



POSITION PAPER IN SUPPORT OF
Massachusetts Fairness in Private Construction Contracts Act

JUNE 2009

BACKGROUND

Getting paid for work performed is not only a universal expectation, but is fundamental to good performance and business survival. Yet in construction, contractors are often unable to enforce the payment provisions in their contracts. A recent survey of Massachusetts subcontractors identified slow payment as *the business issue of greatest concern to them*, just as it has long been a serious issue in the construction industry nationwide.

Recognizing the problem, most states have long had legislation regulating payments on public construction, and in recent years, more than half have also enacted legislation mandating fair payment practices in private construction. Illinois became the latest state to enact a private sector “prompt pay” law in July 2007, joining Kansas, Arizona, Oregon, Connecticut, and New York, among others.

The Massachusetts proposal, filed by ASM in 2007, is the result of nearly two years of effort. It borrows heavily from the laws in other states, but is generally less restrictive and more respectful of freedom to contract. At essence, the Massachusetts legislation is simple: It requires that all construction contracts include reasonable payment terms that apply equitably to all parties, and it provides remedies for parties who do not receive timely payment – including the right to stop work, without fear of unfair reprisal.

On the national level, owners, general contractors, subcontractors, designers and surety professionals have endorsed fair payment as the industry standard, and included fair payment provisions in the “ConsensusDOCS” model contracts that were released in fall 2007. Fair payment terms have also long been the norm in AIA’s standard contract forms. While a positive step, model contracts are not a universal solution, however, since many companies typically change the documents, or do not use them at all.

As a practical reality, legislation provides the only sure means of achieving change. In Massachusetts, the Fairness in Private Construction Contracts Act will provide parties to construction contracts lasting payment remedies that are unavailable through any other means – and in so doing, will create a better business environment that contributes to a strong economy in our state.

PURPOSE AND BENEFITS

The purpose of this legislation is to remedy the failure in Massachusetts contract law to adequately enforce obligations to make timely payment for the performance of work in the construction industry.

1. Why is existing contract law in Massachusetts inadequate?

- a. Currently, there are few rules that apply to private contracts for construction in Massachusetts. The federal Uniform Commercial Code (UCC) promotes honesty, good

faith and fair dealing in the commercial sale of goods, but does not apply to transactions involving real property. And

common law, though applicable to construction, provides little guidance because it is sometimes contradictory: For example, failure to pay for performance is a material breach of contract in Massachusetts, giving contractors the right to stop work. Yet failure to perform the work may constitute a breach of contract as well, resulting in forfeiture of all amounts due. Fear of forfeiting payment is a “gun to the head” that compels many contractors to continue performing work without payment – often on advice of counsel – long after sound business practice would dictate they stop.

In short, federal UCC law does not apply to construction, and common law is not organized with construction in mind, which means there is no ready or practical means to ensure that parties receive payment for work performed.

- b. As numerous other states have concluded, it takes statutory law to resolve payment problems in private construction. The ultimate goal of the ASM legislation is promote a more cooperative business environment, based on the sound public policy principles of good faith and fair dealing, without unduly restricting freedom to contract.

2. Why is action needed?

- a. The Massachusetts construction industry is in crisis, with chronic slow payment – and even nonpayment – now the normal state of affairs. Many companies must wait 60, 90, 120 days or more for payment, while covering the costs of payroll and materials at their own expense the entire time. Such delay can mean financial disaster for contractors and subcontractors, as it forces them to extend credit to a project well beyond the point where it is reasonable to do so. In effect, they are serving as banks, with no guarantee of return.
- b. This situation is a hardship for subcontractors in particular, as they bear most of the costs for labor and material, and have the most to lose when they don’t get paid. The endless struggle to get paid is a hardship not only for the company itself, but also for the workers who depend on the company for their jobs and benefits. Chronic cash flow problems have caused some subcontractors to leave the business altogether or move to other states, and forced others into bankruptcy – in all cases, leaving workers unemployed, and in some cases, their pensions unfunded.
- c. Owners, too, are hurt by slow payment, because it drives up the cost of construction, as contractors add contingency to all jobs to cover potential non-payment. Owners are also affected when contractors or subcontractors who have not been paid are simply unable to continue, creating disruptions and delay.
- d. Nonpayment is a serious problem not just for the companies affected, but for the state as a whole. Construction represents a significant segment of the Massachusetts economy, employing many thousands of workers and creating the built environment on which so many other businesses and workers depend. As recent high profile bankruptcies demonstrate – the failure of even one company directly affects dozens of others, and the workers they employ. The more companies that are struggling financially, the greater the ripple effect throughout the economy of our state.
- e. Chronic slow payment and nonpayment creates a dysfunctional business environment that retards the growth of small businesses, and ultimately hurts the economy of the commonwealth.

3. How will the legislation help?

- a. The legislation does not dictate when payments must be made. It simply requires that all contracts include specific, reasonable payment terms that apply equally to all parties, up and down the tiers – owners, contractors, sub-contractors, and sub-subcontractors (including material suppliers). The legislation leaves the specific timing of requisitions, approvals and payments to the discretion of the parties, in order to respect “private right of contract.”
- b. The legislation gives all parties who are not paid timely in accordance with the contract the right to suspend work, and eventually terminate, without being held in breach of contract.
- c. Mindful of the realities of construction projects, the legislation allows for withholding of amounts due for any legitimate reason – such as retainage, good faith claims or disputed amounts.
- d. There is no reason to fear that contractors or subcontractors would suddenly bring construction to a halt by invoking the statute. Construction is a service business, and service aims to please the customer. Suspension and termination would be a last resort, when all else has failed. Such action by a contractor or subcontractor would serve either to get the necessary attention to resolve the payment problem, or would provide a legitimate escape from an unreasonable situation that puts the contractor or subcontractor’s business at risk.

4. Who will benefit from the Fairness in Private Construction legislation?

- a. All parties to a construction contract will benefit significantly from increased stability in the industry that results from fair and reliable payment practices. Owners will get better pricing and better assurance of performance on time and on budget. Contractors and subcontractors will be assured the cash flow necessary to pay vendors, meet payroll, and perform the work. By extension, sub-subcontractors, vendors and workers will benefit as well.
- b. The general public will benefit by having a stable, well-functioning construction industry that offers good jobs and career opportunities for people at all skill levels, in both the trades and management. Ultimately, the commonwealth as a whole will benefit by having an industry that promotes the growth of small businesses, creates jobs, and helps strengthen our position in the ever-more-competitive national and global economy.

For more information, contact:

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SUMMARY

Massachusetts Fairness in Private Construction Contracts Act

Unlike “prompt pay” statutes in other states, ASM’s bill does not mandate when payments must be made for work performed. It simply requires that all contracts include specific, reasonable payment terms, and provides remedies to parties who are not paid in accordance with those terms – including the right to suspend work, without fear of unfair reprisal. The legislation leaves the specific timing of requisitions, approvals and payments to the discretion of the parties, in order to respect “private right of contract.”

The legislation includes these key provisions:

- 1) The requirements of the statute apply equally to all parties up and down the tiers – owners, contractors, sub-contractors, and sub-subcontractors (including material suppliers).
- 2) All contracts must include a specific requisition and payment schedule. The legislation does not dictate the schedule, leaving it to the discretion of the parties; but in the absence of a specific schedule in the contract, the default billing and payment schedule will be 30 days.
- 3) All contracts must include a specific time for approval of requisitions, but the time is not set by statute. All parties must give timely notice of amounts not approved. Approved requisitions must be passed up the tiers timely, and failure to do so cannot be used as a reason to withhold payment.
- 4) Payment for changes in the work is due in the normal requisition & payment cycle, provided the changes were authorized in writing. Payment cannot be contingent on having formal written change orders adjusting the contract price.
- 5) All parties may withhold payment for legitimate reasons: i.e., for retainage reserved by the owner or for good faith claims or disputed amounts.
- 6) The contract must state a specific time for payments to be made. In the absence of a specific time in the contract, the Owner must pay within 30 days of receiving a requisition, and each lower tier party must pay within 7 days of receiving payment.
- 7) Contingent payment provisions (aka “pay-if-paid”) are not allowed.
- 8) Interest, computed at the legal rate, is incurred for every day payment is late.
- 9) All parties have the right to suspend work, with 7 days notice, if payment is not received within 7 days after the due date; and the suspension cannot be considered a breach of contract.
- 10) The contract time must be extended, and contract sum increased, for contracts affected by suspension.
- 11) All parties have the right to terminate work, with 7 days notice and without penalty, after a suspension of more than 30 days.
- 12) There can be no provisions waiving litigation rights, or rights to resolve disputes through other means. Venue for all actions is to be Massachusetts only.
- 13) The prevailing party in any legal action is entitled to attorney’s fees.
- 14) The law applies to all private construction except small residential projects and certain public-private projects.

States with Prompt Payment Laws for Private Construction

Dates indicate either date of first passage,
or date of major amendments expanding the law.

1. Alabama
2. Arizona – 2002
3. California – 2005
4. Connecticut – 1999
5. Delaware
6. Florida
7. Georgia
8. Illinois – 2007
9. Kansas – 2005
10. Kentucky – 2007
11. Maine
12. Maryland
13. Minnesota
14. Mississippi
15. Missouri – 1999
16. Montana
17. Nevada
18. New Jersey – 2006
19. New Mexico – 2007
20. New York – 2003
21. North Carolina
22. Ohio
23. Oregon – 2004
24. Pennsylvania – 2004
25. South Carolina
26. Tennessee – 2007
27. Texas
28. Utah
29. Vermont



July 2, 2008

His Excellency Deval Patrick
Governor, Commonwealth of Massachusetts
State House, Room 360
Boston, MA 02133

RE: H. 4730, An Act to Promote Fairness in Private Construction Contracts

Dear Governor Patrick:

I write to you today in follow up to a conversation you had recently concerning H. 4730, our “Prompt Pay” legislation, at an event co-hosted by Stephen Harold and Greg Hanley. As you may recall, Tom Theroux of the Plumbing, Heating, Cooling Contractors of Massachusetts (PHCC) briefly described the bill, and mentioned how important it is to the members of PHCC – and in fact, to all contractors and subcontractors. You expressed interest in the proposed legislation and asked for more information about it.

H.4730, filed by our organization, addresses what is arguably the most serious concern for construction professionals today: getting paid for work performed. Typically, subcontractors are forced to wait 60, 90, 120 days or more to receive payment for their work, while paying the weekly costs of labor and material the entire time. We know of no other industry where payment delays are as bad as in construction. Yet there is little an unpaid contractor can do. If he stops work, he’s in breach of contract, but if he keeps working, he risks serious financial harm. If he chooses not to work for slow-paying companies, he may as well close his doors. In short, he has no leverage, and is in a no-win situation.

Slow payment is a problem not just in Massachusetts but in every state of the union. Recognizing the problem, more than half the states (see the attached list) have already passed legislation requiring fair payment in private construction, as a matter of public policy.

H. 4730 is modeled on laws that have already been passed in Arizona, Connecticut, Kansas, New Jersey, New York and Oregon, among others. Our proposal is different, however, in that it does not go as far, because we understand the reluctance to interfere with private contracts.

Attached is an information packet that provides more background and detail on the legislation, as well as a copy of the bill itself. At its core, the legislation is simple:

- It requires that all contracts include reasonable payment terms, negotiated by the parties. Unlike most “prompt pay” laws, it does not mandate specific pay periods, but leaves that to the discretion of the parties.
- It requires that all parties pay undisputed amounts in accordance with the contract, or incur consequences. (The bill allows withholding of payment in cases of legitimate dispute.)

- It gives all parties who not paid timely the right to stop work, without being held in breach of contract – which is virtually impossible today.
- The bill calls for payment practices that are fair to all parties equally – owner, contractor, subcontractor, and sub-subcontractor – and it does not put any parties at special advantage.

There are some who will say payment problems should be addressed privately, through education and promotion of industry “best practices.” Experience has shown that that approach does not work. Prompt payment terms have long been the norm in the contract documents published by the American Institute of Architects (AIA), which are considered the industry standard. However, most companies modify the AIA forms, if they use them at all, and payment terms rarely survive unchanged.

In short, H.4730 is a bill that corrects problems that can’t be fixed any other way. It will help ensure the cash flow that companies need to stay in business, which is all the more important in these times of economic uncertainty. As we have seen all too often recently, many small companies have been badly hurt in the fallout from high profile bankruptcies – because they kept working when they hadn’t been paid. H.4730 would provide some recourse, and allow a company to take action before nonpayment causes financial disaster for the company itself and all those who depend on the company for their jobs.

H.4730 has received swift and favorable action in the Massachusetts House, and is currently in the Committee on Bills in Third Reading. We hope it will not be long before it reaches your desk, and we urge your support. By ensuring fair payment practices, the bill promotes the growth and success of small businesses in Massachusetts, which are critical to the economic well-being of the commonwealth.

We would welcome the opportunity to meet with you and your staff to discuss this important measure and answer any questions you may have.

Thank you for your consideration.

Sincerely,



Monica Lawton
CEO

cc: Scott Packard, President, Associated Subcontractors of Massachusetts
Thomas Theroux, Executive Director, PHCC of Massachusetts

The Associated Subcontractors of Massachusetts, Inc. (ASM), founded in 1950, is a statewide trade association representing nearly 400 specialty contractors and suppliers in the commercial construction industry. Members include companies both large and small, union and open shop, who together employ over 25,000 workers on private and public building construction in the Commonwealth.