

# Construction Payment Reform Act of 2002

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The first day of Colorado's 2002 Legislative session saw the introduction of a bill that, if passed in its current form, would significantly impair the rights of owners, contractors, subcontractors and second-tier subcontractors to negotiate the payment terms of their contracts. Dubbed the Construction Payment Reform Act of 2002, HB 02-1062, the "Proposed Act" would apply to all construction projects in Colorado, with the exception of single- or double-family residences. This article discusses the provisions of this proposed prompt-payment act.

### I. PROOF OF SUFFICIENT FUNDS

First, under the Proposed Act, a project owner must provide evidence to the contractor and subcontractors that it has set aside sufficient funds to satisfy all known expenditures, including change orders, and that such funds are available for payment to them. If the contractor or subcontractors are not satisfied with the evidence, they may delay or suspend construction until the owner produces satisfactory evidence.

### II. PROGRESS PAYMENTS

#### *A. To the Contractor*

Second, the Proposed Act dictates a schedule for draw requests and payments. Contractors must submit draw requests on or before the first day of each month, incorporating all work performed during the previous month. If within seven days after receipt of a draw request the owner fails to issue a "written statement contesting the . . . request and stating in detail the specific work that is not approved, the reasons why such work is not approved, and the reasons all or part of the progress payment is withheld", the entire draw request is deemed approved.

Progress payments to the contractor under the Proposed Act are due within twenty-one days after receipt of a draw request. If the owner fails to make a payment within the twenty-one day period, the contractor, within seven days after payment is due, may serve the owner with written notice that payment is past due and that the contractor may be entitled to suspend work and recover reasonable and necessary demobilization and remobilization costs, interest at 15% per annum on late payments, and reasonable attorney fees incurred to secure payment.

#### *B. To Subcontractors*

The Proposed Act also covers subcontractors. All of a subcontractor's work is deemed approved unless the contractor

notifies the subcontractor otherwise prior to submission of the contractor's draw request to the owner, or three days after the contractor receives notice from the owner that the subcontractor's work is contested.

Within seven days after payment from the owner to the contractor, the contractor must pay its subcontractors. To enforce this, subcontractors are entitled to a list of the dates on which the owner made payments to the contractor. A contractor's failure to supply this information constitutes a material breach of the subcontract. Perhaps to avoid a pay-if-paid situation, the Proposed Act requires payment to subcontractors no later than twenty-one days after submission of a draw request.

If the contractor fails to make a payment when due, the subcontractor, within seven days after payment is due, may serve the contractor with written notice that payment is past due, and that the subcontractor may be entitled to suspend work and recover demobilization and remobilization costs, interest at 15% per annum, and reasonable attorney fees incurred to secure payment from the contractor.

Additionally, if the contractor is "unable" to pay a subcontractor as a result of the owner's failure to pay to the contractor, the subcontractor, within seven days after payment is due, may serve the OWNER with written notice that payment is past due, and that the subcontractor may be entitled to recover demobilization and remobilization costs, interest at 15% per annum, and reasonable attorney fees incurred to secure payment from the OWNER.

#### *C. To Suppliers and Second-Tier Subcontractors*

Suppliers' materials and a second-tier subcontractor's work would be deemed approved unless the subcontractor notifies the supplier or second-tier subcontractor otherwise prior to submission of the contractor's draw request to the owner, or three days after the contractor receives notice from the owner that said work is contested.

The Proposed Act would also require payment by subcontractors to its suppliers and second-tier subcontractors no later than seven days after the contractor makes payment to the subcontractor.

If the subcontractor fails to make a payment when due, the supplier or second-tier subcontractor, within seven days after payment is due, may serve the subcontractor with written notice that payment is past due, and that the supplier or second-tier subcontractor may be entitled to suspend work and recover demobilization and remobilization costs, interest at 15% per annum, and reasonable attorney fees incurred to secure payment from the subcontractor.

#### *D. Parties Barred from Contracting Around the Proposed Act*

In a separate section ironically titled "Freedom of Contract," the Proposed Act would prohibit parties from agreeing to extend or modify "the latest time allowed for payment under this act . . . ." Thus, the parties would not have the freedom to negotiate a

payment schedule that allows payment later than the Proposed Act.

The Proposed Act would also void any contract provision prohibiting suspension of work for failure of prompt payment. Thus, it would arguably void Section 4.3.3 of AIA Document A201-1997 inasmuch as it requires continued performance by the contractor pending final resolution of a claim, defined to include "a demand or assertion by one of the parties seeking . . . payment of money . . . ."

### **III. FINAL PAYMENT**

#### *A. Retainage Percentage*

Third, with respect to the final payment, the Proposed Act would prohibit retainage in excess of five percent. Additionally, the rate of retainage withheld from the subcontractor must be equal to the retainage from the contractor's payment from the owner for the subcontract work.

#### *B. Timing of Final Payment*

##### **1. To the Contractor**

Final payment to the contractor, including all retainage, would become due and payable thirty days after the issuance of a certificate of occupancy or a certification of substantial completion. The Proposed Act would require the owner to pay the contractor's final billing no later than fourteen days after its receipt.

The contractor's final billing would be deemed approved unless the owner, no later than seven days after receipt of the contractor's final billing, serves the contractor with a written statement that includes a detailed description of the items that the owner disapproves, and the reasons why.

##### **2. To Subcontractors**

Final payment to subcontractors would be due and payable within seven days after the issuance of a certificate of occupancy or a certification of substantial completion. An obvious problem here is that this section requires payment to the subcontractor prior to when payment is due the contractor.

The subcontractor's work is deemed approved unless the contractor notifies the subcontractor otherwise in writing before it submits its final billing to the owner. The notification must include a detailed description of the disapproved items, and the reasons for the disapproval.

##### **3. To Suppliers and Second-Tier Subcontractors**

Final payment to suppliers and second-tier subcontractors becomes due and payable within seven days after the subcontractor receives final payment from the contractor for the second-tier subcontractor. The second-tier subcontractor's work is deemed approved unless the subcontractor notifies the subcontractor otherwise in writing before the contractor submits its final billing to the owner. The notification must include a detailed description of the disapproved items, and the reasons for the disapproval.

#### *C. Final Punch List*

The Proposed Act would give the Owner ten days after issuance of the certificate of occupancy or certificate of substantial completion to deliver a final punch list to the contractor. If there is a dispute regarding completed work, the owner is permitted to withhold payment of no more than one-half the reasonable amount of the disputed work. Once the final punch list is completed, the owner must pay the remaining final balance within fourteen days.

The contractor must "promptly" deliver the final punch list to the subcontractor. Once the punch list work is completed, any remaining retainage becomes due and payable from the contractor within seven days.

#### **IV. CHOICE OF LAW AND VENUE**

Under the Proposed Act, any dispute involving projects located in Colorado must be litigated or arbitrated in Colorado, and are governed by Colorado law. The Act prohibits parties from contracting around this requirement.

#### **V. CONCLUSION**

It must be remembered that this Proposed Act is just that, "proposed." If it becomes law, it will likely undergo several revisions. But this is a bill worth keeping an eye on, as its passage in any form will alter the rights of parties to construction contracts to draft their own payment provisions. Our office will be tracking this bill, and you can contact us with any questions you have about it.

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