Opinion No. 51-5395

August 3, 1951

BY: JOE L. MARTINEZ, Attorney General

TO: Mr. Burton G. Dwyre State Highway Engineer State Highway Department Santa Fe, New Mexico

*{*85}* I am in receipt of your letter of July 26, in which you request an opinion from this office concerning the payment to contractors Lizar and Donaldson of the 15% retainage sum (totalling $ 14,675.35) on Proj. No. S-36(2), for the satisfaction of undisputed claims of laborers, materialmen and sub-contractors. You point out that the other claimant, Chas. C. Terry, has brought suit in a State district court against the contractors and the bonding company on his claim of $ 5,936.55. You and members of your staff have discussed this case at some length with this office. I understand that you are disposed to comply strictly with your contract with Lizar and Donaldson, and that you wish to make no "liberal" disbursement of public funds which might establish a precedent for the future. In view of the foregoing you ask whether you are obligated or can, under the terms of your contract, make such a payment of the retainage sum to the contractors. This appears to be your primary question and your main concern. However, you also ask whether "by reason of Mr. Terry having filed suit against the contractor and the bonding company for collection of his claims, he has altered his rights under a distribution of the contractors' moneys held by the State Highway Commission as a 15% retainage on Progress Estimates, so that he could not claim a portion of such moneys." I will attempt to answer both of these questions.

As far as the undisputed claims, totalling $ 14,554.79, are concerned. and taking into account your wish to comply strictly with the contract, I believe that there is little doubt of the decision to be reached. I shall disregard for the moment the fact that there is one disputed claim upon which suit is being brought in a State court. In regard to payment of the 15% retainage, Sec. I, I-6 of the Standard Specifications (which are by reference included in the contract and the bond) says: "From each current estimate 15% of the total amount shall be deducted and held by the State until 'acceptance and final payment', and the contractor will be paid the balance * * * *."

*{*86}* § 58-237, N.M.S.A., says in part: "* * * no more than 85% of the contract price of the work shall be paid in advance of the full completion of such contract and its acceptance by the State Highway Engineer * * *."

Elsewhere in the Specifications, Sec. I, I-2, paragraph 2, it is said: "Before payment the contractor shall satisfy the engineer that he has fully settled and paid for all materials, and equipment used and for all labor done in connection with the contract." (This provision is, of course, to be distinguished, throughout this opinion, from the retainage provision, supra.)

Again in Sec. I, I-7, we find this language: "Before release of Final Payment the contractor will be required to furnish the engineer with a sworn statement that all bills against the work, as per Sec. I, I-2, have been paid." In my opinion, the foregoing excerpts can only mean that your office is not obligated to release the retainage fund until these undisputed claims have been settled and paid, and the certificate to that effect has been filed by the contractor. Such payment of creditors could be made by the contractor, or the bonding company, or both.

What is the effect on this of the fact that there is one creditor, Terry, who has a disputed claim, upon which suit is being brought in court? Can payment be made legally to the contractor of the retainage sum after the settlement of the undisputed claims, but before a final judgment has been rendered in court as to the disputed claim? A strict interpretation of the Specifications will lead us inevitably to the conclusion that "fully settled and paid for equipment and for all labor done" and "a sworn statement that all bills against the work * * * have been paid" mean that no payment of the retainage and no final settlement can be made until after judgment is rendered in the State court.

In my opinion, however, there is argument and authority against so strict a construction and application of the contract and bond. Although not controlling nor sufficient reasons, standing alone, to depart from the letter of the contract and bond, the practical objections to so strict a construction are obvious. Under such a construction it might easily be several months, and if an appeal is taken, one or two years, before Terry's "just claim" is legally determined and the contractor receives final payment and the retainage sum. It is likewise obvious that neither the contractor nor the bonding company, as defendants in the suit, could pay the now-disputed sum to Terry before such time. (I am assuming, of course, that a settlement of the suit before final determination is unlikely.) Furthermore, the implications of so strict an interpretation of this form of contract and bond are disturbing. It would be perfectly possible in such an instance for one to institute a suit based upon a fictitious or mala fide claim for the sole purpose of holding up final payment to the contractor.

I have searched in vain for authority to the effect that institution of a suit in court by one of the claimants constitutes "payment" or, in and of itself, alters the terms of the bond or contract. The point does not seem to have been decided, very likely because of the fact that most of such contracts are more liberal in their terms than is the one we are considering, and because of the latitude many public authorities employ in their interpretation or waiver of certain provisions. Many such contracts and bonds contain the stipulation that the contractor shall not be given final payments until the contractor has paid **or made provision for** the payment of laborers and materialmen. But aside from these more liberal contracts, in the absence of any controlling legislative provision, where the retention by public authorities of moneys due the contractor until laborers and materialmen have been paid *{*87}* **is a matter of contract** between the contractor and the public body, it seems clear that the public authorities may waive the provision and pay the contractor without incurring any liability to the laborers, materialmen, and sub-contractors. See 50 Am. Jur. 801, 37 L.R.A. (N.S.) 576. It is undisputable, in my opinion,

that the Standard Specifications, here a part of the contract and bond, are not "controlling legislative provisions" as this term is used above.

It is not the intention or purpose of this office to suggest such a waiver in the case of the Terry claim. In my opinion, however, and as I have suggested above, a strict construction of this type of contract and bond could work a real hardship. And it is further my opinion that the result of such a waiver would in no way be a misuse of public funds or be violative of § 58-237, N.M.S.A.

There is still another question to be considered: If the undisputed claims are to be paid and final payment made to the contractor, will Terry, by bringing suit in State court on the bond, relinquish claim to a portion of the retainage sum? It is my opinion that Terry will have no claim to a portion of this retainage fund. I have already indicated above that a waiver of a provision as to payment of the contractor does not leave the public authority liable to unpaid claimants. But let us consider the subject more fully.

What is the nature of the retainage fund? In some jurisdictions it is provided by statute that the funds be used to satisfy the claims of unpaid laborers and materialmen. But funds retained under **general provisions** calling for retention of a stipulated percentage of the contract price provide not only funds to be used in the event of the contractor's default in his obligations to the body, but funds out of which the contractor's surety may be paid in the event the latter is compelled to make good defaults of the contractor or to complete the contract upon his abandonment of it. See 164 U.S. 227, 172 P. 126, 50 Am. Jur. 798. It is clear from a reading of § 68-237 and your Standard Specifications Section I, I-6, that the New Mexico retainage provision is of the latter type, phrased in general terms. The retainage provision does not, then, specifically provide for payment of laborers, materialmen, or sub-contractors. It gives no lien or vested interest to such unpaid claimants. On the other hand, the **bond** we are considering is specifically conditioned upon the payment of all just claims for labor performed and materials and supplies furnished. as § 6-511, N.M.S.A., requires that it must be. § 6-512, N.M.S.A., moreover, provides that unpaid laborers, materialmen, or sub-contractors may bring an action on the bond. Incidentally, it was decided in New Mexico, in Portland Cement Company v. Williams, 32 N.M. 68, 49 A.L.R. 525, at a time before the present section, § 6-511, was in force, that a materialman could sue on a contractor's bond which was not specifically conditioned upon the payment of materialmen. And in the instant case, even if it be contended that the payments to the contractor are premature and not as specifically authorized in the original contract, the bonding company is not released, since it has specifically consented to such payment. See 43 Am. Jur. 912, 50 Am. Jur. 988.

In some jurisdictions, a provision in a public contractor's bond requiring the contractor furnish evidence that he has paid all claims and materials before he himself may receive full payment, is a complicating feature and is held to deny the laborers or materialmen the right to sue on the bond. It is reasoned by these courts that such a provision is designed for the sole protection of the public body, and that the unpaid claimants must look to money due the contractor for satisfaction of their claims. But such is not the law

in New Mexico, nor in the better reasoned cases in other jurisdictions. See 77 A.L.R. 116. These latter cases hold that this type of provision *{*88}* is for the benefit of materialmen and laborers, and that they may sue on the bond. Such a holding is found in the leading New Mexico case on the subject, Portland Cement Company v. Williams, 32 N.M. 68, where the Court said that the provision in the bond, similar to the one we are considering, created an obligation for the direct and substantial benefit of the materialmen and laborers.

I hope that this opinion has proved helpful. I have tried to give a fairly full interpretation of the contract and bond in question, while trying not to do violence to either. I would be most happy to discuss this case further if such be your desire.