

LENDERS DENIED OWNER PROTECTIONS AGAINST MERITLESS LIENS AND STOP NOTICES

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True to its reputation as a bellwether in the arena of California construction law, the Third District of the California Court of Appeal in Sacramento, recently issued a decision distinguishing the rights of a construction lender from the rights of the project owner in the face of lien and stop (payment) notice claims. In 2007, Sacramento area general engineering contractor, Cal Sierra Construction, recorded a mechanic's lien and served a stop notice, claiming the bankruptcy of the developer, Dunmore Croftwood, left Cal Sierra unpaid for its work on a Rocklin subdivision project. In the wake of Dunmore's bankruptcy, Cal Sierra sued to enforce its mechanic's lien and stop notice against construction lenders Comerica Bank, Affinity Bank and United Commercial Bank (the "banks"). The banks' pre-trial motion to remove the lien and stop notice was granted by the Placer County Superior Court. The Court of Appeal reversed the ruling, holding that the Lambert motion filed by the banks was available only to the owner of the project.

If work begins before the construction lender's deed of trust on the project property (to secure repayment of the construction loan) is recorded, an unpaid contractor's lien may have "priority" over the construction lender's interest and may potentially "wipe out" the lender's deed of trust.*¹ This may force the bank to consider payment of the lien claim in order to protect its security interest. Similarly, service of a subcontractor's bonded stop notice on a construction lender will require the lender to withhold disbursement of construction funds equal to the amount of the stop notice claim if sufficient funds remain in the loan account. The claimant must file a lawsuit to foreclose the lien and to enforce the stop notice to obtain recovery on its claims.

In *Lambert v. Superior Court*, the First District Court of Appeal approved a procedure whereby an owner may file a motion before trial to force the claimant to establish the "probable validity" of the lien or stop notice. If the claimant is unable to meet this burden, the lien or stop notice will

be released. This has become known as a “Lambert motion”.

In the Cal Sierra case, the trial court ruled in favor of the banks’ Lambert motion, finding that claimant had either been paid for the work performed or did not perform the work and released the lien and stop notice. On appeal, Cal Sierra argued that the Lambert motion is available only to the project owner (and not the construction lender), and the bank’s property or funds are not affected or encumbered by a mechanic’s lien or stop notice pending the resolution of the dispute. The Court of Appeal agreed, holding that neither a mechanic’s lien nor a stop notice is a taking of lender’s property; only the owner’s property interests are affected. The Court reasoned that a lien threatens to deprive the owner of the project property, an interest not shared with the lender. It further held that the construction funds, having been committed by the lender to owner’s use for the project, are beyond any protected interest of the lender. To extend the Lambert motion procedure to the banks would deprive the lien or stop notice claimant due process of the law.

The Lambert motion is an important tool available to an owner to challenge a meritless lien or stop notice claim without having to endure the time and expense of a trial, particularly where a mechanic’s lien release bond or a stop notice release bond is not available for interim relief. Construction lenders must look elsewhere for protection, including more stringent and concurrent monitoring of the project, and careful review of payment applications, schedules of value and lien releases before allowing disbursement of construction funds.

1 A construction lender may “reverse” the loss of priority of its deed of trust to a site improvement contractor’s lien if the loan was made solely to fund the site improvements and disbursements to the borrower were prohibited until the site improver was paid in full (Civil Code §8458, former Civil Code §3137), or by recording a payment bond for 50% of the loan amount (Id.). This issue was not discussed in the Cal Sierra opinion.