

## Memorandum 2007-45

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

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This memorandum continues a discussion of comments on the public work part of the Commission's tentative recommendation on *Mechanics Lien Law* (June 2006). A supplement to this memorandum will discuss one final issue relating to a mandatory payment bond remedy on a "hybrid" work of improvement.

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

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

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

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

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

## WAIVER AND RELEASE ISSUES

### **Form of Waiver and Release of Public Work Right**

Proposed Public Contract Code Section 42310, continuing existing law, provides that a public entity or direct contractor may not impair any right granted to a claimant under the public work part of the proposed law, other than by a “waiver and release” specified in the section:

#### **§ 42310. Terms of contract**

42310. (a) A public entity or direct contractor may not, by contract or otherwise, waive, affect, or impair a claimant’s rights under this part, whether with or without notice, except with the claimant’s written consent, and any term of a contract that purports to do so is void and unenforceable.

(b) A claimant’s written consent is void and unenforceable unless and until the claimant executes and delivers a waiver and release under this article.

**Comment.** Section 42310 continues the first and second sentences of former Civil Code Section 3262(a) without substantive change, to the extent they related to a public works contract.

....

The Department of Water Resources (hereinafter “DWR”) asserts that Section 42310 is inconsistent with proposed Public Contract Code Section 42340, and that a portion of Section 42310 should therefore be deleted. CLRC Memorandum 2007-25, Exhibit p. 3.

Section 42340 provides that a public work claimant may release one particular public work right, a stop payment notice claim, as follows:

#### **§ 42340. Reduction or release of stop payment notice**

42340. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall be in writing and may be given in a form other than a waiver and release form provided in this article.

....

**Comment.** Section 42340 restates the second, third, and fourth sentences of subdivision (b) of former Civil Code Section 3262, to the extent they related to a public works contract.

....

DWR’s assertion appears to be based on the fact that under Section 42310, the relinquishment of *any* public work right requires a “waiver and release” under the article in which Section 42310 appears, whereas Section 42340 provides that

the relinquishment of *one* of those public work rights (the reduction or release of a stop payment notice) may occur by “*other* than a waiver and release form” provided in that same article.

Upon close examination however, the staff does not believe that the two sections are inconsistent.

Section 42310 does provide that the relinquishment of any public work right, including the release of a stop payment notice, requires a “waiver and release” under the article in the proposed law containing Section 42310.

However, Section 42340 is *one of the sections in that article*, which provides for how the “waiver and release” of a stop payment notice claim may occur. Per Section 42340, a waiver and release of this particular public work right must be in writing, and otherwise need not be in any particular form (such as a form required for certain *other* waivers and releases addressed in the article).

**The staff does not recommend a revision of Section 42310 to address the issue raised by DWR.**

### **Conditions for Waiver and Release**

Proposed Public Contract Code Section 42320 specifies certain conditions for a valid waiver and release of rights by a claimant:

#### **§ 42320. Waiver and release**

42320. A claimant’s waiver and release does not release the public entity or surety on a payment bond from a claim unless both of the following conditions are satisfied:

(a) The waiver and release is in substantially the form provided in this article and is signed by the claimant.

(b) If the release is a conditional release, there is evidence of payment to the claimant. Evidence of payment may be either of the following:

(1) The claimant’s endorsement on a single or joint payee check that has been paid by the financial institution on which it was drawn.

(2) Written acknowledgment of payment by the claimant.

DWR contends that Section 42320 is also inconsistent with Section 42340, relating to the release of a stop payment notice claim, presumably for the same reason discussed in the previous section of this memorandum. CLRC Memorandum 2007-25, Exhibit p. 3. DWR suggests — without further explanation — that Section 42320 be deleted in its entirety.

Again, the staff does not see the inconsistency. Section 42320(a) requires that any waiver and release must be in substantially the form provided “*in this article.*” Section 42340 is a section in that article. Thus, a release given under Section 42340 should satisfy Section 42320(a).

**The staff does not recommend revising or deleting Section 42320 based on DWR’s suggestion.**

### **Effect of Statement of Claimant on Claim**

Proposed Public Contract Code Section 42330 describes the effect of a statement made by a claimant on a pending claim:

#### **§ 42330. Statement of claimant**

42330. An oral or written statement purporting to waive, release, impair or otherwise adversely affect a claim is void and unenforceable and does not create an estoppel or impairment of the claim unless either of the following conditions is satisfied:

(1) The statement is pursuant to a waiver and release under this article.

(2) The claimant has actually received payment in full for the claim.

**Comment.** Section 42330 continues former Civil Code Section 3262(b) without substantive change, to the extent it related to a public works contract.

....

Without explanation, DWR suggests that Section 42330 be revised as follows:

#### **§ 42330. Statement of claimant**

42330. An oral or written statement purporting to amend, withdraw, waive, release, impair or otherwise ~~adversely~~ affect a claim is void and unenforceable and does not create an estoppel or impairment of the claim unless ~~either~~ one of the following conditions is satisfied:

~~(1) The statement is pursuant to a waiver and release under this article.~~

~~(2) The claimant has actually received payment in full for the claim.~~

(1) The claimant has acknowledged receipt of payment in full for the claim.

(2) The claimant has served documentation on the public entity that substantially conforms to the requirements of Section 44120 setting forth the conditions of any amendment, withdrawal, waiver or release of the claim.

(3) Satisfaction of a final judgment on or entry of a dismissal with prejudice of an action by claimant on the claim.

CLRC Memorandum 2007-25, Exhibit p. 3.

Section 42330 accurately continues language from existing Civil Code Section 3262(b) without substantive change. Each of DWR's suggested revisions would appear to make substantive changes to existing law.

The text of Section 3262 was considered by the Legislature, and substantively amended, in 2006. In the absence of any demonstrated problem with the provision as continued by proposed Section 42330, **the staff does not recommend substantive revision of the section in the context of this study.**

## **Reduction or Release of Stop Payment Notice**

### *Partial Release*

As previously discussed, proposed Public Contract Code Section 42340 provides rules for a claimant's reduction or release of a stop payment notice claim:

#### **§ 42340. Reduction or release of stop payment notice**

42340. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall be in writing and may be given in a form other than a waiver and release form provided in this article.

(b) A claimant's reduction or release of a stop payment notice has the following effect:

(1) The reduction or release releases the claimant's right to enforce payment of the claim stated in the notice to the extent of the reduction or release.

(2) The reduction or release releases the public entity from the obligation to withhold funds pursuant to the notice to the extent of the reduction or release.

(3) The reduction or release does not preclude the claimant from giving a subsequent stop payment notice that is timely and proper.

(4) The reduction or release does not release any right of the claimant other than the right to enforce payment of the claim stated in the stop payment notice to the extent of the reduction or release.

Comments on that provision are discussed below.

### *Service on Public Entity*

DWR suggests that Section 42340 expressly require that the reduction or release described by the section be served on the public entity in accordance with applicable notice provisions of the proposed law. CLRC Memorandum 2007-25, Exhibit pp. 3-4.

The staff believes DWR's suggestion has merit. The writing required by Section 42340 is similar in form to other notices given on a public work.

The staff recommends that **Section 42340(a) be revised to read:**

**§ 42340. Reduction or release of stop payment notice**

42340. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall ~~be in writing and~~ comply with Article 2 (commencing with Section 42100). The reduction or release may be given in a form other than a waiver and release form provided in this article.

*Amount Withheld After Partial Release*

The Regents of the University of California ("UC") report significant confusion over the sum it must withhold after a claimant partially releases (i.e., reduces) a stop payment notice. CLRC Memorandum 2006-39, Exhibit p. 83. UC suggests that a reduction of a stop payment notice state the dollar amount to remain withheld after the reduction.

That seems sensible. The staff recommends that **Section 42340 be revised as follows:**

**§ 42340. Reduction or release of stop payment notice**

42340. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall be in writing and may be given in a form other than a waiver and release form provided in this article.

(b) The writing shall identify whether it is a reduction of the amount of the stop payment notice, or a release of the notice in its entirety. If the writing is a reduction, it shall state the amount of the reduction, and the amount to remain withheld after the reduction.

(c) A claimant's reduction or release of a stop payment notice has the following effect:

(1) The reduction or release releases the claimant's right to enforce payment of the claim stated in the notice to the extent of the reduction or release.

(2) The reduction or release releases the public entity from the obligation to withhold funds pursuant to the notice to the extent of the reduction or release.

(3) The reduction or release does not preclude the claimant from giving a subsequent stop payment notice that is timely and proper.

(4) The reduction or release does not release any right of the claimant other than the right to enforce payment of the claim stated in the stop payment notice to the extent of the reduction or release.

**Comment.** Subdivisions (a) and (c) of Section 42340 restates ~~restate~~ the second, third, and fourth sentences of subdivision (b) of

former Civil Code Section 3262, to the extent they related to a public works contract.

Subdivision (b) of Section 42340 is new.

....

**A similar revision should be made to the corresponding provision relating to the reduction of a private work stop payment notice:**

**§ 7166. Reduction or release of stop payment notice**

7166. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall be in writing and may be given in a form other than a waiver and release form provided in this article.

(b) The writing shall identify whether it is a reduction of the amount of the stop payment notice, or a release of the notice in its entirety. If the writing is a reduction, it shall state the amount of the reduction, and the amount to remain withheld.

(c) A claimant's reduction or release of a stop payment notice has the following effect:

(1) The reduction or release releases the claimant's right to enforce payment of the claim stated in the notice to the extent of the reduction or release.

(2) The reduction or release releases the public entity from the obligation to withhold funds pursuant to the notice to the extent of the reduction or release.

(3) The reduction or release does not preclude the claimant from giving a subsequent stop payment notice that is timely and proper.

(4) The reduction or release does not release any right of the claimant other than the right to enforce payment of the claim stated in the stop payment notice to the extent of the reduction or release.

**Comment.** Subdivisions (a) and (c) of Section 7166 ~~restates~~ restate the second, third, and fourth sentences of subdivision (b) of former Civil Code Section 3262.

Subdivision (b) of Section 42340 is new.

See also Sections 7002 ("claimant" defined), 7032 ("person" defined), 7042 ("stop payment notice" defined).

*Use of Standard Forms for Release of Stop Payment Notice*

California State University ("CSU") requests clarification of a statement in the narrative part of the tentative recommendation, relating to the release of a stop payment notice:

Legislation operative January 1, 2006, makes clear that the general statutory waiver and release forms [contained in Civil Code Section 3262] are inapplicable to a claimant's release of a stop payment notice or reduction of the amount claimed in the notice.

Tentative Recommendation on *Mechanics Lien Law* (June 2006), p. 41 (footnote omitted).

CSU asserts the legislation referenced did not *preclude* the release of a stop payment notice by using a statutory waiver and release form contained in Civil Code Section 3262, as is implied by the tentative recommendation.

CSU is correct. The referenced legislation provides that use of the otherwise mandatory statutory forms in Civil Code Section 3262 is not required to release a stop payment notice, but the legislation did not expressly preclude the use of a statutory form for that purpose.

The staff recommends that **the statement in the tentative recommendation, when included in a final recommendation, be revised to read:**

Legislation operative January 1, 2006, makes clear that the general statutory waiver and release forms ~~are inapplicable to~~ need not be used for a claimant's release of a stop payment notice or **reduction** of the amount claimed in the notice.

**Further, to avoid any similar confusion in interpreting the text of Section 42340, the staff recommends that Section 42340 be revised as follows:**

§ 42340. Reduction or release of stop payment notice

42340. (a) A claimant may reduce the amount of, or release in its entirety, a stop payment notice. The reduction or release shall be in writing ~~and may be given in a form other than~~ , but need not be a waiver and release form provided in this article.

....

### **Accord and Satisfaction or Settlement Agreement**

Proposed Public Contract Code Section 42350 discusses the enforceability of either an accord and satisfaction or a settlement agreement of a pending public work claim:

#### **§ 42350. Accord and satisfaction or settlement agreement not affected**

42350. This article does not affect the enforceability of either an accord and satisfaction concerning a good faith dispute or an agreement made in settlement of an action pending in court if the accord and satisfaction or agreement and settlement make specific reference to the claim.

**Comment.** Section 42350 continues former Civil Code Section 3262(c) without substantive change, to the extent it related to a public works contract.

DWR asks whether Section 42350 should contain a cross-reference to Section 42340, to indicate the interaction between the two sections. CLRC Memorandum 2007-08, Exhibit p. 4.

Section 42350 already references the entire article in which Section 42340 appears. Adding a specific cross-reference to Section 42340 could create a negative inference relating to the impact of Section 42350 on the other sections in the article.

**The staff recommends against including a specific cross-reference to Section 42340 in Section 42350.**

### **Waiver and Release Forms**

Proposed Public Contract Code Sections 42360 through 42390 set forth standardized waiver and release forms for use in public works projects.

#### *Deletion of Standardized Forms*

DWR asserts that 2005 legislation makes clear that statutory forms are no longer required in public works projects, and urges that all four sections be deleted from the proposed law. CLRC Memorandum 2007-08, Exhibit p. 4.

DWR does not identify the specific legislation referenced in its comment. However, as best as the staff is able to determine, existing Civil Code Section 3262 (which was substantively amended in 2005) continues to require that any waiver and release of rights that a public entity or direct contractor seeks on a public works project (other than the reduction or release of a stop payment notice claim) must “follow substantially” the form language provided in the section. See Civ. Code § 3262(d). This requirement in Section 3262(d) is continued in proposed Public Contract Code Section 42320.

The American Insurance Association, National Association of Surety Bond Producers, and Surety & Fidelity Association of America (“joint surety commenters”) also object to the proposed law’s continuation of the statutory waiver and release forms, arguing that the form language is too restrictive. CLRC Memorandum 2006-39, Exhibit p. 100. The group asserts, as it did when commenting on the corresponding forms required on a private work, that parties to a construction project should enjoy greater freedom of contract, particularly once a project is underway.

In light of the Legislature’s recent consideration of Section 3262, the staff does not believe it appropriate to revisit the mandatory nature of the statutory forms

in the context of this study. That was the Commission decision regarding the corresponding private work provisions. See CLRC Memorandum 2006-48, pp. 25-26; CLRC Minutes (December 2006), p. 3.

**The staff does not recommend deletion of Sections 42360 through 42390.**

*Revision of Form Language*

Proposed Public Contract Code Sections 42360 and 42380 specify language that must be included in two of the waiver and release forms. Each section also allows certain identified items to be excepted from the coverage of the waiver and release form.

Mr. Sam Abdulaziz, an attorney in North Hollywood, suggests the exception language should be revised as follows:

**Exceptions**

This document does not affect any of the following:

- (1) Retentions.
- (2) Extras for which the claimant has not received payment.
- (3) The following requests for progress payments for which the claimant has previously given a conditional waiver and release but has not received payment:

....

CLRC Memorandum 2006-39, Exhibit p. 20.

Mr. Abdulaziz's concern appears to be that a "progress payment" for which a claimant "has not received payment" does not yet exist, and the reference may be confusing.

The Commission has previously considered and declined to adopt the same suggested revision of the two corresponding private work provisions. CLRC Memorandum 2006-48, p. 34; CLRC Minutes (December 2006), p. 3.

The staff believes the provision as worded is sufficiently clear, and the concern about Mr. Abdulaziz's suggestion remains the same. The revision could actually add confusion, by implying that what was excepted from the waiver and release were previous *requests* for progress payments, rather than the agreed upon progress payments themselves.

**The staff recommends against the suggested revision of the form language.**

## PRELIMINARY NOTICE ISSUES

### Content of Preliminary Notice

Proposed Public Contract Code Section 43030 specifies the required content of a preliminary notice given on a public work:

43030. A preliminary notice shall state with substantial accuracy all of the following:

(1) A general description of the labor, service, equipment, or material provided or to be provided.

(2) The name and address of the person providing the labor, service, equipment, or material.

(3) The name of the person that contracted for the labor, service, equipment, or material.

(4) A description of the site sufficient for identification.

**Comment.** Section 43030 restates part of the first sentence of former Civil Code Section 3098(a), and revises it for conformity with the preliminary notice for private work.

....

Gibbs, Giden, Locher & Turner LLP (“GGLT”), a law firm in Los Angeles, argues that the requirement that a public work preliminary notice state information “with substantial accuracy” will be a lightning rod for litigation, and urges deletion of the requirement. CLRC Memorandum 2006-48, Exhibit pp. 162-163. The firm points out that proposed Civil Code Section 7204, the section of the proposed law governing a private work preliminary notice, does not include this requirement.

GGLT is correct that proposed Section 7204 does not require information in a private work preliminary notice to be provided with “substantial accuracy.” However, that difference in treatment between proposed Civil Code Section 7204 and proposed Public Contract Code Section 43030 is in existing law. Compare Civ. Code §§ 3097, 3098(a).

Moreover, although the staff is not certain of the rationale underlying the different treatment in the two existing sections, the nature of the difference does not suggest inadvertence, particularly because the two sections were enacted as part of the same bill in 1969. Deletion of the “substantial accuracy” reference in proposed Section 43030 — or addition of the reference to the proposed law’s private work preliminary notice provision — could thus be a potentially substantive change in existing law.

The Commission also has received no information indicating that the “substantial accuracy” reference in existing Civil Code Section 3098 has been causing any problems.

**The staff recommends against deleting the reference to “substantial accuracy” in proposed Public Contract Code Section 43030.**

GGLT also points out that existing law requires that a private work preliminary notice contain “an estimate of the total price” of the work to be provided (Civ. Code § 3097(c)(1)), and suggests that the Commission add the same requirement for a preliminary notice on a public work. CLRC Memorandum 2006-39, Exhibit p. 163.

**GGLT’s concern has already been substantially addressed by the Commission’s recent approval of standardized notice provisions in the public work part of the proposed law.** Proposed Public Contract Code Section 42102(a)(5) provides that any notice given by a claimant on a public work shall include all of the following:

- (i) A general statement of the labor, service, equipment or material provided or to be provided by the claimant.
- (ii) ....
- (iii) A statement or estimate of the claimant’s demand, if any, after deducting all just credits and offsets.

See CLRC Memorandum 2007- 25, pp. 16-17; CLRC Minutes (June 2007), p. 3.

## STOP PAYMENT NOTICE ISSUES

### **Exclusivity of Stop Payment Notice Remedy**

Section 44110 provides that a claim against a public work construction fund may only be made pursuant to either a stop payment notice, or a direct written contract with the holder of the fund:

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

44110. The rights of all persons furnishing work pursuant to a public works contract, with respect to any fund for payment of construction costs, are governed exclusively by this chapter, and no person may assert any legal or equitable right with respect to such fund, other than a right created by direct written contract between such person and the person holding the fund, except pursuant to the provisions of this chapter.

**Comment.** Section 44110 restates former Civil Code Section 3264 to the extent it applied to a public works contract. ....

*Inconsistency with Other Provisions Relating to Public Construction Fund*

Laborers Group contends that the provision of existing law continued by Section 44110 should apply only to a private work of improvement, and Section 44110 thus does not belong in the proposed law. CLRC Memorandum 2007-34, Exhibit p. 9.

Laborers Group points out that there are other statutory provisions outside the mechanics lien law that provide for withholding of or payment from public funds on construction projects, without requiring either a stop payment notice or a written contract with the holder of the fund. See, e.g., Code Civ. Proc. § 708.760 (satisfaction of judgment against direct contractor on public work), Labor Code § 1727 (public entity to withhold amounts needed to satisfy prevailing wage violations from funds due direct contractor on public work).

At the August meeting, Laborers Group also noted that a claimant may assert a “right with respect to any fund for payment of construction costs” on a public work, by bringing a tort claim against the public entity for failure to require an approved payment bond. *N.V. Heathorn, Inc. v. County of San Mateo*, 126 Cal. App. 4th 1526, 25 Cal. Rptr. 3d 400 (2005).

Section 44110 arguably conflicts with these sections, and this holding.

*Existing Law*

Section 44110 continues Civil Code Section 3264, which provides as follows:

3264. The rights of all persons furnishing labor, services, equipment, or materials for any work of improvement, with respect to any fund for payment of construction costs, are governed exclusively by Chapters 3 (commencing with Section 3156) and 4 (commencing with Section 3179) of this title, and no person may assert any legal or equitable right with respect to such fund, other than a right created by direct written contract between such person and the person holding the fund, except pursuant to the provisions of such chapters.

The Chapter 4 referenced in Section 3264 is a chapter in the existing mechanics lien statute that applies *only* to public works. This reference is a strong indication that existing Section 3264 was intended to apply to both public and private work.

It does appear to be correct that statutes and holdings outside the mechanics lien law allow for the assertion of rights against a public work construction fund, by means other than a stop payment notice or direct contract claim. As existing Section 3264 — read literally — conflicts with those provisions and holdings, the continuation of Section 3264 in the proposed law would perpetuate that conflict.

But this conflict appears to be more of a theoretical problem than a real world problem. The staff doubts Section 3264 has been read to preclude claims of the type discussed above.

Instead, as discussed in the First Supplement to CLRC Memorandum 2007-08, pp. 1-6, it appears that the Legislature's primary intent in enacting Section 3264 was simply to compel claimants on a work of improvement seeking to assert a claim against a construction fund to follow established stop payment notice procedures. A secondary purpose would appear to have been to limit *equitable* (i.e., non-statutory) claims against an established construction fund, by any person.

#### *Recommendation*

Section 3264 was clearly intended to apply to a public work. That application should be preserved, as it serves an important purpose in limiting the exposure of a public construction fund. The section should be continued, in at least some form, in the proposed law.

A verbatim continuation of the language of the section would perpetuate the apparent conflict with other more specific statutory provisions and appellate decisions. However, that is the state of existing law, and the Commission has no evidence the conflict is causing any real world problem. Further, adding statutory exceptions to the general language of Section 3264 could suggest by negative implication that any exceptions not specifically mentioned *were* intended to be superseded by the proposed law.

**The staff believes the best course for the Commission to follow on this issue is to simply continue the existing language of the provision.** Doing so would avoid any unintended consequences, and would also preserve whatever common understanding currently exists among both practitioners and trial courts as to Section 3264, and its relationship with the other provisions and holding discussed above.

### *Rights of Sureties*

The American Insurance Association, National Association of Surety Bond Producers, and Surety & Fidelity Association of America (“joint surety commenters”) argue that Section 44110 should be revised to allow sureties rights against a public work construction fund. CLRC Memorandum 2006-39, Exhibit p. 100. At minimum, the group asserts that the section should not deprive sureties of rights they may already have under existing law.

The group raised both of the same contentions in connection with proposed Civil Code Section 7500, a virtually identical section of the proposed law governing claims against a construction fund on a private work. See CLRC Memorandum 2007-08, pp. 2-3; First Supplement to CLRC Memorandum 2007-08. The Commission declined to expand the scope of Section 7500 as requested, but did address the group’s second contention by revising Section 7500 to mirror the language of existing law. First Supplement to CLRC Memorandum 2007-08, p. 5-6, CLRC Minutes (April 2007), p. 3.

Subsequently, the Commission revised the language of proposed Public Contract Code Section 44110 in the same manner, to again mirror the language of existing law. See CLRC Memorandum 2007-25, pp. 9-10; CLRC Minutes (June 2007), p. 3.

At the Commission’s August meeting, the joint surety commenters supplemented their argument on this issue. The group noted that existing Civil Code Section 2849, a section generally relating to the rights of a surety against a creditor’s security, supports an argument that a surety may assert a claim against a construction fund.

Section 2849 does authorize a surety, under certain circumstances, to assert a claim against a direct contractor’s “security.” However, it is not clear whether a public work construction fund constitutes such security, and if so whether Section 2849 would be interpreted as superseding existing Section 3264.

In any event, Sections 2849 and 3264 are both a part of existing law. To avoid what might be significant unintended consequences, the staff advises preserving whatever balance currently exists between the two sections, by retaining each section’s existing language.

**The staff recommends against deletion or further revision of Section 44110.**

## **Signature and Verification of Stop Payment Notice**

In conjunction with the Commission's approval of standardized notice provisions in the public work part of the proposed law, many specific proposed notice provisions were revised or deleted, in order to avoid duplication. CLRC Memorandum 2007-25, pp. 15-23; CLRC Minutes (June 2007), p. 3.

As part of this process, proposed Public Contract Code Section 44120, a section relating to the content of a stop payment notice, was deleted as superfluous. However, a small substantive provision within Section 44120 should have been retained, since the provision is *not* duplicated elsewhere.

The staff recommends that **proposed Public Contract Code Section 44120 be reinstated in the public work part of the proposed law, to read as follows:**

### **§ 44120. Contents of stop payment notice**

44120. A stop payment notice shall comply with the requirements of Article 2 (commencing with Section 42100), and shall be signed and verified by the claimant.

## **Scope of Stop Payment Notice**

The proposed law does not contain a provision addressing what items may be claimed in a stop payment notice on a public work. Comments on that issue are discussed below.

### *Claim for Work Not Yet Performed*

Granite Rock Company ("Graniterock"), a material supplier and subcontractor, believes that the proposed law should specify just what work may be included in a public work stop payment notice. CLRC Memorandum 2006-39, Exhibit pp. 6-7. It points out that since a claimant may give a stop payment notice at any time after the claimant begins work, the proposed law may allow a stop payment notice to include a claim for work that has not yet been performed.

The Commission has previously discussed this issue at some length, in the context of a private work stop payment notice. CLRC Memorandum 2007-08, Exhibit pp. 12-14. In that discussion, the staff suggested that reasonably strong policy arguments could be made for allowing *or* prohibiting a stop payment notice for work that has not yet been performed. The staff also noted some ambiguous language in the existing law's definition of a stop payment notice which could support either conclusion.

However, the majority of commenters on the issue expressed the opinion that a stop payment notice may be given only for work already performed.

While leaving the door open for future consideration of any contrary legislative history, the Commission then decided to add the following language to the private work stop payment notice provision:

“The notice may only be given for the amount due the claimant for work provided.”

See proposed Civil Code Section 7502(b), CLRC Minutes (March 2007), p. 3.

The staff sees no reason for different treatment of a public work stop payment notice. **The language above should be added to the public work part of the proposed law.**

#### *Claim for Extra-Contractual Work*

The private work part of the proposed law also includes proposed Civil Code Section 7502(b), which clarifies the *kind* of work that may be included in a private work stop payment notice:

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

7502. ....

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

CLRC Memorandum 2007-08, pp. 4-5; CLRC Minutes (March 2007), p. 3.

That language is actually derived from existing law clarifying the nature of work that may be included in a mechanics lien claim. See existing Civ. Code § 3123(b). Most practitioners view the permissible scope of a private work stop payment notice as coextensive with the permissible scope of a mechanics lien claim. See CLRC Memorandum 2005-31, pp. 3-4.

The staff believes that the language in proposed Civil Code Section 7502(c) would also be helpful in proposed Public Contract Code Section 44120, relating to the content of a public work stop payment notice.

**The staff recommends that Section 44120 be revised to include the language from proposed Civil Code Section 7502(c), set out above. With both of the changes recommended above, proposed Public Contract Code Section 44120 would read as follows:**

**§ 44120. Contents of stop payment notice**

44120. (a) A stop payment notice shall comply with the requirements of Article 2 (commencing with Section 42100), and shall be signed and verified by the claimant.

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

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

**Comment.** Subdivisions (a) and (b) of Section 44120 supersede subdivisions (a)-(d) of former Section 3103. See also Sections 42100-42114 (notice). A stop payment notice may be executed by the claimant's agent. See Section 42090 (agency).

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

**Service of Stop Payment Notice**

Proposed Public Contract Code Section 44130 governs how a stop payment notice shall be given to a public entity:

**§ 44130. Giving of stop payment notice**

44130. (a) Except as provided in subdivision (b), a stop payment notice shall comply with the requirements of Article 2 (commencing with Section 42100).

(b) A stop payment notice shall be given to the public entity by giving the notice to the following person:

(1) In the case of a public works contract of the state, the director of the department that awarded the contract.

(2) In the case of a public works contract of a public entity other than the state, the office of the controller, auditor, or other public disbursing officer whose duty it is to make payment pursuant to the contract, or the commissioners, managers, trustees, officers, board of supervisors, board of trustees, common council, or other body by which the contract was awarded.

**Comment.** Section 44130 restates the first unnumbered paragraph of former Civil Code Section 3103.

DWR suggests that a stop payment notice should be given to a public entity in the same manner as other public work notices. CLRC Memorandum 2007-08, Exhibit p. 4. DWR also suggests that a copy of the notice should be given to the direct contractor.

Section 44130 accurately continues existing law, and DWR offers no reason to overturn a prior legislative determination of how a stop payment notice should be delivered.

DWR's second suggestion has some appeal. However, the staff believes it is common practice for a direct contractor to be notified when a stop payment notice is given, either by the claimant or by the public entity. If instead of relying on that common practice, the proposed law *required* that a claimant give a copy of a stop payment notice to the direct contractor, the staff is concerned that failure to adequately comply with this requirement could then be argued as a basis for invalidating the stop payment notice.

**The staff does not recommend the suggested revisions to Section 44130.**

### **Time For Giving Stop Payment Notice**

Proposed Public Contract Code Section 44140 is intended to identify the last date by which a claimant may give a stop payment notice:

#### **§ 44140. Time for giving notice**

44140. A stop payment notice is not effective unless given within 30 days after recordation of a notice of completion or, if a notice of completion is not recorded, within 90 days after completion.

**Comment.** Section 44140 restates former Civil Code Section 3184. ....

#### *Inconsistency with Existing Law*

The Association of California Surety Companies ("Surety Association") challenges the reference in Section 44140 to "30 days after recordation of a notice of completion," asserting that recordation of a notice of completion does not constitute "completion" under the proposed law. CLRC Memorandum 2006-39, Exhibit p. 123.

Surety Association is correct that the recordation of a notice of completion does not constitute "completion" under either existing or the proposed law.

However, Section 44140 nevertheless accurately continues existing law. Existing Civil Code Section 3184, the section which Section 44140 continues, sets time limits for giving a stop payment notice that are based on *either* the event of completion, *or* the recordation of a notice of completion.

### *Clarification of Language*

However, the staff does believe the use of the word “within” in Section 44140 may be problematic. As worded, the section could be read to require that a stop payment notice must be given *after* either recordation of a notice of completion, or the event of completion itself.

This would constitute an unintended and significant change in existing law, as the existing mechanics lien statute allows a stop payment notice to be given before completion.

To avoid any misreading, the staff recommends that **Section 44140 be revised as follows:**

#### **§ 44140. Time for giving notice**

44140. A stop payment notice is not effective unless given ~~within 30 days after recordation of a notice of completion or, if a notice of completion is not recorded, within 90 days after completion~~ before the earlier of the following times:

- (1) Ninety days after completion.
- (2) Thirty days after recordation of a notice of completion.



#### **Amount Withheld Upon Receipt of Stop Payment Notice**

A public entity that receives a stop payment notice from a claimant does not immediately pay the claimant the amount stated in the notice. Rather, the public entity’s obligation upon receipt of a stop payment notice is to *withhold* the amount stated in the notice from funds otherwise to be paid to the direct contractor. Civ. Code § 3186.

The amount then remains withheld (assuming the notice is not released) until the time for all stop payment notices on the job has expired, in order for the public entity to ascertain whether there remains a sufficient amount in the construction fund to pay all valid stop payment notice claims. If there is not, a pro rata calculation is made on each valid claim. Civ. Code § 3190.

In some cases litigation may be required, initiated either by the public entity or by a claimant, to determine how or whether to pay a stop payment notice claim.

Proposed Public Contract Code Section 44150 continues existing law on these points. On receipt of a stop payment notice, a public entity must withhold an amount sufficient to pay the claim stated in the notice, plus the reasonable anticipated cost to the public entity of any litigation that may be required based on the stop payment notice:

**§ 44150. Duty to withhold funds**

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

(b) The public entity may satisfy its duty under this section by refusing to release funds held in escrow under Section 10263 or 22300.

**Comment.** Section 44150 restates former Civil Code Section 3186.

....

*Public Entity Litigation Costs*

Gibbs, Giden, Locher & Turner LLP ("GGLT"), a law firm in Los Angeles, asserts that there is no consensus among practitioners as to what constitutes a public entity's "reasonable cost of litigation," and that most public entities routinely withhold 125% of the amount of the stop payment notice claim (consistent with the amount required for a stop payment notice release bond, to be discussed in a later section of this memorandum). CLRC Memorandum 2006-39, Exhibit p. 164. GGLT suggests that Section 44150 should expressly require withholding of 125% of the amount of a stop payment notice, in order to simplify the section and provide more certainty for public entities.

The Commission has no hard information relating to amounts that are normally withheld by public entities for their costs of litigation, and has not heard from any public entity that the unquantified requirement in existing law is causing any problem.

**The staff recommends against the proposed change.**

*Consistency with Related Provision*

Proposed Public Contract Code Section 44160 (which also continues existing law), authorizes a public entity to *pay* whatever amount is due a direct contractor, only after withholding the total amount of all claims stated in all received stop payment notices, "plus any interest and court costs that might reasonably be anticipated in connection with the claims":

**§ 44160. Payment notwithstanding stop payment notice**

44160. (a) This chapter does not prohibit payment of funds to a direct contractor if a stop payment notice is not received before the disbursing officer actually surrenders possession of the funds.

(b) This chapter does not prohibit payment of any amount due to a direct contractor in excess of the amount necessary to pay the total amount of all claims stated in stop payment notices received by the public entity at the time of payment plus any interest and court costs that might reasonably be anticipated in connection with the claims.

**Comment.** Section 44160 restates former Civil Code Section 3187.

....

DWR asserts that the reference to “court costs” in Sections 44160 should be changed to “litigation costs,” to be consistent with Section 44150. CLRC Memorandum 2007-08, Exhibit p. 4.

DWR’s basic contention has merit. In order for Sections 44150 and 44160 to make sense when read together (as well as existing Civil Code Sections 3186 and 3187, which Sections 44150 and 44160 continue), the two sections must both be understood to reference the same sum to be withheld by a public entity, upon receipt of a stop payment notice. Both sections should unambiguously require the public entity to withhold (in addition to the amount stated in the stop payment notice) any court costs and interest that might need to be paid to a successful claimant, as well as the expected litigation costs for the public entity.

The staff recommends that **the two sections be reconciled and revised as follows:**

**§ 44150. Duty to withhold funds**

44150. (a) The public entity shall, on receipt of a stop payment notice, withhold from ~~the direct contractor sufficient~~ funds due or to become due to the direct contractor a sufficient amount to pay the claim stated in the stop payment notice, any interest and court costs of the claimant reasonably anticipated in connection with the claims, and ~~to provide for~~ the public entity’s reasonable cost of any litigation pursuant to the stop payment notice.

(b) The public entity may satisfy its duty under this section by refusing to release funds held in escrow under Section 10263 or 22300.

**§ 44160. Payment notwithstanding stop payment notice**

44160. (a) This chapter does not prohibit payment of funds to a direct contractor if a stop payment notice is not received before the disbursing officer actually surrenders possession of the funds.

(b) This chapter does not prohibit payment of any amount due to a direct contractor in excess of the amount ~~necessary to pay the total amount of all claims stated in~~ required to be withheld pursuant to subdivision (a) of Section 44150, as to all stop payment notices received by the public entity at the time of payment plus any interest and court costs that might reasonably be anticipated in connection with the claims.

### **Notice to Claimant of Time to Enforce Stop Payment Notice**

Public Contract Code Section 44170 requires a public entity, upon completion of a public work, to provide specified information to any stop payment notice claimant that paid the entity \$10.00 when giving the notice:

#### **§ 44170. Notice to claimant**

44170. (a) Not later than 10 days after completion of a public works contract, the public entity shall give notice to each claimant that has given a stop payment notice of the time within which payment of the claim stated in a stop payment notice must be enforced.

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

**Comment.** Section 44170 restates former Civil Code Section 3185. See also Sections 42080 (mailed notice), 44420 (time for enforcement of payment of claim stated in stop payment notice). The \$2 fee is increased to \$10 in recognition of the change in the value of the dollar since the fee's enactment.

#### *Definition of Completion*

GGLT suggests that this section should contain a cross-reference to proposed Public Contract Code Section 42210, defining completion. CLRC Memorandum 2005-39, Exhibit p. 164.

There exist other references to the event of completion in various sections of the proposed law that do not cross-reference Section 42210. Similarly, there are many sections in the proposed law that reference other special terms defined elsewhere, and do not contain an accompanying cross-reference in the text of the section.

The Commission's regular practice in this regard is to include a cross-reference to a specially defined term in the section Comment. The staff recommends that **the Comment to Section 44170 be revised accordingly:**

**Comment.** Section 44170 restates former Civil Code Section 3185. See also Sections 42080 (mailed notice), 42210 (completion), 44420 (time for enforcement of payment of claim stated in stop payment notice). The \$2 fee is increased to \$10 in recognition of the change in the value of the dollar since the fee's enactment.

*Conformity with Existing Law*

Existing Civil Code Section 3185, the section continued by proposed Public Contract Code Section 44170, provides that the required information to be given by the public entity must also be provided upon *recordation of a notice of completion*:

3185. No later than 10 days after the filing of a notice of completion or after the cessation of labor has been deemed a completion of the public work or after the acceptance of completion, whichever is later, the public entity shall give notice of the expiration of such period to each stop notice claimant ....

It is not clear why proposed Public Contract Code Section 44170, in continuing Civil Code Section 3185, deleted recordation of a notice of completion as an event triggering the public entity's duty to provide the information required by this section.

It might have been assumed that recordation could not occur until after completion, thus rendering recordation superfluous as a triggering event.

However, the recordation of a notice of completion dictates a shorter period of time for a stop payment notice claimant to enforce a claim — 30 days from recordation, as compared to 90 days from completion. Proposed Public Contract Code Section 44140. Thus, in the event that a public entity records a notice of the completion, the public entity is obligated to give notice of a substantially different enforcement period than the enforcement period advised of after the event of completion.

The staff recommends that **Section 44140 be revised to restore recordation of a notice of completion as a triggering event:**

**§ 44170. Notice to claimant**

44170. (a) Not later than 10 days after recordation of a notice of completion or after completion of a public works contract, whichever is later, the public entity shall give notice to each claimant that has given a stop payment notice of the time within which payment of the claim stated in a stop payment notice must be enforced.

....

### *Reminder of Duty in Stop Payment Notice*

The Associated General Contractors of California (“AGC”), suggest that a public work stop payment notice should affirmatively remind the public entity of its statutory duty under proposed Public Contract Code Section 44170. Third Supplement to CLRC Memorandum 2006-48, Exhibit p. 28.

The staff has not been made aware that public entities have been failing to comply with their statutory obligation under this provision. A public entity risks a significant consequence for non-compliance — it may be estopped from asserting the applicable statute of limitation applicable to enforcement of the stop payment notice claim. See *J. H. Thompson Corp. v. DC Contractors*, 4 Cal. App. 4th 1355, 7 Cal. Rptr. 2d 604 (1992). Also, the receipt of the \$10 fee should serve as a reminder.

A claimant can of course always voluntarily remind a public entity of its statutory obligations, and needs no statutory authority to do so. However, *requiring* a claimant to include such a reminder in a stop payment notice could be problematic. If the claimant failed to give the required reminder — which is supposed to be for the claimant’s own benefit — the failure could be used by the public entity to argue it was excused from its obligation under Section 44170.

**The staff recommends against making the suggested addition to the proposed law.**

### *Payment by Claimant*

CSU advises that the cost of providing the notice specified in Section 44170 is actually much higher than \$10.00. CLRC Memorandum 2006-39, Exhibit p. 103. CSU suggests that the Commission consider raising the amount a claimant must pay for the return notice to \$20.00 or higher.

Under existing Civil Code Section 3185, the fee is \$2.00. The proposed law increases the fee to \$10.00, to account for inflation since the enactment of the provision in 1969. 1969 Cal. Stats ch. 1362. The Commission realized at the time of its decision to raise the fee that the cost to a public entity to process the fee may exceed \$10.00, but settled on the figure as a compromise of competing considerations. See CLRC Memorandum 2005-43, pp. 13-14.

**The staff sees no reason for the Commission to revisit its previous analysis on this issue.**



### *Recorded Notice of Cessation as Triggering Event*

At the August meeting, the Commission restored to the proposed law the recordation of a notice of cessation, an existing statutory procedure that the proposed law had not continued. CLRC Memorandum 2007-34, pp. 26-31, CLRC Minutes (August 2007), p. 3. Under existing law, and now under the proposed law, the recordation of a notice of cessation shortens the time period for both giving and enforcing stop payment notice claims.

At the same meeting, Laborers Group inquired whether the recordation of a notice of cessation would trigger a public entity's duty to provide notice under Section 44170.

Existing law does not require a public entity to provide such notice upon the recordation of a notice of cessation. Civ. Code § 3185. Rather, as discussed previously, the events triggering the notice required by Section 3185 that require return notice by the public entity are completion, or the recordation of a notice of completion.

However, given that the effect of recordation of a notice of cessation is the same as the effect of recordation of a notice of completion, it would make sense to require a public entity to give the notice required by Section 3185 after recordation of either type of notice. Moreover, given that public entities are currently required to provide notice upon recordation of a notice of completion, requiring the notice upon recordation of the substantially similar notice of cessation should not add any significant burden.

The staff recommends that **Section 44170 be further revised to read:**

#### **§ 44170. Notice to claimant**

44170. (a) Not later than 10 days after recordation of a notice of completion or cessation or after completion of a public works contract, whichever is later, the public entity shall give notice to each claimant that has given a stop payment notice of the time within which payment of the claim stated in a stop payment notice must be enforced.

....

#### **Stop Payment Notice Release Bond**

Under proposed Public Contract Code Section 44180, if a contractor or subcontractor disputes a claimant's stop payment notice, the public entity may in its discretion accept a release bond from the direct contractor, and release the withheld funds:

### **§ 44180. Release bond**

44180. (a) If the direct contractor or a subcontractor disputes the correctness, validity, or enforceability of the claim stated in a stop payment notice, the public entity may, in its discretion, permit the direct contractor to give the public entity a release bond. The bond shall be executed by an admitted surety insurer, in an amount equal to 125 percent of the claim stated in the stop payment notice, conditioned for the payment of any amount the claimant recovers in an action on the claim, together with court costs if the claimant prevails.

(b) On receipt of a release bond, the public entity shall not withhold funds from the direct contractor pursuant to the stop payment notice.

(c) The surety on a release bond is jointly and severally liable to the claimant with the sureties on any payment bond given under Chapter 5 (commencing with Section 45010).

**Comment.** Section 44180 restates former Civil Code Section 3196.

(UC has pointed out a typographical omission in this section. The staff is grateful for the submission, and has corrected the error.)

#### *Dispute as to Stop Payment Notice*

Section 44180 provides that, before a release bond may be given, a specified person must *dispute the validity* of the stop payment notice for which the release bond is given. GGLT suggests that the Commission delete this provision from Section 44180. CLRC Memorandum 2006-39, Exhibit p. 164.

The staff believes GGLT's suggestion has merit.

As noted by GGLT, in drafting the Tentative Recommendation the Commission deleted similar language from a parallel provision in existing law relating to a release bond on a *private* work. See existing Civ. Code § 3171; proposed Civ. Code § 7510; CLRC Memorandum 2005-31, p. 8. The Commission's reasoning relating to this private work provision is equally applicable to a release bond on a public work.

Logically speaking, a person that seeks to give a public entity a release bond *does* dispute the validity of the stop payment notice at issue, or the person would simply arrange for the claimant to be paid. Further, a person is not likely to be able to even obtain a release bond, unless the person can demonstrate a legitimate dispute suggesting the stop payment notice will ultimately not need to be paid.

It thus appears the provisions in existing law relating to the giving of release bonds are simply describing an available remedy under existing law, *in the event* a person disputes a stop payment notice.

However, as worded, the references in these provisions to disputing the validity of a stop payment notice are confusing. They could be interpreted as requiring *proof* of a subjective motivation for giving the bond, as a *precondition* of giving a bond. This would be an awkward and unworkable construction of the provisions, as the law provides no mechanism for offering or evaluating such proof.

The staff recommends that **Section 44180 be revised as follows, consistent with proposed Civil Code Section 7510:**

**§ 44180. Release bond**

44180. (a) ~~If the direct contractor or a subcontractor disputes the correctness, validity, or enforceability of the claim stated in a stop payment notice, the~~ A public entity may, in its discretion, permit the direct contractor to give the public entity a release bond. The bond shall be executed by an admitted surety insurer, in an amount equal to 125 percent of the claim stated in the stop payment notice, conditioned for the payment of any amount the claimant recovers in an action on the claim, together with court costs if the claimant prevails.

(b) On receipt of a release bond, the public entity shall not withhold funds from the direct contractor pursuant to the stop payment notice.

(c) ....

*Discretion of Public Entity to Refuse Release Bond*

Mr. Abdulaziz suggests a change in existing law, arguing that a public entity should not have discretion to reject a release bond from an admitted surety insurer. CLRC Memorandum 2006-39, Exhibit p. 20. Surety Association concurs, and adds that at the present time many public entities refuse to accept any type of release bond. CLRC Memorandum 2006-39, Exhibit p. 124.

GGLT echoes this complaint, noting also that the corresponding private work provision in existing law (Civ. Code § 3171) does not allow the holder of the construction fund to refuse to accept a bond. CLRC Memorandum 2006-39, Exhibit p. 164.

It is understandable why public entities would opt to reject an offered release bond under existing law. As existing Civil Code Section 3196 affords a public entity discretion to decide whether or not to accept a bond, a clearly erroneous

decision — e.g., accepting a bond from a clearly inadequate surety — might result in liability to claimants whose stop payment notices were released pursuant to the bond, but were then unable to collect on the bond.

If the proposed law removed that discretion, however, and mandated that a public entity accept a release bond from an admitted surety insurer, the risk of liability would be reduced to near zero. The public entity would need only to confirm the status of the surety, and the details of the bond, at which point it would be obligated to accept the bond and release the stop payment notice.

There still would be *some* liability exposure if the public entity failed to adequately perform even those tasks, and there may also be some administrative cost involved in fulfilling those responsibilities. For an extremely small public entity, these considerations might not be insignificant.

**The staff makes no recommendation on this issue. If the Commission wishes to change existing law and require a public entity to accept a release bond from an admitted surety insurer, the staff suggests the following further revision of Section 44180, consistent with proposed Civil Code Section 7510, the corresponding private work section:**

#### **§ 44180. Release bond**

44180. (a) ~~If the direct contractor or a subcontractor disputes the correctness, validity, or enforceability of the claim stated in a stop payment notice, the public entity may, in its discretion, permit the direct contractor to give the public entity a release bond. A direct contractor may obtain release of funds withheld pursuant to a stop payment notice by giving the public entity a release bond.~~ The bond shall be executed by an admitted surety insurer, in an amount equal to 125 percent of the claim stated in the stop payment notice, conditioned for the payment of any amount the claimant recovers in an action on the claim, together with court costs if the claimant prevails.

(b) On receipt of a release bond, the public entity shall not withhold funds from the direct contractor pursuant to the stop payment notice.

(c) The surety on a release bond is jointly and severally liable to the claimant with the sureties on any payment bond given under Chapter 5 (commencing with Section 45010).

#### *Amount of Release Bond*

DWR asserts that the reference to “court costs” in Section 44180 should be changed to “litigation costs,” to be consistent with language used in Section 44150. CLRC Memorandum 2007-25, Exhibit p. 4.

The reference in Section 44180 to “court costs, if the claimant prevails” is clearly a reference to court costs anticipated to be incurred by the stop payment notice claimant, rather than those anticipated to be incurred by the public entity. (Civil Code Section 3196, the section continued by Section 44180, is in accord, referencing the claimant’s costs of suit.)

As the reference in Section 44150 is to the *public entity’s* “litigation costs,” a term which may not be coextensive with the commonly understood meaning of “court costs,” consistency in terminology is not necessary, and might constitute a change in the law.

**The staff recommends against revising the reference to “court costs” in Section 44180.**

### **Summary Stop Payment Notice Proceeding**

Proposed Public Contract Code Sections 44210 through 44280, continuing existing law, provide for a summary proceeding that allows a direct contractor to contest a stop payment notice.

Section 44270 sets forth procedures required to be followed in connection with this summary proceeding:

#### **§ 44270. Court determination**

44270. (a) No findings are required in a summary proceeding under this article.

(b) If the hearing is before the court sitting without a jury and no evidence other than the affidavit and counteraffidavit is offered, the court may, if satisfied that sufficient facts are shown, make a determination on the basis of the affidavit and counteraffidavit. If the court is not satisfied that sufficient facts are shown, the court shall order the hearing continued for production of other evidence, oral or documentary, or the filing of other affidavits and counteraffidavits.

(c) At the conclusion of the hearing, the court shall make an order determining whether the demand for release is allowed. The court’s order is determinative of the right of the claimant to have funds further withheld by the public entity.

(d) The direct contractor shall serve a copy of the court’s order on the public entity.

**Comment.** Section 44270 restates former Civil Code Section 3203. Former Civil Code Section 3204 relating to jury trial is not continued; proceedings under this article are tried to the judge, not to a jury.

....

Mr. Abdulaziz questions whether it is sufficiently clear that under Section 44270 a court is empowered only to determine whether a stop payment notice should be released, and may not determine the valid amount of the claim. CLRC Memorandum 2006-39, Exhibit p. 14.

**The staff believes subdivision (c) is sufficiently clear on this point.**

Surety Association points out that subdivision (b) may imply that this summary proceeding may be tried before a jury. That was not the Commission's intent. CLRC Memorandum 2006-39, Exhibit p. 124.

The staff recommends that **Section 44270 be revised as follows:**

**§ 44270. Court determination**

44270. (a) No findings are required in a summary proceeding under this article.

(b) If at the hearing ~~is before the court sitting without a jury and~~ no evidence other than the affidavit and counteraffidavit is offered, the court may, if satisfied that sufficient facts are shown, make a determination on the basis of the affidavit and counteraffidavit. If the court is not satisfied that sufficient facts are shown, the court shall order the hearing continued for production of other evidence, oral or documentary, or the filing of other affidavits and counteraffidavits.

**Statute of Limitation for Enforcement of Claim**

Proposed Public Contract Code Section 44420 provides the time limitation for enforcing a stop payment notice claim:

**§ 44420. Time for enforcement of payment of claim stated in stop payment notice**

44420. (a) The claimant shall commence an action against the public entity and the direct contractor to enforce payment of the claim stated in a stop payment notice not earlier than 10 days after the date the claimant gives the stop payment notice and not later than 90 days after expiration of the time within which a stop payment notice must be given.

(b) An action under this section may not be brought to trial or judgment entered before expiration of the time provided in subdivision (a).

(c) If a claimant does not commence an action to enforce payment of the claim stated in a stop payment notice within the time provided in subdivision (a), the notice ceases to be effective and the public entity shall release funds withheld pursuant to the notice.

**Comment.** Section 44420 restates former Civil Code Section 3210. ....

DWR takes issue with the phrasing of subdivision (c), contending that instead of referencing “the *time* provided in subdivision (a),” the subdivision should reference “the *90 day period* provided in subdivision (a).” CLRC Memorandum 2007-25, Exhibit p. 4.

Section 44420 specifies both a first date and a last date for a claimant’s enforcement of a stop payment notice claim (by filing a complaint in court). The issue raised by DWR is whether the consequences specified in Section 44420(c) apply only when the “last date” provision is violated (i.e., a tardy filing, *after* the expiration of the 90 day period referenced in subdivision (a)), or whether the specified consequences also apply when the “first date” provision is violated (i.e., a premature filing, *before* the expiration of 10 day period referenced in subdivision (a)).

The staff agrees with DWR’s contention that the provision of existing law continued by Section 44420(c) was intended to apply only to a violation of the “last date” provision.

Existing Civil Code Section 3210 provides (with emphasis added):

3210. An action against the original contractor and the public entity to enforce payment of the claim stated in the stop notice may be commenced at any time after 10 days from the date of the service of the stop notice upon the public entity and shall be commenced not later than 90 days following the expiration of the period within which stop notices must be filed as provided in Section 3184. No such action shall be brought to trial or judgment entered until the expiration of said 90-day period. *No money or bond shall be withheld by reason of any such notice longer than the expiration of such 90-day period unless proceedings be commenced in a proper court within that time by the claimant to enforce his claim, and if such proceedings have not been commenced such notice shall cease to be effective and the moneys or bonds withheld shall be paid or delivered to the contractor or other person to whom they are due.*

In its first sentence, Section 3210 references both the first date on which a claimant may commence an action to enforce a stop payment notice, as well as the last date on which this enforcement action shall be commenced. However, the italicized portion of the section, specifying the consequence for a violation of the section, clearly refers only to the 90 day time period marking the last day for filing the enforcement action.

In order to more precisely continue existing law, this treatment should be continued in Section 44420.

The staff recommends that **Section 44420 be revised as follows:**

**§ 44420. Time for enforcement of payment of claim stated in stop payment notice**

44420. (a) The claimant shall commence an action against the public entity and the direct contractor to enforce payment of the claim stated in a stop payment notice not earlier than 10 days after the date the claimant gives the stop payment notice.

(b) The claimant shall commence an action against the public entity and the direct contractor to enforce payment of the claim stated in a stop payment notice and not later than 90 days after expiration of the time within which a stop payment notice must be given.

~~(b)~~ (c) An action under this section may not be brought to trial or judgment entered before expiration of the time provided in subdivision ~~(a)~~ (b).

~~(c)~~ (d) If a claimant does not commence an action to enforce payment of the claim stated in a stop payment notice within the time provided in subdivision ~~(a)~~ (b), the notice ceases to be effective and the public entity shall release funds withheld pursuant to the notice.

**Notice Prior to Enforcement of Claim**

Proposed Public Contract Code Section 44430 provides that, if a claimant commences an action to enforce a stop payment notice claim, the claimant shall give notice of the action to the public entity within five days:

**§ 44430. Notice of action**

44430. Within five days after commencement of an action to enforce payment of the claim stated in a stop payment notice, the claimant shall give notice of commencement of the action to the public entity in the same manner that a stop payment notice is given.

**Comment.** Section 44430 restates former Civil Code Section 3211. See Section 44130 (giving of stop payment notice).

....

Section 44430 continues existing law. Despite the apparently mandatory language of the continued provision, an appellate opinion has ruled that the provision is directory only. *Sunlight Elec. Supply Co. v. McKee*, 226 Cal. App. 2d 47, 37 Cal. Rptr. 782 (1964).

Mr. William Last, an attorney in San Mateo, favors doing away with this provision, in order to eliminate the possibility that a different appellate court will someday hold the notice is mandatory. CLRC Memorandum 2006-39, Exhibit

p. 7. Mr. Last indicates he personally rarely sends this notice, and believes deletion of the provision will have no impact on practitioners.

The Commission has previously addressed this issue when discussing proposed Civil Code Section 7550, the virtually identical corresponding private work provision, and decided the safest course was to simply continue existing law. CLRC Minutes (March 2007) p. 4. Consistent with the Commission's treatment of the issue in the private work context, the staff recommends that **the proposed law continue this provision in the public work part of the proposed law, with no substantive change to the language used in existing law.**

## PAYMENT BOND ISSUES

### **Inconsistency with Other Statutory Provision**

Proposed Public Contract Code Section 45010 requires a direct contractor on most public works projects to obtain a payment bond before commencement of work.

#### **§ 45010. Payment bond requirement**

45010. (a) A direct contractor that is awarded a public works contract involving an expenditure in excess of twenty-five thousand dollars (\$25,000) shall, before commencement of work, give a payment bond to and approved by the public entity.

....

GGLT points out a conflict between Section 45010 and existing Government Code Section 14975, which after a conforming revision to correct a cross-reference will read:

#### **Gov't Code § 14975 (amended). Payment bond**

14975. Notwithstanding the provisions of Section 45010 of the Public Contract Code, the contractor under any contract made under this chapter need not provide a payment bond before the commencement of the work but must provide a payment bond as otherwise required by law prior to payment under the contract.

CLRC Memorandum 2006-39, Exhibit p. 165. GGLT notes that while proposed Public Contract Code Section 45010 requires a direct contractor to provide a payment bond prior to commencement of work, Government Code Section 14975 requires the payment bond to be provided only prior to the direct contractor's receipt of payment.

However, there is a clear rationale for the express exception to proposed Public Contract Code Section 45010 provided for in Government Code Section 14975. The latter section appears in a chapter in the Government Code relating to events occurring during a declared state of emergency. Given the likely exigencies involved in such a situation, the Legislature may well have perceived the need to allow a direct contractor to immediately begin doing repair work, before the arrangements to secure a payment bond have been completed.

**The staff recommends against disturbing that special rule.**



### **Coverage of Supplemental Contract**

Under subdivision (c) of Section 45010, a direct contractor who has initially provided a payment bond may perform work on a supplemental contract without obtaining a bond for the supplemental contract, if the public entity agrees:

#### **§ 45010. Payment bond requirement**

45010. (a) ....

(c) A payment bond given and approved under this section is sufficient to permit performance of work pursuant to a public works contract that supplements the contract for which the bond is given, if the requirement of a new bond is waived by the public entity.

....

The joint surety commenters criticize subdivision (c), alleging that claimants that do work pursuant to an unbonded supplemental contract may be precluded from making a claim against the original payment bond for the supplemental work. CLRC Memorandum 2006-39, Exhibit p. 94.

The group has some reason for concern. In *Electrical Electronic Control, Inc. v. Los Angeles Unified School District*, 126 Cal. App. 4th 601, 24 Cal. Rptr. 3d 316 (2005), the court held that, unless the bond provides otherwise, a mandatory public work payment bond covers only work performed pursuant to the particular contract for which the bond is issued, and does *not* cover the entire public work of improvement. That could mean that a payment bond on the main contract would not cover payment owed on a supplemental contract.

The staff recommends that **subdivision (c) be revised as follows:**

(c) A payment bond given and approved under this section is ~~sufficient to~~ will permit performance of and provide coverage for work pursuant to a public works contract that supplements the

contract for which the bond is given, if the requirement of a new bond is waived by the public entity.

....

**Comment.** Section 45010 restates former Civil Code Section 3247. The transitional provisions of the former section are omitted due to lapse of time.

Subdivision (c) is an exception to the rule stated in *Electrical Electronic Control, Inc. v. Los Angeles Unified*, 126 Cal. App. 4th 601, 24 Cal. Rptr. 3d 316 (2005), holding that a payment bond under former Civil Code Section 3247, unless otherwise stated or agreed upon, provides coverage only for work performed pursuant to the contract for which the bond was given.

See also Sections 41030 (“design professional” defined), 41040 (“direct contractor” defined), 41090 (“payment bond” defined), 41120 (“public entity” defined), 41130 (“public works contract” defined).

### **Issuance of Bond by Admitted Surety Insurer**

A section in the Bond and Undertaking Law (Code Civ. Proc. § 995.311) provides that any bond required on a public works contract must be executed by an admitted surety insurer.

The joint surety commenters suggest that, to better advise public entities, this requirement should be included in the proposed law as well. CLRC Memorandum 2006-39, Exhibit p. 93-94.

The staff agrees, and recommends that **Section 45030 be revised as follows:**

#### **§ 45030. Bond requirements**

45030. (a) A payment bond shall be in an amount not less than one hundred percent of the total amount payable pursuant to the public works contract. The bond shall be in the form of a bond and not a deposit in lieu of bond. The bond shall be executed by an admitted surety insurer.

(b) ....

**Comment.** Section 45030 restates former Civil Code Section 3248 and supersedes former Civil Code Section 3096.

Subdivision (a) also restates a part of Code of Civil Procedure Section 995.311(a), which provides that a payment bond required on a public works contract shall be executed by an admitted surety insurer.

....

### *State Public Entities*

California State University (“CSU”) would like to be exempted from the provisions of existing Public Contract Code Section 7103 (a section outside the

mechanics lien statute), which requires a payment bond on most state construction projects with a contract price of more than \$5,000. CLRC Memorandum 2006-39, Exhibit p. 103.

**Substantive revision of a section of the Public Contract Code that is not a part of the existing mechanics lien statute is beyond the scope of this study.**

### **Construction of the Payment Bond**

Proposed Public Contract Code Section 45040 sets forth various rules relating to how a public work payment bond is to be construed:

#### **§ 45040. Construction of bond**

45040. (a) A payment bond shall be construed most strongly against the surety and in favor of the beneficiary.

(b) A surety is not released from liability to the beneficiary by reason of a breach of the public works contract between the public entity and the direct contractor or on the part of the beneficiary.

(c) Except as otherwise provided by statute, the sole conditions of recovery on the bond are that the beneficiary is a person authorized under Section 42030 to assert a claim against a payment bond and has not been paid the full amount of the claim.

**Comment.** Section 45040 restates former Civil Code Section 3226.

....

The joint surety commenters assert that this section should be deleted in its entirety, arguing that none of the three subdivisions — which all continue existing law — are “logical or reasonable” when applied to a public work payment bond. CLRC Memorandum 2006-39, Exhibit p. 95.

With regard to subdivision (a), the joint surety commenters note that on a public work project the form of bond is selected by the public entity, and included in the bid documents for the project. The commenters argue that therefore, as neither the surety nor the direct contractor has control of the form or language of the bond, there is no basis for construing the bond against either.

However, no matter how harsh the terms of a bond required by the public entity, the surety and the direct contractor may be able to ameliorate at least some of that harshness by either adjusting the premium charged for the bond, or by spreading the effect of any problematic provision as a necessary business expense. On the other hand, the beneficiaries of the bond, who also have no input about the terms of the bond, also have no way to compensate for an onerous provision.

With regard to subdivision (b), the commenters argue it does not make sense that a claimant should still be able to collect on a bond claim, when it has breached its own contract obligations.

However, the breach referenced by subdivision (b) has to be a breach involving something *other* than a failure to perform work. If a claimant fails to perform work, the claimant has no valid claim against the bond. See proposed Pub. Cont. Code § 42030. But if the claimant *has* provided work on the job of some value, but has breached some other provision of the claimant's contract (e.g., work was provided late, some notice was not given, etc.), it does not appear irrational for the Legislature to provide that this contractual breach should not preclude payment under the payment bond for the value of whatever work was provided.

With regard to subdivision (c), the commenters argue that the subdivision is contrary to other sections in the proposed law for recovery on a bond claim (e.g., prior notice of the claim), and should be deleted.

The Commission has already addressed this contention by adding language to the subdivision that clarifies the inconsistencies ("Except as otherwise provided by statute ..."). CRLC Memorandum 2007-25, p. 10; CLRC Minutes (June 2006), p. 3.

**The staff recommends against any revision of Section 45040 based on the comment of the joint surety commenters.**

### **Statute of Limitations**

Proposed Public Contract Code Section 45050 provides the limitation period within which a claimant may seek to enforce a payment bond claim:

#### **§ 45050. Statute of limitations**

45050. A claimant may commence an action to enforce the liability on a payment bond at any time after the claimant ceases to provide work, but not later than six months after the period in which a stop payment notice may be given under Section 44140.

The joint surety commenters suggest this section would be easier to understand if the reference to proposed Public Contract Code Section 44140 was replaced by the time period specified in that section. CLRC Memorandum 2006-39, Exhibit p. 95. GGLT concurs. CLRC Memorandum 2006-39, Exhibit p. 165.

Section 44140 provides:

**§ 44140. Time for giving notice**

44140. A stop payment notice is not effective unless given within 30 days after recordation of a notice of cessation or notice of completion or, if a notice of cessation or completion is not recorded, within 90 days after cessation or completion.

The staff generally agrees with the commenters, and recommends that **Section 45050 be revised as follows:**

**§ 45050. Statute of limitations**

45050. A claimant may commence an action to enforce the liability on a payment bond at any time after the claimant ceases to provide work, but not later than ~~six months after the period in which a stop payment notice may be given under Section 44140~~ 210 days after recordation of a notice of cessation or notice of completion or, if a notice of cessation or completion is not recorded, not later than 270 days after cessation or completion.

**Comment.** Section 45050 restates former Civil Code Section 3249, and broadens it to cover enforcement of any liability on the bond, not limited to the liability of the surety. Code Civ. Proc. § 996.440 (judgment on bond against principal and sureties).

Former Civil Code Section 3249 required an action on a payment bond to be enforced within six months of the time a stop payment notice may be given as provided in former Civil Code Section 3184. The time periods provided in former Civil Code Section 3184 for the giving of a stop payment notice are included in the time periods provided in this section.

....

**Notice Prior to Enforcement of Bond Claim**

Proposed Public Contract Code Section 45060 specifies the notice a claimant must give prior to enforcing a payment bond claim:

**§ 45060. Notice required**

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

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

**Comment.** Section 45060 restates former Civil Code Section 3252(a).

....

The joint surety commenters criticize this section, which continues existing law, for the same reason many commenters objected to proposed Civil Code Section 7212, a parallel provision governing a private work payment bond claim. CLRC Memorandum 2006-39, Exhibit pp. 92-93, 95. See CLRC Memorandum 2007-11, pp. 22-24.

In sum, the commenters contend that subdivision (b) unfairly exposes a direct contractor — who is jointly liable on a payment bond claim — to the possibility of having to pay twice for the same work. The subdivision allows a worker or lower tier subcontractor to provide the first notice of a claim against a payment bond after a job is already complete, when the direct contractor may have already paid the subcontractor who should have paid the claimant.

There may be merit in this complaint. However, as noted previously, the provision appears to represent a political compromise between competing interest groups, and previous attempts to modify this provision have failed.

The staff recommends that **existing law on this issue not be disturbed.**

Respectfully submitted,

Steve Cohen  
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