

Mastering Final Payment



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Mastering Final Payment

Introduction

“He who pays the piper can call the tune.”

—John Ray, *English Proverbs*

This proverb from three centuries ago, in a whimsical way, makes a simple point: He who has the gold makes the rules. Since they are several levels down the “payment chain,” construction subcontractors are used to playing by others’ rules — indeed, rules that often are slanted against them. Experienced subcontractors know that playing by others’ rules does not, however, mean that there are not measures they can take to protect their companies against mistreatment.

Before a subcontractor starts work, the subcontractor can ask for as much information as possible to help it assert lien and payment bond rights – a copy of the bond, the address of the owner, etc. Before or during project work, the subcontractor can avoid waiving lien and bond rights for unpaid work.

The subcontract agreement can be written to entitle the subcontractor to timely and full payment for work it properly performs. This requires care because agreements often are worded to give customers enormous leverage to keep subcontractor funds as long as possible. Even with the subcontractor’s work complete, its customer may be entitled to hold retainage and other sums until final completion, final acceptance of the project, or some other milestone possibly not related to the subcontractor’s work. In the meantime, the subcontractor’s need to meet payroll, capital expenses, etc., is the same as always. A long wait for final payment can cause serious cash-flow problems.

When the subcontractor is feeling financially squeezed is exactly the time when having effective rights to payment becomes most important. Under pressure to pay employees and vendors, many subcontractors have forfeited claims for payment to receive retainage or final payment. These subcontractors learned the hard way that accepting a check for final payment usually legally erases the ability to pursue payment for outstanding claims such as unapproved change orders.

The alternative is for the subcontractor to negotiate an agreement that explicitly says that it does not waive its right to make claims for retainage, change orders or other outstanding items that are subject to dispute. Many proprietary contract documents do not sufficiently protect subcontractor rights, so carefully review the terms, including terms incorporated by reference. The subcontractor can negotiate to have the ability to pursue such claims beyond substantial completion, owner occupancy and final completion.

When possible, establish a date certain for final payment in the subcontract. ASA’s “Addendum to Subcontract,” part of ASA’s [Subcontract Documents Suite](#), includes terms setting a firm due date for final payment, including applicable retainage—30 days

after completion of work. ASA's [Subcontract Documents Suite](#) is available to ASA members on the ASA Web site at www.asaonline.com.

Another key to receiving full, final payment is to document out-of-scope work with approved, written change orders. Unapproved change orders may seem like they are in the "course of business," but don't count on being paid for them! In addition, subcontractors may run into many punch list problems where out-of-scope work is added after-the-fact. Avoid this by photographing and otherwise documenting work when it is complete to demonstrate that any extra work is really repair to damaged work or wear-and-tear.

Line-item release of retainage and escrow accounts for interest on retainage can help subcontractors receive timely payment of retainage for undisputed portions of completed work. For more information on the retainage laws in your state, see the Foundation of ASA's [Retainage Laws in the 50 States](#).

Remember the golden rule, and make sure that she who has the gold makes rules your company can live with!

Analysis

Payments to construction contractors and subcontractors can be divided into two categories: progress payments and final payment. While progress payments, as their name suggests, are made in contemplation of continuing work and further payment obligations, final payment is just that: the final payment under the construction contract, after all work has been completed and warranties have commenced.

The hallmark of final payment is that, absent clear expression of a contrary intent, it will constitute what the law calls an "accord and satisfaction," which amounts to an enforceable and final settlement, by the party accepting payment, of all disputes and claims relating to the construction contract or subcontract. Pursuant to generally applicable law governing negotiable instruments such as checks, the giving and acceptance of a check is *prima facie* evidence that the check constituted payment in full of the disputed account, and the party receiving the check has the burden of proof to show that a reasonable person would not have understood that the payment meant to discharge the entire amount claimed or owed. Thus, a check accompanied by a statement that it constitutes final payment will amount to a waiver of any other outstanding claims under the contract by the party accepting the check, unless a contrary intention is clearly demonstrated.

Another distinction between progress payments and final payment is that construction project owners often will hold a pre-determined percentage from each progress payment, some or all of which is retained until final payment, when all remaining funds are finally released. The funds held from progress payments are commonly referred to as "retainage" or "retention" in the United States. Prime contractors usually retain from the progress payments that they make to their subcontractors. For construction subcontractors who specialize in work completed early in the project schedule, the

release and payment of retainage always constitutes “final payment” because progress payments covering the entirety of their work will have been received well in advance of project completion.

The term final payment can occur subsequent to the release of retainage for many other subcontractors and for prime contractors, however, because many construction contracts provide for release of most retainage upon the occurrence of substantial completion of the project, with a smaller balance withheld for completion of punch-list items (i.e., uncompleted or improperly completed project items). In such cases, final completion, and thus final payment, occurs after the punch-list and other close-out items (e.g., delivery of manufacturers’ warranties and maintenance instructions) are completed. Amounts withheld from the release of retainage at substantial completion are generally a multiple of the estimated reasonable value of the punch-list items, and are frequently augmented by unpaid amounts for properly completed extra, or change order, work, which the project owner has not yet approved.

Even though final payment may not always be tied to release of retainage on every project, many prime contractors and subcontractors associate release of retainage with final payment because of unfair contractual terms which provide that no retainage is released until final completion, notwithstanding the occurrence of substantial completion, the satisfactory completion of work by most (or all) subcontractors, and owner occupancy of the project.

Whether retainage and change order approvals are withheld until substantial completion, final completion, or according to some other timetable, a large fund generally remains after the substantial completion of a project for potential use as leverage to resolve meritorious claims for extra work properly performed, for delay claims, and for other claims, even long after the owner has occupied the building, and often at the expense of faultless subcontractors who have properly completed their work.

Whatever definition of final payment is used for a project or by a project participant, the risks of delay or non-receipt of final payment extend well beyond the ordinary risks of credit-worthiness, miscommunication, or even outright dishonesty that may be associated with progress payments.

ASA Member Concerns

A 2015 survey revealed that ASA’s members rank “final payment” as the most serious issue impacting the success of their businesses, with 100 percent of respondents ranking final payment as a “very serious” or “somewhat serious” concern. Final payment even outstripped “pay-if-paid clauses” as having the most serious impact on ASA-member businesses. Certainly, delays that occur between the time the project is substantially complete and final completion appear to cause great contention during construction projects.

Thus, contract terms governing final payment are arguably the most important single factor for owners and prime contractors to consider when attempting to secure low and responsible bids for their projects. Proposed contract terms that are written to make subcontractors feel secure about timely receipt of final payment, by providing, for example, for line-item release of retainage (i.e., release of retained amounts relating to the work of early-finishing subcontractors) or no retainage, for clearly discernable lines between punch-list items and warranty items (which are corrected after final payment), for prompt approval of change orders, and for preservation of subcontractor claims after the time of final payment, will be viewed most favorably by prospective project bidders.

Owners interested in achieving quality at a reasonable price cannot ignore subcontractor concerns about final payment, as subcontractors widely recognize the difficulties and delays that are likely to be encountered.

Industry Policies

The variable meanings associated with “final payment” are illustrated by the “Guideline on Better General Contractor-Subcontractor Relations,” jointly published by ASA, the Associated General Contractors of America, and the Associated Specialty Contractors, and ASA, as part of [Guidelines for a Successful Construction Project](#). The guideline recommends:

“Upon receipt of the substantial completion punch list, the general contractor should request release of final payment, including retainage, less withholding sufficient to complete the punch list of omissions and deficiencies. Upon receipt of such payment, the general contractor should make payment to each subcontractor in the same manner.”

It is thus AGC’s, ASC’s and ASA’s policy to recommend a payment regime where most retainage is released at substantial completion, less only a “withholding sufficient to complete the punch list of omissions and deficiencies.” Note that the “Guideline” refers to the release of retainage as “final payment” even as it contemplates that some of the contract balance will be subject to “withholding” and, one hopes, subsequent payment to the contractors and subcontractors performing work.

Whether the favored industry practice of releasing most retainage upon substantial completion (rather than holding all retainage until final completion) is followed:

“Delays that occur between the time the project is substantially complete and final completion appear to cause the greatest contention during construction projects. The most problematic causes of delay include

- *approving change orders;*
- *completing punch lists;*
- *obtaining closeout documents; and*
- *creating a rolling punch list.*

“Change orders. Change orders are often the source of disputes on construction projects and delays in final completion. Reasons for change orders may include new project requirements, resolution of conflicts in plans or specifications, or problems with materials availability. Frequently the decision to make a change must be made on-site to prevent work stoppage. However, the owner’s representative must formally approve the change before payment can be authorized. Delays can occur when the value or authority to approve change orders is questioned.

“Punchlist items. Delays to completion can also be caused when a subcontractor does not return to complete a punch list item in a timely manner. The delay may be purposeful, as when the cost to complete the punch list work exceeds the contract balance or when the subcontractor is earning a greater rate of return on a new project. However, delay by any one subcontractor in completing punch list items can delay the payment of retainage to all parties.

“Closeout documentation. Another barrier to final completion is the failure of the general contractor or a subcontractor to provide required closeout documentation in a timely manner. The owner must have warranty documents on all equipment installed as part of the construction project. In addition, there are other construction documents, such as revised construction plans, that are needed to properly maintain the facility. Failure of any one party to provide these documents can also delay the payment of retainage to all parties.

“Rolling punch lists. Final project completion can also be delayed by what has become known as the “rolling” punch list. Sometimes, several punch lists are created in addition to the required punch list submitted by the owner or the owner’s representative. The creation of these additional punch lists requires subcontractors to return to the project multiple times after they have completed all contracted work. For instance, due to the specific time requirements associated with the school year, a school facility may be issued a Certificate of Occupancy at substantial completion. Once occupied, the representative of the school board may prepare a punch list, the school principal may create another punch list, and individual classroom teachers yet another. Frequently, these needed corrections may have been caused during the move to occupy or through use and would have more appropriately been classified as maintenance or warranty items. Project closeouts should be restricted to only those punch lists designated pursuant to contract. Requiring that subcontractors, who have moved onto other projects and who are of the understanding they have completed their work, return to correct newly created punch lists is economically costly and delays the payment of retainage.”

As to change orders, the “Guideline” counsels that “Change-order work should not begin until after the owner or owner’s agent issues a written authorization to proceed,” while admitting that “The major problem affecting the proper execution of change orders is the time lag between the submittal of the cost and time estimate for changes and acceptance or rejection by the owner.” The “Guideline” recommends that “it is essential for the contractor and subcontractors to state prominently on the face of each proposal a reasonable time period during which the quoted price may be considered firm and after which the project will be delayed.” In other words, the “Guideline” recognizes that a quick decision to perform extra work, in order “to prevent a work stoppage,” is not in the interest of contractors and subcontractors who do not wish to see their payment for extra work held hostage to punch-list items and unrelated payment disputes. Instead, owner-approval should be secured before any extra work is performed.

The problem of the recalcitrant subcontractor, whose failure to timely complete a punch-list item prevents the final payment of all the other, faultless subcontractors on the project, is also addressed in the joint AGC, ASC and ASA “Guideline on Punchlist Procedures”:

“If after final inspection of the work there remains a question of whether one or more punch list items have been properly completed, the owner’s agent should issue a certificate that notes those items remaining in question. Final payment including any retained monies for that portion should be made, less an amount which the owner’s agent reasonably estimates would be required to cover the cost of completing any remaining punch list item(s). Said amount shall be withheld only until satisfactory completion of the remaining items.”

The “Guideline” thus recommends a piece-meal approach to final payment, which arguably undermines the project owner’s leverage to address the concern that delay may be purposeful, as when the cost to complete the punch list work exceeds the contract balance or when the subcontractor is earning a greater rate of return on a new project.

Another solution is endorsed in the “AGC/ASA/ASC Joint Position on Retainage” which states that “Where retainage is used, retained amounts should be deposited in an escrow account, which bears interest, inuring to the contractor and the subcontractor in their respective shares.” Interest on retainage provides some margin of protection for faultless subcontractors who are awaiting an unreasonably delayed final payment.

Finally, the problem of “rolling” or multiple punch lists, can be exacerbated by owner occupancy of the project following substantial completion. Ideally, a single punch-list would be prepared by the same project stakeholder who approves the certificate that the project is, in fact, substantially complete. The original punch-list would thus be easily identified, and would not be easily modified or supplemented, assuming that “Release of withheld funds [is] conditioned *solely* upon satisfaction of substantial completion punch list items [emphasis supplied],” as is recommended by the AGC, ASA and ASC joint “Guideline on Better General Contractor-Subcontractor Relations.” The “Guideline”

recommends that “Omissions and/or deficiencies noted after the substantial completion punch list should be treated as warranty items and therefore independent of substantial completion, the punch list, and the final payment conditions.”

Industry Practice

Provisions to protect construction businesses from final payment abuses are increasingly common, but not universally embraced. Interest on retainage, for example, has found its way into many public procurement laws as well as state regulation of private agreements. Model industry documents increasingly contemplate the use of line-item release of retainage for the benefit of early finishing subcontractors.

Public Procurement

Federal procurement laws divide payments under construction contracts into progress payments and final payment. Final payment occurs only upon “completion and acceptance of all work” as well as “release of all claims against the Government,” requirements which essentially incorporate the state law concept of an “accord and satisfaction” at the time of final payment.

Release of retainage and final payment are not interrelated on federal construction as with other projects. This is because retainage cannot be held on federal procurement contracts without “cause,” and “should not be used as a substitute for good contract management” by the contracting officer. Moreover, prime contractors cannot hold retainage because they are forbidden from requesting payment by the government for any amount to be withheld from a subcontractor. These restrictions have effectively ended the practice of holding retainage on federal construction projects.

Federal construction contracts may, however, provide for government use and possession of all or part of project improvements prior to completion, and in such cases the contracting officer is responsible for furnishing a “list of items of work remaining to be performed or corrected.” While the federal procurement rules avoid the terms “substantial completion” and “punch-list,” they nonetheless follow the general practice of using catch-all language to avoid binding the project owner, by providing that “failure of the Contracting Officer to list any item of work shall not relieve the Contractor of responsibility for complying with the terms of the contract.” Final completion and payment, then, is not tied to the punch-list, and so the punch-list is susceptible to addition and changes. However, the federal procurement rules are sensitive to at least some of the problems of the “rolling punch list,” where they provide that the contractor is “relieved” of any responsibility for loss or damage to the work “resulting from the Government’s possession or use.”

Federal procurement regulations forbid contracting officers from directing or encouraging contractors to perform extra work without a written change order, and changes cannot generally be requested without certification of funding. Of course, contractors and contracting officers may disagree whether a change has occurred and whether a price adjustment is appropriate, and so it is certainly possible for final payment to be delayed pending resolution of a dispute over changes and extras on a

federal project. Increasingly, federal agencies delay the review, approval and payment of change orders until the end of a project. Nonetheless, recourse to contract appeals boards, and the general prohibition against arbitrary or capricious action by agency personnel under the Administrative Procedures Act, should provide some measure of relief against any opportunistic behavior at the time of final payment. Moreover, the contracting officer will not have any direct profit motive to engage in opportunistic attempts to underpay contractors.

State procurement practices vary. Only New Mexico has followed the federal lead to effectively abolish retainage, but nearly all states have limits on the percentage amounts that may lawfully be retained. Many permit the contractor to substitute securities for retainage, and the securities earn interest for the benefit of the contractor. A few states have gone beyond the substitution of securities and directly require retained funds to be deposited in an account which earns interest for the benefit of the contractor and subcontractors.

Model Contract Forms

The [ConsensusDocs](#) Form 750, Standard Agreement Between Constructor and Subcontractor, makes clear that the prime contractor should pay a subcontractor once its work is complete, rather than waiting for the completion of the entire project.

“8.3.1 APPLICATION Upon acceptance of the Subcontract Work by Owner and Constructor and receipt from Subcontractor of evidence of fulfillment of Subcontractor’s obligations in accordance with the Subcontract Documents and the subsection below, Constructor shall incorporate Subcontractor’s application for final payment into Constructor’s next application for payment to Owner without delay, or notify Subcontractor if there is a delay and the reasons for the delay.”

The ConsensusDocs Form 750 then requires the prime contractor to pay a subcontractor promptly after receiving payment from the owner and makes clear that payment cannot be delayed for the fault of someone other than the subcontractor.

“8.3.3 TIME OF PAYMENT Final payment of the balance due of the Subcontract Amount shall be made to Subcontractor within seven (7) Days after receipt by Constructor of final payment from Owner for such Subcontract Work.

“8.3.4 FINAL PAYMENT DELAY If Owner or its designated agent does not issue a certificate for final payment or Constructor does not receive such payment for any cause which is not the fault of Subcontractor, Constructor shall promptly inform Subcontractor in writing. If final payment from Owner for such Subcontract Work is not received by Constructor, through no fault of Subcontractor, Constructor will make payment to Subcontractor within a reasonable time.”

The ConsensusDocs Form 750 article on final payment also addresses the waiver of claims:

“8.3.5 WAIVER OF CLAIMS Final payment shall constitute a waiver of all claims by Subcontractor relating to the Subcontract Work, but shall in no way relieve Subcontractor of liability for the obligations assumed under §3.20 [Layout Responsibilities and Levels] and §3.21 [Correction of Covered Subcontract Work], or for faulty or defective work or services discovered after final payment, nor relieve Constructor for claims made in writing by Subcontractor as required by the Subcontract Documents before its application for final payment as unsettled at the time of such payment.”

Government Regulation

Timing and release of payments for private construction projects are increasingly the subject of state legislation and regulation.

ASA and the Foundation of ASA maintain up-to-date resources detailing state restrictions on payment and retainage. See [Prompt Payment in the 50 States](#) and [Retainage Laws in the 50 States](#), both of which are available free for ASA members on the [ASA Web site](#).

Protecting Your Business

Subcontractors can protect their rights to retainage and final payment if they diligently pursue payment from all available angles, and recognize that they are in business to make money first and friends second (or not at all). At the outset, subcontractors must understand that unscrupulous or desperate prime contractors may bid projects with little or no anticipated profit margin, gambling that money can be chipped away from the profits of subcontractors, or, at worst, that unwary subcontractors can be effectively cannibalized by the diligent application of harsh and unfair subcontract terms. Disputes slowing final payment and release of retainage are perhaps the most fertile grounds for such unfair practices. Every construction project carries the potential to bring financial ruin to at least a few of the subcontractors involved, with the final number determined as a function of the profit margin (if any) that the prime contractor bids into the project.

Before beginning work on a project, a subcontractor should insist on obtaining all the information needed to assert lien and bond rights. Subcontractors must understand, and must make clear to others, that it provides labor and materials on credit, in exchange for a promise of payment in the future. As such, a subcontractor is a creditor who requires the same kinds of information and security that other creditors, like banks, regularly insist upon. A subcontractor should obtain information *before starting work* as it is unlikely to be volunteered when project payments fall behind. Then, a subcontractor should calendar the deadlines for notices required to assert lien and bond rights so that security for final payment and retainage can be perfected.

Because it does business as a creditor of the project, a subcontractor should insist on the opportunity to review the applicable loan agreement funding the project. Terms affecting the timing of draws should be compared to contract terms governing progress payments to determine whether the owner and prime contractor have an unrealistic

payment schedule. Moreover, the treatment of retainage should be studied to determine whether it is held by the bank, the owner or in escrow.

Also before beginning work on a project, a subcontractor should obtain copies of the documents governing the release of retainage, including the owner's contract with the prime contractor. Those documents are nearly always incorporated by reference into the subcontract, which typically provides that the contractor will have all the same rights against the subcontractor as the owner has against the contractor. A subcontractor should never agree to be bound to contract terms when they are not permitted to have copies of those terms; contractor refusal to provide those terms is an overreach and should always be challenged by a subcontractor. It is as though the subcontractor were being asked to review the subcontract terms while wearing a blindfold. Timidity with a subcontractor's right to know the terms of its own subcontract can only set the wrong precedent for future dealings during the of the project.

A subcontractor should study the subcontract and related documents to determine retainage amounts and the projected time for release of retainage. Ideally, the subcontractor's bid price will take account of the lost time-value of the retained funds (i.e., interest). The subcontractor should review the terms with an eye toward understanding who will have the leverage to settle claims at the end of a troubled project. Knowledge of the likely leverage situation prior to bid will better inform a subcontractor's bid price.

An early-finishing subcontractor should be especially alert for terms permitting early or line-item release of retainage, and should insist on having the full benefit of such terms when available. Whether a subcontractor typically finishes early or late in the project, it should be sensitive to the possibility that retainage could be delayed by the failure of another subcontractor to complete a punch-list item. As the prime contractor made the hiring decisions at the outset of the project based on its own determinations of the most responsible bidders, the prime contractor should be held responsible for its choices when such delays occur, and should not penalize other subcontractors for its own bad decisions. Thus, a subcontractor should seek subcontract terms setting a firm due date for final payment including applicable retainage, such as 30 days after completion of the subcontractor's work.

During project performance, a subcontractor should scrupulously endeavor to avoid performing extra work without the written change authorizations expressly required by its subcontract. A subcontractor who performs extra work without a written change order may find that its right to payment for the extra work has been bargained away by a prime contractor anxious to reach a settlement with the owner and receive its own final payment. Absent payment by the owner, the subcontract likely has terms (such as pay-if-paid terms) that are intended to cut-off the subcontractor's right to payment. Thus, a subcontractor who fails to insist on written authorization for extra work puts itself in an extremely vulnerable position with the potential to turn a money-making project into a loss. Model and proprietary subcontracts universally describe change orders as written instruments (as opposed to verbal instructions or field directives), making it clear that a

subcontractor cannot be forced to perform work outside the scope of its subcontract without the proper documentation.

A subcontractor should not shy away from following the claims procedures in its subcontract. Where a subcontractor receives field directives or verbal commands that conflict with the scope of work described in the subcontract, the subcontractor should immediately assert a written claim for the delay likely to be caused when the subcontractor is forced to stop work for lack of a written change authorization.

A subcontractor who avoids performing extra work without a written change order will find that its leverage for release of retainage and final payment is considerably increased at the end of the project.

A late-finishing subcontractor should be alert to rolling punch-list items, and should make liberal use of photographic evidence to anticipate punch-list items that may result from damage caused by other contractors or by occupants who move into the project upon substantial completion. Documented abuse of punch-list procedures to delay final completion can be an asset.

Conclusion

The time between substantial completion of the project, when the owner occupies the project, and final completion, is rife with uncertainty for prime contractors and their subcontractors. The owner enjoys the use of the project, but nonetheless may continue to hold a disproportionate amount of project funds in the form of retainage and unapproved change orders, often for use as leverage to resolve outstanding claims against the interests of the contractor and subcontractors. The risks of delay or non-receipt of final payment extend well beyond the ordinary credit risks associated with progress payments. A subcontractor should give serious consideration before a project is even bid, to the risk that disputes, whether meritorious or contrived, will severely impact or even prevent the receipt of final payment after substantial completion.