



Payment and Retainage: When the Payments Stop Coming Bulletin # 5 - Updated May 18, 2020

There are few businesses tougher than subcontracting. The bidding can be cut-throat. A project schedule can be thrown off by something out of the subcontractor's control, such as the recent outbreak of COVID-19. Additional work may be forced on the subcontractor under its bid because of errors of other parties in defining the scope of work. However, when the dust settles and the work is done, at least the subcontractor always gets paid – and for those who believe that, there is a very nice bridge for sale in Brooklyn.

Factors Contributing to Subcontractor Non-Payment

Even without COVID-19, every subcontractor has run into payment issues at some time. There are any number of problems that can arise. A developer may be undercapitalized or have claims against it that cause it to withhold payment or to seek bankruptcy protection. A project lender may stop funding because of a developer default, an environmental concern, government regulatory action, or some other factor. A general contractor may get involved in a dispute with the owner over the work, project schedule, or escalating costs. A general contractor may take advantage of an unfavorable subcontract to unilaterally withhold amounts or impose an unreasonable retainage on the subcontractor. Minor defects in the documentation may allow a construction manager to reject payment applications in order to use a subcontractor's money for an extra month.

A subcontractor's assessment of the risk of non-payment on a project will vary with the size of the project and other factors. A subcontractor should verify whether or not a payment and performance bond is in effect for the project. The existence of a bond provides significant payment assurance to the subcontractor. If there is no bond, a subcontractor should attempt to get information on the owner and the project, including whether committed financing is in place to allow project completion. Is the developer/owner considered financially sound? Is the general contractor generally viewed as stable and well-capitalized, or in some financial trouble? Is the subcontract large enough that delays in payment or non-payment for several months' work could seriously damage the subcontractor's business?

Key Subcontract Questions

Subcontractors must carefully review the proposed subcontract agreement and consider the following questions:

- Is the retainage level set artificially high?
- Is the subcontractor's retainage percentage set higher than the general contractor's percentage?
- Does the retainage step-down once a substantial portion of the work has been completed?
- Does the subcontract contain "pay when paid" language?
- Is the subcontractor entitled to be paid for materials and equipment stored on site, upon notification to the owner and proper verification that the materials and equipment have arrived at the site?
- Does the subcontract provide for an equitable adjustment to the contract price if the subcontractor leaves the site due to nonpayment and must come back later?

- Is interest to be paid to the subcontractor on late payments?
- Is the subcontractor asked to waive its mechanic's lien rights?
- Is release of the subcontract retainage tied to completion of the entire project or just acceptance of the subcontractor's work?
- Is the subcontractor permitted to walk off the job within a reasonable period of time after a progress payment is due and not paid?
- Does the general contractor have a unilateral right to withhold payment, without advance notice, if it believes the subcontractor's work is defective?
- If such a payment is withheld, does the subcontractor have a quick and efficient remedy to enforce its rights under the subcontract?

Subcontractor Payment Rights Under ConsensusDocs 750 and Other Form Contracts

A subcontractor does have some control over the form of subcontract it signs. For example, ConsensusDocs 750 is a carefully thought-out form created by the construction industry to address problems with payment and other common issues. Under ConsensusDocs 750, a general contractor is only entitled to reject a payment application under limited circumstances. As to non-conforming work, a contractor must provide the subcontractor with advance notice, providing the subcontractor the opportunity to correct the work before payment is withheld. A subcontractor is also specifically permitted to apply for payment on materials and equipment not incorporated into the subcontract work, but delivered to and suitably stored on or off the worksite. A contractor is required to pay the subcontractor "within a reasonable time" even if it has not received payment from the owner, so long as the subcontractor's fault was not a cause of the non-payment to the contractor.

ConsensusDocs 750 also provides a specific process for the subcontractor to stop work on the project if the contractor does not provide payment. The subcontractor may stop work if: (1) the subcontractor does not receive a progress payment within seven days after such payment is due, as long as the reason for nonpayment is not the fault of the contractor; and (2) the subcontractor gives seven days written notice to the contractor. Once the contractor has paid the full amount owed to the subcontractor, the subcontract amount must be adjusted for the reasonable and verified costs of shutdown, delay, and startup. The subcontractor may also terminate the subcontract if work has been stopped for thirty calendar days because the subcontractor has not received progress payments.

Form contracts will also specifically provide a process for final payment under the contract. Under ConsensusDocs 750, once the subcontract work has been accepted by the owner and contractor, and the subcontractor provides evidence of fulfillment of the subcontract, the contractor must incorporate the subcontractor's application for final payment into the next application for payment from the owner. Even when the owner does not distribute funds to the contractor for payment of the final subcontract work, the contractor must still make final payment to the subcontractor within a reasonable amount of time.

Bottom Line

Now, more than ever, before signing anything, a subcontractor should carefully review payment provisions and procedures included in any contract. Form contracts, such as ConsensusDocs 750, are occasionally amended from their original form, and a general understanding of the form contract is no guarantee that a subcontractor understands the contract before them. In the unfortunate event that payments stop coming, closely follow all notice requirements in the contract before leaving the jobsite. As seen above, many form construction contracts provide the subcontractor with remedies for non-payment if the subcontractor follows the proper procedures. Failure to comply with technical notice requirements in the subcontract or leaving the job site too soon after nonpayment can place a subcontractor's legal position in serious jeopardy.

This Bulletin was written by SMACNA's General Counsel, Felhaber Larson