

**Prepared Testimony of Thomas O. Williams, Esquire to
the Commerce Committee of the Commonwealth of Pennsylvania House of Representatives
Regarding House Bill No. 726, Session of 2015**

Good morning Chairman Harris and members of the Committee. I am honored to appear today and to have the opportunity to speak with you this morning on the proposed amendments to the Pennsylvania Contractor and Subcontractor Payment Act and House Bill 726. By way of introduction and background, I have practiced law in the Commonwealth of Pennsylvania since 1993 with the law firm of Reager & Adler, P.C., and my practice has predominantly focused on the area of construction law. Both I and members of our firm's Dispute Resolution Group have represented all participants in a construction project including owners, general contractors, various trade prime contractors, subcontractors, suppliers, surety companies and insurance companies through thousands of projects from contract negotiation through dispute resolution with many of those disputes ending up in mediation, arbitration, litigation or, on occasion, all three over issues of payment.

As advocates and representatives of all players in construction projects from contract negotiation through dispute resolution, we favor no particular group, and to be clear I am not here today to advocate on behalf of any sector or player in the construction industry which may be impacted by the proposed amendments.

The Pennsylvania Contractor and Subcontractor Payment Act, known in the industry by the shorthand "Prompt Payment Act," was passed in February of 1994. A few years later, in 1998, the Pennsylvania legislature also passed the Commonwealth Procurement Code, which included prompt payment provisions which in large part mirror the provisions contained in the Prompt Payment Act. Generally speaking the Commonwealth Procurement Code prompt

payment provisions apply to publicly funded construction projects, while the Contractor and Subcontractor Payment Act applies to privately owned construction projects in Pennsylvania.

Since the passage of the Prompt Payment Act and the Commonwealth Procurement Code prompt payment provisions, all players in construction projects and their legal counsel have all pretty much learned to live with and by and large have conducted themselves within the requirements of these two laws. However, over time many in the construction industry, largely lower tier subcontractors, have seen efforts by some to erode or eliminate the protections set forth in the Prompt Payment Act by the insertion of provisions in contracts which seek to waive subcontractor and supplier rights under the Prompt Payment Act. What we have with the amendments set forth in House Bill 726 is a desire by those impacted by these contractual waiver provisions to reassert those prompt payment rights, to make the relationship more even-handed, and to push back on the shifting of the payment risk present in some contracts.

It is important to note that in the construction industry, contracts may be oral, or written, very short, or incredibly lengthy including literally hundreds of pages. As long as there is an agreed upon exchange of consideration and a meeting of the minds, courts will generally enforce all of the contracts which I referenced. No matter the form or length the contract takes, it is important to keep in mind that contracts, when boiled down to their essence, are really nothing more than risk shifting devices with those risks often, but not always, dictated by the party with the most economic power and leverage. All risks known and unknown, anticipated or unanticipated come with a cost of some kind. For example, who will take on the risk of changes in the scope of work due to changed conditions discovered during the progress of the project?

Who will take on the risk of injuries on a project? And most relevant to today's hearings, who will take on the risk of non-payment?

The proposed amendments contained in House Bill 726, chiefly the proposed prohibition of contract waiver provisions set forth at Section 3(c), is a clear effort to legislatively thwart attempts by those who would seek by contractual provision to undo the protections of the Prompt Pay Act. Though the impetus for this provision seems to be the subcontractor and supplier community, I would note that the proposed prohibition contained in the amended language at Section 3(c) against contractual waivers of the protections of the Prompt Pay Act also benefits contractors with respect to their contractual relationships with project owners as much as it benefits the subcontractors and suppliers in their contracts with the contractor. In that regard, one would believe that contractors and subcontractors alike would support the legislature's efforts in preserving their similar payment rights under the Act by the proposed waiver prohibition. Though it would seem to some unthinkable that a contractor would wish to maintain its Prompt Payment Act rights against a recalcitrant owner while simultaneously by contract seek to have its subcontractors waive those same rights for prompt payment, it does happen. This is not a widespread practice among contractors, only a small minority in my experience, as of yet. However, I believe that if our appellate courts opine that these contractual waivers of statutory rights to prompt payment are enforceable, it will necessarily encourage more of the same.

Presumably, in passing both the Prompt Payment Act and the prompt pay provisions of the Procurement Code, the Pennsylvania legislature was furthering a policy of fairness and for reasonably prompt payment for those construction companies that provide labor and materials. For those on the Committee and those in the construction industry who may favor

a hands off approach by the legislature in this regard, thereby advocating a freedom of contract approach, of which I am generally a strong advocate, there is much legislative precedent prohibiting contractual waivers of statutory rights like the one proposed in House Bill 726. A quick sampling of relatively recent legislative enactments containing prohibitions against the waiver of statutory rights include the Pennsylvania Mechanic's Lien Law, the Landlord and Tenant Act, and the Home Improvement Consumer Protection Act, just to name a few.

Further evidence of the Pennsylvania legislature's desire to protect the statutory rights to prompt payment contained in the Prompt Payment Act as well as the Procurement Code are specifically set forth in Section 514 of the Prompt Payment Act and Section 3937 of the Procurement Code, respectively. Both of these provisions specifically set forth that contractual provisions which seek to require contract disputes to be resolved under the laws or jurisdiction of another state are unenforceable.

Other proposed amendments contained in House Bill 726 propose to require that notice of asserted good faith reasons for withholding payment be made in writing by the party intending to withhold payment. Since there are many "good faith" claims that can be fabricated when convenient, and I have seen many such claims, a written notice is desirable, provided the time within which to provide such notice is reasonable. Here, House Bill 726 does not seek to shorten the notice period regarding deficiency items, only that the notice now be in writing.

House Bill 726, at Section 8, does seek to reduce the written notice time period from 10 to 7 working days for notification of errors contained in invoices. By contrast, the Procurement Code prompt pay provisions regarding both good faith notices of deficiencies and notices of invoice defects provides a 15 day period. A reduction in the time for the giving of notices of defects in invoices which to a payee seem eminently reasonable may not be

reasonable, and may actually lead to unnecessary disputes or otherwise avoidable litigation.

Shortening the timeframe for the giving of written notices may force construction foreman and project managers to make rushed determinations and judgments which may ultimately benefit no one. Since there is a benefit in consistency, and because many contractors are involved in both private and public construction projects, I would encourage as much as practicable consistency in the deadlines and notice provisions in the Procurement Code and the Prompt Payment Act so that contractors, subcontractors and their counsel may avoid a multiplicity of legislative timing schemes.

At Section 12 titled “Penalty and attorney fee,” there is a proposed increase of the rate of penalty interest to be paid by an offending owner, contractor or subcontractor from the current 1% monthly to 1.5% monthly. As a reference the Procurement Code at Section 3935 has a penalty interest rate of 1%. There is no apparent justification or logic behind the proposed increase in the penalty interest rate but to exact a heavier penalty against those who do not comply with the Act.

Finally, I have just a few comments on the proposed changes at Section 9 titled “Retainage.” There at Subsection (a) (1) the proposed amendment allows for the posting of security in the form of a maintenance bond in lieu of retainage. While this added procedure may lead to a contractor or subcontractor securing the release of its retainage more promptly, it may result in confusion and yet another source of dispute. For example, there is no provision specifying the rating of the surety bond and no provision requiring acceptance of the proposed security by either the owner or contractor. It would appear that the Committee would benefit from the input of professionals in the surety bond industry for comment on this proposed change.

This concludes my prepared testimony, and I would be happy to address any questions the Committee might have at this time.

Thank you.

Respectfully Submitted,

Thomas O. Williams