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The Massachusetts Retainage Act: A Breakdown

A new law is now in effect for contracts executed after November 6, 2014, that not only affects the amount of retainage that a construction stakeholder may withhold but also mandates processes for project completion. In short, the new law is a game changer. The summary below describes how the game has very recently changed in Massachusetts private construction.

DOES THE NEW LAW GOVERN MY PROJECT?

The new law applies to projects where the contract for construction is one for which a "lien may be established under sections 2 or 4 of chapter 254 on a project for which the person whose contract with the project owner has an original contract price of \$3,000,000 or more . . ." However, the statute does not apply to projects containing or designed to contain at least one but not more than four dwelling units.

WHAT EXACTLY DOES THE NEW LAW REQUIRE?

The statute (1) imposes a limit on the amount of retainage that may be withheld, (2) creates a detailed mandatory process for establishing the date of substantial completion, (3) establishes a mandatory process for submitting punch lists and completing punch list items, and (4) mandates a process for the application for payment and payment of retainage.

Link to the act here: <https://malegislature.gov/Laws/SessionLaws/Acts/2014/Chapter276>

HOW MUCH CAN A CONSTRUCTION STAKEHOLDER BACK AS RETAINAGE?

The statute imposes a limit of 5 percent on the amount of retainage a construction stakeholder may assert on an applicable project.

THE NEW "SUBSTANTIAL COMPLETION" PROCESS

The statute defines substantial completion as "the stage in the progress of the project when the work required by the contract for construction with the project Owner is sufficiently complete in accordance with the contract for construction so that the project Owner may occupy or utilize the work for its intended use." Substantial completion may apply to all or a part of a project. This definition should be familiar to construction stakeholders because it does not differ vastly from that contained in other General Laws and industry standard form contracts.

The statute outlines the substantial completion process as follows:

1. The contractor must submit a Notice of Substantial Completion (in accordance with the statutory form provided in subsection c) within 14 days of reaching the stage of the project that the contractor believes meets the definition above.
2. The owner must then accept or reject the contractor's notice within 14 days after its receipt. If the owner fails to act on the notice, *it will be deemed accepted* after the 14-day time period lapses. Upon acceptance, the project's substantial completion date is established and binding for all purposes outlined in the project's construction contract (for example, liquidated damages cut off, commencement of warranties, and insurance coverages).
3. If the owner rejects the contractor's notice, the rejection notice must state the factual and contractual basis for rejection and be certified as being made in good faith. The contractor may avail itself of the construction contract's dispute resolution procedures on an expedited basis. If the contractor does not submit to the dispute resolution process, it may resubmit the notice to the owner and seek acceptance again.

THE PUNCH LIST PROCESS

The Massachusetts legislature has also established a statutory punch list submittal and completion protocol:

1. The owner must provide the contractor with a written punch list (again, certified as being made in good faith) within 14 days after acceptance of the Substantial Completion Notice. The punch list must include a description of all incomplete/defective work and a list of all required "deliverables." The statute defines a deliverable as "a project close-out document required to be submitted by the person seeking payment of retainage under the person's contract for construction; provided, however, that a lien waiver or release, which is a deliverable, shall comply with chapter 254; and provided further, that 'deliverable' shall not include any document affirming, certifying or confirming completion or correction of labor, materials or other items furnished or incomplete or defective work." The contractor may dispute items on the punch list.
2. The contractor must then pass the list on to its subcontractors within an additional 7 days (21 days after acceptance of Notice of Substantial Completion). The contractor is free to add items to the list it passes down to its subcontractors. Like the owner's list, the contractor's list must be certified as being made in good faith. Subcontractors may also dispute items on the punch list the contractor provides.
3. After the process above has been completed, the owner and the contractor must fulfill their punch list obligations "in good faith and in a timely manner."

WHEN AND HOW DOES RETAINAGE GET PAID?

Stakeholders against whom retainage is being held may seek release of retainage no sooner than 60 days following substantial completion or a final and binding resolution of a dispute about the substantial completion date. Note, however, that the owner and contractor may allow for an earlier submission of an application for payment of retainage in the construction contract. The application for payment of retainage (1) must be certified as being made in good faith and (2) must include the punch list previously received, indicating whether each item on that list has been completed or repaired, and a list of each deliverable delivered.

The stakeholder receiving the retainage application must then release retainage amounts for such items within 30 days. That stakeholder, however, may continue to withhold amounts for (1) outstanding work

and/or incomplete or defective work, (2) missing deliverables, and (3) pending claims.

The amount an owner may withhold at this stage is limited to the following:

1. The reasonable value of outstanding deliverables agreed upon by the parties and, absent an agreement, not more than 2.5 percent of the total adjusted contract price
2. 150 percent of the cost to correct incomplete or defective items
3. The reasonable value of claims and any costs, expenses, and attorneys' fees incurred as a result of the claims *if permitted in the contract*

Owners have a special restriction when it comes to continued retainage withholding. Specifically, unless an owner has declared the prime contractor in default, the owner cannot hold retainage for subcontractor work that is not the subject of the owner's claim(s) against the prime contractor.

WHAT DOES THIS MEAN TO ME?

This new legislation, like the Prompt Payment Act, will have a broad and lasting impact on the construction industry in Massachusetts. Regardless of what a construction contract says, the act will control for projects with a contract value over \$3 million (with the notable exception for smaller residential projects). The most glaring trap for the unwary is the automatic or deemed approval of a Notice of Substantial Completion because "approval" of the notice establishes the substantial completion date for various critical issues (for example, liquidated damages and warranties). Further, as projects close out, owners and contractors may begin to feel a cash flow squeeze when lower-tier contractors begin to avail themselves of the retainage payout process. It will be some time before construction stakeholders know the full impact of the new law, but parties may wish to build the new deadlines and strictures into both contracts and contract administration protocols.

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