

The New Massachusetts Prompt Payment Act and Its Impact to New Hampshire Contractors

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Introduction

Massachusetts law has long required prompt payment of contractors and subcontractors on public projects. On public contracts, state agencies must make payment to prime contractors within certain time limits, and prime contractors must pay subcontractors and suppliers promptly upon receipt of payment from the government entity. On private projects, until recently, payment terms were left to the parties to negotiate in their contracts and subcontracts. The remedy to effectuate late or non-payment was often limited to mechanic's liens and/or breach of contract lawsuits.

The current recession has led to a nationwide trend toward the adoption of "prompt payment acts" to ensure timely payments to contractors and subcontractors on private construction projects. On August 10, 2010, Massachusetts joined thirty two other states by enacting a "Prompt-Payment Act" (the "Act"). The Act will be codified at M.G.L. ch. 149, § 29E and was effective beginning November 8, 2010.

The Act represents a major shift in the law of private construction contracts in Massachusetts and will have an immediate effect on owners, developers, contractors, subcontractors, and material suppliers. Among other important provisions, the Act establishes strict time periods for the submission and approval of periodic payment requests and change

orders on private construction projects. As discussed below, the Act will significantly impact New Hampshire contractors doing business in Massachusetts. This article will review the key provisions of the Act and the potential impact to New Hampshire contractors.

Application of the Act

The Act applies to residential and commercial projects with an original contract price of \$3 million or more, excluding residential projects of four units or less. The Act applies to any contract that may be subject to the Massachusetts Mechanic's Lien Law, M.G.L. ch. 254; therefore, owners, general contractors, subcontractors, sub-subcontractors, and material suppliers are affected. The Act became effective on November 8, 2010 and applies to projects on which the prime contract is entered into after that date. There is no "reach back" provision; therefore existing projects are not affected.

Overview of M.G.L. ch. 149, §29E

TIME PERIODS FOR APPROVAL/REJECTION OF PERIODIC PAYMENT APPLICATIONS

The Act establishes "not to exceed" time periods for the submission and approval or rejection of periodic payment requests. Periodic payment requests must be submitted within 30 days of the performance of the work. Unfortunately, this means that a monthly submission date tied to a calendar day (such as the 15th of each month) would now be a statutory violation as some months have 31 days. The payment applications must be approved or rejected by the Owner within 15 days of submission. The approval/rejection period is extended by 7 days for each tier below the prime contract (thus, a general contractor would have 22 days (15+7) to approve or reject a subcontractors payment application. Payment must

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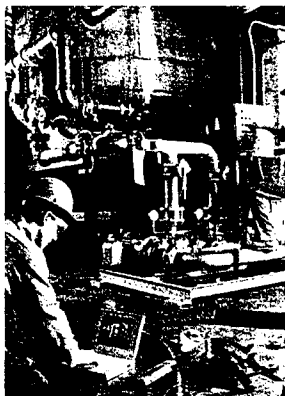
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be made within 45 days of approval.

A payment request that is neither approved nor rejected within the required timeframe is deemed approved, unless it is rejected before the date payment is due. Thus, a general contractor could actually wait the 22 days (for approval/rejection) have it "deemed" approved, and wait another 44 days (one day before payment is due) for a total of 66 days, and then reject the payment application. Rejection of a payment application must be made in writing, explain the factual and contractual basis for the rejection, and be certified as being made in good faith. Rejection of a payment request shall be subject to dispute resolution procedures. However, any contract provision requiring a party to delay the commencement of dispute resolution procedures to a date later than 60 days after the rejection of the payment application is void and unenforceable. It is therefore no longer acceptable to delay the resolution of disputed payment requests until the end of the project.

TIME PERIODS FOR APPROVAL/REJECTION OF CHANGE ORDERS

The Act establishes "not to exceed" time periods for the approval or rejection of any written request to increase the contract price, i.e., change orders. A written change order increasing the contract price must be approved or rejected within 30 days after commencing the change order work or within 30 days after receipt of the written request, whichever is later. Much like the payment application process above, the deadline for approving or rejecting change orders is extended 7 days longer than the above tier for each tier below the prime contract. A written change order that is not approved or rejected within the specified timeframe is deemed approved, but may be rejected at any time up until the date payment is due. Rejection of a change order must be made in writing, explain the factual and contractual basis for the rejection, and be certified as being made in good faith. Any contract provision requiring a party to delay the commencement of dispute resolution procedures to a date later than 60 days after the rejection of the change order is void and unenforceable.

PAY-IF-PAID PROVISIONS ARE UNENFORCEABLE

The Act makes any contract clause that conditions payment on the receipt of payment from another entity, e.g., "pay-if-paid" clauses, unenforceable, except in two limited circumstances.

First, pay-if-paid clauses may only be enforceable when nonpayment by the owner is due to a subcontractor's failure to perform the work under its contract and the subcontractor fails to cure the problem within the cure/notice time period provided in the contract (or within 14 days if the contract does not contain a cure and notice provision).

Second, pay-if-paid clauses may only be enforceable if the owner is insolvent or becomes insolvent within 90 days of submission of the payment application and the general contractor took specific steps to secure payment by filing a mechanic's lien before submitting its first payment request, maintaining the lien, and pursuing all reasonable legal remedies to obtain payment. Subcontractors can request that the general contractor disclose in writing the remedies pursued to secure payment, and a response is due within 10 days of the request. If there is no response, or if

the subcontractor requests in writing that additional remedies be pursued and the general contractor fails unreasonably to do so, then the subcontractor can seek an expedited determination under MGL ch. 254 §15A as to what remedies are "reasonable."

The Act requires that both of the above exceptions be expressly stated in the contract.

SUBCONTRACTORS MAY STOP WORK IF PAYMENT IS OVERDUE BY 30 DAYS

The Act states that any contract terms requiring a party to continue performance when payment is overdue by at least 30 days will be void and unenforceable unless there is a dispute regarding the quality of work or a notice of default. In essence, subcontractors are no longer at risk of being in breach of contract if they stop work when payment is overdue for at least 30 days.

REQUIREMENTS OF THE ACT MAY NOT BE WAIVED

Any contract terms purporting to waive or limit the effect of the Act will be void and unenforceable.

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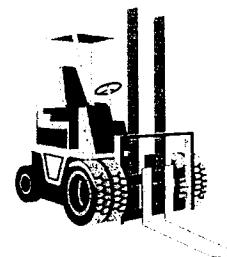
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Illustrative Examples of the Massachusetts Prompt Pay Act

The following examples illustrate the “not to exceed” time periods in the Act and some of the potential issues raised by the Act.

EXAMPLE #1 – THE APPROVAL PROBLEM

- Day 1: Subcontractor (“Sub”) submits payment requisition to general contractor (“GC”).
- Day 2: GC approves Sub’s requisition. GC submits its own requisition to Owner (Sub’s 45 days start).
- Day 17: Lack of written approval/rejection within 15 days by Owner means Owner is deemed to have approved GC’s requisition. (GC’s 45 days begins).
- Day 47: GC payment due to Sub.
- Day 62: Owner payment due to GC.

In this example, the general contractor’s quick approval of a subcontractor’s invoice results in the general contractor having to pay the subcontractor before receiving payment from the Owner. The general contractor’s requisition is deemed approved by the Owner when the Owner fails to act within 15 days. Notably, the Owner could potentially reject the general contractor’s requisition after the general contractor has made payment to the subcontractor.

EXAMPLE #2 – TIMING BY DEFAULT

- Day 1: Subcontractor (“Sub”) submits payment requisition to general contractor (“GC”).
- Day 7: GC submits its payment requisition to the Owner including Sub’s.
- Day 22: GC has 22 days (15 + 7 because Sub is one tier below) to ap-

prove/reject. Lack of action by GC means Sub’s payment requisition is deemed approved by day 22. (Sub’s 45 days begin).

- Day 22: Owner has 15 days to approve GC’s payment requisition. Lack of action by Owner means GC’s payment requisition is deemed approved by day 22. (GC’s 45 days begin).
- Day 67: Sub is due payment from GC.
- Day 67: GC is due payment from Owner.

This example indicates the timing by default scenario when a subcontractor submits a payment requisition to the general contractor and the general contractor bundles the subcontractor’s payment requisition with its own req-

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uisition and submits them both to the Owner.

EXAMPLE #3 – THE SEVEN DAY RULE

- Day 1: Duct work insulation vendor submits invoice to duct insulation Sub (42 days for approval)
- Day 7: Duct insulation Sub submits payment requisition to duct work Sub (36 days for approval)
- Day 14: Duct work Sub submits payment requisition to HVAC Sub (29 days for approval)
- Day 21: HVAC Sub submits payment requisition to GC (22 days for approval)
- Day 28: GC submits payment requisition to Owner (15 days for approval)
- Day 43: Owner deemed to have approved GC's payment requisition by expiration of 15 days. GC deemed to have approved Sub's payment requisition by expiration

of 22 days, etc. (45 days begins for everyone).

- Day 88: Everyone's payment is due

In this example, approval by default results in everyone's payment becoming due on the same day. Written approval of an invoice by any of the above entities would immediately start the 45 day clock, resulting in payment becoming due to a lesser entity before that entity is due payment.

A general contractor/subcontractor relationship was used for all of these examples, for ease of understanding. However, it is critical to understand that these time delays in payment will also occur between subcontractor/sub-subcontractors and subcontractors/materialmen. Thus, a subcontractor could be placed in the position of owing its subcontractors and suppliers just as easily as the general contractors in the examples above.

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Impact to Standard Form Contracts

The Act will require revisions to standard form contracts commonly used by general contractors, subcontractors, and material suppliers. At the very least, the terms of this statute will require revisions to the following:

- Billing intervals shall be no more than 30 days, except that the Act allows the initial billing period to be up to 14 days longer. The 30 day maximum billing period does not facilitate end-of-the-month billing;
- Timing allowances for approval or rejection of payment applications;
- What is required for a rejection of a payment application;
- The timing and trigger for payment;
- Pay-when-paid clauses virtually ineffective – cannot extend beyond the 45 day period;
- Timing allowances for written requests to increase the contract price (i.e. change order proposals that increase the contract sum); and,

- The two exceptions to the general rule that pay-if-paid clauses are unenforceable must be expressly included in the contract.

Impact to New Hampshire Contractors

New Hampshire general contractors participating in private construction projects in Massachusetts must be aware of the necessary contract revisions. Standard-form AIA contracts, in their present form, or a company's standard form contracts will not comply with the Act.

Ultimately, the Act will require owners, contractors, subcontractors, and suppliers to institute administrative and project management changes to address and manage risk and ensure compliance. There will be a need for increased vigilance in the tracking of invoices, approval/rejection periods, deadlines, and "deemed approved" dates. Regular communication between key project participants will be the key to compliance.

Advice To Build On

It's no secret the construction industry has always been a risky venture. This is especially true in today's volatile economy.

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