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Supply & Demand: How a Construction Project's Cash Flow Can Leave You Strapped

By Paul C. Bauducco

Whether you're physically working on a property, or supplying materials to a construction project you've never seen, as a business owner you can be left holding an empty bag instead of payment for services rendered or materials provided.

Private and public construction projects today are generally working with more restrictive budgets, leading property owners and financial institutions to delay progress payments and release of retention payments to general contractors. These delays in payment can cause general contractors to suffer cash flow shortages. When general contractors don't have enough cash to make payroll or cover their own expenses, they may misuse funds intended for subcontractors.

This can leave suppliers or subcontractors in a hostage situation financially – with the general contractors who fail to pass on progress payments on a timely basis, or who improperly withhold retention payments received for work performed or material provided by their subcontractors – holding the gun. Here are three ways you can help ensure timely payment:

Joint Check Agreements

One method you as a subcontractor or vendor can use to avoid delayed payments from general contractors is to request a joint check agreement from the owner/construction lender and general contractor.

In this type of agreement, the owner/construction lender, general contractor and subcontractor agree that work relating to specific construction or materials provided on a project will be paid by a check made payable jointly to the general contractor and the subcontractor who performed the work or provided the materials. The general contractor must notify the subcontractor that a payment has been made and get the subcontractor's signature in order to cash the check, preventing the general contractor from hiding and keeping subcontractor payments.

However, not every owner, construction lender or general contractor will agree to a joint check agreement because it increases the amount of time and paperwork necessary to make payments on the project. General contractors may refuse such an agreement because it restricts their "flexibility" to use such payments.

Conditional Mechanic's Lien Releases

Owners and construction lenders almost always require general contractors to obtain mechanic's lien releases from their subcontractors in connection with progress and final payments. Regardless of whether there is a joint check agreement in place, subcontractors should provide lien releases which are *conditional on receipt of payment* for the work covered in the release.

In the event the subcontractor does not receive payment for the work or materials reflected in the "conditional" release, it will not be barred from recording a mechanic's lien to secure its payment.

Prompt Payment Statute

California Business and Professions Code §7108.5 can be used to impose penalties which may cause the general contractor to make prompt payment to subcontractors. A general contractor withholding payments received from an owner/construction lender due to a subcontractor can be subject to a penalty of two percent per month for the unpaid amounts due. If the subcontractor is forced to bring a lawsuit to collect funds wrongfully withheld, the "prevailing party" will also be entitled to an award of attorney's fees and costs.

The code also allows general contractors to withhold up to 150 percent of any payment to subcontractors when there is a "good faith dispute." Currently there is a split of opinion in the appellate courts as to whether the determination of a "good faith dispute" should be based on the "subjective belief" of the general contractor or on what a "reasonable person" would "objectively determine".

Even with the "good faith dispute" exception, §7108.5's penalties are substantial and provide a valuable tool for obtaining prompt payment from general contractors.

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