

CLIENT NEWS BRIEF

Court Decision Reinforces Public Agencies' Right to Access Retention Funds

An appellate court has confirmed that a public agency can access retention funds held in escrow simply by declaring the contractor to be in default on the public works project. In *Pittsburg Unified School District v. S.J. Amoroso Construction Co., Inc.* (December 22, 2014) 2014 Cal.App. Lexis 1175, the contractor attempted to distinguish its case from other recent court decisions that allowed such access, but the court rejected its arguments.

Generally, if requested by a contractor on a public works project, the owner must put retention funds in an escrow account pursuant to an agreement signed by the owner, the contractor, and the bank. The escrow agreement language is generally required by statute (Public Contract Code § 22300), and it allows the owner to withdraw the retention funds after giving written notice to the bank of default by the contractor.

In upholding the right of the school district in this case to access the retention funds, the court rejected the contractor's argument that the district had to await a favorable judicial ruling on the merits of the case. As stated by the court: "The rule (the contractor) urges us to adopt – that a public project owner must await judicial resolution of the underlying contract dispute before it can withdraw retention funds – would undermine the entire purpose of retention. It would deny an owner the funds to complete its project until long after the intended completion date for the project. (The contractor's) position is unsupported by logic or law."

The court also rejected the many other arguments raised by the contractor, concluding that the owner's unilateral right to declare a default and take possession of the escrow funds did not violate either Civil Code section 1670, which requires that any dispute regarding one party's unilateral decision under a public works contract be resolved by arbitration or litigation, or any alleged due process rights of the contractor. Also, the fact that the owner did not issue a "formal" declaration of default was found to be irrelevant – the owner clearly made a determination of default by terminating the contract and notifying the contractor of its breach. The court determined that Public Contract Code section 22300 "requires only a notice of default to the escrow agent and not a formal determination of fault by the governing board...." The court also rejected the contractor's argument that the retention funds were held in trust for subcontractors.

This decision reinforces an owner's right to determine a default, thus giving an owner significant flexibility when trying to close out a troubled project, including accessing retention funds that are held in escrow. Despite confirmation of this rule of law, owners must still proceed cautiously. If an owner is found to have wrongly determined that a default (breach of contract) has occurred, it could be found liable to the contractor in later litigation.

If this decision is not reheard by the appellate court, or reversed or depublished by the California Supreme Court, it will be binding precedent on trial courts across the state. If you have any questions regarding this case, or construction

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Harold M. Freiman
Partner
Walnut Creek Office
hfreiman@lozanosmith.com



Arne B. Sandberg
Senior Counsel
Walnut Creek Office
asandberg@lozanosmith.com



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