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Progress Payment Penalty Statutes**THIS ISSUE**

The California Court of Appeal has held that the “final payment” owed to a contractor is not a “progress payment,” the improper withholding of which would entitle a contractor to progress payment penalties. How does this impact contractors and property owners?

PROMPT PAYMENT STATUTES

The December 2006 issue of R.E.A.C.H. “A Contractor’s View of Prompt Payment Statutes” gives full treatment to the issue of both California and Federal Prompt Payment Statutes. As the Courts of Appeal make important changes to these laws, we provide these updates.

Where once payment delays were rampant, and contractors were often forced to obtain high-priced, short-term loans to cover debts while awaiting payment on undisputed amounts, there are now prompt payment statutes that tend ensure payment of undisputed amounts in a reasonable time from the date of billing. Prompt payment statutes are intended to encourage those who legitimately owe money to contractors to make the payments owed or face penalties of up to 2% per month in addition to interest owed on the unpaid balance and possibly even attorney fees.

The Prompt Payment laws are a confusing, contradictory conundrum of statutory morass; and the cases interpreting the codes are not much clearer. The basic principle is that when money owed to a contractor is unjustifiably withheld, the contractor will be entitled to collect a penalty payment to compensate for his losses and deter further similar conduct.

But a recent appellate decision found that withholding the “final payment” owed to a contractor is not the same as withholding a “progress payment,” and does not entitle a contractor to the award of any prompt payment penalty.

BACKGROUND FACTS

Phillip Boyce hired Murray's Iron Works, Inc. to install decorative railings in a home he was building. Boyce paid Murray's 50 percent of the contract price up front, with the balance due upon completion.

After Murray's completed the job, Boyce presented a punch list of items that he found unsatisfactory. Murray's completed the punch list in December 2002, and Boyce paid Murray's an additional \$50,000. But he did not pay the balance of \$66,222.40 due under the contract.

In February 2003, Boyce informed Murray's that he was dissatisfied with the job because he had wanted real gold leaf, rather than imitation gold leaf, on all the ironwork. Murray's responded that the contract did not call for real gold leaf, and that Boyce knew that Murray's did not work with real gold leaf, as they had discussed before entering into the contract.

Boyce refused to pay the balance due under the contract. Murray's sued Boyce for the \$66,222.40 due under the contract, plus interest and civil penalties under the Prompt Payment Statutes.

The jury rendered judgment in favor of Murray's for the full balance of \$66,222.40 due under the contract and, finding that Boyce's withholding of that money was not justified, awarded Murray's \$49,004.65 in Prompt Payment Penalties. The Prompt Payment Statue at issue authorizes a 2% monthly penalty on any wrongfully withheld "progress payments" owed to a contractor.

The Court of Appeal affirmed that portion of the judgment awarding Murray's the balance due under its contract. But the court reversed the Prompt Payment Penalties award, holding that the penalty statute was inapplicable. The Court explained that the statute applies to "progress payments" only. After lengthy analysis, the court

concluded that a final payment is not a progress payment for purposes of the Prompt Payment Statutes.

The Court noted that where an owner fails to make a required progress payment, one of the remedies available to the contractor is to stop work. But that remedy, obviously, is no longer available once work has been completed. It made sense, accordingly, to find that a progress payment and a final payment are not the same thing. By this backhanded logic, the Court found that the contractor, already without one of its remedies — the ability to stop work — should be denied another — the pressure of a prompt payment penalty.

WHAT DOES THIS MEAN?

In reviewing this decision, one has to ask "isn't it usually the last payment that is withheld improperly?" The withholding of a progress payment is usually related to some performance issue. When resolved, the progress payments get paid. And, pursuant to relatively recently added legislation, if an owner unjustifiably fails to pay a contractor during the course of construction, the contractor may serve a "10-day stop work order" on the owner. And the contractor's right to stop work under this statute is "in addition to any and all other rights" the contractor has available.

But historically owners would use the improper withholding of the *final* payment to pressure contractors into accepting less than was actually owed after the job was complete. This was the underlying reason for creating the Prompt Payment Statutes: to ensure that contractors, under pressure to pay subcontractors, employees and material suppliers, were not forced to accept less than they are entitled to when they no longer had the ability to cease working on the project.

Thus it seems, with the Court having ruled that there can be no statutory penalty for improperly withholding a final payment, the contractor's only remedy after finishing a project is to record a lien against the property, or in the case of a public project file a stop notice, and sue to enforce his rights.

For more information on the recording and perfecting of mechanic's liens, please see R.E.A.C.H. issues for July and October 2006.

CONCLUSION

Contractors, already facing an ever tightening net of case law and statutes eliminating their rights, have just lost another major collection tool. And attorneys facing this issue must be familiar with the most recent pronouncement on this issue.

NEXT ISSUE

When do real estate agents act as contractors?

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