

# PREVAILING OWNERS ARE ENTITLED TO RECOVER PROMPT PAYMENT ATTORNEY'S FEES IN CALIFORNIA

(2005)

by Gregory R. Shaughnessy

In an important decision that substantially raises the stakes in a large percentage of construction lawsuits, in *Taylor v. Van-Catlin Construction* (2005) 130 Cal.App.4<sup>th</sup> 1061, the Court of Appeal held that an owner, who had prevailed in an arbitration with a contractor who sought prompt payment penalties, was entitled to recover its attorney's fees and costs from the contractor.

By way of background, over the past decade California has enacted many statutes that impose "prompt payment" requirements and penalties for violation of these requirements. Civil Code Section 3260 is one such statute, which requires owners to issue retention payments to contractors within 45 days following completion of a project, and contractors to pass through the money to the subcontractors within 10 days following the contractor's receipt of the money. Penalties for non-compliance include payment of 2% per month on the wrongfully withheld amount plus payment of attorney's fees. The owner or contractor is entitled to withhold 150% of any amounts as to which there is a "bona fide" dispute.

In *Taylor* an owner retained a contractor to remodel a residence. When the owner refused to pay the contractor the full amount due under the contract, the contractor filed a demand for arbitration, and the owner asserted a counterclaim. The arbitrator awarded the owner damages of \$156,166.73, subject to an offset of \$47,782.58. The arbitrator also awarded the owner \$74,310.38 in attorney's fees.

The owner filed a petition in superior court to confirm the arbitration award. The contractor argued that the award of attorney's fees was

beyond the arbitrator's authority under Civil Code Section 3260, one of the California "prompt payment" statutes. The superior court found that the arbitrator "seemed to conclude" that there was a bona fide dispute between the parties, and that under *Darling v. Controlled Environments* (2001) 89 Cal. App. 4<sup>th</sup> 1221, "a party is entitled to attorney's fees only in cases where a bona fide dispute did not exist." The superior court reversed the arbitrator's award of attorney's fees.

The Court of Appeal reversed and reinstated the award of attorney's fees. It noted that in the arbitration the contractor had requested attorney's fees and had asserted that Civil Code Section 3260 applied to the action. In making its decision, the court was required to address the *Darling* decision.

In *Darling* a subcontractor who installed a concrete floor filed suit to collect retention money due under the subcontract. The contractor did not pay the subcontractor the money because of a dispute over whether the floor flatness met the requirements of the subcontract. Ultimately the court found that the subcontractor's interpretation was correct and awarded the subcontractor damages.

The subcontractor requested an award of attorney's fees as the prevailing party, arguing that whether there was a bona fide dispute was irrelevant. The court held that there was a bona fide dispute between the parties and stated that where there is a bona fide dispute, there is no basis for awarding the 2% per month prompt payment penalty. The court further held that where there can be no award of the 2% per

month penalty, there can be no award of attorney's fees.

Ultimately the *Darling* court found that the contractor had withheld in excess of 150% of the disputed amount, and the court remanded the case to the superior court for further factual determinations and an award of attorney's fees. Importantly, the court held that in determining whether a party withheld in excess of the 150%, the court is to look at the circumstances that existed at the time that the payment was not made, and not at the circumstances at the time of trial.

In *Taylor* the court interpreted the sentence in Section 3260 that provides: "Additionally, in any action for the collection of funds wrongfully withheld, the prevailing party shall be entitled to his or her attorney's fees and costs." The court found no ambiguity with this language, stating:

If the funds are NOT wrongfully withheld, the owner will prevail in the contractor's action to recover them. Having prevailed, the owner then "shall be entitled to his or her attorney's fees and costs."

The court in *Taylor* disagreed with broad language in the *Darling* decision that implies that if the contractor had been the prevailing party, it would have been denied attorney fees because it had acted in good faith (there was a bona fide dispute). If this was the case, the court noted, a prevailing contractor would never be able to recover attorney's fees in an action by a subcontractor. The contractor would prevail by showing that the amount that was withheld was withheld based on a "bona fide" dispute and the contractor was wrong (as in *Darling*), in which case neither side recovers attorney fees, or the contractor could prevail by showing that the withheld amounts were withheld based on a bona fide dispute where the contractor was correct (as in *Taylor*, where the owner was correct).

### Comment

The decision in *Taylor* is potentially very significant. It is common practice in construction litigation to include, in a complaint by a subcontractor against a contractor or a contractor against an owner to collect money due under a contract, a demand for prompt payment penalties under Section 3260 and other statutes. Under *Taylor*, this triggers the right to recover attorney fees by BOTH the subcontractor and contractor, and by the contractor and owner. Under *Darling* and *Taylor* the following rules apply (using the contractor/owner scenario, which would be the same as the contractor/subcontractor scenario, where NETAF = Not entitled to attorney fees and ETAF = entitled to attorney fees):

Owner prevails on the withheld amount: Owner ETAF (*Taylor*)

Contractor prevails on the withheld amount, bona fide dispute found as to withheld amount: both parties NETAF (*Darling*)

Contractor prevails, no bona fide dispute as to withheld amount: Contractor ETAF (*Darling*, part 2)

Under *Darling* a court makes a determination as to the amount in dispute based on the facts as they exist at the time that the withheld amount is not paid. Given that an award of attorney's fees will now be available to owners who prevail against contractors, and contractors who prevail against subcontractors, where prompt payment penalties are demanded, contractors and subcontractors may need to consider, on a case by case basis, whether to include such a demand. Owners and contractors should make a written record, at the time of non-payment, of the basis of non-payment, making sure that the 150% exceeds the balance due.

Contractors and subcontractors may wish to implement a procedure, where payment is not received, of issuing a letter to the owner or contractor asking why payment has not been made. If no explanation is forthcoming, this

would tend to support inclusion of a request for prompt payment penalties in the complaint. If the response was a detailed breakdown of a backcharge or series of backcharges which appear to have substantial validity, the contractor or subcontractor may hesitate to include a request for prompt payment penalties in the complaint.

Certainly attorneys representing contractors and subcontractors can no longer just blithely include a demand for prompt payment penalties in every complaint in any construction collection action.

Gregory R. Shaughnessy specializes in construction and real estate and regularly advises owners, general contractors and subcontractors on their legal rights and remedies and in the negotiating and drafting of general contracts, subcontracts and related documents.

For more information about the issues discussed in this article, Mr. Shaughnessy can be reached at (415) 435-2409

E-Mail: [grs@grs-law.com](mailto:grs@grs-law.com)

Website: [www.grs-law.com](http://www.grs-law.com)