

Assembly Bill No. 1534

CHAPTER 823

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

[Approved by Governor October 12, 2001. Filed
with Secretary of State October 13, 2001.]

LEGISLATIVE COUNSEL'S DIGEST

AB 1534, 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, addition to, or repair of the property, where the value of the contract is either (1) more than \$5,000,000 where the owner's interest is a fee simple absolute interest in the property, or (2) more than \$1,000,000 where the owner's interest is less than a fee simple absolute interest in the property, 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 escrow account, as specified. The bill's requirements would not apply to the construction of single-family residences, as defined, and specified associated fixed works, public works projects, or housing developments eligible for a density bonus, as specified. The bill would also exempt certain qualified publicly traded companies and qualified private companies, as defined, from the above requirements.

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

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

3110.5. (a) (1) This section shall apply only to an owner who contracts for a work of improvement for construction, alteration, addition to, or repair upon, property, whether the contracting owner is the owner of a fee simple absolute interest in the property or the owner of any lesser interest in the property. For purposes of this section, a lessee of real property shall be considered to be the owner of a fee simple absolute interest in that real property if and only if: (A) the initial term



of the lease is at least 35 years and (B) the lease covers one or more lawful parcels under the Subdivision Map Act (Division 2 (commencing with Section 66410) of Title 7 of the Government Code) and any applicable local ordinances adopted pursuant thereto, in their entirety, including, but not limited to, parcels approved pursuant to certificate of compliance proceedings. For purposes of this section, the owner of a fee simple absolute interest shall not be deemed to be the owner of less than a fee simple absolute interest by reason of any mortgages, deeds of trust, ground leases, or other liens or encumbrances or rights to occupancy that may encumber the fee simple absolute interest. When the owner contracting for the work of improvement is an owner of an interest in the property which is less than a fee simple absolute interest, nothing in this section shall require the owner of the fee simple absolute interest who does not contract for the work of improvement to provide any security pursuant to this section or to comply with any of the other obligations of an owner under this section. When the owner contracting for the work of improvement is an owner of the fee simple absolute interest in the property, nothing in this section shall require the owner of an interest in the property which is less than a fee simple absolute interest who does not contract for the work of improvement to provide any security pursuant to this section or to comply with any of the other obligations of an owner under this section.

(2) An owner contracting for a work of improvement is subject to this section only if one of the following conditions is satisfied:

(A) The owner contracting for the work of improvement is the owner of a fee simple absolute interest in the property upon which the work of improvement is to be made, and the value of the contract for the work of improvement is more than five million dollars (\$5,000,000).

(B) The owner contracting for the work of improvement is the owner of an interest which is less than a fee simple absolute interest, including a leasehold interest, in the property upon which the work of improvement is to be made, and the value of the contract for the work of improvement is more than one million dollars (\$1,000,000).

(b) When an owner of property, whether an owner of a fee simple absolute interest or any lesser interest therein, contracts for any work of improvement for construction, alteration, addition to, or repair upon, the property, and the contracting owner is subject to the requirements of this section, as determined by subdivision (a), the contracting owner shall supply to the original contractor, if a lending institution is providing a construction loan, a copy certified by the county recorder of the recorded construction mortgage or deed of trust that shall disclose the amount of the construction loan. In addition, if the contracting owner is not the majority owner of the original contractor, the contracting owner shall



provide security for the contracting owner's payment obligations under the construction contract. The security shall be used only when the contracting owner defaults on his or her contractual obligations to the original contractor. The security for the contracting owner's payment obligations under the construction contract shall be provided by one of the following means:

(1) A payment bond, as defined in Section 3096, in the amount of either (A) not less than 25 percent of the total amount of any construction contract that is subject to this section where the construction contract provides that the work of improvement is scheduled to be substantially completed within six months following the commencement thereof, or (B) not less than 15 percent of the total amount of any other construction contract that is subject to this section, which payment bond shall be payable upon default by the contracting owner of any undisputed amount under the contract that has been due and payable for more than 30 days. The payment bond shall be from a California admitted surety which is either listed in the Department of the Treasury's Listing of Approved Sureties (Department Circular 570) or that has an A.M. Best rating of A or better and has an underwriting limitation, pursuant to Section 12090 of the Insurance Code, greater than the value of the contract amount of the bond.

(2) An irrevocable letter of credit from a financial institution, as defined in Section 5107 of the Financial Code, inuring to the benefit of the original contractor in the amount of either (A) not less than 25 percent of the total amount of any construction contract that is subject to this section where the construction contract provides that the work of improvement is scheduled to be substantially completed within six months following the commencement thereof, or (B) not less than 15 percent of the total amount of any other construction contract that is subject to this section. The maturity date of the letter of credit and other terms of the letter of credit shall be determined by agreement between the contracting owner, the original contractor, and the issuer of the letter of credit provided that the contracting owner shall be required to maintain the letter of credit in effect until the contracting owner has satisfied all of its payment obligations to the original contractor.

(3) (A) An escrow account, designated as a "construction security escrow account," maintained with an escrow agent licensed under the Escrow Law, as set forth in Division 6 (commencing with Section 17000) of the Financial Code, or with any person exempt from the Escrow Law pursuant to paragraph (1) or (3) of subdivision (a) of Section 17006 of the Financial Code, which construction security escrow account shall be located in California and in which the contracting owner shall deposit funds in the amount provided in



subparagraph (B); provided that the original contractor shall not be obligated to accept a construction security escrow account as security unless the contracting owner establishes to the reasonable satisfaction of the original contractor (which may be established by a written opinion of legal counsel for the contracting owner), that the contracting owner has granted the original contractor a perfected, first priority security interest in the construction security escrow account and all funds deposited by the contracting owner therein and the proceeds thereof. The funds on deposit in the construction security escrow account shall be the sole property of the contracting owner, subject to the security interest in favor of the original contractor. The escrowholder shall be instructed by the contracting owner and the original contractor to hold the funds on deposit in the construction security escrow account for the purpose of perfecting the original contractor's security interest therein and to disburse those funds only upon the joint authorization of the contracting owner and the original contractor, or in accordance with an order of any court which is binding on both the owner and the original contractor. Nothing in this section shall be construed to require any construction lender to agree to deposit proceeds of a construction loan in a construction security escrow account.

(B) Prior to commencement of the work under the construction contract, the contracting owner shall make an initial deposit to the construction security escrow account in the amount of either (i) not less than 25 percent of the total amount of any construction contract which is subject to this section where the construction contract provides that the work of improvement is scheduled to be substantially completed within six months following the commencement thereof, or (ii) not less than 15 percent of the total amount of any other construction contract which is subject to this section. In addition, if the construction contract provides for a so-called retainage or retention to be withheld from periodic payments to the original contractor, the contracting owner shall deposit all amounts withheld as retainage or retention in the construction security escrow account at the same time the contracting owner makes the corresponding payment to the original contractor from which the retainage or retention is withheld provided, however, that in no event shall the amount required to be maintained on deposit in the construction security escrow account exceed the total amount of future payments remaining to be due the original contractor under its construction contract (as the same may be adjusted by agreement between the contracting owner and the original contractor). Whenever the amount of funds on deposit in the construction security escrow account equals or exceeds the total amount of future payments remaining to be due the original contractor, the contracting owner and the original contractor



shall authorize the disbursement to the original contractor of funds on deposit in the construction security escrow account to pay progress payments then due the original contractor under its construction contract (in whole or in part), but in no event shall either party be obligated to authorize the disbursement of any funds that would cause the amount remaining on deposit in the construction security escrow account following that disbursement to be less than the total amount of future payments remaining to be due the original contractor after application of any funds disbursed to the original contractor. The contracting owner and the original contractor shall authorize the disbursement to the contracting owner of any funds remaining on deposit in the construction security escrow account after the original contractor has been paid all amounts due under its construction contract. The contracting owner and the original contractor shall authorize the disbursement of funds on deposit in the construction security escrow account in accordance with the order of any court which is binding on both of them. The contracting owner and the original contractor may agree in the construction contract upon additional conditions for the disbursement of funds on deposit in the construction security escrow account provided that the conditions shall not cause the amount remaining on deposit in the construction security escrow account to be less than the amount required pursuant to this subparagraph.

(c) For the purposes of subdivision (b), in cases where the price under the construction contract is not a fixed price, the amount of security to be provided shall be determined with reference to the guaranteed maximum price, if there is one, or if there is no guaranteed maximum price, the amount of security shall be determined with reference to the contracting owner's and original contractor's good faith estimate as to the total cost anticipated to be incurred under the construction contract. Whenever any contracting owner that is required to provide security under this section with respect to a construction contract fails to provide that security or fails to maintain that security as required, the original contractor may make written demand on the contracting owner to do so, and if the contracting owner fails to provide and maintain that security within 10 days after the original contractor makes written demand on the owner, the original contractor may suspend work until the required security is provided and maintained in accordance with this section.

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



(e) Nothing in this section shall apply to the construction of single-family residences, including single-family residences located within a subdivision, and any associated fixed works that require the services of a general engineering contractor, as defined in Section 7056 of the Business and Professions Code, any public works projects, or housing developments eligible for a density bonus pursuant to Section 65915 of the Government Code. As used in this section, the term “single-family” residence means a real property improvement used or intended to be used as a dwelling unit for one family.

(f) This section does not apply to either of the following:

(1) Any contract where the contracting owner is either a qualified publicly traded company or a wholly owned subsidiary of a qualified publicly traded company, provided that the obligations of the subsidiary under the construction contract are guaranteed by the parent which is a qualified publicly traded company. As used in this section, the term “qualified publicly traded company” means any company having a class of equity securities listed for trading on the New York Stock Exchange, the American Stock Exchange or the NASDAQ stock market and the nonsubordinated debt securities thereof which are rated as “investment grade” by either Fitch IBCA, Inc., Moody’s Investor Services, Inc., Standard & Poor’s Ratings Services or a similar statistical rating organization which is nationally recognized for rating the creditworthiness of publicly traded companies. If at any time prior to final payment of all sums due under the construction contract the nonsubordinated debt securities of the qualified publicly traded company are downgraded to below “investment grade” by one of the referenced rating agencies, the contracting owner of the property will no longer be exempt from the provisions of this section.

(2) Any contract where the contracting owner is either a qualified private company or a wholly owned subsidiary of a qualified private company, provided that the obligations of the subsidiary under the construction contract are guaranteed by the parent which is a qualified private company. As used in this section, the term “qualified private company” means any company that has no equity securities listed for trading on the New York Stock Exchange, the American Stock Exchange or the NASDAQ stock market, and that has a net worth determined in accordance with generally accepted accounting principles in excess of fifty million dollars (\$50,000,000). If at any time prior to final payment of all sums due under the construction contract the net worth of the qualified private company is reduced below the level referenced in this section the owner of the property will no longer be exempt from the provisions of this section.



(g) It shall be against public policy to waive the provisions of this section in any contract for any private work of improvement to which this section applies.

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