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**IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA**

**FOURTH APPELLATE DISTRICT**

**DIVISION TWO**

HJH CONSTRUCTION, INC.,

Plaintiff and Respondent,

v.

CALIFORNIA BANK & TRUST, as  
Assignee, etc.,

Defendant and Appellant.

E053033

(Super.Ct.No. INC081550)

OPINION

APPEAL from the Superior Court of Riverside County. Mark E. Johnson, Judge.

Affirmed with directions.

Troutman Sanders, Dan E. Chambers, Amy A. Hoff, and Thomas H. Prouty for  
Defendant and Appellant.

Marc S. Homme; Law Offices of Rodney L. Soda and Rodney L. Soda for  
Plaintiff and Respondent.

This action arises out of a failed real estate development project in Palm Springs, California. P.S. Racquet Club Properties, LLC (Borrower), the owner/developer, borrowed money from Vineyard Bank. Borrower entered into an agreement with plaintiff and respondent HJH Construction, Inc. (HJH) wherein HJH agreed to serve as the general contractor on the project. When Borrower defaulted on the loan, Vineyard Bank attempted to foreclose on the property. Simultaneously, HJH recorded its mechanic's lien and initiated this action. Subsequently, the FDIC closed Vineyard Bank and sold its interest and liabilities with respect to the loan to Borrower to defendant and appellant California Bank & Trust (Lender). HJH's action was tried before the court and judgment was entered in its favor, awarding damages, attorney fees and costs. The judgment is based on a stop notice against Lender and foreclosure on mechanic's lien. Lender appeals.

## I. PROCEDURAL BACKGROUND AND FACTS

On November 1, 2004, (Borrower) purchased the Racquet Club of Palm Springs. At the time of the purchase, the Racquet Club consisted of 10.1 acres with 20 existing structures, including storage, restaurant, and conference area. Van Scott Jones (Jones<sup>1</sup>) was one of the Borrower's principals. Borrower sought a general contractor and approval from the City of Palm Springs to develop the property for residential use (the Project).

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<sup>1</sup> Sometimes Jones is referred to as "Scott" in the reporter's transcript.

Early in 2006, Jones approached Hal Hall (Hall), owner of HJH, to discuss the possibility of HJH serving as general contractor. Borrower and HJH entered into an oral cost plus fee contract, whereby it was agreed that HJH was to be reimbursed for its costs, and paid a fee of \$1.2 million over a term of 24 months at the rate of \$50,000 per month from the date of the construction loan funding. Both Jones and Hall had previously worked on a “handshake” agreement with other parties. In May 2006, HJH began work on the Project. Payment was to commence with the eventual funding of the construction loan.

In December 2006, Lender sent Borrower a letter of interest requesting further information. Lender also required a written contract between Borrower and HJH. Thus, on or about January 12, 2007, Borrower and HJH entered into a written Construction Contract to submit to Lender. HJH prepared the Construction Contract, which was a standard short form “AIA” agreement between owner and contractor with typewritten insertions of the terms of the oral agreement, including the payment of \$1.2 million to HJH over 24 months.; RT 17, 143, 691 } The parties intended to memorialize the terms of their preexisting oral agreement. However, the Construction Contract represented that construction work had not yet begun. In response to one of the title insurance company’s questionnaires dated January 29, 2007, Borrower described “the current stage of construction” as “not yet started.” Sean Johnson, the executive vice-president of Lender, briefly reviewed the contract but never raised an issue concerning the fee of \$1.2 million being paid over 24 months. Hall did not take part in the negotiations between Borrower

and Lender, nor did Lender have any communications with HJH about the contract or the job.

Based on Borrower's representations and information, Lender and Borrower entered into a written Construction Loan Agreement dated January 19, 2007 (the Loan Agreement). According to the Loan Agreement, Lender did not agree to loan Borrower a set, specific amount of money. Instead, the Loan Agreement provided, "The Loan shall be in an amount not to exceed the principal sum of U.S. \$15,180,000.00 and shall bear interest on so much of the principal sum as shall be advanced pursuant to the terms of this Agreement and the Related Documents." Borrower could "apply" for weekly advances to pay for labor and materials provided for the Project. However, Lender could refuse to pay the requested advances if Borrower failed to comply in any respect with any of the Loan Agreement's provisions. The Loan Agreement contemplated use of a fund control system through which application for advances would be submitted, processed, and if approved, paid.

Borrower executed a promissory note promising to pay Lender, on or before April 19, 2008, the sum of the outstanding principal amounts advanced under the Loan Agreement plus interest calculated from the date of each advance. Borrower agreed to make regular monthly payments of all accrued unpaid interest due, beginning February 10, 2007. Lender recorded a construction deed of trust on January 31, 2007.

At the owner's request, work on the Project began in May 2006 and continued intermittently through January 2007. The pre-Loan Agreement construction work consisted of tearing down the north side of the restaurant building after a fire occurred,

removing trees that were affected by the fire, demolition of curb and gutter, installing a two-and-one-half-inch water line, demolition of a gate and pilasters, watering the site for dust control, and “potholing” to ascertain the location of utility lines.

The parties stipulated on the record that the Commonwealth Land Title Insurance Company file did not contain a title inspection report, i.e., there had been no inspection of the property. Sometime in mid-October or early November 2006, at least two to three months before the construction trust deed recorded, the bank, through Johnson, made its only pre-loan visit to the site. At no time prior to the recordation of the loan had anyone from the bank asked Hall if he had performed any work at the site. Additionally, Lender’s inspector, Randy Banuelos, did not inspect the property for the first time until February 17, 2007, at least two weeks after the construction trust deed had recorded. During the visit, Banuelos did not enter every area of the site.

About January 25, 2007, Borrower, HJH and California Fund Control, Inc. (CFC) entered into a fund control agreement setting forth specific provisions regarding the fund control process. The starting point for the process was a construction cost breakdown, or a form setting forth the budget for the Project by particular cost categories. In mid-January 2007, Borrower submitted a completed and signed construction cost breakdown to Lender.

Pursuant to the fund control agreement, Borrower submitted payment requests to CFC stating the requested amount, an allocation of the amounts to the construction cost breakdown’s various cost categories, the payees’ names, and the amount to be disbursed

to each payee. HJH retained receipts or invoices for the work and materials provided in order to support its payment requests.

Upon receipt of a payment request, CFC provided Lender with a computer-generated inspection report summarizing the payment request and reflecting past disbursements by cost category. Lender reviewed CFC's report and determined whether to approve the disbursement application. Upon approval, Lender deposited the exact amount of approved funds with CFC, and CFC issued the exact amount to the payees, leaving a zero balance in the CFC account.

If a particular construction cost category was in jeopardy of running over budget, Lender had the discretion to approve reallocations. Thus, from time to time, Borrower submitted reallocation requests to Lender, many of which Lender approved. However, on multiple occasions Borrower and HJH also secretly reallocated HJH's alleged costs from one line item to another before submitting payment requests.

Borrower's monthly interest payments were made via a transfer from an "interest reserve" built into the loan as one of the Project's budgeted costs so that Borrower would not have to go out of pocket to make monthly interest payments. The interest reserve's budget amount (\$1,408,570) was determined in the loan underwriting process as an amount likely to cover interest that would accrue on Lender's potential future advances. As interest payments came due, Lender reduced the interest reserve's budget by the amount owed, which effectively reduced by that same sum the maximum potential amount that could be disbursed over the Loan Agreement's term.

Lender applied interest charges to the interest reserve line item from February 2007 to April 2008, with the last application occurring on April 21, 2008. However, in April 2008, Borrower defaulted under the Loan Agreement by failing to repay the amounts advanced by Lender upon maturity. On May 5, 2008, a pre-workout agreement was signed by Lender, Borrower and the loan guarantors. Borrower and guarantors also executed an Agreement Regarding Protective Advances (Protective Advance Agreement). Under the Protective Advance Agreement, Borrower and guarantors acknowledged Borrower's default and their request that the Lender "make additional advances under the Loan from time to time in order to protect and preserve the collateral, including without limitation, for the payment of certain safety, security, maintenance, development and construction costs for the Project." On May 6, 2008, the Lender served a notice of default and election to sell under deed of trust, which was recorded on May 9. As of May 2008, approximately \$5 million was still available to be disbursed under the loan.

Between May and August 2008, while Lender and Borrower discussed potential solutions to Borrower's default, Lender made certain post default construction disbursements under the Protective Advance Agreement. These construction disbursements occurred on June 6, June 13, June 18, July 15, and August 1, 2008, with the final advance being made on August 29, 2008. About September 26, 2008, Lender's representatives met with Borrower's representative, Jones, to discuss issues relating to Borrower's default. One issue discussed was that the Project was facing approximately \$1 million in cost overruns. Lender informed Jones that it would assess the information

provided. The Lender then proposed that Borrower deposit \$1.7 million with Lender to pay outstanding and future interest payments and to cover cost overruns, and that Lender would thereafter advance the requested \$348,543.10. However, as Borrower was not able to come up with the additional \$1.7 million, Lender neither approved nor disbursed the requested \$348,543.10 advance.

While Borrower attempted to cure its default and salvage the Project, it also consulted with bankruptcy counsel and was contemplating filing for bankruptcy during the summer of 2008. During this period, Jones was in regular contact with HJH about Borrower's default and his attempts to negotiate a workout, as well as Lender's position. Although Lender allowed HJH to continue working and made post default protective advances under the Protective Advance Agreement, at no time did Lender promise Borrower that it would make further advances or pay for post default work performed at the Project.

By October 2008, it was clear to Borrower that Lender was not going to approve further advances, and sometime that month Jones informed HJH that as a result, work on the Project should stop. At that time, the loan had fully matured and was in default, and Lender was trying to foreclose on the property.

On October 2, 2008, HJH recorded a mechanic's lien in the total amount of \$744,371.43 for services and materials furnished by it. Borrower filed bankruptcy in late October to stay the foreclosure. And on October 31, HJH filed its complaint alleging breach of contract and common counts against Borrower, and a cause of action for

foreclosure of mechanic's lien against the Lender and Borrower. On November 4, HJH recorded an amended mechanic's lien against the property in the amount of \$786,790.98.

On January 30, 2009, approximately five months after Lender's final post default protective advance and three months after Borrower's bankruptcy filing, HJH issued a bonded stop notice to Lender, claiming \$782,300.91 due to it for labor and materials furnished for the Project. Lender received the stop notice on February 2, 2009. On February 18, HJH filed a first amended complaint adding a fifth cause of action for foreclosure of stop notice against Lender. At the time Lender received the bonded stop notice, its internal accounting records stated there were "Construction Funds—Undisburs[ed]" in the sum of \$1,443,406.19. This internal bank record also states Lender actually segregated the amount of \$977,877 to provide for the "Bonded Stop Notice—HJH Con" claim. This "Budget Listing" document is dated February 6, 2009, approximately seven days after HJH had served Lender with the bonded stop notice. Lender's "Project Budget Listing" dated March 30, 2009, not only shows the bonded stop notice of HJH in the sum of \$977,877, but also that another amount identified as being a bonded stop notice for "Roquet Inc." had been deducted from the undisbursed loan funds, which were in the sum of \$1,362,521.19.

Lender nonjudicially foreclosed on the property through a trustee's sale on March 25, 2009. Its offer of \$7.38 million was the highest bid at the foreclosure sale.

On September 13, 2010, a court trial commenced. Lender argued that the remaining portion of the construction loan was not available for the stop notice of HJH. However, the evidence shows there were undisbursed proceeds from the loan available,

and the Loan Agreement characterizes the entire loan as “a fund,” wherein Borrower applies for advances and/or payments based on adequate proof of satisfactory completion of work. Thus, “loan funds” means the undisbursed proceeds of the loan, together with any equity funds or other deposits required from Borrower.

By November 1, 2010, the court issued its Statement of Decision finding for HJH on both of its claims. With respect to the stop notice claim, the court concluded “there were undisbursed construction loan funds within the possession of [Lender],” and that the “total amount of projected loan funds were not expended at the time [HJH] filed and served its bonded stop notice.” The court based this conclusion on three things: (1) its understanding of a February 2009 computer printout; (2) Johnson’s testimony, which the court characterized as indicating that “the funds allocated for the . . . project were in the nature of a ‘reserve fund’”; and (3) its conclusion that *Familian Corp. v. Imperial Bank* (1989) 213 Cal.App.3d 681 (*Familian*) was “directly applicable to the nature of [the Lender’s] construction loan to [Borrower] and the fund control arrangement.” Regarding the mechanic’s lien, the court found that HJH commenced a work of improvement in November 2006, and thus, the lien attached before the Lender’s deed of trust was recorded.

The same amount of damages, \$690,719.98 plus costs and interest, was awarded on both claims. HJH was also awarded its attorney fees with respect to the stop notice claim. Judgment was entered on March 11, 2011, in favor of HJH.

## II. WAS LENDER LIABLE ON HJH'S STOP NOTICE?

“A mechanic’s lien is a claim against the real property upon which a claimant has bestowed labor or furnished materials and is founded in California Constitution, article XIV, section 3. The lien is effected by the filing of a claim of lien within certain time limitations [citations] and by meeting other statutory requirements. Because of the unique constitutional command establishing mechanics’ liens, ‘the courts have uniformly classified the mechanics’ lien laws as remedial legislation, to be liberally construed for the protection of laborers and materialmen.’ [Citation.]” (*Kim v. JF Enterprises* (1996) 42 Cal.App.4th 849, 854.) “The purpose of a mechanics’ lien is to prevent unjust enrichment of a property owner at the expense of laborers or material suppliers. [Citation.]” (*Basic Modular Facilities, Inc., v. Ehsanipour* (1999) 70 Cal.App.4th 1480, 1483.)

“A stop payment notice (sometimes called a stop notice or notice to withhold in case law and in the industry) is a statutory remedy designed to reach unexpended construction funds in the owner’s or construction lender’s hands . . . .” (Cal. Mechanics’ Liens and Related Construction Remedies (Cont.Ed.Bar 4th ed. 2012) § 2.95, p. 133; Civ. Code, § 8500 et seq.)<sup>2</sup> The statutory scheme that encompasses the stop notice law also encompasses mechanic’s liens and offers protection to materialmen, laborers, contractors, and subcontractors who furnish labor and materials at a construction project. (*Connolly*

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<sup>2</sup> Civil Code sections 3264 through 3267 were replaced by sections 8000 through 9566 effective July 1, 2012 (see Stats. 2010, ch. 697). Because this case was tried and the appeal was briefed prior to the effective date, we will refer to the former sections.

*Development, Inc. v. Superior Court* (1976) 17 Cal.3d 803, 808 (*Connolly*)). By serving a stop notice on a construction lender, the claimant creates a lien on the construction loan funds for his/her benefit. (*Id.* at p. 813.)

Here, after it was clear that Borrower would not be able to escape from default, HJH recorded a mechanic's lien in the total amount of \$744,371.43 for services and materials furnished by it. It also initiated this action and issued a bonded stop notice to the Lender. Following a court trial, the court concluded "there were undisbursed construction loan funds within the possession of [Lender]," and that the "total amount of projected loan funds were not expended at the time [HJH] filed and served its bonded stop notice." The court's conclusion was based on (1) the February 2009 data system printout entitled "Westin and Muir system," (2) Johnson's testimony indicating that "the funds allocated for the . . . project were in the nature of a 'reserve fund,'" and (3) the case of *Familian, supra*, 213 Cal.App.3d 681.

On appeal, Lender contends the trial court's "conclusion that there was a construction fund held by [it] containing undisbursed funds committed to Borrower when HJH issued its Stop Notice was founded on an erroneous interpretation and application of the Loan Agreement and of California's stop notice law." Citing the applicable statute (Civ. Code, former § 3162, see now §§ 8536, 8538, 8542), Lender's sole issue relating to the stop notice is whether there actually was a construction fund that contained funds that it "may be obligated to pay."

According to Lender, it did not agree to loan Borrower a specific sum of money or continue to approve and pay Borrower's payment requests. Rather, the Loan Agreement conditioned Lender's obligation to make advances on Borrower remaining current on its payment obligations to Lender. Because Borrower was not current on its payment obligations at the time Lender received the stop notice, Lender maintains it "simply had no construction fund containing unexpended amounts that [it] was obligated to pay for the project." Further, Lender argues there were no "unexpended construction funds from amounts previously disbursed by [it] . . . [because] it deposited with CFC only the exact amount to cover the approved request, which was then disbursed to the payees, leaving a zero balance."

In response, HJH criticizes Lender's argument for primarily relying on the loan documents and the construction contract, neither of which HJH was party to. According to HJH, Lender's generated documents pertain only to Lender and Borrower, while "the mechanics' lien law is there solely to protect the contractor and to provide that contractor with certain inalienable rights under our Constitution." Pointing out that "the trial court made a factual finding that [Lender's] funds were undisbursed loan funds subject to the stop notice no matter how it characterized it" (underlining in original), HJH argues this case is similar to the case in *Familian, supra*, 213 Cal.App.3d 681. We agree with HJH.

As both parties point out, the trial court found the Lender's funds were undisbursed loan funds subject to the stop notice, regardless of how Lender characterized them. Such finding is supported by the evidence: (1) Lender's internal accounting records, which state there were "Construction Funds—Undisburs[ed]" in the sum of

\$1,443,406.19; (2) the same internal bank record, which also states the bank actually segregated the amount of \$977,877 to provide for the “Bonded Stop Notice—HJH Con” claim; (3) the same internal bank record, which is dated February 6, 2009, approximately seven days after HJH had served Lender with the bonded stop notice; and (4) Lender’s “Project Budget Listing” dated March 30, 2009, which not only showed the bonded stop notice of HJH in the sum of \$977,877, but also that another amount identified as also being bonded stop notice for “Roquet Inc.” had been deducted from the undisbursed loan funds that were in the sum of \$1,362,521.19.

Lender argues the trial court misinterpreted the Loan Agreement because it expressly provides that its obligation to make advances is subject to approximately 20 conditions precedent, including that Borrower remain current on its payment obligations to Lender. Thus, according to Lender, it “did not agree to loan Borrower a set, specific amount of money, nor did it promise to continue to approve and pay Borrower’s payment requests.” We disagree. The Loan Agreement defines “Loan Fund” as meaning “the undisbursed proceeds of the Loan under this Agreement together with any equity funds or other deposits required from Borrower under this Agreement.” The amount of the Loan was set at \$15,180,000. Once Lender created a loan fund, the entire fund is subject to the bonded stop notice. (Civ. Code, former § 3162.)

As HJH points out, for years lenders have attempted to circumvent the mandate of Civil Code, former section 3162, subdivision (a), which in relevant part provided: “Upon receipt of a stop notice pursuant to [former] Section 3159, the construction lender may, and upon receipt of a bonded stop notice the construction *lender shall*, except as provided

in this section, *withhold* from the borrower or other person to whom it or the owner may be obligated to make payments or advancement *out of the construction fund, sufficient money to answer the claim and any claim of lien that may be recorded therefor*. The construction lender shall be subject to the following: [¶] (1) The construction lender shall withhold funds pursuant to a bonded stop notice filed by an original contractor, regardless of whether a payment bond has previously been recorded in the office of the county recorder where the site is located in accordance with [former] Section 3235. . . .” (Italics added.) Despite lenders’ attempts to draft loan documents around this statutory mandate, courts have continually made it clear that lenders may not deprive a contractor of its stop notice rights on the entire loan fund.

In *A-1 Door & Materials Co. v. Fresno Guar. Sav. & Loan Assn.* (1964) 61 Cal.2d 728, our state’s highest court rejected the lender’s claimed right to use its undisbursed funds to reduce the borrower’s debt or to complete the buildings as provided in the loan agreement. The court held that “Subsection (h) [of Civil Code former section 1190.1, which was replaced with Civil Code former section 3162, subdivision (a),] requires that funds earmarked for construction purposes be used to pay suppliers of labor and materials who file claims under the subsection and therefore supersedes the private arrangements of borrower and lender.” (*Id.* at p. 734.) *Familian* provides further guidance on lenders’ attempts to circumvent stop notices; however, Lender faults the trial court for relying on that case.

In *Familian*, a lender loaned \$ 3.8 million to finance construction of condominium units. (*Familian, supra*, 213 Cal.App.3d at p. 683.) The loan was secured by a deed of trust on the real property. (*Ibid.*) As a condition, the lender required that a portion of the loan funds be segregated into a preallocated interest reserve account. (*Id.* at pp. 686-687.) During the course of construction, the lender paid itself interest, fees and expenses totaling \$528,000 out of this account. (*Id.* at p. 683.) With approximately \$188,000 remaining in unexpended loan funds, the lender received bonded stop notices for \$105,000 and foreclosed on the trust deed. Later, it received additional stop notices totaling \$427,000. It interpleaded the unexpended \$105,000 with the trial court and argued that the stop notice claimants were entitled to a pro rata recovery of that amount only. (*Ibid.*)

Familian Corp. had supplied plumbing materials on the project and was one of the bonded stop notice claimants. It moved for summary judgment, contending it was improper for the construction lender to maintain a preallocation reserve to pay the costs of the construction loan, to disburse payment to itself from the loan proceeds, to obtain through foreclosure property rendered more valuable because of Familian's supplies, and to then assert it could not pay for the work and materials because the construction funds had already been spent. (*Familian, supra*, 231 Cal.App.3d at p. 683.) The trial court granted summary judgment for Familian, holding that the preallocation and segregation of funds to pay unearned loan fees, interest and costs constituted an assignment within the meaning of Civil Code former section 3166 that could not take priority over a stop notice claim. (*Familian, supra*, at pp. 685-688.)

The *Familian* court reasoned that the stop notice laws were intended to protect laborers and materialmen, whose ““credit risks are not as diffused as those of other creditors,”” who ““extend a bigger block of credit, . . . have more riding on one transaction, . . . have more people vitally dependent upon eventual payment [and] have much more to lose in the event of default.”” (*Familian, supra*, 213 Cal.App.3d at p. 687.) In contrast, a secured construction lender is protected not only by a first prior encumbrance on the property that has increased in value as a result of the claimant’s labor and materials, but also by the terms of a loan agreement that allows it full control of the loan funds, including the establishment of whatever reserves or other devices necessary to protect its interests. (*Id.* at pp. 687-688.) Given the remedial purposes of the statute, *Familian* stated that Civil Code former section 3166 ““must be liberally construed to effect its objects and to promote justice. [Citations.]”” (*Familian, supra*, at p. 685.)

The *Familian* court provided a well-reasoned analysis of the underlying policy of the law concerning lender agreements and loan funds as applied to stop notices and mechanic’s liens, which we find applicable to the facts in this case. Although the situation in *Familian* involved the lender prepaying itself more than \$500,000 of preallocated construction loan expenses, including interest, here Lender merely reserved a portion of the loan funds for construction interest. However, regardless of the reserved construction interest portion, there were sufficient funds available to pay HJH. Thus, there was no disgorgement of funds already paid to Lender. Even if a lender were required to disgorge funds previously paid to it in order to pay stop notice claimants, the

*Familian* court reasoned that such requirement would prevent lenders from structuring their loans to enable them to obtain an unjust double recovery. “A construction lender would need only to deduct its profits at the inception of the loan to assure a double recovery at the expense of those who enhance the value of the property by supplying labor and materials.” (*Familian, supra*, 213 Cal.App.3d at p. 687.)

Notwithstanding the above, Lender challenges the evidence the trial court relied upon. It contends the Westin and Muir document, which identified the budgeted amount, the amount paid, the amount allocated to a particular item and the amount available, was misinterpreted by the trial court. According to Lender and its representatives, “the amount reflected in the ‘Amt. Avail.’ column did *not* reflect the amount of money available to Borrower in February 2009, because the [Lender’s] obligation to advance additional funds never arose due to Borrower’s prior default, and because the Westin and Muir system is merely an internal tracking system.” As we have already stated, we reject any claim that the loan documents allowed Lender to circumvent the stop notice statute. More importantly, the court heard and considered the testimony of Sean Johnson, Lender’s former executive vice-president. According to Johnson, upon approval of the loan, Lender earmarked the loan amount, i.e., \$15,180,000, and then as disbursements were advanced against the loan, the amount available was reduced. While Lender argues that Johnson’s testimony establishes that Lender did not create a separate account or transfer money anywhere, we agree with the trial court’s interpretation that the documents showed the amount available for disbursements at the time of receipt of the stop notice. Lender’s attempt to shield the undisbursed balance of the loan fund from

claimants such as HJH by arguing there was no balance if Borrower failed to fulfill any conditions precedent is merely an attempt to circumvent the mandate of Civil Code former section 3162.

Based on the above, the trial court correctly found that Lender was liable on HJH's stop notice claim.<sup>3</sup>

### III. PRIORITY OF HJH'S MECHANIC'S LIEN

The trial court found that by demolishing part of a fire-damaged building on the Property in November 2006, HJH commenced work of improvement before Lender recorded its deed of trust. Lender contends the trial court erred in granting priority to HJH's mechanic's lien over Lender's construction deed of trust, because "any alleged work was legally insufficient to constitute the commencement of a work of improvement and provide constructive notice that such work had commenced, particularly here where HJH and Borrower represented to [Lender] that construction had not commenced."

Lender acknowledges that HJH did perform work on the Property prior to the recordation of the Lender's deed of trust;<sup>4</sup> however, it contends that such work "[did] not constitute the commencement of a work of improvement." Lender argues it had

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<sup>3</sup> Because we have found that Lender is liable on HJH's stop notice claim, Lender's claim that the award of attorney fees must also be reversed is moot.

<sup>4</sup> Lender notes the following work that occurred prior to recordation of its deed of trust: (1) HJH repaired a sign that had blown down; (2) HJH tore down a 60-by-15 foot structure and trees that had been damaged in a fire; (3) HJH pulled down a gate, removed some curb and gutter and installed a two-inch water line behind the restaurant so that it could get its water truck on the Property and water it down to control the dust in order to avoid fines from the city; and (4) HJH dug approximately seven to eight holes in the ground for the purpose of locating water and sewer lines.

inspected the Property before agreeing to provide financing and did not notice any signs of construction or improvements. More importantly, it points out that “Borrower never informed [Lender] that HJH had commenced construction at the Property.” Rather, Borrower and HJH represented that work would commence on a date to be ““determined upon approvals from all governmental agencies,”” which were not issued until March 2007. Moreover, Lender notes that, (1) according to the Loan Agreement, Borrower stated it would not permit any work or materials to be used in connection with the Project until Lender had recorded its deed of trust, and (2) on January 27, 2007, Borrower described the current stage of construction as ““not yet started”” in answer to a title insurance company’s questionnaires.

In response, HJH argues there were two types of improvements to the property entitled to mechanic’s lien rights, namely, site improvement and actual work of improvement. Site improvement is defined, in relevant part, as “the demolishing or removing of improvements, trees, or other vegetation located thereon, or drilling test holes or the grading, filling, or otherwise improving of any lot or tract of land . . . or constructing or installing sewers or other public utilities therein, or constructing any areas, vaults, cellars or rooms under said sidewalks or making any improvement thereon.” (Civ. Code, former § 3102.) Actual work of improvement, in relevant part, “includes but is not restricted to the construction, alteration, addition to, or repair, in whole or in part, of any building, . . . the filling, leveling, or grading of any lot or tract of land, the demolition of buildings, and the removal of buildings. . . .” (Civ. Code, former § 3106.)

According to HJH, California courts “have taken a very liberal and expansive view of the term ‘work of improvement’ and ‘commencement’ of work of improvement.” “In *English v. Olympic Auditorium, Inc.* [(1933)] 217 Cal. 631 . . . it was held that the digging of a test hole and hauling of lumber on the premises were sufficient to constitute work commencement. That case in turn cited *Simons Brick Co. v. Hetzel* [(1925)] 72 Cal.App. 1 . . . where the excavation of a trench was held sufficient even though no tools or materials or other evidence of building of any description had been brought on the premises.” (*Jay Bailey Const. Co. v. Berry Hotel Corp.* (1963) 221 Cal.App.2d 135, 138.) In *Notle v. Smith* (1961) 189 Cal.App.2d 140, 148, the court held that the installation of underground boundary markers constituted a work of improvement and was in and of itself sufficient to give rise to a claim of lien. In contrast, courts have rejected mechanic’s lien priority claims where the claimant’s work was not sufficiently visible. (See also *Tracy Price Assoc. v. Hebard* (1968) 266 Cal.App.2d 778, 781 [Fourth Dist., Div. Two] [work only involved preparation of plans and specifications by an engineer along with a visit to the site with portable equipment in connection therewith]; *D’Orsay Internat. Partners v. Superior Court* (2004) 123 Cal.App.4th 836, 838, 844 [lien for building design related services worth approximately \$850,000 not entitled to priority where no physical visible construction commenced].) Thus, HJH argues that, along with its potholing, its “demolition of a major portion of a large structure and adjacent trees . . . clearly is within the statute.” We agree.

“It is a question of fact whether improvement has been commenced. [Citation.]” (*Arthur B. Siri, Inc. v. Bridges* (1961) 189 Cal.App.2d 599, 601-602.) In the instant case,

the facts disclose that after Borrower had purchased the Property it entered into a handshake agreement with HJH in which HJH would act as general contractor on the Project, HJH began work as early as May 2006 and continuing up until Lender recorded its deed of trust, and HJH was not paid prior to February 2007. Thus, the trial court properly found that “demolition of the fire-damaged building by HJH in November 2006 was a work of improvement to the project within the meaning of [Civil Code former] Section 3106 [because t]his building was scheduled to be demolished during one of the phases of the project, and the demolition was advanced to November 2006 because the building constituted a safety hazard.” Likewise, the trial court was correct in finding that the demolition was a work of improvement because (1) “HJH’s only purpose in removing the building was in contemplation of its duties as the General Contractor on the project[, and (2)] HJH was not paid before February 2007 for the demolition of the fire-damaged building.” The fact that Lender failed to discover the work that HJH had already performed is not the fault of HJH or Borrower, but rather Lender’s own failure to act more diligently in its inspection of the Property.

#### IV. DAMAGES AWARD

HJH was awarded \$690,719.98 as the reasonable value of its work and the amount due under its contract with Borrower. This amount was less than the amount HJH claimed. In support of its claim for damages, HJH submitted Exhibit 20, which consists of four master invoices prepared by HJH. Each invoice identifies the work performed, the name of the subcontractor, the amount billed, and the invoice number. Attached to each master invoice were invoices from the various subcontractors that provided the

backup documentation for each item/costs listed on the master invoice. At trial, Lender objected to the admission of the subcontractor-prepared backup documentation on hearsay and foundational grounds. The trial court overruled the objection and admitted the master invoices and backup documentations into evidence. Although the trial court found the subcontractor-prepared backup documentation to be hearsay, it admitted the evidence “for the limited purpose of corroborating [Hall’s] testimony.” The court relied on *Pacific Gas & E. Co. v. G. W. Thomas Drayage etc. Co.* (1968) 69 Cal.2d 33 (*Pacific Gas*)<sup>5</sup>; *McAllister v. George* (1977) 73 Cal.App.3d 258, 263 (where invoice for dental services was authenticated by its contents, “contrary inferences flowing from the facts that the bill was handwritten, not on official stationery, and signed by a student were issues going to the weight of the evidence . . . .”); *Imperial Cattle Co. v. Imperial Irrigation Dist.* (1985) 167 Cal.App.3d 263, 272, (condemnation certificates prepared by veterinarians employed by the federal government fall within the “official records” exception to the hearsay rule), disapproved in part on other grounds in *Bunch v. Coachella Valley Water Dist.* (1997) 15 Cal.4th 432; and *Jazayeri v. Mao* (2009) 174 Cal.App.4th 301, 316 (“documents containing operative facts, such as the words forming an agreement, are not hearsay”).

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<sup>5</sup> “Since invoices, bills, and receipts for repairs are hearsay, they are inadmissible independently to prove that liability for the repairs was incurred, that payment was made, or that the charges were reasonable. [Citations.] If, however, a party testifies that he incurred or discharged a liability for repairs, any of these documents may be admitted for the limited purpose of corroborating his testimony [citations], and if the charges were paid, the testimony and documents are evidence that the charges were reasonable. [Citations.]” (*Pacific Gas, supra*, 69 Cal.2d at pp. 42-43).

On appeal, Lender claims the evidence was insufficient to establish the award of damages. Specifically, it contends the material and subcontractor invoices submitted by HJH in support of its claim constituted inadmissible hearsay, lacking foundation. Even if the subcontractor invoices were properly admitted for the limited purpose of corroborating Hall's testimony, Lender maintains that, because they reflect "labor and materials provided by the third-party subcontractors, not HJH[,] and the third-party subcontractors prepared such invoices," the trial court erred in not requiring the subcontractors to testify that the invoices accurately reflected their work. We disagree.

"The lien claimant has the burden of establishing the validity of the lien [citation], including that the labor, services and/or materials were actually used in the construction, the reasonable value of the work and/or materials, and the date of completion or cessation of work. [Citation.] The actual amount due on the lien presents a question of fact for the trial court [citation], regardless of whether that question is resolved by motion or requires full trial. But the lien claimant is entitled to utilize the statutory procedure to recover that amount actually owed." (*Basic Modular Facilities, Inc., v. Ehsanipour, supra*, 70 Cal.App.4th at p. 1485.)

In addition to Exhibit 20, HJH offered the testimonies of Hall and Jones. Hall, the general contractor, testified that HJH was paid \$50,000 per month for supervision of the Project. He made sure the "materials that were to be delivered to the site were, in fact, delivered." He reviewed the invoices to make certain they "reflected the work that was actually done," and that "the materials that were invoiced were, in fact, used for that project." If HJH received invoices or bills that did not comport with Hall's recollection

of the work done, such invoices or bills were pulled out of the order. He had to compare the work performed against the invoices because he “had several different types of inspections.” He went on to state, “[W]e had the city giving me the inspection for the building permit portion. I had the wrap insurance inspector coming in to make sure that we were installing everything correctly. I had the bank inspector coming in giving me inspections for . . . work that had been completed. And I had [Jones] there at least twice a week to make sure that the work was getting done and we were moving forward, not sitting on our hands.” Hall was present on the job every day and saw the work that had been performed. He knew exactly what was done by each subcontractor, and there was always a comparison made between the invoices and materials received/work performed. Such comparison was in the ordinary course of HJH’s business. Based on Hall’s training, experience, and observations, HJH’s claim of \$786,790.98 represents the “reasonable value for the services performed and the materials used in the works of improvement for that project.”<sup>6</sup> Jones testified as to the reasonable value of the Property, which included the work product represented in HJH’s claim. Jones was experienced in developing projects of a similar nature.

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<sup>6</sup> Lender contends that, had HJH actually paid the charges stated on the invoices, then the documents could have supported a finding that the amounts contained in the subcontractors’ invoices would have been deemed reasonable. We disagree. Given Hall’s testimony, only reasonable charges were included in HJH’s master invoice. If something was not reasonable or had not been performed, Hall “pulled” the invoice. He was responsible for making sure the work was performed and the materials were provided in order to pass the several inspections.

The trial court properly admitted Exhibit 20 for the purpose of corroborating Hall's testimony. In *McAllister v. George, supra*, 73 Cal.App.3d at page 263, defendant contested on hearsay grounds the admissibility of a dental bill to prove medical expenses incurred as damages. The court rejected defendant's objection stating: "In the circumstances of this case this contention lacks merit. Plaintiff testified that the dental services were performed, that he received a bill for them, and that he paid the bill. It has been held that under such circumstances the bill, which ordinarily would constitute inadmissible hearsay, is nevertheless admissible for the limited purpose of corroborating plaintiff's testimony and showing that the charges were reasonable. [Citations.]" (*Ibid.*)

In *Imperial Cattle Co. v. Imperial Irrigation Dist., supra*, 167 Cal.App.3d at p. 272, the plaintiff was allowed, over defendant's hearsay objection, to introduce evidence of USDA cattle condemnation certificates in order to establish the number of its cattle that had contracted disease as the result of defendant's negligence. Rejecting defendant's challenge on appeal, our colleagues in Division One of this district held: "The condemnation certificates appear to fall clearly within the 'official records' exception to the hearsay rule. . . . The record demonstrates that condemnation certificates are prepared by veterinarians employed by the federal government following an inspection of each cattle carcass if the veterinarian determines that the meat is infected with measles. Such evidence not only satisfies the first two predicates to the invocation of [Evidence Code] section 1280 but also indicates the basic trustworthiness of the documents." (*Ibid.*)

Given the nature of the contractor/subcontractor working relationship and the record before this court, we conclude the trial court correctly applied the case law and

admitted Exhibit 20 into evidence. Hall testified that he had personal knowledge of the materials supplied/work performed by the subcontractors and that their invoices attached to HJH's master invoice accurately reflected the materials supplied and/or the work performed on the Project.

## V. ATTORNEY FEES AND COSTS

The trial court award attorney fees and costs to HJH pursuant to Civil Code former section 3176 (see now § 8558). In determining the amount of the award, the trial court chose to award 80 percent of the amount requested on the grounds that while HJH could recover its fees on its stop notice claim, it could not on its mechanic's lien, and given the fact that there was some overlapping of HJH's litigation of both claims, 80 percent seemed a fair compromise. On appeal, HJH faults the trial court for apportioning the attorney fee claim between the stop notice and the mechanic's lien causes of action. It requests this court to "award [HJH] its entire attorney's fees incurred in defending this appeal as well as costs" on the grounds that its counsel's non-fee claim (mechanic's lien) is "so closely related to the work on the fee claim[ (stop notice)] that an apportionment is impossible . . . ." We disagree.

"Where fees are authorized for some causes of action in a complaint but not for others, allocation is a matter within the trial court's discretion. [Citation.] A trial court's exercise of discretion is abused only when its ruling ""exceeds the bounds of reason, all of the circumstances before it being considered."" [Citations.]" (*Amtower v. Photon Dynamics, Inc.* (2008) 158 Cal.App.4th 1582, 1604.) Given the causes of action and the

record before this court, we conclude the trial court acted within its discretion in awarding 80 percent of the amount requested.

VI. DISPOSITION

The judgment is affirmed, as is the award of attorney fees and costs. HJH is awarded its costs on appeal, including attorney fees, and the matter is remanded to the trial court to determine the reasonable amount of those fees and costs.

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

HOLLENHORST

Acting P. J.

We concur:

KING

J.

MILLER

J.