

Second Supplement to Memorandum 2000-78

Mechanic's Liens (Homeowner's Recovery Fund)

Attached to this supplement is an edited version of a Homeowner's Lien Recovery Act based on a draft offered by Professor Clark Kelso and the Institute for Legislative Practice. The basic draft proposal was included in earlier materials, but not discussed in any detail. (See First Supplement to Memorandum 2000-47, Exhibit pp. 1-10, on agenda of July meeting in San Diego.)

The key to the proposal is a fee added to the building permit based on the value of the project. Professor Kelso believes that the fee could be in a modest amount, and tied to the value of the project, would avoid the regressive aspects of flat-fee indemnity fund proposals. It is recognized that the appropriate amount of the fee would need to be studied.

Prof. Kelso described the proposal as follows in his letter of July 18:

In an effort to assist the Law Revision Commission and the Legislature in their consideration of this issue, we propose an alternative solution to the problem of double-payment by homeowners. As we see it, the double-payment problem is best approached through an insurance-type program. Under current law, most homeowners are at risk of a double-payment situation, although most homeowners are either unaware of the risk or willing to take that risk in order to avoid the costs of protecting themselves against it. In an idealized world, an enlightened homeowner who wished to avoid the risk of a mechanics' lien would purchase insurance against such a risk (or would self-insure). Then, if a mechanic's lien is placed upon the property because of non-payment by the general contractor, and the owner has already paid the general contractor, the lien holder could be paid from the insurance funds, resulting in the lien being discharged.

....

Although AB 2113 [Honda, 1999-2000 session] is intended to protect homeowners, it proposes to finance the [Contractor Default Recovery Fund] by initially imposing a \$200 annual fee upon licensed home improvement contractors and giving the Contractors' State License Board the responsibility for

recommending adjustments to the fee to meet the projected claims over the next year.

On first glance, it is arguably appropriate to finance the CDRF from fees paid by home improvement contractors since those contractors, as well as home owners, stand to benefit from creation of the CDRF. However, under current law, home improvement contractors already have a potent weapon to collect payments through the lien law, a weapon that has constitutional support. Thus, from the perspective of home improvement contractors who are comparing AB 2113 with existing law, AB 2113 increases the cost of doing business without creating significantly greater security for payment than currently exists. Moreover, it is not at all clear that the burden of additional fees would actually weigh equally upon all contractors. For example, sub-contractors who have established long-standing, stable relationships with general contractors and who may never face the problem of non-payment will be required to pay the same fee as sub-contractors who are at a much greater risk of non-payment.

Arguably, since AB 2113 would impose the identical fee upon all home improvement contractors, the increased costs would ultimately be borne, at least in some measure, by homeowners (since subcontractors would attempt to pass the increased cost to general contractors who, in turn, would attempt to pass the increased cost to homeowners). Since the primary benefit of AB 2113 is to homeowners (compared to existing law), it is appropriate that homeowners be responsible for paying for any statewide insurance program.

Our proposal builds upon Assemblyman Honda's AB 2113. As with AB 2113, we propose creation of a fund, called the Homeowner's Relief Recovery Fund ("HRRF"), to be administered by the Contractors' State License Board, which would be used to make payments to sub-contractors or homeowners in situations where the homeowner has already paid the general contractor for work performed by the sub-contractor (we are uncertain whether the program is best administered by having a sub-contractor make a claim against the fund or having a homeowner make a claim against the fund). Since the primary benefit of the fund is to homeowners, we propose that a modest Homeowner's Lien Protection Fee be added to residential building permit fees. The Homeowner's Lien Protection Fee would be collected by the local jurisdiction at the time a residential building permit is issued and, after a deduction for local expenses associated with collection of the fee, would be forwarded to the State Treasury for deposit in the HRRF.

We are not breaking any new ground in proposing that a state fund be financed by fees on building permits. The Strong Motion

Instrumentation Program (Pub. Res. Code §§ 2700-2709.1) requires that all persons receiving building permits pay an additional fee, the amount of which is in relation to the total value of all labor and material to be used within a building project. Pub. Res. Code § 2705. Thus, there is already a mechanism for using county and city building permit fees to support a statewide program.

As with the Strong Motion Instrumentation Program, we propose funding the Homeowner's Relief Recovery Fund through a small fee added to the fees already charged for the issuance of residential building permits which are issued to the homeowner or land improver. This fee would be a small fraction of the value of the proposed improvement, including the value of all labor and materials used. Under this approach, the cost of protecting homeowners against the risk of double-payment will be borne by homeowners themselves, which is appropriate since they are the ones who most directly benefit from the change in law proposed by this legislation.

Because of the uncertainty regarding the exact scope of the double-payment problem, we have not attempted to suggest how large the fee should be to provide sufficient funds for the Homeowner's Relief Recovery Fund to operate properly. However, if a reliable estimate of the yearly costs can be developed, it will be a straightforward process to determine the rate for the fee based upon the funds raised by the Strong Motion Instrumentation Program.

This looks like an interesting approach that may solve some of the problems with recovery fund proposals. Gordon Hunt has recommended consideration of this proposal as a backup alternative to the mandatory 50% bond approach considered at the October meeting. (See First Supplement to Memorandum 2000-63 & Exhibit pp. 5-6.) Adam Streltzer has seconded Mr. Hunt's remarks in a letter attached to the main memorandum. (See Memorandum 2000-78, Exhibit p. 7.)

If time permits, we would like to work through the draft proposal at the December meeting to get an idea of how well it might work and find out what interested persons have to say about its details.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

HOMEOWNER’S LIEN RECOVERY ACT PROPOSAL

Staff Note. This draft is a modified version of the “Homeowner’s Relief Recovery Act” materials submitted by Prof. J. Clark Kelso and the Institute for Legislative Practice. The staff has revised some section numbers and made other editorial revisions to conform, in part, to Commission drafting style. Additional revisions were necessary because the term “claimant” appear to have been used to refer to both the homeowner and the lienholder. The staff is not certain that all the issues have been resolved in this connection, but we will continue to work with the original drafters to clarify doubtful points. The term “prime contractor” has been substituted for “original contractor” for consistency with an earlier Commission decision. Other definitions have been revised from the original proposal to avoid using terms in the general mechanic’s lien statute that have a different meaning in this statute. If the Commission decides to pursue this proposal, we would provide Comments and make additional technical changes. For the original draft, see First Supplement to Memorandum 2000-47, Exhibit pp. 1-10.

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Civ. Code §§ 3155-3155.16 (added). Homeowner’s Lien Recovery Act

SECTION 1. Article 8 (commencing with Section 3155) is added to Chapter 2 of Title 15 of Part 4 of Division 3 of the Civil Code, to read:

Article 8. Homeowner’s Lien Recovery Act

§ 3155. Short title

3155. This article may be cited as the Homeowner’s Lien Recovery Act.

1 **§ 3155.01. Definitions**

2 3155.01. Unless the provision or context otherwise requires, the following
3 definitions govern the construction of this article:

4 (a) “Board” means the Contractors’ State License Board.

5 (b) “Full payment” or “paid in full” means that the person who provided labor,
6 services, equipment, or material has received compensation equal to its reasonable
7 value. A person is not considered to have been paid in full if 10 percent or more of
8 any retention proceeds have been withheld.

9 (c) “Fund” means the Homeowner’s Lien Recovery Fund established by this
10 article.

11 (d) “Home” means an existing single-family dwelling that is the homeowner’s
12 primary residence.

13 (e) “Homeowner” means the record owner of a home.

14 (f) “Lienholder” means a person not in direct contractual privity with the
15 homeowner, who has recorded a lien under this title and who has not been paid in
16 full.

17 (g) “Prime contractor” means a person who has a direct contractual relationship
18 with the homeowner to provide labor, services, equipment, or material toward a
19 work of improvement on the home.

20 **§ 3155.02. Precondition to bringing action to foreclose mechanic’s lien**

21 3155.02. (a) A lienholder may not commence an action under this title to enforce
22 a lien on a home unless (1) a hearing officer first determines, in a hearing held
23 pursuant to this article, that the homeowner has not paid the prime contractor in
24 full, or (2) the homeowner has not complied with subdivision (b).

25 (b) The homeowner’s protection under this article applies only if the homeowner
26 complies with all of the following requirements:

27 (1) Hires only a licensed prime contractor pursuant to a written contract.

28 (2) Prepares an affidavit that the homeowner has paid the prime contractor in
29 full.

30 (3) Records the affidavit not later than 30 days after [receiving notice of the
31 recording of a claim of lien by the lienholder]. [*Staff Note: the original draft ran*
32 *30 days after the preliminary notice given under Section 3097, but there is not*
33 *likely to be a dispute at that point in the process.*]

34 (4) Serves the affidavit on the lienholder.

35 **§ 3155.03. Establishment of fund, limits on recovery**

36 3155.03. (a) There is hereby established within the State Treasury the
37 Homeowner’s Lien Recovery Fund, which is hereby continuously appropriated for
38 the purpose of administering this article, including paying the compensation of
39 hearing officers appointed under this article, and providing monetary relief to a
40 lienholder.

1 (b) Notwithstanding any other provision, payments from the fund to satisfy
2 claims may not exceed the following amounts:

3 (1) Seventy-five thousand dollars (\$75,000) per home.

4 (2) Two hundred fifty thousand dollars (\$250,000) per homeowner over the
5 homeowner's lifetime.

6 (c) If claims against the fund exceed the limit in paragraph (1) of subdivision (b),
7 the amount shall be apportioned pro rata among the lienholders awarded
8 compensation from the fund.

9 (d) Except as provided in this article, the state is not liable for any claims against
10 the fund.

11 **§ 3155.04. Requirement of recorded lien**

12 3155.04. In order to establish a claim from the Homeowner's Lien Recovery
13 Fund, a homeowner shall provide evidence a lien is recorded against his or her
14 home pursuant to this title.

15 **§ 3155.05. Administration by Contractors' State License Board**

16 3155.05. (a) The board shall administer the fund and shall develop rules and
17 regulations to administer the fund pursuant to this article.

18 (b) The board may file a civil action against any licensed prime contractor in
19 order to obtain reimbursement to the fund for any payments made to a lienholder
20 upon a finding by a hearing officer that the prime contractor failed to pay the
21 lienholder in full.

22 **§ 3155.06. Determination and collection of fees**

23 3155.06. (a) Counties and cities shall collect a fee from each applicant for a
24 building permit. The fee shall be equal to a specific amount of the proposed
25 building construction for which the building permit is issued as determined by the
26 local building officials. The fee amount shall be assessed as follows:

27 (1) Homes shall be assessed at the rate of fifty dollars (\$50) per one hundred
28 thousand dollars (\$100,000), with appropriate fractions thereof. Of the amount
29 assessed, forty-five dollars (\$45) shall go to the fund and five dollars (\$5) shall go
30 to the local city or county collecting the fee.

31 (2) The fee shall be assessed on all works of improvement performed on existing
32 homes and homes where construction is yet to commence.

33 (3) The fee shall only be assessed on building permits homes and no other
34 building permit applicants may be assessed the fee under this section.

35 (b) The board shall annually determine whether the fees collected are sufficient
36 to meet the projected claims over the next year and annually report to the
37 Legislature on the need to increase or decrease fees. In making this determination,
38 the board shall exclude in any fund balance moneys in the fund that are
39 encumbered by claims approved pursuant to this article.

40 (c) The board is responsible for an annual review or audit of the fund.

1 **§ 3155.07. Deposit of fees**

2 3155.07 All fees collected pursuant to 3155.06, except those retained by the
3 local city or county collecting the fee, shall be deposited in the State Treasury in
4 the Homeowner's Lien Recovery Fund, which is hereby created, to be used
5 exclusively for the purposes of this article.

6 **§ 3155.08. Extension of lien foreclosure period**

7 3155.08. Notwithstanding [any other provision of law], the time for a lienholder
8 to bring an action to foreclose a lien is extended to 60 days after service of the
9 decision by a hearing officer regarding the homeowner's claim against the fund.

10 **§ 3155.09. Claim against fund**

11 3155.09. Within 90 days after a lienholder has recorded a lien on a home, the
12 homeowner shall file a claim with the board. This claim shall include the
13 following:

14 (a) A copy of the contract, purchase order, invoices, delivery tickets, credit
15 application, or other documentation evidencing the homeowner's contractual
16 relationship with the prime contractor.

17 (b) A copy of any preliminary notice given by the lienholder to the homeowner,
18 together with the proof of service, if the lienholder is otherwise required to serve a
19 preliminary notice.

20 (c) A copy of the lien recorded in the office of the county recorder.

21 (d) A statement of account showing all charges and credits, and any balance due.

22 (e) Proof of service of the appropriate documents described in subdivisions (a) to
23 (d), inclusive, on both the prime contractor and the lienholder.

24 **§ 3155.10. Notice of homeowner's claim, response**

25 3155.10. (a) Promptly after the homeowner's claim has been filed with the board
26 under Section 3155.09, the board shall notify the prime contractor and the
27 lienholder of the filing.

28 (b) The prime contractor's response shall be filed within 15 days after receipt of
29 the notice. The response shall state in detail the defense against the homeowner's
30 claim and include all documents the respondent claims support the defense. If the
31 prime contractor contends that it has not been paid in full, the prime contractor
32 shall provide a copy of all documents in support of this contention.

33 (c) The homeowner, the prime contractor, and the lienholder shall submit any
34 other information to assist the hearing officer to make the determinations required
35 by this article.

36 **§ 3155.11. Default by prime contractor**

37 3155.11. If the prime contractor fails to respond to the homeowner's claim, the
38 hearing officer shall find that the homeowner paid the prime contractor in full and
39 shall determine the value of the claim based on the documentation provided.

1 **§ 3155.12. Hearing date**

2 3155.12. The board shall set a hearing date within 60 days of receipt of the
3 homeowner's claim at the office of the board nearest to the site of the work of
4 improvement before the hearing officer. To the extent possible, all claims
5 submitted on the same project shall be consolidated and heard at the same hearing.
6 The board shall give notice of the date, time, and location of the hearing to the
7 parties.

8 **§ 3155.13. Determinations at hearing**

9 3155.13. (a) At the hearing, the hearing officer shall first determine whether the
10 homeowner has paid the prime contractor in full.

11 (b) If the hearing officer determines that the homeowner has not paid the prime
12 contractor in full, the hearing officer shall dismiss the claim and issue a finding
13 that the lienholder may pursue foreclosure of its lien.

14 (c) If the hearing officer determines that the homeowner has paid the prime
15 contractor in full, the hearing officer shall determine the validity and reasonable
16 value of the claim and, if it is determined to be valid, enter an order directing the
17 board to pay the amount of the claim to the lienholder from the fund, subject to the
18 limitations in subdivision (b) of Section 3155.03.

19 **§ 3155.14. Conduct of hearing, qualifications of hearing officers**

20 3155.14. (a) The hearing shall be conducted in accordance with Chapter 5
21 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the
22 Government Code.

23 (b) A hearing officer appointed by the board shall be an attorney licensed to
24 practice in this state with at least five years of experience in mechanic's lien law.

25 **§ 3155.15. Obligations of parties**

26 3155.15. (a) The hearing officer's findings are final and impose obligations on
27 the homeowner, prime contractor, and lienholder only to the extent that the
28 homeowner, prime contractor, or lienholder agree to be bound by the obligations.
29 The remedies available to a party under this article, including the right to receive
30 payment from the fund, are not available to a party that does not agree to the
31 obligations. A lienholder is deemed to agree to the obligations only by recording a
32 release of the lien in the county recorder's office where the real property is
33 located. The hearing officer's findings may be entered into evidence in a later civil
34 action or proceeding. The findings of the hearing officer shall be served on the
35 homeowner, the prime contractor, the lienholder, and the board not later than 10
36 days after the hearing.

37 (b) Following receipt of an order pursuant to Section 3155.13, within 10 days
38 after receiving evidence that the lienholder has recorded a release of its lien in the
39 county recorder's office where the real property is located, the board shall pay the
40 amount of the homeowner's claim, subject to the limitations in subdivision (b) of

1 Section 3155.03. This evidence shall be submitted within 15 days after the hearing
2 officer's findings are served.

3 **§ 3155.16. Contractor's license suspension**

4 3155.16. A finding by the hearing officer that the prime contractor was paid in
5 full and failed to make timely payments to a lienholder on the work of
6 improvement, except a finding made pursuant to Section 3155.11, is grounds for
7 immediate suspension of the prime contractor's license. The prime contractor shall
8 be given notice of a hearing to challenge the finding, which shall be conducted
9 within 60 days of the date of the suspension, pursuant to the procedures of the
10 board. If the finding is sustained, the prime contractor's license shall be
11 immediately revoked and may not be reinstated until the prime contractor can
12 supply to the board a license bond as provided in Section 7071.8 of the Business
13 and Professions Code in the amount of fifty thousand dollars (\$50,000).

14 **§ 3155.17. Forms**

15 3155.17. The county recorder shall make available forms for the affidavit
16 described in Section 3155.02 and a notice regarding the homeowner's rights under
17 this article. The Judicial Council shall adopt forms for the affidavit and the notice.

18 **Uncodified**

19 **SEC. 2.** No reimbursement is required by this act pursuant to Section 6 of Article
20 XIII B of the California Constitution for certain costs that may be incurred by a
21 local agency or school district because in that regard this act creates a new crime
22 or infraction, eliminates a crime or infraction, or changes the penalty for a crime or
23 infraction, within the meaning of Section 17556 of the Government Code, or
24 changes the definition of a crime within the meaning of Section 6 of Article XIII B
25 of the California Constitution.

26 However, notwithstanding Section 17610 of the Government Code, if the
27 Commission on State Mandates determines that this act contains other costs
28 mandated by the state, reimbursement to local agencies and school districts for
29 those costs shall be made pursuant to Part 7 (commencing with Section 17500) of
30 Division 4 of Title 2 of the Government Code. If the statewide cost of the claim
31 for reimbursement does not exceed one million dollars (\$1,000,000),
32 reimbursement shall be made from the State Mandates Claims Fund.

33
