What is it?

Retention is money earned by the contractor and its subcontractors that the law permits a public entity to withhold as security for the owner to guarantee the full performance of the public work of improvement.
What is it?

Together with the performance bond, it is the only other security a public entity owner has.

What is it?

Unlike the performance bond, it is the only security that can be readily accessed if needed, provided that proper contractual requirements are in the bid documents and contract.
What is it?

In fact, the law recognizes:
(1) The security nature of retention; and
(2) Owner’s priority claim to retention when needed to complete a contract/project.

What is it?

- Money earned by general and subcontractors but to which a public entity owner has a priority claim if needed to complete the public work of improvement.
Key Concepts

Knowing that retention is not the owner’s money, you must also know and understand what a public entity owner must do to properly secure its interests and avoid risks presented by retention withholding.

Key Concepts

* New Changes to Retention Law
* Options for the Escrow Agreement
* “Completion” definitions/traps
* Effective Close Out Process
New Changes - Retention Law

(Effective January 1, 2012 ends 2016)

* 5% maximum withhold, unless
* Board finding that a project is “substantially complex”

Public Contract Code section 7201

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New Changes - Retention Law

Should you want to withhold more than 5%, the Board must:

- Establish criteria as to why the project is “substantially complex”;
- Do so at a properly noticed public hearing; and
- Include the finding in the bid documents.
New Changes - Retention Law

* 5% maximum withhold applies to ALL project participants:

Owner – General
General – Subcontractors
Subcontractors – Sub-Subcontractors

New Changes - Retention Law

Public Contract Code section 7201 does not impact Public Contract Code sections 7107 (release of undisputed retention) or 9203 (reduction of retention withhold for good performance after 50% done).
**Escrow Agreement**

**PCC section 22300 option**

Most contractors opt for the escrowed retention permitted by PCC section 22300.

Be careful here… 1st risk trap for the public entity owner.

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**Escrow Agreement**

Recall that escrowed retention can be the most readily accessed form of security that an owner has to complete a project when the contractor can not or will not do so.

Do not lose the opportunity to protect yourself.
Escrow Agreement

What are we really talking about:

* Nature of an Escrow Agreement.
* Agent acts on “mutual” instructions only.
* If dispute and mutual instructions not clear, agent has no obligation to act.

Escrow Agreement

PCC section 22300 (f) (7) states:

“The Owner shall have a right to draw upon the securities in the event of default by the Contractor. Upon seven days' written notice to the Escrow Agent From the owner of the default, the Escrow Agent shall immediately convert the securities To cash and shall distribute the cash as Instructed by the Owner.”
Escrow Agreement

What is an “event of default”?

What if contractor disputes the owner’s contention?

What do you think the escrow agent is going to do?

Exercise your option and better protect your public entity:

PCC section 22300 (f) (7) states:

“The escrow agreement used hereunder shall be null, void, and unenforceable unless it is substantially similar to the following form:”
**Escrow Agreement**

Change PCC section 22300 (f) (7) to read:

“The Owner shall have a right to draw upon the securities if the owner declares in writing a default by the Contractor. Upon seven days' written notice to the Escrow Agent from the owner of the default, the Escrow Agent shall immediately convert the securities to cash and shall distribute the cash as instructed by the Owner.”

**Escrow Agreement**

The 1st risk trap is therefore the “inability to access retention” trap.

Do not get caught up in it, “words” matter!
Completion – When is it?

The concept of “completion” is linked to retention as the former triggers the public entity owner’s obligation to release all “undisputed” retention to the contractor.

Many mis-understand the “completion” concept and increase their risks unnecessarily.

Completion – When is it?

Public Contract Code section 7107 sets forth four definitions of “completion” for purposes of releasing “undisputed retention”.

Importantly, 7107 states that “the earlier of” these situations shall control.
Completion – When is it?

PCC section 7107 (a) (1):

“The occupation, beneficial use, and enjoyment of a work of improvement, excluding any operation only for testing, startup, or commissioning, by the public agency, or its agent, accompanied by cessation of labor on the work of improvement.”

Completion – When is it?

PCC section 7107 (a) (2):

“The acceptance by the public agency, or its agent, of the work of improvement.”
<table>
<thead>
<tr>
<th>Completion – When is it?</th>
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<tbody>
<tr>
<td><strong>PCC section 7107 (a) (3):</strong></td>
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<tr>
<td>“After the commencement of a work of improvement, a cessation of labor on the work of improvement for a continuous period of 100 days or more, due to factors beyond the control of the contractor.”</td>
</tr>
<tr>
<td><strong>PCC section 7107 (a) (4):</strong></td>
</tr>
<tr>
<td>“After the commencement of a work of improvement, a cessation of labor on the work of improvement for a continuous period of 30 days or more, if the public agency files for record a notice of cessation or a notice of completion.”</td>
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</tbody>
</table>
Completion – When is it?

The earliest of these (trigger release):

(1) occupation/beneficial use-no labor;
(2) acceptance of the project;
(3) 100 continuous days-no labor - no fault of general contractor;
(4) 30 continuous days – no labor – notice of cessation filed.

Completion – When is it?

“Notice of Completion” trap
Do not fall into it!

Be careful here… 2nd risk trap for the public entity owner.
Effective Close Out Process

If you do not have one, you are unnecessarily increasing your risk substantially …..

Effective Close Out Process

Required Components

Scheduled
Final Punch List - “Substantial Completion”
Estimated Value for Each Item on List
Description of deficiency for each item
Conveyed to contractor (and surety)
Stated deadline by which to act
Use of 3rd party contractors
Joint check option
Interplay with Performance Bond language
Effective Close Out Process

The 3rd risk trap is not having an effective close out process, because if you do not, you will not be able to justify in “good faith” the amount of “disputed” retention you are holding and you will not know the proper amount of “undisputed” retention to release.

Effective Close Out Process

Public Contract Code section 7107 (f) states:

“In the event that retention payments are not made within the time periods required by this section, the public entity or original contractor withholding the unpaid amounts shall be subject to a charge of 2 percent per month on the improperly withheld amount, in lieu of any interest otherwise due. Additionally, in any action for the collection of funds wrongfully withheld, the prevailing party shall be entitled to attorney's fees and costs.”
**Effective Close Out Process**

- “improperly withheld amount”
- “wrongfully withheld”

These two phrases within PCC section 7107 (f) have been determined to mean that there was a good faith dispute between owner and contractor when viewed from an objectively reasonable person’s perspective.

**Effective Close Out Process**

Given that retention is not the owner’s money, but only money the owner has a priority security interest in, if you have not explained why an item is on a punch list, what the estimated value of it is, and told the contractor this in writing, how do you ever expect to convince a judge that your reasons to withhold were “objectively reasonable” under the circumstances???
Effective Close Out Process

You therefore must have an effective close out process is to avoid the 2% per month penalty and attorney’s fees claims that contractors will bring against you if you do not have one.

Thank You

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Please do not hesitate to call upon us.