

Construction Law Newsletter

ENFORCING YOUR RIGHT TO PAYMENT — THE PAYMENT BOND

Summer 2004

This article is the second of a three-part series on the statutory remedies available to contractors that have not been paid for labor, services, equipment or material furnished on a public works project. The Spring issue included an article on *Stop Notices*. This issue will address the other remedy available for contractors seeking payment for work done on a state or local project: the *Payment Bond*.

One of the most widely used remedies available to an unpaid subcontractor on a California public works project is a claim against the payment bond. The payment bond — also called a labor and material bond — is a surety bond that is required to be posted on all state public works projects in excess of \$5,000 and all local public works projects in excess of \$25,000. The surety — or bonding company — guarantees that the contractor — or bond principal — will pay for all work performed and materials used on the project, and is required to make such payments if the contractor fails to do so.

California law requires that the prime contractor post a payment bond in an amount equal to 100 percent of the total amount payable by the terms of the contract. Further, the payment bond must provide that, if the original contractor or subcontractor fails to pay amounts due, the surety will pay the claims (in an amount not exceeding the sum specified in the payment bond), plus reasonable attorneys fees if an action is brought to enforce the

surety's obligation on the bond. In addition, the payment bond protects all *claimants* that provide work or material to the bond principal (i.e. the prime contractor) or a subcontractor. The term *claimants* includes lower tier subcontractors and suppliers but does not include a material supplier to a supplier.

To enforce a claim on the payment bond, a claimant must have previously served either (i) a preliminary 20-day notice or (ii) a written notice to the surety and the prime contractor. This requirement does not apply, however, to any claimant that has a direct contract with the prime contractor or has performed labor for wages.

The requirements for a valid preliminary 20-day notice was discussed in the article in the Spring issue on *Stop Notices*.

If the claimant does not serve the preliminary notice within 20 days after it first furnishes work or material to the job site, it must still give notice but the claimant loses stop notice and payment bond rights for work or material supplied more than 20 days before the notice was given. The written notice must describe the labor, services, equipment, or material furnished or agreed to be furnished by the claimant, the name of the party that has been furnished labor, services, equipment, or material, and the value of the work already furnished or to be furnished by the claimant.

(Continued on page 2)

Serving the
Construction Industry
Since 1981



Inside this issue:

Enforcing Your Right to Payment — The Payment Bond 1

New Federal Overtime Regulations Take Effect 2

Emergency Procurements: Termination For Convenience Cannot Create An Emergency 3

Updates 3 & 4

Payment Bonds (cont.) ...

(Continued from page 1)

The claimant must send the notice by personal delivery or by registered or certified mail to the surety and the prime contractor.

A legal action against the surety on a payment bond may be brought by a claimant at any time after the claimant last furnished labor or material. The deadline for filing a legal action against the payment bond surety is six months after the expiration of the period for filing a stop notice. (The expiration of the period for filing a stop notice is either 90 days from completion of a project and acceptance by the public entity or 30 days from recording a notice of completion if the public entity files such a notice within 10 days of acceptance).

The surety's liability on the payment bond is the amount due on the claimant's contract. The claimant may recover the principal amount of its claim, attorneys fees and, if the claim is for a liquidated and ascertainable amount, interest on the unpaid amount. In addition, the surety may be held responsible for penalties assessed under any applicable California prompt payment statute.

An unpaid subcontractor or supplier may proceed against the surety on the payment bond at the same time it files a stop notice. The remedies are *independent* and are often pursued concurrently by a claimant. The claimant can recover only once, however, for the monies it is owed. ♦

— Patricia A. Meagher



NEW FEDERAL OVERTIME REGULATIONS TAKE EFFECT

New federal overtime regulations took effect on August 23, 2004. The new regulations change federal overtime law for some employees. While some changes will benefit employers by offering more flexibility in defining exempt employees, most changes will benefit employees by providing greater overtime protection. Construction companies that employ exempt employees such as supervisors or project managers must determine whether their exempt positions meet the new federal standard. In doing so, construction companies that perform work in California must proceed with caution. California overtime laws are and will continue to be more stringent than the federal regulations. Thus, before re-

structuring employment practices based on the new federal regulations, employers must analyze their employment practices under California law. Compliance with federal overtime rules is no defense if you are sued under California law.

Tests Determinative Of Exempt Status

Both federal and California law employ two tests to determine whether an employee is exempt from overtime laws – a “salary” test and a “duties” test. Under the salary test, exempt employees must be paid on a salary basis (*i.e.*, a predetermined weekly wage) and a minimum weekly amount. As discussed below, the minimum amount differs under federal and California law. Under the duties test, the employee must perform certain “exempt” duties. Exempt duties differ depending on whether the employee is categorized as professional, administrative, or executive. Unless the employee falls within one of the automatic exemptions, he or she must satisfy both tests to be exempt.

Salary Test

- *Minimum Amount*

Prior to August 23, 2004, employees who earn as little as \$155 weekly can be exempt from federal overtime laws. The new federal regulations increase the minimum exempt salary to \$455 weekly. Thus, construction companies that wish to exempt their supervisors, project managers and any other white collar worker must, under federal law, pay them at least \$455 weekly. However, exempt employees who work in California, or are subject to California labor laws, must be paid the law minimum salary under state law which is currently \$540 per week.

- *Pay Docking*

Federal and California laws have prohibited employers from docking the pay (partial week docking) of exempt employees for employer initiated reasons such as disciplinary suspensions and furloughs unless the entire week's pay is docked. This rule changes under the new federal regulations. Employers may dock the pay of exempt employees in whole-day increments without risking the loss of the employee's exempt status under federal law. However, if the employee is protected by California law, pay docking may continue to cause the employee to lose their exempt status under California law. Although California law has generally adopted the federal pay docking rule, it may decide not to follow the new overtime regulation since it is less favorable to employees than existing California law. Therefore, you should not dock the pay of exempt employees for disciplinary suspensions and furloughs in California unless you are prepared to pay them overtime.

(Continued on page 3)

New Federal Overtime (cont.) ...

(Continued from page 2)

Duties Test

- *Highly Compensated Employees*

There are three categories of exempt employees: (1) professional; (2) executive; and (3) administrative. The new federal regulations create a fourth category called "highly compensated employees." This exempt category includes workers who earn at least \$100,000 annually, perform office or non-manual work as their "primary duty" (which does not preclude the performance of some manual labor as may be the case for supervisors), and who customarily and regularly perform at least one exempt duty. If applicable, this fourth category may be the easiest way of exempting employees such as site supervisors or project managers who are unable to satisfy one of the duties tests but are paid a six-figure salary. Unfortunately, highly compensated employees are not automatically exempt from California overtime laws. They must still fall within one of the traditionally recognized categories of exempt status employees (e.g., administrative, executive or professional).

Conclusion

Sweeping changes to the federal overtime regulations took effect on August 23, 2004. The new regulations determine whether white collar employees are entitled to overtime or are considered exempt employees. However, California construction firms that seek to change hourly employees to exempt employees should be wary of reclassifying their employees based on these new federal regulations. California's overtime laws are more stringent in favor of requiring payment of overtime. Therefore, before relying on these new federal regulations to re-characterize borderline white collar workers, California construction firms should analyze whether their proposed employment practices meet California's more stringent overtime standards. In most cases, if an employee barely meets the federal threshold for exempt status, he or she will still be entitled to overtime in California. ♦

— *Dennis C. Huie*

Robert Osier's and David Tomlinson's recent presentation to the North Bay District of AGC entitled "Enforcing Payment — Fundamentals and Recent Developments" is available at

www.rjop.com/publish.htm

EMERGENCY PROCUREMENTS: TERMINATION FOR CONVENIENCE CANNOT CREATE AN EMERGENCY



As the adage goes, "poor planning on your part does not constitute an emergency on my part." The recent decision of *Marshall v. Pasadena Unified School District*, 119 Cal. App. 4th 1241 (June 29, 2004), demonstrates that the adage applies to public contracting as much as it does to anything else. In particular, the court held that the Pasadena Unified School District ("District") could not use a termination for convenience to create an emergency, thereby permitting it to avoid putting the project out for competitive bidding again.

Marshall involves a construction project at an elementary school in Pasadena. In November 2000, the District awarded the contract to the lowest responsible bidder, B.F. Construction, Inc. (BFCI). A little more than a year after award, the project began to fall apart with BFCI writing a letter to the District complaining of, among other things, uncompensated change orders. In addition, BFCI suggested that the District terminate the project for convenience and put the project out for rebid.

The District, apparently persuaded by the contractor's letter, terminated the contract for convenience on February 1, 2002. Two months later, pursuant to an emergency resolution, it awarded a contract for the project to Hayward Construction Company ("Hayward"). The District made the award on an emergency basis and did not put the project out for rebid.

On June 3, 2002, PW, a general contractor whose president was a former vice president of BFCI, challenged the District's actions in awarding the contract to Hayward without a competitive rebid. In particular, PW contended that no "emergency" existed that would justify avoiding the competitive bidding process.

The trial court agreed with PW. The District then appealed, arguing, among other things, that an emergency existed permitting it to award the contract to Hayward without opening the project up to competition.

The Court of Appeal disagreed pointing out that "emergency" is defined in Public Contract Code Section 1102 to mean "a sudden, unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services." The Court noted that the emergency ex-

(Continued on page 4)

Emergency Procurements (cont.) ...

(Continued from page 3)

ception should be strictly construed and only used in situations that are "of grave character and serious moment."

Given this framework, the Court concluded that the District's own decision to terminate a contract for the District's convenience did not come close to meeting the standard for an emergency. Further, the Court questioned the concerns raised by the District for the well being of the students. In particular, the Court doubted whether the concerns were legitimate because the District had waited a significant period of time after the termination for convenience before it awarded the new contract. It then concluded that the trial court appropriately set aside the District's award to Hayward.

The decision in *Marshall* serves as a reminder that laws requiring open competition for public contracts exist to prevent favoritism, fraud, and corruption in such projects. Further, the laws are designed to ensure that public funds are used properly. As such, courts will carefully scrutinize attempts by public entities to avoid open competition. Unless it is truly necessary to bypass open competition, a court is likely to reject an attempt to do so.

It is also notable that, although the award was set aside, Hayward was still entitled to be paid for its work on the project. The District cited prior cases suggesting that if the award was illegal, Hayward was barred from recovering for work it already performed. The Court rejected the District's argument, noting that Hayward was in no position to know that the award was illegal and was therefore permitted to recover its costs of performance because it had proceeded with a good faith belief that its contract with the District was valid.

— Mark A. Kahn

Upcoming Events

Aaron P. Silberman will speak on "Legal Issues and Strategic Tips for Defending Against False Claims Allegations" on September 18, 2004, at the Association of General Contractors of California's Legal Advisory Committee Retreat at Carmel Valley Ranch.

Register by contacting spellerd@agc-ca.org.

RJOP News

Rogers Joseph O'Donnell & Phillips is a corporate sponsor of the mid-year meeting of Women Construction Owners and Executives, USA from September 17-19, 2004, at the Hyatt Regency San Francisco Airport Hotel.

Register by contacting
khuskey@swinerton.com.

ROGERS JOSEPH O'DONNELL & PHILLIPS

Construction Law Practice Group

Neil H. O'Donnell, Esq.
J. Michael Matthews, Esq.
Patricia A. Meagher, Esq.
Aaron P. Silberman, Esq.*
Robert M. Osier, R.A., Esq.
David J. Tomlinson, P.E., Esq.
Dennis C. Huie, Esq.*
Mark A. Kahn, Esq.

**Also members of the Employment Law Practice Group*

311 California Street, 10th Floor
San Francisco, CA 94104
Telephone: 415.956.2828
Facsimile: 415.956.6457
website: www.rjop.com

© 2004 Rogers Joseph O'Donnell & Phillips
All Rights Reserved.

*To obtain more information about
our law firm or the articles in this newsletter,
please contact
Patricia Meagher at pmeagher@rjop.com*

DISCLAIMER

The material contained in this newsletter is for informational purposes only and does not constitute legal advice. For specific advice, you are advised to contact your legal counsel.