

CONTRACTORS ARM YOURSELVES-THE BONDED STOP NOTICE

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by Gregory R. Shaughnessy

A little used and frequently overlooked weapon in the arsenal of an unpaid contractor on a private work of improvement is the bonded stop notice. For the sophisticated and aggressive contractor, the bonded stop notice can be one of the most effective remedies available under California law.

The bonded stop notice on a private project must be distinguished from a stop notice on a public project. Perhaps the most important distinction is that a general contractor has no stop notice rights on a public work of improvement. In addition, on public projects a bond is not required to accompany the stop notice.

The bonded stop notice on a private project is directed to the construction lender, who is *required* to withhold the amount stated in the stop notice from funds that might otherwise be subject to disbursement to the owner/developer. If a payment bond has been recorded, the construction lender has the option to elect not to withhold funds pursuant to a bonded stop notice filed by someone other than the general contractor (i.e. subcontractors and suppliers).

The law governing bonded stop notices is set forth in California Civil Code Sections 3083 and 3158 - 3176.5. Important features of the bonded stop notice include:

1. The successful claimant is entitled to recover attorney's fees and costs, including the cost of the bond premium for the stop notice;
2. The claimant is also entitled to an award of interest at the legal rate from the date the bonded stop notice is served; and
3. The claimant need not wait until after their work has been completed to serve the bonded stop notice.

The importance of this last point must be emphasized. In order to record a mechanic's lien, a claimant must wait until it has completed its work (Civil Code Sections 3115 and 3116). This leaves the unpaid contractor who is considering recording a mechanic's lien with the difficult choice between abandoning the Project, cutting its losses and recording its mechanic's lien or completing the Project and gambling on being paid. Of course, at the end of the job almost all of the construction loan will have been disbursed and many other parties will also be recording mechanic's liens.

On the other hand, the bonded stop notice, served in the middle of the project on the construction lender, will immediately grab the serious attention of the construction lender and the owner. It also allows the claimant to inject itself directly into the relationship between the construction lender and the owner.

Even where a contractor waits until the end of the job, when the construction loan has been largely depleted, it may still be worth the investment of the price of a stop notice bond premium to file a bonded stop notice. This is based on the fact that a contractor is entitled to priority against the construction loan over charges by the bank against the construction loan for interest, loan fees and other costs. In Familian Corp. v Imperial Bank (1989) 213 Cal. App. 3d 681 several contractors filed stop notices totaling \$427,000 at the end of a project. The bank only held \$188,000 in unexpended construction loan funds, which would have resulted in only partial payment to the stop notice claimants. However, the bank had paid itself \$528,000 (out of a total loan of \$3,800,000) for loan expenses including interest, loan fees and general and administrative expenses. In ruling in favor of the stop notice claimants, the court in effect added the \$528,000 in bank charges to the \$188,000 in unexpended construction loan funds, which created a fund large enough to allow the stop notice claimants to be paid in full.

In summary, aggressive contractors should consider using the bonded stop notice to encourage prompt payment during the project. Even at the end of the project the bonded stop notice may provide an effective tool to reach a portion of the expended construction loan funds.

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