

## **“Payment Security”**

**a topic included in the seminar: “Economic Challenges and Opportunities in Construction Law,” sponsored by the Bar Association of Metropolitan St. Louis (BAMSL) on June 4, 2009**

**by**

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**This article discusses ways in which to secure payment on a construction project, or at least enhance the possibilities of payment. At no time in our recent economic past has it been more important to understand better ways to enhance payment.**

### **Contract**

**Today more than ever, it is important that parties consider and whenever possible put in place a written contract to define the agreement between the parties and to set out expectations including risk associated with a construction project. At no place is this potentially more important than in how a contractor or subcontractor or supplier will be paid and when. While no contract provision is foolproof, the industry practice of pegging payments to construction progress long has been considered a reasonably safe course for relative security in payment, both to the owner and to the contractor. The contract basis for payment often defines the most appropriate type of payment security to put in place.**

**For example, for lump sum or fixed price contracts (where the contract is for a specified amount of work at an all-in total price) the progress payment often is based upon defined milestones. This typically is an effective means of**

providing payment security. These milestones can be set based on certain intervals of work being achieved, or certain time periods, or both, or based on other events. The important point is that once work has reached a contractually established milestone, this allows the contractor to know when payment will occur. It also allows the owner or whoever is the payor (lender, etc.) to have assurances that the work has reached an established level before additional payment will take place.

By contrast, if the parties have agreed on a cost plus material contract (where the contractor receives reimbursement for its actual costs and an additional percentage on top of that to cover overhead and profit) progress payments based upon milestones is not the best way to provide payment security. Instead, payments more typically are based upon actual costs incurred during a period of time (for example, on a monthly basis). This requires careful paperwork and additional review and scrutiny to determine not only what costs were incurred, but whether those costs were reasonable. Owners and others who are making payments under this contractual arrangement need to be vigilant and consistent in review and approval of payments. The security, however, is in the paperwork itself which provides a means to monitor work versus cash flow.

### Know With Whom You Are Doing Business

It is certainly common sense, but often overlooked, that one of the best forms of payment security is to know the party or parties with whom you are doing business. Quite often in construction, the parties know each other,

either by prior work experience or by reputation. This more than perhaps anything else (including even an extremely well written contract) has insured payment over the years. Established parties with good reputations want to make payment to keep their good standing in the construction industry. Even when times are tight and cash flow is restricted, good parties work very hard to make payments. And when they cannot for whatever reason, they often work with the party to whom money is owed by making concessions on the construction project or by presenting other construction opportunities to offset the inability to make timely payment.

As our parents taught us at an early age, our reputations are based on the associations we make and keep. So too is the likelihood of being paid. Litigation often seems to be more prominent between parties who have not done business with each other before, who are from out of town, or who know that this is a one-time construction project. By contrast, parties who do business with each other on a regular basis either tend not to engage in disputes over payment or if they must, to handle it in a more confidential and discreet manner, such as arbitration rather than litigation. All of this enhances the possibility of being paid at least part of what otherwise is owed.

### Mechanic's Lien Waivers

Virtually all private construction projects have the possibility that a mechanic's lien will be filed on the property to secure payment. While very few mechanic's liens ever result in the actual foreclosure of the property, in recent times we have actually seen some foreclosures due to loan defaults and thus



and Contractor.

The undersigned acknowledges that all other claims and/or entitlement to payment, without reservation, for labor, equipment and/or materials provided through the Last Date are permanently waived, along with any mechanic's lien rights thereon.

Provided Owner is not in breach of the payment provisions of the contract between Owner and Contractor, Contractor shall defend and indemnify the Owner, Owner's employees, and the Property against all liens, claims and lawsuits of subcontractors or suppliers of Contractor of every tier related in any way to labor, equipment and/or materials provided to or for the benefit of the Property through the Last Date.

\_\_\_\_\_  
(Contractor)

By:\_\_\_\_\_

Title:\_\_\_\_\_

Subscribed and sworn to before me, this \_\_\_ day of \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
Notary Public

My Commission expires:

\_\_\_\_\_

Here is an example of a final lien waiver:

**FULL AND FINAL WAIVER OF LIEN  
Labor and Materials**

State of\_\_\_\_\_

County of\_\_\_\_\_

\_\_\_\_\_20\_\_\_\_



with the point in time when the partial lien waiver is given. Or a partial lien waiver can be based upon other circumstances.

Lien waivers require additional paperwork and are accordingly somewhat burdensome. Unless the owner really looks at the lien waiver and understands what it is for, an owner often views a partial lien waiver as just a ceremonial act. This can have serious financial consequences when the project goes poorly and a mechanic's lien ends up being filed.

Lien waivers are an established means of securing payment and protecting all parties. They are provided under the mechanic's lien statutes in Missouri, in Illinois, and in other states as well. The statutory means is in place to provide payment security through lien waivers, but it is the implementation that is sometimes lacking.

### Payment Bond

A payment bond provides security or guarantee to a subcontractor or a supplier that he or she will be paid in case the actual party to the contract defaults or otherwise does not make payment. In public works contracts in Missouri, payment bonds are actually required for construction projects where the estimated cost exceeds \$25,000. Section 107.170 R.S.Mo. Clearly, a payment bond is a good practice to secure payment and is well established in the construction industry. Perhaps now more than ever, parties should continue to be vigilant in requesting, if not requiring, that payment bonds be put in place.

### Interest and Attorney Fees; Missouri's Prompt Pay Act for Public and Private Contracts

While the possibility of interest and attorney fees does not guarantee that payment will occur, it has become increasingly a large potential expense and thus often serves as a healthy motivator to make payment. Both Missouri and federal statutes provide for the assessment of interest in favor of those waiting to receive payment, and Missouri law also allows attorney fees under certain circumstances. Increasingly, litigants around this country are looking for ways to recover interest for late payments and the recovery of their own attorney fees when it is necessary to litigate the dispute.

**I. Public and Private Contracts under Missouri's Prompt Payment Act**

**A. The Public Prompt Payment Act**

Enacted in 1990, Missouri's Public Prompt Payment Act can be found at § 34.057 R.S.Mo. It reads as follows:

**34.057. Public works contracts—prompt payment by public owner to contractor—prompt payment by contractor to subcontractor—progress payments—retainage—late payment charges—withholding of payments**

**1. Unless contrary to any federal funding requirements or unless funds from a state grant are not timely received by the contracting public municipality but notwithstanding any other law to the contrary, all public works contracts made and awarded by the appropriate officer, board or agency of the state or of a political subdivision of the state or of any district therein, including any municipality, county and any board referred to as the public owner, for construction, reconstruction or alteration of any public works project, shall provide for prompt payment by the public owner to the contractor and prompt payment by the contractor to the subcontractor and material supplier in accordance with the following:**

**(1) A public owner shall make progress payments to the contractor on at least a monthly basis as the work progresses, or, on a lump sum basis according to the terms of the lump sum contract.**

Except in the case of lump sum contracts, payments shall be based upon estimates prepared at least monthly of work performed and material delivered, as determined by the project architect or engineer. Retainage withheld on public works projects shall not exceed five percent of the value of the contract or subcontract unless the public owner and the architect or engineer determine that a higher rate of retainage is required to ensure performance of the contract. Retainage, however, shall not exceed ten percent of the value of the contract or subcontract. Except as provided in subsection 4 of this section, the public owner shall pay the contractor the amount due, less a retainage not to exceed ten percent, within thirty days following the latter of the following:

(a) The date of delivery of materials or construction services purchased;

(b) The date, as designated by the public owner, upon which the invoice is duly delivered to the person or place designated by the public owner; or

(c) In those instances in which the contractor approves the public owner's estimate, the date upon which such notice of approval is duly delivered to the person or place designated by the public owner;

(2) Payments shall be considered received within the context of this section when they are duly posted with the United States Postal Service or other agreed upon delivery service or when they are hand-delivered to an authorized person or place as agreed to by the contracting parties;

(3) If, in the discretion of the owner and the project architect or engineer and the contractor, it is determined that a subcontractor's performance has been completed and the subcontractor can be released prior to substantial completion of the public works contract without risk to the public owner, the contractor shall request such adjustment in retainage, if any, from the public owner as necessary to enable the contractor to pay the subcontractor in full. The public owner may reduce or eliminate retainage on any contract payment if, in the public owner's opinion, the work is proceeding satisfactorily. If retainage is released and there are any remaining minor items to be completed, an amount equal to two hundred percent of the value of each item as determined by the public owner's duly authorized representative shall be withheld until such item or items are completed;

**(5) All estimates or invoices for supplies and services purchased, approved and processed, or final payments, shall be paid promptly and shall be subject to late payment charges provided in this section. Except as provided in subsection 4 of this section, if the contractor has not been paid within thirty days as set forth in subdivision (1) of subsection 1 of this section, the contracting agency shall pay the contractor, in addition to the payment due him, interest at the rate of one and one-half percent per month calculated from the expiration of the thirty-day period until fully paid;**

**(6) When a contractor receives any payment, the contractor shall pay each subcontractor and material supplier in proportion to the work completed by each subcontractor and material supplier his application less any retention not to exceed ten percent. If the contractor receives less than the full payment due under the public construction contract, the contractor shall be obligated to disburse on a pro rata basis those funds received, with the contractor, subcontractors and material suppliers each receiving a prorated portion based on the amount of payment. When, however, the public owner does not release the full payment due under the contract because there are specific areas of work or materials he is rejecting or because he has otherwise determined such areas are not suitable for payment then those specific subcontractors or suppliers involved shall not be paid for that portion of the work rejected or deemed not suitable for payment and all other subcontractors and suppliers shall be paid in full;**

**(7) If the contractor, without reasonable cause, fails to make any payment to his subcontractors and material suppliers within fifteen days after receipt of payment under the public construction contract, the contractor shall pay to his subcontractors and material suppliers, in addition to the payment due them, interest in the amount of one and one-half percent per month, calculated from the expiration of the fifteen-day period until fully paid. This subdivision shall also apply to any payments made by subcontractors and material suppliers to their subcontractors and material suppliers and to all payments made to lower tier subcontractors and material suppliers throughout the contracting chain;**

**(8) The public owner shall make final payment of all moneys owed to the contractor, less than any offsets or deductions authorized in the contract or otherwise authorized by law, within thirty days of the due date. Final payment shall be considered due upon the earliest of the following events:**

**(a) Completion of the project and filing with the owner of all required documentation and certifications, in complete and acceptable form, in accordance with the terms and conditions of the contract;**

**(b) The project is certified by the architect or engineer authorized to make such certification on behalf of the owner as having been completed, including the filing of all documentation and certifications required by the contract, in complete and acceptable form; or**

**(c) The project is certified by the contracting authority as having been completed, including the filing of all documentation and certifications required by the contract, in complete and acceptable form.**

**2. Nothing in this section shall prevent the contractor or subcontractor, at the time of application or certification to the public owner or contractor, from withholding such applications or certifications to the owner or contractor for payment to the subcontractor or material supplier. Amounts intended to be withheld shall not be included in such applications or certifications to the public owner or contractor. Reasons for withholding such applications or certifications shall include, but not be limited to, the following: unsatisfactory job progress; defective construction work or material not remedied; disputed work; failure to comply with other material provisions of the contract; third party claims filed or reasonable evidence that a claim will be filed; failure of the subcontractor to make timely payments for labor, equipment and materials; damage to a contractor or another subcontractor or material supplier; reasonable evidence that the contract can not be completed for the unpaid balance of the subcontract sum or a reasonable amount for retention, not to exceed the initial percentage retained by the owner.**

**3. Should the contractor determine, after application or certification has been made and after payment has been received from the public owner, or after payment has been received by a contractor based upon the public owner's estimate of materials in place and work performed as provided by contract, that all or a portion of the moneys needs to be withheld from a specific subcontractor or material supplier for any of the reasons enumerated in this section, and such moneys are withheld from such subcontractor or material supplier, then such undistributed amounts shall be specifically identified in writing and deducted**

from the next application or certification made to the public owner or from the next estimate by the public owner of payment due the contractor, until a resolution of the matter has been achieved. Disputes shall be resolved in accordance with the terms of the contract documents. Upon such resolution the amounts withheld by the contractor from the subcontractor or material supplier shall be included in the next application or certification made to the public owner or the next estimate by the public owner and shall be paid promptly in accordance with the provisions of this section. This subsection shall also apply to applications or certifications made by subcontractors or material suppliers to the contractor and throughout the various tiers of the contracting chain.

4. The contracts which provide for payments to the contractor based upon the public owner's estimate of materials in place and work performed rather than applications or certifications submitted by the contractor, the public owner shall pay the contractor within thirty days following the date upon which the estimate is required by contract to be completed by the public owner, the amount due less a retainage not to exceed five percent. All such estimates by the public owner shall be paid promptly and shall be subject to late payment charges as provided in this subsection. After the thirtieth day following the date upon which the estimate is required by contract to be completed by the public owner, the contracting agency shall pay the contractor, in addition to the payment due him, interest at a rate of one and one-half percent per month calculated from the expiration of the thirty-day period until fully paid.

5. Nothing in this section shall prevent the owner from withholding payment or final payment from the contractor, or a subcontractor or material supplier. Reasons for withholding payment or final payment shall include, but not be limited to, the following: liquidated damages, unsatisfactory job progress; defective construction work or material not remedied; disputed work; failure to comply with any material provision of the contract; third party claims filed or reasonable evidence that a claim will be filed; failure to make timely payments for labor, equipment or materials; damage to a contractor, subcontractor or material supplier; reasonable evidence that a subcontractor or material supplier cannot be fully compensated under its contract with the contractor for the unpaid balance of the contract sum; or citation by the enforcing authority for acts of the contractor or subcontractor which do not comply with any material provision of the contract and which result in a violation of any federal, state or local law,

regulation or ordinance applicable to that project causing additional costs or damages to the owner.

6. Notwithstanding any other provisions in this section to the contrary, no late payment interest shall be due and owing for payments which are withheld in good faith for reasonable cause pursuant to subsections 2 and 5 of this section. If it is determined by a court of competent jurisdiction that a payment which was withheld pursuant to subsections 2 and 5 of this section was not withheld in good faith for reasonable cause, the court may impose interest at the rate of one and one-half percent per month calculated from the date of the invoice and may, in its discretion, award reasonable attorney fees to the prevailing party. In any civil action or part of a civil action brought pursuant to this section, if a court determines after a hearing for such purpose that the cause was initiated, or a defense was asserted, or a motion was filed, or any proceeding therein was done frivolously and in bad faith, the court shall require the party who initiated such cause, asserted such defense, filed such motion, or caused such proceeding to be had to pay the other party named in such action the amount of the costs attributable thereto and reasonable expenses incurred by such party, including reasonable attorney fees.

**B. Some of the Pertinent Provisions in the Act**

**1. To Whom is the Statute Applicable?**

The statute applies to all public works contracts that are made or awarded by an officer, board or agency of the State of Missouri or any political subdivision thereof, including municipalities, counties and others who typically are considered public owners. It relates to any construction, reconstruction or alteration of any public works project. In addition, it not only applies to payments by the public owner to its contractor, but also payments by the contractor to subcontractors and material suppliers.

**2. What Does the Act Provide For?**

The Act requires the public owner to pay its contractor what is owed less a retainage not to exceed 10% within 30 days following the latter of (a) the delivery of materials or construction services; (b) the date designated by the public owner when the invoice is duly delivered to the person or place designated by the public owner; or (c) in those instances in which the contractor approves the public owner's estimate, the date upon which such notice of approval is duly delivered to the person or place designated by the public owner.

### 3. What Type of Payment is Covered?

The Act covers progress payments from the public owner to a contractor required on at least a monthly basis as the work progresses, or a lump sum payment at the end of the contract according to the contract's terms. Progress payments can be based upon estimates prepared on at least a monthly basis of work performed and material delivered. A public owner may hold retainage between 5% and 10% of the value of the contract or subcontract unless the public owner and the architect or engineer determines that a higher rate of retainage is required to ensure performance of the contract. In no instance, however, shall retainage exceed 10% of the value of the contract or subcontract.

In addition, the public owner can release additional retainage if satisfied that the work is proceeding satisfactorily. The public owner may, however, even if releasing additional retainage, hold an amount

equal to 200% of the value of any specific item determined by the public owner's representative to be incomplete.

#### **4. Retainage**

Owners typically hold retainage for as long as possible as leverage over contractors and subcontractors. This Act addresses this subject by requiring that the public owner pay the retainage less offsets and deductions authorized in the contract or otherwise authorized by law to the contractor after substantial completion of the contract work and acceptance of the public owner's authorized representative, or as may be otherwise provided in the contract specifications for state highway road and bridge projects. Payment of retainage, like progress payments, must be made within 30 days of the due date.

#### **5. Penalty for Late Payment**

If payments as set forth above are not made within 30 days of the due date, the public agency shall pay the contractor in addition to the amount due, interest at the rate of 1½% per month calculated to begin from the first day after the 30-day period and will continue until paid in full.

#### **6. Contractor Must Timely Pay**

Once a contractor receives payment, it must timely pay each subcontractor and material supplier in proportion to the work completed by that subcontractor or material supplier pursuant to pay applications minus retainage not to exceed 10%. Typically, the problem arises that a

subcontractor or material supplier has completed work, submitted an appropriate pay application to the contractor, but the contractor has not yet been paid by the public owner. If a contractor receives less than full payment due from the public owner, the contractor then must disburse on a pro rata basis such funds received between the various subcontractors and material suppliers each receiving a prorated portion based on the amount of payment the contractor received.

Should a public owner be having specific difficulty with one or more identifiable areas of work performed by one or more subcontractors or material suppliers, then the contractor shall not pay the amounts otherwise due to such subcontractor or material supplier and all other subcontractors and suppliers shall be paid in full.

#### **7. Contractor Must Pay Within Fifteen Days**

Unless there is reasonable cause, the contractor shall pay its subcontractor and material supplier within 15 days after receipt of payment from the public entity. Late payment beyond this point subjects the contractor to interest at 1½% per month calculated from the expiration of the 15-day period. This requirement also applies to all other lower tier subcontractors and material suppliers throughout the contracting chain.

#### **8. Final Payment**

The public entity shall make final payment of amounts due to its contractor, less offsets and deductions authorized by contract or by law,

within 30 days of the due date. The due date is the earliest of: (a) completion of the project and the filing of the appropriate documentation and certifications; or (b) the project is certified by the architect or engineer as being complete, including the filing of appropriate documentation or (c) the project is certified by the contracting authority as being complete, including the filing of appropriate documentation and certification.

#### **9. Unsatisfactory Work**

Unsatisfactory work can be excluded from contractor applications and owner certifications of money to be paid and forms a legitimate reason not to request or make payment at that point for the amount covered by the unsatisfactory work. Specifically, payments can be withheld based on unsatisfactory job progress, defective construction work or material not remedied, disputed work, failure to comply with other material provisions of the contract, third party claims filed or reasonable evidence that a claim will be filed, failure of the subcontractor to make timely payments of labor, equipment and materials, damage to a contract or other subcontractor or material supplier, reasonable evidence that the contract cannot be completed for the unpaid balance of the subcontract sum or a reasonable amount of retention. The withheld amount cannot exceed the initial percentage retained by the owner pursuant to the original contract. As you can see, there are substantial

and numerous reasons articulated in the statute why moneys can be withheld until important issues are resolved.

#### **10. Withheld Payments**

Payments that are withheld based upon a specific articulated reason (such as unsatisfactory job progress) shall be separately designated and noted so there will be no misunderstanding as to the disputed work and the amount being withheld. Payments otherwise due shall then be paid in accordance with the provisions of the contract. In addition, the owner may withhold payments from the contractor for reasons stated above, plus the additional reason of liquidated damages.

#### **11. How Are Disputed Sums Withheld to be Resolved?**

Notwithstanding any other provision in the Act, no late payment is due if withheld in good faith for reasonable cause as set forth in Subsections 2 and 5, which delineate various reasons why money can be withheld, such as unsatisfactory job progress. This statutory exception creates considerable leeway for a public agency to not pay the contractor and the contractor to not pay a subcontractor despite the Act's overall emphasis that payments are to be made on time. Whether money has been withheld in good faith for reasonable cause is to be determined by a court and if the court determines that the payment was not withheld in good faith for reasonable cause, the court may impose interest at the rate of 1½% per month calculated from the date of the invoice and may in its discretion award reasonable attorney fees to the prevailing party.

In addition, should the court determine that the position advanced by one party or the other over the dispute as to non-payment was in fact done frivolously and in bad faith, the court is required by statute to assess against the violating party the amount of the cost attributable to such action or position and reasonable expenses incurred, including reasonable attorney fees.

Few statutes in Missouri offer a court such wide discretion in determining that costs and attorney fees can and in certain instances shall be awarded when there is not a viable reason for non-payment or positions advanced in a dispute are done frivolously and in bad faith. In the case of a frivolous position, the legislature went one step further by mandating that the court must award reasonable attorney fees against the offending party.

## 12. Some Recent Case Law

In *Gill Construction, Inc. v. 18th & Vine Authority*, 157 S.W.3d 699 (Mo. App. W.D. 2005), the Western District declined to consider arguments on appeal over whether the jury should have considered application of the Prompt Pay Act because the contractor failed to show any evidence that the contracts were public works contracts. The Western District concluded that this argument was not made or preserved in a motion for directed verdict and therefore would not be heard on appeal. The Western District reached the same conclusion regarding the city's further arguments that the Prompt Pay Act did not

apply because there was no final invoice and payment was withheld in good faith for reasonable cause. The court's result emphasizes the need to identify early various potential deficiencies in a contractor's or subcontractor's claim under the Prompt Pay Act and to be sure to raise those issues in a timely manner at and after trial.

In *Jerry Bennett Masonry, Inc. v. Crossland Construction Co., Inc.*, 171 S.W.3d 81 (Mo. App. S.D. 2005), the Southern District noted that the Public Prompt Pay Act promotes timely payment and it is considered a remedial statute requiring liberal interpretation. The appellate court determined that there was sufficient evidence for the trial court to make an implicit determination that lack of sufficient manpower by the subcontractor contributed to the contractor's delay in completing the project in a timely fashion. Accordingly, the appellate court found that the trial court did not err in not awarding prejudgment interest at the rate of 18% pursuant to § 34.057.

While the Act itself is to be liberally construed, much like Missouri's mechanic's lien actions, the requisite requirements are strictly construed and compliance with them is decided initially by the trial court before a prompt payment issue can be submitted to the jury. In *Environmental Protection, Inspection, and Consulting, Inc. v. City of Kansas City*, 37 S.W.3d 360 (Mo. App. W.D. 2001), the Western District affirmed a trial court's decision to overturn a jury verdict against a public owner under the Prompt Payment Statute. The jury had awarded late

payment interest of 18%. The trial court was convinced in a post-trial motion, however, that there had been no or insufficient evidence that the contractor had complied with the documentation prerequisite under the Act. Without meeting this prerequisite, the issue should not have been submitted to the jury. “By failing to present evidence of its compliance with the documentation prerequisites, EPIC made no submissible claim under the Prompt Payment Statute and had no basis for submitting the bad faith withholding issue to the jury. The trial court properly granted JNOV and appropriately set aside the jury’s award of late payment interest.” *Id.* at 372.

In *Building Erection Services Co. v. Plastic Sales & Mfg. Co., Inc.*, 163 S.W.3d 472 (Mo. App. W.D.), the Western District of Missouri made clear that to be entitled to a recovery of attorney fees under § 34.057.6, the action had to be based upon breach of contract. Failure to prevail on a breach of contract claim renders in apposite § 34.057.6. While the claimant may recover on some other theory, such as quantum meruit, absent breach of contract § 37.057 does not come into play.

#### C. Missouri’s Private Prompt Payment Act

Missouri enacted in 1995 a statute that encourages prompt payment for those contracts that are not public in nature but rather are private construction contracts. The provision can be found at § 431.180 R.S.Mo., and reads as follows:

**1. All persons who enter into a contract for private design or construction work after August 28, 1995, shall make all scheduled payments pursuant to the terms of the contract.**

**2. Any person who has not been paid in accordance with subsection 1 of this section may bring an action in a court of competent jurisdiction against a person who has failed to pay. The court may in addition to any other award for damages, award interest at the rate of up to one and one-half percent per month from the date payment was due pursuant to the terms of the contract, and reasonable attorney fees, to the prevailing party. If the parties elect to resolve the dispute by arbitration pursuant to section 435.350, RSMo, the arbitrator may award any remedy that a court is authorized to award hereunder.**

**3. The provisions of this section shall not apply to contracts for private construction work for the building, improvement, repair or remodeling of owner-occupied residential property of four units or less.**

**4. For purposes of this section, design or construction work shall include design, construction, alteration, repair or maintenance of any building, roadway or other structure or improvement to real property, or demolition or [FN1] excavation connected therewith, and shall include the furnishing of surveying, architectural, engineering or landscape design, planning or management services, labor or materials, in connection with such work.**

**Unlike the Public Prompt Payment Act, Missouri's Private Prompt Payment Act is brief. It does allow for the award of interest of up to 1½% per month and in the discretion of the court, reasonable attorney fees to the prevailing party. It also provides that an arbitrator may make a similar award of interest and attorney fees should the issue be presented to the arbitrator.**

**The Act does not apply to private construction projects for the building, improvement, repair or remodeling of owner-occupied residential property of four units or less. Therefore, it does not apply to typical residential remodeling projects. It is broad enough, however, to include design work, surveying,**

architectural, engineering and landscape design, planning and management services, and labor for same.

In *Structure and Design, Unlimited, Inc. v. Contemporary Concepts Building and Design, Inc.*, 151 S.W.3d 904 (Mo. App. W.D. 2004), the Western District made clear that decisions regarding attorney fees under § 431.180 rest with the sound “discretion” of the trial court. Attacks on appeal that a trial court abused its discretion in refusing to award attorney fees will be difficult to launch and the appellate courts will typically place great deference on a trial judge’s decision whether to award such attorney fees.

#### D. Recent Case Law

Recent case law makes clear that owners and contractors in private contracts clearly risk paying for the other side’s attorney fees and up to eighteen percent interest when they withhold scheduled payments. They cannot rely on a good faith belief of reasonable cause, such as poor workmanship or untimely delivery, to justify withholding payments otherwise due pursuant to the contract.

The case is *Vance Brothers, Inc. v. Obermiller Construction Services, Inc.*, 181 S.W.3d 562 (Mo. 2006), handed down by the Supreme Court of Missouri on January 10, 2006. The Supreme Court took this case on a transfer from the Western District Court of Appeals. The Supreme Court seldom accepts such transfers, highlighting perhaps its interest in weighing in on this important issue.

The decision has sweeping ramifications for all construction projects in Missouri that involve private contracts and places an emphatic declaration from Missouri's highest court that disputes during construction will not justify withholding scheduled payments.

This result will prompt prudent owners and contractors who would otherwise like to withhold contractually scheduled payments to reconsider whether they can afford this risk. Owners and contractors sometimes withhold payment for leverage and sometimes because of a legitimate and serious dispute over the work. Neither may be a safe approach.

More owners and contractors now are likely to pay what the contract calls for and then resolve their dispute in court or arbitration.

The case involves Obermiller Construction, the general contractor for several Wal-Mart stores. Obermiller contracted with Vance Brothers to apply micro surfacing to the stores' parking lots in Fort Scott and Topeka, Kansas.

A dispute arose over the quality of the work, causing Obermiller to withhold a scheduled payment. Vance sued on account, alleging the payment was owed. Obermiller countersued in several counts including breach of contract, alleging poor workmanship.

The jury returned a verdict for Vance on its claim and for Vance on Obermiller's counterclaim. Prior to the trial starting, they both agreed that the judge would decide the issue of attorney fees and interest after the jury's verdict.

There was no question that the trial court could award attorney fees and interest under certain circumstances pursuant to §431.180 R.S.Mo., Missouri's Private Prompt Payment Act.

This Act provides that all persons who enter into a contract for private design or construction work "shall make all scheduled payments pursuant to the terms of the contract." It also states that the court "may" in addition to other damages "award interest at the rate of up to one and one-half percent per month from the date payment was due pursuant to the terms of the contract, and reasonable attorney fees, to the prevailing party."

The Act offers no exceptions to when payment can be withheld. Nevertheless, many attorneys believed that a "good-faith" exception existed in the Act, since such an exception clearly is in Missouri's Public Works Prompt Payment Act, §34.057.

The Public Works Act covers construction projects on public jobs and allows for the recovery of up to eighteen percent interest and attorney fees. The Public Works Act also provides that such a recovery can exist if a payment "was not withheld in good faith for reasonable cause." There is no similar provision in the Private Prompt Payment Act.

Disputes over workmanship and timely performance often create good faith reasons to withhold a scheduled payment under the Public Works Act. Obermiller argued that this same exception should apply to the Private Act as well.

The Supreme Court summarily rejected this argument by simply stating that such an exception is not in the Act and therefore it does not apply.

In reaching this result, the high court reaffirmed the trial court's award of \$61,400.00 in attorney fees to Vance even though the trial court did not award any interest. Obermiller had argued that interest must be awarded first before attorney fees could be awarded.

The Supreme Court concluded that the Act does not require a finding of interest first. The trial judge has the discretion to award interest, or attorney fees, or both, or neither.

Eighteen percent interest and attorney fees are significant damages in many cases. Few statutes in Missouri give a trial judge such widespread power over damage issues.

The high court also concluded that Vance could recover even though its cause of action was for an account, not for breach of contract. The Act allows an aggrieved contractor or subcontractor to "bring an action in a court of competent jurisdiction against a person who has failed to pay."

The Act does not require that the cause of action has to be for breach of contract. However, there must be a contractual basis for the scheduled payment before the Act will apply.

## II. Federal Prompt Payment Act

The federal government has in place a Federal Prompt Payment Act found at 31.U.S.C. § 3901-3907. It applies to construction projects with the federal government. While the Act covers many activities beyond merely

construction, it does specifically contain a section regarding construction contracts. See § 3903(6). Under this section, payments are required either on the date payment is due per the contract for the item of property or service provided, or 30 days after proper invoice for the amount due if a specific payment date is not established by contract. § 3903(a). It further provides in subsection (6) that payment of interest on construction contracts shall be made on:

(A) a progress payment (including a monthly percentage-of-completion progress payment or milestone payments for completed phases, increments, or segments of any project) that is approved as payable by the agency pursuant to subsection (B) of this section and remains unpaid for—

(i) a period of more than 14 days after receipt of the payment request by the place or person designated by the agency to first receive such requests; or

(ii) a longer period, specified in the solicitation, if required to afford the Government a practicable opportunity to adequately inspect the work and to determine the adequacy of the contractor's performance under the contract; and

(B) any amounts which the agency has retained pursuant to a prime contract clause providing for retaining a percentage of progress payments otherwise due to a contractor and that are approved for release to the contractor, if such retained amounts are not paid to the contractor by a date specified in the contract or, in the absence of such a specified date, by the 30<sup>th</sup> day after final acceptance;

The federal agency is not required to approve an application for payment under this section unless the payment includes (a) substantiation of the amounts requested, and (b) a certification by the prime contractor that the amounts requested are for performance required under the specifications and contract documents and that payments to subcontractors for such work will be

made from the proceeds of the payment received and that the application does not include any amounts which the prime contractor intends to withhold or retain from a subcontractor. Defective applications shall be returned within seven days to the contractor, identifying the defect.

Interest is computed at a rate established by the Secretary of the Treasury and published in the Federal Register. The government in a subsequent invoice is to provide a notice stating the amount of interest penalty that it is including with the payment and the rate of such interest, as well as the period covered. § 3902(c)(2).

The Act contains a large exception to when the interest penalty comes into play. Section 3907(c) states:

Except as provided in § 3904 of this title, this chapter does not require an interest penalty on a payment that is not made because of a dispute between the head of an agency and a business concern over the amount of payment or compliance with the contract. A claim related to the dispute, and interest payable for the period during which the dispute is being resolved, is subject to the Contract Disputes Act of 1978 (41 U.S.C. 601 et seq.).

This provision certainly gives an agency considerable latitude in deciding when payments should be made and in defending claims and requests for interest based upon nonpayment.

### III. Other Statutes

Even if neither § 34.057 nor 431.180 R.S.Mo. applies, a claimant may still rely upon a general interest statute under Missouri law to obtain an award of pre-judgment interest at 9% per year. The section is 408.020 R.S.Mo. and it provides as follows:

Creditors shall be allowed to receive interest at the rate of nine percent per annum, when no other rate is agreed upon, for all moneys after they become due and payable, on written contracts, and on accounts after they become due and demand of payment is made; for money recovered for the use of another, and retained without the owner's knowledge of the receipt, and for all other money due or to become due for the forbearance of payment whereof an express promise to pay interest has been made.

This section applies to requests for payment pursuant to a written contract and in instances where there is no written contract when money becomes due on account. It also applies when the parties in dispute have not agreed by contract on an interest rate.

This section only applies, however, to a liquidated amount. "In order to be liquidated so as to allow interest, the claim must be fixed and determined or readily determinable, but it is sufficient if it is ascertainable by computation." *Schnucks Mkts, Inc. v. Cassilly*, 724 S.W.2d 664, 668 (Mo. App. E.D. 1987).

The mere fact that a party denies liability or defends a claim or disputes the existence of a bona fide dispute as to the amount of the alleged indebtedness, does not preclude recovery of interest under this statute. *Jerry Bennett Masonry, Inc. v. Crossland Construction Co., Inc.*, 171 S.W.3d 81, 90 (Mo. App. S.D. 2005).

In *Jerry Bennett Masonry*, the Southern District affirmed the trial court's decision not to award 18% interest pursuant to § 34.057, finding that the trial court made no express determination that a contractor acted in bad faith without reasonable cause in withholding payment from its subcontractor. The appellate court did determine, however, that the trial court erred by not

awarding subcontractor interest at the rate of 9% pursuant § 408.020 after the contractor was paid its retainage by the district.

#### IV. Contract Provisions

The parties, generally speaking, to a construction contract may specifically provide in the contract for interest and attorney fees. They may specify how interest is to be determined, the amount of interest, how attorney fees are to be determined, and even what particular events may trigger a potential claim for attorney fees.

#### Letters of Credit

Probably more difficult to get now than at any time in the recent past would be a letter of credit, but it is still one of the best means to secure payment. A letter of credit, simply speaking, is a means by which some established financial institution, typically a bank, states that it will stand behind the payment obligations of a party should that party for whatever reason not be able to make payment. Typically a letter of credit is an actual letter written by the financial institution establishing the basis of when that institution will make payments. Of course, a letter of credit comes at a cost or a premium which must be paid. In essence, a letter of credit is simply a form of insurance.

Letters of credit over the years have been used in the construction industry. They are frequently in place when dealing with international companies, companies with known financial stresses, or when shell companies have been established for a particular construction project, and without a letter

of credit, there is little guarantee in case of a default that that shell corporation could make payment.

All parties to construction projects should be vigilant in considering establishing a letter of credit on a construction project.

### Joint Checks

Under the joint check rule, subcontractors require that their general contractor and owner provide checks naming both the general contractor and the individual subcontractor as payees. By doing this, the subcontractors are protected and they get paid if the owner pays.

The joint check rule is judicially recognized by this Court. In *Board of Educ. of the City of St. Louis v. Vince Kelly Construction Co.*, 963 S.W.2d 331 (Mo. App. E.D. 1997) this Court stated that the “Missouri Court of Appeals adopted the joint check rule in *Southwest Hardware & Lumber Co. v. Borgerson*, 77 S.W.2d 195 (Mo. App. 1934).” *Id.* at 333. It further stated:

The joint check rule has been widely adopted by other state courts. The dual purpose of the rule, as explained by the adopting courts, is to protect suppliers and laborers by ensuring payment and also to protect owners and general contractors by eliminating potential lien claims.

*Id.* at 334.

There has been some resistance to the joint check rule over the years in that it provides an extra step to the contractor and subcontractor before they

can reconcile receipt of money. In today's challenging economic times, however, it certainly makes sense for all parties to establish that payment is actually going to the party or parties who should be receiving it. Thus, the joint check rule seems to make more sense now than at any time in the recent past.

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