



Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536



Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 1020 (as introduced 4-27-22)
Sponsor: Senator Dan Lauwers
Committee: Economic and Small Business Development

Date Completed: 5-26-22

CONTENT

The bill would enact the "Construction Payments Act" to do the following:

- **Prescribe provisions that each construction contract awarded by an owner to a contractor would have to include.**
- **Prescribe provisions that each construction contract awarded by a contractor to a subcontractor or supplier would have to include.**
- **Require an owner or contractor to provide notice to a contractor, subcontractor, or supplier, as applicable, as to why all or a portion of a payment was being withheld within 10 days after receiving the disputed invoice.**
- **Require an owner to pay a contractor strictly in accordance with the terms of the contract.**
- **Prescribe procedures if payment terms were not specified in a contract.**
- **Prescribe circumstances under which a provision in a contract for a construction would be against public policy and would be void and unenforceable.**
- **Specify that the Act would apply only to private commercial construction projects and would not apply to public works contracts and certain residential contracts.**
- **Require a court or arbitrator to award damages due equal to the amount that was determined by the court or arbitrator to have been wrongfully withheld if arbitration or litigation were commenced to recover payment due and it were determined that the owner, contractor, or subcontractor had failed to comply with the payment terms described in the Act.**
- **Require a court or arbitrator to award the prevailing party its reasonable attorney fees, arbitration costs, and expenses for expert witnesses.**

Definitions

The proposed Act would define "billing period" as the payment cycle agreed to by the parties, or, in the absence of an agreement, the calendar month within which the work is performed.

"Construction project" would mean any improvement, renovation, addition, or development to real property. "Improvement" would mean the result of services, labor, or material provided by a contractor, subcontractor, supplier, or laborer, including surveying, engineering and architectural planning, construction management, clearing, demolishing, excavating, filling, building, erecting, constructing, altering, repairing, ornamenting, landscaping, paving; leasing equipment, prefabricated materials, or components stored on or off site; or installing or affixing a fixture or material, pursuant to a contract. Improvement would not include stock material stored off site.

"Contract" would mean a contract, including any and all additions to, deletions from, and amendments to the contract, of whatever nature, to provide improvements to real property.

"Contractor" would include an architect, engineer, general contractor, construction manager, subcontractor, lower-tiered subcontractors, supplier, or other person, who enters into any contract with another person to furnish services, labor, or materials in connection with the erection, construction, completion, alteration, or repair of any building or commercial project that provides actual improvement to the real property. "General contractor" would mean a contractor who contracts with an owner or lessee to provide, directly or indirectly, through contracts with subcontractors, suppliers, or laborers, the improvements to the real property described in the notice of commencement under the Constructions Lien Act. "Subcontractor" would mean a person that enters into a contract to furnish labor or materials to a contractor. "Supplier" would mean a person that enters into a contract with a person to supply materials, rental equipment, prefabricated materials, or components, which by its use or incorporation into the project improve the real estate. "Laborer" would mean an individual who, pursuant to a contract with a contractor or subcontractor, provides an improvement to real property through the individual's personal labor.

"Court" would mean the district or circuit court of Michigan subject to the venue and jurisdictional requirements of each court.

"Owner" would mean a person, or its agent, that has an interest in the lands or premises upon which a contractor has undertaken to erect, construct, complete, alter, or repair any building or addition to a building, construction project, or development. "Person" would mean a corporation, partnership, limited liability company, association, or other legal entity or a natural person.

"Money" or "funds" would include all money or funds due to a contractor, subcontractor, supplier, or laborer in connection with a contract for the development, erection, construction, completion, alteration, or repair of any building or construction project.

Contractor Contracts

The proposed Act would require each construction contract awarded by an owner to a contractor to include all the following:

- A payment clause that obligated the owner to pay the contractor for satisfactory performance under the contract within 30 days after the end of the billing period.
- A statement that the owner had sufficient funds or financing in place as of the contract's effective date to complete the scope of work identified in the contract.
- An interest clause that obligated the owner to pay the contractor interest on wrongfully withheld amounts due, equal to 12% per annum, on each payment not made in accordance with the payment clause included in the contract.

The interest would apply to the period beginning on the day after the required date and ending on the date on which payment of that amount due was made. Any amount of interest that remained unpaid at the end of any 30-day period would have to be added to the principal amount of the debt, and thereafter interest penalties would accrue on that amount.

A contract provision could not be construed to impair the right of the owner to include in its contract provisions that allowed the owner to retain a specified percentage, which bore a reasonable relationship to the value of the dispute or claim, of each progress payment otherwise due to a contractor for unsatisfactory, incomplete performance or disputed scope of work under the contract without incurring any obligation to incur interest. In that case, the

owner would have to notify the contractor as to why all or a portion of the payment was being withheld within 10 days of receiving the disputed invoice. If the owner and contractor were unable to come to an agreement within 30 days after the notice was issued, the owner would have to deposit the amount of the withheld payment into a verifiable and Federally insured interest-bearing bank or credit union account created for the project. The contractor would be entitled to receive verification of the deposit within 10 days after issuing a notice requesting verification of the deposit to the owner. The deposited money would have to remain in that account until the owner and contractor resolved their dispute or a court or arbitrator ordered how the deposited funds were to be disbursed.

If it were determined by a court of competent jurisdiction or arbitrator that a withheld payment was not withheld in good faith for reasonable cause, the court or arbitrator could award reasonable attorney fees to the prevailing party. In a civil action or arbitration brought under the Act, if a court or arbitrator determined after a hearing that the case was initiated, a defense was asserted, a motion was filed, or any proceeding in that matter was done frivolously or in bad faith, the court or arbitrator would have to require the party that engaged in that activity to pay the other party named in the action the amount of the costs attributable to those actions and reasonable expenses incurred by that party, including reasonable attorney fees.

Once an owner had made payment to the contractor according to the payment terms of the construction contract or the Act's provisions, future claims for the withheld payment against the owner by the contractor would be barred.

Subcontractor & Supplier Contracts

Under the proposed Act, each construction contract awarded by a contractor to a subcontractor or supplier would have to include all the following:

- A payment clause that obligated the contractor to pay the subcontractor and each supplier for satisfactory performance under the subcontract within seven calendar days out of the amount paid to the contractor.
- An interest clause that obligated the contractor to pay the subcontractor or supplier interest on wrongfully withheld amounts due, equal to 12% per annum, on each payment not made in accordance with the payment clause included in the contract.

The interest would apply to the period beginning on the day after the required date and ending on the date on which payment of that amount due was made. Any amount of interest that remained unpaid at the end of any 30-day period would have to be added to the principal amount of the debt, and thereafter interest penalties would accrue on that amount.

A contract provision described above could not be construed to impair the right of the contractor to include in its contract provisions that permit the contractor to retain a specified percentage, which bore a reasonable relationship to the value of the dispute or claim, of each progress payment otherwise due to a subcontractor or supplier for unsatisfactory performance, delays, or a dispute regarding the scope of work under the contract without incurring any obligation to incur interest. In that case, the contractor would have to notify the subcontractor or supplier as to why all or a portion of the payment was being withheld within 10 days after receiving disputed invoice. If the contractor, subcontractor, or supplier were unable to come to an agreement within 30 days after the notice was issued, the contractor would have to deposit the amount of the withheld payment into a verifiable and Federally insured interest-bearing bank or credit union account created for the subject project. The subcontractor or supplier would be entitled to receive verification of the deposit within 10 days after issuing a notice to the contractor requesting verification of the deposit by the

contractor. The deposited money would have to remain in that account until the contractor and subcontractor or supplier resolved their dispute, or a court or arbitrator ordered how the deposited funds were to be disbursed.

If it were determined by a court of competent jurisdiction or arbitrator that a withheld payment was not withheld in good faith for reasonable cause, the court or arbitrator could award reasonable attorney fees to the prevailing party. In any civil action or arbitration brought under the Act, if a court or arbitrator determined after a hearing for that the cause was initiated, a defense was asserted, a motion was filed, or any proceeding in that matter was done frivolously or in bad faith, the court or arbitrator would have to require the party that engaged in that activity to pay the other party named in the action the amount of the costs attributable to those actions and reasonable expenses incurred by the party, including reasonable attorney fees.

Once a contractor had made payment to the subcontractor or supplier according to the payment terms of the construction contract or the Act's provisions, future claims for the withheld payment against the contractor or any surety of the contractor from the subcontractor or supplier on the subject project would be barred.

Payment Terms

The Act would require an owner to pay the contractor strictly in accordance with the terms of the contract. If the terms of the contract did not contain a term governing payment, the contractor could submit an invoice to the owner for payments at the end of the billing period for one or both of the following:

- Work already commenced but not fully completed if the invoiced work were completed by the end of the billing period.
- Materials already supplied to the project.

If the contract between the owner and a contractor did not contain a provision governing when invoices could be submitted, a contractor could submit a partial invoice every 30 days for payment for work performed or a final invoice when the agreed-upon work was fully completed. The owner would have to pay all undisputed amounts owed to the contractor within 30 days after the end of the billing period or 30 days after delivery of the invoice by the contractor, whichever was later. These provisions would prohibit an owner from retaining a specified percentage of each progress payment and final payment that was due to a contractor, subcontractor, and supplier to ensure satisfactory performance under the contract.

If payment terms were not specified in the contract between the general contractor and a subcontractor or supplier, a general contractor would have to pay all undisputed amounts owed to its subcontractors, suppliers, or materialmen within seven days after receiving payment for the subcontractor's work or supplier's materials by the general contractor.

If payment terms were not specified in the contract between the subcontractor and its subcontractors or suppliers, a subcontractor would have to pay all undisputed amounts owed to its subcontractors, suppliers, or materialmen within seven days after receiving payment for the subcontractors' work or suppliers' materials by the subcontractor.

An owner could not retain a specified percentage of each progress payment or final payment that was due to a contractor, subcontractor, or supplier for satisfactory performance under the contract.

A general contractor, a construction manager, a prime contractor, or a subcontractor or their agents could not retain a specified percentage of each progress payment or final payment that was due to a subcontractor, supplier, lower-tiered subcontractor, or lower-tiered supplier for satisfactory performance under the contract.

If an owner or contractor disputed any amounts stated in an invoice for payment, then all of the following would apply:

- The party disputing the invoice would have to notify the other party in writing within 10 days after receiving the disputed invoice.
- The party disputing the invoice would have to, in the written notice of dispute, specifically describe in detail the items within the invoice that were disputed.
- If the written notice of dispute were not given within the required 10-day period, the invoice would be considered accepted as submitted.
- If the written notice of dispute were not given within the required 10-day period, the lack of notice would not constitute acceptance of the work performed.

Void & Unenforceable Contracts

Under the proposed Act, a provision in a contract for a construction project that included one or more of the following would be against public policy and would be void and unenforceable:

- A requirement that a contractor assumed the risk of nonpayment of the owner.
- A requirement that a contractor waive any statutory or other right to commence litigation or arbitration until payment was made to the general or prime contractor.
- A requirement to make subject to payment by the owner, the obligation of a contractor and its surety under any payment or performance bond, or to make any payment to a claimant under that bond.
- A requirement that a contractor rely on the credit of the owner and not on the credit of the general or prime contractor or of a bonding company.
- A requirement that a dispute or claim arising from a construction project located in Michigan between the contractor, subcontractor, or supplier be governed or subject to the laws of a state other than Michigan or require litigation, arbitration, mediation, or other dispute resolution processes to occur in a state other than Michigan.
- A requirement that a contractor waive any provisions provided by the Act.

Applicability

The proposed Act would not apply to any of the following:

- Public works contracts.
- Residential contracts for the erection, alteration, or repair of any single residential dwelling, attached multiple residential dwellings less than seven units, detached condominiums, site condominiums, or premises used or intended to be used for residency purposes and related facilities appurtenant to the premises, used or intended to be used as an adjunct or residential occupancy.

The burden of proving an exemption from the Act would be on the person claiming the exemption.

The Act would apply only to private commercial construction projects, including apartment buildings, lofts, motels, hotels, office buildings, medical buildings, retail buildings, industrial buildings, shopping malls, parking structures, storage buildings, barns, mixed residential and

commercial use buildings, private schools, restaurants, churches, places of worship, and related facilities, fixtures, and structures appurtenant to the premises.

Arbitration & Litigation

Under the Act, if arbitration or litigation were commenced to recover payment due and it was determined that the owner, contractor, or subcontractor had failed to comply with the payment terms described in the Act, the court or arbitrator would have to award damages due equal to the amount that was determined by the court or arbitrator to have been wrongfully withheld. An amount could not be considered to have been wrongfully withheld to the extent that it bore a reasonable relationship to the value of any disputed amount or claim held in good faith by the owner, contractor, or subcontractor against whom the contractor or subcontractor was seeking to recover payment.

Absent any agreements to the contrary between the parties, the court or arbitrator in any arbitration proceeding arising under the Act would have to award to the substantially prevailing party its reasonable attorney fees, arbitration costs, and expenses for expert witnesses.

BACKGROUND

Originally enacted in 1982 to expedite the payment process from government agencies, the Federal Prompt Payment Act (PPA) requires Federal construction contracts to include a prompt payment clause. The PPA allows contractors to recover interest at a set rate if, upon proper notice, the Federal government fails to make timely payments. The PPA also requires contractors to make prompt payments to subcontracts. In 1988, the PPA was amended to include provisions prescribing time limits, interest rates, and other restrictions on construction contracts and payment, including a requirement that contractors pay interest on any amount that they have been paid but have failed to earn due to deficient performance.

Following the passage of the PPA, many states enacted their own prompt payment laws. According to data from the American Subcontractors Association, as of 2019, 49 out of 50 states, as well as the District of Columbia, have a prompt payment law governing public contracts, and roughly two-thirds of states have a prompt payment law governing private contracts.

Public Act 524 of 1980 governs construction contracts with certain public agencies. "Public agency" means the State, or a county, city, township, village, assessment district,¹ or other political subdivision, corporation, commission, agency, or authority created by law. The term does not include the Michigan Department of Transportation, a school district, junior or community college, the Michigan State Housing Development Authority, and a municipal electric utility or agency. Public Act 524 requires a construction contract to include a provision designating a person representation a contractor who submits written requests for progress payments. Public Act 524 also prescribes certain time periods in which progress payments requested must be paid. If a public agency fails to make a timely progress payment, the person may submit a request for progress payments to include reasonable interests on the amounts past due.

Legislative Analyst: Tyler P. VanHuyse

¹ "Assessment district" means the real property within a distinct area upon which special assessments are levied or imposed for the construction, reconstruction, betterment, replacement, or repair of a facility to be paid for by funds derived from those special assessments imposed or levied on the benefited real property.

FISCAL IMPACT

The bill would have no fiscal impact on the State and an indeterminate fiscal impact on local courts systems. By providing a process for the resolution of payment disputes for private commercial construction projects, the bill could increase civil litigation filings for those disputes, most likely in circuit courts. On the other hand, statutory language outlining a process for resolving disputes can reduce litigation, particularly when litigation outcomes are predictable. While courts can raise nominal amounts of revenue due to increased filing fees, increased case filings also add to court administrative costs. Any fiscal impact on district and circuit courts likely would be minimal.

Fiscal Analyst: Michael Siracuse

SAS\S2122\s1020sa

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.