



California Construction Industry Faces New Payment Framework in 2026

By Herman S. Chatrath

California's construction remedy statutes change frequently as lawmakers respond to industry concerns. Traditionally, contractors facing payment disputes on private projects could record mechanics liens, sue for breach of contract, or pursue limited statutory remedies. Two new California laws from the 2025 legislative session will significantly expand contractors' remedies for payment and retention disputes on private construction projects. Both take effect January 1, 2026, and apply to contracts signed after that date. This article explains these important changes for owners, general contractors, and subcontractors.

The Private Works Change Order Fair Payment Act (SB 440)

Senate Bill 440 (Civil Code § 8850) creates a mandatory process for resolving payment disputes on some private construction projects. It addresses a longstanding problem of contractors and subcontractors often face over payment delays or disputes arising from changed work conditions, creating cash flow problems that can threaten their businesses. The new process applies to private construction projects except for a residential project that is not mixed use and does not exceed four stories. As written, both conditions must exist for a project to be exempt from the new requirements. This means that a multi-family residential apartment project, over four stories is exempt if it is not a mixed-use project. Similarly, the typical single-family residential development is exempt from the new requirements as long as it does not include mixed uses and is four stories or less.

For a qualifying project, when a general contractor has a payment dispute with an owner involving change orders, delays, disputed scope, or any contested payment amount, they must now follow specific steps set out in section 8850. First, the general contractor must send to the owner a written claim by certified or registered mail. This can't just be your standard change order or invoice; it needs to be a separate demand that references the statute.

Once the owner receives the written claim, they have 30 days to respond in writing, identifying what they agree to pay and what they dispute. Undisputed amounts must be paid within 60 days of that response. Miss these deadlines, and the financial consequences are severe. The same procedures apply between general contractors and subcontractors for qualifying projects.

Why This Matters

The law creates real leverage for general contractors and subcontractors through two mechanisms. First, unpaid amounts accrue interest at 2% per month—24% annually. Second, if disputed amounts are later found to be owed, that same 24% interest applies retroactively from when payment was originally due. This is a strong incentive to resolve issues over disputed amounts.

If an owner doesn't respond within 30 days, the claim is automatically denied. This triggers a two-step process that can allow the general contractor or subcontractor to stop work in as soon as 40 days following denial of the claim. For owners, ignoring these claims is not an option. The dispute resolution process moves through several stages: informal negotiations, then non-binding mediation, and finally litigation or arbitration. The parties can agree to skip the informal conference and mediation, but that is the only part of the process they can modify.

These rights cannot be waived by contract. The statute explicitly says any such waiver is void and against public policy. Your standard contract language needs review to make sure it does not conflict with these requirements.

Who Is Covered

While the law applies to most private construction projects except residential buildings of four stories or less that aren't mixed-use, it sunsets, or expires, on January 1, 2030. This gives owners, general contractors, and subcontractors four years to test how well the new procedures work.

In addition to a subcontractor's right to file claims with the general contractor, subcontractors can ask general contractors to present their claims directly to owners. The general contractor does not have to agree, but must explain why it refused to pay. What happens if a general contractor wrongly refuses? The statute doesn't say, which means courts will eventually need to sort that out. It also gives the Legislature more to play with in the next legislative session.

Lower Retention Limits (SB 61)

Senate Bill 61 (Civil Code § 8811) cuts the maximum retention from the traditional 10% to 5% on some private projects. This applies at every level, from owner to general contractor, and from general contractor down to all subcontractors.

The retention rate must flow down. If you agree to 3% retention with the owner, you can only withhold 3% from your subs. Total retention over the project cannot exceed 5% of the contract price.

Certain exceptions apply. Like SB 440, residential projects which are not mixed use and are four stories or less are exempt. The cap also doesn't apply if bid documents required performance and payment bonds that weren't ultimately provided. Although, there is no mechanism to adjust retention after the contract is signed if bonds fall through. Courts must award attorney fees to the prevailing party in disputes over these provisions, and like the Fair Payment Act, you can't contract around these limits.

What You Need to Do Now

All parties involved in private construction should review their standard contracts immediately. Your current forms likely do not comply with these laws, and non-compliant provisions are void.

Contractors need to train project managers on these new procedures and set up systems to track the various deadlines. When submitting claims under SB 440, remember to use certified mail, make it a separate demand, and reference the statute. While the 24% retroactive interest provides powerful leverage, consider the business implications carefully.

Owners must develop procedures for evaluating and responding to SB 440 claims within 30 days, as the automatic denial and work stoppage provisions leave no room for delay. Consider whether your contracts need reciprocal interest provisions for when you prevail in disputes. With retention potentially capped at 5%, owners and general contractors may need to rely more heavily on performance bonds or letters of credit for project security.

Subcontractors should ensure their contracts include proper flow-down language, so retention percentages stay consistent with upstream agreements. Owners and general contractors should also address what happens if required bonds aren't obtained and how that affects allowable retention rates.

Final Thoughts

These are not minor technical changes. The Fair Payment Act fundamentally alters the balance of power in payment disputes, and the retention cap removes a traditional security mechanism owners have relied on for

decades. The four-year sunset on the Fair Payment Act suggests California lawmakers are not certain these rules will work as intended, but for the next four years, they are the law and compliance is not optional.

Standard industry practices, like continuing work while disputes are resolved, or relying on contractual dispute procedures, won't protect you if they conflict with these statutes. The paperwork burden is substantial, and repeatedly invoking these procedures might affect relationships with owners and future business opportunities. Review your contracts, train your people, and develop new procedures before January 1.

Coleman & Horowitz, LLP represents clients in construction matters including business entity formation, corporate governance, contract preparation and review, bid disputes, lien disputes, bond disputes and collection for unpaid work. If you have any questions about this article or our services, contact the author, Herman S. Chatrath, or David J. Weiland, head of our litigation department, at (559) 248-4820 or (800) 891-8362 or hchatrath@ch-law.com or dweiland@ch-law.com.

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