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## California Prompt-Payment Statutes

*Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*

### **Summary**

The Court in *Martin Brothers Construction v. Thompson Pacific Construction* concluded that Public Contract Code section 7107(e) applies to *any good faith dispute* between a general contractor and subcontractor. The Court ruled that the general contractor could withhold 150 percent of a disputed claim with its subcontractor without violating the prompt-payment statutes. The Court rejected the subcontractor's argument that the prompt-payment rules only apply to disputes arising out of the original scope of work and not to disputes over change orders. Additionally, the Court ruled that parties to a construction contract could contractually "opt out" of the timing requirements for progress payments as contained in Business and Professions Code section 7108.5.

### **Practical Application**

The Court's decision makes it clear that disputes related to change orders or other additional work performed by a subcontractor on a public works project are covered by Public Contract Code section 7107. Furthermore, general contractors will be permitted to withhold retention payments to a subcontractor provided that the general contractor does not withhold more than 150 percent of the disputed claim. In this economy, when budgets and funds are stretched, the Court's ruling will give general contractors more incentive to withhold retention payments if there is a good faith dispute with respect to change orders or other work performed by the subcontractor. Furthermore, general contractors will not have to fear the prompt-payment statute penalty provisions, which can be severe (two percent penalty per month) provided that the general contractor can show that there was a good faith dispute regarding the subcontractor's work on the project. Finally, general contractors have more latitude now to include contract provisions that modify the timing of progress payments as this type of provision was upheld by the Court and found not to violate Business and Professions Code section 7108.5.

### **Background**

Thompson was the general contractor on a public works project and subcontracted with Martin Brothers to perform the installation of site clearing, grading, and paving work for the Elk Grove

Unified School District. During construction, a number of disputes arose over change orders and extra work performed by Martin Brothers. Martin Brothers filed suit seeking payment of the disputed work and sought damages for violation of the prompt-payment statutes. Prior to the time of the trial, Thompson tendered all amounts that were alleged to be owed except for the damages related to prompt penalties, interest and attorney's fees. The trial court found that Thompson had not violated the applicable prompt-payment statutes and entered judgment in favor of Thompson, awarding Thompson a judgment in the amount of \$150,000 in attorney's fees. The Court of Appeal of the State of California affirmed the judgment.

### **California's "Prompt-Payment" Statutes**

California Public Contract code section 7107 governs retention payments on contracts for construction of any public work of improvement. California Business and Professions Code section 7108.5 governs payment of progress payments for both public and private works of improvement. Section 7107 requires the public entity to pay the general contractor the retention proceeds within 60 days of completion of the Project. (See link for full citation of section 7107 <http://codes.lp.findlaw.com/cacode/PCC/1/d2/1/7/s7107>). Section 7107 also requires the general contractor to pay its respective subcontractors within seven days of receipt of the proceeds from the public entity. Moreover, section 7108.5 requires the prime contractor or subcontractor to pay any subcontractor within ten days of receipt of each progress payment, unless otherwise agreed to in writing. (See <http://codes.lp.findlaw.com/cacode/BPC/1/d3/9/7/s7108.5>).

### **Court's Analysis**

The Court's analysis for denial of prompt-payment penalties in this matter is two fold. First, the Court reasoned that section 7107 section (e) provides that if a bona fide dispute exists between the subcontractor and general contractor, the general contractor is permitted to withhold 150 percent of the disputed amount. The Court of Appeal rejected Martin Brothers' argument that the statute only applies to "honest disputes." The Court further reasoned that section 7107(e) must be interpreted to include disputes over change orders and disputed additional work performed during the construction process. Second, the Court found that Thompson and Martin Brothers had "otherwise agreed" to alter the timing of progress payments and had effectively "opted out" of Business and Professions Code section 7108.5 by the provision in their subcontracts that stated: "Subcontractor agrees that payment is not due until Subcontractor has furnished all applicable administrative documentation required by the contract documents and the applicable releases pursuant to Civil Code §3262." The Court concluded that parties to a construction contract can effectively alter the timing of progress payments and that the parties are free to contract around section 7108.5.