



ATTORNEYS AT LAW

Release of Subcontractor Retainage: When Is It Legally Required?

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Subcontractors often have to wait for the release of their retainage. But how long can a General Contractor (GC) continue to hold retainage funds?

From the GC's point of view, it needs to hold the retainage as an offset in case the owner assesses back-charges or liquidated damages upon close out of the project that are based upon defects in the subcontractor's work.

From the subcontractor's perspective, retainage should be released upon successful completion of its work as opposed to completion of the entire project. Earlier trades, in particular, would have to wait potentially for years on major projects until retainage was released.

The courts are in general agreement that a contractual provision which does not require the release of retainage to a subcontractor until the GC has received its retention from the owner does not run afoul of the "paid if paid" prohibition established in the landmark West-Fair Electric decision interpreting §34 of the NY Lien Law. The courts have held that such a provision merely fixes the time at which payment (release of retainage) is due and does not shift the risk of the owner's non-payment from the GC to the subcontractor.

However, after a project is completed, the subcontractor does not have to wait indefinitely until the GC's retainage is released by the owner. That would shift the risk to the subcontractor and would run afoul of the "paid if paid" prohibition.

Generally, there are two determinative factors: (1) is there a provision in the subcontract authorizing the GC to hold all retainage until the project is completed and its own retainage is released, and (2) if the project is complete, has the owner alleged any defects in the work of the particular contractor in maintaining retainage funds of the GC.

Two recent New York State appellate courts have recently reviewed this issue. The decisions of these courts highlight that it is not the GC, but the owner, in approving or contesting the propriety of contract work, that is the key to whether the GC can rightfully continue to hold a subcontractor's retainage. In both cases the subcontractor sued for its share of retained funds.

In the first appellate case, the subcontractor sued for the balance due on its subcontract relating to the delivery and installation of food service equipment on a school reconstruction project. The GC had paid the full subcontract price, less the contractual 10% retainage. As a defense, the GC claimed that since the owner had not accepted the project as finally complete, the contractor had no obligation to release the retainage. The subcontract provided that the GC could withhold the 10% retainage until such time as the entire construction project was completed and accepted by the owner of the project.

In response, the subcontractor asserted that this retainage provision was an unenforceable “pay-if-paid” clause, which is void against public policy in the State of New York. The appellate court disagreed, finding that this provision merely fixed the time when payment of the retainage was due and did not shift the risk of the owner’s failure to pay upon the subcontractor, which is the standard in assessing the validity of a “pay-if-paid” clause. Since the sufficiency of the subcontractor’s work had yet to be accepted by the owner, the GC rightfully could continue to hold the subcontract retainage.

Conversely, in the second appellate case, a mechanical and plumbing subcontractor on a project at the Turning Stone Casino & Resort sued the GC for various damages based upon its alleged breach of the subcontract agreement. The subcontractor was successful in obtaining a judgment for payment of its entire contract balance, including its retainage. The subcontractor established that it had completed its work in full under its subcontract. Although the GC alleged that backcharges were asserted by the owner, no evidence was produced to show that this subcontractor’s work was defective or in any way part of the basis for the owner’s backcharges. The court, therefore, found that the GC did not have a legally valid reason for continuing to hold this subcontractor’s retainage.

G & C Commentary:

The timing of the release of retention is a matter for contract negotiations. Generally, the GC will attempt to contractually require that it is not obligated to release retention to his subcontractor until such time as the GC has received his retention from the owner. Such a contract clause has the effect of requiring the subcontractor to wait until the project is completed before it has a claim to its retention. Such a provision is enforceable.

Addressing this issue during subcontract negotiations is critical. Subcontractors, especially those who perform early trades, should attempt to negotiate “hold-until-the-end” provisions out of proposed subcontracts. Subcontractors should insist that once the owner has paid for and accepted the subcontractor’s work, that the subcontractor be entitled to the release of its retention regardless of whether or not the owner still holds retention against the GC.

Retainage is not an insurance fund that the GC can use at its whim to reduce the risk of its own unrelated payment shortfalls or backcharges imposed by the owner that do not relate to the particular subcontract. If the subcontractor's work has been accepted as complete, or if there is no evidence that any deficiencies have been raised by the owner that relates to the particular subcontractor's work, then there is no legitimate reason for the GC to continue to hold the subcontractor's retainage.

However, if the owner has not yet finally accepted the work, or if there is evidence that the owner has rejected or found deficient all or a portion of the subcontractor's work, the GC rightfully may continue to hold all or the appropriate portion of the subcontractor's retainage to ensure remediation and acceptance of the subcontractor's work.

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