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Massachusetts' new retainage law: Good neighbor or neighborhood bully?

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Whenever a new family moved into our neighborhood when I was a kid, we pondered whether they had a son and, if so, would he get along with all of the other kids in the neighborhood, or would he become the neighborhood bully? On August 8, 2014, after several years of contentious wrangling, governor Deval Patrick signed into law a bill disarmingly titled "An Act Relative to Fair Retainage Payments in Private Construction," thus joining Massachusetts with a handful of other states which have enacted laws regulating the amount and manner in which retainage is held and released on private construction projects. The new law takes effect on November 8, 2014, and, for now at least, it is unclear whether this new law will be a good neighbor or the neighborhood bully.

Massachusetts' new retainage law was several years in the making and was spearheaded by the Associated Subcontractors of Mass. (ASM) - a local subcontractor trade association. It was originally opposed by the Associated General Contractors of Mass. (AGC), a trade group representing general contractors. Amidst strong opposition by NAIOP Mass., the Greater Boston Real Estate Board, (GBREB) and other construction user groups, the bill was enacted only a short time before it would have been pocket vetoed. AGC eventually supported the bill.

Although touted as a "retainage" law, the new law is much broader in scope than simply capping the amount of retainage on construction contracts at 5%; it has supplanted a significant portion of the construction contract negotiation process with a rigid set of procedures, timetables and definitions which cannot be waived or modified by the contracting parties. Retainage is the construction equivalent of a security deposit; the owner retains a certain percentage of the contract amount, customarily 10% in the private sector, which gets reduced and then fully released once the contractor achieves completion milestones known as substantial completion and final completion. Before the new law was enacted, the amount of retainage and the manner in which it was held and released was negotiated by the contracting parties.

In addition to the 5% cap, following are the new law's key provisions:

The new law applies to private building construction projects of $3 million or more, excluding projects of one to four dwelling units.

"Substantial Completion" of a project is defined as being "sufficiently complete . . . so that the . . .owner may occupy or utilize the work for its intended use." This definition may apply to an entire project or to a specific phase if the construction contract so expressly permits.

Once the contractor believes that he has achieved substantial completion, he "shall submit, not later than 14 days after substantial completion, a notice of substantial completion to the owner." The new law is silent on what happens if the contractor fails to deliver the notice within the 14 day period. The owner then has 14 days to respond to such notice. If he accepts the contractor's substantial completion notice, he can sign it. If he rejects the notice, he must, within the same 14 day response

period, so notify the contractor specifying "the factual and contractual basis for the rejection and a certification that the rejection is made in good faith." If the owner does nothing within the 14 day response period, the project will be deemed to be substantially complete on the date specified in the contractor's notice.

If the contractor disagrees with the owner's rejection, he must initiate a claim under the disputes resolution provisions contained in the construction contract within seven days thereafter. The new law does not specify what happens if the contractor fails to initiate his claim within the seven day period or what happens if the contract contains no disputes resolution provisions. Presumably, he is obliged to engage in the costly process of hiring a lawyer and filing suit against the owner.

If the owner has accepted the substantial completion date specified in the contractor's notice either by signing the notice or by remaining silent, the owner must submit a punchlist to the contractor within 14 days thereafter. The contractor must pass this punchlist along to his subcontractors within seven additional days thereafter. The punchlist can only be monetized in an amount not greater than 150% of the value of incomplete or defective work, and so-called "deliverables" punchlist items are capped at 2.5% of the contract amount. The owner's delivery of the punchlist is a pre-condition to his right hold any retainage after substantial completion has been achieved.

Once substantial completion has been established, the contractor "may" submit a written application for payment of retainage. The owner must pay the retainage not later than 30 days following the contractor's submission of the application.

The owner cannot withhold any portion of the retainage due to subcontractors for claims that do not involve such subcontractors' work.

There is an overarching obligation that owners and contractors must fulfill their obligations under the new law "in good faith and in a timely manner." The new law is silent on its applicability to architects and engineers.

These provisions flow down to all subcontractors.

Sound complicated? It is - and those are only the highlights.

How will this new process work in the field? ASM argues that the new law will promote fairness and equity in getting retainage released to contractors and subcontractors as quickly as possible. This, says ASM, will reduce or eliminate the burden on contractors and subcontractors who finance their work and to ensure that owners don't trump up feigned excuses for failing or refusing to release retainage. This will, also according to ASM, result in lower costs for owners. Owners groups like NAIOP Mass. and the GBREB claim that capping retainage at 5% will serve as a disincentive for contractors to finish their work and may prompt construction lenders to require additional security such as a surety bond, a completion guaranty or additional collateral. Others claim the new law will simply promote more litigation, and at a much earlier stage in the construction process.

Both sides have valid points. Only time will tell if the new law turns out to be a good neighbor or a neighborhood bully.

Several things are certain, however. The new law will require owners and contractors to revamp their construction contract documents and will be required to adjust the manner and method by which they deal with each other on the issues of retainage and project completion. Construction lenders will also likely need to weigh in on the effects of the new law on their construction lending practices.

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