

**BE VERY CAREFUL DRAFTING
HOME IMPROVEMENT CONTRACTS
IN CALIFORNIA**

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If one was to name the most highly regulated profession in the State of California, you would probably choose doctors or lawyers or morticians and you would be wrong – very wrong. Contractors who perform home improvements for residential homeowners are the most tightly regulated profession in the State of California. The laws regulating the drafting of Home Improvement Contracts (“HIC”) are extremely specific and difficult to put into practice. In fact, it would not be surprising if most home improvement contracts being used today are not statutorily compliant.

In 2005, AB316 specifically amended section 7159¹ of the *Business & Professions Code*. The proposed changes found in AB316 do not make HICs clearer and easier to understand, but rather more difficult to draft. The major problem with section 7159 is that it is confusing and redundant, making compliance difficult for contractors. Further, the requirements do not take into account the realities of home improvement work. Lastly, the provisions are a real trap to the practitioner who may be unwary of the legal requirements. A home improvement contract should be a simple thing to draft – and easy to understand for the Homeowner, but, as you will see, there is no such thing as a simple one-page construction contract when it comes to home improvement work.

A. Formatting

First, it should be noted that these new provisions only apply to remodeling of existing residences. "Home improvement" means the repairing, remodeling, altering, converting, or modernizing of, or adding to, residential property.² Contracts for new construction of single family residences are covered in Sec. 7164 of the Bus. & Prof. Code.

Second, the new HICs are regulated right down to the font. The contract must be legible and readable in at least 10-point type with each heading in at least 10-point boldface type.³ A copy of the fully executed contract must be given to the homeowner prior to work being performed, as homeowner's receipt of the contract initiates its rights to cancel.⁴ The contractor must include the following statement, in at least 12-point boldface type: "**You are entitled to a completely filled in copy of this agreement signed by both you and the contractor before any work may be started.**"⁵

The first page of the contract must contain the date upon which the owner signed the contract and the name and address of the contractor including license number preceded by a statement advising the buyer that a "Notice of Cancellation" can be sent to the address noted.⁶ The heading "**Home Improvement**" in at least 10-point boldface type must at the top of the document.⁷

B. Required Provisions⁸

I. Price

The most negotiated part of the contract is the price. The law states that under the heading "**Contract Price**" the amount of the entire cost of the contract, including profit, labor, and materials, excluding finance charges must be listed.⁹ There are no provisions that

allow for a “cost plus” contract or for contracts on a time and materials basis which are common in the Home Improvement industry. In order to get around this issue, best practice is to include an estimate of the total cost of the contract or use a “not to exceed” amount to regulate the price of the contract.

2. Scope of Work

It is extremely important that the contract precisely describe the work being performed. Not only is it required, it prevents later disputes with the owner. Under the heading “**Description of the Project and Description of the Significant Materials to be Used and Equipment to be Installed**” there must be a description of the project and description of materials to be installed. For swimming pool contracts, this must include a drawing showing the shape, size, dimensions of the construction, equipment, and specifications.¹⁰ If a contractor is providing a specific brand of bathroom fixtures, sink, stove, refrigerator, lighting, carpeting and other floor surfaces, burglar and smoke alarms, paints, textured coatings, siding and other wall surfaces, insulation, roofing, air conditioning and heating systems, and/or appliances, the contract or specifications must include a description of the goods or materials, including any brand name, model number, or similar designation.¹¹

3. Down Payment

This is probably the most difficult issue for home improvement contractors. The law severely limits what a contractor can charge as a “down payment.” If a down payment is to be charged, it must be listed under the heading “**Downpayment**” and include the actual amount of the down payment followed by the following statement in 12-point boldface type: “**THE DOWNPAYMENT MAY NOT EXCEED \$1,000 OR EXCEED 10% OF THE CONTRACT PRICE, WHICHEVER IS LESS.**”¹² This is probably the most infuriating provision for contractors as it prevents contractors from collecting money up front for materials. These costs can be significant for custom items and forces contractors to finance the project and possibly be left with worthless materials if the owner fails to make payment.

4. Progress Payments

If there are going to be planned progress payments, other than the down payment, the details of these payments must be set forth as follows: Under the heading “**Schedule Of Progress Payments**” each progress payment shall be stated in dollars, which specifically references the amount of work or services to be performed and any materials to be supplied. This shall be preceded with the following statement in 12-point boldface type:

“The schedule of progress payments must specifically describe each phase of work, including the type and amount of work or services scheduled to be supplied in each phase, along with the amount of each proposed progress payment. IT IS AGAINST THE LAW FOR A CONTRACTOR TO COLLECT PAYMENT FOR WORK NOT YET COMPLETED, OR FOR MATERIALS NOT YET DELIVERED. HOWEVER, A CONTRACTOR MAY REQUIRE A DOWN PAYMENT.”¹³

Except for the down payment, contractors may not request, nor accept payment that exceeds the value of the work performed or the materials delivered.¹⁴ As mentioned this puts contractors in a serious bind when it come to ordering custom materials as the contractor is not allowed to accept payment for materials not yet delivered.

One way around this provision is to provide a payment and performance bond, lien and completion bond or a bond equivalent to joint control.¹⁵ A contractor with any of these bonds may accept payment prior to completion. Further, the warnings about down payment and progress payments do not need to be included if bonds are provided.

5. Time

Under the heading “**Approximate Start Date,**” the date upon which the project commencement is anticipated, includes a statement which defines substantial commencement of the work, and under the heading, “**Approximate Completion Date,**” the approximate completion date.¹⁶ If applicable, under the heading “**List Of Documents To Be Incorporated Into the Contract**” shall be followed by, obviously, the list of the documents to be incorporated into the contract.¹⁷

6. Change Orders

Change orders can only become part of the contract if they are in writing and signed by all parties prior to commencement of the work covered by the change order.¹⁸ This provision is actually bad for the homeowner as it allows the contractor an opportunity to demand an unreasonable price for the extra work since no work can be performed prior to a written order. A better drafted provision would allow the homeowner to order a change requiring a contractor to perform with the price to be agreed upon through some formula at a later date. The following statement must be included under the heading, “**Note About Extra Work and Change Orders**”:

“Extra Work and Change Orders become part of the contract once the order is prepared in writing and signed by the parties prior to the commencement of any work covered by the new change order. The order must describe the scope of the extra work or change, the cost to be added or subtracted from the contract, and the effect the order will have on the schedule of progress payments.”¹⁹

Also, a statement that the buyer may not require a contractor to perform extra work without written authorization and a statement informing buyer that extra/change order work is not enforceable against the buyer unless the change order also identifies all the following in writing: (i) the scope of work encompassed by the order; (ii) the amount to be added or subtracted from the contract; and (iii) the effect the order will make on the progress payments or completion date. The contract must also include a statement informing the buyer that the contractor’s failure to comply with the requirements of this paragraph does not preclude the recovery of compensation for work performed based on legal or equitable remedies designed to prevent unjust enrichment.²⁰ Lastly, the change order form itself must be included as part of the contract.²¹ This is recommended to be included as an attachment.

7. Other Notices

In no particular section of the contract, the contractor must include a statement of essentially the following — once payment has been made for any portion of the work, the contractor, prior to any further payment being made, shall furnish to the owner a full and unconditional release from any potential lien claimant claim or mechanics lien authorized pursuant to *Civil Code* §8400-8404 for the portion of work for which payment has previously been made.²² When representing homeowners it is extremely important that prior to progress payments being made, the homeowner obtain an unconditional release on the previous payment from the contractor and each of the subcontractors that served 20-preliminary notices.

The contract must also provide a notice, in close proximity to the signatures, that the owner has the right to require the contractor to have a performance or payment bond. Unless the project is very expensive, the cost of the bond may not be worth the protection. Even though an owner can require the bond, the contractor is not required to pay for the extra cost incurred by the bond.²³

C. Required Notices²⁴

The following notices may either be included as part of the contract or in an attachment to the contract.²⁵

1. Insurance. Under the heading “**Commercial General Liability Insurance (CGL)**,” the following statement must be included (as applicable):

“(The name on the license or ‘This contractor’) does not carry commercial general liability insurance.” or “(The name on the license or ‘This contractor’) carries commercial general liability insurance written by (the insurance company). You may call the (insurance company) at _____ to check the contractor’s insurance coverage” or “(The name on the license or ‘This contractor’) is self-insured”²⁶ or “(The name on the license or ‘This contractor’) is a limited liability company that carries liability insurance or maintains other security as required by law. You may call (the insurance company or trust company or bank) at _____ to check on the contractor’s insurance coverage or security.”

2. Workers Compensation. You must include the following notice regarding workers compensation insurance under the heading “**Workers Compensation Insurance**” as follows (as applicable):

“(The name on the license or ‘This contractor’) has no employees and is exempt from workers’ compensation requirements.” Or “(The name on the license or ‘This contractor’) carries workers’ compensation insurance for all employees.”

²⁷

3. Mechanics Liens. The following notice is required under the heading **“MECHANICS LIEN WARNING.”**²⁸:

“Anyone who helps improve your property, but who is not paid, may record what is called a mechanics lien on your property. A mechanic’s lien is a claim, like a mortgage or home equity loan, made against your property and recorded with the county recorder.

“Even if you pay your contractor in full, unpaid subcontractors, suppliers, and laborers who helped to improve your property may record mechanics’ liens and sue you in court to foreclose the lien. If a court finds the lien is valid, you could be forced to pay twice or have a court officer sell your home to pay the lien. Liens can also affect your credit.

“To preserve their right to record a lien, each subcontractor and material supplier must provide you with a document called a ‘20-day Preliminary Notice.’ This notice is not a lien. The purpose of the notice is to let you know that the person who sends you the notice has the right to record a lien on your property if he or she is not paid.

“**BE CAREFUL.** The Preliminary Notice can be sent up to 20 days after the subcontractor starts work or the supplier provides material. This can be a big problem if you pay your contractor before you have received the Preliminary Notices.

“You will not get Preliminary Notices from your prime contractor or from laborers who work on your project. The law assumes that you already know they are improving your property.

“**PROTECT YOURSELF FROM LIENS.** You can protect yourself from liens by getting a list from your contractor of all the subcontractors and material suppliers that work on your project. Find out from your contractor when these subcontractors started work and when these suppliers delivered goods or materials. Then wait 20 days, paying attention to the Preliminary Notices you receive.

“**PAY WITH JOINT CHECKS.** One way to protect yourself is to pay with a joint check. When your contractor tells you it is time to pay for the work of a subcontractor or supplier who has provided you with a Preliminary Notice, write a joint check payable to both the contractor and the subcontractor or material supplier.

“For other ways to prevent liens, visit CSLB’s Internet Website at www.cslb.ca.gov or call CSLB at 800-321-CSLB (2752).

“REMEMBER, IF YOU DO NOTHING, YOU RISK HAVING A LIEN PLACED ON YOUR HOME. This can mean that you may have to pay twice, or face the forced sale of your home to pay what you owe.” (§ 7159(e)(4))

4. CSLB Notice. The following notice shall be provided in at least 12-point typeface:

“Information about the Contractors State License Board (CSLB): CSLB is the state consumer protection agency that licenses and regulates construction contractors. Contact CSLB for information about the licensed contractor you are considering, including information about disclosable complaints, disciplinary actions and civil judgments that are reported to CSLB.

“Use only licensed contractors. If you file a complaint against a licensed contractor within the legal deadline (usually four years), CSLB has authority to investigate the complaint. If you use an unlicensed contractor, CSLB may not be able to help you resolve your complaint. Your only remedy may be in civil court, and you may be liable for damages arising out of any injuries to the unlicensed contractor or the unlicensed contractor’s employees.

“For more information:

Visit CSLB’s Internet Website at www.cslb.ca.gov

Call CSLB at 800-321-CSLB (2752)

Write CSLB at P.O. Box 26000, Sacramento, CA 95826.” (§ 7159(e)(5))

5. Three-Day Right to Cancel. The “Three-Day Right to Cancel Notice” shall be provided to the buyer unless a contract is: (1) negotiated at the contractor’s place of business; (2) subject to the “Seven-Day Right to Cancel” (discussed below); or (3) the contractor is subject to licensure under the Alarm Company Act. The notice must be in 12-point boldface font and in immediate proximity to the signature. The owner must also acknowledge receipt of the notice by signing and dating the notice form on the signature page. Most importantly, this notice must be written in the same language (for example, Spanish, etc.) that was principally used in the oral sales presentation for the contract. The notice must be in the following form:

“Three-Day Right to Cancel

“You, the buyer, have the right to cancel this contract within three business days. You may cancel by e-mailing, mailing, faxing, or delivering a written notice to the contractor at the contractor’s place of business by midnight of the third business day after you received a signed and dated copy of the contract that includes this notice. Include your name, your address, and the date you received the signed copy of the contract and this notice.

“If you cancel, the contractor must return to you anything you paid within 10 days of receiving the notice of cancellation. For your part, you must make available to the contractor at your residence, in

substantially as good condition as you received it, any goods delivered to you under this contract or sale. Or, you may, if you wish, comply with the contractor's instructions on how to return the goods at the contractor's expense and risk. If you do make the goods available to the contractor and the contractor does not pick them up within 20 days of the date of your notice of cancellation, you may keep them without any further obligation. If you fail to make the goods available to the contractor, or if you agree to return the goods to the contractor and fail to do so, then you remain liable for performance of all obligations under the contract."

This notice shall also be accompanied by the following completed form in duplicate. This notice must also be in the same language that the contract was negotiated in.²⁹

"Notice of Cancellation

/enter date of transaction/

(Date)

"You may cancel this transaction, without any penalty or obligation, within three business days from the above date.

"If you cancel, any property traded in, any payments made by you under the contract or sale, and any negotiable instrument executed by you will be returned within 10 days following receipt by the seller of your cancellation notice, and any security interest arising out of the transaction will be canceled.

"If you cancel, you must make available to the seller at your residence, in substantially as good condition as when received, any goods delivered to you under this contract or sale, or you may, if you wish, comply with the instructions of the seller regarding the return shipment of the goods at the seller's expense and risk. If you do make the goods available to the seller and the seller does not pick them up within 20 days of the date of your notice of cancellation, you may retain or dispose of the goods without any further obligation. If you fail to make the goods available to the seller, or if you agree to return the goods to the seller and fail to do so, then you remain liable for performance of all obligations under the contract.

"To cancel this transaction, mail or deliver a signed and dated copy of this cancellation notice, or any other written notice, or send a telegram to, /name of seller/ at /address of seller's place of business/ not later than midnight of _____. (Date)

"I hereby cancel this transaction. _____ (Date)
_____ (Buyer's signature)"

6. Seven-Day Right to Cancel: There is a seven-day right to cancel if the contract is for the repair or restoration of a residential premise damaged by “any sudden or catastrophic event for which a state of emergency has been declared by the President of the United States or the governor.” The seven-day right to cancel has the same requirements as the three day right to cancel except instead of three days, the owner is allowed seven days to cancel the transaction.³⁰

D. Service and Repair Contracts

AB316 also creates a brand new type of contract called “Service and Repair Contracts.” A “Service and Repair Contract” is defined as an agreement between an owner and a contractor for: (a) home improvement work that is \$750 or less; (b) where the buyer initiated the contact with the contractor and requested the work; (c) the contractor does not sell to the buyer goods or service beyond those reasonably necessary to take care of the particular work; and (d) no payment is due or accepted by the contractor until the work is completed. The requirements for “Service and Repair Contracts” are beyond the scope of this article, but should be reviewed by counsel who has clients who consistently perform minor home improvement work. Be warned, however, the provisions are as equally detailed as those summarized herein.³¹

E. Penalties for Failure to Comply

The penalty for failing to provide the aforementioned notices subjects the licensee to discipline by the CSLB.³² This is probably the easiest method for the CSLB to impose discipline. Once they receive a consumer’s complaint, they will most likely ask for the contract between the parties. If the contract is not in compliance, the contractor can be subject to discipline even before the complaint is actually dealt with. Further, a violation for failing to provide the contract amount, overcharging on the down payment, or accepting payment that exceeds the value of the work performed, subjects the licensee to a misdemeanor punishable by a fine not less than \$100 or more than \$5,000, or by imprisonment in county jail not exceeding one (1) year or both.³³ The statute of limitations for violations of these sections is only two (2) years. The statute runs from the date that the buyer signs the contract and is not applicable to any administrative disciplinary action.

If a person violates Section 7159.5 as part of a plan to scheme or defraud owners or tenants in connection with the damage caused by a natural disaster, the court can order the person to make full restitution to the victim based on the person’s ability to pay. In addition to full restitution and imprisonment authorized by the section, the court can impose a fine of not less than \$500 and not more than \$25,000.³⁴

F. Effect of Non-Compliance

As mentioned, the primary penalty for failing to provide the specific information, notices, and disclosures as required by Section 7159 is that the licensee is subject to discipline. But failing to follow these provisions can have other unintended consequences. There are two cases in California that have interpreted similar requirements found in the current Sections

7159 and 7164. The first is Arya Group, Inc. v. Cher (2000) 77 Cal.App.4th 610, 91 Cal.Rptr.2d 815. In this case, a contractor negotiated an oral agreement with Cher to design and construct her Malibu home for the sum of \$4,217,529. The parties' oral agreement was subsequently memorialized in a written contract which was never signed by Cher. The narrow issue was whether the contractor was precluded under Section 7164 from pursuing a breach of contract claim as a result of its failure to secure a signed written contract as required by that section. (Section 7164 contains almost identical provisions to Section 7159 for the construction of a single family dwelling and is intended to afford consumers who contract for the construction of a single family dwelling the same safeguards available under Section 7159.) Following the Asdourian decision (as discussed below), the Court in Arya held that the contractor may seek to enforce his oral contract claim against Cher to the extent that Cher would be otherwise unjustly enriched as a result of her failure to compensate the contractor for the reasonable value of its work on the Malibu construction project. The contract was not necessarily void simply due to the failure of the contractor to abide by the requirements of Section 7164.

In Asdourian v. Araj (1985) 38 Cal.3d 276, 211 Cal.Rptr. 703, the contractor sought compensation from two sophisticated property owners for remodeling work performed pursuant to oral contracts. The owners contended that since the agreements between the parties were oral, they violated Section 7159 and thus were void. Although the Supreme Court acknowledged that "generally speaking" a contract made in violation of regulatory statute is void, it stressed that "the rule is not an inflexible one to be applied in its full rigor under any and all circumstances," and "a wide range of exceptions have been recognized." Id. at 291. In addition, the Court stated that "in compelling cases, illegal contracts were being enforced in order to avoid unjust enrichment to a defendant in a disproportionately harsh penalty upon plaintiff." Id. at 292.

In reviewing the evolution of Section 7159, the Arya Court determined that the legislature intended neither that the express misdemeanor penalty provision of the statute would be exclusive, nor that all contracts made in violation of the statute would be void, thus opening the door to enforcement of noncomplying contracts in appropriate cases. Arya, 77 Cal.App.4th at 615. The Court concluded that the Asdourian case was just such a case, citing the fact that (1) the defendants were not members of the group primarily in need of the statute's protection (*i.e.*, unsophisticated consumers); (2) contracts made in violation of Section 7159 were not "inherently illegal"; and (3) if the defendants were allowed to retain the value of the benefits bestowed by the plaintiff without compensation, they would be unjustly enriched. Id.

In analyzing both of these cases, it is clear that an HIC that violates the provisions of Section 7159, or Section 7164 for that matter, would not necessarily be void and unenforceable if the contract were with an owner who was sophisticated (not a member of the class that the statute was intended to protect), and if significant unjust enrichment would result if the contract were to be held to be void. This, however, should not provide any comfort for the contractor that does not abide by these provisions. Contractors should always take special care with owners that are unsophisticated (especially the elderly) in providing construction services. Therefore, it is best practice for contractors to draft contracts in compliance with

Section 7159 rather than rely upon the hope that a court may, down the road, find that a failure to comply with the requirements of Section 7159 does not void the contract.

G. Conclusion

As you can see, the legislature has not made much progress in making home improvement contracts easier to understand or to draft by the contractor. Regardless, all contractors should update its contracts to comply with these requirements.

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¹ §7159

² § 7151

³³ § 7159(c)(1) & (2).

⁴ § 7159(c)(3)(A).

⁵ § 7159(d)(4).

⁶ Also the name and registration number of the home improvement salesperson, if applicable. § 7159(c)(3)(B) and § 7159(d)(1) & (2).

⁷ § 7159(d)(3).

⁸ Required terms as set forth in this section must be in the contract itself and cannot be part of an attachment.

⁹ § 7159.5(a)(1).

¹⁰ § 7159(d)(7). Swimming pool contracts have even more rigid requirements than HICs. These further required provisions are not addressed in this article.

¹¹ § 7162.

¹² § 7159(d)(8).

¹³ § 7159(d)(9)

¹⁴ § 7159.5(a)(5).

¹⁵ § 7159.5(a)(8)

¹⁶ § 7159(d)(10) and (11).

¹⁷ § 7159(d)(12).

¹⁸ § 7159(c)(5).

¹⁹ § 7159(d)(13)

²⁰ § 7159(e)(3).

²¹ § 7159(c)(5).

²² In striking contradiction to this Section, proposed Section 7159.5 only requires the contractor to furnish the unconditional release for any portion of the work that the payment has been made upon “request” by the owner for such release. Clearly, this contradicts the requirement that the contractor shall provide the owner this release under Section 7159. Thus, the better practice is to provide the release regardless of a specific request. § 7159(c)(4)

²³ § 7159(c)(6).

²⁴ It is recommended that these items be provided within the contract itself rather than in an attachment, as the statute requires an actual notice in the contract that the required notice is contained in an attachment.

²⁵ These notices can be included as an attachment to the contract.

²⁶ If this notice and the notice re workers compensation is provided in an attachment, you must provide a notice in the contract itself stating “A notice concerning commercial general liability insurance/workers compensation is attached to this contract.” (§ 7159(e)(1))

²⁷ § 7159(e)(2)

²⁸ Of significant note, AB316 does not require this section to be in any particular font or boldface type but it is recommended to put this provision in bold.

²⁹ § 7159(e)(6)

³⁰ § 7159(e)(7).

³¹ § 7159.10.

³² § 7159(a)(3).

³³ § 7159.5(b).

³⁴ § 7159.5(c).