

Construction Law Newsletter

ENFORCING YOUR RIGHT TO PAYMENT — STOP NOTICES

Spring 2004

Most contractors performing public works are generally familiar with the remedies available for payment of labor, services, equipment or material furnished on a public work project. On state and local projects, the remedies are the *stop notice* and the *payment bond* claim. On federal government projects, the remedy is a bond claim under the *Miller Act*.

This article is the first of three addressing payment remedies. It focuses on the steps a contractor must take to *enforce* its right to payment through an action on the *stop notice*. The second article will appear in the next edition of the *Newsletter* and will address claims against the payment bond surety. The final article will appear in a later edition of the *Newsletter* and will address Miller Act bond claims.

An unpaid contractor perfects its claim for work performed on a public project in California by filing a stop notice — sometimes called a notice to withhold. The stop notice obligates the public entity to freeze the funds of the public project. By itself, the stop notice does not result in the payment of the contractor's claim; rather, it constitutes a lien on the earnings of the *original contractor* (defined as the contractor that has a direct contractual relationship with the owner) held by the public entity.

Subcontractors with a direct contract with the *original contractor* can file a stop notice at any time they have a valid claim against the original contractor. Subcontractors at other tiers (e.g. those not in direct

contract with the original contractor) must have filed a preliminary notice within 20 days of commencement of their work or delivery of material or equipment to the job site. This 20 days notice — commonly referred to as the *preliminary notice* — is filed with both the contractor and the public entity personally or by first-class, registered or certified mail. The preliminary notice must be in writing, describe the labor, services, equipment, or material furnished or to be furnished, and identify the party that will be furnished with the labor, services, equipment, or material.

The preliminary notice preserves the right of lower tier subcontractors to file stop notice claims. Note that on most projects there is only one original contractor and that contractor is the general or prime contractor. In some instances, however, the owner may serve as its own contractor and contract directly with specialty contractors in which case each specialty contractor is also an original contractor. Persons performing actual labor for wages need not serve a preliminary notice.

If you are required by law to serve a preliminary notice and fail to do so in a timely manner, you are barred from recovery on the stop notice for work performed more than 20 days before the stop notice was given.

There are three requirements for filing a stop notice claim. First, the contractor — called the *claimant* —

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Enforcing Your Right to Payment ...

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must have furnished labor, services, equipment, or material with the understanding that it would be used in a particular public work of improvement. Second, the claimant's labor, services, equipment, or material must have, in fact, been incorporated into the public work of improvement. Third, the claimant must fit within one of the following categories identified by the statute: (a) a subcontractor at any tier; (b) certain transporters of material; (c) a material supplier to a subcontractor; (d) an equipment lessor; (e) an architect or engineer whose work is actually used in construction; (f) a mechanic, artisan, machinist, builder and or teamster; (g) those making site improvements; (h) a registered hazardous waste hauler or (i) any other person performing labor on or bestowing services that contribute to the public work of improvement.

There are also requirements for the stop notice itself. It must be in writing, state the claimant's name and address, describe the labor, services, equipment, or material furnished or agreed to be furnished, state the name of the party that has been furnished with the labor, services, equipment, or material, and state the value of the work already done or items furnished as well as the value of the work agreed to be done by the claimant. The stop notice also must be signed and verified by the claimant. Note that willful execution and submission of a false stop notice results in forfeiture and may expose the claimant to liability under California *False Claim* statute.

Stop notices on public works for the State of California are to be filed with the director of the department that entered into the construction contract. Stop notices for all other public works projects must be filed in the office of the controller, auditor, or other public disbursing officer in charge of making payments under the contract, or with the commissioners, managers, or Board of Supervisors that awarded the contract. The stop notice must be served personally or by registered or certified mail within 30 days of the time the public entity records a notice of completion, a notice of acceptance or a notice of cessation. Although there are limited exceptions to this rule, timely filing of the stop notice is *mandatory* and indeed early service of a stop notice is recommended since the stop notice affects only those funds not yet disbursed to the original contractor.

As noted above, a stop notice only requires that the public entity withhold the *undisbursed* project funds. To collect the amount owed, a claimant must

file an action – a lawsuit – to enforce the stop notice. An action to enforce the stop notice can be filed 10 days after the stop notice is served, and must be filed prior to 90 days after the expiration of the period during which stop notices must be filed.

Finally, if the original contractor disputes the stop notice, the public entity has the discretion to allow the contractor to file a release bond. The stop notice release bond is executed by a corporate surety (usually a surety other than the payment bond surety) in an amount equal to 125 percent of the claim. The release bond must provide for the payment of any sum that the stop notice claimant may recover on its claim together with its costs of pursuing the action. A claimant's lawsuit to enforce the stop notice and collect the sum owed in such circumstances is against the stop notice release bond surety rather than the public owner or the contractor that was provided with, but failed to pay for, the labor, equipment, services or materials that are the subject of the stop notice. ♦

— Patricia A. Meagher



Women Construction Owners and Executives (“WCOE”) will hold its mid-year meeting at the Hyatt Regency, San Francisco Airport on September 17-19, 2004. For information and registration, contact Karen Huskey at khuskey@swinerton.com or Visit www.wcoeusa.org

DETERMINING WHETHER YOUR PROJECT IS A PUBLIC WORK

The line between projects considered public works and projects considered private projects is increasingly blurred by partnering between government agencies and private developers. In recent years, there have been more projects involving private developers with leases on public property, or joint funding arrangements. It therefore has become more important to determine whether a project may be considered a *public* work and, if so, for what purposes.

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At the onset of the project, a developer working with a public entity must determine whether the project is a *public work* and thus subject to *competitive bidding* laws. A developer also must determine whether its project is subject to *prevailing wage* requirements. In addition, contractors and subcontractors should determine the project's status for purposes of *payment enforcement* procedures. Because the three California statutory schemes governing these areas each define public work somewhat differently, a project may be considered a public work for one purpose but not another. Accordingly, developers must recognize that a determination that the project is a *public work* for prevailing wage laws does not necessarily mean that it is a *public work* for competitive bidding purposes. Moreover, contractors and subcontractors should not rely on the developer's determination of the status of the project in deciding what payment enforcement procedures apply.

First, whether a project is a *public work* subject to *competitive bidding* requirements is determined by Public Contracts Code Section 1101. This Section focuses on the subject matter of the work by defining a *public work* contract as an agreement for the erection, construction, alteration, repair, or improvement of any public structure, building, road or other public improvement of any kind. Expenditure of public funds is not necessary for such agreements to be subject to competitive bidding requirements. *Boydston v. Napa Sanitation District*, 222 Cal. App. 3d 1362 (1990).

Second, Labor Code Section 1720 defines a *public work* for *prevailing wage* purposes. The Labor Code focuses on the source of the funding and defines *public work* to include work done under contract and "paid for in whole or in part out of public funds." In 2002, the California Legislature amended Section 1720 to include a detailed and broad description of what work is "paid for in whole or in part out of public funds." As amended, it includes forms of indirect public payment such as "[f]ees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of the contract, that are paid, reduced, charged at less than fair market value, waived, or forgiven by the state or political subdivision." Thus, if a state or local government reduces the fees normally charged to developers, for example, the project is a *public work* for purposes of prevailing wage. Complimentary to Section 1720 is Labor Code Section 1720.2, which further broadens the scope of projects subject to prevailing wage requirements to include certain projects on privately owned property where more

than half of the property's space is leased to a state or local governmental entity. Note also that an agreement between the developer/contractor and the public entity that a project is not a *public work* does not excuse the developer/contractor (and subcontractors) from complying with prevailing wage laws if the Director of the Department of Industrial Relations determines otherwise. *Lusardi Construction Co. v. Aubry*, 1 Cal. 4th 976 (1992). Effective this year, however, a contractor may recover from an awarding agency any additional wages, penalties, and attorneys' fees it incurs due to the agency's erroneous representation that the project is not a *public work* for prevailing wage purposes. Labor Code § 1726(c).

Third, contractors, subcontractors and suppliers must look to the definition of *public work* found in the Civil Code to determine whether the project is public or private for purposes of *enforcing the right to payment* for services and materials provided. As most contractors, subcontractors and suppliers are aware, different procedures apply for stop notices and payment bond claims depending on whether the project is public or private. These procedures are set forth in several California statutes including Civil Code §§ 3156-3176.5 (stop notices for private works), §§ 3179-3214 (stop notices for public works), §§ 3235-3242 (payment bonds for private works), and §§ 3247-3252 (payment bonds for public works). Thus, it is important for contractors, subcontractors and suppliers to determine the status of the project for payment pur-

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Federal Court Refuses to Throw Out San Francisco's False Claims Lawsuit Against Tutor-Saliba

On May 19, 2004, in a federal lawsuit by the City of San Francisco against Tutor-Saliba concerning the San Francisco International Airport, the court refused to dismiss the City's claims under the State False Claims Act, but it did dismiss the City's claims under the City's False Claims Ordinance, finding the ordinance invalid because it is duplicative of the State Act. This is significant because the City ordinance, unlike the State Act, would have allowed the City to recover its attorneys' fees if it were to win at trial.

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poses. Civil Code Section 3100 defines a *public work* as any work of improvement contracted for by a public entity. A public entity, in turn, includes both state and local governmental entities including special districts and public agencies.



Accordingly, the potential therefore exists for a project to be public work for one purpose but not for another. Projects involving leases provide a good example. In *Boydston v. Napa Sanitation District*, 222 Cal. App. 3d 1362 (1990), a lease to operate sanitation district pastures for the purpose of utilizing reclaimed water was found to constitute a *public work* contract subject to *competitive bidding* requirements. By contrast, in *Progress Glass Company, Inc.*, 100 Cal. App. 3d 720 (1980), a project under which a developer entered into a long-term lease with a county government to build a privately operated motel on county property was found to be a *private project* and thus the payment bond was governed by the statutory provisions for private works.

The applicable statutory provisions also will dictate the notice requirements and time limitations with which a contractor, subcontractor or supplier must comply. It is therefore important that contractors make their own independent determinations as to whether a project is public or private under the Civil Code as early as possible to ensure their ability to enforce payment. ■

— David J. Tomlinson

GUIDELINES FOR A SUCCESSFUL CONSTRUCTION PROJECT NOW AVAILABLE ON INTERNET

The popular "Guideline for Successful Construction Project," published jointly by the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors is now available in PDF Format for viewing and download free of charge.

RJOP News

Our firm's presentation to the ABA's Forum on the Construction Industry entitled "Construction Dilemmas: Caught Between The Rock and A Hard Place" is available in PDF format at www.rjop.com

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