



CLIENT NEWS BRIEF

April 2010
Number 13

COURT RULING ON DISPUTE BETWEEN CONTRACTOR AND SUBCONTRACTOR COULD HAVE IMPLICATIONS FOR PUBLIC ENTITIES

An open question has existed for years as to how aggressively a public entity owner can withhold retention from a prime contractor under Public Contract Code section 7107 ("section 7107"). The statute requires prompt payment of retention, but also appears to permit aggressive withholding of retention from a prime contractor for any "dispute." An appellate court decision late last year provided further guidance on the meaning of "dispute" and how aggressively retention may be withheld.

The court in Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc. (2009) 179 Cal.App.4th 1401, blessed a prime contractor's aggressive withholding of funds from a subcontractor on a public works project, and this holding may also apply to similar action by public owners. Specifically, the court held that even though the only dispute was a claim by the subcontractor for additional compensation, the general contractor could still withhold previously-earned and unrelated retention from the subcontractor without incurring late payment penalties under section 7107. The California Supreme Court recently declined to review the decision, thus making it final.

Thompson Pacific Construction, Inc. ("Thompson Pacific") entered a contract with Elk Grove Unified School District ("District") to construct a high school and middle school. Thompson Pacific subcontracted with Martin Brothers Construction, Inc. ("Martin Brothers") for site clearing, grading and paving. In June 2004, Martin Brothers sought additional payment for extra work beyond its subcontract, and filed a stop notice at the end of the project. The stop notice also included a claim for retention. In August 2004, the District released the withheld stop notice funds to Thompson Pacific after Thompson Pacific submitted a stop notice release bond. However, Thompson Pacific did not transfer these funds to Martin Brothers until 2005, when the dispute appeared to have settled. Martin Brothers accepted the settlement payments but still sought statutory late payment penalties, interest and attorneys' fees from the general contractor. A trial court denied Martin Brothers' claims and entered judgment for Thompson Pacific.

On appeal, Martin Brothers argued for late payment penalties under subdivision (e) of section 7107. That subdivision permits a general contractor on a public works project to withhold up to 150% of the value of a "bona fide dispute" from retention proceeds owed to a subcontractor. Martin Brothers argued that a bona fide dispute did not exist and that Thompson Pacific withheld retention in violation of section 7107. Martin Brothers contended that the actual

CLIENT NEWS BRIEF

April 2010

Number 13

dispute between the contractors concerned alleged extra work for which Martin Brothers sought additional compensation, and therefore Thompson Pacific had no right to withhold money, including retention, that Martin Brothers had previously earned on the existing contract. Martin Brothers pointed out that prior appellate decisions only permitted withholding of retention under section 7107 with regard to alleged inadequate or incomplete work by the subcontractor, for which the subcontractor presumably would not be owed payment under the base contract.

The appellate court rejected Martin Brothers' position, instead holding that "a dispute does not change its character depending on its subject. The subject is immaterial to its nature as a dispute. ... There is simply nothing in the language of section 7107(e) that evinces a legislative intent to limit the types of honest dispute that will justify the withholding of retention." The court ruled that a general contractor can withhold retention from a subcontractor if *any* bona fide dispute exists, regardless of its nature, specifically including a dispute for "the monetary value of the portion of a change order that is disputed and that would otherwise be paid out of the retention proceeds."

This decision is relevant to public entities since the court's interpretation of subdivision (e) of section 7107 could possibly be applied to subdivision (c) of the same statute, which governs a public agency's withholding of retention from a general contractor. Subdivision (c) of section 7107 permits a public owner to withhold up to 150% of the value of a "dispute." Based on the logic of the decision in the Martin Brothers case, the term "dispute" in subdivision (c) of section 7107 could also be construed broadly so that whenever a general contractor pursues a claim against a public agency for additional compensation, the public entity could withhold funds from retention already earned, without incurring late payment penalties.

However, public agencies should consult with legal counsel about the potential risk of taking such action. The interpretation of subdivision (c) of section 7107 was not at issue in this case. A different court addressing subdivision (c) might reach a different conclusion.

If you have any questions regarding this decision, or about handling contractor claims in general, do not hesitate to contact one of our [seven offices](#) located statewide, or consult our [website](#).

Written by:

[Arne Sandberg](#)

Senior Counsel

Walnut Creek Office

asandberg@lozanosmith.com

[Greg Wedner](#)

Shareholder

Sacramento Office

gwedner@lozanosmith.com



As the information contained herein is necessarily general, its application to a particular set of facts and circumstances may vary. For this reason, this News Brief does not constitute legal advice. We recommend that you consult with your counsel prior to acting on the information contained herein.