

How to Take Full Advantage of California's Prompt Pay Laws

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Please note that this article is only intended to provide some general educational information regarding California's Prompt Pay Statutes. Deciding whether or not you or your company may have the right to prompt pay penalties in accordance with these statutes is a decision you should make only after reviewing the current laws, facts, and circumstances of your situation with an experienced construction law attorney.

The California Legislature enacted a series of laws, commonly referred to as “prompt payment” statutes. The prompt payment statutes are powerful tools that penalize owners and prime contractors who fail to make timely progress and retention payments. These laws are found in California Civil Code §§ 3260, 3260.1, 3260.2 (applicable to owners of private works), Civil Code §§ 3262.5, 3320, 3321 (applicable on private works) Business & Professions Code § 7108.5 (applicable to contractors) and Public Contract Code §§ 7107, 10261.5, 10262.5, 10853, 20104.50 (applicable on public works) and provide strong remedies against excessive withholding.

All “prompt payment” statutes work the same way, but certain time limits vary on public works. On private works, the owner must pay each progress payment within thirty (30) days after the prime contractor makes a valid demand for payment. If payment isn't received on the 30th day, the prime contractor can post a “notice of intent to file 10 day stop work order.” On the 35th day, if the owner continues to withhold a progress payment without justification, the prime contractor has the right to serve a “10-day stop work order” on the owner. The notice may be served personally, or by certified mail, and must be given to all subcontractors, as well as to the owner. If the owner fails to pay within the ten (10) day period, the prime contractor may stop working on the project, without liability for delaying the project.

The final retention is also subject to prompt payment requirements. Owners of private works must pay the final retention to the prime contractor within forty-five (45) days of the completion of the project. California public entities must pay the prime contractor the final retention within 60 days of the project's completion.

On both public and private works, the prime contractor must pay subcontractors within ten (10) days after receiving a progress payment from the owner. However, on works for public utilities, the prime contractor has fifteen (15) days after receipt of a progress payment to pay the subcontractors.

The sole exception to the prompt payment requirements arises when there is a good faith dispute as to a portion of the work. The owner or the prime contractor may only withhold one and one-half times (150%) of the amount disputed. Any amount in excess of 150% of the disputed amount is deemed to have been “wrongfully withheld.”

If the prime contractor or subcontractor notifies the owner or prime contractor that disputed work has been completed in accordance with the terms of the contract, the owner or prime contractor has ten days in which to accept or reject the work. If the work is accepted, the owner or prime contractor has ten (10) days in which to pay.

If the owner or contractor wrongfully withholds more than one and one-half times (150%) of the amount in dispute, penalties apply. The first penalty is a two percent (2%) per month charge on any amount “wrongfully withheld.”

More importantly, if an owner or a prime contractor has wrongfully withheld payment, the prime contractor or subcontractor may recover its attorneys’ fees in addition to the statutory penalty. This has the practical effect of inserting an attorneys’ fees clause into virtually every construction contract in California.

A contractor’s failure to promptly pay subcontractors is a violation of the licensing law, and subject the contractor to discipline by the Board, in addition to civil liability. Penalties for failure to promptly pay a subcontractor may be recovered in either a civil lawsuit or a disciplinary hearing before the Contractors State License Board. *Morton Eng’g & Constr., Inc. v. Patscheck* (2001) 87 Cal.App.4th 712, 104 Cal.Rptr.2d 815. However, in order for a subcontractor to recover statutory penalties and attorneys’ fees, the subcontractor must prove that the prime contractor received payment from the owner. *McAndrew v. Hazegh* (App. 4 Dist. 2005) 27 Cal.Rptr.3d 836, 128 Cal.App.4th 1563.

The penalties imposed by the prompt payment statutes also “flow through” to bond sureties. For example, a surety on a stop notice release bond is also subject to the prompt payment statutes up to the amount of the bond. *National Tech. Sys. v. Superior Court* (2002) 97 Cal.App.4th 415, 118 Cal.Rptr.2d 465.

The owner or prime contractor does not have to provide notice of the existence of a dispute within the period in which payment must be made. *Alpha Mechanical, Heating & Air Conditioning, Inc. v. Travelers Cas. & Surety Co. of America* (2005) 133 Cal.App.4th 1319, 35 Cal.Rptr.3d 496. However, the dispute must be raised before the project has been completed and approved. *City Street Imp. Co. v. City of Marysville* (1909) 155 Cal. 419, 101 P. 308.

Unfortunately, courts have not specifically defined what constitutes a “good faith” dispute. “Good faith, or its absence, involves a factual inquiry into the plaintiff’s subjective state of mind. Did he or she believe the action was valid? What was his or her intent or purpose in pursuing it? A subjective state of mind will rarely be susceptible of direct proof; usually the trial court will be required to infer it from circumstantial evidence.” *Knight v. City of Capitola* (1992) 4 Cal.App.4th 918, 932, 6 Cal.Rptr.2d 874.

Used properly, the prompt payment statutes’ two percent (2%) per month statutory penalty, coupled with recovery of attorneys’ fees, provide a powerful tool for contractors to use to obtain timely payment for their work.

If you have any questions or comments regarding this article, please do not hesitate to contact Jason Weisberg at Green & Campbell, LLP.

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