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California Provides Guidance for Mechanics Lien Claimants

By

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Those familiar with California's mechanics lien laws are well aware of the many hoops that lien claimants have to jump through to ensure that they have a valid lien claim against the property they improved. From the service of the preliminary notice to the contents of the lien itself to the timely filing of a lawsuit to foreclose, claimants must be vigilant to preserve their claim. Make one mistake and your lien could be invalid. Rarely does a single case address even a portion of the multitude of potential issues facing a subcontractor or supplier seeking to enforce its lien claim. However, in *Palomar Grading & Paving, Inc. et al. v. Wells Fargo Bank NA, et al.*, 2014 WL 5159502 (October 14, 2014), the California Court of Appeal answered ten discrete questions, routinely confronted by claimants, involving the operation of California's mechanics lien laws. Despite doing so, however, the court only certified 1 of these 10 issues for publication.

The California legislature revised its mechanics lien law (effective July 1, 2012) and relocated the applicable statutes to sections 8000 and 9000 of the *Civil Code*. Although *Palomar Grading* discusses the old lien law (because the liens at issue were recorded prior to the effective date), due to the lack of substantive changes in the law, claimants should be guided by the answers provided by the court.

As many can attest, the California construction industry was recently hit by a major recession. This case was no different for a developer of a Kohl's department store in Riverside County, California. There, after not receiving full payment, four different subcontractors recorded mechanics liens and thereafter filed suit to foreclose on those liens.

1. Does a Claimant Forfeit its Mechanics Lien by Failing to Name Future Owner of the Property in its Preliminary Notice?

Claimant is only required to name the *current* "owner or reputed owner" of the property at the time the notice is served in its preliminary notice. Claimant is not required to name potential or likely future owners.

2. Is a Mechanics Lien Void where a Claimant Performed Work after Recording its Lien?

The court relied on section 3115 (now 8412) to conclude that the recording of the lien was not premature and therefore not void. Section 3115 provides that the first date for *general* contractors (not subcontractors) to record a lien is after "completion of the contract." Where the prime contractor breaches the contract by making clear that did not intend to pay subcontractor's invoices, subcontractor's future obligations under the contract were excused and/or discharged and subcontractor could record a mechanics lien as of that date. However, the court did not address section 3116 (now 8414) which provides that claimants *other than direct contractors* (such as the subcontractors in this case) cannot record a lien until the claimant ceases to provide work. The court similarly did not focus on the subcontractor's argument that it had substantially completed its work and only performed punchlist items after the date of recording. The question remains unanswered whether a subcontractor "ceases to perform work" despite uncompleted punchlist items (the nature and extent of the punchlist work to be performed could be determinative). Other courts have held that a project is "completed" even though minor imperfections in the work still need to be corrected.

3. Does a Contractor Forfeit its Lien by Failing to Name the Current Owner of Property?

As with a preliminary notice, a claimant is only required to name the "owner or reputed owner" of the property in its mechanics lien. Where a claimant has no actual knowledge of the true owner, its lien is not void for failing to name the current owner.

4. Is a Lien Void where a Claimant did not list Correct Address?

The court went out of its way to acknowledge that the accuracy of property descriptions has been problematic in California mechanics lien law for over 125 years and reconciliation of all of the decisions in this field could be impossible. Recent decisions have been more deferential to lien claimants. The description of the property in the lien document must only be "sufficient for identification" and mistakes or errors will only invalidate the lien where there is intent to defraud or the description fails to put a third party on notice of the claim.

5. Does the 90-Day Deadline to File an Action to Foreclose on a Lien Prevent Subsequent Amendment of Complaint Naming True Property Owner?

It is undisputed that all claimants in this case filed suit to foreclose on their respective liens prior to the expiration of the statutory 90-day deadline. Nevertheless, two of the claimants later amended their complaints to add Kohl's and Wells Fargo as defendants upon discovery their ownership interests in the property. The court found that claimants will be precluded from adding such defendants if the claimants had *actual knowledge* of the true owner's identity at the time the original complaint was filed. In the absence of such knowledge, the claim against the true owners was not time barred.

6. Is a Claimant's Recovery Limited to Amount Stated in Lien?

A claimant may recover the reasonable value of its work or the contract price, whichever is less. California does not limit recovery to the figure identified in the lien. Where the owner makes no

argument that the amount sought is *unreasonable*, claimant is entitled to recover the contract price.

7. Can a Claimant be Awarded Amounts that the Claimant Owes to Others?

A subcontractor or supplier can only recover on its lien claim those amounts due to it "after deducting all claims of other *claimants*" embraced within that party's contract. For purposes of California lien law, a claimant is defined as a person entitled record a claim of lien, give a stop payment notice or recover on a payment bond. A subcontractor or supplier need not deduct the claims of lower tier subcontractors or suppliers who are not entitled to record a lien, and therefore are not "*claimants*". The court held that a second-tier subcontractor, whose corporate status was suspended by the time of trial and judgment, was not legally entitled to prosecute any claims, lien otherwise, as a result of this suspension, and therefore the claimant was not required to deduct the claim of said subcontractor. In addition, it appears that when faced with the question of whether to give a potential windfall to a claimant or property owner, the court here would prefer the mechanics lien claimant.

8. Should Judgment on a Mechanics Lien be Allocated between the Affected Parcels

Where "one united project" or work of improvement affects multiple parcels, the claimant need not allocate between the different parcels. The court, in its discretion, may prepare such an allocation. In *Palomar Grading*, the court determined that the project was a single work of improvement finding that "from its inception to completion [it] was one unified project, including all three parcels," with one owner, one lender and one general contractor and no such allocation was required.

9. Is a Claimant Entitled to Prejudgment Interest?

A claimant, like other plaintiffs, is entitled to prejudgment interest where damages are "certain, or capable of being made certain by calculation" and the right to recover such damages is vested on a particular day. By contrast, where an amount is incapable of calculation, such as the case where the court exercises its discretion to allocate among different parcels, prejudgment interest may not be awarded.

10. What is the Rate of Prejudgment Interest Recoverable on a Mechanics Lien Claim?

The California Constitution (Article XV, Section 1) provides for a default rate of interest of 7 percent per annum. Alternatively, *Civil Code* section 3289 allows for interest at 10 percent for a *breach of contract*. Typically, where subcontractors and suppliers are concerned, there is no direct contract with the owner. The court in *Palomar Grading* held that in the case of *innocent*, noncontracting owners, claimants can only recover prejudgment interest at the constitutional default rate of 7%. The court, however, specifically left open the question of the applicable rate of interest where a *culpable* owner is involved, i.e., a lien is recorded a result of the owner's breach of the construction contract.

Although only the final issue, regarding the rate of prejudgment interest, was certified for publication and can be cited by lawyers and judges, this case provides helpful guidance on

several questions routinely confronted by mechanics lien claimants. In addition, this case confirms California's longstanding public policy in favor of mechanics lien claimants. Claimants should also be encouraged that the courts continue to liberally construe the law for the protection of laborers and material suppliers.

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