

California Contractors Beware: California Supreme Court Narrows Prompt Payment Exceptions

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A unanimous California Supreme Court made it clear that the term "prompt payment" in the context of California's prompt payment statutes¹ really means "prompt payment," and any exception applies narrowly. The court's ruling in *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.*² held that the "good faith dispute" exception to the contractor's obligation to promptly pay the retention to downstream subcontractors applies only if the good faith dispute is directly relevant to the specific payment that would otherwise be due. Previously, the controlling authority held that the direct contractor could withhold payment if there was any good faith dispute, even if unrelated to the payment of retention.

In *United Riggers*, a dispute arose between a subcontractor and general contractor regarding payment of money allegedly owed above the contract price. The subcontractor claimed it was owed additional money for the general contractor's mismanagement of the project and for outstanding change order requests. Neither the contractor nor the subcontractor disputed that the subcontractor satisfactorily completed all of its contract work. Nevertheless, the general contractor refused to release the retention, relying on the dispute over the subcontractor's demand for additional money. The subcontractor sued for late payment, asserting a cause of action (among others) under the California prompt payment statutes. After bench trial, the trial court entered judgment for the contractor.

The Court of Appeal reversed on the prompt payment claim, stating that the withheld money had to specifically relate to the dispute at hand. That is, the contractor could not rely on the dispute over mismanagement and the subcontractor's demand for additional payment to justify withholding the subcontractor's portion of the retention.

The California Supreme Court agreed. The court examined the statutory scheme as a whole—including prompt payment statutes governing private and public projects; progress payments and retention payments; and payments from owners, developers and government agencies to direct contractors and from direct to subcontractors—and concluded that the policy behind the statutes was to ensure prompt payment to the downstream contractors. Thus, the court held that withholding of retention payments must be related to a good faith dispute over the specific payment at issue—even though, unlike other statutes³, this statute does not explicitly provide that the dispute must be related to the specific payment due.

The court explicitly disapproved the ruling in *Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*⁴, which had held that the California prompt payment statutes permitted the owner/contractor to withhold 150 percent of a disputed amount whether or not that dispute directly related to the specific payment being sought. Notably, the court found that the subcontractor was justified in pursuing its case, even though it was eventually paid the full retention amount, because the late payment entitled the subcontractor to recover penalties, attorney fees and costs.

The key takeaway from this is that the California Supreme Court sharpened the teeth on the prompt payment statutes and the right to collect penalties, attorney fees and costs for unjustified late payments. Developers and contractors

must be sure to pay their downstream contractors within the permitted payment window, and that any amounts withheld from payment are due to a "good faith dispute" directly relevant to the specific payment that would otherwise be due. As always, careful recordkeeping will be critical.

For more information or assistance with California construction disputes, contact your Dentons team or this alert's key contacts.

1. e.g., Bus. & Prof. Code § 7108.5, Civ. Code § 8800 et seq., Pub. Contracts Code §§ 7107, 10261 et seq.↔

2. *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.*, 416 P. 3d 792, 232 Cal. Rptr. 3d 428 (2018)↔

3. e.g., Civ. Code 8812(c)↔

4. *Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*, 179 Cal. App. 4th 1401 (2009)↔

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