CONTRACTOR NOT BARRED BY FAILURE TO OBTAIN WRITTEN HOME IMPROVEMENT CONTRACT

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Many general contractors include home improvement projects within the scope of work they perform. Business & Professions Code § 7159 has long required all home improvement contracts over $500 to be in writing. Section 7159 further provides that where the contract is not in writing, the contract may be voidable. An issue has, however, existed as to whether an oral home improvement contract can be enforced and, if so, under what circumstances.
The Second District Court of Appeal recently answered the question in HinerfeldWard, Inc. v. Lipian (September 1, 2010) 2010 DJDAR 13999, where the court determined that an oral home improvement contract may be enforceable where the owners were sophisticated and actively involved with the construction project, the work was completed to the owners' satisfaction, and it would be an injustice not to enforce the contract.

In Hinerfeld-Ward, the Lipians purchased property in Los Angeles for the purpose of remodeling it. They retained an architect to begin design work on the project. After the original contractor quit, the architect recommended Hinerfeld-Ward. Oral negotiations ensued between Hinerfeld-Ward and the Lipians, which outlined the scope of the work to be performed. The Lipians directed Hinerfeld-Ward to begin work on the project without the parties signing a contract.

As work progressed, Hinerfeld-Ward provided the Lipians with invoices outlining the work to be performed. In addition, when additional work was requested, written directives were issued. After a significant portion of the work was completed, Hinerfeld-Ward was terminated by the Lipians. The Lipians then received a final invoice, which went unpaid.

Hinerfeld-Ward sued for the monies owed at the time that they were terminated and the Lipians sued for negligence. The Lipians also defended on the basis that because HinerfeldWard failed to provide a written agreement, the contract should be deemed void.

The jury found in favor of Hinerfeld-Ward and, on Lipians' cross-complaint, awarded them only $1,000 in damages. Hinerfeld-Ward then applied for interest under the Prompt Pay Act sections found in Civil Code § 3260.1(b) as well as attorney's fees. The Lipians then appealed.

On appeal, the first issue to be dealt with by the court was whether or not Hinerfeld-Ward could sue, even though it did not have a written home improvement contract. The court determined that there was no bar to the enforcement of a contract under the appropriate circumstances. The court noted that the Supreme Court previously held in Asdourn v. Araj (1985) 38 Cal.3d 276 that because Business & Professions Code § 7159 does not contain any express prohibition against the enforcement of a contract, an oral agreement may be enforceable under certain circumstances, including where the work has been completed, performed under authority granted by the owners and was ratified by the owners. The court found that many of those circumstances existed here, including the fact that while the Lipians were not contractors, they were experienced in home improvement and provided significant participation in the construction process. The court also noted that the Lipians would be unjustly enriched if Hinerfeld were not allowed its recovery.

The court then discussed whether or not prompt pay penalties and attorney's fees were recoverable. In doing so, the court found that the jury had sufficient evidence to find that the Lipians had withheld in excess of 150% of the amount in dispute and, as such, Hinerfeld was entitled to interest at 2.5% per month. The court also found that the awarding of attorney's fees under Civil Code § 3260.1, while not a penalty, was still recoverable. Lastly, while the court found that some of the testimony that Lipian sought to introduce was improperly excluded, it did not prejudice them and, as such, affirmed the award.

This case highlights the need for a written contract before any construction project is commenced. First, had a contract been entered into in this case, there is a possibility that the contractor could have lost everything if the court found that the owners were not sophisticated and did not participate in the construction process, leaving it to the contractor to do so. Second, the written contract would have included the written scope of the project so as to eliminate some of the negligence claims that were raised by the Lipians. Third, the contract could have included an alternative dispute resolution and attorney's fees clause that may have avoided trial altogether. Thus, it is the better practice to provide a written contract on all projects than to guess which projects constitute a home improvement contract and which do not.

STOP NOTICE CLAIM NOT BARRED BY ERRONEOUS PRELIMINARY NOTICE

Contractors have a wide variety of remedies available to them to secure payment on private projects. Most widely known is a mechanic's lien. Another effective remedy is the bonded stop notice, which requires the construction lender to set aside funds to satisfy a claim instead of disbursing the monies to the owner or general contractor.

As with the mechanic's lien, a prerequisite to serving and enforcing a stop notice is the delivery of a preliminary notice within 20 days of the date work is first performed on the project. The 20-Day Preliminary Notice must be served on the owner or reputed owner, the general contractor or reputed general contractor, as well as the finance company or reputed finance company. The failure to either timely or properly serve the 20-day notice will preclude any recovery.

What if, however, notice is given to the wrong bank in the 20-Day Preliminary Notice? The Fourth District Court of Appeal recently answered this question in Force Framing, Inc. v. Chinatrust Bank (U.S.A.) (August 31, 2010) 2010 DJDAR 13880 ("Force Framing"). In Force Framing, Force Framing entered into a subcontract with 92 Magnolia LLC, which was serving as owner and general contractor on the project. As the project started, Magnolia provided Force Framing with an information sheet, which listed East West Bank as the construction lender. Relying on this information, Force Framing provided the 20-Day Preliminary Notice to East West Bank. It later learned that Chinatrust Bank was the construction lender and, when it was not paid, served a stop notice on Chinatrust Bank. When that was not satisfied, Force Framing filed suit to enforce the stop notice.

In response to the complaint, Chinatrust Bank filed a motion for summary judgment on the grounds that Force Framing failed to properly serve the 20-Day Preliminary Notice because it failed to serve Chinatrust Bank with the notice. The bank argued that because a deed of trust had been recorded in connection with the construction loan, Force Framing could not rely on the information sheet provided by Magnolia in preparing the 20-Day Preliminary Notice. The trial court agreed and Force Framing appealed.

The appellate court reversed the trial court, finding that a triable issue of fact existed as to whether or not Force Framing was entitled to reasonably rely on the information sheet provided by Magnolia. It noted that the statute that provided the requirements

for the 20-Day Preliminary Notice (Civil Code § 3097) required notice to be given to the "reputed" lender. The court also noted that the prior decisions dealing with this issue held that while relying on a construction deed is sufficient, that was not the only method of obtaining information inasmuch as California law also requires that subcontracts include a space for the name of the general contractor, owner or reputed owner, and construction lender, thus inferring that the subcontractors should be able to rely on that information in giving notice to the lender. Previous decisions had also held that where an owner or general contractor had given information as to the name of the lender which the subcontractor/supplier had no reason to believe was incorrect, it is sufficient compliance with the 20-Day Preliminary Notice requirement. Doing so would further the public policy of liberally construing mechanic lien laws in favor of protecting laborers and materialmen.

Force Framing should remind all potential lien claimants to obtain the best information possible prior to serving a 20-Day Preliminary Notice. Every subcontractor/supplier should obtain information from the owner and/or general contractor as to the name of the owner, the general contractor, and construction lender. Where possible, check with the local company or county recorder's office to determine if a construction loan deed of trust has been recorded on the property, which should then provide the name of the construction lender to be included in the 20-Day Preliminary Notice. Taking the extra step can assure payment. Failing to take reasonable steps to obtain the name of the construction lender could preclude you from enforcing a mechanic's lien or stop notice.

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