

ASSEMBLY BILL

No. 1534

Introduced by Assembly Member Longville

February 23, 2001

An act to add Section 3110.5 to the Civil Code, relating to works of improvement.

LEGISLATIVE COUNSEL'S DIGEST

AB 1534, as introduced, Longville. Contractors: works of improvement.

Existing statutory law generally governs payment provisions contained in contracts for works of improvement.

This bill would require an owner of property who contracts for a work of improvement, for construction, alteration, or repair of the property, where the value of the contract is more than \$5,000,000, to provide to the original contractor, if a lending institution is providing a construction loan, a copy of the recorded construction mortgage or deed of trust that shall disclose the amount of the construction loan. The bill would also require an owner who is not the majority owner of the original contractor to provide security for that project by a payment bond, irrevocable letter of credit, or a construction security account, as specified. The bill's requirements would not apply to the construction of single-family residences and specified associated fixed works, public works projects, or housing developments eligible for a density bonus, as specified. The bill would also exempt certain publicly-traded companies and qualified private companies, as defined, from the above requirements.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 3110.5 is added to the Civil Code, to
2 read:

3 3110.5. (a) When an owner of property contracts for any
4 work of improvement for construction, alteration, or repair upon
5 the property, and the value of the contract for the work of
6 improvement is more than five million dollars (\$5,000,000), the
7 owner shall supply to the original contractor, if a lending
8 institution is providing a construction loan, a copy certified by the
9 county recorder of the recorded construction mortgage or deed of
10 trust that shall disclose the amount of the construction loan. In
11 addition if the owner is not the majority owner of the original
12 contractor, the owner shall provide security for the project. The
13 security shall be used only when the owner defaults on his or her
14 contractual obligations to the original contractor, by one of the
15 following means:

16 (1) A payment bond, as defined in Section 3096, in the amount
17 of 15 percent of the contract, which is payable upon default by the
18 owner of any undisputed amount under the contract that has been
19 due and payable for more than 30 days. The payment bond shall
20 be from a California admitted surety listed in the Department of
21 the Treasury’s Listing of Approved Sureties (Department Circular
22 570) with an underwriting limitation greater than the value of the
23 contract.

24 (2) An irrevocable letter of credit from a financial institution,
25 as defined in Section 5107 of the Financial Code, inuring to the
26 benefit of the original contractor in the amount of not less than 15
27 percent of the total construction contract amount. The maturity
28 date of the letter of credit and other terms of the letter of credit shall
29 be determined by agreement between the owner, the original
30 contractor, and the issuer of the letter of credit provided that the
31 owner shall be required to maintain the letter of credit in effect
32 until the owner has satisfied all of its payment obligations to the
33 original contractor.

34 (3) (A) A deposit account, as defined in subdivision (e) of
35 Section 9105 of the Commercial Code, maintained with a financial
36 institution, as defined in Section 5107 of the Financial Code,
37 located in California, designated as a “construction security
38 account,” in which the owner shall maintain on deposit funds in



1 the amount provided in subparagraph (B); provided that the
2 original contractor shall not be obligated to accept a construction
3 security account as security unless the owner establishes to the
4 reasonable satisfaction of the original contractor (which may be
5 established by a written opinion of legal counsel for the owner),
6 that the owner has granted the original contractor a perfected, first
7 priority security interest in the construction security account and
8 all funds therein and the proceeds thereof. The funds on deposit in
9 the construction security account shall be the sole property of the
10 owner, subject to the security interest in favor of the original
11 contractor. Withdrawals from the construction security account
12 shall require the signature of at least one representative of the
13 owner and at least one representative of the original contractor, as
14 the same shall be designated on the signature card for the
15 construction security account. Nothing in this statute shall be
16 construed to impose any duties on any financial institution with
17 respect to any construction security account beyond the duties
18 imposed on financial institutions with respect to deposit accounts
19 generally. Nothing in this statute shall be construed to require any
20 construction lender to agree to deposit proceeds of a construction
21 loan in a construction security account.

22 (B) The amount of funds to be maintained on deposit in the
23 construction security account from time to time shall be an amount
24 equal to the sum of the cost of the work to be incurred during a
25 three-month period commencing with the current month, unless
26 work was performed in the prior month for which no progress
27 payment has been made, in which case the three-month period
28 shall commence with the prior month, based on a schedule of
29 estimated costs to be incurred during each month of the work,
30 which schedule shall be agreed upon by the owner and the original
31 contractor prior to execution of the original contractor's contract
32 and incorporated as a part of that contract (subject to adjustment
33 from time to time by agreement between the owner or his or her
34 representative and the original contractor); plus the total amount
35 of retainage held by the owner for all prior months; provided,
36 however, that in no event shall the amount required to be
37 maintained on deposit in the construction security account exceed
38 the total amount of future payments remaining to be due the
39 original contractor under its construction contract (or as adjusted
40 by agreement between the owner or his or her representative and



1 the original contractor). Whenever the total amount of funds on
2 deposit in a construction security account established pursuant to
3 subparagraph (A) is less than the amount required pursuant to this
4 subparagraph, the owner shall deposit the amount of the shortfall
5 in the construction security account, and if the owner fails to
6 deposit the required funds within 10 days after receipt of written
7 demand to do so by the original contractor, the original contractor
8 may suspend work until the deposit is made.

9 (C) The owner and the original contractor shall be obligated to
10 authorize the disbursement of funds from a construction security
11 account established pursuant to subparagraph (A) in accordance
12 with the provisions of this subparagraph. The provisions of this
13 subparagraph shall create obligations only on the part of the owner
14 and the original contractor to authorize the disbursement of funds
15 from a construction security account as set forth herein, and this
16 subparagraph shall not affect the duties imposed on the financial
17 institution with which a construction security account is
18 maintained with respect thereto. The financial institution with
19 which a construction security account is maintained shall have no
20 duty to determine whether the conditions for disbursement from
21 a construction security account set forth in this subparagraph have
22 been satisfied. Whenever the amount of funds on deposit in the
23 construction security account exceeds the amount required
24 pursuant to subparagraph (B), the owner and the original
25 contractor shall authorize the disbursement to the original
26 contractor of the excess funds on deposit in the construction
27 security account to pay progress payments due the original
28 contractor under its construction contract (in whole or in part), but
29 in no event shall either party be obligated to authorize the
30 disbursement of any funds that would cause the amount remaining
31 on deposit in the construction security account following the
32 disbursement to be less than the amount required pursuant to
33 subparagraph (B). The owner and the original contractor shall
34 authorize the disbursement to the owner of any funds remaining
35 on deposit in the construction security account after the original
36 contractor has been paid all amounts due under its construction
37 contract. The owner and the original contractor shall authorize the
38 disbursement of any funds on deposit in the construction security
39 account in accordance with the order of any court which is binding
40 on both of them. The owner and the original contractor may agree



1 in the construction contract upon other conditions for the
2 disbursement of funds on deposit in the construction security
3 account, provided that the conditions shall not cause the amount
4 remaining on deposit in the construction security account to be less
5 than the amount required pursuant to subparagraph (B).

6 (b) No part of this section shall be interpreted to affect
7 provisions in this code providing for mechanics' liens, stop
8 notices, bond remedies, or prompt payment rights of a
9 subcontractor, including the original contractor's payment
10 responsibilities as set forth in Section 7108.5 of the Business and
11 Professions Code and Section 10262 of the Public Contract Code.

12 (c) Nothing in this section shall apply to the construction of
13 single-family residences and any associated fixed works that
14 require the services of a general engineering contractor, as defined
15 in Section 7056 of the Business and Professions Code, any public
16 works projects, or housing developments eligible for a density
17 bonus pursuant to Section 65915 of the Government Code.

18 (d) Exempt from this section are publicly-traded companies,
19 provided that the obligations under the construction contract are
20 guaranteed by the publicly-traded company. As used in this
21 section, the term "publicly-traded company" means any company
22 having a class of equity securities listed for trading on the New
23 York Stock Exchange, the American Stock Exchange or the
24 NASDAQ stock market or any wholly-owned subsidiary of any
25 such company, provided that the obligations under the
26 construction contract are guaranteed by the publicly-traded parent
27 company. Also exempt from this section are qualified private
28 companies. As used in this section, the term "qualified private
29 company" means any company other than a publicly-traded
30 company that has a net worth determined in accordance with
31 generally accepted accounting principles in excess of fifty million
32 dollars (\$50,000,000), or any wholly owned subsidiary of any
33 company that is not publicly traded, provided that the obligations
34 under the construction contract are guaranteed by the parent
35 company and that parent company has a net worth determined in
36 accordance with generally accepted accounting principles in
37 excess of fifty million dollars (\$50,000,000).

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