



Friday, January 23, 2009

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http://www.sddt.com

Source Code: 20090122cyb

Legal action may follow nonpayment of contractors on infrastructure projects

By **MONICA UNHOLD**, The Daily Transcript

Friday, January 23, 2009

Construction attorneys and bond insurers expect a wave of litigation to follow increasing uncertainty about the future of state-funded infrastructure projects.

A variety of legal issues will arise if the state misses payments to contractors and postpones or cancels contracts.

Earlier this month, nine San Diego contractors on Department of Transportation projects experienced what officials are now calling "the December scare" after being informed the state may not pay them for materials expended and work completed in December.

Due to the state's deficit and legislature's failure to pass a budget, the Pooled Money Investment Board froze funding on more than 5,300 ongoing and soon-to-begin construction projects. California lacks the \$12 billion necessary to keep infrastructure, school, highway and habitat restoration projects moving through July.

If contractors do not receive payment for completed work in a timely fashion, lawyers expect to see a deluge of bond claims by subcontractors against general contractors.

In California, contractors must secure bonds on their state-funded projects to insure they will complete the work and pay their debts to subcontractors and material suppliers.

Most contracts between general contractors and subcontractors contain "pay when paid" and "pay if paid" clauses. Such contracts are unenforceable and the courts will likely hold general contractors responsible for paying subcontractors whether or not they are paid by the state, said attorney Pam Scholefield of San Diego-based **Scholefield Associates**.

If a general contractor refuses to pay a subcontractor for work completed because the general has not been paid by the state, the subcontractor's most likely action would be to file a bond claim against the general contractor, Scholefield said. Such claims usually take nearly a year to resolve, however if the subcontractor can prove the work in question has been completed, the claim will likely be awarded.

Construction attorney Kevin Carlin, of **Carlin Law Group**, took a different stance, saying general contractors may be able to defend bond claims from subcontractors until they themselves have been paid, especially if they can prove they are unable to pay.

Both attorneys said all parties typically try to avoid such claims. Such disputes are costly for general contractors who are required to legally defend the bond company, and for subcontractors who must pay for legal proceedings usually lasting eight to 12 months.

Bonding companies expect to see an increase in subcontractors filing claims against general contractors for nonpayment. Underwriters are beginning to inquire about a public entity's financial viability when assessing the risk of bonding such projects, said Mike Thomas, vice president of surety practice for **Willis Group**.

"An underwriter looks at a contractor's ability to pay its bills and how that may affect its ability to deliver the project," Thomas said.

Financial troubles stemming from nonpayment by the state could also inhibit contractors' ability to secure bonds for future projects, Thomas said.

Outside of bond claims, contractors' options are few if the state decides it will not pay. Contractors cannot levy a mechanic's lien against a public entity, said Sam Abdulaziz of Anaheim-based **Abdulaziz, Grossbart and Rudman**. Such claims are a common way for subcontractors to secure payment from nonpaying general contractors or owners on private sector construction projects.

On private projects, if contractors do not receive payment they may file a "stop work order" and avoid liability for

any delay damages incurred, however the procedure does not apply to public projects, Scholefield said.

Subcontractors also have few options, they could file a "stop notice" to let a public entity know they have not been paid by the general contractor, but depending on the contract they may still be required to continue work.

The magnitude of the state's budget crisis and the potential effect on state construction projects have left the state in uncharted waters, Scholefield said.

In some contracts completion is defined as a cessation of work for more than 60 days. Such terms could effect the deadlines for filing stop notices and bond claims. Each contract differs and some may include "termination by convenience" clauses, in which the state could end the contracts and be required to compensate contractors only for work previously completed, Scholefield said. Any project shut down will incur the costs of cleaning up sites. Just one of the agencies with projects slated to be shut down, Caltrans estimates the cost of closing down and barricading transportation work sites will come to \$350 million.

Due to the lengthy and costly nature of litigation, subcontractors may opt for negotiations rather than bond claims, but the longer they go unpaid the harder they will likely push for payment, Thomas said.

Many subcontractors are especially wary of the state withholding payment because their companies are typically much smaller than general contractors and do not have the capital to pay basic expenses without pay.

"A lot of residential subcontractors are looking to do public works because (the residential market) has dried up," Thomas said. "It's pretty serious."

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