

GET PAID!

CALIFORNIA MECHANIC'S LIENS,
STOP NOTICES, AND PAYMENT
BOND CLAIMS

IN PLAIN ENGLISH

A publication of Hunt Ortmann Palffy
Nieves Darling & Mah, Inc.



PREFACE

Getting paid, *on time*, is critical. This handbook explains the tools available to contractors and equipment/material suppliers to secure payment on California construction projects.

Broken down into separate chapters for private and public projects, the handbook covers mechanic's liens, stop notices, and payment bond claims. Mindful that a late payment is essentially the same as getting stiffed, a bonus chapter on California prompt payment laws is also included.

Over the years, we have discovered that many contractors and suppliers are simply unfamiliar with the legal tools available to help get them paid. We have written this handbook with that in mind. It explains those tools and the basics of how they work. We hope you find it useful.

If we can be of further assistance to you, please contact us.

This edition of the Get Paid Handbook was a collaborative work by Shareholders Dale Ortmann and John Darling.

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Very special thanks to Wahid Guirguis for his tireless efforts creating and editing prior editions of the Get Paid Handbook.

LIMITATIONS / DISCLAIMER

This pocket handbook is not intended to be inclusive of all applicable statutes or laws surrounding Mechanic's Liens, Stop Notices, and Payment Bond Claims. Rather, it simply provides a general understanding of those remedies and how they work. Every project differs in its facts and circumstances. Accordingly, in specific situations, you should always consult your lawyer.




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INTRODUCTION & OVERVIEW

What can you do to secure payment for work, equipment and materials you supplied to a California project?

There are several tools you, as a contractor/subcontractor or equipment/material supplier, can use to secure payment on construction projects, but the availability of those tools will depend on whether the project you are working on is private or public.

PRIVATE PROJECTS

If it is a private project, i.e. privately funded and constructed on private property, the most powerful tool to secure payment is recording what is known as a “**Mechanic’s Lien.**” What is that you ask? It is a document that you would record in the County Records of the county in which the project is located. Its purpose is to put the world on notice that you are claiming an interest in the property that you improved by your labor, equipment and/or materials, without receiving full payment. Once that document is recorded, the owner of the property will generally be unable to re-finance or sell the property without first resolving this lien. Later in this handbook, I will discuss what you need to do to perfect and enforce this interest.

The next tool available on private projects is the “**Stop Notice**” or the “**Stop Payment Notice.**” This is a document that you do not record in the County Records. Rather, you serve it on certain individuals/ entities that control the issuance of payment on the project (we will call them “Mo-

ney Holders”) such as the owner or lender. Your hope is for those Money Holders to stop payment of any funds due to the general contractor. That will then create a pot of money with those Money Holders from which you can recover.

As will be discussed later, most of the time where there is a construction loan, the deed of trust securing that loan will be recorded before the work starts. That will give the bank (construction lender) first priority ahead of your Mechanic’s Lien. If the project is unsuccessful and the bank forecloses, your Mechanic’s Lien will likely be “wiped out” by foreclosure. If you haven’t served a stop notice on the bank, you will have no other security for your claim. In light of this, you should always consider both recording a Mechanic’s Lien and serving a Stop Payment Notice at the end of the job if you haven’t been paid.

The third tool which “may” be available on private projects is a claim on a “**Payment Bond.**” I say “may” because on private projects, unlike the public ones, there are generally no laws that require those bonds. Nonetheless, on large private projects, it is not uncommon to have those bonds. This is great, but you ask what is a payment bond anyway? Well, it is a document issued by a surety company (sometimes referred to as a bonding company) which essentially guarantees that subcontractors and material suppliers will get paid on a project, up to the amount of the bond. So, this bond, if available, the surety company that issued it, will be yet another money holder against whom you may seek payment in case you are not paid on a project.

QUESTION

How do you know if this type of bond is available on the project you are working on?

Typically, this kind of information would be attached to construction contracts and subcontracts. Additionally, you can always, and you should, ask the party you are contracting with whether a payment bond exists; and if so, ask for that information up front in writing before the project starts and before any disputes occur. Sometimes the payment bond will be recorded in the Recorder's office in the county where the project is located. You can get a copy of the bond from the Recorder's office.

PUBLIC PROJECTS

So do the tools to secure payment on public works differ on public projects? Before I answer that, let me explain what is considered a public project or a public work. The California Public Contract Code § 1101 defines a **“Public Works Contract”** as “an agreement for the erection, construction, alteration, repair, or improvement of any public structure, building, road, or other public improvement of any kind.” So, it is generally any construction project contracted for by a public agency¹. Those agencies would include the Regents of the University of California, a county, a city, a district, a public authority and any other political subdivision in California.

¹ This simple definition may however become more complicated in today's environment given Public Private Partnerships. It is important to differentiate between public and private projects so you are able to figure out what remedies are available to you to secure and collect your money. If you are unable to differentiate, make sure you consult with your lawyer.

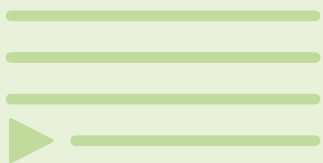
On public works projects, the tools for securing payments are similar but not identical to those of private works. You still have the **Stop Payment Notice** and the **Payment Bond** claim, but remember **NO Mechanic's Liens**. You cannot record a Mechanic's Lien on a public property. Does that mean you lost the most powerful tool to recover for your work? Thankfully, no. Because you cannot record a Mechanic's Lien on a public property, the law provides that public agencies require from general contractors bidding public projects, a payment bond on projects exceeding \$25,000 in construction cost. The payment bond would have to be for 100% of the total amount payable under the construction contract.

NOTE



Federal projects have a different set of payment security tools. Those are specified in the Miller Act and are beyond the scope of this book. If you are involved with a federal project, it is important to become familiar with those tools.

ONE LAST WORD



Before I get into the “nuts and bolts,” remember that whether it is a lien, stop payment notice claim, or payment bond claim, those do not affect your claims based on a breach of contract. Those are available to you separately.



CHAPTER ONE: PRIVATE PROJECTS

Now that we have been introduced to the tools of securing payment on both public and private projects, let us discuss the nuts and bolts of each one.

1.a. THE MECHANIC'S LIEN

Who Can Record It?

The full list of persons entitled to record a Mechanic's Lien is found in *California Civil Code* Section 8400. Generally, they include the following: materialmen, direct contractors, sub-contractors, lessors of equipment, licensed architects, registered engineers, licensed land surveyors, machinists, builders, teamsters or any persons who provided labor, materials or equipment (referred throughout this handbook as "LME") to improve the property.

What Does The Mechanic's Lien Form Look Like and Where Do I Get A Copy?

The lien to be recorded must have a proof of service affidavit showing service on the owner of the project. So, not only do you record the Mechanic's Lien, but you also have to serve a copy of it on the Owner as well. Now, if you are one of the persons entitled to record a lien as explained above, please feel free to request the new lien form by emailing your information to info@huntortmann.com. We will gladly send you a copy of the new lien form at no charge to you.

What Does It Contain?

The form must contain the following items: the amount of your demand after deducting credits and offsets, the name of the owner or reputed owner, the name of the person you contracted with or to whom you supplied materials, general statement of what materials or labor you provided, description of the project sufficient to identify it (this means the address generally), and **the proof of service on the owner affidavit and a 10-point boldface type warning statement NOTICE OF MECHANIC'S LIEN.** (See Civil Code § 8416).

You must also sign and verify the lien as well as the Affidavit of Service.

REMEMBER that the amount of the lien must be for LME furnished to and incorporated into the project. If your claim proceeds in Court, you will have to prove that element. In other words, if you are an electrician and you provided wiring to the project, you will have to show that the wiring was incorporated in the work. So, keep your delivery tickets and make sure they are signed by someone at the entity you contracted with, e.g. a field superintendent with the general contractor.

Also, if you have provided work to a condominium or multi-unit project, you should attempt to allocate your work by unit.

What Do You Do With The Lien Form Once You Filled It Out?

You must not only record the lien, but you have to also serve a copy of it on the property owner. If you fail to do that, you may not be able to enforce your lien. As is always recommended, service can be accomplished by Certified Mail Return Receipt Requested. Make sure you keep the mailing receipt and that signed return card (commonly referred to as the “green card”) in a safe place and give them to your lawyer as they will be needed in the foreclosure action to prove your claim, if the dispute proceeds to litigation.

QUESTION

What can you include in the amount you are seeking in the lien?

This is a very important question because in California, if you intentionally inflate or overstate the amount of your lien, you will risk it being invalidated in court. You should include in the amount the reasonable value of the LME furnished or the price you agreed upon, (i.e. the contract price) whichever is less. You can also include amounts due under written change orders, or as a result of breach of contract. Some types of claims cannot be added to the amount of the lien. For instance, you cannot include in it interest or attorneys’ fees. If you are unsure as to what to include, consult your lawyer.

Where Do You Record The Lien?

It is very important to **record the lien in the County Records where the project is located**. So, for instance, if your project is in Santa Ana, you must record in the Orange County Records. If you record it in the Los Angeles County Records, your lien is invalid.

What If You Have Erroneous Information In The Lien?

It is very important to have the correct information in the lien. If you do not, you risk that it may be invalidated by the court. However, if there are minor errors, you may still be able to enforce your lien.

NOTE



If you include erroneous information in the lien “with the intent to defraud,” your lien will be invalidated. That will become a question of fact in the foreclosure action, if raised by the attorney for the Owner. (Civil Code § 8422(b)(1)).

Erroneous information in the lien would also invalidate *it* if an innocent third party buys the property without knowledge of your lien. Because the information in the lien was erroneous, it did not provide proper notice of the claim to the buyer (*Civil Code § 8422(b)(2)*). It is better to avoid all these problems at the outset. Before you record your lien, make sure it contains the correct information!

When Can You Record A Mechanic's Lien?

The analysis of the deadline as to when you can record a Mechanic's Lien can be confusing. However, once you understand the operative triggers, it is simple. So, I will attempt to simplify it. The focus is mostly on the completion of the work.

Once you understand how to calculate the deadline to record a Mechanic's Lien, that deadline will also apply to when you can serve a stop notice.

The Main Trigger is "Completion" of The Project

Completion here is a legal term. Completion occurs when any of the following events take place:

- (a) actual completion of the project;
- (b) occupation or use of the project by the owner accompanied by stoppage of work;
- (c) stoppage of work for a continuance period of 60 days;
- (d) recordation of a Notice of Cessation of Work after work stoppage for a period of a continuous 30 days.

NOTE



Notwithstanding the foregoing, if the project is subject to acceptance by a public entity, completion occurs when that acceptance takes place. "Acceptance" by the private owner, alone, is no longer a term that can be used to determine completion on a private project. (Civil Code § 8180).

The Secondary Trigger is the Status of Your Work

The general contractor, or the contractor who is directly contracted with the owner, generally cannot record a lien until completing the contract. (*Civil Code § 8412*). All others cannot record their liens until they have ceased providing LME to the project. (*Civil Code § 8414*).

NOTE



Under the old statutory scheme, the term original contractor is used for contractors, who have a direct relationship with the owner.

Notice of Completion “NOC”

If there is a valid Notice of Completion recorded for the Project, that reduces the period within which claimants can record a lien or serve a stop notice as follows: The general contractor has 60 days after recordation of that NOC to record his/her Mechanic’s Lien or serve a stop notice. All others have 30 days only after recordation of that NOC to record a Mechanic’s Lien or serve a stop payment notice.

If there is no NOC, all claimants have 90 days from actual Completion to record a lien or serve a stop payment notice.

Example: A project is stopped on June 3, 2012. No work takes place for a continuous 60 days. That will result in a “Completion” on August 2, 2012. If no Notice of Cessation of Labor or Notice of Completion is recorded, that will mean that all claimants have 90 days to record a lien or serve a stop notice from the August 2, 2012 date which is October 31, 2012. Any lien or stop notice after that date is likely invalid.

SERVING THE NOTICE: If an owner records a NOC or Notice of Cessation, the owner shall, within 10 days of the date the notice is filed for recordation, serve a copy of it to all the following: (1) direct contractors (mainly the general contractors or subs who are directly contracted with the owner); and (2) claimants who have served the owner with a preliminary notice. If the owner fails to serve a copy of those notices to a claimant covered by the foregoing, the notice is INEFFECTIVE to reduce the time for that specific claimant to record a lien or serve a stop notice. In other words, that claimant will have the full 90 days from the date the Notice of Completion was recorded to record a lien or serve a stop notice. (Civil Code § 8190).

NOTE



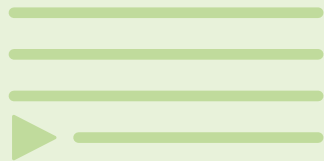
For a small fee to a credit reporting service, you can request that a Notice of Completion for a particular project be monitored. Upon recordation of a NOC, you would be notified. You should take advantage of that service.

NOTE



On projects that are constructed in phases or multi-prime projects, there may be separate NOC for each phase. Make sure you are aware of the specific phase you worked on.

ONE LAST WORD



If you make the calculation and you discover that you are just a few days late, do not despair and consult with your lawyer immediately. There may be exceptions, defenses, or reasons why you still have a chance.

PREREQUISITES TO RECORDING THE MECHANIC'S LIEN

Now that we know what a Mechanic's Lien is, it is important to also know what requirements, if any, must be met before a lien could be recorded. In some instances, as discussed below, a Preliminary Notice is required before you can record a Mechanic's Lien.

The Preliminary Notice or the "20-day Notice"

This is a notice prescribed by statute, which must be served. **The Preliminary Notice form can be found by visiting our website, www.huntortmann.com.** It is necessary under certain circumstances and without it, a lien, stop notice or bond claim will in most cases be invalid.

Who Needs To Give This Notice?

This Notice must be given by anyone, **EXCEPT** the general contractor (direct contractor) and wage claimants, who want to later record a Mechanic's Lien, or file a stop notice on a project. So mainly the subcontractors and material suppliers have to serve this Notice.

A general contractor typically does not have to serve the Preliminary Notice because they have a direct relationship with the owner of a project.

HOWEVER:

GENERAL CONTRACTORS OR ANYONE CONTRACTING DIRECTLY WITH THE OWNER BEWARE: You will have to serve a Preliminary Notice on the lender of the project if there is one. (*Civil Code § 8200(e)(2)*).

Also, construction contracts must identify any construction lender. (*Civil Code § 8170*). This does not apply to home improvement contracts or pool contracts. If the lender is not identified, you should still attempt some due diligence to verify whether a lender is involved. (*Civil Code § 8208*) requires direct contractors to make owner and lender information available to subcontractors and material/equipment suppliers, or any person seeking to give a Preliminary Notice.

When one or more construction loans are obtained after commencement of a project, the owner must give notice of the name and

address of the lenders issuing those loans to everyone who had served a Preliminary Notice on the owner. (*Civil Code § 8210*).

When Do You Send It?

This Notice must be given within the first 20 days after the claimant first starts providing LME to the project. For example, if you start providing LME on April 1, 2011, by April 21, 2011, your Notice should be served.

However, practically speaking, if you fall in the category of those who have to serve this Preliminary Notice as explained previously, you should send this as soon as you execute your subcontract or receive a purchase order.

QUESTION

What if you forgot to serve a preliminary notice, what happens?

You should serve it as soon as you find out, BUT it will only cover LME for the 20 days preceding the date you serve it. Any LME provided prior to those 20 days will not be included. However, you would be able to claim those in a breach of contract action against the party you contracted with.

To Whom Do You Send It?

You send it to the owner or reputed owner of the project, the lender or reputed lender, and

the general contractor. If you are a subcontractor hired directly by an owner/builder, i.e. there is no general contractor, you must send this Notice to the lender or reputed lender.

How Do You Send It?

You can do it by personal service, registered mail, or certified mail, or by express mail. If you send it by registered, certified, or express mail, your service is completed at the time you drop it in the mail. **Practically speaking, you should always send your preliminary notice certified mail with return receipt requested.** Be sure to save the receipt from the post office showing that you paid for certified, registered, or express mail. Once you receive the signed receipt or the little “green card,” you should file it in your project file with your preliminary notice. This will be an important part of proving your case in court, should the matter proceed to litigation.

Also, whoever served the Preliminary Notice must sign a declaration explaining when, how, and to whom the Preliminary Notice was served. If you need a form for this, email us at info@huntortmann.com.

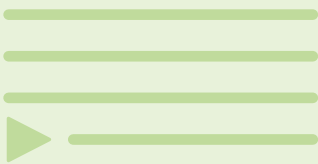
If you use a company to serve preliminary notices: Make sure you ask for that proof of service or you risk not being able to enforce your lien.

QUESTION

What if you find a Notice of Non-Responsibility posted and recorded on the project you are working on?

You would find this type of notice on tenant improvement work typically where the party that lets out the construction contracts is the tenant in a building. The owner, or the landlord, in that case must post and record within 10 days of actual knowledge of the construction a Notice of Non-Responsibility to avoid liability if the tenant fails to make payments to the contractor. This Notice will not always be effective especially if the court ultimately finds that the landlord was “participating” in the construction somehow, such as requesting the tenant improvement to be built. (Civil Code § 8444).

ONE LAST WORD



Beware when filling out your Preliminary Notice, especially the sections dealing with amount, the party who you contracted with, and description of the materials. **The amount you include in the notice must be a rational estimate of the LME you will provide to the project.** If you are a subcontractor, that will generally mean your contract price, but if you are an equipment or a material supplier, sometimes this is difficult to ascertain. You would need to show the court that it was a rational estimate. If you simply use any number or you just have a habit for all projects to put the same number, you may seriously affect your lien rights. Also, if you erroneously list the wrong party in the section which

asks for the party with whom you contracted, you may affect your lien rights. Further, make sure you provide a sufficient description for your work, i.e. plumbing fixtures and plumbing work, HVAC equipment, or carpentry and framing as applicable.

THE LAWSUIT TO FORECLOSE ON THE LIEN

Now that you have your lien recorded, what do you do with it? You should not wait as the statute of limitation for filing suit on a lien has a very short trigger.

When Do You File It?

Once you record your lien, and serve it on the owner, you must file your foreclosure action **within 90 days from the date of recordation**. So, it is important to consult with your lawyer soon after you record your lien.

BEWARE: If you do not foreclose on your Mechanic's Lien in a timely manner, i.e. within 90 days of recordation, your lien becomes void and you must release it. If you do not, the owner can petition the court to remove the lien and recover reasonable attorneys' fees against you in that process.

Where Do You File the Suit to Foreclose?

It has to be filed in Court in the county where the project is located.

Do You Recover Attorneys' Fees If You Win?

Not under the Mechanic's Lien theory, but if your contract provides for recovery of attorney's fees, those may be separately recovered under a breach of contract theory. **Remember**, you should never add estimated attorneys' fees in your recorded lien.

Notice of Pendency of Action

You must record a "**Notice of Pendency of Action**" **within 20 days of commencing the foreclosure action**. Failure to comply can affect the priority of your lien against subsequent purchases or encumbrances. Your attorney should perform this step.

QUESTION

How Important Is Priority?

If you have an interest or claim on the real property that you improved through your labor, that interest is evaluated by the court against all other interests in the same property and first in line has the first right to the property. So it is important that you record the Notice of Pendency of Action so that any purchaser of the property you improved after that date would have notice of your action and you, in turn, maintain your priority.

WHAT IS NEXT AFTER SUIT IS FILED TO FORECLOSE ON THE MECHANIC'S LIEN?

Notice of Pendency of Action

As we discussed, you must also record a Notice of Pendency of Action within 20 days of the commencement of the foreclosure action. You must do that in the county where the project is located. This notice is important because only from the time of recording that notice is a purchaser or a person who has an interest in that property be deemed to have notice of the foreclosure action. (*Civil Code § 8461*).

Failure to record this notice will affect your priority rights.

The notice should be mailed prior to recording, by registered or certified mail, return receipt requested, to all known addresses of the parties to whom your lien is adverse, along with the owner of the property. If there is a lender, serve that lender with a copy too. In short, serve all those who may have an interest in the property on which the project lies. (CCP § 405.22).

Receiving Payment and Releases

Most of the time, after suit is filed, the lien claimant receives payment. However, before payment is made, the claimant is usually asked to provide the requisite "Releases." There are four different type of Releases mandated

by statute. They are found in *Civil Code* §§ 8132, 8134, 8136, and 8138, respectively, as discussed below.

NOTE



These releases are used each month during construction – they are part of the progress payment process. After suit is filed, before you receive payment, you will likely be asked to sign the applicable release, including a release of lien and dismissal of the lawsuit.

Conditional Waiver and Release In Exchange for Progress Payment

For the form, See (*Civil Code* § 8132). The Conditional Releases are only effective when payment is received. Compare this to the Unconditional Releases which are effective upon signing. **Thus, make sure you do not sign an unconditional form of release unless you have actually received payment.**

Unconditional Waiver and Release In Exchange for Progress Payment For the form, See (*Civil Code* § 8134).

Conditional Waiver and Release In Exchange for Final Payment

For the form, See (*Civil Code* § 8136).

Unconditional Waiver and Release In Exchange for Final Payment

For the form, See (*Civil Code § 8138*). Remember, **do not sign this Release until you have received all your payments on the Project.**

If No Payment Is Received

The suit proceeds to trial where the claimant proves the claim of lien and the Court evaluates that claim along with any other claims on the subject property. Hence, it is important for a lien claimant to name all parties who have a claim of interest in the property. If there is a construction lender who holds a deed of trust, the lender must also be named. The Court will determine the priority of all interests.

Priority

If there are multiple lien claimants, they will all usually be treated as having the same priority. Their priority will not be measured by when they were recorded, but rather when the work on the project commenced. Work is considered commenced when some actual physical work on the project is apparent and visible and the work is of a permanent nature.

NOTE

Whether a construction deed of trust will have priority over Mechanic's Liens recorded on a project will depend on when the trust deed was recorded relative to the commencement of the work on the project. If it was recorded before any work took place on the project, then the trust deed will have priority. Generally, because the lender has priority most of the time, your lien may be "wiped out" by foreclosure.

Accordingly, you should always consider both recording a lien and serving a stop payment notice.



The Contractor May Obtain a Release Bond

In some instances, the general contractor (direct contractor) may obtain a Mechanic's Lien Release Bond and record it prior to the filing of the foreclosure action or even after a suit is filed. In that case, the lawsuit should be brought or amended, to bring the claim on that Release Bond and the lien should be released. The required amount of the release bond is 125% of the lien amount. (*Civil Code § 8424(b)*). Mechanic's Lien Release Bond and record it prior to the filing of the foreclosure action or even after a suit is filed. In that case, the lawsuit should be brought or amended, to bring the claim on that Release Bond and the lien should be released. The required amount of the release bond is 125% of the lien amount. (*Civil Code § 8424(b)*).

1.b. THE STOP PAYMENT NOTICE

What Does It Contain?

Similar to the Mechanic's Lien, it contains the name of the claimant, the name of the person/entity to whom LME was provided, the kind of LME provided, the amount of the LME provided, the amount paid, the balance due, and the date from which interest accrues. After you fill in the Stop Payment Notice, you must sign it and verify it. If you do not have a form for the Stop Project Notice, you may contact me to obtain a free form.

Who Can Use It?

The same persons entitled to record a Mechanic's Lien, except that a direct contractor may not serve a Stop Payment Notice upon an owner.

What Do You Do With The Stop Payment Notice Form Once Completed?

You serve it on the Money Holders. For the manner of service, follow the same procedure as you would with a Mechanic's Lien.

REMEMBER: You do not record a Stop Payment Notice.

Whom Do You Serve It On?

You serve it on the Money Holders we discussed: the owner or reputed owner of the project, and the lender or reputed lender.

BEWARE: (*Civil Code § 8506(b)*). provides that a Stop Payment Notice to a construction lender holding construction funds is NOT effective unless "... given to the manager or other responsible officer or person at the office or branch of the lender administering or holding the construction funds."

When Do You Serve It?

The deadline to serve a Stop Payment Notice is the same as recording a Mechanic's Lien. See discussion in the Mechanic's Lien section.

What Else You Need To Do?

If there is a construction lender on the project, **the most important thing to do in private works** is to contact your insurance broker and obtain a stop notice bond for 125% of the amount of the stop notice. You will need to serve that with your Stop Payment Notice.

QUESTION

Why is it important to obtain the bond?

By providing a bond with the stop notice, the construction lender will be required to withhold funds, if any still remain with the lender (Civil Code § 8536). The prevailing party in a lawsuit on a bonded stop notice would be entitled to reasonable attorneys' fees. (Civil Code § 8558).

BEWARE: Make sure the bond you obtain for the Stop Payment Notice is 125% of the amount sought. If the bond is for less than that amount, you will lose the effectiveness of the bonded Stop Payment Notice as the lender will not be obligated to withhold funds.

QUESTION

What is the Notice of Election on the Stop Payment Notice Form?

If the claimant signs that Notice of Election in the Stop Payment Notice, serves the lender with a self-addressed stamped envelope, and the job is bonded, the lender can elect not to withhold. However, the lender must send the claimant a copy of the payment bond for the project. This is another way to ascertain if the job is bonded. To recap, the Stop Payment Notice to the lender should consist of three documents: 1) the Stop Payment Notice; 2) the bond for 125% of the claim and 3) a self-addressed stamped envelope.

PREREQUISITES TO SERVING THE STOP PAYMENT NOTICE

The prerequisites to serving a Stop Payment Notice are the same as for the Mechanic's Lien, mainly the Preliminary Notice, as required.

Recall the same rules for the Preliminary Notice as discussed under the Mechanic's Lien section apply here as well. The best way to serve all the documents described in this handbook is through Certified Mail Return Receipt Requested. Once you get the receipts back, make sure you staple them to a copy of your Lien, Stop Payment Notice, or Preliminary Notice. You will need all those receipts to prove your claim in court.

THE LAWSUIT TO ENFORCE THE STOP PAYMENT NOTICE

Now that you have served your Stop Payment Notice properly, what do you do with it? You should not wait, as the statute of limitation for filing suit to enforce it, like in the case of the Mechanic's Lien, has a very short trigger.

When Do You File It?

Unlike the Mechanic's Lien, the deadline to filing suit to enforce the Stop Payment Notice is not really tied to the date of serving the Stop Payment Notice. Rather, it is tied to the completion of the project. The only tie to the date of service is that you cannot file the lawsuit within the first 10 days

after service of the Stop Payment Notice. **The lawsuit must be filed no later than the 90th day after the deadline to record a Mechanic's Lien.**

At this point, you should have already calculated, as discussed earlier, the deadline to record liens and serve Stop Payment Notices on the project. So, add 90 days from that deadline and that will be the deadline to file suit. If the lawsuit is not timely filed, your Stop Payment Notice will be invalid.

Other Requirements

Notice of filing the Stop Payment Notice Action must be given within 5 days after the filing of the action. (*Civil Code § 8550(e)*). This will be done by your attorney.

The lawsuit cannot proceed to trial until 90 days have passed after the deadline to record Mechanic's Liens on the project.

If various subcontractors or various parties, file separate Stop Payment Notice actions, the owner or lender may compel all claimants to consolidate in one action. (*Civil Code § 8552*).

BEWARE: If the lawsuit is filed and is not completed within 2 years, the Court has discretion to dismiss the case. (*Civil Code § 8554*).

Where Do You File the Suit to Enforce the Stop Payment Notice?

Typically, this cause of action is accompanied with a cause of action to foreclose on a Mechanic's Lien and it is thus also filed in Court in the county where the project is located.

Do You Recover Attorneys' Fees If You Win?

As indicated above, if the Stop Payment Notice was properly accompanied by a bond, the prevailing party is entitled to its reasonable attorneys' fees. (*Civil Code § 8558*).

QUESTION

Do you get interest too?

Just like the case with attorneys' fees, if the Stop Payment Notice was properly bonded, the prevailing party is entitled to interest on the amount recovered from the date of service of the Stop Payment Notice. (*Civil Code § 8560*).

WHAT IS NEXT AFTER SUIT IS FILED TO ENFORCE THE STOP PAYMENT NOTICE?

Notice of Filing the Stop Payment Notice Action

As indicated above, the Notice of Filing the Stop Payment Notice Action must be given to the Money Holders within 5 days after the filing of the action. (*Civil Code § 8550(e)*). This should be done by your attorney.

Receiving Payment and Releases

Works the same way as with Mechanic's Liens. See the discussion earlier in the handbook.

If No Payment Is Received

The suit proceeds to trial. Remember that if there are multiple Stop Payment Notice lawsuits, they will likely be consolidated into one and each claimant will have to prove his/her claim. If there are insufficient funds withheld to cover the amounts of all valid Stop Payment Notices, each claimant will share pro-rata in the amount withheld. For example, if your claim is 1/5th of all total Stop Payment Notice claims, you will receive 1/5th of the amount withheld.

1.c. THE PAYMENT BOND ALSO KNOWN AS THE LABOR AND MATERIALS BOND

Those types of bonds are not always found in private works. In public works projects, however, they are almost always required.

In private works, an owner may protect itself and limit any potential recovery on Mechanic's Liens at the end of the project by filing the prime contract with the County Recorder and recording a payment bond of not less than 50% of the amount of that contract. If this is done, the Court must, when it is equitable to do so, limit all the recovery on all Mechanic's Liens on the project to the amount due from the owner to the general contractor. Any deficiency still

remaining would be entered by the Court as a judgment against the direct (general) contractor and its surety that issued the payment bond. (*Civil Code § 8600*).

The Prerequisites To Making A Payment Bond Claim

In order to make a claim on a Payment Bond, you must have served a Preliminary Notice if you have no direct contractual relationship with the owner, as discussed previously in this book. However, if you have failed to do so, you have a saving mechanism which works as follows: within 15 days of when a NOC is recorded OR within 75 days of actual completion, if there is no NOC recorded, you serve the surety that issued the Payment Bond and the principal on the Bond, most likely the direct contractor, with a written notice of claim on the Bond. (*Civil Code § 8612-8614*).

The Notice to the surety must comply with *Civil Code § 8102* and include: The name and address of the owner or reputed owner, name and address of the lender, if any, name and address of the general contractor, a description of the project sufficient to identify it, name and address of the person giving the notice and its relationship to the project and the parties to the project, a description of the work provided, the name of the person to whom the work subject to the notice was provided, and amount due after deducting all credits and offsets.

LIMITATION:

If you are a claimant that does not have a direct relationship with the direct contractor, such as a second tier subcontractor or a material supplier to a subcontractor, and you have failed to provide a preliminary notice as required, you may not be able to take advantage of this saving mechanism if: all progress payments, except for those disputed in good faith, have been made by the direct contractor to the first tier subcontractor you contracted with or the first tier subcontractor was terminated from the project pursuant to its contract with the direct contractor, and all payments, except those disputed in good faith, have been made by the direct contractor to the subcontractor as of the termination date. (*Civil Code § 8612(c) and (d)*).

Practically, you should make the claim anyway as you may not be aware of facts supporting the foregoing. Just be aware that the surety may apply this defense, if available.

REMEMBER: The safest bet is to always make sure you serve your Preliminary Notice, if you are required to do so as discussed earlier, at the start of your work on any project.

THE LAWSUIT TO ENFORCE THE PAYMENT BOND CLAIM

When Do You File It?

The lawsuit to enforce a claim on a Payment Bond on private projects must be filed no later than 6 months from the completion of the Project. (*Civil Code § 8610*).

Do You Recover Attorney's Fees If You Win?

On private projects, it would depend on what the contract and the actual Bond provide. Generally, you will not recover attorney's fees on a private works payment bond.

WHAT IS NEXT AFTER SUIT IS FILED TO ENFORCE A PAYMENT BOND CLAIM?

Receiving Payment and Releases

Works the same way as with Mechanic's Liens. See our previous discussions under that section.

If No Payment Is Received

The suit proceeds to trial.

Now we have completed the discussion about Mechanic's Liens, Stop Payment Notices and Payment Bond Claims on private projects. There are many similarities and some differences on public projects, which we will discuss next.



CHAPTER TWO: PUBLIC PROJECTS

First, remember that on public works, you cannot record a Mechanic's Lien. The tools you have available to secure payment for your LME on public projects are generally the Stop Payment Notice and the Payment Bond Claim.

2.a. THE STOP PAYMENT NOTICE

What Does It Contain?

It contains the name of the claimant, the name of the person/entity to whom LME was provided, the kind of LME provided, the amount of the LME provided, the amount paid, the balance due, and the date from which interest accrues. After you fill out the Stop Payment Notice, you must sign it and verify it.

Who Can Use It?

All persons providing LME on the public project, except the direct contractor

What Do You Do With The Stop Notice Form Once You Filled It Out?

Once the form is complete, you serve it.

Whom Do You Serve It On?

In the case of any project for the State, the Stop Payment Notice shall be filed with the Director of the department that issued the contract. In the case of any other public work, the notice shall be filed with the office of the controller, auditor or other public disbursing officer whose duty is to issue payments on the contract, or with the commissioners, managers, trustees, officers, board of supervisors, board of trustees, common council or other body by whom the contract was awarded. (*Civil Code § 9354*). For the manner of service, follow the same procedure as you would with a Preliminary Notice (*Civil Code § 9354*). The most practical way is service by certified mail, return receipt requested.

When Do You Serve It?

The deadline to serve a Stop Payment Notice is 30 days after a valid Notice of Completion, Notice of Cessation, or Notice of Acceptance is recorded. If no such notices are recorded, it must be filed within 90 days from Completion of the project. (*Civil Code § 9356*). Completion of the project occurs upon acceptance of the work by the public agency.

BEWARE: 60 days of continued cessation or stoppage of work on some public works is also considered a completion and thus triggers the running of the time allowed for you to serve a Stop Payment Notice. This does not apply to contracts performed for state agencies. (*Civil Code § 9200*). If you are unsure, consult your lawyer.

QUESTION

Do you need to obtain a bond for your stop notice similar to private works?

No. Assuming the Stop Payment Notice is valid, the public agency is required to withhold from available funds due to the contractor. The key word here is “due.” If there are no funds due to the general contractor, there is nothing to withhold from!

PREREQUISITES TO SERVING THE STOP PAYMENT NOTICE

The Preliminary Notice or the “20-day Notice”

The same notice as discussed under private works. This is a notice prescribed by statute, which must be served. It is necessary under certain circumstances and without it, you may not be able to enforce your Stop Payment Notice rights.

Who Should Serve It?

In public works, everyone is required to serve a Preliminary Notice except the general contractor (direct contractor), workers working for wages, and those with direct contact with the general contractor. So, first tier subcontractors who have a direct contact with the general contractor do not have to serve a Preliminary Notice as a prerequisite to a Stop Payment Notice on a public work. The reason is that first tier subcontractors are known to the owner through the bid of the direct contractor on the project. Second

tier subcontractors or material/equipment suppliers have to serve the Preliminary Notice.

When Do You Send It?

You send it as discussed earlier under the Private Works section.

To Whom Do You Send It?

You send it to the direct contractor and the public agency.

How Do You Send It?

Same as discussed under private works. You can send it by registered or certified mail, express mail or overnight delivery. Practically speaking, **you should always send your Preliminary Notice certified mail with return receipt requested.** Once you receive the signed receipt or the little “green card,” you should file it in your project file with your Preliminary Notice. This will be an important part of proving your case in court, should the matter proceeds to litigation. Be sure to fill out the proof of notice declaration and keep any documentation of service, such as receipts for materials, and the signed green card. (*Civil Code § 9302, 8106, 8110*).

THE LAWSUIT TO ENFORCE THE STOP PAYMENT NOTICE

When Do You File It?

You cannot file the lawsuit within the first 10 days after service of the Stop Payment Notice.

The lawsuit must be filed no later than the 90th day after the deadline to file a Stop Payment Notice.

Example: Project has a Notice of Completion recorded on July 2, 2022. Since there is a NOC recorded, you have 30 days to serve a Stop Payment Notice. This makes the deadline to do that August 1, 2022. In this case, you would have to file suit before 90 days expire. So again, do not delay or you will lose your rights.

Other Requirements

Similar to private works, notice of filing the Stop Payment Notice action must be given to the public agency within 5 days after the filing of the action. (*Civil Code § 9504*). This is done by your attorney.

If various subcontractors or various parties file separate Stop Payment Notice actions, they may be all consolidated. In some instances, the public agency may choose to “interplead” funds which means deposit any available funds due to the contractor with the court. All claimants will then proceed to prove their Stop Payment Notice claims to the court. (*Civil Code § 9506*).

BEWARE: Similar to private works, if the lawsuit is filed and is not completed within 2 years, the Court has discretion to dismiss the case. (*Civil Code § 9508*).

Where Do You File the Suit To Enforce the Stop Payment Notice?

Typically this cause of action is accompanied with other claims and is filed in Court in the county where the project is located.

WHAT IS NEXT AFTER SUIT IS FILED TO ENFORCE THE STOP PAYMENT NOTICE?

Notice of Filing the Stop Payment Notice Action

As indicated above, the Notice of Filing the Stop Payment Notice Action must be given within 5 days after the filing of the action. This is done by your attorney.

Receiving Payment and Releases

Works the same way as with Mechanic's Liens. The same payment release terms apply to private and public works.

If No Payment is Received

The suit proceeds to trial. Remember that if there are multiple stop notice lawsuits, they will likely be consolidated into one and each claimant will have to prove his/her claim.

If There Are Insufficient Funds Withheld

To cover the amounts of all valid Stop Payment Notices, each claimant will share pro-rata in the amount withheld. For example, if your claim is

1/5th of all total Stop Payment Notice claims, you will receive 1/5th of the amount withheld. (*Civil Code § 9450*).

If the Stop Payment Notice is willfully overstated or false, such as including work not provided for the specific public works contract for which the Stop Payment Notice was given, the claimant will lose and forfeit his/her rights. (*Civil Code § 9454*).

SUMMARY PROCEEDINGS TO RELEASE STOP NOTICE FUNDS

Be aware that a general contractor (direct contractor) may obtain release of funds withheld by the public agency pursuant to a Stop Payment Notice using summary proceedings. If you have not already done so, it is important to consult with your lawyer if you reach this process because this summary proceeding will end up in court. The public agency does not decide on the validity of the documents filed in these proceedings. Rather, those documents end up in court for a declaration of rights by the judge.

The summary proceedings would be available under certain circumstances in which the direct contractor may contend:

The Stop Payment Notice filed is not based on a type of claim authorized by law;

The claimant on the Stop Payment Notice is not authorized to use the Stop Payment Notice remedy;

The claim is excessive; or

There is no basis for the claim in the stop notice.

(Civil Code § 9400).

PROCEDURE

The general contractor (direct contractor) serves on the public agency the original and a copy of an affidavit, including an allegation of the grounds for releasing the funds withheld along with the facts supporting that allegation, a demand for release of all or a portion of those funds withheld improperly, and the address of the direct contractor within California for the purpose of permitting service of papers.

The public agency serves the copy of the affidavit on the claimant that filed the Stop Payment Notice, along with a notice indicating that they would release the funds unless the claimant files a counter-affidavit on or before the time stated in that notice. That time, by law, shall not be less than 10 days nor more than 20 days from the date service of the copy of the affidavit.

The claimant serves a counter-affidavit contesting the affidavit of the direct contractor. It must describe the specific basis on which the claimant contests the direct contractor's affidavit. The counter-affidavit shall be served within the time specified along with a proof of service of a copy of it on the direct contractor. Service shall be by personal delivery. You can use certified mail or express mail but make sure you retain

the proof of service receipt of the “green card.” (*Civil Code* §§ 9406, 8106 and 8110).

If no counter-affidavit is filed in the time specified, the public agency immediately releases funds to the direct contractor without further notice to the claimant. The public agency will not be liable to the claimant for that release. (*Civil Code* § 9406 (b)).

If the counter-affidavit is filed timely and complies with the requirements, the public agency will not determine the validity of the submitted documents. Rather, at that point, either the claimant or the direct contractor may commence a declaration of rights action in court. Then, either party may file a motion for determination of rights. The party making the motion shall serve notice of same on the public agency and other party not less than 5 days before the hearing. The court shall hear the motion within 15 days or, at a later time if good cause exists. The original affidavit and counter-affidavit will be filed by the public agency with the court and will constitute the pleadings. At the hearing, the direct contractor will have the burden of proof to show why release of funds is warranted.

The court will issue a ruling of either maintaining the withholding or releasing of the funds. For further details of the entire procedure, see (*Civil Code* §§ 9400-9414).

2.b. THE PAYMENT BOND ALSO KNOWN AS THE LABOR AND MATERIALS BOND

In all public works contracts exceeding \$25,000, the direct contractor is required to provide a Labor and Materials Bond equal to 100% of the contract amount. (*Civil Code § 9550*). The Bond will be for the benefit of subcontractors and material suppliers. (*Civil Code § 9566*).

The Prerequisites To Making A Payment Bond Claim

In order to make a claim on a Payment Bond, you must have served a Preliminary Notice as discussed previously in this handbook. However, if you have failed to do so, you have a saving mechanism which works as follows: Within 15 days of when a NOC is recorded OR within 75 days of actual completion, if there is no NOC recorded, serve the surety that issued the Payment Bond and the principal on the Bond, most likely the direct contractor, with a written notice of claim on the Bond. (*Civil Code § 9560*).

LIMITATION:

The same limitation of this saving mechanism, relative to those who do not have a direct relationship with the direct contractor, where the direct contractor has made all undisputed pro-gress payments, as discussed under the Payment Bond on Private Works earlier in this handbook, applies. (*See Civil Code § 9560*).

Again, however, practically speaking, you should make the Payment Bond Claim even if you have concerns about whether you have protected all your rights to do so. Then, consult with your lawyer as you may not know all the facts which trigger this limitation.

THE LAWSUIT TO ENFORCE THE PAYMENT BOND CLAIM

When Do You File It?

The lawsuit to enforce a claim on a Payment Bond on public projects must be filed at any time after the claimant ceases work, but not later than 6 months from the deadline to serve a Stop Payment Notice. (*Civil Code § 9558*).

Example: There is actual completion on July 6, 2022. No notice of completion recorded. That would mean that the deadline to serve a Stop Payment Notice is 90 days from that date on October 4, 2022. The deadline to file suit on the Payment Bond then would be 6 months later or April 4, 2023.

Practically speaking, however, most public projects will have a Notice of Completion recorded, thus shortening the time to serve a Stop Notice to 30 days. So beware!

NOTE



For a small fee to a monitoring service, you can request that a Notice of Completion for a particular public work be monitored. Upon recordation of a Notice of Completion, you would be notified. You should take advantage of this service.

Do You Recover Attorneys' Fees If You Win?

Yes, because the statute requires that the Bond provide for reasonable attorneys' fees to the prevailing party. (*Civil Code § 9564*). Of course, it is important for you and your lawyer to carefully evaluate your claim, because if you lose, you will be required to pay for the sureties' attorneys' fees.


WHAT IS NEXT AFTER SUIT IS FILED TO ENFORCE A PAYMENT BOND CLAIM?

Receiving Payment and Releases:

Works the same way as with Mechanic's Liens.

If No Payment Is Received:

The suit proceeds to trial.



BONUS CHAPTER: PROMPT PAYMENT LAWS

In California, there are laws that generally mandate that the owner make timely payments to its direct contractor; and similarly that the direct contractor make timely payments to the subcontractors. The laws that apply again differ and depend on whether the project is private or public.

3.a. PRIVATE WORKS

Progress Payments

From The Owner To The Direct Contractor

Unless the contract between the owner and the direct contractor provides otherwise, the owner should pay the direct contractor within 30 days following receipt of a demand for payment, the amount due under that request. However, if there is a good faith dispute, the owner may withhold up to 150% of the disputed amount.

If an amount is wrongfully withheld by the owner, the direct contractor would be entitled to a penalty of 2% per month on the improperly withheld amount in lieu of interest otherwise due. See (Civil Code § 8800).

QUESTION

Do you get attorneys' fees if you win?

Yes. If you bring suit and you prevail, you would be entitled to "reasonable attorneys' fees."

From The Direct Contractor to The Subcontractor; Or From Subcontractor to Second Tier Subcontractor

A direct contractor should pay a subcontractor, not later than seven (7) days after receipt of each progress payment, from the owner, the respective amount allowed to the direct contractor on account of the work performed by that subcontractor.

However, if there is a good faith dispute, the direct contractor may withhold up to 150% of the disputed amount. The foregoing also works the same way for subcontractors' payments to lower tiered subcontractors. (*Business & Professions Code § 7108.5*).

QUESTION

What happens if the direct contractor does not make payment as provided above?

The law provides that those who violate this rule would be subject disciplinary action by the Licensing Board and also to a penalty, payable to the subcontractor, of 2 percent of the undisputed amount due per month for every month that payment is not made.

This penalty would likely not be collected unless suit is filed and the subcontractor claimant prevails. If that takes place, the subcontractor also would be entitled to attorneys' fees and costs.

From A Direct Contractor To A Subcontractor On A Project With A Public Utility

Unless otherwise agreed to in writing between **the direct contractor and the subcontractor, the direct contractor must pay the subcontractor within 21 days after receipt of each progress payment**, from the Public Utility, the respective amount allowed to the direct contractor on account of the work performed by that subcontractor.

Again, if there is a good faith dispute, the direct contractor may withhold up to 150% of the disputed amount.

If a direct contractor (direct contractor) violated this law, he/she would be liable for 2% penalty per month. This penalty would likely not be collected unless suit is filed and the subcontractor claimant prevails. If that takes place, the subcontractor also would be entitled to reasonable attorneys' fees and costs. (*Civil Code § 8802*).

Final Payments or Retention Payments

From The Owner To The Direct Contractor

The owner must release retention within 45 days after the date of completion. If you are wondering how you would know the date of completion? The date of completion here would be:

- (a) the date a certificate of occupancy is issued;
- (b) the date of completion indicated in a valid NOC;
- (c) the date of completion as defined by the law, as discussed earlier in this handbook.

Again, if there is a good faith dispute, the owner may withhold up to 150% of the disputed amount. The prevailing party would be entitled to reasonable attorneys' fees. (*Civil Code §§ 8810, 8812, 8818*).

IMPORTANT: The prompt payment laws cannot be waived by contract.

From The Direct Contractor To A Subcontractor

If a direct contractor withheld retention from a subcontractor, the direct contractor must, **no later than 10 days after the receipt of all or part of the retention from the owner**, pay that subcontractor his/her share of the retention.

The same rules regarding withholding, penalties, and attorneys' fees discussed above apply. (*Civil Code § 8814 and 8818*).

NOTE



If there is a violation in passing-through a progress payment, the violator may be subject to the 2% penalty per month, and on top of that 10% interest. In the case of a retention payment, the 2% per month penalty is in place of interest.

3.b. PUBLIC PROJECTS

Progress Payments

From The State Or Local Agency To The Direct Contractor

The State or local agency must pay the Direct Contractor, within 30 days following receipt of a proper demand for payment, the amount due under that request.

If an amount is wrongfully withheld by the State or local agency, the Direct Contractor would be entitled to 10% interest per annum or the legal rate for interest. (*Public Contract Code § 10261.5 and CCP § 685.010*).

QUESTION

Do you get attorneys' fees if you prevail?

The statute does not provide for recovery of attorney fees.

From The Direct Contractor to The Subcontractor; Or From Subcontractor to Second Tier Subcontractor

A direct contractor must pay a subcontractor, not later than seven (7) days after receipt of each progress payment, from the public agency, the respective amount allowed to the direct contractor on account of the work performed by that subcontractor.

However, if there is a good faith dispute, the direct contractor may withhold up to 150% of the disputed amount. The foregoing also works the same way for subcontractors' payments to lower tiered subcontractors. (See Business & Professions Code § 7108.5 and Public Contract Code § 10262.5).

QUESTION

What happens if the direct contractor does not make payment as provided above?

The law provides that those who violate this rule would be subject to disciplinary action by the Licensing Board and also to a penalty, payable to the subcontractor, of 2 percent of the amount due per month for every month that payment is not made.

This penalty would likely not be collected unless suit is filed and the subcontractor claimant prevails. If that takes place, the subcontractor also would be entitled to attorneys' fees and costs.

The subcontractor could also possibly recover 10% interest on top of the penalty.

Final Payments or Retention Payments

**From The State (Except the California State University) Or Any Local Agency
To The Direct Contractor**

The State or local agency should release retention within 60 days after completion.

That period could be increased to 90 days in the case of State agencies that chose to retain an amount equal to or less than 125% of the estimated value of remaining work. For the purposes of this section, completion here is defined in the law as any of the following:

- (a) occupation and beneficial use of the project by the public agency coupled with stoppage of work;
- (b) acceptance by the public agency;
- (c) after work started, it stopped for a continuous 100 days or more due to factors outside the control of the direct contractor;
- (d) stoppage of work for a continuous 30 days coupled with the recordation of a notice of cessation of work or notice of completion.

Again, if there is a good faith dispute, the public agency may withhold funds from the direct contractor, but in an action to recover the withheld funds, the prevailing party would be entitled to attorneys' fees and a 2% penalty per month on the improperly withheld amount instead of interest. (*Public Contract Code § 7107*).

IMPORTANT: As indicated previously, the prompt payment laws cannot be waived by contract.

From California State University To The Direct Contractor

The California State University (CSU) should release retention within 39 days after the request of the direct contractor per the contract.

Again, the CSU may withhold for disputed amounts. If an amount is wrongfully withheld, the direct contractor would be entitled to 10% interest per annum or the legal rate for interest. (See *Public Contract Code § 10853 and CCP § 685.010*).

From The Direct Contractor To A Subcontractor

A direct contractor should pay a subcontractor, not later than seven (7) days after receipt of retention, from the public agency, the respective amount allowed to the direct contractor on account of the work performed by that subcontractor.

Again, if there is a good faith dispute, the direct contractor may withhold up to 150% of the disputed amount. The prevailing party would be entitled to attorneys' fees. (*Public Contract Code § 7107*).

NOTE



If there is a violation in passing-through the retention, the violator may be subject to the 2% penalty per month instead of interest.