

# 'Prompt Pay' For Construction May Still Apply Amid COVID-19

By **Teri Sherman and Gaetano Piccirilli** (April 3, 2020)

New Jersey, Pennsylvania and New York's prompt pay laws require strict adherence to contractual or statutory deadlines for payment in connection with construction projects and may impose penalties on owners and contractors where payment is untimely or wrongfully withheld. Now, in the days of COVID-19, owners and contractors must consider their payment obligations and the application of prompt pay laws.



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As of the date of this article, to varying degrees construction is open for business in each state. In New Jersey, construction is deemed an "essential business" with limited restrictions on the type of work that may be performed.

Prior to this week, New York similarly deemed that construction was "essential." However, in response to COVID-19's continued impact, New York has limited the types of construction work deemed essential (e.g., medical and affordable housing).



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In contrast, Pennsylvania has taken the most severe approach, deeming all but "emergency repairs" and the construction of medical facilities "life-sustaining." Pennsylvania and New York do allow project-by-project waivers upon application.

The importance of these closure orders on prompt pay requirements is that projects are moving forward even with many other businesses being impacted, including the business of lenders and owners. Even still, owners, contractors and subcontractors cannot take their prompt payment responsibilities for granted.

Preliminarily, it's important to state the frameworks of the prompt pay statutes. The statutes of each state, Pennsylvania, New York and New Jersey, vary in important ways, including timelines, ability to contract around, defenses and penalties. These statutes are summarized below.

## **The New Jersey Prompt Payment Act**

The New Jersey Prompt Payment Act contains two important deadlines.

First, as between an owner and contractor, that an invoice or "AIA" (the billing standard of the American Institute of Architects) is "deemed approved and certified 20 days after the owner receives it unless the owner provides, before the end of the 20-day period, a written statement of the amount withheld and the reason for withholding payment." [1]

Second, as between an owner and contractor, the owner shall pay to the prime contractor the amount due within 30 calendar days of the billing date. [2]

Similarly, if a subcontractor or sub-subcontractor has performed in accordance with the provisions of its contract, and the parties have not otherwise agreed in writing, then the prime contractor shall pay to its subcontractor (and the subcontractor shall pay to its sub-subcontractor) the full amount received from owner for work completed or services

rendered within 10 calendar days.[3]

If payment is not timely made as outlined above, the delinquent party shall be liable for the amount owed, plus interest at the prime rate plus 1%.[4] In addition, upon seven days' written notice, a prime contractor or subcontractor may suspend its work without penalty for breach of contract until such time as the required payment is made.[5] Attorney fees and costs may also be awarded if the contractor files suit and prevails.[6]

### **The Pennsylvania Statute**

Pennsylvania has separate statutes that govern public and private construction projects. Here, we are focused on private projects and the Pennsylvania Contractor and Subcontractor Payment Act, or CAPSA, codified at Title 73 of the Pennsylvania Statutes, Section 501 et seq., applies to all private projects except (1) residential projects with six or fewer units and (2) contracts for the purchase of materials by a person performing work on their own property. Like with public projects, the payment schedule for private projects is determined by the contract itself.[7]

If the contract does not specify time frames for payment, CAPSA provides that payment of interim and final invoices shall be due to the prime contractor within 20 days of the end of a billing period or 20 days after delivery of the invoice, whichever is later.[8] The prime contractor must then make payment to subcontractors and material suppliers within 14 days of the date that payment is received from the owner or the invoice is received, whichever is later.[9]

This same time frame applies to every other payment due down the chain on the project.[10] In addition, upon 10 days' written notice, a prime contractor or subcontractor may suspend its work without penalty for breach of contract until such time as the required payment is made.[11]

Payment may be withheld for "deficiency items" if written notice is provided within seven calendar days.[12] The paying party, however, must still pay all nondeficiency items (i.e., amounts appropriately due and owing) within the statutory time frames to avoid penalties.

If payment is not made within seven days of the due date set by CAPSA, interest of 1% per month will begin to accrue and continue until the balance is paid. An additional penalty equal to 1% per month may be imposed where amounts are withheld in bad faith, along with attorney fees and costs if the contractor files suit and prevails.[13]

CASPA does not define "bad faith" or otherwise outline specific situations when payment may be deemed to be wrongfully withheld. A "good faith belief" that work is deficient or was not performed in accordance with the terms of the contract may be grounds for not imposing the additional 1% penalty, but what constitutes good faith or bad faith is likely to turn on the specific facts at issue.[14]

### **The New York Prompt Payment Act**

New York's Prompt Payment Act, or PPA, is set forth in sections 756-758 of Article 35-E of the General Business Law. It applies to all contracts exceeding \$150,000 to construct, reconstruct, alter, maintain, move or demolish any building, structure or improvement, or otherwise excavate, develop or improve land within New York. The PPA does not apply to contracts awarded by the state or public departments, or to certain defined residential developments.[15]

The PPA requires that an owner must approve or disapprove all or a portion of an invoice from a prime contractor within 12 business days of delivery of the invoice and all contractually required documentation.[16] If the owner disapproves all or a portion of the invoice, the owner must provide a written statement within 12 business days.[17] If 12 business days have passed and the owner has not sent a notice of its disapproval in writing, then the owner will be deemed to have approved the invoice in full.[18]

Once the owner has approved an invoice, the owner must tender payment to the prime contractor within 30 days, and the prime contractor must in turn tender payment to its subcontractors within seven days, provided that all contractually required documentation and waivers are received.[19] Likewise, subcontractors must tender payment to their sub-subcontractors within seven days of receiving payment from the prime contractor, again provided that all contractually required documentation and waivers are received.

A party that fails to make timely payment will be liable for damages plus interest at the rate of 1% per month.[20] In addition, the contractor and subcontractor may suspend the work, provided certain notices are provided to certain upstream parties involved, and shall be entitled to payment for costs incurred in remobilizing at a later date.[21]

The PPA, however, provides a specific exception and extends payment deadlines where the owner, contractor or subcontractor has (1) "obtained a loan intended to pay for all or part of the construction contract"; (2) "timely requested disbursement of proceeds from that loan"; and (3) the "lender is legally obligated to disburse such proceeds" but "failed to do so in a timely manner." [22] Neither Pennsylvania nor New Jersey's statutes contain such an exception.

### **Impact of COVID-19 on Payment Deadlines**

COVID-19 has resulted in an environment unlike we have ever experienced before. Neither the New Jersey, Pennsylvania or New York statutes expressly provide for the tolling of statutory payment deadlines or penalties in a crisis or pandemic such as we are currently experiencing.

To our knowledge, no court or legislative body has yet considered whether such tolling or waiving of penalties may be appropriate considering COVID-19. Similarly, because the requirements of the prompt pay laws are statutory and not contractual, doctrines such as force majeure that may forgive nonperformance likely do not apply.

Owners, contractors and subcontractors looking to get their arms around the impact of COVID-19 on their payment obligations ought to consider several items.

### ***Avoid the default provisions of the contract and statute.***

Each prompt pay act provides for certain turnaround related to the review of payment applications. The New Jersey Prompt Payment Act provides that invoices/AIA are "deemed approved and certified 20 days after" the owner receives it, should the owner not provide a written statement of the amount withheld and the reasons for withholding. Similarly, CASPA and PPA have deadlines to identify deficiency items. Contracting parties should continue to respond to invoices/AIAs under the assumption that the rules are not mitigated by COVID-19.

### ***Communicate clearly and promptly with your contracting party.***

Proving that payment was wrongfully withheld, however, is likely a question of fact that will turn upon events and contract language. For this reason, we recommend that parties experiencing issues with obtaining funding or payment be clear with others regarding the challenges of COVID-19. In addition to allowing for your contracting party a chance to understand, you likely mitigate the downside/punitive aspects of the prompt pay acts.

***Understand how the actions or inactions of others may impact payment obligations.***

For example, in New York, extensions to payment obligations may be applicable where COVID-19 results in lenders failing to disburse payment.

Relatedly, the interplay between the contract, the act(s), and the availability of “pay if” or “pay when” paid clauses is important. A contract may contain a “pay when paid” clause that allows a prime contractor whose payment has been delayed by the owner to delay its own payments to subcontractors during the period of delay. These provisions are enforceable even with the prompt pay act.

The same may also be true in Pennsylvania and New Jersey where the contract contains a “pay if paid” clause, meaning that the prime contractor is obligated to pay its subcontractors if and only if it first gets paid from by the owner. (“Pay if paid” clauses are illegal in New York.)

Notwithstanding a pay if or pay when paid clause, however, a party that frustrated occurrence of the underlying payment may not rely on such clauses to avoid its payment obligation.[23] Even inadvertent acts could constitute frustration precluding reliance on these clauses, and courts tend to be reluctant to enforce such provisions against subcontractors where the subcontractor seeking payment was not responsible for the delay or condition giving rise to the owner’s failure to make timely payment to the prime contractor.[24]

For these reasons, even if judges are sympathetic to the novel conditions and complications caused by COVID-19, it may be difficult to prove that failure to make all or a portion of a given payment was the direct result of COVID-19. It may be equally difficult to prove that payment should be excused by a “pay when paid” or “paid if paid” clause as a result of COVID-19. Owners, contractors and subcontractors should therefore promptly respond to invoices/AIAs and exercise caution in withholding payments that may otherwise be due and owing solely to COVID-19.

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[1] N.J.S.A. 2A:30A-2(A).

[2] Id.

[3] N.J.S.A. 2A:30A-2(B).

[4] N.J.S.A. 2A:30A-2(C).

[5] N.J.S.A. 2A:30A-2(D).

[6] N.J.S.A. 2A:30A-2(F).

[7] 73 P.S. § 505(a).

[8] Id. § 505(c).

[9] Id. § 507(c).

[10] Id.

[11] Id. § 505(e).

[12] Id. § 511; see also id. § 502 (defining “deficiency items” as “[w]ork performed but which the owner, the contractor or the inspector will not certify as being completed according to the specifications of a construction contract”).

[13] Id. § 512.

[14] See, e.g., *Waller Corp. v. Warren Plaza, Inc.*, 95 A.3d 313, 319 (Pa. Super. Ct. 2014); *Quinn Construction, Inc. v. R.C. Dolner LLC*, 187 F. Appx. 129 (3d Cir.2006) (applying PA law).

[15] N.Y. Gen. Bus. Law § 756.

[16] Id. § 756-a(2).

[17] Id.

[18] Id.

[19] Id. § 756-a(3).

[20] Id. § 756-b.

[21] Id.

[22] Id. § 756-d.

[23] See, e.g., *Howley v. Scranton Life Ins. Co.*, 53 A.2d 613, 616 (Pa. 1947); *Midlantic Fire, LLC v. Ernest Bock & Sons, Inc.*, No. A-3177-14T2, 2016 WL 3093075, at \*2 (N.J. Super. Ct. App. Div. June 3, 2016).

[24] *Midlantic Fire*, 2016 WL 3093075, at \*2; *Quinn Constr., Inc. v. Skanska USA Bldg., Inc.*, 730 F. Supp. 2d 401, 421 (E.D. Pa. 2010).