded stop
31 notice filed by ~~any other person named in Sections~~ a claimant described in Section
32 ~~3110, 3111, and or 3112, other than an original contractor~~, unless a payment bond
33 has previously been recorded ~~in the office of the county recorder where the site is~~
34 ~~located in accordance with Section 3235 pursuant to Chapter 6 (commencing with~~
35 ~~Section 3235).~~ If a payment bond has previously been recorded, the construction
36 lender may, at its option, withhold funds pursuant to the ~~bonded~~ stop notice or
37 bonded stop notice, or may elect not to withhold pursuant to the ~~bonded~~ stop
38 notice or bonded stop notice given by anyone other than an original contractor.


39 (3) If, when giving the construction lender the stop notice or bonded stop notice,
40 the claimant makes a written request for notice of the election, accompanied by a
41 preaddressed, stamped envelope, the construction lender shall furnish the claimant
42 a copy of the bond within 30 days after making the election. A lender ~~shall~~ is not

1 be liable for a failure to furnish a copy of the bond if the failure was not intentional
2 and resulted from a ~~bona fide~~ good faith error, if the lender maintains reasonable
3 procedures to avoid such an this type of error, and if the error was corrected not
4 later than 20 days from the date on which the violation was discovered. The
5 payment bond may be recorded at any time prior to the ~~servicing~~ service of the first
6 stop notice. The notice may only be given for materials, equipment, or services
7 furnished, or labor performed.

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

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

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

23  **Note.** This section is identical to Section 3162, except for the different wording of the first
24 sentence of subdivision (a) and the last sentence of subdivision (a)(3), which does not appear in
25 Section 3162. This confusing and needless repetition is likely to be the subject of amendments in
26 the general revision of the mechanic's lien statute.

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

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

29 3160. Service of a stop notice or a bonded stop notice ~~shall be~~ is effective only if
30 the claimant has satisfied both of the following requirements:

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

34 (b) Served ~~his~~ the stop notice as ~~defined in Section 3103 or his~~ or bonded stop
35 notice as ~~defined in Section 3083~~ prior to the expiration of the period within which
36 ~~his a~~ claim of lien ~~must~~ is required to be recorded under Section 3115, 3116, or
37 3117.

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

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

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

3 3161. ~~It shall be the duty of the owner upon~~ (a) Upon receipt of a stop notice
4 pursuant to Section 3158 ~~to, the owner shall~~ withhold from the original contractor
5 or from any person acting under his or her authority and to whom labor or
6 materials, or both, have been furnished, or agreed to be furnished, sufficient
7 money due or to become due to ~~such~~ the original contractor to answer such claim
8 and any claim of lien that may be recorded therefor, unless a payment bond has
9 been recorded pursuant to ~~the provisions of Section 3235 Chapter 6 (commencing~~
10 with Section 3235), in which case the owner may, but is not obligated to, withhold
11 ~~such~~ the money.

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

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

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

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

22 3162. (a) ~~Upon~~ Except as otherwise provided in this section, upon receipt of a an
23 unbonded stop notice pursuant to Section 3159, the construction lender may, and
24 upon receipt of a bonded stop notice the construction lender shall, ~~except as~~
25 ~~provided in this section,~~ withhold from the borrower or other person to whom it
26 the construction lender or the owner may be obligated to make payments or
27 advancement out of the construction fund, sufficient money to answer the claim
28 and any claim of lien that may be recorded therefor. The construction lender shall
29 be is subject to the following duties:

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

35 (2) The construction lender shall withhold funds pursuant to a bonded stop
36 notice filed by ~~any other person named in Sections~~ a claimant described in Section
37 3110, 3111, and or 3112, other than an original contractor, unless a payment bond
38 has previously been recorded ~~in the office of the county recorder where the site is~~
39 ~~located in accordance with Section 3235~~ pursuant to Chapter 6 (commencing with
40 Section 3235). If a payment bond has previously been recorded, the construction
41 lender may, at its option, withhold funds pursuant to the ~~bonded~~ stop notice or


1 bonded stop notice, or may elect not to withhold pursuant to the ~~bonded~~ stop
2 notice or bonded stop notice given by anyone other than an original contractor.

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

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

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

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

28  **Note.** This section is identical to Section 3159, except for the different wording of the first
29 sentence of subdivision (a) and the last sentence of Section 3159(a)(3), which does not appear in
30 this section. This confusing and needless repetition is likely to be the subject of amendments in
31 the general revision of the mechanic's lien statute.