

PROMPT PAY ACTS FOR CONTRACTORS AND SUBCONTRACTORS

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I. Introduction.

The contractor/subcontractor prompt pay acts were enacted in the 1990's and remain confusing and ambiguous. The courts have had occasion to interpret them for over a decade and have helped clarify several items. The recent amendments to the Mechanics' Lien law may make the prompt pay acts a less-favored remedy, as waivability of lien claims is reduced. However, the prompt pay acts remain important and can be dangerous traps for the unwary.

There are three prompt pay acts: acts applicable to (1) private construction jobs; (2) public contracts; and (3) contracts with Commonwealth agencies (the Procurement Code). This analysis will focus on the act applicable to private contracts but will note significant differences between the other two prompt pay acts, where applicable.

In general, the prompt pay acts do two things: (1) create a timing mechanism for payments down to the various contract tiers; and (2) provide penalties for failing to pay on a timely basis without justification.

II. Owner Payment Obligations.

Building "owners" are defined as persons who have an interest in real property that is improved and who ordered the improvement to be made. This includes successors in interest. Building "improvements" subject to the act, include almost any construction work. There are no contract minimum amounts triggering applicability of the act requirements. However, it has been held that the prompt pay acts do not apply to contracts for single-family homes.

Owner payment obligations include the following:

1. Owners are required to pay in accordance with the contract; or in the absence of a contract, pay within 20 days after invoiced or after the end of the "billing period," whichever is later. Billing period is the cycle defined in the contract or if the contract does not specify one, the calendar month in which work is to be performed.

2. To preserve its right to withhold from any payments that might otherwise be due, the owner must notify the contractor of any “deficiency items,” for which payment is withheld, within seven (7) days of owner’s receipt of the invoice. The Procurement Code and Public Contract Act give the government agency 15 calendar days to notify. It is unclear whether this means the first invoice after the deficiency item arose, but, to be safe, owners should assume so to avoid creating an argument that they waived. A “deficiency item” is work performed but which the owner, contractor or inspector will not certify as being completed according to the contract specifications. The act does not define how much may be withheld or how that amount is to be determined. Note that owners must pay invoiced amounts for work that has been “satisfactorily completed.”
3. If an invoice is incorrect or incomplete, owners must notify in writing the invoicing party of the defect within ten (10) working days of receipt of the invoice.
4. Owners must pay retainage within 30 days after final acceptance of work.
5. If payments are not timely made in accordance with the act, the owner must pay:
 - Interest at the rate of 1% per month starting the eighth day after payment is due;
 - Penalty of 1% or the amount wrongfully withheld if litigation commences;
 - Attorney fees to a contractor that is a prevailing party in litigation. [Note that under the Procurement Code, the wrongful withholding must be proven to have been “arbitrary or vexatious” to obtain attorneys’ fees.]

III. Contractor Payment Obligations.

1. Contractors are required to disclose, before a subcontract is executed, the due date for receipt of payments from the owner. If this disclosure is **not** made, contractors must pay subs as though the owner has satisfied its contractual or statutory payment obligations to the contractor.
2. Contractors must pay subs the full proportional amount received for each sub’s work, based on work completed under the subcontract, within 14 days after receipt of payment from the owner or receipt of

the sub's invoice, whichever is later, unless a "deficiency item" with the sub's work has been identified. [Note that the Procurement Code Act requires payment by 14 days after receipt of payment from the owner - regardless of invoicing.]

3. Contractors must notify subs within seven (7) calendar days of the receipt of notice of the deficiency item if they intend to withhold from the sub's payments on account of the item. [Note that the Procurement Code gives contractors 15 calendar days from the date of the applicable invoice to notify the sub of deficiency items.] Thus, this notice may be required before payment for the work subject to the item is invoiced. It is unclear whether and how this requirement applies if the contractor, not the owner, first observes the "deficiency item." Contractors must pay subs for any invoiced work that is satisfactorily completed (i.e., not subject to a deficiency item claim).
4. It would appear that contractors must notify subs of invoice documentation problems in the same manner owners notify contractors. (See Section II.3)
5. Contractors must pay withheld retainage in accordance with the agreement. Retainage must be paid within 30 days of final acceptance of work. Contractors must pay subs retainage within 14 days after receipt of their retainage. (If anyone sees potential inconsistencies between those various requirements, they are not alone.) [Under the Procurement Code, contractors must pay subs earned shares of retainage within 20 days of receipt of payment by the contractor.]
6. Contractors may be liable to subs for the same categories of payments owners may owe contractors for any failure to timely pay under the act. (See Section II.5)
7. Once a contractor has made payment to a sub in accordance with the contract and act, claims against the contractor by parties owed payment from the sub who has been paid, would be barred. This bars supplier claims against contractors who have fully paid subs, though suppliers may obviously file lien claims under the Lien Law, as amended.

IV. Subcontractor Payment Obligations.

It was the apparent intent of the act to make subs pay sub-subs and suppliers in the same way contractors pay subs. The language of the act does not necessarily do this with respect to all provisions, but subs should follow the requirements listed in part III above to be safe.

V. How the Courts have Interpreted the Prompt Pay Acts.

The Prompt Pay Acts have been in place for over a decade. The Courts have interpreted them to mean what they say, namely, that owners or contractors that withhold money properly billed and due contractors or subcontractors, respectively, will be subject to the full panoply of remedies aggrieved prompt pay claimants may request. This includes interest, penalties, and even attorneys' fees. For example, where an owner failed to notify a contractor of deficient work, and an engineer's testing demonstrated that the work was satisfactory, the owner had no good faith basis to withhold money from the contractor, and interest and penalties were awarded, with the Court also willing to award attorneys' fees.

However, if an owner notifies the contractor of work it considers deficient, and has a good faith basis to believe that the work is deficient, courts are hesitant to impose the harsh penalties and attorneys fees remedies of the prompt pay acts. In addition, to be a "substantially prevailing" party for purposes of obtaining attorneys' fees, a party may have to show it was 100% vindicated; even the slightest recovery by the other side may preclude such an award. Thus, in *Zavatchen v. RHF Holdings*, two defendants who were sued by contractors for \$90,000 were not awarded attorneys' fees when the suing parties were awarded only \$300, or less than 1% of their claim.

It is also not reasonable to withhold payments of earned contract monies as a device to encourage settlement of other claims (e.g. for extra work allegedly performed) by the contractor. The only proper grounds for withholding earned contract payments are (1) deficiency items of which the contractor was given proper notice and (2) improper or incomplete invoicing of the work for which payments are claimed.

VI. Conclusion.

The prompt pay acts present pitfalls as well as opportunities. If payers are delaying payment for work done and have not identified any "deficiency

items,” they may be in danger of having to pay penalties or interest. Similarly, contractors should identify deficiency items in subs’ work as early as possible, to justify payment withholdings that may be necessary.

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