

New Massachusetts Law Imposes Limits and Controls on Retainage under Construction Contracts

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On August 9, 2014, Governor Patrick signed SB2271 (<https://malegislature.gov/Bills/188/Senate/S2271>) into law. This law will have important impacts on both private developers and contractors. The Act limits the amount of retainage withheld under construction contracts and imposes procedures that strictly regulate payment of withheld amounts.

The main features of the law are:

- It applies to private construction contracts in excess of \$3,000,000 executed after November 6, 2014, except for projects designed to contain 1-4 residences.
- Retainage may not exceed 5% of any progress payment.
- At the time of Substantial Completion, retainage must be reduced to: (i) 150% of the value of the punchlist, (ii) 100% of claims, and (iii) the agreed upon value of missing deliverables, or, if there is no agreed upon value, then the reasonable value of deliverables, not exceeding 2.5% of the contract price.
- A schedule for establishing Substantial Completion, initiating disputes, dispute resolution and payment is imposed.
- Each notice and statement from any party in the retainage payment and dispute resolution process must be made in good faith.
- An Owner's rejection of the Contractor's Notice of Substantial Completion must include the factual and contractual basis of the rejection. A Notice of Substantial Completion is deemed accepted if not rejected by the Owner within 14 days after receipt.
- Payment of retainage must be made within 30 days after submission of an Application for Payment by the Contractor. Note that the 30 day payment period is shorter than the 45 day period which is imposed under the recently passed Massachusetts Prompt Pay Law.

The law will have significant impacts:

- The retainage limits imposed by the Act, both during the performance of the Work and upon Substantial Completion, are less than those often negotiated under current practice.

- The maximum retainage limit of 5% applies to every progress payment prior to Substantial Completion, thus making it unlawful, for example, to retain 10% of each progress payment through 50% completion of the Work, and 0% thereafter.
- Given the lower maximum retainage amounts permitted under the Act, in negotiating guaranteed maximum price contracts, Owners may be reluctant to exclude the Contractor's "general conditions costs" and fee payments from retainage, as Owners have often been willing to do in the past.
- There may be an increase in administrative costs incurred by Owners in order to enable them to comply with the strict scheduling requirements and the obligation to give a specific factual and contractual basis for rejection of the Contractor's Notice of Substantial Completion.
- The good faith certifications may lead to increased exposure, of all parties, to claims for treble damages and attorneys' fees under Chapter 93A of the General Laws.
- Since the Act requires that the Contractor initiate dispute resolution procedures within 7 days after the Contractor's receipt of the Owner's rejection of a Notice of Substantial Completion, Owners may want to consider adding to the construction contract early steps to the dispute resolution process (e.g., meetings between senior representatives of the parties and/or mediation) before either litigation or arbitration is commenced.
- Owners may consider assigning values to deliverables in the construction contract, in order to avoid disputes about the amount of retainage associated with deliverables at the time of Substantial Completion.

If you have questions about the new Act, please contact your usual Goulston & Storrs attorney or any member of the firm's Construction Law Group listed below.

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