

Subcontractors Seek Anti-Indemnity, Retainage and Prompt Pay Reforms

by Luke McFadden, ASA Director of Government Relations

Every day we are inundated with new and supposedly better, funnier, faster, or more convenient things. Remember pet rocks? Parachute pants? Karaoke bars? Pet rocks, parachute pants and karaoke bars were fashion and social trends that - happily - do not remain part of our lives today. Of course, not all trends relate to fashion or social life. Some trends relate to reform, such as legislative and judicial reforms affecting construction subcontractors. With a number of recent and positive changes in the states, this is one trend subcontractors can definitely live with.

When *The ASA Report. The Policy Environment in the States* was published in early fall 2004, it came as little surprise to many specialty trade contractors that 98 percent of the states failed to provide adequate prompt payment protections to construction subcontractors. The states' performance was just as poor on many other issues. Surely, progress has been incremental. But a broad survey of subcontractor issues shows that progress is being made, and almost always it is led by ASA members.

Since the introduction of ASA's Subcontractors Transfer of Risk Action Plan (STRAP) in the fall of 2001, the movement to reform indemnity laws has steadily gained momentum. States such as Montana and New Mexico instituted reform in recent years. The Oregon Supreme Court struck down a challenge to Oregon's potent anti-indemnity law, which continues to protect

subcontractors. The court agreed with a legal brief filed by ASA that argued that Oregon law does not permit a general contractor, named as an "additional insured" on a subcontractor's general liability insurance policy, to coverage under the policy "for losses arising in whole or in part from the [general contractor]'s fault."

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Opponents of the ASA-led anti-indemnity movement have taken notice and are starting to fight back. In the spring of 2005, Colorado construction subcontractors celebrated the passage of a bill to establish limited-form indemnity and prohibit any party from contractually transferring responsibility for its own negligence to another party. The celebration was short-lived, however. Gov. Bill Owens (R) vetoed the bill with the support of homebuilder, construction owner and other groups, stating: "General Contractors, investors and property owners must be able to retain the right to bargain for protection from subcontractors." An anti-indemnity bill in Arizona to block broad-form indemnity, and limit hold harmless clauses and additional insured agreements, passed through the Arizona House, but died in the Arizona Senate. Undeterred, subcontractors in Arizona,

California, Colorado and elsewhere, are mapping out their next moves to achieve indemnity reform.

ASA members have long advocated for the elimination of retainage, arguing that its purported necessity is illusory and that it causes subcontractors undue financial hardship. This argument has been bolstered by Clemson University's

study, "Retainage Practice in the Construction Industry," published by the Foundation of ASA (for sale online at www.contractorsknowledgenetwork.org). The construction industry is witnessing a trend toward enactment of retainage reform laws, in particular retainage maximums. Most recently, five states enacted laws strengthening the rights of subcontractors through retainage maximums.

One state addressed retainage on private work, while four states enacted laws regarding retainage on public work. ASA members led the reform movements in each of these instances. The Kansas Legislature established a 10 percent maximum for retainage on all private work. Legislators in Wisconsin reduced the maximum retainage level on progress payments for state and local public projects from 10 to 5 percent on the first half of the project,

while Montana legislators reduced public works retainage from 10 to 5 percent for the duration of the contract. Florida legislators passed a law establishing a maximum of 10 percent retainage on the first half of the project, consequently reduced to 5 percent on the second half of the project. In South Carolina, retainage on public and private work was capped at 3.5 percent. Working from the successes in these states, ASA members in Arizona, California, Maryland, North Carolina, Ohio and elsewhere are seeking retainage reform. In North Carolina, ASA members are participating in a retainage study group organized by members of the North Carolina Legislature to study the effects and develop possible remedies to retainage in the state's construction industry.

One trend to watch is a growing number of states examining and enacting legislation allowing public entities to use electronic reverse auctions.

The seriousness of slow payment as an issue is undiminished from previous years. ASA's 2004 Member Needs Assessment revealed that more than 75 percent of ASA members consider slow final payment and slow progress payments as the most serious issues facing subcontractors.

The push for reform of prompt payment laws is a constant struggle. In the past year, ASA members in several states persuaded legislators to pass laws strengthening payment protections for construction subcontractors. A prompt payment bill that passed in Kansas requires construction owners on private work to pay prime contractors within 30 days for completed, undisputed work, and contractors to pay their subcontractors within seven days of receipt of payment for the subcontractors' work. ASA of Florida successfully lobbied for the enactment of a new law reducing the progress payment schedule from contractors to subcontractors on state and local public projects from 15 to 10 days, and from subcontractors to sub-subcontractors from 15 to seven days. ASA of Oklahoma convinced Oklahoma legislators to pass a law requiring payments to

subcontractors on all undisputed state and local work to be made within 10 days after the general contractor receives payment for a subcontractor's work from the owner.

What are legislatures doing to protect construction subcontractors when payment simply is not made? Subcontractors lament the prohibitive cost of solutions such as taking delinquent clients to court or suspending work. Thanks to ASA members' diligence, there is a trend toward providing relief to subcontractors when they are forced to take action. New laws in Florida, Kansas and Oklahoma all extend the right to be reimbursed for de- and re-mobilization costs when a subcontractor is forced to suspend work for late payment. These new state laws also award attorney fees

to the prevailing party in a dispute. Such laws empower subcontractors to seek the payments that are due to them, while limiting frivolous suits by forcing the losing party to reimburse the prevailing party.

Filing a mechanic's lien is an essential protection for subcontractors, and the courts continue their traditional hesitancy to tamper with the fundamental right of subcontractors to claim liens on private property which they have constructed or improved. In a decision with repercussions far beyond state borders, the Rhode Island Supreme Court agreed with ASA in a case in which a construction owner challenged the lien filing process as purportedly violating its constitutional "due process" rights. ASA and the Rhode Island Subcontractors Association submitted a "friend of the court" brief in the case arguing that the filing of a lien notice expresses the subcontractors' economic interest in the property and does not violate constitutional "due process" protections. The fundamental right to file a lien survived the challenge.

Subcontractors are also concerned, however, with the constant

pressure put on them to sign away their lien rights through waivers and releases. In Tennessee, legislation prohibiting contractual lien waivers was enacted thanks to the grassroots action of ASA members in that state. The bill passed through the Tennessee General Assembly without a single dissenting vote.

Often, payment to subcontractors is usurped by pay-if-paid clauses, which predicate subcontractor payment on another party's receipt of funds. While there has been less activity on this issue than in some years, there were some important developments. Kansas legislators passed legislation declaring that a pay-if-paid clause is no defense to a claim to enforce a mechanic's lien or payment bond. Further, in a case in which ASA voiced subcontractor concerns, an Arizona appeals court denied a payment surety's request that the court publish a decision stating pay-if-paid clauses do not violate Arizona's Prompt Pay Act.

One trend to watch is a growing number of states examining and enacting legislation allowing public entities to use electronic reverse auctions. In the spring of 2005, 12 reverse auction bills were introduced, according to ASA's legislative tracking service. [This tracking service is available to all ASA members in the members-only section of the ASA Web site.] The salient question for subcontractors is whether and how such laws impact bidding. Some laws that are "on the books" already, such as Minnesota's, allow the use of the reverse auction bidding but specifically prohibit the purchasing of construction services using this method. Other state laws are not clear and may pose a threat to subcontractors who want to ensure the integrity of procurement processes.

While pet rocks, karaoke machines and parachute pants were fads, the important trend of reform continues, overall, to level the playing field for construction. ■

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