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California Supreme Court Resolves Split Of Authority And Holds That A “Good Faith Dispute” Exception In Prompt Payment Statutes Permit Extended Withholding Of Retention Only When There Is A Dispute Over Entitlement To The Retention Monies Themselves.

In 2010, Universal City Studios (“Universal”) entered into agreements to build a new ride at its theme park. For the new attraction that would become Transformers: The Ride, Universal selected Coast Iron & Steel Co. (“Coast Iron”) as the direct contractor to design, furnish, and install metal work. Universal agreed to pay Coast Iron on a monthly basis for amounts billed, minus a 10 percent withholding – referred to in the construction industry as a “retention” – as protection against nonperformance. Upon its receipt of payments from Universal, Coast Iron was contractually responsible for making corresponding payments to its subcontractors. One such subcontractor was United Riggers & Erectors, Inc. (“United Riggers”) which was responsible for installing the metal work Coast Iron fabricated and supplied. The contract between Coast Iron and United Riggers called for United Riggers to receive approximately \$700,000 for its work. Due to approved change orders that amount eventually rose to just under \$1.5 million.

United Riggers completed its work to Coast Iron’s satisfaction. In March 2012, once all work on the project was finished, Coast Iron asked United Riggers for a final bill. In its final bill, United Riggers demanded additional amounts that would have brought its pay to \$1.85 million. United Riggers stated the additional amounts resulted from Coast Iron’s mismanagement of the project. Coast Iron refused payment, responding instead that it would “see [United Riggers] in court!!”

In August 2012, Universal paid out the 10 percent withheld as a retention to Coast Iron, which in turn owed \$149,602.52 of that amount to United Riggers. Although United Riggers requested payment, Coast Iron refused to pay forward any part of the retention to United Riggers.

In January 2013, United Riggers sued Coast Iron claiming that Coast Iron had violated the “prompt payment statute” by failing to make timely payment of the retention monies Coast Iron had received from Universal and in turn owed United Riggers. The prompt payment statute provides: “If a direct contractor has withheld a retention from one or more subcontractors, the direct contractor shall, within 10 days after receiving all or part of a retention payment, pay to each subcontractor from whom retention has been withheld that subcontractor’s share of the payment.” (Civ. Code, § 8814, subd. (a).)

Coast Iron argued that the prompt payment statute has an exception for good faith disputes. This exception provides: “If a good faith dispute exists between the direct contractor and a subcontractor, the direct contractor may withhold from the retention to the subcontractor an amount not in excess of 150 percent of the estimated value of the disputed amount.” (Civ. Code, § 8814, subd. (c).) Coast Iron argued that the good faith exception is without limitation, and thus, a good faith dispute as to any matter can support withholding.

After a bench trial, the trial court agreed with Coast Iron and entered judgment in its favor. United Riggers appealed. The Court of Appeal reversed the trial court’s decision. In doing so, the Court of Appeal held that limiting withholding to disputes specifically related to the withheld monies was more in harmony with what the Legislature had contemplated in enacting the prompt payment statute. Accordingly, Coast Iron could not use the parties’ dispute over project mismanagement to justify withholding United Riggers’ portion of the retention.

Coast Iron appealed and the California Supreme Court affirmed. “The dispute exception excuses payment only when a good faith dispute exists over a statutory or contractual precondition to that payment, such as the adequacy of the construction work for which the payment is consideration. Controversies concerning unrelated work or additional payments above the amount both sides agree is owed will not excuse delay; a direct contractor cannot withhold payment where the underlying obligation to pay those specific monies is undisputed.”

United Riggers & Erectors, Inc. v. Coast Iron & Steel Co. (2018) __Cal.4th __ [2018 WL 2188916].

Note:

This case involves the “good faith dispute” exception in the prompt payment statutes governing retention payments from direct contractors to subcontractors. The “good faith dispute” exception also exists in the prompt payment statutes governing retention payments from owners to direct contracts in both public and private projects. (See, Pub. Contract Code, §§ 7107, subd. (c), 10262.5, subd. (a); Bus. & Prof. Code, § 7108.5, subd. (a).) The Court’s analysis and holding will likely apply with equal force in those contexts.

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