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Insights: Alerts

New California Statutes Reshape Retainage and Payment Practices in Private Construction Contracts

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Written by **Brian G. Corgan**

Effective January 1, 2026, two groundbreaking California statutes will significantly impact private construction contracts executed after this date. The first, California Civil Code § 8811, imposes a strict five percent (5%) cap on retainage for most private projects, fundamentally changing the longstanding practice of parties negotiating retainage terms and percentages. The second, California Civil Code § 8850, introduces an elaborate prompt payment and claim resolution framework for private works, aimed at alleviating payment delays and providing clear procedures for the resolution of construction contract disputes.

Together, these statutes are poised to enhance payment transparency, limit tactical withholding of funds, and encourage prompt, fair compensation for contractors and subcontractors, while also creating new compliance obligations and potential penalties for owners. Construction industry participants should familiarize themselves with these changes to ensure contractual practices align with the new statutory requirements and to mitigate risks associated with noncompliance.

I. Retainage

The question of a project owner's, contractor's, and subcontractor's contractual right to hold retainage often leads to contentious situations, particularly where the entity holding retainage may be doing so for tactical reasons unrelated to the legitimate purposes for which retainage is to be withheld. Retainage is designed to protect an owner, contractor, or subcontractor from nonperformance or defective performance by downstream entities a tier or perhaps many tiers below. Retainage provisions take many forms. The standard retainage provision permits withholding of ten percent (10%) until a specific milestone is reached on a project. Often that milestone is final completion. In other instances, retainage may be released in whole or in part upon substantial completion, or mechanical completion on a heavy industrial project. Upon substantial or mechanical completion, the retainage might drop to five percent (5%), with the remaining five percent (5%) released upon final completion. There are often many variations, formulae, and staggered percentages used to structure retainage withholding and release.

The most common retainage provisions authorize holding ten percent (10%) until the project is fifty percent (50%) complete, at which point retainage may be reduced to five percent (5%) until final completion. However, it is not uncommon on complex mechanical projects to have staggered withholding and releases of retainage,

such as an initial retainage of ten percent (10%) reduced to seven and one-half percent (7.5%) upon mechanical completion, reduced further to five percent (5%) upon satisfaction of a unit's minimum performance criteria such as peak and nominal output, further reduced to two and one-half percent (2.5%) upon completion of punch-list items, and then paid in full upon delivery of as-builts, operations and maintenance manuals, and other specified closeout documents. The contractual variants are virtually limitless and are often the subject of intense contract negotiation, particularly when the contract price is substantial, as it is on most industrial projects. Parties typically have the unfettered right to structure retainage withholding and payments as they see fit, or as their bargaining power permits. But no more in California.

Effective January 1, 2026, Cal. Civ. Code § 8811 imposes a five percent (5%) maximum cap on retention for most private construction projects. The mandate applies to “a contract relating to a private work of improvement entered into on or after January 1, 2026.” [Cal. Civ. Code §8811(a).] The mandate applies only to contracts entered after the effective date. It has no retroactive effect.

The new statute applies to retainage payments withheld from any progress payment on a private work or improvement project either by an owner to the entity in privity with the owner, referred to in the code as the “direct contractor,” retainage withholdings by a general contractor from “any subcontractor,” and by a subcontractor from “any subcontractor” thereunder. No withholding, at any tier, may exceed five percent (5%) of the payment. [Cal. Civ. Code § 8811 (b) (1) (A)] For the avoidance of any doubt, the statute specifically provides that “in no event shall the total retention proceeds withheld exceed 5 percent of the contract price.” [Cal. Civ. Code § 8811 (B)] In addition, the “direct contractor,” or general contractor in privity with the owner may not include a retainage percentage in its subcontracts that exceeds the percentage specified in its prime contract. [Cal. Civ. Code § 8811 (C)]. For example, if the general contractor is successful in negotiating a retainage of two percent (2%) in its prime contract, it cannot exact a retainage in excess of that percentage in its subcontracts.

The statute has two express exceptions. First, the retainage limitation does not apply to a general contractor or a subcontractor if at the time a bid is requested written notice is provided that a payment and performance bond is required and the subcontractor fails to provide the required bond from a qualified surety. [Cal. Civ. Code § 8811 (2)] Second, the statute does not apply to residential construction that is not a mixed-use facility or does not exceed four stories. [Cal. Civ. Code § 8811 (3)] For any enforcement proceedings under the statute “a court shall award reasonable attorney's fees to the prevailing party.” [Cal. Civ. Code § 8811 (c)] Finally, although an express reference is not included, given that the new statutory provision falls within Chapter 8, “Prompt Payment,” § 8820 entitled “Waiver against public policy” applies (“It is against public policy to waive the provisions of this article by contract.”)

II. Prompt Payment

In a relatively unusual issuance of “Legislative findings and declarations”, the California legislature has enacted another section within its Prompt Payment Chapter 8 of the California Civil Code. The new provision is Cal. Civ. Code § 8850 titled “Legislative findings and declarations relating to construction contract claims and payment disputes; definitions; application of section; claim resolution process.” The statutory section applies only to private construction contracts entered into subsequent to January 1, 2026. [Cal. Civ. Code § 8850 (n).] Of interest, and introducing a complicating factor into the statute's enforceability, is the statutory mandate that § 8850 shall only remain in effect until January 1, 2030 [Cal. Civ. Code § 8851]. Of course, depending on the

legislature's assessment of the statutory provision's efficacy, it can be extended by legislative action.

The statutory provision starts by articulating legislative findings and declarations relative to confronting problems inherent in construction performed on private works projects within the state of California. The statute specifies that it is “in the best interests of the state and its citizens to ensure that all construction business performed on a private works project in the state that is complete and not in dispute is paid in full and in a timely manner.” [Cal. Civ. Code § 8850 (a)(1)]. Another legislative finding incorporated into the statutory provision is that “Delays in payment for works of improvement and site improvements impose significant financial hardships on contractors, particularly small businesses, disadvantaged business enterprises, and disabled veteran business enterprises.” [Cal. Civ. Code § 8850 (a)(2)]. The introductory portions of the statue go on to provide that “[t]he lack of clear procedures for resolving disputes related to change orders often leads to costly litigation where a predetermined method could avoid such costs.” [Cal. Civ. Code § 8850 (a)(3)]. Finally, it is noted and declared that “[p]rompt and fair payment promotes economic stability within the construction industry and ensures efficient project completion.” Cal. Civ. Code § 8850 (a)(4). With those introductory findings and declarations set out, the statute mandates that § 8850 applies to any claim asserted by a contractor or a subcontractor in connection with a work of improvement or site improvement, as defined in the statute. [Cal Civ. Code, § 8850 (b).] While the statute is largely, and some might say exclusively, for the benefit of contractors and subcontractors, it does provide safeguards to owners that have good faith bona fide disputes with contractor or subcontractor claims and who proceed with the processes and timelines set out in the statute.

After declaring the legislative findings and declarations, § 8850 sets out the definitions of “Claim,” “Owner,” and “Project Manager.” The definition of a claim that falls within the scope of the statute is quite broad. It encompasses a request for a time extension, any requests for relief from damages or penalties (presumably liquidated damages, although the statutory text of “penalty” is ironic) for delay assessed by an owner, payment of money or damages arising from work done by the contractor, and payment of an amount that is disputed by the owner. Upon receipt of a claim, which by definition must be sent by registered mail or certified mail with return receipt requested, the owner shall perform a reasonable review of the claim within a period not to exceed 30 days and within that time frame must provide the claimant a written statement identifying what portion of the claim is disputed and that which is undisputed. [Cal. Civ. Code § 8850 (d)(1)(A)]. The claimant is obligated to furnish reasonable documentation supporting its claim. [Cal. Civ. Code § 8850 (B)]. The owner is then obligated to make payment of any undisputed portion of the claim within 60 days after the owner issues its written statement. [Cal. Civ. Code § 8850 (d)(3)].

If a claimant disputes all or any portion of the owner's written response to its claims, it may demand in writing an informal conference to meet and confer for settlement of the issues in dispute. [Cal. Civ. Code § 8850 (e)(1)]. That demand must be sent by registered mail or certified mail, return receipt requested. [Cal. Civ. Code § 8850 (e)(2)]. Thereafter, the owner must schedule a meet and confer within 30 days. [Cal. Civ. Code § 8850 (e)(2)]. Within ten business days following the conclusion of the meet and confer conference, the owner shall provide the claimant a written statement identifying the portion of the claim that remains in dispute and that portion that is undisputed. [Cal. Civ. Code § 8850 (e)(3)]. Payment of any undisputed portion of the claim determined to be due subsequent to the meet and confer must be paid within 60 days after the owner issues its written statement. [Cal. Civ. Code § 8850 (e)(4)]. If there remains any disputed portion of the claim after the meet and confer, the remaining disputed portion of the claims are to be submitted to nonbinding mediation. [Cal. Civ. Code § 8850

(f)]. The owner and claimant are to mutually agree to a mediator within 10 days after the disputed portion of the claim has been identified in writing, and in the absence of such agreement the contractor may select the mediator to be used. [Cal. Civ. Code § 8850 (f)(2)(3)]. Significantly, if the owner refuses mediation, the contractor may carry out the process described in § 8850 (k) which under certain circumstances may include the right to suspend performance of work without any penalty. If mediation is unsuccessful those portions of the claim remaining in dispute are subject to the dispute resolution procedure specified in the parties' written contract. [Cal. Civ. Code § 8850 (f)(4)]. If no such dispute resolution forum is specified, then by final judgment. [Cal. Civ. Code § 8850 (f)(4)].

If an owner fails to respond within the time periods described in the statute or fails to "otherwise meet the requirements of this section" there is a deemed denial of the claim. [Cal. Civ. Code § 8850 (g)(1)]. A deemed denial attributable to the owner's failure to respond to the claim shall not constitute an adverse finding regarding the merits of the claim or the responsibility or quantification of the claim. [Cal. Civ. Code § 8850 (g)(2)]. Undisputed amounts not paid timely are subject to penalty interest computed at 2% per month. [Cal. Civ. Code § 8850 (h)(1)]. The more significant portion of the statue is § 8550 (h)(2) providing that "[d]isputed amounts which are later found to be owed through the dispute resolution procedures specified in the party's contract or by final judgment…shall bear interest at 2% per month, beginning from the date on which those amounts would have been due had they not been disputed." [Cal. Civ. Code § 8850 (h)(2)]. This is by far the heaviest hammer in the statute and will likely play a significant role in the negotiation and resolution of disputed claims. Twenty-four percent (24%) *per annum* yields a significant payout in a relatively short period of time. Owners may cry foul given that there is no prevailing party provision for attorneys' fees and costs, and the statute's penalty interest provision does not provide a level playing field relative to overstated or unsupported claims. That criticism may be appropriate.

There is also a series of subsections dealing with subcontractor claims and the contractor's obligation to pass through such claims to the owner. [Cal. Civ. Code § 8850 (j)(1)-(3)]. The most significant aspect of those provisions is that the contractor "shall make no settlement of any [subcontractor] claim to which the subcontractor does not approve, in writing." [Cal. Civ. Code § 8850 (j)(B)]. This could give a subcontractor enormous leverage, particularly where an owner insists upon a global settlement including the contractor and all subcontractors.

In addition to the significant penalty interest provisions, the statute provides for work stoppages in certain circumstances. Pursuant to § 8550(k) "[t]he contractor and subcontractor shall have the right to suspend performance of their work, without penalty, until payment is received" where the specified procedure is followed. That procedure consists of two components. First, the owner must be informed by registered or certified mail that payment is due pursuant to the statute. [Cal. Civ. Code § 8850 (k)(1)]. In this incredibly important provision, there is no definition of when "payment is due pursuant to this section," although the most logical reading is that the provision applies to undisputed amounts or amounts determined to be due under the "disputes resolution procedures elected in the written contract of the parties." Counsel and most contractors recognize that this is a somewhat hollow right as it is virtually unheard of where a formal disputes resolution process concludes mid-project or at a time when a work stoppage would be a meaningful remedy. The statute does pose an interesting issue where the parties' contract utilizes a Disputes Review Board (DRB), where the DRB is authorized to issue interim decisions that are ultimately subject to challenge by a dissatisfied party. May a contractor stop work

where a DRB has provided interim monetary relief, subject to a post-completion challenge and the owner fails to make payment? Second, 30 days after sending the notice that payment is due, the contractor or subcontractor must send a 10-day written notice of intent to stop work to the owner by registered or certified mail, return receipt requested. [Cal. Civ. Code § 8850 (k)(2)]. The statute specifically provides that any attempt to wave the rights granted to contractors and subcontractors under the statute is void. [Cal. Civ. Code § 8850 (m)(1)].

Owner, contractor, and subcontractor personnel involved in California projects, both in the office and in the field, must be educated as to the requisites and timelines in the statute. The potential alone for penalty interest and work stoppages is quite significant, and strict statutory compliance must be adhered to in order to protect one's interests.

For further guidance on how these new California statutes may affect your business or to discuss compliance strategies, please contact our team.

Related People

Brian G. Corgan

t 404.815.6217

bcorgan@ktslaw.com