Subcontractor Contract & Collections Handbook

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ACKNOWLEDGMENTS

Sweeney Mason LLP is a full-service law firm providing substantially all of the legal services required by small and mid-sized companies. Sweeney Mason represents clients in seven primary areas of the law, including Civil Litigation, Construction, Corporate and Business, Intellectual Property, Labor and Employment, Estate Planning, Trusts and Probate, and Real Estate law.
Sweeney Mason has a long-standing relationship with the National Electrical Contractors Association and is proud to present this Handbook to its members. The authors look forward to collaboration with members, so please do not hesitate to contact them with questions related to the Handbook or individual legal matters.

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CHAPTER ONE
CRITICAL ISSUES IN CONSTRUCTION COLLECTION FOR SUBCONTRACTORS

I. Introduction

Construction collection processes and remedies include a vast array of considerations for any contractor, as well as consideration of a number of complicated and sometimes challenging legal concepts. This handbook is designed to provide both substantive information on the law surrounding these processes and remedies, while also incorporating areas of business consideration and providing practical tools that electrical contractors can utilize to improve their practices and protect their collection rights.

This handbook will discuss things such as change orders and change order procedures, collection remedies such mechanics liens, stop notices, and payment bonds, critical contract provisions to consider when negotiating your contracts and subcontracts, and tools that the electrical subcontracting community can utilize to ensure that subcontractors are paid for their work. This handbook breaks down into various chapters, including on private works change orders, public works change orders, private works collection remedies, public works collection remedies, and key contract provisions. The handbook has been digitized with a variety of easy-to-use links that make the handbook an efficient source of information on a variety of topics. Further, we include various forms that can be modified to address specific issues, which subcontractors can utilize during the course of construction and after work is complete, including to get paid. Links to these forms are provided throughout as well. In short, we hope this provides another useful tool to the contracting community to ensure that contractors are paid for their work.

In Chapter One, we will provide brief overviews of critical issues that subcontractors often encounter during the course of construction, as well as after project completion. Links are provided to the subsequent chapters that cover these topics in more granular detail, along with links to various forms that subcontractors may utilize to improve their collection efforts.

II. Maximizing Collection of Change Orders

While there are some important differences with respect to change orders in the private and public work contexts, fundamentally, changes in the work and the requirements for documenting and collecting for change work is quite similar and driven by the parties' contract. In the context of any work of improvement, it is critical that the contractor promptly issue notice of the potential change as soon as possible after identifying the change work or changed site condition.

Key issues in maximizing collection for change order work include:

1) What do the terms in the subcontract state and was the subcontract aggressively negotiated?
2) Is the subcontractor obligated to perform change order work if price and terms cannot be agreed upon?
3) How does the subcontractor require the prime contractor and owner to process change orders so that payment can be timely received
4) What recourse does the Subcontractor have if items 2 and 3 above are not resolved?
5) What is the impact of change directives? Is the response time reasonable?

Beyond providing proper notification of the changed condition and correlated work, it is critical (if possible) to price the work promptly and *prior to* performing the work. Many contracts provide that the contractor must perform the work even in the event that a written change order and price adjustment is not agreed upon between the parties. While this is addressed in detail elsewhere in Chapters 2 and 4, avoiding this scenario by providing pricing with a promptly delivered proposed change order can be an effective documentary tool and help contractors protect their collection rights as a project unfolds. Contracts often have onerous change order and change directive procedures, which include "work through dispute" provisions. These procedures place subcontractors at practical, legal, and (sometimes extreme) financial disadvantages. Limiting the application of these provisions and confirming that the subcontractor always retains its right to payment for their work are critical to protecting rights and remedies.

Presentation and documentation of the change order is critical, including tracking the project accounting and scope adjustment. Contractors should carefully read and consider the terms of written change orders, as these documents effectively alter the terms of the operative contract or subcontract, including by changing the scope of work, price of work, and time for performance. Other terms (such as releases and waivers) may also be built into the written change order, so subcontractors should carefully consider these terms and how their rights may be affected.

Change orders on public works projects are governed by both contract and statute. The statutes that govern these provisions are myriad and often pertain to specific types of public entities, types of projects, or scopes. It is important to familiarize yourself not only with the contract requirements but also as to which statutory provisions may be implicated by each specific project on which you work. Moreover, it is critical to ensure that the public agency personnel directing the work has the authority needed to direct changes and execute change orders. There are additional considerations that contractors must take into account on public works, including importantly the False Claims Act, which renders it a crime to submit a false claim on a public work project.

These subjects are discussed in much more detail in the chapters that follow. Links to the chapters and various forms are provided below.

Links to Chapters:

The following are links to Chapters Two and Four, which discuss in much more detail various issues pertaining to changes in work and change order processes:

- Chapter 2: Private Works Change Orders
- Chapter 4: Public Works Change Orders

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with change orders:

- Form 2 – Notice of Potential Change / Changed Site Condition
- Form 5 – Change Order Proposal

III. Maximizing Collection Remedies and Procedures

When money is due and owing to a subcontractor, various collection remedies are available on both private and public works. These include mechanics liens on private works and stop payment notices and payment bonds on both private and public works projects. In most instances, the issuance of a preliminary notice at the inception of work is a predicate to the subcontractor's right to enforce these remedies. The requirements for enforcing these various rights are quite strict and, often, time sensitive. Subcontractors should be aware of these requirements in order to protect their rights and maximize their collection efforts.

These subjects are discussed in much more detail in the Chapters that follow. Links to the Chapters and various forms are provided below. Key issues include:

1) When is retention really due?
2) Are attorney's fees recoverable?
3) Is interest recoverable?
4) What is the law on paid when paid clauses? How long does the prime contractor have to pay?
5) When can the subcontractor record a lien or serve a stop payment notice?
6) Can I stop work if I do not get paid progress or change order payments?

With respect to Pay If Paid/Pay When Paid provisions, these provisions seek to limit an upstream contractor's obligation to pay a subcontractor such that payment only comes due "if" the upstream contractor is paid or following such payment. Pay "if" paid provisions are unenforceable in California; however, pay "when" paid provisions are generally enforceable provided that such provisions are (i) reasonable and (ii) not worded so as to covertly act as pay "if" paid clauses. Case law pertaining to these issues is discussed in more detail within the handbook.

Links to Chapters:

The following are links to Chapters Three and Five, which discuss in much more detail various issues pertaining to changes in work and change order processes:

- Chapter 3: Private Works Collection Remedies and Procedures
- Chapter 5: Public Works Collection Remedies and Procedures

IV. When Can Subcontractors Assert Prompt Payment Penalties?

One area of inquiry often raised by contractors pertains to remedies for untimely payments or the bad faith withholding of money due. Often this results in a discussion regarding prompt payment penalties. These penalties emanate from statutory requirements regarding the timely payment of progress payments and retention. The regulatory scheme regarding these penalties spans both private and public works and applies to payments to both direct contractor and subcontractor. However, subcontractors should be aware that the regulations applicable to prompt payment laws are covered in a number of disparate code sections and their application is often quite specific to a given situation. These code sections include:

- **Private Works**:

    - Civ. Code 8800 – owner shall pay contractor retention payment within 30 days from demand; 2% per month penalty for failure to pay.
    - Bus & Prof Code 7108.5 – contractor to subcontractor progress payments required within 7 days of receipt of payment; 2% per month penalty and attorneys' fees recovery.
    - Civ. Code 8812-8818 – contractor to subcontractor retention must be paid within 45 days after completion and 10 days of acceptance of work; 2% per month penalty plus attorneys' fees recovery.

- **Public Works**:

    - Bus & Prof Code 7108.5 - contractor to subcontractor progress payments within 7 days of receipt of payment; 2% per month penalty and attorneys' fees recovery, except where Pub. Contract Code 10262 applies.
    - Civ. Code 8800 – owner to contractor retention payment within 30 days from demand; 2% per month penalty for failure to pay.
        - Civ. Code Sec. 8802: additional 21 days for public utilities contracts.
    - Pub. Contract Code 10262.5 - contractor to subcontractor progress payments within 7 days of receipt of payment form the state agency; 2% per month penalty and attorneys' fees recovery.
    - Pub. Contract Code 20104.5: local entity to contractor payments within 30 days; applicable legal rate of interest of 10% per annum.
    - Pub. Contract Code 7107: owner to contractor retention must be paid within 60 days from completion (as defined in the statute); contractor to subcontractor retention must be paid within 7 days from receipt of retention from owner; 2% per month penalty plus attorneys' fees recovery.

The above is a very basic summary of the statutory provisions. The substance and application of these statutes can be far more complicated. Attached to this handbook is a helpful matrix (linked below) that articulates when and under what circumstances prompt payment penalties apply, as well as a form demand letter that can be used in certain circumstances to make demand for payment and penalties.

The penalties themselves are onerous, equating in most cases to a 2% per month penalty on the sum due to the contractor. While seemingly small, that percentage can add up very quickly. For example, if $500,000 is due and owing to the contractor and remains unpaid for one year, prompt penalties may result in an additional penalty equal to $120,000!

There are often a variety of mechanisms in place, both contractually and statutorily, that mitigate the application and impact of these provisions. These include a statutory right in many instances for the owner, public agency, or direct contractor to withhold a percentage of the amount owed in the event of a good faith dispute, which avoids the penalties associated with prompt pay, as well as the ability in certain circumstances for parties to contract for extended lengths of time to make payment.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with change orders and collections:

- Form 6 – Preliminary Notice
- Form 7 – Prompt Payment Matrix
- Form 8 – Mechanics Lien
- Form 11 – Stop Payment Notice
- Form 12 – Post-Completion Bond Notice
- Form 15 – Retention Release Letter (Public Work)

V. The Most Critical Subcontract Provisions Unrelated to Collections

Contractors must also be aware of other key contract provisions when negotiating their contracts and subcontracts prior to commencement of work. Because many claims and other matters arising during the course of a project are regulated through the applicable contractual relationship, negotiation of favorable terms is absolutely vital towards protecting the rights of subcontractors. Some of these key contract provisions include:

- **Scope:** Many construction disputes relate to an ill-defined scope of work and/or exclusions from the scope of work. This has a trickle-down effect in that it places changes and change directives in dispute as well.
- **Indemnity**: Indemnity provisions are, essentially, a contractual risk-shifting mechanism by which one party shifts the risks of the parties' conduct to the other party. Traditionally, there are three types of indemnity provisions (Type I, II, and III). While a subcontractor should seek to limit the scope of their indemnity to claims arising as a result only of their own negligence, often this is not how contractual indemnity provisions end up.
- **No damages for delay**: These provisions often limit or eliminate the subcontractor's ability to recover money when the project is delayed as a result of factors beyond the subcontractor's control. In some cases, this can substantially increase the subcontractor's costs, as general condition costs are extended and undermine profit margins. Seeking to limit the reach of these provisions and identifying instances where damages are recoverable for delay is important to protecting subcontractor payment rights

Dispute Resolution Provisions: Often overlooked, dispute resolution provisions are critical insofar as they set the stage (including forum, discovery, and other parameters) for any litigation or legal proceedings between the parties in the event of a dispute. Often, these provisions also impose prerequisites or other steps/stages to the contractual dispute processing and can impose penalties on parties who fail to follow them. Careful attention to these provisions is often important to protecting subcontractor claims. These subjects are discussed in much more detail in the Chapters that follow.

CHAPTER TWO
CHANGE ORDERS ON PRIVATE WORKS

I. Change Order Rights Generally

Change orders are the result of work not specified in the contract or the result of changed conditions. In the private work context, change orders are a creature of (i) contract and (ii) project-specific circumstances. A typical private work contract provision will articulate a contract price – whether fixed or a "not to exceed" – but provide the owner (in the case of a prime contract) or prime contractor (in the case of a subcontract) a right to request or direct the prime contractor or subcontractor to perform extra or additional work outside the agreed upon scope. Circumstances that may result in such extra or additional work include, but may not be limited to, unforeseen site conditions, owner preference, governmental requirements, or design alterations.

To effectuate this extra or additional work, most construction contracts will require the parties agree upon the impact such work will have on the overall ***price*** of the work and the ***time*** for performance. The contract will also generally require such impacts be reduced to a written change order signed by the relevant parties. Questions of extra work arise on virtually every project. Generally, by virtue of the contract language, change orders become part of and subject to the terms, conditions and obligations of the contract.

If the owner or prime contractor requests extra work and yet there is no agreement on a written change order, multiple legal theories allow for recovery, including:

- Oral modification of a written change order
- Waiver of the written requirement
- Oral rescission of a writing requirement
- Estoppel
- Unjust enrichment

Understanding these theories of recovery is critical, including because the practical realities of project prosecution often result in extra work being performed without signed change orders and also because contract provisions may require this extra work to be performed where a dispute exists either as to scope (i.e. whether the work is truly extra work) and/or pricing, in which subcontractors should know their rights to recover for the work performed.

1. Owner Directed Change/Extra Work in Derogation of Writing Requirement

Where the contract provisions are followed and cost and time impacts are reduced to a written change order, signed by all parties, the party performing the change work will have a sound contractual basis to enforce its right to payment. However, experience informs that it is common for changes to be ordered/directed by the upstream party and implemented without adherence to the change order provisions of the underlying contract. Two primary reasons for this are (i) the parties' cumulative and shared desire to maintain the project schedule and (ii) field personnel's lack of knowledge regarding the contractual change order procedures.

As authors Acret and Perrochet point out, "courts have not dealt tenderly with those who would thus try to reap the benefit of the contractor's work and pay nothing in return." Acret and

Perrochet, California Construction Law Manual (2023-2024 ed.), sec. 1:43. Courts have expressed this reluctance for over 100 years, including dating back to the case of Wyman *v. Hooker*. There the court held that, where extra work was performed with the knowledge and consent of the upstream party, such work performed at the direction of the upstream party must be compensated. The court effectively held that the owner who provides directions to perform work but fails or refuses to execute a change order for that work is generally estopped from invoking contrary contract provisions to deprive the performing party of payment. *Wyman v. Hooker* (1905) 2 Cal.App. 36; *see also Macisaac & Menke co. v. Cardox Corp.* (1961) 193 Cal.App.2d 661, 669-670. As the court in *Wyman* noted:

> The extra work … was done with the knowledge and consent of defendant … and they waived the written stipulation the separate written estimate of extra work should be submitted, by orally agreeing to and countenancing the work without written estimates. Had it not been for defendants' consent thus given, the work would not have been thus done. He will not now be permitted to repudiate the work done.
> *Wyman, supra,* at 36.

Nevertheless, it is critical that a contractor who is directed to perform change work issue notice of the changed condition as soon as possible, including with an estimated cost of the work and time impact.

2. Contractor's Options Where Owner or Prime Contractor Wrongfully Requires Extra Work or Project Conditions Require a Change

Contractors have various options when they encounter a situation where extra work is wrongfully directed or disputed, and when project conditions necessitate a change. Of course, in these circumstances it is ideal for the contractor to obtain a signed change order, but where that is not possible, the various alternative options below should be considered.

a. Proceed Under Protest

Contract law provides for a duty to bargain in good faith. The case of *Coleman Eng'g Co. v. North Am. Aviation, Inc*. (1966) 65 Cal.App.2nd 396 obligates the parties to negotiate in good faith for changes. When bargaining does not produce an agreement for the change the contractor must decide to proceed under protest.

b. Stopping of Work

Stopping work is a drastic and risky option! If the contractor's cessation is deemed wrongful, the contractor puts itself at risk for the cost of any associated delays as well as cost increases. While a material breach (for example not agreeing to pay for extra work) excuses further performance, the law is vague on what constitutes a material breach or a minor breach! The most prudent course is therefore to proceed with the work under written protest. Another option is to proceed under protest and simultaneously file a legal action for declaratory relief.

See *Ted Jacob Eng'g., Inc v. Ratcliff Architects* (2010) 187 CA 4th 945. However, this is an expensive option, and the contract claims provisions must be followed.

c. Determine whether the extra work is severable.

Stopping work is not justified if the proposed extra work is severable from the project, stopping work is not justified. In the case of *Karz v. Department of Prof. and Vocational Standards* (1936) the court found that a proposed extra of building a pool did not justify the Contractor refusing to continue with building the subject house.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with change orders:

- Form 1 – Draft Response to Directed Change
- Form 2 – Notice of Changed Condition
- Form 3 – Constructive Change Notice

3. Legal Theories Available to Contractor

a. Oral Modification of a Written Contract

California Civil Code Section 1698 provides that a written contract can be modified by an ***executed*** oral agreement. A contractor's obligations under contract were deemed fully executed in the case of *Sanders Construction Co v. San Joaquin First Fed. Sav. & Loan Ass'n* (1982) 136 Cal.App.3d. 387 when an oral modification required the contractor not to construct a building and the contractor abstained from construction. *D.L. Godbey & Sons Construction Co. v. Deane* (1952) 39 Cal.App.2nd 429 found that where the contractor performed extra work that was orally requested the contract was deemed executed.

b. Party Conduct as Effecting a Waiver or Recission of Written Requirement

Courts will also look to party conduct in determining whether a contractual requirement relating to written change orders bars recovery of a subcontractor. Courts undertake this analysis from a general disposition that contractors should be paid for work performed and they apply the law liberally to reach this conclusion. In that regard, the doctrine of waiver is frequently used to avoid contractual requirements for written change orders and provides a basis for potential entitlement to change and extra work. Courts have held this much in numerous cases. *See e.g. Weeshoff Constr. Co. v. Los Angeles County Flood Control Dist.* (1979) 88 Cal.App.3d. 579; *see also Howard J. White, inc. v. Varian Assocs.* (1960) 178 Cal.App.2d. 348; *Bavin & Burch co. v. Bard* (1927) 81 Cal.App.722.

In *Howard J. White, Inc.,* for example, Plaintiff builder and Defendant contractor entered into a construction contract whereby Plaintiff agreed to construct a vacuum tube production facility for Defendant within 240 days after commencement. The contract gave the Defendant the right to change the specifications by written order. Throughout the project, 26 change orders were issued. On multiple occasions, Defendant gave oral instructions to do additional electrical work outside

of the original scope of the contract; Plaintiff proceeded with the extra work and presented these costs in multiple change orders. When the work was completed, the Plaintiff filed an action to recover the balance due under the contract. Defendant claimed that Plaintiff only completed the extra work to speed up the Project and avoid Plaintiff-caused delays, as the work was originally Defendant's scope. The appellate court affirmed the trial court's decision that parties may by their conduct waive the requirement of a written contract that no extra work shall be done except upon written order stating that:

> Waiver may be shown by conduct, and it may be the result of an act which, according to its natural import, is so inconsistent with the intent to enforce the right in question as to induce a reasonable belief that such right has been relinquished. (internal citations omitted)

Another species of waiver is the concept that the parties conduct may operate to rescind a portion of their contract which requires change orders and extra work directives be in writing. In the case of *Bavin & Burch Co. v. Bard* (1927) 81 Cal.App.722, the court found that the contract provision requiring written authorization for extra work was ineffective because the parties can orally rescind that provision and proceed based on oral directives. The court's holding in this regard was later echoed in *Opdyke & Butler v. Silver* (1952) 111 CA 2d 912 ("*Opdyke*"). In *Opdyke*, the parties operated during the course of construction in a manner that consistently ignored the contractual requirements regarding written change orders. Ultimately, the court held that this consistent disregard of the contract requirements operated to waive, via recission, the necessity of written change orders and extra work directives, so as to allow the contractor who performed change work by oral directives to recover compensation for that work. *id.*

Notwithstanding the above, it is important to emphasize that the courts' willingness to deploy the doctrine of waiver seems to be focused on private works, as recent case law (discussed below) signals that, in the public works context, courts are far less willing to ignore specific contractual requirements for written change order work.

c. Estoppel

Similarly, when a contracting party requests and agrees to pay for extra work it may be estopped from enforcing a contractual provision requiring change orders to be in writing. *Bailey v. Breetwor* (1962) 206 Cal.App.2d 287.

d. Unjust Enrichment and/or Quantum Meruit

Since contractors who perform work that was orally requested cannot repossess or recover the work, an owner would be "unjustly enriched" if it were permitted to disclaim an oral promise to pay. While a prime contractor may recover from an owner for unjust enrichment, subcontractors have another problem with such a claim, that being lack of privity with the owner. *R.D. Reeder Lathing Co. v. Allen* (1967) 66 Cal.2d 373. The subcontractor does have a remedy though, a ***mechanics lien***.

Another basis for recovery is "quantum meruit" even in the event unjust enrichment is absent. Where an owner induces a contractor to perform work, and the contractor reasonably expects payment, courts have ruled that recovery is warranted. *Earhart v. William Low Co.* (1979) 25 Cal.3d 503.

4. Extra Work Change Orders by Unauthorized Agent

The contractor that performs change and extra work pursuant to the upstream party's oral directive must take care to ensure that the directive is being provided by an appropriate party. A common issue that arises with verbal change directives is whether the party ordering such work was in fact authorized to do so. The liberality of courts in awarding payment for extra work does not extend work order by unauthorized personnel. *Acret and Perrochet*, *supra* at 1:44; *see also Acoustics, Inv. v. Trepte Constr. Co.* (1971) 14 Cal.App.3d 887 ("subordinate field personnel cannot waive the mandatory contract acquirement that order changes or additions or extras be approved in writing…"). As such, it is critical to ensure that any verbal change order or extra work directives are provided by contractually authorized agents or the owner/general contractor themselves.

5. Processing the Claim and the Role of the Prime Contractor

A subcontractor will generally submit a claim for additional cost and / or time to the prime contractor with which it is in privity of contract. The prime contractor will then submit the claim to the owner for approval along with its own markup. The process is subject to multiple considerations including but not limited to: a) does the prime contractor believe the claim is justified, b) what is the legal and business relationship with the subcontractor, c) what is the legal and business relationship between the prime contractor and the owner, and d) how much economic benefit (markup) will the prime contractor receive from the change order.

The prime contractor will likely minimize any economic impact from the subcontractors' claims. When owners refuse to pay for a change order, the prime contractor may well decide to battle the subcontractor rather than the owner.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with change orders:

- Form 4 – Change Order Proposal Checklist
- Form 5 – Change Order Proposal

II. Are Change Orders Recoverable Through Mechanic's Liens?

1. Preliminary 20-day Notice

Civil Code Section 8102 requires a contractor (or other claimant) seeking to enforce its mechanics lien rights to have first served a preliminary notice to the applicable parties on the subject project. *See infra,* at Chapter 3. Among other requirements, the notice must include, "A statement or estimate of the claimant's demand, if any, after deducting all just credits and offsets." Cal. Civ. Code 8102. In other words, the notice must include an estimate of the cost of the work to be provided and materials to be delivered, and this is confirmed in the private work context in Civil Code Section 8202 which references Section 8102 and requires "an estimate of the total price of the work provided and to be provided."

With respect to change orders and extra work, provided that the price estimate is reasonably determined based on information in the contractor's knowledge at the time the preliminary notice

is issued, then such change order and extra work will be covered by the notice. Specifically, Civil Code section 8206(a) provides that "a claimant need give only one preliminary notice to each person to which notice must be given," and 8206(c) confirms that "A preliminary notice that contains a general description of work provided by the claimant to the date of the notice also covers work provided by the claimant after the date of the notice *whether or not they are within the scope of the general description contained notice.*" *See* Civil Code 8206(c) (emphasis added). These code sections underscore that change order and extra work are subsumed into preliminary notices issued at the outset of a job; however, where change orders are significant and result in potentially cardinal changes to the job, best practices dictate that an amended preliminary notice may be appropriate to issue, particularly because there is no statutory penalty for undertaking such action.

The above notwithstanding, it is important to emphasize the need to "reasonably estimate" a final estimate for the work provided and contained in the preliminary notice. Failure to include a reasonable estimate of the value of services may result in disqualification of the notice and any subsequently lien, including as it relates to change order work and extra work. *See Rental Equip., Inc. v. McDaniel Builders, Inc.* (2001) 91 Cal.App.4th 445 (invalidating preliminary notice and lien where claimant included estimated value of $10,000 with no rational basis and sought enforcement of lien claim in excess of $150,000).

2. Inclusion of Extra/Change Work in Lien Amount

The importance of properly tracking the magnitude (in dollars) of extra change work cannot be overstated, particularly in the context of mechanics lien claims. This is, in large part, because a contractor or subcontractor is permitted to include in the amount of its mechanics lien claim price adjustments resulting from written change orders and oral promises to pay for change for extra work. In *Basic Modular Facilities, Inc. v. Ehsanipour* (1999) 70 Cal.App.4th 1480, the court analyzed the provisions of California Civil Code section 3123 (the predecessor to the current code provision, Sec. 8430(c)) and noted that this code section allows for a lien claimant to recover the reasonable value of its work and materials furnished or the price agreed upon by the parties, whichever is less. The court noted that the applicable code provision allows a lien claimant to recover for oral modifications to the contract provided that the claimant establishes that the owner rescinded, abandoned, or breached the contract. *Id.; see also* Baier, et al., California Mechanics Liens and Related Construction Remedies (4th ed. Vol 1), Sec. 2:51. As such, price adjustments reflected in written change orders, as well as those orally promised, may be included in a mechanics lien, but contractors should carefully track such work, and document the changes so as to be able to establish its claim.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with change orders:

- Form 5 – Change Order Proposal
- Form 6 – Preliminary Notice
- Form 8 – Mechanics Lien
- Form 18 – Change Order Request Demand Letter

CHAPTER THREE
PRIVATE WORKS COLLECTION PROCESSES & PROCEDURES

I. Introduction

In the context of private construction projects, a contractor or subcontractor owed money for its work has multiple avenues of collection. These collection tools are based in contract, statute, and even the California Constitution. The variety of collection tools available to contractors include claims under the operative contract or subcontract, enforcement of mechanics lien rights, enforcement of stop payment notice rights, and claims on various bonds (primarily payment bonds).

While contractors enjoy a variety of collection mechanisms, there are critical administrative and procedural steps that must be followed in order to enforce these rights. These requirements include proper licensure (and avoiding critical licensure "traps") and the proper preparation and service of a statutorily compliant preliminary notice. Failure to adhere to these critical requirements often results in a forfeiture of many (and in some cases all) of the collection tools otherwise available to contractors and subcontractors.

This chapter focuses on both the procedural steps described above on private works, as well as the primary collection tools that contractors may utilize in order to collect money owed to them. It is largely a primer and is *not* designed to cover in granular detail the often-labyrinthine subject of construction claims, with all of its nuances and fact/dynamic-specific issues and potential outcomes.

II. Licensure

1. Requirements

The construction industry is a heavily regulated industry. The Contractors' State License Law begins at *California Business & Professions Code 7000*, and with very limited exception, effectively states that every contractor in California must have a license for the classification of work in which it engages. If you are not properly licensed at all times during performance of your work, you cannot bring suit to collect monies owed to you and, in fact, you may be exposed to substantial penalties and risks discussed in more detail below.

2. Risks and Penalties of Unlicensed Construction Activity

The primary risks and penalties associated with performing construction work without a license are set forth in California Business & Professions Code 7031. Section 7031 acts as both a "sword" and a "shield" in these circumstances and both (i) prevents an unlicensed contractor from pursuing and collecting money owed to it and (ii) requires the unlicensed contractor to disgorge any monies paid to it during the course of a project on which it was unlicensed at any time. Cal. Bus. Prof. Code 7031.

With respect to the prohibition on collection, and in relevant part, Section 7031(a) states:

> "[N]o person engaged in the business or acting in the capacity of a contractor, may bring or maintain any action, or recover in law or

> equity in any action, in any court of this state for the collection of compensation for the performance of any act or contract where a license is required by this chapter without alleging that they were a duly licensed contractor at all times during the performance of that act or contract regardless of the merits of the cause of action brought by the person…"

By its terms, the statute prevents a contractor who was unlicensed at any time during the course of construction or the project from filing a lawsuit to recover compensation for work and acts as the "shield" behind which a defendant who would otherwise owe the contractor money can insulate itself from liability.[1]

Section 7031(b) continues the onerous penalties associated with unlicensed contractor work by stating:

> [A] person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor for performance of any act or contract.

This section of the code acts as the "sword" in permitting parties who have paid the unlicensed contractor for prior work performed to disgorge and recover from such contractor the monies that were paid. *See e.g. Ahdout v. Hekmatjah* (2013) 213 Cal. App. 4th 21 (B & P C 7031 constitutes a clear-cut and explicit legislative expression of public policy mandating the disgorgement of compensation received by an unlicensed contractor)*; see also Alatriste v. Cesar's Exterior Design* (2010) Cal.App.4th 656, 669-672 (discussing legislative history, judicial treatment and substantial breadth of policy pertaining to Sec. 7031); *see also Pacific Caisson & Shoring, Inc. v. Bernards Bros., Inc.* (2011) 36 Cal.App.4th 1246 (subcontractor subject to Bus. Prof. Code 7031 where its license was suspended by CSLB for two months during the course of a months-long construction project).

Section 7031 does provide a substantial compliance exception to the licensure rules where a contractor (1) had been duly licensed as a contractor in this state prior to the performance of the act or contract, (2) acted reasonably and in good faith to maintain proper licensure, and (3) acted promptly and in good faith to remedy the failure to comply with the licensure requirements upon learning of the failure. *See* Cal. Bus. Prof. Code 7031(e). However, given the policies and severity of the penalties associated with unlicensed work, a contractor should be weary of placing itself in a position of having to rely on "substantial compliance" with the licensure rules.

Any argument that Section 7031 works an injustice upon contractors who performed work or provided services in connection with a construction project has been repeatedly rejected by California courts. In the seminal case of *Hydrotech Systems, Ltd. v. Oasis Waterpark* the Court addressed this concern and stated:

> The purpose of the licensing law is to protect the public from incompetence and dishonesty in those who provide building and construction services … Section 7031 advances this purpose by withholding judicial aid from those who seek compensation for

[1] Cal. Bus. Prof. Code 7031(c) operates as an extension of this prohibition by preventing an unlicensed contractor from maintaining any form of security interest against property, which would include a mechanics lien.

> unlicensed contract work. The obvious statutory intent is to discourage persons who have failed to comply with the licensing law from offering or providing their unlicensed services for pay. Because of the strength and clarity of this policy, it is well settled that section 7031 applies despite injustice to the unlicensed contractor. 'Section 7031 represents a legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness between the parties, and that such deterrence can best be realized by denying violators the right to maintain any action for compensation in the courts of this state.'" (citations omitted).
> *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 Cal.3d 988, 995.

The importance of proper licensure cannot be overstated. The draconian penalties that unlicensed contractors face can inflict irreparable damage on a contractor's business and prevent any form of collection action by the contractor.

3. Licensure Traps

a. Worker's Compensation Requirements

Where a contractor fails to maintain the appropriate workers' compensation insurance for all of its employees, its license is deemed suspended by operation of law. *See Sanders Construction Co., Inc. v. Cerda* (2009) 175 Cal. App. 4th 430. Cal Bus & Prof Code § 7125.2 (2016) states in relevant part:

> The failure of a licensee to obtain or maintain workers' compensation insurance coverage, if required under this chapter, shall result in the automatic suspension of the license by operation of law in accordance with the provisions of this section…

As a result, failure to obtain and maintain appropriate worker's compensation insurance will render a contractor subject to the prohibitions and penalties set forth in Section 7031.

The case of *Wright v. Issak* is instructive. There, a contractor and homeowner litigated a construction claim, with the homeowner asserting a breach of contract/violation of Bus. Prof. Code 7031 and seeking disgorgement of sums paid to the contractor. The basis of the allegation was that the contractor underreported his payroll and, as a result, did not carry appropriate workers' compensation coverage during the course of the contractor's work. The court agreed with the homeowner, holding that the failure to obtain appropriate workers' compensation coverage rendered the contractor's license suspended by operation of law under Bus. & Prof. Code § 7125.2 and subjected the contractor to the severe statutory penalties of Bus. & Prof. Code § 7031. *Wright v. Issak* (2007) 149 Cal App 4th 1116-1124. In sum, obtaining and maintaining proper workers' compensation for *all* employees is part and parcel to maintaining proper licensure.

b. Joint Ventures

Joint venturing is becoming more and more popular in the construction industry, particularly on larger projects where engaging in a joint venture may provide a competitive bidding

advantage to the licensees. Critically, even where the members of the joint venture are both licensed, the joint venture itself requires a separate license in order to avoid the penalties described above and protect future collection rights. Cal. Bus. Prof. Code 7029.1(a) states:

> Except as provided in this section, it is unlawful for any two or more licensees, each of whom has been issued a license to act separately in the capacity of a contractor within this state, to be awarded a contract jointly or otherwise act as a contractor without first having secured a joint venture license in accordance with the provisions of this chapter.

While the law does permit the joint venture to *bid* on projects prior to licensure issue, a license must be obtained prior to entering into a contract and performing work. *See* Cal. Bus. Prof. Code 7029.1(b).

III. Preliminary Notices

The preliminary notice is generally a single page document that provides various project stakeholders with basic factual information regarding a subcontractor's (or any claimant's) involvement in a project. From a policy perspective, the preliminary notice makes sense: contractors should necessarily be required to notify parties with whom they are not in direct privity of contract of their involvement in construction projects and potential lien rights so that those parties can protect their own interests and ensure that the contractors and subcontractors are properly and timely paid. With respect to collection of money owed, few (if any) documents are more important than the preliminary notice.

For most claimants, including subcontractors, who provide work, services or material integrated into a work of improvement, service of a statutorily compliant preliminary notice is a mandatory prerequisite to enforcing mechanics lien rights, stop payment notice rights, and payment bond rights. California Civil Code 8200 provides:

> (a) Except as otherwise provided by statute, before recording a lien claim, giving a stop payment notice, or asserting a claim against a payment bond, a claimant ***shall*** give preliminary notice to the following persons:
> (1) The owner or reputed owner.
> (2) The direct contractor or reputed direct contractor to which the claimant provides work, either directly or through one or more subcontractors.
> (3) The construction lender or reputed construction lender, if any.
> Cal. Civil Code Sec. 8200(a) (emphasis added).

This requirement is echoed in Civil Code Sec. 8410 (mechanics liens) and 8508 (stop payment notices); *see also e.g. Brewer Corp. v. Point Ctr. Fin.* (2014) 223 CA4th 831.[2] While there are exceptions to the requirement of preliminary notice service, for purposes of best practices

[2] As discussed elsewhere, the process regarding enforcement of payment bond rights deviates slightly in that, where a preliminary notice is not served, a post-completion bond notice may be served in order to preserve these rights.

guidance, claimants and especially trade contractors should serve a notice on every project in which they are involved as a matter of course.

Notably, only one preliminary notice is required for each project, except in the circumstance where a single contractor performs various scopes of work under distinct contracts. *See* Baier, et al., California Mechanics Liens and Related Construction Remedies, Sec. 3.18 (4th Ed. 2024).[3] In such a case, a separate notice is required for each subcontract. *See* Cal. Civil Code 8206.

The penalty for failing to serve a preliminary notice is draconian, harsh and typically strictly enforced. One who fails to serve a statutorily compliant notice on the requisite parties will be barred from enforcing stop payment notice and/or mechanics lien rights. *See e.g. Harold l. James, Inc. v. Five Points Ranch, Inc.* (1984) 158 CA3d 1; *see also Fuller v. American Forest Products Co.* (Unpub. App. 5th Dist. 1988) (notice insufficient where outdated form was used).

1. Form and Contents

The California Civil Code specifies the form that the preliminary notice must take in order to meet the statutory requirements set forth in the code. Cal. Civ. Code 8102, 8202. The contents of the notice must contain basic project information, including the name of the owner reputed owner, the name of the general contractor, the name of any construction lender, the general description of work being provided, and an estimated value of that work. *Id.* Further, the code requires a notice to property owners be included in each notice, the requirements for such notice including not only the substance of the notice but also font, typeface, and boldness.

Form 6 contains a form preliminary notice for ease of reference, which reflects all information required to be included in the preliminary notice under the code. NECA contractors are encouraged to refer to this document for the purpose of preparing statutorily compliant preliminary notices.

2. Service Requirements

The preliminary notice must be served within 20 days after the claimant has first furnished work, services, or material to the project jobsite; provided that where service is late the notice is not invalidated, but rather the claimant is limited in the amount it can seek via lien or stop payment notice to the value of the work performed within 20 days prior to service of the notice. *See e.g.* Cal. Civ. Code 8204; *see also Brown Co. v. Appellate Dept.* (1983) 148 Cal.App.3d 891 (service of notice not premature even where given prior to delivery of materials to the jobsite).[4]

The parties upon whom the notice must be served include, as noted in the statute, the project owner or reputed owner, any construction lender associated with the project, and the general contractor or reputed general contractor.[5] *See* Cal. Civil Code 8200(a).

Permissible methods of service include personal delivery, overnight delivery, and Certified U.S. Mail – Return Receipt Requested. Cal. Civ. Code 8106-8110. The authors strongly encourage

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[3] Baier, et al. acted as a critical source reference for the information contained herein, including as a predicate source to various cases and statutes cited herein.

[4] Note that payment bond claimants have a separate vehicle to cure late notices, which is the post-completion bond notice discussed below.

[5] While the law provides for some deviation from service requirements, such as in the case of an order with actual knowledge of the work being performed, relying on such legal doctrines is a risky proposition that can otherwise be avoided by simply serving the correct parties in a timely fashion. *See Truestone, Inc. v. Simi W. Indus. Park II* (1984) 163 CA3d 715.

claimants to serve preliminary notices by overnight delivery or Certified US Mail, including because these methods allow for reliable tracking via courier reporting or the certification receipts (i.e. green receipts), which should be saved in the event of a future dispute. While personal service is valid, proof of the service may be problematic thereby negating a mechanics lien.

3. Substantial Compliance – Is It Sufficient?

The California Civil Code contains a detailed recitation of the requirements for preliminary notice. But does a claimant have recourse in the event they seek to comply with the code requirements but deviate from such requirements?

The doctrine of substantial compliance has been applied to relieve claimants of the otherwise strict enforcement of the preliminary notice requirements in certain instances. However, despite the application of the substantial compliance doctrine in narrow circumstances claimants are strongly encouraged to follow the letter of the law, both in terms of the preliminary notice content, and service requirements in order to avoid a potentially prolonged and expensive legal battle to determine whether or not the doctrine applies.

The above notwithstanding, courts are often practical in examining whether a claimant has met its obligation to provide notice of its lien rights to a project owner and other parties required to receive such notice. For example, the court in *Harold L. James, Inc. v. Five Points Ranch, Inc.* held that while service and notice requirements must be strictly enforced, minor deviations in the body of the preliminary notice form will not defeat an otherwise effective notice. *Harold L. James, Inc. v. Five Points Ranch, Inc.* (1984) 158 CA3d 1, 7.

Moreover, in *Industrial Asphalt, Inc. v. Garrett Corp.* (1986) 180 CA3d 1001, the court permitted a subcontractor to enforce its mechanics lien even though it failed to serve its preliminary notice on the direct contractor. The court determined that the owner received the notice, and this was sufficient to avoid prejudice to the real party in interest vis-à-vis the lien claim – i.e. the owner of the land subject to the lien.

The above notwithstanding, the importance of adherence to the preliminary notice code requirements cannot be understated.

IV. Contract Claims and Prompt Payment Statutes

The first, and simplest, basis for recovering money owed to a contractor is a claim for breach of contract. In virtually every relationship between an owner and general contractor (or a general contractor and subcontractor) a contractual relationship exists that requires one party to provide construction work and services and the other party to pay for that work or those services. Where such work and services are provided, but payment is not made in accordance with the terms of the contract, the party providing the service has a claim for breach of contract. While contracts can be both verbal and written and thus enforceable, proof of the contract is a requisite for recovery such that a written contract is a practical necessity. Such a claim is typically brought by way of a lawsuit filed in the superior court where the project is located.

However, a contractual claim for money owed is not exclusive of the other powerful remedies available to contractors who are not paid for their work. Cal. Civ. Code 8468. Rather, it is in addition to such remedies. Claims for breach of contract can be, and often are, brought in tandem with claims to foreclose mechanics' liens, claims on stop payment notices, and claims on payment bonds.

As part of any contract claim, an evaluation regarding the application of California's prompt payment statutes is appropriate. Prompt payment laws apply in a variety of circumstances to owners, direct contractors, and subcontractors (where downstream subcontractors exist). These laws require undisputed progress payments and retention payments be paid within a specified period of time or the payor will be subject to penalties of 2% per month on the amount owed. *See e.g.* Cal. Civ. Code 8800, 8812, 8814; *see also* Cal. Bus. Prof. Code 7108.5. In some cases, the 2% penalty is in lieu of interest, and in some cases, it is in *addition to* interest. In the event of litigation involving violations of the prompt payment statutes, the prevailing party in such litigation is generally entitled to recover its attorneys' fees and costs per statute. There are numerous different prompt payment laws, each applying in specific circumstances. A matrix describing the various prompt payment laws, their application, and penalties is attached as **Form 7.**

V. Mechanics Liens

The mechanics lien is an incredibly powerful tool that allows contractors who are owed money for their work to place involuntary encumbrances on the properties to which they provide construction work, services, equipment or materials. In California, the mechanics lien is rooted in the California Constitution and is the only creditor remedy born out of the Constitution. *Connolly Dev. Inc. v. Sup. Ct.* (1976) 17 C3d 803.

Generally, the remedy applies only to private works of improvement and is available to a broad cross-section of potential claimants – i.e. basically any person or company that provides construction work, services, or material to a work of improvement. *See* Cal. Civ. Code 8400. With respect to contractors (as opposed to material suppliers), any contractor seeking to enforce its mechanics lien rights must, of course, be licensed.

1. Preliminary Notice Requirement

As noted above, in order for most claimants to enforce their mechanics lien rights they must serve a preliminary notice in the format and manner described above. *See* Cal. Civil Code 8410. While not all claimants are required to serve a preliminary notice, it is strongly advised that contractors and subcontractors serve the notice on each and every project on which they work, including because there is no penalty for serving a notice where one is not otherwise required.[6]

2. Form of Notice, Recordation, and Service

The California Civil Code specifies the contents that must be included in the lien for it to be valid. Cal. Civ. Code 8416. The contents of the lien must contain the amount of the demand after deducting all credits and offsets, the name of the owner or reputed owner, the general nature of the work furnished, the name of the person who employed the claimant or to whom claimant furnished the work, the claimant's address, a description of the site sufficient for identification, an affidavit of proof of service on the owner, and a specific statement in boldface type entitled "Notice of Mechanics Lien." *Id.* **Form 8** contains a form mechanics lien, which reflects a code compliant

[6] Claimants that need not serve a notice are those which are in direct contract with the project owner; however, even claimants in direct contract with a project owner are required to serve the preliminary notice where a construction lender is in place. *See* Cal. Civ. Code 8200. Again, the rules in this respect are cumbersome and it is best not to have personnel trying to make a determination as to whether a notice is necessary. Instead, they should simply serve one on all project.

lien. NECA contractors are encouraged to refer to this document for purposes of preparing statutorily compliant mechanics liens (in the event they do not retain counsel to do this for them, which is recommended).

Once the lien is properly prepared, it must be recorded with the recorder's office in the county in which the property that is subject to the lien is located. Cal. Civ. Code 8060(b); *See also* Cal Civ. Code 8412-8414 (recordation required). It is recommended that a claimant confirm the correct ownership of the property through a title company or service as part of the lien preparation process.

With respect to service, a copy of the lien must be served on the owner or reputed owner by registered mail, certified mail, or first-class mail, which must be evidenced by a certificate of mailing. Cal. Civ. Code 8416(c)(1). Service must be made upon the construction lender or to the direct contractor in the same manner as described above. *Id.* At 8416(c)(2). Proper service is critical and required for the mechanics lien to be enforceable. In the event service is not properly effectuated the lien claim will be unenforceable as a matter of law. *Id.* At 8416(e).

3. Completion Requirements/Notice of Completion

Prior to recording the mechanics lien, the claimant's work must be complete. Time limits for recordation of a lien depend on multiple factors, including whether the claimant is a direct contractor or subcontractor and whether a notice of completion is recorded by the project owner.

Regarding a direct contractor, recordation of the lien is only permissible following completion of the overall work of improvement. Civil Code 8180(a) sets forth four identifiers for a private work of improvement that signal completion, which include:

- Actual completion;
- Occupation or use by the owner or the owner's agent, accompanied by a cessation of labor;
- Cessation of labor for a continuous period of 60 days;
- Recordation of a notice of cessation after cessation of labor for a continuous period of 30 days.

  Cal. Civ. Code 8180(a).

Generally speaking, a contract is "complete" when the contractor's work requirements have been performed in full, excused or discharged. *See Howard S. Wright Const. Co. v. BBIC Investors,* LLC (2006) 136 CA4th 228 (emphasizing that an owner's indication of non-payment where money is owed constituted "completion" so as to allow for lien recordation). With respect to the "actual completion" standard, the court in *Picerne Constr. Corp. v. Castellino Villas* (2016) 244 CA4th 1201 stated that actual completion, as opposed to substantial completion, triggered the 90-day deadline to recording mechanics lien. In so holding, the court emphasized the need to provide claimants with the maximum amount of time to assert a lien right and determined that a "substantial completion" standard (as opposed to an "actual completion" standard) jeopardized a contractors' lien rights by forcing recordation of the lien much sooner.

While a direct contractor must achieve project completion in order to record a lien, a claimant not in direct contract with a project owner (e.g. a subcontractor) need only achieve scope completion for its lien rights to be triggered. Thus, even where the project is ongoing, a subcontractor may record a lien where its scope of work is deemed complete. *See* Cal. Civ. Code 8414(a).

Once triggered via completion as set forth above, and subject to the recordation of a notice of completion (as discussed below), a claimant has 90 days after completion to record a mechanics lien. *See* Cal. Civ. Code 9414(b)(1).

Understanding completion requirements is critical because if a mechanics lien is premature, it is void and unenforceable. Generally, where a contractor believes completion has occurred and money is owed, a confirming letter documenting such belief can facilitate establishing completion and the triggering of lien rights.

Beyond the class of claimants as a factor determining when lien rights accrue, the recordation of a notice of completion will significantly impact the requirements as to when a lien must be recorded as follows:

- For a direct contractor, if a compliant notice of completion (or notice of cessation of labor) is recorded and properly served, the mechanics lien must be recorded within ***60 days*** following the recordation of such notice. Cal. Civ. Code 8412(b).
- For other claimants, including subcontractors, if a compliant notice of completion (or notice of cessation of labor) is recorded and properly served, the mechanics lien must be recorded within ***30 days*** following the recordation of such notice. Cal. Civ. Code 8412(b).

4. Amount Recoverable

California Civil Code 8430(a) informs that a mechanics lien may only seek the amount of the claimant's contract price or the reasonable value of the work, whichever is less. Importantly, the law permits any claimant to include in its mechanics lien the value of work performed pursuant to a written modification of the contract. Cal. Civ. Code 8430(c). This effectively permits contractors to include in their lien the value of any change order work performed, whether or not change orders are executed or approved by the owner or general contractor, as the case may be. *See Basic Modular Facilities, Inc. v. Ehsanipour* (1999) 70 CA4th 1480. In addition to the value of change orders, interest is also a recoverable sum under the mechanics lien law.

While the value of change order work can be included in the mechanics lien amount, case law suggests that the value of any impacts or delays may not be included in the amount sought. The Court in *Lambert v. Superior Court* (1991) 228 CA3d 383 held that delay damages are not part of the reasonable value of work, even if the contract characterized them as such. Moreover, the statutory language applicable to the calculation of the mechanics lien amount informs that the costs to be included are limited to the extent of the reasonable value of the labor, service, equipment, or material actually furnished, which would suggest delay damages cannot be included in the mechanics lien amount. Cal. Civ Code. 8430. Likewise, attorneys' fees are not recoverable in a mechanics lien action. *Abbett Elec. Corp. v. Cal. Fed. Sav. & Loan Ass'n* (1991) 230 CA3d 355.

5. Commencement of Enforcement Action

Once recorded, an action to foreclose a mechanics lien must be commenced within 90 days from the date of recordation. Cal. Civ. Code 8460(a). Failure to timely commence a lawsuit to foreclose the lien will, by operation of law, render the lien void and unenforceable. The 90-day limitation period can be extended if the claimant and owner agree to extend credit. Such a letter

of credit must be recorded and there are strict limits on the length of the permissible extension. *See* Cal. Civ. Code 8460(b). A form of such letter of credit is attached as **Form 9.**

Promptly after the claimant files suit to foreclose the lien, but in no event more than 20 days following commencement of the action, the law requires that a *lis pendens* (notice of pending action) be recorded with the appropriate county recorder's office. Cal. Civ. Code 8461. The *lis pendens* is an important tool because it puts the world on "constructive notice" that the lien exists and encumbers the property. Such notice allows the claimant to pursue in a foreclosure action a bona fide purchaser of the subject property in the event it is sold.

6. Tenant Improvement Nuances

Given the volume of tenant improvement work that contractors do, a separate word is in order regarding the nuances of recording a lien where such work is commissioned by the tenant. Tenant improvement work, specifically where such work is ordered by the tenant and not the landlord, has specific and unique impacts on a claimant's mechanics lien rights. As a general principle, we start from the policy perspective that the lien law is designed to prevent owners from being unjustly enriched. *See supra* Acret, at 6:65 (citing *Burton v. Sosinsky* (1988) 203 Cal.App.3d 562).

More generally, if the person who orders work to be done owns less than a fee simple interest in the land (e.g. a lease), the mechanics lien will attach only to that party's interest. However, if the owner in that situation is aware of the work of improvement and fails to post and record a notice of non-responsibility (see below), such owner's interest will also be subject to the lien. *See* Baier, et al., California Mechanics Liens and Related Construction Remedies, Sec. 2.63. Thus, at a minimum a lien recorded in the tenant improvement context will attach to the leasehold interest of the tenant, but more often it will also attach to the land of the owner (provided preliminary notice requirements are met, and no notice of non-responsibility is recorded). This distinction is why a preliminary notice for a tenant improvement project must be served on both the tenant (likely the contracting party) and the landlord (the property Owner).

a. Non-Responsibility

California Civil Code 8444 states that where work is commissioned by a tenant with the knowledge of the owner, the interest of the owner subject to mechanics lien claims unless the owner, within 10 days of knowledge of the work of improvement, post a notice of non-responsibility on the property and records a copy of the notice at the county recorder's office. The notice must be signed and verified by the owner, contain a description of the property, and a statement that the person giving the notice is not responsible for claims arising from the work. *See supra* Acret, at 6:67. When properly posted and recorded, a notice of non-responsibility will relieve the owner from liability and insulate the property from a claim on a mechanics lien. Strict compliance with the posting and recording requirements under the Code is required. *See Arhtur B. Siri, Inc. v. Bridges* (1961) 189 Cal.App.2d 599. A form of Notice of Non-Responsibility is attached as **Form 10**.

b. Participating Owner Doctrine

Courts have limited an owner's ability to utilize the prophylactic measures of California Civil Code 8444 where they have deemed the owner "participating" in the work of improvement. Thus, simply receiving a notice of non-responsibility should not deter a contractor from recording

a lien, including where that contractor suspects the owner of the property is participating in the work of improvement. Participation, as contemplated by the doctrine, comes in many forms. Participation has been deemed to occur where:

- The lease requires by its terms that improvements be made. *Ott Hardware Co. v. Yost* (1945) 69 Cal.App.2d 593.
- The improvements revert to the owner at the end of a fixed period and the rent is calculated based on tenant profitability. *Los Banos Gravel Co. v. Freeman* (1976) 58 Cal.App3d 785.
- The owner maintains control over plans and specs and receives a fee for its role in construction. *Howard S. Wright Construction Co. v. Superior Court* (2003) 106 Cal.App.4th 314.

Other circumstances that may give rise to a claim of "participation" by the owner include providing rent abatement as consideration for the tenant's contemplated work. The doctrine is flexible and applied on a fact-specific basis, so it is important to remember that just because an owner records a notice of non-responsibility, this alone does not necessarily protect the underlying property from a mechanics lien claim.

VI. Stop Payment Notices

Parties who have mechanics lien rights also have stop payment notice rights. *See* Cal. Civ. Code 8530. A stop payment notice (often referred to as a "stop notice") is a statutory tool utilized to freeze construction funds held by owners and/or lenders and prevent distribution of funds in the amount claimed in the notice. Cal. Civ. Code 8044, 8520(a). It is a very effective tool to protect contractor and subcontractor payment rights, particularly where there may not be sufficient equity in the subject property to protect mechanics lien rights. Moreover, when a project fails, a stop payment notice, "may be the more valuable remedy because it is a direct charge on unexpended loan funds; mechanics lien claims nearly always compete with the lender's foreclosure under its deed of trust. Unless mechanics liens have priority, they are terminated by the lender's foreclosure, but stop payment notices reach unexpended construction funds even after foreclosure." *See* Baier, et al., *supra*, at Sec. 2.96 (internal citations omitted).

Where the funds are held by the owner, service of the stop payment notice on the owner (typically by a subcontractor) freezes funds that would otherwise be distributed to the direct contractor. Where the funds are held by a lender, service of the stop payment notice on the lender (among others) freezes funds that would otherwise be distributed to the owner and/or direct contractor. The funds are then held until such time as the dispute surrounding the fees is resolved (be it by trial or dispute resolution process) or a release bond is obtained.

1. Preliminary Notice Requirement

As is the case with mechanics liens, in order for most claimants to enforce their stop payment notice rights they must serve a preliminary notice in the format and manner described above. *See* Cal. Civil Code 8200. Civil Code 8200 imposes an absolute obligation to give a preliminary notice to a lender as a prerequisite to the validity of a stop payment notice. *Romak Iron Works v. Prudential Ins. Co.* (1980) 104CA3d 767, 773.

As noted above, while not all claimants are required to serve a preliminary notice, it is strongly advised that contractors and subcontractors serve the notice on every project on which they work, including because there is no penalty for serving a notice where one is not otherwise required.

2. Amount Recoverable

While the stop payment notice will include the total amount owed to the claimant for work performed, the amount *recoverable* under a stop payment notice is limited to the net amount owing to the claimant. "Net amount" is calculated by reducing any funds withheld by the owner or lender to satisfy stop payment notice claims of all claimants who have filed bonded stop payment notices for work done on behalf of the direct contractor or a subcontractor claimant. Cal. Civ. Code 8542. This essentially means that, if the funds withheld under a series of stop payment notice are insufficient to pay all valid stop notice claims, the funds are distributed among the claimants based on a pro rata allocation, first going to pay bonded stop payment notice claims, and second to pay unbonded stop payment notice claims. *See* Cal. Civ. Code 8540(a). Prorations are determined without regard to the order in which stop payment notices are received. *See* Cal. Civ. Code 8540(b).

Like mechanics liens, interest is recoverable from the date the stop payment notice is given; however, one critical difference between the mechanics lien right and the bonded stop notice (see below regarding bonding of the stop notice) in the private works context is that, under California Civil Code 8558, the prevailing party in an action to enforce a bonded stop payment notice is entitled to recover reasonable attorneys' fees. *See also Mechanical Wholesale Corp. v. Fuji Bank, Ltd.* (1996) 42 Cal.App.4th 1647.

The stop payment notice remedy is extremely important in an environment where property values have depreciated. While a lender's foreclosure may eliminate all mechanics lien claims, a bonded stop payment notice to a construction lender will be recoverable provided that loan funds have not been fully disbursed.

The stop payment notice remedy is not a remedy that should be used lightly, and preparation of the notice, including with respect to the amount must be carefully considered. A claimant that serves a false stop payment notice or that includes in the stop payment notice amounts for work not yet performed will forfeit its right to distribution of the frozen proceeds *and also forfeits its mechanics lien rights! See* Cal. Civ. Code 8504.

3. Preparing, Bonding, and Serving the Stop Payment Notice

The California Civil Code specifies the contents that must be included in the stop payment notice for it to be valid. Cal. Civ. Code 8102, 8502. The contents of the lien must contain the estimated total value of work to be done or provided, the amount due to the claimant, the name of the owner or reputed owner, lender, and general contractor, the general nature of the work furnished, the name of the person who employed the claimant or to whom the claimant furnished the work, the claimant's address, a description of the site sufficient for identification, and a verification. *Id.* **Form 11** contains a form stop payment notice for ease of reference, which reflects all information required to be included in the notice under the code. NECA contractors are encouraged to refer to this document for purposes of preparing statutorily compliant stop payment notices (in the event they do not retain counsel to do this for them, which is recommended);

however, it is noteworthy that minor variances in form and content will not defeat the stop payment notice if it is sufficient to substantially inform the holder of funds of the requisite information.

With respect to service, a copy of the stop payment notice must be served on the owner or reputed owner and construction lender, if any, by registered mail, certified mail, express mail, or overnight delivery. *See* Cal. Civ. Code 8502, *et. seq.* Service of the stop payment notice may also be effectuated via personal delivery to the owner and lender (via manager or responsible officer). *Id.* Proper service is critical and required for the stop payment notice to be enforceable. Critically, and as opposed to the mechanics lien right, one significant benefit of the stop payment notice is that the claimant need not wait until its work is complete to serve the notice. Instead, the stop payment notice can be served during the course of construction, allowing the claimant to continue to perform per contract while at the same time protecting its right to payment.

Unlike in public works (discussed elsewhere), in the private works space, stop payment notices that are not bonded are ineffective when served on a construction lender and can effectively be ignored. Cal. Civ. Code 8536; *Manos v. Degen* 1988) 203 CA3d 1237. However, bonded stop payment notices (i.e. a stop payment notice accompanied by a bond equal to 125 percent of the claim) trigger a *mandatory* withholding of the funds claimed by the lender. Except in rare cases, the lender's failure to withhold the funds sought by the stop payment notice will expose the lender to personal liability. *Calhoun v. Huntington Park First Sav. & Loan* (1960) 186 CA2d 451.

The distinction between bonded and unbonded stop payment notices is less critical where there is no lender involved and the notice is served on the owner. An unbonded stop payment notice served on a project owner has the same impact as a bonded notice served on a lender and triggers the owner's obligation to withhold the funds sought unless and until it takes affirmative action to address the stop payment notice (such as obtain a release bond). *See* Cal. Civ. Code 8522.

4. Commencement of Action to Enforce

A claimant may commence a lawsuit to enforce a stop payment notice any time after 10 days from the date of giving the notice; provided that such a suit *must* be filed not later than 90 days after expiration of the time within which a stop payment notice must be given. Cal. Civ. Code 8550. Put another way, the claimant must initiate an action to enforce its stop payment notice rights within 90 days after expiration of the deadline to record a mechanics lien. Failure to timely initiate a lawsuit to enforce stop payment notice rights results in the notice becoming ineffective by operation of law, and funds dispersed.

Importantly, after filing suit, a claimant *must* serve a "Notice of Commencement of Action" within 5 days of filing. The notice must be served on the same parties that received the sop payment notice and comply with various civil code requirements. Failure to timely serve the Notice of Commencement of Action may result in the release of the funds otherwise subject to the stop payment notice and a limitation or loss of a claimant's rights. *Id.* At this juncture, it is imperative that a claimant consult and have counsel actively involved in the claims process, as litigation surrounding stop payment notices (and all remedies) can be complex and mistakes fatal to a claimant's rights.

VII. Payment and Release Bonds

1. Payment Bonds

A payment bond is, effectively, a contractual guarantee (i.e. a bonded contract) for payment to those supplying labor, work, materials, and equipment to construction projects. The bond is underwritten and issued by a surety to a principal on the bond (often, in the context of private works, the direct contractor). Payment bonds are, admittedly, uncommon in the context of private works, but on larger scale projects are sometimes required by the owner as a condition of the prime contract. In the event the principal (e.g. the direct contractor) fails to satisfy its contractual payment obligations, the payment bond provides a powerful tool against which the subcontractor claimant may seek the sums due and owing. In such a case, claimants are permitted to recover sums due from both the surety and the principal on the bond. *See* Baier, et al, *supra*, at Sec. 1.5. For private works, the only requirements for recovery on the bond are that the claimant is a person entitled to enforce a mechanics lien and that the claimant was not paid for the work performed. Cal. Civ. Code 8154, 8608.

Payment bonds are powerful collection tools, in part, because California law requires that such bonds be construed strongly against the surety and in favor of the claimant. Cal. Civ. Code 8154. Thus, courts will go to great lengths to enforce bond terms against the surety where able and appropriate. Further, the payment bond and its terms inure to the benefit of all persons who provided work to the general contractor either directly or through a subcontractor. Cal. Civ. Code 8608.

a. Preliminary Notice Requirement

In order to enforce a claim against the payment bond, a claimant may give preliminary notice as discussed above under subheading "Preliminary Notices". Cal. Civ. Code 8612(a). However, this is one of the few instances in which failure to properly and timely serve a preliminary notice is not fatal to a claimant's recovery. Rather, in the event a claimant fails to timely and properly serve a preliminary notice, they may preserve their claim on a payment bond by serving a post-completion bond notice.

b. Post-Completion Bond Notice

If a preliminary notice was not provided, a claimant may still enforce a claim against a payment bond by giving written notice to the bond surety and principal on the bond within 15 days after the recording of a notice of completion, or 75 days after completion of the work of improvement if a notice of completion was not recorded. Cal. Civ. Code 8612(b). The form of the post-completion bond notice is exacting and largely mirrors the requirements of the preliminary notice. A sample, code-compliant post-completion bond notice is attached as **Form 12**.

The above notwithstanding, the law has been modified to limit the ability of second-tier subcontractors to utilize the post-completion bond notice procedure. Specifically, the procedure does not apply to a claimant who does not have a direct contractual relationship with the general contractor, and:

(1) All progress payments, except for those disputed in good faith, have been made to a subcontractor who has a direct contractual relationship with the general contractor; or

(2) The subcontractor who has a direct contractual relationship with the general contractor has been terminated from the project, and all progress payments, except those disputed in good faith, have been made as of the termination date.
Cal. Civ. Code 8612(d).

With respect to the bond surety, the notice must be served at the surety's address shown on the bond for service of notices, papers, and other documents, or on the records of the Department of Insurance. If mailed, the notice has to be mailed via registered or certified mail, express mail, or overnight delivery by an express service carrier. Cal. Civ. Code 8110.

Even where a preliminary notice or post-completion bond notice is properly served, it is recommended that notice be provided to the bond surety, including so as to trigger certain investigatory obligations of the surety. This should be, ideally, prior to initiating an action on the bond as a prompt surety investigation can result in payment short of litigation.

The above notwithstanding, proper service of a preliminary notice is by far the preferred method of protecting payment bond rights for all claimants.

c. Commencement of Action

A claimant has four years from the date of the breach to bring an action against the bond surety. Cal. Civ. Code 8609; Cal. Civ. Proc. 337. Critically, the terms of the payment bond may (and often do) shorten the time to file a claim, as long as the time to commence action is at least six months from the date of completion and the bond is recorded.[7] *Id.* The shortening of the limitations period is typically reflected in the terms and language of the bond itself. So, acting aggressively to protect your payment bond rights, and understanding the terms of the bond, are critical and it is advisable to seek counsel to facilitate such a claim.

Within the context of an action to recover on a payment bond, the claimant may seek the unpaid sums due and owing to it under contract (or in some cases the reasonable value of the work), impacts resulting from delays, prejudgment interest, statutory prompt payment penalties, costs, and attorneys' fees if applicable through statute or contract. Thus, the breadth of liability under the bond can be significant and which, when coupled with a surety's statutory obligations to investigate claims, can create significant leverage for a claimant.

2. Release Bonds (Mechanics Liens and Stop Payment Notices)

Release bonds can be obtained for both mechanics liens and stop payment notices in order to effectuate the release of the lien from title so as to free the land from the encumbrance and/or unfreeze the funds otherwise held by the owner or lender. These bonds require the claimant to pursue the surety underwriting the release bond instead of the project owner and/or the lender. With respect to mechanics liens, the release bond must be recorded, but this is not the case for stop payment notice release bonds. Release bonds must meet certain statutory requirements, including that they must be in an amount equal to 125% of the amount claimed. One benefit to claimants of the release bonds is that they can be expensive to obtain, often require collateral, and typically require the principal on the both to agree to indemnify the underwriting surety. These requirements can strongly incentivize the principal of the release bond to issue payment to the claimant.

[7] If a payment bond is recorded before the completion of a project, an action to enforce the payment bond has to be filed within six months of the completion of the work of improvement. Cal. Civ. Code 8610.

Any action on a mechanics lien release bond must be brought within 6 months of the bond's recordation, provided notice of the recordation is provided to the claimant. Cal. Civ. Code 8424. Where the bond is obtained *after* a lawsuit to foreclose the lien is commenced, this limitation period does not apply; however, the release bond should be added to the action promptly after notice of recordation is received.

Any action on a stop payment notice release bond must be brought within 3 years from the date the bond is executed. *Winick Corp. v. General Ins.* (1986) 187 CA3d 142, 148.

Contractors often grow concerned when their lien and stop payment notice rights appear to be compromised by the existence of a release bond. However, the introduction of a release bond into an action or dispute is typically a positive development insofar as a surety will often seek to resolve cases more aggressively than project stakeholders and generally maintains appropriate liquidity levels to pay out on claims. As such, claimants should typically welcome the introduction of a release bond surety into their claims procedures and disputes.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with private works collection:

- Form 6 – Preliminary Notice
- Form 7 – Prompt Payment Matrix
- Form 8 – Mechanics Lien
- Form 9 – Letter of Credit
- Form 10 – Notice of Non-Responsibility
- Form 11 – Stop Payment Notice
- Form 12 – Post-Completion Bond Notice
- Form 16 – Retention Release Letter (Private Work)
- Form 17 – Progress Payment Demand Letter

CHAPTER FOUR
CHANGE ORDERS ON PUBLIC WORKS

I. Introduction

This chapter is designed to highlight key issues contractors may face when pursuing extra work claims on public works projects. "Extra work" is the term of art used to describe work that is not specified in the contract, drawings, or specifications but that is nevertheless performed by a contractor, for which the contractor claims additional compensation.

II. Extra Work

Many times extra-work disputes are really disputes over the scope of the work. The public entity likely contends that the contract requires the contractor to perform a certain item of work; the contractor contends that it is extra work outside the scope of the contract. Public contract clauses usually require the contractor to give written notice of its contention within a specified number of days. Such provisions are expressly approved under Civil Code §1511(1) in the event that performance is prevented or delayed.

The notice requirement provides a necessary function to the administration of the project. It permits the public entity to take steps to minimize delays or extra costs and to identify other work that the contractor can perform. Furthermore, if claimed extra work is being performed, the public entity has the opportunity to monitor the labor and equipment used, for purposes of fairly pricing the extra work. While notice may be inconvenient for the contractor, the possibility of being foreclosed from asserting claims of extra work makes it imperative for the contractor to comply. There is, however, an argument under Civil Code §2782(b) that a written notice requirement cannot be enforced if it would relieve a public agency from the consequences of its own active negligence

1. State and Local Contracts

State contracts may include provisions for the performance of extra work which is required for proper completion of the whole work contemplated. Pub. Cont. C §10251. The extra-work provisions of county contracts are controlled by Pub. Cont. C §§20136, 20139, 20142-20143, and 20145. Work under $50,000 may be authorized by a County Board of Supervisors. If the original contract price is more than $50,000 but less than $250,000, the county official can be authorized to order changes or additions up to 10 percent of the original contract price. Pub. Cont. C. §20142(a). For contracts over $250,000, the extra cost for any change or addition may not exceed $25,000 plus 5 percent of the amount of the original contract price in excess of $250,000.

County construction contracts may not be altered in any manner except under Pub. Cont. C §20136 and the process for such alterations is not always clear, and may include:

- As provided in Pub. Cont. C §20142.
- As provided for in the contract itself; or
- By order of two-thirds vote of the board of supervisors and the contractor's consent.

2. Public Contract Code 7104

Public Contract Code §7104 requires any public works contract of a local agency that involves digging trenches or other excavations deeper than 4 feet to contain specified clauses regarding notice, investigation, change orders, and disputes with respect to the following:

- Subsurface or latent physical conditions at the site differing from "those indicated" by information that was available to bidders before the bid date; and
- Unknown physical conditions of any unusual nature that differ materially from those ordinarily encountered and generally recognized as inherent in the work provided for in the contract.

If, after investigation, a local agency finds that such conditions do materially differ, the agency must issue a change order per the contract. The issuance of a change order would presumably authorize additional payment.

A case which details the impact of Pub. Cont. C §7104 is *Condon-Johnson & Assocs., Inc. v. Sacramento Mun. Util. Dist.* (2007) 149 CA4th 1384. In that case the contractor encountered harder rock than "indicated" in the contract and SMUD refused to issue a change order. After trial the contractor was awarded $1,265,166 for equitable adjustment.

3. Obstacles to Enforcement

A contractor seeking to enforce payment for extra work from a public entity may encounter certain obstacles. When preparing an extra-work claim the contractor should research applicable statutes, charters, and ordinances to learn whether extra work is covered. There may be one or more contractual provisions that inhibit payment for extra work, thus it is important to review potential ordinances authorizing a claim.

A common contract clause may state the contract price includes compensation for all work performed by the contractor unless the contractor obtains a written extra-work order signed by an authorized representative of the public entity, specifying the extra compensation to be paid. The public entity's position may be supported by certain clauses, such as the "engineer's decision is final" clause or a "no-damages-for-delay" clause.

4. Public Contract Code Section 9204

Public Contract Code Section 9204 confirms the right of contractors to present pass-through claims for subcontractors and allows subcontractors to request that claims be passed through. A general contractor is not required to pass through claims to the owner; however, if the general contractor decides not to do so, it must inform the subcontractor in writing why it has not presented a claim on the subcontractor's behalf.

5. Implied Warranty of Plans and Specifications

The public entity has an obligation to fairly and reasonably represent known conditions that would have a material effect on a contractor's bid and contract language does not insulate a public entity from liability for misrepresentations in the contract documents.

Contractors are entitled to recover for extra work when necessitated by incorrect plans and specs furnished by owner The case of (*G. Voskanian Const., Inc. v. Alhambra Unified Sch. Dist.*, 204 Cal.App.4th 981, 992 (2012) is instructive. In that case:

> On appeal, and in affirming the judgment for Voskanian, the court held that while a contractual requirement that change orders be in writing could not be waived or orally modified, Voskanian was entitled to the extra work performed as it was necessitated by incorrect plans and specifications issued by the District. As Voskanian's entitlement to recover for extra work on the relocation contract the court stated, "based on the eventual approval of the District," and Voskanian's entitlement to recover for extra work on the fire alarm contract was supported by the errors in the design documents, the "legal argument that there can be no oral modification of a public works contract and that the District's representatives lacked the authority to modify the contract are irrelevant."
>
> The Court held that, "It is settled law that 'A contractor of public works who, acting reasonably*, is misled by incorrect plans and specifications* issued by the public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made *may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented*. [Citations.] This rule is mainly based on the theory that the furnishing of misleading plans and specifications by the public body constitutes a breach of an implied warranty of their correctness.' (*Souza v. McCue Constr. Co. v. Superior Court*, 57 Cal.2d 510–511, italics added; accord, *Los Angeles Unified School Dist. v. Great American Ins. Co*. (2010) 49 Cal.4th 739, 744 [112 Cal. Rptr. 3d 230, 234 P.3d 490].)

To recover damages for extra work because of a public entity's misrepresentation, a contractor need not prove an affirmative fraudulent intent to conceal material facts. *Los Angeles Unified Sch. Dist. V. Great Am. Ins. Co.* (2010) 49 C4th 739, 747. While a public entity may be liable for failing to disclose information in its possession, the Supreme Court noted that a public entity does not have an obligation to investigate circumstances that may affect the cost of performance by a contractor (aside from providing prospective bidders with correct plans and specifications).

6. Interest on Extra Work claims

Except in unusual circumstances, courts tend to find that extra-work claims are unliquidated. In *MacIsaac & Menke Co. v. Cardox Corp.* (1961) 193 CA2d 661, 672, the court said that interest before judgment could not be awarded, because the extra work was performed under abnormal conditions and therefore the increased cost could not be ascertained by computation but had to await completion before being made certain. However, in *Peter Kiewit*

Sons' Co. v. Pasadena City Jr. College Dist. (1963) 59 C2d 241, the district withheld the final payment of $137,000 because of a dispute over $35,000. The court bifurcated the amounts and held that interest was properly awarded on $102,000 because the money withheld in excess of that sum was more than adequate to satisfy all of the offsets claimed by the district.

The same problem of the unliquidated nature of the claims exists in stop payment notice and payment bond claims. Under both remedies, there is entitlement to interest, but an award of prejudgment interest will be subject to the determination of whether the amounts claimed were liquidated.

7. Performance Under Protest

Under the provision of many public contracts, claims for extra work are dealt with either through a negotiated contract change order or, if no price can be agreed on, by force account. Force account work in this context involves the public entity monitoring the contractor's use of its equipment and labor, and paying the contractor based on established rates and markups. If there is a dispute concerning whether work performed by the contractor is extra work, then the contractor can notify the public entity of its desire to contest the issue in advance of performing the work, giving the public entity the opportunity to monitor the work as though it was being performed on a force account basis. Based on the use of a force account as a means of tracking costs, many public contracts require contractors to perform work beyond the scope of the work in the original contract. The contractor's remedy is to claim additional compensation. In the absence of language in the contract requiring the contractor to proceed with the work, the contractor has a choice of stopping work or suing for lost profits, rescinding the contract and suing for the reasonable value of the work performed, or proceeding under protest and later suing for damages for breach of contract. *McConnell v. Corona City Water Co.* (1906) 149 C 60. One case held that a contractor, by proceeding under protest, does not waive its claim. *Gogo v. Los Angeles County Flood Control Dis.* (1941) 45 Ca2d 334, 338 (contractor induced to sign contract by misrepresentation).

When the contract documents require a written protest specifying in detail the work performed and the resulting cost, a protest letter that fails to comply with the contract requirements is ineffective. *Acoustics, Inc. v. Trepte Constr. Co.* (1971) 14 CA3d 887. As a result, a claimant must take care to maintain detailed documentation relating to the force account work.

8. Public Agent's Authority

Agreements concerning extra work are sometimes reached in the field, with little or no documentation. Contractors should document these field agreements and be sure that the agreements are signed off by public entity personnel who have the authority to permit changes to the work. There have been circumstances when subordinate field personnel have exceeded their authority to approve changes, and the public entity has refused to authorize and/or pay for the charges agreed on in the field.

III. Public Entity Reduction of Work

A public entity usually reserves the right to delete portions of the work. In *Hensler v. City of Los Angeles* (1954) 124 CA2d 71, the city engineer deleted, by change order, about 20 percent of the work, which included installing runways and taxiways. The work was deleted because the

State Division of Highways refused to connect a bypass road to existing highways. The city deleted the work from the contract and later awarded it to another contractor. The original contractor sued the city for the profit that would have made if it had performed the deleted portion of the work. The city defended on the ground that the contract permitted the engineer to delete up to 25 percent of the work. The court of appeal affirmed judgment for the contractor, holding that the purpose of the clause was to permit deletions that would advance the project originally contemplated, not to permit deletions that prevented the project's completion. It was not the amount of work deleted that constituted the city's breach of contract but the nature of the work. The term "deleted work" means work omitted entirely from the project, not work taken from one contractor and later given to another.

IV. Subcontractor Issues

An agreement between the subcontractor and the prime contractor for the assignment of the subcontractor's claims to the contractor is a common means to address the lack of privity between the subcontractor and the public entity. These agreements have been deemed enforceable. See, *e.g. Howard Contracting, Inc. v. G.A. MacDonald Constr. Co.* (1998) 71 CA4th 38; *D.A. Parrish & Sons v. County Sanitation Dist.* (1959) 174 Ca2d 406; *Maurice L. Bein, Inc. v. Housing Auth.* (1958) 157 CA2d 670. Under these agreements, the contractor may agree to include the subcontractor's claim along with its own claims against the public entity, or the contractor may take an assignment of the claim in name only and permit the subcontractor to pursue the claim. These pass-through claims present several areas of risk.

If a subcontractor and prime contractor reach an agreement to have the prime contractor present the subcontractor's claims in litigation, evidence of the agreement must be presented as part of the contractor's case, or the claim may be barred. In *Howard Contracting, Inc. v. G.A. MacDonald Constr. Co.* (1988) 71 CA4th 38, a prime contractor agreed to pursue the claims of a subcontractor in exchange for an agreement that the subcontractor would accept any damages awarded in full resolution of its claims. The contractor neglected to present evidence of its agreement with the subcontractor, and the public entity successfully challenged the pass-through claim.

The absence of privity of contract between owner and subcontractor does not prevent a prime contractor from stating a "pass-through" claim of a subcontractor against a project owner. In *Howard Contracting, Inc., supra,* the court of appeal held that failure to award damages to the subcontractor was error. The prime contractor and the subcontractor had entered into a settlement and litigation agreement under which the prime contractor pursued the subcontractor's claim along with its own on a pass-through basis. The trial court erroneously refused to admit the pass-through agreement into evidence.

V. No Damages for Delay Provisions

A clause much favored by drafters of public construction contracts provides that if a public entity's acts delay a contractor in the performance of a project, the contractor will be entitled to an extension of time but not to damages for the delay. In *Hansen v. Covell* (1933) 218 C 622, the California Supreme Court reversed the trial court decision that of time awarded damages to the contractor for delays caused by the owner. The court held that an extension is the contractor's exclusive remedy. However, if voiding the no damages-for-delay clause results in an

unconscionable advantage in the public entity's favor, it will not be enforced. In *Milovich v. City of Los Angeles* (1941) 42 CA2d 364, the contract (a) provided that the contractor would be entitled to an extension of time if the owner delayed the job and (b) stated: "This article does not exclude the recovery of damages for delay by either party under other provisions in the contract documents." The court affirmed judgment in favor of the contractor, holding if a contract "provides for extension of time for completion in case of delay in the work caused by the acts or neglect of the department or its employees, and then declares that it does not exclude the recovery of damages for delay by either party, the contractor is not foreclosed from recovery damages by procuring extensions of time, where he was compelled to keep his machinery on the ground in idleness by reason of the delay."

A contractor may recover damages for delay under certain circumstances, despite a no-damages-for-delay provision in public entity prime contracts and subcontracts. Pub Cont. C §7102. The contractor will be entitled to damages for delay if the delay was unreasonable and was not contemplated by the parties at the time of contracting. Section 7102 prohibits public entities from requiring the waiver, alteration, or limitation of the applicability of its provisions. Any waiver, alteration, or limitation is void. See *Howard Contracting, Inc. v. G.A. MacDonald Const. Co.* (1988) 71 CA4th 38.

VI. Prompt Payment Rights

Prime contractors or contractors on State projects must pay their subcontractors within 10 days after receiving each progress payment or pay a penalty to the subcontractor of 2 percent per month. Pub. Cont. Code §10262.5(a).

In a good faith dispute, the contractor or subcontractor may withhold up to 150 percent of the disputed amount. The prevailing party in an action to recover wrongfully withheld progress payments is entitled to attorneys' fees and costs. Direct contractors who contract with public utilities must pay their subcontractors their share of progress payments within 15 working days after receiving each progress payment from the public utility, unless otherwise agreed in writing. If a good faith dispute exists, the contractor may withhold no more than 150 percent of the disputed amount. Civil Code §8802(a)-(b). A contractor who violates the requirement must pay the subcontractor a penalty of 2 percent of the disputed amount per month. In an action to collect wrongfully withheld funds, the prevailing party is entitled to attorney fees and costs. Civil Code §8802(c).

VII. False Claims

The False Claims Act (Govt C §§12650-12656) imposes substantial liability on any person who knowingly presents a false claim, or knowingly uses a false record or statement, to induce a public entity to pay a claim, consisting of triple the amount of damages sustained by the entity plus cots, attorney fees, and a fine for each false claim. Govt C §12651(1)-(2). Damages may also be recovered against a person who learns of a false submission and fails to disclose the falsity to the public entity within a reasonable time after such a discovery. Thus, extreme care should be taken by subcontractors when submitting public works claims.

Links to Forms:

The following are links to various forms that contractors may find useful or encounter when dealing with public works collection:

- Form 7 – Prompt Payment Matrix
- Form 11 – Stop Payment Notice
- Form 13 – Request for Notification of Completion
- Form 15 – Retention Release Letter (Public Work)
- Form 17 – Progress Payment Demand Letter

CHAPTER FIVE
PUBLIC PROJECT CLAIMS COLLECTION – PROCESSES AND PROCEDURES

I. Introduction

As is the case with private construction projects, in the context of public construction projects, a contractor or subcontractor owed money for its work has multiple avenues of collection. The variety of collection tools available to contractors include claims under the operative contract or subcontract, enforcement of stop payment notice rights, and claims on various bonds (primarily payment bonds).

The procedural requirements for claims are often more onerous on public construction projects than private ones, and so (as discussed below) contractors must familiarize themselves closely with the bid and contract documents to understand the contractual claims procedures. There is some overlap, however, between public and private projects, and the procedures for collection in the public context do include proper licensure and, in many instances, the proper preparation and service of a statutorily compliant preliminary notice. Failure to adhere to these requirements can result in a forfeiture of many (and in some cases all) of the collection tools otherwise available to contractors and subcontractors on public projects.

This chapter focuses on both the procedural steps described above on private works, as well as the primary collection tools that contractors may utilize in order to recover monies owed. Like its sister chapter relating to private works, this chapter is largely a primer and is *not* designed to cover in granular detail the often-labyrinthine subject of construction claims, with all of its nuances and fact/dynamic-specific issues and potential outcomes.

II. Licensure

With respect to public works projects, the licensure requirements, and risks of unlicensed activities, are largely the same as those on private works. As such, the reader is referred back to the detailed discussion on licensure and licensure traps contained in Chapter Two (Private Works Claims Procedures).

In essence, however, proper licensure through the CSLB is paramount with respect to protecting a contractor's collection rights. Lack of proper licensure *at all times* during the course of a public works construction project will result in the contractor being unable to bring claims for monies owed and can result in disgorgement. However, unlike private projects, lack of proper licensure at the time of bidding on a public works contract can result in the contractor losing the bid (or being substituted out of an upstream contractor's bid) insofar as it will be deemed a non-responsible bidder. *See e.g. Ghilotti Construction Co. v. City of Richmond* (1996) 45 Cal.App.4th 897 (discussing responsibility and responsiveness components of public bid requirements).

Further, the same licensure traps that exist in the private works space, specifically, with respect to worker's compensation and joint venturing also exist in the public works space. *See* Chapter Two (Private Works Collection Procedures). As public works bidding has become more competitive over the years, the authors have seen contractors become more active in the joint venturing space, as it often allows them to bid more competitively for public works projects and, as a result, focus must be paid to properly licensing these joint ventures so as to avoid the licensure risks described above and elsewhere. *Id.; see also* Cal. Bus. Prof. Code 7029.1(a)-(b).

If you are not properly licensed at all times during performance of your work, you cannot bring suit to collect monies owed to you and, in fact, you may be exposed to substantial penalties

and risks. *Ibid; see also* Cal. Bus. Prof. Code 7031 (discussing inability of unlicensed contractor to pursue collection of monies owed and exposure to disgorgement for sums paid as penalty for unlicensed construction activity).

III. Preliminary Notices

As is the case with private works projects, serving a code-compliant preliminary notice is critical to the enforcement of collection rights in the public works context. However, it should be noted that there is a critical distinction in the law regarding who must serve the preliminary notice on a public works project. Civil Code 9300(a) provides that claimants who lack a direct contractual relationship with a direct contractor must serve the preliminary notice on the public entity and the direct contractor to preserve their collection rights. Cal. Civ. Code 9300(a). Thus, a subcontractor in *direct* contract with a direct contractor need not serve a preliminary notice in order to preserve stop payment notice and payment bond rights.

Specifically, California Civil Code 9300 provides:

> (a) Except as otherwise provided by statute, before giving a stop payment notice or asserting a claim against a payment bond, a claimant shall give preliminary notice to the following persons:
>
> (1) The public entity.
>
> (2) The direct contractor to which the claimant provides work.
>
> (b) Notwithstanding subdivision (a):
>
> (1) A laborer is not required to give preliminary notice.
>
> (2) A claimant that has a direct contractual relationship with a direct contractor is not required to give preliminary notice.
>
> (c) Compliance with this section is a necessary prerequisite to the validity of a stop payment notice under this title.
>
> (d) Compliance with this section or with Section 9562 is a necessary prerequisite to the validity of a claim against a payment bond under this title.

The above notwithstanding, best practice informs that contractors (especially when in doubt) should serve a notice on every project in which they are involved as a matter of course. This will avoid any dispute about whether the contractor was required to serve the notice, particularly because "compliance with this section is a necessary prerequisite to the validity of a stop payment notice under this title." Cal. Civ. Code 9300(c). Furthermore, the Code structure is somewhat ambiguous as it renders a "subcontractor" subject to CSLB disciplinary action for failing to serve a preliminary notice (Cal. Civ. Code 9306) even though a "subcontractor" may not be otherwise required to send the notice under Civil code 9300. In sum, it is best to serve the notice.

1. Form and Contents

The California Civil Code specifies a form that the preliminary notice must take in order to meet the statutory requirements set forth in the code. With respect to these requirements for a public works preliminary notice, the Code refers back to the requirements for a private works preliminary notice. *See* Cal. Civ. Code 9303 (referring back to Cal. Civ. Code 8102). As previously noted, the contents of the notice contained basic project information, including for example the name of the owner reputed owner, the name of the general contractor, the name of

any construction lender, the general description of work being provided, and an estimated value of that work. *Id.* Further, the code requires a specific notice to the property owner be included in each notice, the requirements for such notice including not only the substance of the notice but also font, typeface, and boldness.

Form 6 contains a form preliminary notice for public works projects, which reflects all information required to be included in the pulmonary notice under the code. NECA contractors are encouraged to refer to this document for purposes of preparing statutorily compliant preliminary notices.

2. Service Requirements

The preliminary notice must be served on the direct contractor and project owner within 20 days after the claimant has first furnished work or services or material to the project jobsite; provided that where service is late the notice is not invalidated, but rather the claimant is limited in the amount it can seek via lien or stop payment notice to the value of the work performed within 20 days preceding the service of the notice. *See e.g.* Cal. Civ. Code 9300.[8] For projects performed under contract with the State Dept. of Public Works or the Department of General Services, the notice must be provided to the disbursing officer for the department. Cal. Civil Code 9302(b).

Permissible methods of service include personal delivery, overnight delivery, and Certified U.S. Mail – Return Receipt Requested. Cal. Civ. Code 9302 (referring back to Civ. Code 8106-8110 for permissible manner of giving service). The authors strongly encourage claimants to serve preliminary notices by overnight delivery or Certified US Mail, including because these methods allow for reliable tracking via courier reporting or the certification receipts (i.e. green receipts), which can be saved in the event of a future dispute. While personal service is valid, proof of the service may be problematic thereby negating a mechanics lien.

3. Substantial Compliance – Is It Sufficient?

For a detailed discussion regarding the Doctrine of Substantial Compliance as applied to preliminary notice requirements, please see Chapter Two (Private Works Collection Procedures). There is case law to suggest that, with respect to the contents of the notice itself, substantial compliance will be viewed pragmatically in the public works context. *Suhr v. Metcalfe* (1917), 33 Cal. App. 59 (A notice by a lien claimant notifying the owner of its claim and of the contractor's assignment to it of his rights in the final payment contained substantial information to the owner rendering it sufficient as a stop payment notice, though defective in form), overruled on other grounds, *Peter Kiewit Sons' Co. v. Pasadena City Junior College Dist*. (1963), 59 Cal. 2d 241*; see also Blair Excavators, Inc. v. Paschen Contractors, Inc.* (1992) 9 CA4th 1815 (permitting recovery where preliminary notice stated with "substantial accuracy" estimated cost of the work performed).

The above notwithstanding, Courts will generally strictly construe the service requirements for the notice, such that failure to properly serve the notice will render the claimant unable to enforce its stop payment notice and payment bond rights, except in the case of payment bonds where the claimant has served a compliant post-completion bond notice. *San Joaquin Blocklite, Inc. v. Willden* (1986) 184 Cal. App. 3d 361. Thus, proper notice – both in terms of substance and service – is critical to a contractors' ability to enforce its claims remedies in the public context.

[8] Note that payment bond claimants have a separate vehicle to cure late notices, which is the post-completion bond notice discussed below.

IV. Contract Claims, Change Orders and Prompt Payment Statutes

a. Contract Claims

Contractors with a *direct* contractual relationship with a public entity may pursue a claim for breach of contract against the entity. The contractual claims may include sums due for unpaid labor and materials, and these claims may be brought even if the contractor has provided the entity with statutory release and waiver forms. *See Tesco Controls, Inc. v. Monterey Mechanical Co.* (2004) 124 CA4th 780. Importantly, from a subcontractor point of view, in the public works context a subcontractor cannot recover against the public entity under a breach of contract theory nor can claims for quantum meruit or other quasi-contract theories be asserted against the public entity. *See* Baier, et al. California Mechanics Liens and Related Construction Remedies (4th Ed. 2024), Sec. 4.12 (citing *Southern Cal. Acoustics Co. v. C.V. Holders, Inc.* (1969) 71 C2d 719). Notwithstanding the above, a subcontractor may pursue contract claims against the direct contractor with which it is in contract.

With respect to change orders, a contractor or subcontractor, as the case may be, may include in any contract claim the value of any change work directed by the owner or direct contractor. *See generally* Baier, et al, *supra* at 4.13. For further discussion regarding change orders in the public works context, see Chapter Four.

Two important points with respect to the above:

- It is imperative that a claimant follow the letter of all contract documents with respect to claims process and presentation. Failure to follow the procedures contained in such documents can and often does result in forfeiture of all or some of the claimant's rights, including because courts strictly construe public contract requirements. *See e.g. P&D Consultants, Inc. v. City of Carlsbad* (2010) 190 CA4th 1332 (discussing the fact that public contracts can require written change orders and cannot be modified orally).
- Furthermore, in the public contract context, claimants must also comply with the Government Claims Act in their presentation of their claims, absent modification of these requirements by contract. *See* Govt. C. 810-996.6. These procedures can be nuanced and it is recommended that counsel be consulted as a public contract claim is prepared and presented. Further, presentation of a false claim, willfully made, is both a crime and results in the forfeiture of the claimant's right to recover funds, including under a stop payment notice, so care must be taken in the preparation and presentation of such claims. *See* Cal. Civ. Code 9454.

b. Prompt Payment Laws

In addition to the above, prompt payment laws apply in a variety of circumstances to public entities and other stakeholders on public works projects. These laws require undisputed progress payments and retention payments be paid within a specified period of time or the payor will be subject to penalties of 2% per month on the amount owed. In some cases, the 2% penalty is in lieu of interest, and in some cases it is in *addition to* interest. In the event of litigation involving violations of the prompt payment statutes, the prevailing party in such litigation is entitled to recover its attorneys' fees and costs per statute. A matrix describing the various prompt payment laws, their application in the public works context, and penalties is attached as **Form 7**.

As is the case in the private works context, a contractual claim for money owed is not exclusive of the other powerful remedies available to contractors and can be brought in tandem with claims to enforce stop payment notice and payment bond rights.

V. Mechanics Liens - Not Available

Unlike in the private work area, in the context of public works, contractors do not have any right to record and enforce a mechanics lien against the project. *See North Bay Constr., inc. v. City of Petaluma* (2006) 143 CA4th 552. Public entities enjoy sovereign immunity from such claims such that Contractors cannot foreclose a lien on public property.

VI. Stop Payment Notices

Stop payment notices for public works are governed by California Civil Code Sections 9350-9510. The stop payment notice must be provided to the public owner, direct contractor, and the person with whom the claimant contracted for the work. Generally speaking, and with some key exceptions noted below, the process for enforcing a claimant's stop payment notice rights on a public work of improvement follow closely with the process for perfecting those rights on a private work of improvement.

1. Preliminary Notice Requirement

As is the case with public works, in order for most claimants to enforce stop payment notice rights, they must serve a preliminary notice in the format and manner described above, and such obligation is mandatory. *See* Cal. Civil Code 9300. The preliminary notice requirement provides one key distinction between private and public works: as noted above, first tier subcontractors do not need to serve a preliminary notice in order to protect their stop payment notice rights. The animating policy for this distinction lies in the subcontractor listing laws associated with public works. *See* Pub. Cont. Code 4100 et seq. With very limited exception, these laws require direct contractors list all proposed subcontractors in their bid documents in order to avoid bid shopping and pedaling. The listing (and substitution) laws place the awarding agency on notice of first tier subcontractor identity.

As noted above, while not all claimants are required to serve a preliminary notice, it is strongly advised that contractors and subcontractors serve the notice on each and every project on which they work, including because there is no penalty for serving a notice where one is not otherwise required.

2. Amount Recoverable

Pursuant to California Civil Code 9352, the stop payment notice is limited to only the amount due the claimant for work provided through the date of the notice. While the statutory scheme does not require a statement of the amount already paid on account, the balance owed, or the date from which interest is claimed, without these figures the public entity may not know how much it is expected to withhold, so it is advisable to include them. Baier, et al., *supra*, at 4.40.

As is the case in private works, the stop payment notice remedy in the public works context is not a remedy that should be used lightly, and preparation of the notice, including with respect to the amount must be carefully considered. A claimant that serves a false notice or that includes in the notice amounts for work not yet performed will forfeit its right to distribution of the frozen proceeds. Cal. Civ. Code 9504. Moreover, while beyond the scope of this writing, a stop payment

notice that seek sums in excess of that which is due the claimant may expose the party submitting the stop payment notice to liability under California's False Claims Act. *See* Cal. Govt. Code 12650. As such, it is advisable to consult counsel when preparing and serving a stop payment notice, particularly in the public works context.

3. Preparing and Serving the Stop Payment Notice

With respect to public works projects, and as is the case with private works, the California Civil Code specifies the contents that must be included in the stop payment notice for it to be valid. Cal. Civ. Code 9352. The code refers back to the private works statutes and states:

> (a) A stop payment notice shall comply with the requirements of Chapter 2 (commencing with Section 8100) of Title 1, and shall be signed and verified by the claimant.
> (b) The notice shall include a general description of work to be provided, and an estimate of the total amount in value of the work to be provided.
> (c**)** The amount claimed in the notice may include only the amount due the claimant for work provided through the date of the notice.

Effectively, Section 9352 requires that the stop payment notice contain the project address, total amount of the contract (inclusive of changes), the total amount of payments received, the total amount of the claim subject to the stop payment notice, the nature of the work performed, the name of the person to whom the work was furnished, and the name/address of the claimant. Further, the stop payment notice must be verified by the claimant. Cal. Civ. Code 9352. **Form 11** contains a form public works stop payment notice for ease of reference, which reflects all information required to be included in the notice under the code. NECA contractors are encouraged to refer to this document for purposes of preparing statutorily compliant stop payment notices (in the event they do not retain counsel to do this for them, which is recommended); however, it is noteworthy that minor variances in form and content will not defeat the stop payment notice if it is sufficient to substantially inform the holder of funds of the requisite information. ***Importantly, a critical distinction between private and public stop payment notices is that public works stop payment notices need not be bonded because there will not be a lender involved.***

With respect to service, Cal. Civ. Code 9354 specifies on whom the stop payment notice must be served in connection with the private works contract, while also referring back to the private works statutory scheme. The Code provides that:

> (a) Except as provided in subdivision (b), a stop payment notice shall be given in compliance with the requirements of Chapter 2 (commencing with Section 8100) of Title 1.
> (b) A stop payment notice shall be given to the public entity by giving the notice to the following person:
> (1) In the case of a public works contract of the state, the director of the department that awarded the contract.
> (2) In the case of a public works contract of a public entity other than the state, the office of the controller, auditor, or other public disbursing officer whose duty it is to make payment pursuant to the

> contract, or the commissioners, managers, trustees, officers, board of supervisors, board of trustees, common council, or other body by which the contract was awarded.

Thus, a copy of the stop payment notice must be served on the public agency, the direct contractor, and the party with whom the claimant is in contract as specified above by registered mail, certified mail, express mail, or overnight delivery. Cal. Civ. Code 8110. Claimants should note the distinction between State contracts and public contracts with non-State entities and the impact on the appropriate public employee to serve. Proper service is critical and required for the stop payment notice to be enforceable. As opposed to the mechanics lien right, one significant benefit of the stop payment notice is that the claimant need not wait until its work is complete to serve the notice. Instead, the stop payment notice can be served during the course of construction, allowing the claimant to continue to perform per contract while at the same time protecting its right to payment. *See* Baier, et al., at 4:48.

Understanding the definition of "completion" is important for purposes of calculating the deadline to file a stop payment notice on a public works project. Completion occurs by operation of law upon the earlier of either (i) acceptance by the public entity or (ii) cessation of labor on the work of improvement for a continuous period of 60 days. Cal. Civ. Code 9200. Notably, and importantly, the cessation of labor metric for purposes of completion does *not* apply to certain state agency projects awarded under the State Contract Act. Cal. Pub. C 10100-10285.5; 10106. Under those contracts, only acceptance by the awarding agency constitutes completion. Understanding these distinctions is critical to protecting stop payment notice rights.

With the above stated, stop payment notices must be served within 30 days after recordation of a notice of completion or acceptance (which may be recorded within 15 days from completion) *or* 30 days after recordation of the notice of cessation of labor, which may be recorded if labor ceases continuously for at least 30 days. Cal. Civ. Code 9202, 9204. If no notice of completion or cessation is recorded by the awarding agency, then the deadline to serve a stop payment notice is 90 days after cessation of labor. Cal. Civ. Code 9200; *but see* Civ. Code 9356(b) (for arguably a different calculation of the 90 day cessation measure). The authors emphasize the claimant's ability to file a stop payment notice at any point during the project. Waiting to file such a notice until late in the project or after completion or cessation puts the claimant at significant risk, including based on ambiguities in calculating the deadline to submit a notice in the event that funds have already been distributed or diminished. Cal. Civ. Code 9360 (allowing public entity to distribute final payment to direct contractor prior to expiration of stop payment notice filing period).

Civil Code Section 9362 provides a helpful tool for claimants to ensure they are notified of filing deadlines, and provides that, for $10 a public agency must notify a claimant as to when the stop payment notice period expires. Usage of this code section appears limited, so claimants are encouraged to send a brief letter to the public agency enclosing the remittance and explaining what it is for and what duties it triggers under the Code. **Form 13** contains a sample cover letter.

Once properly and timely served, the stop payment notice triggers a duty by the public entity to withhold from the direct contractor sufficient monies due or to become due to pay the claim, interest, and provides for the entity's reasonable cost of litigation, which duty *may* be satisfied by refusing to release escrowed funds. Cal. Civ. Code 9358.

4. Commencement of Action to Enforce, Notice of Commencement and Summary Proceeding

a. Initiating Suit[9]

By this stage, a claimant would be well served to have counsel involved and a corporate entity that intends to file suit must be represented by counsel in any event. Nevertheless, a claimant may commence a lawsuit to enforce a stop payment notice any time after 10 days from the date of giving the notice; provided that such a suit *must* be filed not later than 90 days after expiration of the time within which a stop payment notice must be given. Cal. Civ. Code 9502. Effectively, the claimant's lawsuit to enforce its stop payment notice must be filed within 120 days after notice of completion or 180 days after completion, if no notice of completion is recorded. Failure to timely initiate a lawsuit to enforce stop payment notice rights results in the notice becoming ineffective by operation of law, and funds dispersed. *Id.* The limitations period for commencing suit is strictly enforced. *Adams v. Christopher* (1931) 119 Cal.App. 40.

b. Notice of Commencement

After filing suit, a claimant *must* serve a Notice of Commencement of Action within 5 days of filing. Cal. Civ. Code 9504. A sample Notice of Commencement is attached as **Form 14.** The notice must be served on the same parties that received the stop payment notice and comply with various Civil Code requirements for service. Failure to timely serve the Notice of Commencement of Action may result in a release of the funds otherwise subject to the stop payment notice and a limitation or loss of a claimant's rights. *Id.*

c. Summary Hearing Procedure

Unlike the private works space, in the public works context a summary proceeding is available for direct contractors to challenge the validity of a claimant's stop payment notice. Civil Code 9400 provides four bases upon which a direct contractor may challenge the validity of a stop payment notice, including (i) the claim is not a type for which a stop payment notice is authorized, (ii) the claimant is not a person authorized by statute to serve a stop payment notice, (iii) the amount stated is excessive, and (iv) there is no basis for the claim. Cal. Civ. Code 9400.

In order to initiate the summary process, the direct contractor serves an affidavit of contest on the public agency, and the agency serves it on the claimant. The claimant then has an abbreviated time (10-20 days) to file a counter-affidavit setting forth all of its evidence supporting the validity of its notice. If the claimant fails to do so, the agency may release the funds. If the claimant timely files its counter-affidavit, then the funds remain held while either side initiates a court petition to have the court hear the summary proceeding and determine the validity of the notice. The court may rule on the matter simply based on the affidavits so it is critical to "put your best foot forward" in that regard. The hearing is required to be held within 15 days of either parties' request for hearing. *Id.*

[9] Importantly, and although beyond the scope of this Chapter, before a public entity can be sued, compliance with the Govt. Claims Act must be achieved, effectively by presenting the claim to the agency within 6 months and the agency must respond within 45 days. Govt. C. 810-996.6. The requisite procedures should be aggressively pursued in order to avoid deadlines.

5. Payment and Release Bonds

a. Payment Bonds

A payment bond is, effectively, a contractual guarantee (i.e. a bonded contract) for payment to those supplying labor, work, materials, and equipment to construction projects. The bond is underwritten and issued by a surety to a principal on the bond (often the general/direct contractor). In the event the principal (e.g. the direct contractor) fails to satisfy its contractual payment obligations to, for example, subcontractors the payment bond provides a powerful tool against which the subcontractor claimant may seek the sums due and owing. In such a case, claimants are permitted to recover sums due from both the surety and the obligor / principal on the bond. *See* Baier, et al, *supra*, at Sec. 1.50

With respect to public works, payment bonds underwritten by an admitted surety are required under Cal. Civ. Code 9550 where the expenditure is in excess of $25,000, and work cannot begin until the direct contractor has complied with the bonding requirement and the bond has been approved by the awarding agency. Cal. Civ. Code 9550(a). The amount of the bond can vary, but for most projects it must be in an amount not less than 100 percent of the contract. Cal. Civ. Code 9554. The bond must ensure that the surety will pay obligations ***and reasonable attorneys' fees*** if the direct contractor or a subcontractor fails to pay (i) a claimant authorized to assert a payment bond claim, (ii) amounts due under the Unemployment Insurance Code or (ii) amounts due the EDD with respect to the work or labor. Cal. Civ. Code 9554.

In order to enforce a claim on a payment bond, the sole requirements are that the claimant must (i) have properly served a preliminary notice (or post-completion bond notice, discussed below), (ii) be a party authorized to bring a bond claim, (iii) have not been paid in full and (iv) and bring timely suit on the payment bond. Cal. Civ. Code 9300, 9554, 9558.

For further discussion regarding payment bonds, see Chapter Three (Private Works Collection Processes and Procedures).

i. Preliminary Notice Requirement

In order to enforce a claim against the payment bond, a claimant may give preliminary notice as discussed above under subheading Preliminary Notices. Cal. Civ. Code 9560(a). However, in the event a claimant fails to timely and properly serve a preliminary notice, they may preserve their claim on a payment bond by serving a post-completion bond notice.

ii. Post-Completion Bond Notice

If a preliminary notice was not provided, a claimant may still enforce a claim against a payment bond by giving written notice to the bond surety and principal on the bond within 15 days after the recording of a notice of completion, or 75 days after completion of the work of improvement if a notice of completion was not recorded. Cal. Civ. Code 9560(c). The form of the post-completion bond notice is exacting and largely mirrors the requirements of the preliminary notice. A sample, code-compliant post-completion bond notice is attached as **Form 12**. When utilizing the post-completion bond notice as a curative tool, it is advisable to write to the surety prior to completion to notify them of the issuance of the notice and make demand.

The above notwithstanding, and as was the case in the private works sphere, the law has been modified to limit the ability of sub-subcontractors (and those not in direct privity with direct contractors) to utilize the post-completion bond notice procedure. Specifically, the procedure does

not apply to a claimant who does not have a direct contractual relationship with the general contractor, and:

> (1) All progress payments, except for those disputed in good faith, have been made to a subcontractor who has a direct contractual relationship with the general contractor; or
> (2) The subcontractor who has a direct contractual relationship with the general contractor has been terminated from the project, and all progress payments, except those disputed in good faith, have been made as of the termination date.

Cal. Civ. Code 9560(d).

With respect to the bond surety, the notice must be served at the surety's address shown on the bond for service of notices, papers, and other documents, or on the records of the Department of Insurance. If mailed, the notice has to be mailed via registered or certified mail, express mail, or overnight delivery by an express service carrier. Cal. Civ. Code 9300 (cross-referencing the private works statutes, specifically Cal. Civ. Code 8110 et seq.).

See Chapter Three (Private Works Collection Processes and Procedures) for discussing regarding notification of surety as triggering obligations under insurance code, including to investigate the claim).

iii. Amounts Recoverable

Amounts recoverable against a public works payment bond are determined in large part by contract and consists in principal of the amount due the claimant for work and services performed or delivered to the project. Importantly, and in contrast to the stop payment notices, argument exists to extend the scope of the payment bonds coverage to delay damages as well. This is something to simply keep in mind as you and your counsel evaluate the bond claim. Baier, et al. *supra* at 4.118 (citing *Cates Constr. Inc. v. Talbot Partners* (1999) 21 C4th 28).

Beyond contract-based damages, attorneys' fees are recoverable based on the bonding requirements per statute (Cal. Civ. Code 9554(b)), and interest is recoverable if the claim is ascertainable and subject to liquidation by the court. *City of Salinas v. Souza & McCue Constr. Co.* (1967) 66 C.2d 217. This raises an interesting question where delay damages (which are notoriously difficult to quantify) are included in the bond claim. Such inclusion may render the amount of the claim not subject to liquidation and result in a loss of the right to interest.

Lastly, prompt payment penalties are also recoverable against a public works payment bond. *See Washington Int'l Ins. Co. v. Superior Court* (1988) 62 CA4th 981; *see also First Nat'l Ins. Co. of Am. V. Peralta Cmty. College Dist.* (N.D. Cal. 2013) 2103 US Dist. LEXIS 21265 (citing and discussing *Washington Int'l Ins. Co.*).

iv. Commencement of Action

The statutory deadline to file suit on a payment bond is tied to the stop payment notice deadlines, which makes the statutory scheme somewhat convoluted. Civil Code 9558 states that claimants may commence an action to enforce a payment bond claim at any time after the claimants

ceases to perform work, but not later than six (6) months after the period in which a stop payment notice may be given under Civil Code 9356.

A stop payment notice may be filed either 90 days following completion or cessation or 30 days after acceptance or recording of a notice of completion or cessation. Effectively, when taken together, this means that the deadline by which a lawsuit on a public works payment bond must be filed is either six months, plus 30 days, if a notice of completion, acceptance or cessation is recorded or six months, plus 90 days, if no recordation takes place. Regardless, by the time you are calculating statutes of limitations and deadlines to file suit, it is strongly recommended that outside counsel be heavily involved in your claims processes.

b. Release Bonds

In the public works context, because there is no right to record a mechanics lien, the contractor will not encounter mechanics lien release bonds. However, the contract may encounter a stop payment notice release bond which operates to unfreeze the funds otherwise held by the public agency. A public agency or entity has discretion to allow a direct contractor to obtain a release bond in the amount of 125% of the stop payment notice claim under Cal. Civ. Code 9364. The underwriting surety on the release bond is jointly and severally liable for the sums owed to the claimant with any sureties that have issued payment bonds. Cal. Civ. Code 9364; *see also Glens Falls Ins. Co. v. Murray Plumbing & Heating Corp.* (9th Cir. Cal. 1964), 330 F.2d 800 (Where bond is furnished under this statute to secure payment of disputed claim for materials in event claim adjudicated valid, bond must be most liberally interpreted to effect this statute's purpose and to protect materialman it was intended to protect). Such liability may include attorneys' fees where the underlying contract contains an attorneys' fees clause. *See National Tech. Sys. V. Superior Court* (2002) 97 CA4th 415, 425.

While the govern code sections do not provide a deadline by which to sue the release bond surety, suit should be brought within the timeframe to bring suit on the stop payment notice claim, and practicalities dictate that by the time a release bond is obtained, suit should be commenced in short order, including because the release bond is a strong signal that the claim is disputed. Fundamentally, any action on a stop payment notice release bond must be brought within 3 years from the date the bond is executed but will/should be brought sooner. *Winick Corp. v. General Ins.* (1986) 187 CA3d 142, 148. Moreover, where the bond is obtained *after* a lawsuit have been commenced, the surety should be added by way of amendment to the suit.

For further discussion regarding release bonds, see Chapter Three (Private Works Collection Procedures).

CHAPTER SIX
WHITE PAPERS ON KEY TOPICS

Attached to this Handbook are various White Papers drafted by the authors and relating to a variety of timely topics in construction law, and in particular construction claims. The White Papers will be published periodically as NECA requests additional information on various topics. Please look for updates and keep your email address current with NECA to ensure you receive the White Papers as they are released.

We encourage NECA members to contact their local chapter in the event they would like to receive more information on specific topics.

WHITE PAPER NO. 1 – Key Construction Contract Terms – Indemnity Provisions in California Construction Contracts

WHITE PAPER NO. 2 – Key Construction Contract Terms – Pay-If-Paid/Pay-When-Paid Provisions in California Construction Contracts

WHITE PAPER NO. 3 – Key Construction Contract Terms – Dispute Resolution Provisions in California Construction Contracts

WHITE PAPER NO. 4 – A Key to Subcontractor Payment Rights on Public Works – California Public Contract Code Section 9204

WHITE PAPER NO. 5 – Retention on Private and Public Works: Is There a Difference?

APPENDIX OF AUTHORITIES

Cases

Statutes

Treatises

KEY SOURCE MATERIAL

Acret and Perrochet, California Construction Law Manual (2023-2024 ed.)
Baier, et al., California Mechanics Liens and Related Construction Remedies (4th ed.)

APPENDIX OF FORMS

FORM 1 – RESPONSE TO DIRECTED CHANGE NOTICE
FORM 2 – NOTICE OF CHANGED CONDITION
FORM 3 – CONSTRUCTIVE CHANGE NOTICE
FORM 4 – CHANGE ORDER PROPOSAL CHECKLIST
FORM 5 – CHANGE ORDER PROPOSAL
FORM 6 – PRELIMINARY NOTICE
FORM 7 – PROMPT PAYMENT MATRIX
FORM 8 – MECHANICS LIEN
FORM 9 – LETTER OF CREDIT
FORM 10 – NOTICE OF NON-RESPONSIBILITY
FORM 11 – STOP NOTICE
FORM 12 – POST-COMPLETION BOND NOTICE
FORM 13 – REQUEST FOR NOTIFICATION OF COMPLETION
FORM 14 – NOTICE OF COMMENCEMENT
FORM 15 – RETENTION RELEASE LETTER (PUBLIC WORK)
FORM 16 – RETENTION RELEASE LETTER (PRIVATE WORK)
FORM 17 – PROGRESS PAYMENT DEMAND LETTER
FORM 18 – CHANGE ORDER REQUEST DEMAND LETTER
FORM 19 – PUBLIC CONTRACT CODE SECTION 9204 FLOWCHART

FORM 1

RESPONSE TO DIRECTED CHANGE NOTICE

August 29, 1988
Electrical Subcontractor Inc.
0001 Main Street
Sleepy Hollow, Utopia 00000

Major General Contractor Co., Inc.
1234 Wide Road
Sleepy Hollow, Utopia 00000

Re:
Subject:

Sleepy Hollow High School
Subcontract No. 100-10
Change No. 8
Additional _____

Gentlemen:

This is to acknowledge receipt of the owner's change proposal request No. _ transmitted by your letter of August ___, _____, regarding the procurement and installation of an additional _____in the _____.

We are proceeding immediately with the pricing of this proposed change and assessing its impact on the schedule of our work and the project. As you know this is specially fabricated equipment that requires substantial lead time for submittal and fabrication. Our change order proposal shall follow promptly.

We also confirm our understanding that Electrical Subcontractor Inc. has not been directed to proceed with this added work at this time. We shall only proceed with such work upon issuance of an agreed subcontract change order or a clear written directive from Major General Contractor Co. acknowledging that this work is extra, that we are fully entitled to an equitable subcontract adjustment, and that we are to proceed immediately with the added work.

Very truly yours,

Project Manager
Electrical Subcontractor Inc.

FORM 2

NOTICE OF CHANGED CONDITION

August 29, 1988
Electrical Subcontractor Inc.
0001 Main Street
Sleepy Hollow, Utopia 00000

Major General Contractor Co., Inc.
1234 Wide Road
Sleepy Hollow, Utopia 00000

Re:

Subject:

Sleepy Hollow High School

Subcontract No. 100-10
Extra Work Relative to Defective Design Coordination of Recessed Hallway Lighting

Gentlemen:

We advise you that Electrical Subcontractor, Inc. has today determined from field measurements that there is insufficient area between the mechanical duct system and the ceiling grid for installation of the recessed lighting fixtures as specified.

Accordingly, we request immediate direction from the engineer and architect to promptly resolve this apparent design conflict. We cannot proceed further with installation of these fixtures unless further direction is received. Since this work is on the critical path, it will likely cause a delay in the completion of our work and require additional cost for performance for which we expect full equitable adjustment.

Finally, we request the issuance of a Subcontract Change Order to implement any changes required by the direction and to be compensated for its impact. This cost and time impact, however, cannot be assessed until further direction is received.

Very truly yours,

Project Manager
Electrical Subcontractor Inc.

FORM 3

CONSTRUCTIVE CHANGE NOTICE
August 29, 1988
Electrical Subcontractor Inc.
0001 Main Street
Sleepy Hollow, Utopia 00000

Major General Contractor Co., Inc.
1234 Wide Road
Sleepy Hollow, Utopia 00000

Re: Sleepy Hollow High School
Subcontract No. 100-10

Subject: Access Problems for Kitchen
Electrical Installation Your Letter of
August 26, 1988

Gentlemen:

As we have previously advised, the owner's kitchen installation contractor has now effectively blocked off all reasonable access to the cafeteria and kitchen area. Their equipment and work crews have made it impossible to use scaffolding, as originally planned, for installation of the light fixtures. Yet our crews have been directed, by your letter of August 26th, to continue working in that area. This • will require a much slower and less efficient installation process for our crews. Such out- of-sequence work performed under these difficult conditions will likely delay our completion as well as increase our overall cost of performance.

We consider this condition to constitute a change in our subcontract scope of work, for which Electrical Contractors expects an equitable adjustment to fully compensate for all extra costs incurred, plus reasonable overhead and profit, as well as an appropriate extension of time. We are preparing and shall promptly submit a detailed change order proposal as soon as the full impact of these conditions can be reasonably determined.

Meanwhile, we shall proceed as directed, but will do so under protest and with full reservation of our right to equitable adjustment for these conditions and their impact on our work.

Very truly yours,

Project Manager
Electrical Subcontractor Inc.

FORM 4

CHANGE ORDER PROPOSAL CHECKLIST

1. Confirm that the directive was properly issued.
2. When should the proposal be submitted?
3. What format is required?
4. What documentation is required?
5. Establish the presence of all elements required for adjustment.
6. Include all known costs, including delay and disruption costs.
7. Explain and supplement pricing methodologies.
8. Request appropriate time extensions.
9. Consider cumulative ripple effects.
10. Stipulate a time limit for acceptance.
11. Expressly list any important pricing assumptions.
12. Reserve rights for undeterminable costs or time not yet determined. Price it, preserve it, or lose it!!!

FORM 5

TRADE SUBCONTRACTOR INC.
CHANGE ORDER PROPOSAL

Change Order Proposal No. _____

To: _____

Project: _____

Change Order Proposal Date: _____

Responding To: _____ Directed Change: _____ Other: _____

By: _____

Date: _____

Change Order Request No. _____

Regarding: _____

_____

We propose to perform the work described above as a modification to our Subcontract, upon issuance of a Change Order consistent with the following proposed Subcontract Adjustments:

I. DIRECT COST

a. Labor $ _____
Labor Burden (at ___% of direct labor) $ _____
Other related labor costs (travel, subsistence, etc.) $ _____

TOTAL LABOR $ _____

b. Small tools & consumables (at ___% of direct labor) $ _____
Materials, supplies, equipment (for installation) $ _____
Tax (at ___%) $ _____

TOTAL MATERIAL $ _____

c. Equipment (for use) $ _____
Owned $ _____
Rented $ _____

TOTAL EQUIPMENT $ _____

d. Subcontractors List:

_____ $ _____
_____ $ _____
_____ $ _____
_____ $ _____

Subcontractor Subtotal $ _____
Markup (at ____ %) $ _____

TOTAL SUBCONTRACT COST $ _____

e. Permits & Fees $ _____

TOTAL DIRECT COSTS $ _____

II. INDRECT COSTS: (ITEMIZE & ATTACH EXPLANATION)

_____ $ _____

III. IMPACT COSTS & TIME:

a. Disruption – Inefficiency Labor $ _____
_____ Other $ _____

TOTAL INEFFICIENCY $ _____

b. Delay – Impact Cost Labor $ _____
_____ Other $ _____

c. TOTAL IMPACT COSTS (see (e) below) $ _____
d. Extension of Time _____ Days
e. NOTE: (Check Appropriate Item)
    1. ___ The entries in Paragraphs a, b, and c are final quotes.
    2. ___ The entries in Paragraphs a, b and c are a preliminary determination of the estimated increase in cost and/or time of performance as a result of this change proposal for additional contract money and/or time, as necessary.
    3. ___ Because of the nature of the work affected and the potential for indirect impact on our work resulting from this change, we cannot now adequately estimate the cost and time consequences.

    For items 2 and 3 above, as soon as the full impact can be reasonably determined and quantified, we shall supplement this proposal for additional subcontract money and/or time. However, we specifically advise of our intent to seek full adjustment warranted by these circumstances and reserve the right to request additional contract time and/or money.

IV. CHANGE PROPOSAL – SUBTOTAL $ _____

V. MARKUPS, CREDITS, MISCELLANEOUS

a. Overhead
(____ % or ____ other method) $ _____

SUBTOTAL $ _____

b. Profit (____ %) $ _____

SUBTOTAL $ _____

c. Credits: ($ _____)

SUBTOTAL $ _____

d. Bond and Insurance $ _____

e. Miscellaneous $ _____

VI. TOTAL PROPOSAL PRICE $ _____

VII. TIME EXTENSION REQUESTED
(See III above) _____ Days

VIII. This Proposal may be accepted as described within _____ days of the Change Order Proposal date above. If not accepted by that date it may be withdrawn at our election.

TRADE SUBCONTRACTOR, INC.

_____
Project Manager

* Copies of pertinent schedules, takeoffs, substantiation, or explanation attached.

FORM 6

20-DAY PRELIMINARY NOTICE

TO: _ _[*Names and addresses of owner or reputed owner, direct contractor or reputed direct contractor, and construction lender or reputed construction lender as required in private works by CC §8200, or of direct contractor, public agency, and disbursing officer as required in public works by CC §§9300–9302*]_ _:

You are notified that claimant, _ _[*name and address of person or firm furnishing labor, service, equipment, or material*]_ _, has provided or will provide Work of the following description: _ _[*Describe labor, service, equipment, or material, or a combination of these, that was provided or will be provided*]_ _ for use in and contributing to the building, structure, or other work of improvement on the real property in _ _[*names of city and county*]_ _, California, located at _ _[*describe jobsite sufficiently to identify; include street address, if any; add assessors parcel number and legal description, if possible*]_ _.

The claimant is a(n) _ _[*identify as individual, corporation, partnership, or other entity*]_ _ and is contributing to the work of improvement described above as a(n) _ _[*describe specific relationship, e.g., direct contractor, subcontractor, material supplier, equipment lessor, design professional providing engineering/landscaping/architectural services, or other capacity in which claimant is contributing to the work of improvement*]_ _.

The name(s) of the person(s) or firm(s) to or for whom the claimant provided the Work _ _[*is/are*]_ _: _ _[*List name(s) and address(es)*]_ _.

An estimate of the total price of the above Work to be provided is $_ _[*amount*]_ _.

An estimate of the amount currently owing to claimant for providing through the date of this notice the above Work, after deducting payments and offsets, is $_ _[*amount*]_ _.

The name(s) and address(es) of the owner or reputed owner _ _[*is/are*]_ _: _ _[*List name(s) and address(es)*]_ _.

The name and address of the direct contractor or reputed direct contractor to or through whom the claimant provided the Work is: _ _[*Provide name and address*]_ _.

The name(s) and address(es) of the construction lender(s) or reputed construction lender(s) _ _[*is/are*]_ _: _ _[*List name(s) and address(es)*]_ _.

[*If applicable, add the following option*]

[*Option: Subcontractor claimant's notice of unpaid compensation and employer payments owing to laborers and entities described in CC §8202(b); see CC §8202(b)*]

The name(s) and address(es) of the laborer(s) _ _[*and the express trust fund(s)*]_ _ to whom compensation _ _[*and employer payments*]_ _ _ _[*is/are*]_ _ due and payable are: _ _[*List name(s) and address(es)*]_ _.

[*Continue*]

NOTICE TO PROPERTY OWNER

EVEN THOUGH YOU HAVE PAID YOUR CONTRACTOR IN FULL, if the person or firm that has given you this notice is not paid in full for labor, service, equipment, or material provided or to be provided to your construction project, a lien may be placed on your property. Foreclosure of the lien may lead to loss of all or part of your property. You may wish to protect yourself against this by (1) requiring your contractor to provide a signed release by the person or firm that has given you this notice before making payment to your contractor or (2) any other method that is appropriate under the circumstances.

This notice is required by law to be served by the undersigned as a statement of your legal rights. This notice is not intended to reflect on the financial condition of the contractor or the person employed by you on the construction project.

If you record a notice of cessation or completion of your construction project, you must within 10 days after recordation send a copy of the notice of completion to your contractor and the person or firm that has given you this notice. The notice must be sent by registered or certified mail. Failure to send the notice will extend the deadline to record a claim of lien. You are not required to send the notice if you are a residential homeowner of a dwelling containing four or fewer units.

Date: _ _ _ _ _ _

_ _[*Signature of claimant*]_ _

_ _[*Typed name*]_ _

_ _[*Title of authorized agent*]_ _

_ _[*Telephone number*]_ _

_ _[*Address of claimant*]_ _

PROOF OF SERVICE

On _ _[*date and time*]_ _, the undersigned declarant served copies of the above PRELIMINARY NOTICE on the following persons by _ _[*e.g., personal delivery/certified mail/registered mail/express mail/overnight delivery by express service carrier/leaving the notice and mailing a copy as provided in CCP §415.20*]_ _ at the addresses shown below:

[*List individually all names, addresses, and titles of persons served, and, if applicable, the parties or entities on whose behalf they were served; see §§3.40, 4.28–4.31*]

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: _ _ _ _ _ _ _ _[*Signature*]_ _

_ _[*Typed name*]_ _

[*Attach receipts for mail or delivery when returned*]

FORM 7
PROMPT PAYMENT MATRIX

OUTLINE OF CALIFORNIA PROMPT PAYMENT STATUTES

SCOPE	TYPE OF PAYMENT	PAYOR	PAYEE	TIME FOR PAYMENT	PENALTY & LEGAL FEES	BACKCHARGE LIMITS	EFFECTIVE DATE
Private Works Civ Code § 8800	Progress Payments	Owner	Direct Contractor	30 days after receipt of contractor's request for payment	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of disputed amount	July 1, 2012
Private Works + Civ. Code § 8812-8818	Retention **	Owner ---------- Original Contractor	Original Contractor ---------- Subcontractor	45 days after date of completion ---------- 10 days after receipt from owner	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of disputed amount	July 1, 2012
Private & Public Works Bus & Prof Code §7108.5 and Public Cont. Code § 10262.5	Progress Payment	Any prime contractor or subcontractor	Subcontractors (all tiers)	7days ++ from receipt of funds by contractor *	2% per month in addition to interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	January 1, 2012
Public Works Pub Cont. Code §10261.5 and § 10853	Progress Payments	State agency ---------- State University	Contractor ---------- Contractor	30 days ---------- 39 days	10 % per annum; starts earlier if improper rejection by state agency or state university	None express; implied duty of good faith	January 1, 1991 ---------- January 1, 1993
Public Works Pub Cont. Code §20104.50	Progress Payment	Local government agencies	Contractors	30 days after receipt of contractor's request for payment	10 % per annum; starts earlier if improper rejection by local agency	None express; implied duty of good faith	January 1, 1991
Public Works Civ Code § 3320	Progress and retention	Any public entity	Design professionals	Progress: 30 days from demand Retention: 45 days from demand	1-½ % per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	Contracts entered into after January 1, 1996
Public Works + Pub. Cont. Code §7107	Retention	Any public entity ---------- Original Contractor	Original Contractor ---------- Subcontractor	60 days after date of completion ---------- 7 days from receipt of funds by original contractor	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	Contracts entered into after January 1, 1993
Public Works Civ Code 3321	All payments	Prime Design Professional	Subconsultant design professional	15 days	1-1 1/2 % interest per month in lieu of interest Attorneys' fees to prevailing party	No more than 150% of disputed amount	July 1, 2012

\+ Waiver of any provision prohibited

++ 21 days for public utilities contracts, effective July 1, 2012 Civil Code § 8802

* May be modified by written agreement

** Does not apply to retentions withheld by lender per construction lo agreement

*** Public Contract Code § 10853, effective January 1, 1993

FORM 8

Recording Requested by

After Recording Return to

_____

(Space above this line for recorder's use)

_____

CLAIM OF MECHANICS LIEN

_ _[*Name of claimant*]_ _ hereby claims a mechanics lien on the real property in _ _[*names of city and county*]_ _, California, located at _ _[*describe jobsite sufficiently to identify*]_ _, owned or reputed to be owned by _ _[*name of owner or reputed owner*]_ _, for the sum of $_ _[*amount*]_ _, plus interest at the rate of _ _[*number*]_ _ percent per year from _ _[*date*]_ _, which is due and unpaid (after deducting all just credits and offsets) for _ _[*labor/service/equipment/material*]_ _ furnished by claimant and consisting of _ _[*generally describe the kind of labor, service, equipment, or material*]_ _. Claimant _ _[*was employed to furnish the same by/furnished the same to*]_ _ _ _[*name of person*]_ _ under contract with _ _[*name*]_ _.

Date: _ _ _ _ _ _

_ _[*Signature of claimant*]_ _
_ _[*Typed name*]_ _
_ _[*Title of authorized agent*]_ _
_ _[*Telephone number*]_ _
_ _[*Address of claimant*]_ _

[*Continue with required notice of lien*]

[*Under CC §8416(a)(8), the claim of lien must contain the following notice in at least 10-point boldface type. The letters of the last sentence must be in uppercase, except the Internet address, which must be in lowercase.*]

VERIFICATION

I am the _ _[*claimant/claimant's agent authorized to make this verification on the claimant's behalf*]_ _ and the foregoing Claim of Lien is true of my own knowledge, except for matters stated in it on the basis of my information or belief, and as to those matters I believe it to be true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: _ _ _ _ _ _

_ _[*Signature*]_ _
_ _[*Typed name*]_ _

NOTICE OF MECHANICS LIEN: ATTENTION!

On the recordation of the enclosed MECHANICS LIEN with the county recorder's office of the county where the property is located, your property is subject to the filing of a legal action seeking a court-ordered foreclosure sale of the real property on which the lien has been recorded. That legal action must be filed with the court no later than 90 days after the date the mechanics lien is recorded.

The party identified in the enclosed mechanics lien may have provided labor or materials for improvements to your property and may not have been paid for these items. You are receiving this notice because it is a required step in filing a mechanics lien foreclosure action against your property. The foreclosure action will seek a sale of your property in order to pay for unpaid labor, materials, or improvements provided to your property. This may affect your ability to borrow against, refinance, or sell the property until the mechanics lien is released.

BECAUSE THE LIEN AFFECTS YOUR PROPERTY, YOU MAY WISH TO SPEAK WITH YOUR CONTRACTOR IMMEDIATELY OR CONTACT AN ATTORNEY. FOR MORE INFORMATION ON MECHANICS LIENS, GO TO THE CONTRACTORS' STATE LICENSE BOARD WEBSITE AT http://www.cslb.ca.gov.

PROOF OF SERVICE

On _ _[*date and time*]_ _, the undersigned declarant served copies of the above CLAIM OF MECHANICS LIEN and NOTICE OF MECHANICS LIEN on the _ _[*owner/reputed owner*]_ _ named below by _ _[*registered mail/certified mail/first-class mail*]_ _ at the addresses shown below:

[*List individually all names, addresses, and titles of persons served and, if applicable, the parties or entities on whose behalf they were served; see §3.58*]

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: _ _ _ _ _ _

_ _[*Signature*]_ _
_ _[*Typed name*]_ _

[*Attach certificate of mailing, postage prepaid, and receipts for certified or registered mail when returned*]

FORM 9

AGREEMENT FOR EXTENSION OF TIME TO ENFORCE MECHANICS LIEN

Recordation Requested by After Recordation Return to _____	(Space above this line for recorder's use) _____

EXTENSION OF TIME TO ENFORCE MECHANICS LIEN AND NOTICE OF CREDIT

This agreement is entered into by and between _ _[*name of claimant*]_ _ and _ _[*name of owner*]_ _.

A Mechanics Lien (Claim of Lien) was recorded by _ _[*name of claimant*]_ _ on _ _[*date*]_ _, in _ _[*insert book and page or instrument number*]_ _ of the Official Records of the _ _[*name of county*]_ _ Recorder, State of California, against _ _[*name of owner*]_ _ and against the following described real property:

[*Insert/attach as exhibit legal description of affected properties*]

which is commonly referred to as _ _[*street address*]_ _, California (_ _[*insert assessor's parcel number*]_ _).

[*If applicable, add the following option*]

[*Option: If claimant recorded partial release*]

_ _[*Name of claimant*]_ _ thereafter provided a partial release of the above lien, by which _ _[*name of claimant*]_ _ released said lien from a portion of the above property, described as follows:

[*Insert/attach as exhibit legal description of released properties*]

Said lien remains in effect against the remaining properties, described as follows:

[*Insert/attach as exhibit legal description of affected properties*]

[*Continue*]

The time to commence proceedings to enforce said lien is about to expire unless credit is given as provided for in Civil Code §8460(b).

Therefore, it is agreed by and between _ _[*name of owner*]_ _, Owner, and _ _[*name of claimant*]_ _, Claimant, that a credit (*i.e.,* extension) of _ _[*e.g., 30 days*]_ _ from the date of execution of this instrument is given and that claimant's above-described lien is continued in force for ninety (90) days after the expiration of the credit but in no event later than one (1) year after completion of the work of improvement, as provided in §8460(b).

[*If applicable, add one or more of the following options*]

[*Option 1: If owner is willing to stipulate to any facts concerning the claim of lien, add the following option in full or in part*]

_ _[*Name of owner*]_ _ acknowledges and agrees that $_ _[*amount*]_ _ remains unpaid to _ _[*name of claimant*]_ _ and that the materials specified in the above lien were actually used in the improvement of the above described real property.

[*Option 2: If parties are willing to establish a completion date by stipulation*]

_ _[*Name of owner*]_ _ and _ _[*name of claimant*]_ _ acknowledge and agree that the completion date for the work of improvement was _ _[*date*]_ _.

[*Continue*]

_ _[*Name of owner*]_ _ waives any and all right to object to the filing or maintenance of any action brought to foreclose the above described lien, as long as the action is brought within the period mentioned above, on the ground that the action is barred by any statute of limitation.

Date: _ _ _ _ _ _

_ _[*NAME OF CLAIMANT*]_ _,

By: _ _[*Signature*]_ _
Name: _ _[*Typed name*]_ _
Its: _ _[*Title*]_ _

Date: _ _ _ _ _ _

_ _[*NAME OF OWNER*]_ _,

By: _ _[*Signature*]_ _
Name: _ _[*Typed name*]_ _
Its: _ _[*Title*]_ _

Acknowledgment

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

State of California
County of _ _[*Name of county*]_ _

_____

On _ _[*date*]_ _, before me, _ _[*name and title of officer*]_ _, personally appeared _ _[*name(s)*]_ _, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal:

_ _[*Signature of officer*]_ _ [Officer's seal]

FORM 10

NOTICE OF NONRESPONSIBILITY

TO WHOM IT MAY CONCERN:

NOTICE IS HEREBY GIVEN that _ _[*name of nonparticipating owner*]_ _ has obtained knowledge that a work of improvement has commenced on the real property located at _ _[*street address, city, and county*]_ _, California, further described as: _ _[*Give legal description or other description sufficient for identification*]_ _. The name and address of the direct contractor is _ _[*name and address of direct contractor*]_ _. The name and address of the construction lender is _ _[*name and address of construction lender, if any*]_ _.

The nature of _ _[*name of nonparticipating owner*]_ _'s title or interest in the property is that of _ _[*describe interest, e.g., fee owner, cotenant, reversion*]_ _. The name of the lessee, purchaser under contract, or other person or entity causing the work of improvement to be performed is _ _[*name*]_ _.

The undersigned hereby gives notice that _ _[*name of nonparticipating owner*]_ _, who may be contacted at _ _[*address and telephone number*]_ _, will not be responsible for any claims arising from the work of improvement.

Date: _ _ _ _ _ _ _ _[*Signature*]_ _
_ _[*Typed name*]_ _

VERIFICATION

I have read the foregoing Notice of Non-Responsibility and have personal knowledge of all facts stated in it. I declare under penalty of perjury under the laws of the state of California that the foregoing is true and correct.

Date: _ _ _ _ _ _ _ _[*Signature*]_ _
_ _[*Typed name*]_ _

FORM 11

STOP PAYMENT NOTICE

TO:

_ _[*Name of owner, construction lender, or public officer*]_ _

_ _[*Address (for construction lender, use branch address)*]_ _

RE: Work of improvement located at: _ _[*Describe jobsite and project sufficiently to identify; include street address, if any; add assessor's parcel number and legal description, if possible*]_ _

Claimant, _ _[*name and address*]_ _, has _ _[*furnished/agreed to furnish*]_ _ _ _[*labor/service/equipment/material*]_ _ of the following kind: _ _[*Generally describe labor, service, equipment, or material*]_ _ to or for _ _[*name of person who employed claimant or to or for whom claimant provided work*]_ _ for the work of improvement described above.

The estimated total value of the whole work agreed to be done or provided by claimant is $_ _[*amount*]_ _. The value of that work already done or provided through the date of this notice is $_ _[*amount*]_ _. Claimant has been paid $_ _[*amount*]_ _, but $_ _[*amount*]_ _, plus interest at the rate of _ _[*number*]_ _ percent per year from _ _[*date*]_ _, remains due and unpaid.

The name(s) and address(es) of the owner or reputed owner _ _[*is/are*]_ _: _ _[*List name(s) and address(es)*]_ _.

The name and address of the direct contractor or reputed direct contractor to or through whom the claimant provided the _ _[*labor/service/equipment/material*]_ _ is: _ _[*Provide name and address*]_ _.

The name(s) and address(es) of the construction lender(s) or reputed construction lender(s) _ _[*is/are*]_ _: _ _[*List name(s) and address(es)*]_ _.

You are required to set aside sufficient funds to satisfy this claim with interest.

Date: _ _ _ _ _ _

_ _[*Signature of claimant*]_ _
_ _[*Typed name*]_ _
_ _[*Title of authorized agent*]_ _
_ _[*Telephone number*]_ _
_ _[*Address of claimant*]_ _

VERIFICATION

I am the _ _[*claimant/claimant's agent authorized to make this verification on the claimant's behalf*]_ _ and the foregoing Stop Payment Notice is true of my own knowledge, except for matters stated in it on the basis of my information or belief, and as to those matters I believe it to be true.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: _ _ _ _ _ _

_ _[*Signature*]_ _

_ _[*Typed name*]_ _

FORM 12

NOTICE TO BONDING COMPANY (Private Work and Public Work)

TO OWNER:

_ _[*Name of owner*]_ _

_ _[*Address*]_ _

TO PRIME OR DIRECT CONTRACTOR:

_ _[*Name of prime or direct contractor*]_ _

_ _[*Address*]_ _

TO BONDING COMPANY:

_ _[*Name of bonding company*]_ _

_ _[*Address*]_ _

BOND NUMBER: _ _[*Identification number of bond*]_ _

NOTICE IS HEREBY GIVEN AS FOLLOWS:

(1) That a general description with substantial accuracy of the labor, service, equipment, or material furnished or to be furnished is:

_____

(2) That the name and address of the person who contracted for the purchase or to whom the above labor, service, equipment, or material was furnished or is to be furnished are:

_____

(3) That the general description, address, and location of the jobsite (or work of improvement) are:

_____

(4) That the name and address of the party furnishing the labor, service, equipment, or material described above are:

_ _[*Name*]_ _

_ _[*Address*]_ _

(5) That the relationship of the undersigned party furnishing the labor, service, equipment, or material to the other parties described above is: _ _[*Describe activity, e.g., direct contractor, subcontractor, material supplier, equipment lessor, or design professional providing engineering/landscaping/architectural services, or other capacity in which undersigned party is contributing to the work of improvement*]_ _.

(6) Amount claimed or estimated total price: $_ _[*amount*]_ _.

[*Add one of the following alternatives*]

[*Alternative 1: Signature block for individual*]

Date: _ _ _ _ _ _

_ _[*Signature*]_ _
_ _[*Typed name*]_ _

[*Alternative 2: Signature block for entity*]

Date: _ _ _ _ _ _

_ _[*NAME OF ENTITY*]_ _,
a _ _[*specify entity, e.g., California corporation*]_ _

By: _ _[*Signature*]_ _
Name: _ _[*Typed name*]_ _
Its: _ _[*Title*]_ _

FORM 13

REQUEST FOR NOTIFICATION OF COMPLETION

August 29, 1988
Electrical Subcontractor Inc.
0001 Main Street
Sleepy Hollow, Utopia 00000

Public Owner Entity
1234 Wide Road
Sleepy Hollow, Utopia 00000

Re: Sleepy Hollow High School
Subcontract No. 100-10

Subject: Request for Notification of Completion

To Whom It May Concern:

Electrical Subcontractor, Inc. hereby formally requests notification of the time within which an action to enforce payment of the claim stated in the Stop Payment Notice served on _____ has commenced, no later than ten (10) days of the events as defined per California Civil Code Section 9362(a). $10 payment was provided with the remittance of the Stop Payment Notice, required per California Civil Code Section 9362(c).

Very truly yours,

Project Manager
Electrical Subcontractor Inc.

FORM 14

_ _[*Name of attorney; State Bar number*]_ _
_ _[*Address*]_ _
_ _[*Telephone number*]_ _

Attorney for _ _[*e.g., plaintiff*]_ _, _ _[*name*]_ _

Superior Court of California, County of _ _ _ _ _ _

_ _[_ _ _ _ _ _ *District/Division*]_ _

_ _[*Limited Civil Case*]_ _

_ _[*Name(s)*]_ _, Plaintiff(s) vs _ _[*Name(s)*]_ _, Defendant(s)	No. _ _ _ _ _ _ NOTICE OF COMMENCEMENT OF ACTION ON STOP PAYMENT NOTICE CLAIM

To _ _[*name of public entity*]_ _:

PLEASE TAKE NOTICE that on _ _[*date of filing*]_ _, claimant, _ _[*name*]_ _, filed an action entitled _ _[*name of action*]_ _, _ _[*case number*]_ _, in _ _[*title of court*]_ _ to perfect its rights under the stop payment notice served on _ _[*date of service*]_ _, on the following public works project: _ _[*Identify public works project*]_ _.

Date: _ _ _ _ _ _

_ _[*Signature*]_ _
_ _[*Typed name*]_ _
Attorney for _ _[*name*]_ _

FORM 15

RETENTION RELEASE LETTER (PUBLIC WORK)

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Retention Release for **ABC Construction** for **Any City Public Project**

Dear XXXXXXXXX:

We are writing to demand immediate release of our retention on the **[Name of Project]**. The retention is now overdue and should be paid.

The purpose of retention is to ensure a subcontractor completes its work, and to provide security from lower tier liens in the event the subcontractor has not paid its suppliers. *Yasin v. Solis*, 184 Cal. App. 4th 524, 534 (2010). It is important to note that retention constitutes contract funds due for work already performed. Under the circumstances on this Project, there is no basis to continue to withhold retention. ABC's work is complete, and ABC has provided or will provide releases from its vendors if required.

The Legislature has enacted laws to make sure that subcontractors are promptly paid their retention. Under California law, unpaid retention is due the prime contractor within 60 days of the completion of the work. Completion is defined at a minimum as; 1) completion of the work of improvement or 2) the owner has occupied and is using the property or 3) there has been a cessation of labor. California law exempts testing, startup or commissioning. The above Project is complete – and retention is due – even though testing, startup or commissioning remain to be performed. See Cal. Pub. Contracts Code § 7107.

You, as prime contractor, are required to pay the subcontractor its portion of the retention within 7 days of receipt. Even if there is disagreement as to some aspect of ABC's performance of its obligations, retention is due. A prime contractor is limited to withholding only 150% of the good faith estimate of the amount in dispute. Cal. Pub. Contracts Code § 7107(e).

It is also important to note that a dispute over ABC's proposed change orders, other requests for compensation, or requests for time extensions are not the type of disputes that permit a prime contractor to withhold retention. Doing so would not serve the purpose of retention -- to make sure a subcontractor completes its work, and to provide security from lower tier liens. The retention laws are to ensure timely payment of the retention as soon as the purpose has been served. *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co*., 4 Cal. 5th 1096 (2018) (discussing purpose of prompt payment law).

California law also provides additional remedies for subcontractors when retention is not timely paid. ABC is entitled to 2% per month of the value of the unpaid retention as a penalty when

not paid timely. The law also provides for attorney's fees incurred in an enforcement proceeding.

The express and implied provisions of our subcontract, including the pass-through provisions, make it incumbent upon the prime contractor to take all steps necessary for the prompt release of retention so that the subcontractors can be paid. We do not know if the owner will continue to withhold your retention. However, to the extent that your retention is being withheld for a reason unrelated to ABC's work, it is not appropriate for you to continue to withhold ABC's retention. ABC is entitled to be paid its retention even if the work of other subcontractors (or your own work) has resulted in the owner claiming a dispute. As the party that is ultimately owed the retention (for work performed long ago), we are entitled to, and do hereby claim, a constructive trust over any prompt payment penalties that are owed by the owner for the late payment.

The road to completion is behind us. Our work is done. The owner has received the benefits of our labor. It is no longer appropriate to withhold retention funds for work performed long ago. We therefore respectfully request that all retention withheld be immediately released. If any funds continue to be retained after seven calendar days from the date of this letter, we ask for an immediate accounting of your good faith estimate of the funds withheld in the dispute.

Sincerely,

ABC Electrical

John Doe
Project Manager

cc/ Project Executive

FORM 16

RETENTION RELEASE LETTER (PRIVATE WORK)

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Retention Release for **ABC Electrical** for **Any GC Private Project**

Dear XXXXXXXXX:

We are writing to demand immediate release of our retention on the **[Name of Project]**. The retention is now overdue and should be paid.

The purpose of retention is to ensure a subcontractor completes its work, and to provide security from lower tier liens in the event the subcontractor has not paid its suppliers. *Yasin v. Solis*, 184 Cal. App. 4th 524, 534 (2010). It is important to note that retention constitutes contract funds due for work already performed. Under the circumstances on this Project, there is no basis to continue to withhold retention. ABC's work is complete, and ABC has provided or will provide releases from its vendors if required.

The Legislature has enacted laws to make sure that subcontractors are promptly paid their retention. Under California law, unpaid retention is due the direct contractor within 45 days of the completion of the work. See Cal. Civil Code § 8812. Completion is defined at a minimum as; 1) completion of the work of improvement or 2) the owner has occupied and is using the property or 3) there has been a cessation of labor. See Cal. Civil Code § 8180. You, ACME as the direct contractor, in turn, are required to pay to ABC our portion of the retention within 10 days of receipt. Cal. Civil Code § 8814. If there is a disagreement as to some aspect of the performance of our obligations, our retention is still due. The direct contractor is limited to withholding only 150% of the good faith estimate of the amount in dispute. Cal. Civil Code § 8814.

It is also important to note that a dispute over ABC's proposed change orders, other requests for compensation, or requests for time extensions are not the type of disputes that permit a direct contractor to withhold retention. Doing so would not serve the purpose of retention -- to make sure a subcontractor completes its work, and to provide security from lower tier liens. The retention laws are to ensure timely payment of the retention as soon as the purpose has been served. *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co*., 4 Cal. 5th 1096 (2018) (discussing purpose of prompt payment law).

The prompt payment statutes provide additional remedies for subcontractors when retention is not timely paid. ABC is entitled to 2% per month of unpaid retention as a penalty when not paid timely. The law also provides for attorney fees incurred in an enforcement proceeding. Cal. Civil Code § 8818.

The express and implied provisions of our subcontract make it incumbent upon the direct contractor to take the steps necessary for the prompt release of retention so that we can be paid. We do not know if the owner will continue to withhold your retention. However, to the extent that your retention is being withheld for a reason unrelated to ABC's work, it is not appropriate for you to continue to withhold ABC's retention. ABC is entitled to be paid its retention even if the work of other subcontractors (or your own work) has resulted in the owner claiming a dispute. As the party that is ultimately owed the retention (for work performed long ago), we are entitled to, and do hereby claim, a constructive trust over any prompt payment penalties that are owed by the owner for the late payment.

The road to completion is behind us. Our work is done. The owner has received the benefits of our labor. It is no longer appropriate to withhold retention funds for work performed long ago. We therefore respectfully request that all retention withheld be immediately released. If any funds continue to be retained seven calendar days from the date of this letter, we ask for an immediate accounting of your good faith estimate of the funds withheld in the dispute.

Sincerely,

ABC Electrical

John Doe
Project Manager

cc/ Project Executive

FORM 17

PROGRESS PAYMENT DEMAND LETTER

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Demand for Timely Progress Payments for **ABC Electrical** to **Any GC**

Dear XXXXXXXXX:

We are writing to demand immediate payment of the outstanding invoice(s) on the **[Name of Project]**. The invoice(s) is now overdue and should be paid.

Under California law on both public and private works, progress payments must be made by the prime contractor to a subcontractor within 7 calendar days of receipt of payment by the owner. If the prime contractor fails to do so, the subcontractor is entitled to prompt payment penalties of 2% per month, in addition to statutory interest, and may be entitled to attorneys' fees and costs incurred in order to collect on the outstanding payments. See Bus. Prof. Code §7108.5. In addition, the failure to make timely payment on public projects is violative of Pub. Cont. Code §10262.5

ABC has repeatedly inquired as to the status of and requested the open invoice(s) for the above-referenced project be paid in full, yet we have not received payment to date. If there is no response to this letter by **[Date]**, all legal rights shall be explored, including but not limited to, legal proceedings necessary in accordance with State laws. This demand serves as formal notice to you and may be tendered in court as evidence of your failure to cooperate. We hope to resolve this matter as soon as possible.

The following reasonable documentation is enclosed for your consideration:

- ABC Electrical's Invoice No. **[Invoice Number]** dated **[Date]**;

If any funds continue to be retained following 7 calendar days from the date of this letter, we ask for an immediate accounting of your good faith estimate of the funds withheld in the dispute.

Sincerely,

ABC Electrical

John Doe
Project Manager

cc/ Project Executive

FORM 18

CHANGE ORDER REQUEST DEMAND LETTER

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Request for Response to Outstanding Change Order Requests for **ABC Electrical** to **Any GC**

Dear XXXXXXXXX:

We are writing to demand immediate response to the outstanding change order request(s) on the **[Name of Project]**. The change order request(s) was submitted to Acme on **[Date]** and noted the change order's pricing, applicable time extension and terms were valid for **[number of days]** days.

ABC has repeatedly inquired as to the status of and requested execution of the outstanding change order request(s). If there is no response to this letter by **[Date]**, the change order request will be deemed void, and ABC will provide a new change order request with any updated pricing, time extension and terms as deemed necessary upon request by Acme.

As noted above, in the event that these change order requests are not processed within the next forty-eight (48) hours, they will be deemed void and of no force and effect. In the event that occurs, ABC will prosecute the work pursuant to the applicable contract documents in accordance therewith.

The following reasonable documentation is enclosed for your consideration:

- ABC Electrical's Change Order Request No. **[Change Order Request Number]** dated **[Date]**;

Sincerely,

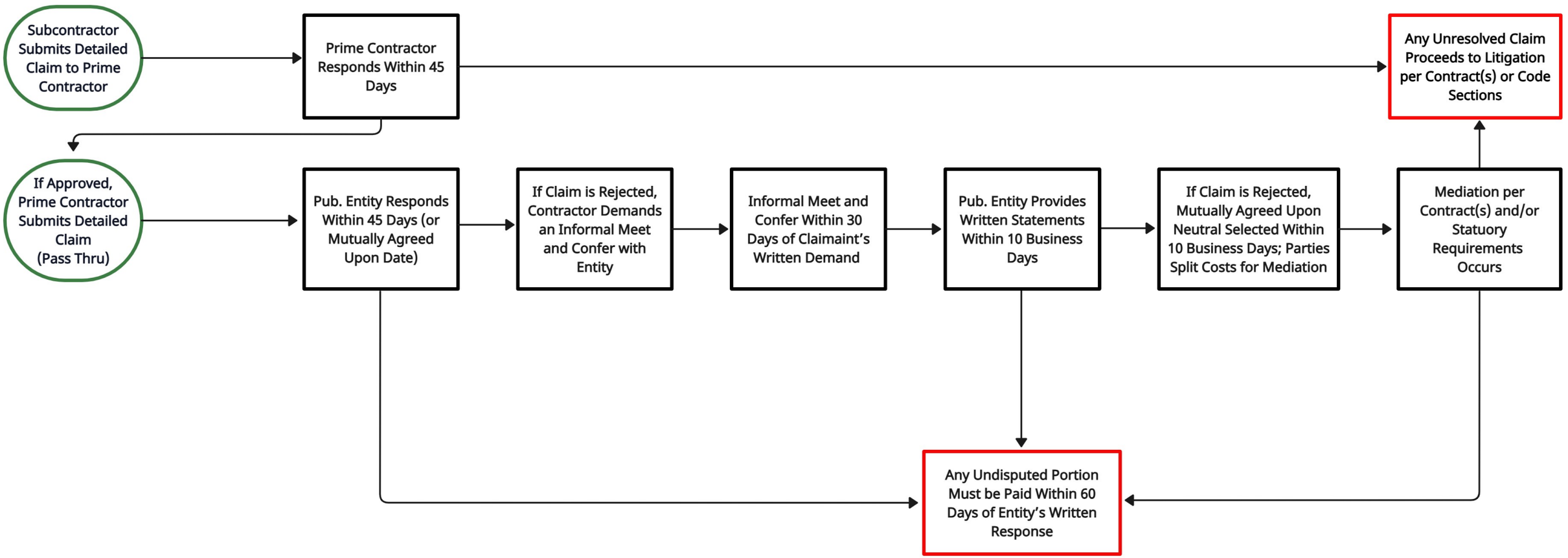
ABC Electrical

John Doe
Project Manager

cc/ Project Executive

FORM 19

PUBLIC CONTRACT CODE SECTION 9204 FLOWCHART



WHITE PAPER NO. 1
Key Construction Contract Terms
Indemnity Provisions in California Construction Contracts

This white paper is the first in a series of papers discussing key terms in construction contracts. It focuses on indemnity provisions in California construction contracts, both in the private and public context. The paper covers the generalities of what indemnity provisions are, how they operate and function, the various types of indemnity provisions one might encounter in construction contracts, and the legalities of various indemnity forms. Sample indemnity provisions are also provided for the benefit of the reader. The paper operates and views indemnity provisions from the perspective of a subcontractor on a construction project.

As noted elsewhere, the indemnity provisions contained in the California Civil Code are complex and very much project-specific, changing depending on the scope of work (design vs. construction), type of project (residential, commercial, or public), and parties to the contract. It is imperative that contractors have these provisions drafted and/or reviewed by competent counsel so as to ensure compliance with the law and, ultimately, enforceability in the event of a dispute.

I. What Is an Indemnity Provision?

In its most fundamental nature, an indemnity provision is a contractual term that shifts risk between parties and requires one party to compensate the other for certain claims, judgments, damages or losses. In the construction context, indemnity provisions often relate to:

- Property damage
- Bodily injury
- Economic loss
- Legal fees or defense obligations

These clauses are often broad and complex, which can create significant liability exposure for the indemnitor (i.e. the party obligated to indemnify), especially for subcontractors or lower-tier participants in a construction project. Often these types of provisions require the subcontractor to indemnify the general contractor for claims, judgments, damages, and losses arising from or relating to the work of the subcontractor. So, for example, in the event an electrical subcontractor's work is negligently installed and results in a fire, the subcontractor would be obligated to compensate the general contractor in the event the general was sued and required to pay money to repair the structure (or compensate a person for bodily injury and damage relating to the fire).

As noted these types of clauses are risk-shifting in nature and often passed from the owner of a project to the general contractor, and then down the chain of contractors and vendors (i.e. from general to sub, and sub to second-tier sub, and so forth). Indemnity provisions allocate risk between the parties and are often a significant point of leverage in the event claims arise on a construction project, specifically claims relating to the work of a subcontractor.

II. The Three Types of Indemnity Clauses

California courts and statutes generally recognize three types of indemnity clauses based on the amount of risk allocated and transferred between the parties. These types of clauses are referred to (cleverly) as Type I, Type II, and Type III indemnity provisions.

1. Type I Indemnity (Broad Form)

In a Type I indemnity provision, the indemnitor (typically the downstream party, or subcontractor) agrees to indemnify the indemnitee (typically the upstream party, or general contractor in this case) for all liability, including losses caused by the *indemnitee's* sole or active negligence. The scope of indemnity in this situation is extremely broad and, as a result, virtually all risk associated with liability, loses and damages arising from a project pass to the indemnitor.

A sample Type I indemnity provision may read like this:

> Subcontractor shall indemnify, defend and hold harmless the Contractor from all claims, assertions, causes of action, losses, judgments, expenses (including reasonable attorneys' fees) or other damages of any kind or nature arising out of or relating to the Project, regardless of whether such claims arise in part from the sole or active negligence of the Contractor.

Fortunately for subcontractors, Type I indemnity provisions are generally not enforceable in California in most construction contexts under Civil Code 2782(a), which voids provisions requiring a subcontractor to indemnify a general contractor for the contractor's sole negligence or willful misconduct. *See* Cal. Civ. Code 2782(a). Civil Code 2782.05 takes this further by making void any indemnity provision that seeks to indemnify a party for the active negligence or willful misconduct of such party. *See* Civil Code 2782.05. Further, in the public works context, a public agency may not be indemnified for its own active negligence, including by subcontractors. As noted above, while generally unenforceable, these types of provisions and their enforceability is highly project, scope and participant-specific and should be reviewed by counsel. Also note other states may permit type I indemnity provisions so beware when contracting with general contractors from outside California.

2. Type II Indemnity (Intermediate Form)

In a Type II indemnity provision, the indemnitor indemnifies the indemnitee for claims, liabilities, losses, etc. arising out of joint negligence, but not when the liabilities, losses, claims, etc. are caused by or arise from the indemnitee's sole negligence, active negligence or willful misconduct.

A sample Type II indemnity provision may read like this:

> With the exception that this provision shall in no event be construed to require indemnification to an extent greater than that permitted under the public policy and laws of the State of California,

> Subcontractor shall indemnify, save harmless and defend Contractor ("Indemnitee"), of and from claims, demands, causes of action in law or in equity, damages, penalties, costs, expenses, actual attorney's fees, experts' fees, consultants' fees, judgments, losses or liabilities, of every kind and nature whatsoever arising out of or in any way connected with or incidental to the performance of the Work under this Agreement or any of the obligations contained in this Agreement, and the Parties further agree that such indemnity, hold harmless and defense obligations shall exist notwithstanding any acts or omissions, misconduct or negligent conduct on the part of the Indemnitees; provided, however, *that there shall be no obligation to indemnify or hold harmless any Indemnitee against that Indemnitee's active negligence or willful misconduct.* Such indemnity and defense obligation shall survive the completion of the Project and/or termination of this Agreement.

This type of indemnity provision became popularized following the passage of California Civil Code 2782.05, and has been generally held enforceable by courts, which have found that such a provision avoids the "sole negligence" or "active negligence" issues presented by the sample Type I indemnity provision above. *See e.g. Oltmans Constr. Co v. Bayside Interiors Inc.* (2017) 10 CA5th 355 (holding that general contractor is not absolutely barred from indemnity for its active negligence but is limited to indemnity for the portion of liability attributable to others). This provision is typically found in most subcontracts.

3. Type III Indemnity (Limited Form)

A Type III indemnity provision is by and far the most equitable of the three forms of indemnity obligations, and generally requires the indemnitor to indemnify the indemnitee only to the extent of the indemnitor's own negligence or wrongful conduct.

A sample Type III indemnity provision is as follows:

> Subcontractor shall indemnify, defend and hold harmless Contractor from all claims, causes of action, losses, liabilities, expenses, and damages of any kind or nature relating to the Project, but only to the extent that such claims, causes of action, losses, liabilities, expenses, and damages are caused by Subcontractor's negligent acts or omissions.

From an enforceability standpoint, these types of indemnity provisions are *always* enforceable under California law. They are generally viewed as fair and equitable, and as a reasonable and just allocation of risk by and among the parties to a construction contract. Subcontractors should attempt to negotiate this form of indemnity in their subcontracts.

III. Defense Obligations vs. Indemnity

In California construction contracts indemnity provisions often include the duty to defend. The examples above all include reference to the indemnitor's obligation to "indemnify, *defend*, and hold harmless…" This duty to defend is generally broader than the obligation to indemnify. Often, the authors counsel their clients that "indemnity" is a remedial concept, applicable to losses *actually* incurred, whereas the duty to defend is immediately triggered upon the *risk of future* loss. In fact, courts have ruled that the duty to defend may arise immediately upon tender—before fault is determined. *See e.g. Centex Homes v. R-Help Constr. Co., Inc*., 32 Cal.App. 5th 1230 (duty to defend arises immediately upon the proper tender of defense, regardless of whether duty to indemnify exists).

Thus, subcontractors should be aware that properly and promptly tendering and/or responding to the tender of a defense under an indemnity provision is critical to preserving the subcontractors' rights. Such tender requires immediate attention once the subcontractor is made aware of a claim (or potential claim).

IV. Best Practices for Drafting and Reviewing Indemnity Clauses

While in no way a replacement for competent counsel, the following are some helpful tips in reviewing and crafting indemnity provisions in your subcontracts:

1. Avoid Type 1 clauses in California and seek to modify these to, at minimum, a Type II provision.
2. Use clear language to define the scope of indemnity and defense.
3. Tailor indemnity to the indemnitor's own work and negligence.
4. Consult California Civil Code §§ 2782 and 2782.05 and related code sections to check and ensure compliance.
5. Be cautious and weary of defense obligations that imply or trigger pre-fault obligations.

V. Conclusion

Indemnity provisions play a critical role in allocating risk on construction projects. However, they are heavily regulated in California and are subject to extreme scrutiny in the event they are implicated in a dispute. These provisions often create a push and pull in contract negotiations, as upstream parties often try to expand the scope of indemnity and defense obligations (think Type I and Type II), while downstream parties seek to narrow the application of such provisions (think Type III). While the California legislature has enacted regulations that seek to reflect a policy against unfair risk-shifting, careful crafting and contract negotiation are imperative to protect subcontractor rights with respect to indemnity protection and obligations.

Legal counsel should always review indemnity language. Properly structured, indemnity can provide reasonable and prudent protection to parties without crossing into the territory of unenforceability.

State of California

CIVIL CODE

Section 2782

2782. (a) Except as provided in Sections 2782.1, 2782.2, 2782.5, and 2782.6, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract and that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable; provided, however, that this section shall not affect the validity of any insurance contract, workers' compensation, or agreement issued by an admitted insurer as defined by the Insurance Code.

(b) (1) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into before January 1, 2013, that purport to impose on the contractor, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable.

(2) Except as provided in Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract with a public agency entered into on or after January 1, 2013, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the public agency from, liability for the active negligence of the public agency are void and unenforceable.

(c) (1) Except as provided in subdivision (d) and Sections 2782.1, 2782.2, and 2782.5, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract entered into on or after January 1, 2013, with the owner of privately owned real property to be improved and as to which the owner is not acting as a contractor or supplier of materials or equipment to the work, that purport to impose on any contractor, subcontractor, or supplier of goods or services, or relieve the owner from, liability are unenforceable to the extent of the active negligence of the owner, including that of its employees.

(2) For purposes of this subdivision, an owner of privately owned real property to be improved includes the owner of any interest therein, other than a mortgage or other interest that is held solely as security for performance of an obligation.

(3) This subdivision shall not apply to a homeowner performing a home improvement project on his or her own single family dwelling.

(d) For all construction contracts, and amendments thereto, entered into after January 1, 2009, for residential construction, as used in Title 7 (commencing with Section 895) of Part 2 of Division 2, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any construction contract, and amendments thereto, that purport to insure or indemnify, including the cost to defend, the builder, as defined in Section 911, or the general contractor or contractor not affiliated with the builder, as described in subdivision (b) of Section 911, by a subcontractor against liability for claims of construction defects are unenforceable to the extent the claims arise out of, pertain to, or relate to the negligence of the builder or contractor or the builder's or contractor's other agents, other servants, or other independent contractors who are directly responsible to the builder, or for defects in design furnished by those persons, or to the extent the claims do not arise out of, pertain to, or relate to the scope of work in the written agreement between the parties. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties. Nothing in this subdivision shall prevent any party from exercising its rights under subdivision (a) of Section 910. This subdivision shall not affect the obligations of an insurance carrier under the holding of Presley Homes, Inc. v. American States Insurance Company (2001) 90 Cal.App.4th 571. Nor shall this subdivision affect the obligations of a builder or subcontractor pursuant to Title 7 (commencing with Section 895) of Part 2 of Division 2.

(e) Subdivision (d) does not prohibit a subcontractor and builder or general contractor from mutually agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not waive or modify the provisions of subdivision (d) subject, however, to paragraphs (1) and (2). A subcontractor shall owe no defense or indemnity obligation to a builder or general contractor for a construction defect claim unless and until the builder or general contractor provides a written tender of the claim, or portion thereof, to the subcontractor which includes all of the information provided to the builder or general contractor by the claimant or claimants, including, but not limited to, information provided pursuant to subdivision (a) of Section 910, relating to claims caused by that subcontractor's scope of work. This written tender shall have the same force and effect as a notice of commencement of a legal proceeding. If a builder or general contractor tenders a claim for construction defects, or a portion thereof, to a subcontractor in the manner specified by this provision, the subcontractor shall elect to perform either of the following, the performance of which shall be deemed to satisfy the subcontractor's defense obligation to the builder or general contractor:

(1) Defend the claim with counsel of its choice, and the subcontractor shall maintain control of the defense for any claim or portion of claim to which the defense obligation applies. If a subcontractor elects to defend under this paragraph, the subcontractor shall provide written notice of the election to the builder or general contractor within a reasonable time period following receipt of the written tender, and in no event later than 90 days following that receipt. Consistent with subdivision (d), the defense by the subcontractor shall be a complete defense of the builder or general contractor of

all claims or portions thereof to the extent alleged to be caused by the subcontractor, including any vicarious liability claims against the builder or general contractor resulting from the subcontractor's scope of work, but not including claims resulting from the scope of work, actions, or omissions of the builder, general contractor, or any other party. Any vicarious liability imposed upon a builder or general contractor for claims caused by the subcontractor electing to defend under this paragraph shall be directly enforceable against the subcontractor by the builder, general contractor, or claimant.

(2) Pay, within 30 days of receipt of an invoice from the builder or general contractor, no more than a reasonable allocated share of the builder's or general contractor's defense fees and costs, on an ongoing basis during the pendency of the claim, subject to reallocation consistent with subdivision (d), and including any amounts reallocated upon final resolution of the claim, either by settlement or judgment. The builder or general contractor shall allocate a share to itself to the extent a claim or claims are alleged to be caused by its work, actions, or omissions, and a share to each subcontractor to the extent a claim or claims are alleged to be caused by the subcontractor's work, actions, or omissions, regardless of whether the builder or general contractor actually tenders the claim to any particular subcontractor, and regardless of whether that subcontractor is participating in the defense. Any amounts not collected from any particular subcontractor may not be collected from any other subcontractor.

(f) Notwithstanding any other provision of law, if a subcontractor fails to timely and adequately perform its obligations under paragraph (1) of subdivision (e), the builder or general contractor shall have the right to pursue a claim against the subcontractor for any resulting compensatory damages, consequential damages, and reasonable attorney's fees. If a subcontractor fails to timely perform its obligations under paragraph (2) of subdivision (e), the builder or general contractor shall have the right to pursue a claim against the subcontractor for any resulting compensatory and consequential damages, as well as for interest on defense and indemnity costs, from the date incurred, at the rate set forth in subdivision (g) of Section 3260, and for the builder's or general contractor's reasonable attorney's fees incurred to recover these amounts. The builder or general contractor shall bear the burden of proof to establish both the subcontractor's failure to perform under either paragraph (1) or (2) of subdivision (e) and any resulting damages. If, upon request by a subcontractor, a builder or general contractor does not reallocate defense fees to subcontractors within 30 days following final resolution of the claim as described above, the subcontractor shall have the right to pursue a claim against the builder or general contractor for any resulting compensatory and consequential damages, as well as for interest on the fees, from the date of final resolution of the claim, at the rate set forth in subdivision (g) of Section 3260, and the subcontractor's reasonable attorney's fees incurred in connection therewith. The subcontractor shall bear the burden of proof to establish both the failure to reallocate the fees and any resulting damages. Nothing in this section shall prohibit the parties from mutually agreeing to reasonable contractual

provisions for damages if any party fails to elect for or perform its obligations as stated in this section.

(g) A builder, general contractor, or subcontractor shall have the right to seek equitable indemnity for any claim governed by this section.

(h) Nothing in this section limits, restricts, or prohibits the right of a builder, general contractor, or subcontractor to seek equitable indemnity against any supplier, design professional, or product manufacturer.

(i) As used in this section, "construction defect" means a violation of the standards set forth in Sections 896 and 897.

(Amended by Stats. 2011, Ch. 707, Sec. 2. (SB 474) Effective January 1, 2012.)

State of California

CIVIL CODE

Section 2782.05

2782.05. (a) Except as provided in subdivision (b), provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any construction contract and amendments thereto entered into on or after January 1, 2013, that purport to insure or indemnify, including the cost to defend, a general contractor, construction manager, or other subcontractor, by a subcontractor against liability for claims of death or bodily injury to persons, injury to property, or any other loss, damage, or expense are void and unenforceable to the extent the claims arise out of, pertain to, or relate to the active negligence or willful misconduct of that general contractor, construction manager, or other subcontractor, or their other agents, other servants, or other independent contractors who are responsible to the general contractor, construction manager, or other subcontractor, or for defects in design furnished by those persons, or to the extent the claims do not arise out of the scope of work of the subcontractor pursuant to the construction contract. This section shall not be waived or modified by contractual agreement, act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties. This section shall not affect the obligations of an insurance carrier under the holding of Presley Homes, Inc. v. American States Insurance Company (2001) 90 Cal.App.4th 571, nor the rights of an insurance carrier under the holding of Buss v. Superior Court (1997) 16 Cal.4th 35.

(b) This section does not apply to:

(1) Contracts for residential construction that are subject to any part of Title 7 (commencing with Section 895) of Part 2 of Division 2.

(2) Direct contracts with a public agency that are governed by subdivision (b) of Section 2782.

(3) Direct contracts with the owner of privately owned real property to be improved that are governed by subdivision (c) of Section 2782.

(4) Any wrap-up insurance policy or program.

(5) A cause of action for breach of contract or warranty that exists independently of an indemnity obligation.

(6) A provision in a construction contract that requires the promisor to purchase or maintain insurance covering the acts or omissions of the promisor, including additional insurance endorsements covering the acts or omissions of the promisor during ongoing and completed operations.

(7) Indemnity provisions contained in loan and financing documents, other than construction contracts to which the contractor and a contracting project owner’s lender are parties.

(8) General agreements of indemnity required by sureties as a condition of execution of bonds for construction contracts.

(9) The benefits and protections provided by the workers' compensation laws.

(10) The benefits or protections provided by the governmental immunity laws.

(11) Provisions that require the purchase of any of the following:

(A) Owners and contractors protective liability insurance.

(B) Railroad protective liability insurance.

(C) Contractors all-risk insurance.

(D) Builders all-risk or named perils property insurance.

(12) Contracts with design professionals.

(13) Any agreement between a promisor and an admitted surety insurer regarding the promisor's obligations as a principal or indemnitor on a bond.

(c) Notwithstanding any choice-of-law rules that would apply the laws of another jurisdiction, the law of California shall apply to every contract to which this section applies.

(d) Any waiver of the provisions of this section is contrary to public policy and is void and unenforceable.

(e) Subdivision (a) does not prohibit a subcontractor and a general contractor or construction manager from mutually agreeing to the timing or immediacy of the defense and provisions for reimbursement of defense fees and costs, so long as that agreement does not waive or modify the provisions of subdivision (a) subject, however, to paragraphs (1) and (2). A subcontractor shall owe no defense or indemnity obligation to a general contractor or construction manager for a claim unless and until the general contractor or construction manager provides a written tender of the claim, or portion thereof, to the subcontractor that includes the information provided by the claimant or claimants relating to claims caused by that subcontractor's scope of work. In addition, the general contractor or construction manager shall provide a written statement regarding how the reasonable allocated share of fees and costs was determined. The written tender shall have the same force and effect as a notice of commencement of a legal proceeding. If a general contractor or construction manager tenders a claim, or portion thereof, to a subcontractor in the manner specified by this subdivision, the subcontractor shall elect to perform either of the following, the performance of which shall be deemed to satisfy the subcontractor's defense obligation to the general contractor or construction manager:

(1) Defend the claim with counsel of its choice, and the subcontractor shall maintain control of the defense for any claim or portion of claim to which the defense obligation applies. If a subcontractor elects to defend under this paragraph, the subcontractor shall provide written notice of the election to the general contractor or construction manager within a reasonable time period following receipt of the written tender, and in no event later than 30 days following that receipt. Consistent with subdivision (a), the defense by the subcontractor shall be a complete defense of the general contractor or construction manager of all claims or portions thereof to the extent alleged to be caused by the subcontractor, including any vicarious liability claims against the general contractor or construction manager resulting from the subcontractor's scope of work,

but not including claims resulting from the scope of work, actions, or omissions of the general contractor or construction manager, or any other party. Any vicarious liability imposed upon a general contractor or construction manager for claims caused by the subcontractor electing to defend under this paragraph shall be directly enforceable against the subcontractor by the general contractor, construction manager, or claimant. All information, documentation, or evidence, if any, relating to a subcontractor's assertion that another party is responsible for the claim shall be provided by that subcontractor to the general contractor or construction manager that tendered the claim.

(2) Pay, within 30 days of receipt of an invoice from the general contractor or construction manager, no more than a reasonable allocated share of the general contractor's or construction manager's defense fees and costs, on an ongoing basis during the pendency of the claim, subject to reallocation consistent with subdivision (a), and including any amounts reallocated upon final resolution of the claim, either by settlement or judgment. The general contractor or construction manager shall allocate a share to itself to the extent a claim or claims are alleged to be caused by its work, actions, or omissions, and a share to each subcontractor to the extent a claim or claims are alleged to be caused by the subcontractor's work, actions, or omissions, regardless of whether the general contractor or construction manager actually tenders the claim to any particular subcontractor, and regardless of whether that subcontractor is participating in the defense. Any amounts not collected from any particular subcontractor may not be collected from any other subcontractor.

(f) Notwithstanding any other provision of law, if a subcontractor fails to timely and adequately perform its obligations under paragraph (1) of subdivision (e), the general contractor or construction manager shall have the right to pursue a claim against the subcontractor for any resulting compensatory damages, consequential damages, and reasonable attorney's fees. If a subcontractor fails to timely perform its obligations under paragraph (2) of subdivision (e), the general contractor or construction manager shall have the right to pursue a claim against the subcontractor for any resulting compensatory damages, interest on defense and indemnity costs, from the date incurred, at the rate set forth in subdivision (g) of Section 3260, consequential damages, and reasonable attorney's fees incurred to recover these amounts. The general contractor or construction manager shall bear the burden of proof to establish both the subcontractor's failure to perform under either paragraph (1) or (2) of subdivision (e) and any resulting damages. If, upon request by a subcontractor, a general contractor or construction manager does not reallocate defense fees to subcontractors within 30 days following final resolution of the claim, the subcontractor shall have the right to pursue a claim against the general contractor or construction manager for any resulting compensatory damages with interest, from the date of final resolution of the claim, at the rate set forth in subdivision (g) of Section 3260. The subcontractor shall bear the burden of proof to establish both the failure to reallocate the fees and any resulting damages. Nothing in this section shall prohibit the parties from mutually agreeing to reasonable contractual provisions for damages if any party fails to elect for or perform its obligations as stated in this section.

(g) For purposes of this section, “construction manager” means a person or entity, other than a public agency or owner of privately owned real property to be improved, who is contracted by a public agency or the owner of privately owned real property to be improved to direct, schedule, or coordinate the work of contractors for a work of improvement, but does not itself perform the work.

(h) For purposes of this section, “general contractor,” in relation to a given subcontractor, means a person who has entered into a construction contract and who has entered into a subcontract with that subcontractor under which the subcontractor agrees to perform a portion of that scope of work. Where a subcontractor has itself subcontracted a portion of its work, that subcontractor, along with its general contractor, shall be considered a general contractor as to its subcontractors.

(i) For purposes of this section, “subcontractor” means a person who has entered into a construction contract either with a contractor to perform a portion of that contractor’s work under a construction contract or with any person to perform a construction contract subject to the direction or control of a general contractor or construction manager.

(j) A general contractor, construction manager, or subcontractor shall have the right to seek equitable indemnity for any claim governed by this section.

(k) Nothing in this section limits, restricts, or prohibits the right of a general contractor, construction manager, or subcontractor to seek equitable indemnity against any supplier, design professional, product manufacturer, or other independent contractor or subcontractor.

(*l*) This section shall not affect the validity of any existing insurance contract or agreement, including, but not limited to, a contract or agreement for workers’ compensation or an agreement issued on or before January 1, 2012, by an admitted insurer, as defined in the Insurance Code.

(m) Nothing in this section shall be construed to affect the obligation, if any, of either a contractor or construction manager to indemnify, including defending or paying the costs to defend, a public agency against any claim arising from the alleged active negligence of the public agency under subdivision (b) of Section 2782 or to indemnify, including defending or paying the costs to defend, an owner of privately owned real property to be improved against any claim arising from the alleged active negligence of the owner under subdivision (c) of Section 2782.

(n) Nothing in this section shall be construed to affect the obligation, if any, of either a contractor or construction manager to provide or maintain insurance covering the acts or omissions of the promisor, including additional insurance endorsements covering the acts or omissions of the promisor during ongoing and completed operations pursuant to a construction contract with a public agency under subdivision (b) of Section 2782 or an owner of privately owned real property to be improved under subdivision (c) of Section 2782.

(Added by Stats. 2011, Ch. 707, Sec. 3. (SB 474) Effective January 1, 2012.)

WHITE PAPER NO. 2
Key Construction Contract Terms
Pay-If-Paid/Pay-When-Paid Provisions in California Construction Contracts

This white paper continues the series of papers discussing key terms in construction contracts. It focuses on pay-if-paid and pay-when-paid provisions in California construction contracts. The paper discusses the typical language of these provisions, the legalities and enforceability of these provisions, and negotiating and contract drafting issues and strategies regarding these provisions and provides key statutory and case law references.

It is imperative that contractors have these provisions drafted and/or reviewed by competent counsel, including to ensure compliance with the law and, ultimately, protect the contractor's rights in the event of a dispute.

I. Introduction

In addition to statutory regulations such as prompt payment statutes, the timing and conditions of payment between parties to a construction contract (particularly between prime contractors and subcontractors) are often governed by the terms and conditions of construction contracts. Embedded within these clauses can often be found "pay if paid" and "pay when paid" provisions. These clauses define whether and when a subcontractor is entitled to payment based on the general contractor's receipt of payment from the project owner and can have serious implications for a subcontractor's right to timely payment.

II. Pay-if-Paid Provisions

A "pay if paid" provision makes the general contractor's obligation to pay the subcontractor conditional upon receipt of payment from the owner. If the owner does not pay the general contractor, the general contractor has no obligation to pay the subcontractor pursuant to the terms of the parties' subcontract agreement. A simple "pay if paid" provision may read like this:

> "Subcontractor shall be entitled to receive payment only if and to the extent that Contractor is paid by Owner for the work performed by Subcontractor."

Understanding the enforceability and legality of "pay if paid" provisions is important. In California, "pay if paid" provisions such as the one above are unenforceable. Courts have deemed them violative of the State's public policy insofar as they attempt to effectuate a waiver the subcontractor's right to be paid for completed work.

The California Supreme Court addressed this issue in *Wm. R. Clarke Corp. v. Safeco Ins. Co. of America* (1997) 15 Cal.4th 882. The court held that such clauses are void, including but not limited to because they conflict with California's mechanic's lien statutes and the

contractor's right to record such a lien as codified in the California Constitution, which are designed to protect subcontractors and suppliers. *See Id.* The Court stated:

> [A] pay if paid provision is void because it violates the public policy that underlies the anti-waiver provisions of the mechanic's lien laws. The Legislature's carefully articulated anti-waiver scheme would amount to little if parties to construction contracts could circumvent it by means of pay if paid provisions having effects indistinguishable from waivers prohibited [by law].

Id. at 890.

III. Pay-when-Paid Provisions

In contrast, a "pay when paid" provision relates to the timing of payment. It allows the prime contractor to delay payment to the subcontractor until payment is received from the owner, but it does not relieve the prime contractor of the ultimate obligation to pay the subcontractor for its work. Further, as is discussed below, it does not provide the prime contract with an unlimited amount of time to make payment either. Rather, under such clauses, payment to the subcontractor must occur within a reasonable time, regardless of whether the owner pays.

A typical "pay when paid" provision may read as follows:

> Upon complete performance of this Subcontract by the Subcontractor and final approval and acceptance of Subcontractor's Work and materials by the Owner, the Contractor will make final payment to the Subcontractor of the balance due to him under this Subcontract within thirty (30) days after full payment for such work and materials has been received by the Contractor from the Owner; provided that Contractor shall make payment to Subcontractor within a reasonable time following proper and timely completion of Subcontractor's work. For purposes of this section, "reasonable time" shall mean the amount of time required for Contractor to obtain payment from Owner for the work performed by Subcontractor, up to and including the amount of time required to submit and prosecute through judgment before the applicable court of law or arbitration provider any claim(s) for payment from Owner relating to Subcontractor's work. Notwithstanding the above, nothing herein shall operate to waive, obviate or otherwise limit in any way Subcontractor's mechanics lien, stop payment notice, or bond rights relating to its work.

As can be seen, this clause typically implies a timing mechanism rather than a condition precedent to payment, which makes it distinguishable from the "pay if paid" provision. As a result, "pay when paid" provisions are generally enforceable, but they may only delay payment for a reasonable time. They cannot be used to indefinitely defer a subcontractor's right to payment. If they do, in fact, result in an indefinite deferral of payment, courts may interpret such overly vague or indefinite pay-when-paid clauses as "pay if paid" in disguise and deem them void and severable from the subcontract. *See e.g. Capitol Steel Fabricators, Inc. v. Mega Construction Co., Inc.* (1997) 58 Cal.App.4th 1049. Such a result may have significant implications with respect to the subcontractor's right to interest and prompt payment penalties.

IV. Drafting and Negotiating Considerations

Drafting and negotiating "pay if paid" and "pay when paid" provisions is important for purposes of protecting contractor rights. The following are some important tips for subcontractors when reviewing, drafting, or negotiating "pay if paid" and "pay when paid" provisions in California construction contracts. These tips help ensure payment protection, compliance with state law, and practical leverage.

1. **Know the Law: "Pay if Paid" Is Unenforceable in California:** Under statutory and case law, such as *Wm. R. Clarke Corp. v. Safeco Ins. Co.* (1997) 15 Cal.4th 882, "pay *if* paid" clauses that make payment contingent on the owner paying the general contractor are void as against public policy.

2. **Disguised "Pay if Paid" Clauses:** Beware of overly broad and/or vague "pay *when* paid" clauses that effectively condition your payment on owner payment without a definite timeline, such that the prime contractor's obligation to pay could drag out indefinitely.

3. **Determine Whether to Negotiate "Pay if Paid" Clauses:** In some cases, it may benefit a knowledgeable subcontractor to allow a blatant "pay if paid" provision to remain in the contract, knowing that it will ultimately be unenforceable. Likewise, in the negotiation context, it may benefit a subcontractor to feign the importance of the provision so as to negotiate towards a more beneficial position somewhere else in the contract. Of course, these negotiating strategies carry risk, and counsel should be consulted.

4. **Always Negotiate a Reasonable Timeframe for Payment:** Ensure "pay *when* paid" clauses include an outside date for payment, such as "within 10 days of invoice." Seek to avoid a situation where a prime contractor can withhold payment so as to allow disputes with the owner (including litigation) to play out, as resolution can take years.

5. **Negotiate Reduction of Retention**: Retention is typically ten percent (10%) on private projects. Try to negotiate a lower retention – e.g. five percent (5 %) – either throughout the project or at a point where work is complete but final payment is pending.

6. **Negotiate Payment Conditions:** Tie your progress payments to the completion of your own work, not general project milestones. Likewise, final payment should be based on your work being complete, not entire project completion. Further, pay attention to the deliverables required as conditions for payment. Track them carefully and ensure complete payment applications are submitted.

7. **Consult Counsel:** Small wording differences (even comma placement) can create, shift, and abrogate risks. Have legal counsel review these clauses carefully to ensure your company is protected.

V. Conclusion

In California, contract provisions that attempt to shift the risk of owner nonpayment to subcontractors via "pay if paid" clauses are unenforceable as a matter of public policy. However, "pay when paid" provisions are generally enforceable if they are interpreted as reasonable timing mechanisms. Clear and precise language surrounding these terms should be used to ensure enforceability and to avoid running afoul of California's strict payment protections, and consideration should be given to negotiating strategies surrounding these provisions.

WHITE PAPER NO. 3
Key Construction Contract Terms
Dispute Resolution Provisions in California Construction Contracts

I. Introduction

Dispute resolution provisions are a critical component of California construction contracts. Given the complexity and potential for conflict in construction projects, parties must address how, where, and by whom disputes will be resolved. Well-drafted dispute resolution clauses can save time, significantly reduce costs, preserve business relationships, and avoid the unpredictability of courtroom litigation.
This white paper discusses why dispute resolution provisions matter, the common types of dispute resolution mechanisms found in construction contracts, and various tips for negotiating and drafting these provisions.

II. Why Dispute Resolution Provisions Matter

Disputes on construction projects are seemingly omnipresent. In the early 2000s, data indicated that in the United States alone, $60,000,000,000 is spent every year on lawsuits, of which the construction industry accounts for nearly $5,000,000,000.[1]

Dispute resolution provisions seek to ameliorate the impact of lengthy and often (extremely) expensive litigation by creating contractual mechanisms designed to offer parties structured approaches to addressing conflict both during the course of construction and following project closeout. Specifically, these provisions (commonly referred to as "ADR provisions") are designed to prevent costly and prolonged litigation, which often take many years to resolve and cost well into the six-figures in attorneys' fees and costs. ADR provisions do so by implementing dispute mechanisms (discussed below) which allow for fast, more streamlined (i.e. efficient) processes for resolving disputes.

Beyond temporal and cost efficiency, these provisions provide certainty and predictability, allowing parties to contract for a binding decision-making process that can afford them certainty as they move through construction projects. Oftentimes, and because the parties themselves are responsible for selecting the decision-makers, the methodologies that can be implemented through the parties' contractual ADR provisions also allow parties to select appropriate decision makers, including people with appropriate expertise in the trade at issue or field of construction generally, as opposed to a judge or jury with little-to-no experience in the field of construction.

Further, certain projects require specific dispute resolution mechanisms under the law, and contracts should account for that.

[1] McCone, Dispute Resolution Strategies for Construction Projects (2002, Mass. Inst. of Tech., Dept. of Civil and Environ. Eng.), pp. 105-106.

III. Common Types of Dispute Resolution (ADR) in Construction Contracts

There are a variety of ADR mechanisms that can be negotiated into construction contracts, each with unique benefits. Some of these alternatives include:

- **Dispute Review Boards**

Dispute Review Boards (or DRBs) combine technical expertise and legal professionals in a single, decision-making board that is often constituted at the outset of a given project and is tasked with following the project throughout its duration.[2] DRBs are comprised of multiple professionals who act as intervenors to resolve disputes during the course of construction projects. Often the boards are comprised of attorneys, tradespeople, architects, engineers, or others with technical expertise relevant to the subject construction project. DRBs are often engaged from the very beginning of the process and are empowered to conduct probing review of disputes.[3] They can be constituted such that they are able to respond promptly to disputes, effectively in real time, and resolve those disputes during the course of a given project.

DRBs have quickly become an industry standard on those types of projects and are gaining popularity among broad cross-sections of the construction industry, including due to their early formation and constant on-site presence during the course of construction.[4] Benefits of DRBs include:

- Their composition includes *both* trade experts and legal experts (as opposed to the traditional post-construction arbitration/litigation/mediation model, which only includes legal experts who are otherwise laypeople in the trades).[5]
- They are often formed at the beginning of the relevant project and as such gain institutional and project-specific knowledge during the course of their work, which can mitigate the effect of "work through dispute" provisions for subs.
- They are generally selected by a cross-section of stakeholders at the outset of the contracting process, thereby creating credibility in the DRB.
- They are generally independent (as opposed to the more traditional architect/owner's representative model.)[6]

While DRBs can increase the parties' administrative project costs, statistics suggest that DRBs can be highly effective, especially for large complex projects. In terms of the results of this technique, "ASCE reports 'that a total of $3.2bn worth of work was completed or

[2] Arocca, Rethinking the Structure of Construction Arbitration: A Dispute Systems Design Approach to the Position of Experts, Harvard Neg. Law Rev., Vol. 27:43, 75-76.
[3] *Id.*
[4] *Id.*
[5] McCone, Dispute Resolution Strategies for Construction Projects (2002, Mass. Inst. of Tech., Dept. of Civil and Environ. Eng.), pp. 105-106.
[6] *See* AIA Form Contract A104-2007 and A201-2007 (identifying architect as the effective intervenor in disputes); *see also* McCone, *supra*, at 105 (discussing independence of DRBs generally).

under construction between 1975 and 1991 using DRB, with 81 disputes heard and non were taken to litigation," with similar construction projects without a DRB suffered from lower levels of performance.[7] While effective on large projects, the process may not be economically efficient on smaller disputes, making an IDM or ombudsman a more palatable option on smaller projects.

- **Initial Decision Maker (IDM)**

The IDM model is common to the standard form AIA contracts. Through this model the parties contractually designate a third party (like an architect) to assess disputes and claims, and render decisions (generally non-binding) relating to the parties' disputes. Benefits of the IDM model include:

- The IDM is generally a party with institutional knowledge of the subject project, and some degree of expertise in the field of construction.
- The IDM is often tasked with following the project and making himself available to the parties in the event of a dispute, thus creating efficiency in the decision-making process.
- The IDM, as a single individual, is often cost effective.

The above notwithstanding, IDMs are generally resisted by contractor parties due to their often conflicted and / or biased nature. For example, the IDM is often the architect on the project and, as such, tends to heavily "rule" against contractors when plan specificity is called into question (e.g. in connection with change orders). Furthermore, to the extent the IDM is the owner-retained architect, bias is obvious as the IDM is effectively paid and serves at the pleasure of the owner.

Where bias or conflict is a concern, the IDM concept can be replaced by an ombudsman who serves in a similar capacity but is a disinterested third party. This option should be considered when evaluating ADR provisions in construction contracts.

- **Mediation**

Mediation is a non-binding process in which a neutral third-party mediator facilitates negotiations between the parties to help them reach a mutually acceptable settlement. In construction contracts, mediation is often required as a first step before arbitration or litigation can proceed, and oftentimes the parties' ability to recover prevailing party attorneys' fees and costs is predicated on their participation in a pre-litigation mediation process.

There are many benefits of mediation, and they include:

[7] McCone, *supra*, pp. 106 (citing Technical Committee on Contracting Practices of the Underground Tech. Research Council. Avoiding and Resolving Disputes During Construction: Successful Practices and Guidelines, 1997).

- A mediated resolution is incredibly time and cost-effective when compared to litigation or arbitration.
- The structure of mediation, including pre-mediation information exchange, can be crafted by the participants.
- Mediation is a confidential process, which facilitates transparency and information exchange.
- Mediation is a private process that is not controlled by the courts, but rather by the parties, and thus parties can consider and factor into resolutions things such as business relationships and other intangibles that are not accounted for in litigation or arbitration.

While mediation does not guarantee a resolution, when properly structured mediation can considerably enhance the likelihood of resolution. This is one reason why California courts and public policy favor mediation and often enforce contractual mediation provisions.

- **Arbitration**

Arbitration is a binding ADR process where a neutral arbitrator (or panel of arbitrators) hears evidence and arguments of the parties and renders a decision that is usually final and enforceable. It is helpful to think about arbitration as essentially "private court." Construction contracts often include mandatory arbitration clauses governed by the Federal Arbitration Act (FAA) or the California Arbitration Act (CAA). California courts generally enforce arbitration provisions unless they are unconscionable or violate public policy.

Arbitration as a dispute resolution mechanism became popularized in the 1980s and early 1990s, and was heralded as a cost effective alternative to expensive litigation. Today, there are many benefits to arbitration, including:

- Arbitration generally provides faster resolution than litigation
- Arbitration decisions are generally binding, final, and non-appealable. The finality of these decisions allows parties to avoid substantial post-award fees and costs, including in the appeals process that is available in litigation.
- Arbitration provisions often allow the parties to select the arbitrator (either via contract or via post-dispute conference, and as a result the arbitrator can be selected with an eye towards the expertise required to resolve the dispute.

Despite these benefits, modern arbitration has become very expensive and the selection process, which is often deferred to the service provider (JAMS or AAA, most commonly), compromises some of the benefits that arbitration offers. As a result, parties should carefully craft arbitration provisions, including with respect to arbitrator selection and consider whether to limit the scope and applicability of arbitration provisions, be it by type or dollar amount in dispute.

IV. Subcontractor-Focused Drafting Tips

Subcontractors should take care when negotiating alternative dispute resolution in their contracts. Drafting tips include:

- Determine whether the various stakeholders will agree to course of construction dispute resolution provisions, such as DRBs, IDMs, or Ombudsman. Depending on the nature of the project, such course of construction dispute resolution systems can be critical to saving time and money, as well as mitigating "work through dispute" provisions.

- Push for Mediation as a Mandatory First Step: Include a defined mediation window to encourage early resolution, and tie recovery of attorneys' fees in litigation to the parties' participation in a pre-litigation mediation session.

- Limit Arbitration to Narrow Issues or Dollar Thresholds: Avoid broad clauses without defined costs, venue, and scope, as well as clauses that call for arbitration panels absent very unique circumstances. Arbitration can be a useful tool, but from a subcontractor's perspective, litigation and the ability to access a jury for case presentation can provide a distinct benefit if litigation becomes necessary.

- Negotiate Venue and Governing Law: Ensure the venue is local (i.e. tied to the subject project location) and California law applies.

- Address Cost-Sharing and Resolution Provider Selection: Clarify who pays and how DRB panels, IDMs, ombudsmen, and arbitrators are chosen. In fact, it is often beneficial to select by name (if possible) those providers and include reference to them by name in the contract documents.

- Provide for Prevailing Party Cost Recovery – Generally Subcontractors engage in the dispute resolution process to collect monies due to them. As such it is imperative to include the right to recover costs including attorney's fees in any proceeding.

- Avoid Tiered Dispute Resolution That Delays Resolution: Limit steps to avoid unnecessary delay or complexity.

V. Conclusion

Dispute resolution provisions are more than boilerplate — they shape the outcome of conflicts before they begin. Subcontractors should review and negotiate these clauses with the same care as payment terms or indemnity language, as they can determine whether the subcontractor can avoid litigation and resolve disputes efficiently and cost effectively or not. A well-structured ADR clause protects your time, money, and rights.

WHITE PAPER NO. 4
A Key to Subcontractor Payment Rights on Public Works
California Public Contract Code Section 9204

I. Introduction

California Public Contract Code ("PCC") Section 9204 establishes a claims resolution process for public works projects, applying to a broad set of contractor claims, including but not limited to claims for time extensions, relief from liquidated damages or back charges, and payments related to unprocessed change orders or work performed outside the original scope of the contract, as well as payments for work actually performed. Moreover, PCC 9204 affirms the right of prime contractors to submit pass-through claims on behalf of subcontractors and permits subcontractors to request that such claims be presented. As discussed in more detail below, while the law does not mandate payment, it requires on all claims that written justification be provided with respect to the basis of payment disputes.

PCC Section 9204 was enacted to address chronic delays in payment to subcontractors and lower-tier contractors on public works projects. It mandates a structured dispute resolution process that public entities must follow, ultimately improving payment flow and protecting the financial interests of contractors and subcontractors engaged in public contracts. Fundamentally, the law's purpose is to ensure timely payment of undisputed claims and to provide a clear mechanism for resolving disputed items.

II. Overview of Public Contract Code Section 9204

PCC Section 9204 is intentionally broad so as to facilitate its stated purpose, which is that, as stated in the law itself:

> The Legislation finds and declares that it is in the best interests of the state and its citizens to ensure that all construction business performed on a public works project in the state that is complete and not in dispute is paid in full and in a timely manner.

PCC Sec. 9204(a).

PCC Section 9204 applies to a broad set of "claims," which are defined by the statute itself. In the context of 9204, "claim" means a demand by a contractor sent by registered or certified mail with return receipt requested for one or more of the following: (i) a time extension, including for relief from delay damages or penalties (e.g. liquidated damages), (ii) payment for work performed by or on behalf of the contractor pursuant to contract, (iii) payment for work performed where such work is not otherwise provided for by contract or to which the claimant is not otherwise entitled (i.e. change or extra work), and (iv) payment of any disputed amount. *See* PCC Sec. 9204(c).

The statute provides a clear set procedures for claimants to assert claims on public works projects, including by establishing various time-measured steps that must be taken, both by the claimant and the public entity, in order evaluate the scale, scope and basis for payment disputes. Through these steps, which are discussed in more detail below, a contractor claimant can obtain the release of the undisputed portion of funds owed to it, while also (i) gaining a clearer understanding of the basis for remaining disputes and (ii) accessing a dispute resolution process that *may* facilitate earlier payment of disputed amounts and allow the claimant to avoid costly and time-consuming litigation.

The process set forth in PCC Section 9204 is discussed in more detail below, and is also set forth in the "Section 9204 Flow Chart" that is attached to this handbook as Form 19 and can be accessed through this link:

- Section 9204 Flow Chart

III. Steps and Timing Under Section 9204

PCC Section 9204 lays out a variety of steps through which a contractor's public works claim must be processed. These steps are as follows:

1. Submittal of Claim: The contractor begins the claims process by submitting a written claim by registered mail or certified mail. It is advisable and, in fact, required under the code, that the contractor (and subcontractor) provide a detailed claim, including back-up documentation to support both the entitlement and quantum aspects of the claim, including to facilitate the agency's review of the claim.

2. Reasonable Review and Response: The public entity must, within a period not to exceed 45 days,[1] conduct a reasonable review of the claim and provide a written response identifying the portions of the claim that are undisputed and those that are disputed.

    a. Where all or any portion of the claim is undisputed, such portion of the claim must be paid to the claimant within 60 days after the public entity issues its written response.

3. Informal Meet and Confer: If the claimant disputes the public agency's position, it may then demand an informal meet and confer conference to settle the disputed portions of the claim, which must be scheduled within 30 days of the agency's receipt of the demand.

4. Written Statement: If after the meet and confer conference, the claim remains unresolved, the public entity must provide a written statement within 10 days after the conference identifying which portions of the claim remain in dispute.

[1] This timeframe may be extended by mutual agreement or in certain circumstances where the agency requires additional layers of governmental approval to respond to the claim.

a. Where all or any portion of the claim is undisputed, such portion of the claim must be paid to the claimant within 60 days after the public entity issues its written statement.

5. Mediation: If the contractor disputes the entity's response, the remaining disputed portion of the claim then proceeds to non-binding mediation, with the parties splitting the costs and agreeing to a mutually agreeable mediator within 10 business days after the agency's written statement of dispute.

    a. Mediation is broadly defined under the code and includes a variety of alternative dispute resolution methods. For a more detailed discussion regarding such methods, please see White Paper No. 3 which can be accessed through this link: White Paper No. 3.

6. In the event that mediation is unsuccessful, the parties must proceed to resolve their remaining dispute pursuant to otherwise applicable contract(s) or code sections.

7. Notably, the public agency's failure to respond or otherwise meet the requirements of the code section shall be deemed a rejection of the entire claim.

IV. Importance for Subcontractors

Although Section 9204 applies to direct contractors, subcontractors benefit significantly by understanding the procedural protections it offers. A well-informed subcontractor can insist that prime contractors invoke Section 9204's procedures and can plan cash flow and legal action timelines accordingly. This awareness also improves leverage in payment negotiations.

More specifically, the code provides protection for subcontractors in the form of a subsection that specifically provides that, where the subcontractor lacks legal standing to assert a claim against the public agency (e.g. privity of contract), the prime contractor can pass through the subcontractor's claim. Following such demand, the prime contractor has 45 days to notify the subcontractor as to whether the claim has been presented and, if not, provide the subcontractor with a written statement of the reasons for not having done so. *See* Pub. Contract Code 9204(d)(5).

Furthermore, amounts not paid timely bear an interest rate of 7% per annum and, with very limited exceptions, the protections of PCC Section 9204 are not waivable by contract or otherwise between the parties.

PCC Section 9204 encourages timely dispute resolution and provides a clear path for escalation, deterring unjustified delays. The mandatory payment of undisputed amounts and structured timelines put pressure on public entities and prime contractors to efficiently resolve payment issues and identify those portions of claims that are undisputed. For subcontractors, this increases the likelihood of timely payments.

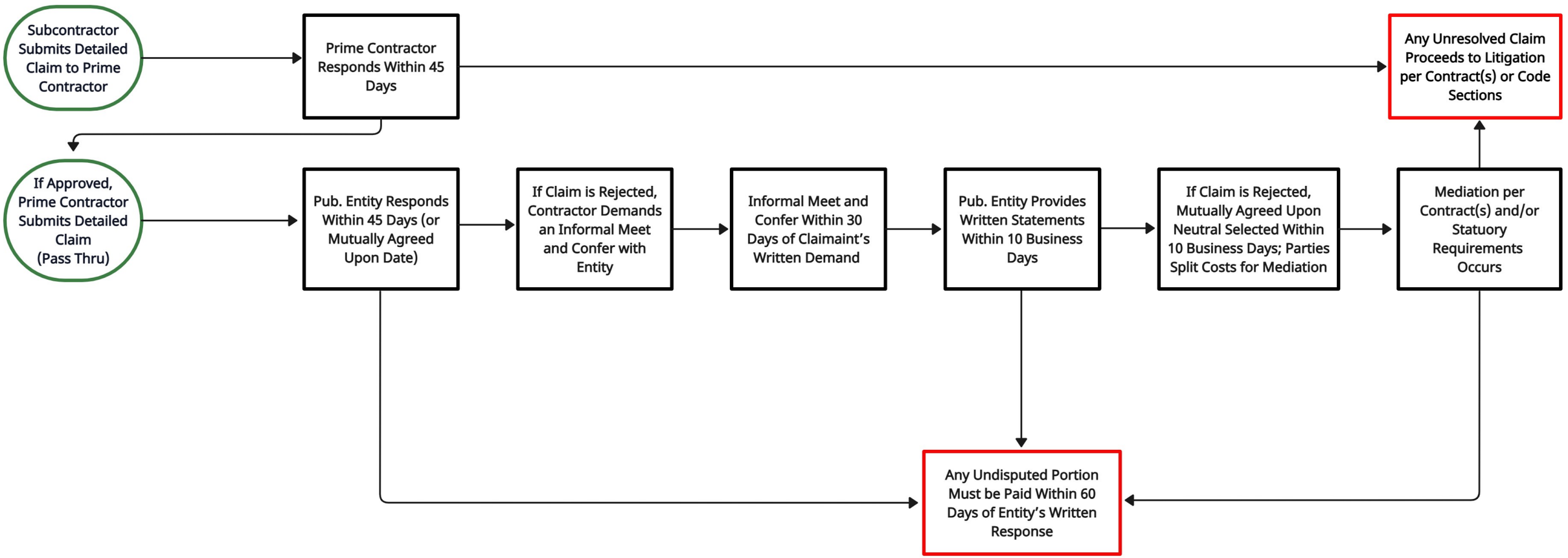
V. Conclusion

PCC Section 9204 plays a crucial role in leveling the playing field for contractors and subcontractors on public projects. By mandating dispute timelines, facilitating mediation, and ensuring prompt payment of undisputed claims, it strengthens financial protections for downstream subcontractors that would otherwise be vulnerable to questionable (or wrongful) withholding..

Special mention should be made of the instrumental role that NECA and its lobbying arm played in the creation and passage of PCC Section 9204. NECA remains at the forefront of protecting the electrical contracting community and is proud of the work done on this bill.

FORM 19

PUBLIC CONTRACT CODE SECTION 9204 FLOWCHART



State of California

PUBLIC CONTRACT CODE

Section 9204

9204. (a) The Legislature finds and declares that it is in the best interests of the state and its citizens to ensure that all construction business performed on a public works project in the state that is complete and not in dispute is paid in full and in a timely manner.

(b) Notwithstanding any other law, including, but not limited to, Article 7.1 (commencing with Section 10240) of Chapter 1 of Part 2, Chapter 10 (commencing with Section 19100) of Part 2, and Article 1.5 (commencing with Section 20104) of Chapter 1 of Part 3, this section shall apply to any claim by a contractor in connection with a public works project.

(c) For purposes of this section:

(1) "Claim" means a separate demand by a contractor sent by registered mail or certified mail with return receipt requested, for one or more of the following:

(A) A time extension, including, without limitation, for relief from damages or penalties for delay assessed by a public entity under a contract for a public works project.

(B) Payment by the public entity of money or damages arising from work done by, or on behalf of, the contractor pursuant to the contract for a public works project and payment for which is not otherwise expressly provided or to which the claimant is not otherwise entitled.

(C) Payment of an amount that is disputed by the public entity.

(2) "Contractor" means any type of contractor within the meaning of Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code who has entered into a direct contract with a public entity for a public works project.

(3) (A) "Public entity" means, without limitation, except as provided in subparagraph (B), a state agency, department, office, division, bureau, board, or commission, the California State University, the University of California, a city, including a charter city, county, including a charter county, city and county, including a charter city and county, district, special district, public authority, political subdivision, public corporation, or nonprofit transit corporation wholly owned by a public agency and formed to carry out the purposes of the public agency.

(B) "Public entity" shall not include the following:

(i) The Department of Water Resources as to any project under the jurisdiction of that department.

(ii) The Department of Transportation as to any project under the jurisdiction of that department.

(iii) The Department of Parks and Recreation as to any project under the jurisdiction of that department.

(iv) The Department of Corrections and Rehabilitation with respect to any project under its jurisdiction pursuant to Chapter 11 (commencing with Section 7000) of Title 7 of Part 3 of the Penal Code.

(v) The Military Department as to any project under the jurisdiction of that department.

(vi) The Department of General Services as to all other projects.

(vii) The High-Speed Rail Authority.

(4) "Public works project" means the erection, construction, alteration, repair, or improvement of any public structure, building, road, or other public improvement of any kind.

(5) "Subcontractor" means any type of contractor within the meaning of Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code who either is in direct contract with a contractor or is a lower tier subcontractor.

(d) (1) (A) Upon receipt of a claim pursuant to this section, the public entity to which the claim applies shall conduct a reasonable review of the claim and, within a period not to exceed 45 days, shall provide the claimant a written statement identifying what portion of the claim is disputed and what portion is undisputed. Upon receipt of a claim, a public entity and a contractor may, by mutual agreement, extend the time period provided in this subdivision.

(B) The claimant shall furnish reasonable documentation to support the claim.

(C) If the public entity needs approval from its governing body to provide the claimant a written statement identifying the disputed portion and the undisputed portion of the claim, and the governing body does not meet within the 45 days or within the mutually agreed to extension of time following receipt of a claim sent by registered mail or certified mail, return receipt requested, the public entity shall have up to three days following the next duly publicly noticed meeting of the governing body after the 45-day period, or extension, expires to provide the claimant a written statement identifying the disputed portion and the undisputed portion.

(D) Any payment due on an undisputed portion of the claim shall be processed and made within 60 days after the public entity issues its written statement. If the public entity fails to issue a written statement, paragraph (3) shall apply.

(2) (A) If the claimant disputes the public entity's written response, or if the public entity fails to respond to a claim issued pursuant to this section within the time prescribed, the claimant may demand in writing an informal conference to meet and confer for settlement of the issues in dispute. Upon receipt of a demand in writing sent by registered mail or certified mail, return receipt requested, the public entity shall schedule a meet and confer conference within 30 days for settlement of the dispute.

(B) Within 10 business days following the conclusion of the meet and confer conference, if the claim or any portion of the claim remains in dispute, the public entity shall provide the claimant a written statement identifying the portion of the claim that remains in dispute and the portion that is undisputed. Any payment due on

an undisputed portion of the claim shall be processed and made within 60 days after the public entity issues its written statement. Any disputed portion of the claim, as identified by the contractor in writing, shall be submitted to nonbinding mediation, with the public entity and the claimant sharing the associated costs equally. The public entity and claimant shall mutually agree to a mediator within 10 business days after the disputed portion of the claim has been identified in writing. If the parties cannot agree upon a mediator, each party shall select a mediator and those mediators shall select a qualified neutral third party to mediate with regard to the disputed portion of the claim. Each party shall bear the fees and costs charged by its respective mediator in connection with the selection of the neutral mediator. If mediation is unsuccessful, the parts of the claim remaining in dispute shall be subject to applicable procedures outside this section.

(C) For purposes of this section, mediation includes any nonbinding process, including, but not limited to, neutral evaluation or a dispute review board, in which an independent third party or board assists the parties in dispute resolution through negotiation or by issuance of an evaluation. Any mediation utilized shall conform to the timeframes in this section.

(D) Unless otherwise agreed to by the public entity and the contractor in writing, the mediation conducted pursuant to this section shall excuse any further obligation under Section 20104.4 to mediate after litigation has been commenced.

(E) This section does not preclude a public entity from requiring arbitration of disputes under private arbitration or the Public Works Contract Arbitration Program, if mediation under this section does not resolve the parties' dispute.

(3) Failure by the public entity to respond to a claim from a contractor within the time periods described in this subdivision or to otherwise meet the time requirements of this section shall result in the claim being deemed rejected in its entirety. A claim that is denied by reason of the public entity's failure to have responded to a claim, or its failure to otherwise meet the time requirements of this section, shall not constitute an adverse finding with regard to the merits of the claim or the responsibility or qualifications of the claimant.

(4) Amounts not paid in a timely manner as required by this section shall bear interest at 7 percent per annum.

(5) If a subcontractor or a lower tier subcontractor lacks legal standing to assert a claim against a public entity because privity of contract does not exist, the contractor may present to the public entity a claim on behalf of a subcontractor or lower tier subcontractor. A subcontractor may request in writing, either on their own behalf or on behalf of a lower tier subcontractor, that the contractor present a claim for work which was performed by the subcontractor or by a lower tier subcontractor on behalf of the subcontractor. The subcontractor requesting that the claim be presented to the public entity shall furnish reasonable documentation to support the claim. Within 45 days of receipt of this written request, the contractor shall notify the subcontractor in writing as to whether the contractor presented the claim to the public entity and, if the original contractor did not present the claim, provide the subcontractor with a statement of the reasons for not having done so.

(e) The text of this section or a summary of it shall be set forth in the plans or specifications for any public works project that may give rise to a claim under this section.

(f) A waiver of the rights granted by this section is void and contrary to public policy, provided, however, that (1) upon receipt of a claim, the parties may mutually agree to waive, in writing, mediation and proceed directly to the commencement of a civil action or binding arbitration, as applicable; and (2) a public entity may prescribe reasonable change order, claim, and dispute resolution procedures and requirements in addition to the provisions of this section, so long as the contractual provisions do not conflict with or otherwise impair the timeframes and procedures set forth in this section.

(g) This section applies to contracts entered into on or after January 1, 2017.

(h) Nothing in this section shall impose liability upon a public entity that makes loans or grants available through a competitive application process, for the failure of an awardee to meet its contractual obligations.

(i) This section shall remain in effect only until January 1, 2027, and as of that date is repealed, unless a later enacted statute that is enacted before January 1, 2027, deletes or extends that date.

(Amended by Stats. 2019, Ch. 489, Sec. 1. (AB 456) Effective January 1, 2020. Repealed as of January 1, 2027, by its own provisions.)

WHITE PAPER NO. 5
Retention on Private and Public Works: Is There a Difference?

I. Introduction – What is retention?

Retention is a mechanism in construction contracts used to ensure satisfactory project performance and completion. Effectively, contractual retention provisions allow upstream stakeholders (i.e. owners to prime contractors and prime contractors to subcontractors) to withhold a certain percentage of funds from each progress payment so as to ensure that the upstream party is financially protected in the event of defective work or project abandonment. In such a case, retention funds can be used to remediate and/or complete the downstream party's work.

In California public works projects, retention is governed by a detailed statutory framework designed to protect contractors, subcontractors, and public entities alike. Moreover, that statutory framework also governs the timely release of retention to downstream parties so as to ensure that those parties are properly and timely paid for their work.

Retention on private construction projects in California is subject to less rigid statutory limitations than those in place for public works; however, prompt payment requirements apply to private works retention and are designed to protect subcontractors and ensure the timely flow of funds throughout the construction payment chain. Moreover, and as discussed below, while there is no present limitation on the amount that may be retained on private works, legislation proposing a limitation is currently being considered.

This white paper outlines the applicable laws, relevant authorities, differences and practical considerations related to retention on California public and private construction projects.

II. Definition and Purpose of Retention

Retention refers to a specified amount (typically in percentage and articulated in the parties' contract) of progress payments withheld by the project owner from the prime contractor (and typically by prime contractors from subcontractors in corresponding amounts) as security to ensure proper performance of work and remedy of defects. For example, if a subcontractor is owed $100,000 for a work performed during a progress pay period, the subcontract may allow the prime contractor withhold 5% of that amount as "retention," in which case the subcontractor would receive $95,000 and the prime contractor would withhold the remaining $5,000 as retention pursuant to the terms of the parties' subcontract.

On both private and public works projects, retention serves as financial leverage for the benefit of the owner and/or prime contractor to encourage timely and proper completion of the contract and to ensure correction of any deficiencies discovered during or shortly after the work is complete. Oftentimes, however, retention is also weaponized against subcontractors as leverage in post-

project negotiation surrounding outstanding, unapproved change orders and/or alleged project deficiencies. As a result, it is critical that subcontractors understand their rights relating to retention.

III. Retention Laws and Statutory Framework

a. Public Works Retention

i. Limits On Retention (Five percent (5%))

Retention on California public works projects is governed primarily by the Public Contract Code (PCC) and the Civil Code. Public Contract Code Section 7201 sets a maximum limit on retention amounts and specifies that with very limited exception, ***retention on a public works project may not exceed 5% of any payment*** for contracts entered into on or after January 1, 2012. However, a public entity may retain more than 5% if it makes a finding, during a properly noticed and public meeting, that a higher retention is necessary due to the project's complexity. Any finding by a public entity that a project is substantially complex shall include a description of the specific project and why it is a unique project that is not regularly, customarily, or routinely performed by the agency or licensed contractors. *See* Pub. Contract Code 7201(b)(5).

With respect to subcontracts, the code specifies that:

> In a contract between the original contractor and a subcontractor, and in a contract between a subcontractor and any subcontractor thereunder, the percentage of the retention proceeds withheld shall not exceed the percentage specified in the contract between the public entity and the original contractor.

Pub. Contract Code 7201(b)(1). Thus, the retention limits established by the prime contract also establish corresponding limits for any subcontractor agreement between the prime and sub, as well as for all second-tier subcontractors.

ii. Prompt Payment on Retention

In addition to the limitations established by PCC 7201, the public contract code also establishes strict prompt payment requirements and penalties in the event that retention is not timely released. *See* Pub. Contract Code 7107. Public Contract Code Section 7107 governs prompt release of retention and specifies that the public entity/awarding body must release undisputed retention amounts within 60 days after the date of completion of the project. *See* Pub. Contract Code 7107(c). Contractors must in turn release retention to their subcontractors within 7 days of receiving retention payment from the public entity. *Id.* at 7107(d); *see also* Cal. Civ. Code Sec. 8814 (requiring prime contractors to release retention to subcontractors within 7 days after receiving payment from the owner, promoting equitable distribution of project funds).

As indicated elsewhere in this Handbook, completion means any of the following:

- The occupation, beneficial use, and enjoyment of a work of improvement, excluding any operation only for testing, startup, or commissioning, by the public agency, or its agent, accompanied by cessation of labor on the work of improvement.
- The acceptance by the public agency, or its agent, of the work of improvement.
- After the commencement of a work of improvement, a cessation of labor on the work of improvement for a continuous period of 100 days or more, due to factors beyond the control of the contractor.
- After the commencement of a work of improvement, a cessation of labor on the work of improvement for a continuous period of 30 days or more, if the public agency files for record a notice of cessation or a notice of completion.

See Pub. Contract Code 7107(c).

The Court in *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.* articulated the history and purpose of the prompt payment statutes, underscoring their import to the free flow of hard-earned money**:**

> Recognizing the industrywide problems slow payments could generate, the Legislature entered the scene in 1990. That year, it enacted the first in a series of laws that supply payees a statutory means for enforcing their right to prompt payment. (Stats. 1990, ch. 1536, § 1, pp. 7214–7215.) The statutory scheme the Legislature erected thereafter imposes comprehensive deadlines for both progress and retention payments from owners to direct contractors, and in turn from direct contractors to their subcontractors, for both public and private projects. (Civ. Code, §§ 8800, 8802, 8812, 8814; Pub. Contract Code, §§ 7107, 10262.5; Bus. & Prof. Code, § 7108.5.) The deadlines are enforced by statutory penalties, typically 2 percent of the unpaid amount per month, and by fee-shifting provisions that make the losing party responsible for attorney fees if a lawsuit is required to enforce the right to payment. (Civ. Code, §§ 8800, subd. (c), 8802, subd. (c), 8818; Pub. Contract Code, §§ 7107, subd. (f), 10262.5, subd. (a); Bus. & Prof. Code, § 7108.5, subds. (b), (c).) ***These statutes are intended to discourage owners and direct contractors from withholding monies owed as a way of granting themselves interest-free loans.*** (Sen. Com. on Judiciary, Analysis of Assem.

> Bill No. 1608 (1991–1992 Reg. Sess.) as amended May 15, 1991, pp. 2–3; Sen. Rules Com., Off. of Sen. Floor Analyses, 3d reading analysis of Assem. Bill No. 1702 (1991–1992 Reg. Sess.) as amended Aug. 20, 1992, pp. 1–2.)

United Riggers & Erectors, Inc. v. Coast Iron & Steel Co. 4 Cal. 5th 1082 (2018); *see also Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.* 179 Cal.App.4th 1401 (2009) (disapproved in part by *United Riggers & Erectors, Inc.*)

However, as the Court noted, the right to retention and to prompt payment penalties is not, as evidenced by the statutory framework itself, unconditional. In the event of a dispute between the public entity and the original contractor, the public entity may withhold from the final payment an amount not to exceed 150 percent of the disputed amount. Likewise, in the event of a bona fide dispute, the general contractor may withhold an amount not to exceed 150 percent of the estimated value of the disputed amount from the subcontractor. *See Id.* at 7107(e).

If a public entity or general contractor wrongfully withholds retention in violation of the statute, the contractor or subcontractor, as the case may be, is entitled to a 2% monthly interest penalty on the amount withheld and, in the event of litigation regarding the unreleased retention, the prevailing party is entitled to recover its attorneys' fees and costs, which can be significant.

- A link to the prompt payment matrix also included in the Appendix of Forms to the Handbook can be found here: **FORM 7**
- A link to the form demand letter relating to retention on public works projects also included in the Appendix of Forms to the Handbook can be found here: **FORM 15**

b. Private Works (No Statutory Limit!)

With respect to private works projects, the driving statutory framework for retention and the prompt payment of retention is the prompt payment framework. Presently, and unlike public works, ***there is no explicit percentage cap in the Civil Code for private projects;*** however, general industry practice is to limit retention to between 5% or 10% on private projects and typically 10%. Since there are no statutory limitations, retention amounts and the procedures and triggers for the release of retention must be clearly defined and stated in the parties' contract and/or subcontract.

That being said, California Civil Code Sections 8810–8822 govern prompt payment and retention on private construction projects. Civil Code 8812 requires an owner who withholds retention to, within 45 days after completion of the work of improvement, pay the retention to the contractor. As is the case in the public works space, if there is a good faith dispute between the owner and direct contractor as to a retention payment due, the owner may withhold from final payment an amount not in excess of 150 percent of the disputed amount. *See* Cal. Civ. Code 8812(c). In turn, Civil Code Section 8814 requires a direct contractor to pay retention to a subcontractor within 10

days after the owner has paid the contractor. Similarly, subcontractors must pay retention to sub-subcontractors within 10 days after receiving retention from upstream.

In the event of disputed work, the prime or subcontractor may prosecute remedial work and give notice that such disputed work has been completed in accordance with the parties' contract. *See* Cal. Civ. Code 8816. Following issuance of such notice, the owner or direct contractor must, within 10 days, give notice advising the notifying party of the acceptance or rejection of the disputed work. For any portion of the corrected work that has been accepted, the owner or direct contractor must pay within 10 days of acceptance the portion of the retention relating to the disputed work. *Id.* at 8816(c).

Civil Code Section 8818 prescribes the penalties relating to the upstream parties' failure to timely pay retention. If a contractor or owner wrongfully withholds retention, the unpaid party is entitled to interest at 2% per month on the improperly withheld amount, in addition to possible attorney fees for enforcing payment.

- A link to the prompt payment matrix also included in the Appendix of Forms to the Handbook can be found here: **FORM 7**
- A link to the form demand letter relating to retention on public works projects also included in the Appendix of Forms to the Handbook can be found here: **FORM 16**

IV. Contract Drafting Advice

a. Public Works

Public Works contracts should be explicit when addressing retention to ensure compliance with all statutory requirements. Unless clearly justified in a public meeting, the retention required to be withheld should not exceed 5% of any payment. The contract's language regarding retention release terms should be clear and defined, including explicit references to Public Contract Code Sections 7201 and 7101, and define "completion" in accordance with California law (see Civil Code Section 9200 et seq.). Further, to enforce compliance and minimize cascading delays and payment disputes, the contract should require contractors to comply with statutory retention release timelines.

In addition to the above, prerequisites for the release of retention should be clearly stated and unambiguous, including but not limited to with respect to deliverables and project closeout requirements (e.g. delivery of manuals, warranties, etc.) are required in order to trigger final payment and issuance of retention. By making these requirements clear, subcontractors can properly prepare their final payment application and avoid a "good faith dispute" under the prompt payment laws, which may otherwise delay the release of their retention.

b. Private Works

While Private Works contracts are not regulated in the same manner as Public Works, they should clearly specify terms of retention, including the percentage and timeline for release, define completion criteria with specific milestones which trigger retention release, and include lien waiver requirements to ensure subcontractors provide proper waivers tied to the retention payments. Private Works contract terms should align with Civil Code Sections 8814 and 8818, and should clearly define 'completion,' whether through a certificate of occupancy, substantial completion, or another milestone. As mentioned above in connection with public works, prerequisites for the release of retention should be clearly stated and unambiguous, including but not limited to with respect to deliverables and project closeout requirements (e.g. delivery of manuals, warranties, etc.) are required in order to trigger final payment and issuance of retention. By making these requirements clear, subcontractors can properly prepare their final payment application and avoid a "good faith dispute" under the prompt payment laws, which may otherwise delay the release of their retention.

V. Conclusion – How Retention Differs on Public and Private Projects

Retention practices on public construction projects in California are heavily regulated to balance the interests of public agencies, contractors, and subcontractors. Strict limitations on retention percentages and mandatory prompt payment laws aim to ensure fair treatment and timely compensation. It is critical for subcontractors to understand these limitations and the rights afforded to them by the legislative framework created for, in large part, their benefit. Compliance with these laws not only avoids penalties but promotes trust and efficiency across the construction chain.

Retention on private works is less rigid from a statutory standpoint. Fortunately, the existing scheme, through prompt payment statutes, emphasizes fair and timely payment practices. While the current law does not impose an explicit cap, it mandates prompt release of retention and imposes significant penalties for wrongful withholding. Moreover, the lack of statutory framework applicable to private works underscores the importance of precise and clear contract drafting, including in regard to retention and the release of such funds.

FORM 7
PROMPT PAYMENT MATRIX

OUTLINE OF CALIFORNIA PROMPT PAYMENT STATUTES

SCOPE	TYPE OF PAYMENT	PAYOR	PAYEE	TIME FOR PAYMENT	PENALTY & LEGAL FEES	BACKCHARGE LIMITS	EFFECTIVE DATE
Private Works Civ Code § 8800	Progress Payments	Owner	Direct Contractor	30 days after receipt of contractor's request for payment	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of disputed amount	July 1, 2012
Private Works + Civ. Code § 8812-8818	Retention **	Owner ---------- Original Contractor	Original Contractor ---------- Subcontractor	45 days after date of completion ---------- 10 days after receipt from owner	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of disputed amount	July 1, 2012
Private & Public Works Bus & Prof Code §7108.5 and Public Cont. Code § 10262.5	Progress Payment	Any prime contractor or subcontractor	Subcontractors (all tiers)	7days ++ from receipt of funds by contractor *	2% per month in addition to interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	January 1, 2012
Public Works Pub Cont. Code §10261.5 and § 10853	Progress Payments	State agency ---------- State University	Contractor ---------- Contractor	30 days ---------- 39 days	10 % per annum; starts earlier if improper rejection by state agency or state university	None express; implied duty of good faith	January 1, 1991 ---------- January 1, 1993
Public Works Pub Cont. Code §20104.50	Progress Payment	Local government agencies	Contractors	30 days after receipt of contractor's request for payment	10 % per annum; starts earlier if improper rejection by local agency	None express; implied duty of good faith	January 1, 1991
Public Works Civ Code § 3320	Progress and retention	Any public entity	Design professionals	Progress: 30 days from demand Retention: 45 days from demand	1-½ % per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	Contracts entered into after January 1, 1996
Public Works + Pub. Cont. Code §7107	Retention	Any public entity ---------- Original Contractor	Original Contractor ---------- Subcontractor	60 days after date of completion ---------- 7 days from receipt of funds by original contractor	2% per month in lieu of interest Attorneys' fees and costs to prevailing party	No more than 150% of amount disputed in good faith	Contracts entered into after January 1, 1993
Public Works Civ Code 3321	All payments	Prime Design Professional	Subconsultant design professional	15 days	1-1 1/2 % interest per month in lieu of interest Attorneys' fees to prevailing party	No more than 150% of disputed amount	July 1, 2012

\+ Waiver of any provision prohibited

++ 21 days for public utilities contracts, effective July 1, 2012 Civil Code § 8802

* May be modified by written agreement

** Does not apply to retentions withheld by lender per construction lo agreement

*** Public Contract Code § 10853, effective January 1, 1993

FORM 15

RETENTION RELEASE LETTER (PUBLIC WORK)

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Retention Release for **ABC Construction** for **Any City Public Project**

Dear XXXXXXXXX:

We are writing to demand immediate release of our retention on the **[Name of Project]**. The retention is now overdue and should be paid.

The purpose of retention is to ensure a subcontractor completes its work, and to provide security from lower tier liens in the event the subcontractor has not paid its suppliers. *Yasin v. Solis*, 184 Cal. App. 4th 524, 534 (2010). It is important to note that retention constitutes contract funds due for work already performed. Under the circumstances on this Project, there is no basis to continue to withhold retention. ABC's work is complete, and ABC has provided or will provide releases from its vendors if required.

The Legislature has enacted laws to make sure that subcontractors are promptly paid their retention. Under California law, unpaid retention is due the prime contractor within 60 days of the completion of the work. Completion is defined at a minimum as; 1) completion of the work of improvement or 2) the owner has occupied and is using the property or 3) there has been a cessation of labor. California law exempts testing, startup or commissioning. The above Project is complete – and retention is due – even though testing, startup or commissioning remain to be performed. See Cal. Pub. Contracts Code § 7107.

You, as prime contractor, are required to pay the subcontractor its portion of the retention within 7 days of receipt. Even if there is disagreement as to some aspect of ABC's performance of its obligations, retention is due. A prime contractor is limited to withholding only 150% of the good faith estimate of the amount in dispute. Cal. Pub. Contracts Code § 7107(e).

It is also important to note that a dispute over ABC's proposed change orders, other requests for compensation, or requests for time extensions are not the type of disputes that permit a prime contractor to withhold retention. Doing so would not serve the purpose of retention -- to make sure a subcontractor completes its work, and to provide security from lower tier liens. The retention laws are to ensure timely payment of the retention as soon as the purpose has been served. *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co*., 4 Cal. 5th 1096 (2018) (discussing purpose of prompt payment law).

California law also provides additional remedies for subcontractors when retention is not timely paid. ABC is entitled to 2% per month of the value of the unpaid retention as a penalty when

not paid timely. The law also provides for attorney's fees incurred in an enforcement proceeding.

The express and implied provisions of our subcontract, including the pass-through provisions, make it incumbent upon the prime contractor to take all steps necessary for the prompt release of retention so that the subcontractors can be paid. We do not know if the owner will continue to withhold your retention. However, to the extent that your retention is being withheld for a reason unrelated to ABC's work, it is not appropriate for you to continue to withhold ABC's retention. ABC is entitled to be paid its retention even if the work of other subcontractors (or your own work) has resulted in the owner claiming a dispute. As the party that is ultimately owed the retention (for work performed long ago), we are entitled to, and do hereby claim, a constructive trust over any prompt payment penalties that are owed by the owner for the late payment.

The road to completion is behind us. Our work is done. The owner has received the benefits of our labor. It is no longer appropriate to withhold retention funds for work performed long ago. We therefore respectfully request that all retention withheld be immediately released. If any funds continue to be retained after seven calendar days from the date of this letter, we ask for an immediate accounting of your good faith estimate of the funds withheld in the dispute.

Sincerely,

ABC Electrical

John Doe
Project Manager

cc/ Project Executive

FORM 16

RETENTION RELEASE LETTER (PRIVATE WORK)

May 1, 2025 (Insert date of letter)

Mr/Ms John Doe
Acme Construction Company
111111 Main Street
Anywhere CA 99999

RE: Retention Release for **ABC Electrical** for **Any GC Private Project**

Dear XXXXXXXXX:

We are writing to demand immediate release of our retention on the **[Name of Project]**. The retention is now overdue and should be paid.

The purpose of retention is to ensure a subcontractor completes its work, and to provide security from lower tier liens in the event the subcontractor has not paid its suppliers. *Yasin v. Solis*, 184 Cal. App. 4th 524, 534 (2010). It is important to note that retention constitutes contract funds due for work already performed. Under the circumstances on this Project, there is no basis to continue to withhold retention. ABC's work is complete, and ABC has provided or will provide releases from its vendors if required.

The Legislature has enacted laws to make sure that subcontractors are promptly paid their retention. Under California law, unpaid retention is due the direct contractor within 45 days of the completion of the work. See Cal. Civil Code § 8812. Completion is defined at a minimum as; 1) completion of the work of improvement or 2) the owner has occupied and is using the property or 3) there has been a cessation of labor. See Cal. Civil Code § 8180. You, ACME as the direct contractor, in turn, are required to pay to ABC our portion of the retention within 10 days of receipt. Cal. Civil Code § 8814. If there is a disagreement as to some aspect of the performance of our obligations, our retention is still due. The direct contractor is limited to withholding only 150% of the good faith estimate of the amount in dispute. Cal. Civil Code § 8814.

It is also important to note that a dispute over ABC's proposed change orders, other requests for compensation, or requests for time extensions are not the type of disputes that permit a direct contractor to withhold retention. Doing so would not serve the purpose of retention -- to make sure a subcontractor completes its work, and to provide security from lower tier liens. The retention laws are to ensure timely payment of the retention as soon as the purpose has been served. *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co*., 4 Cal. 5th 1096 (2018) (discussing purpose of prompt payment law).

The prompt payment statutes provide additional remedies for subcontractors when retention is not timely paid. ABC is entitled to 2% per month of unpaid retention as a penalty when not paid timely. The law also provides for attorney fees incurred in an enforcement proceeding. Cal. Civil Code § 8818.

The express and implied provisions of our subcontract make it incumbent upon the direct contractor to take the steps necessary for the prompt release of retention so that we can be paid. We do not know if the owner will continue to withhold your retention. However, to the extent that your retention is being withheld for a reason unrelated to ABC's work, it is not appropriate for you to continue to withhold ABC's retention. ABC is entitled to be paid its retention even if the work of other subcontractors (or your own work) has resulted in the owner claiming a dispute. As the party that is ultimately owed the retention (for work performed long ago), we are entitled to, and do hereby claim, a constructive trust over any prompt payment penalties that are owed by the owner for the late payment.

The road to completion is behind us. Our work is done. The owner has received the benefits of our labor. It is no longer appropriate to withhold retention funds for work performed long ago. We therefore respectfully request that all retention withheld be immediately released. If any funds continue to be retained seven calendar days from the date of this letter, we ask for an immediate accounting of your good faith estimate of the funds withheld in the dispute.

Sincerely,

ABC Electrical

John Doe
Project Manager

cc/ Project Executive