

Updating Your Subcontractor Retainage Clause

by Quenda Behler Story

It wasn't that long ago when broad retainage clauses, which allow the GC to set conditions on a sub's final payment, were a standard part of agreements with subcontractors. If the subs wanted the work, they signed the contract the way it was presented. Otherwise, the general contractor found someone else who would agree to the terms.

My, how times have changed. Lately, anyone who's successful at getting an electrician or a plumber just to show up should be considered lucky. And subs are using their newfound clout to cross out those retainage clauses completely.

In a subcontract, a retainage clause allows the general contractor to tie final payment for a subcontractor's work to conditions other than the subcontractor's completion of the work. In effect, it allows the general contractor to hold back a portion — or sometimes all — of the sub's money until such conditions have been met. However, these conditions are frequently beyond the subcontractor's control. As a result, this clause has been widely abused by too many general contractors. Horror stories of subcontractors going bankrupt because they were unable to collect from the GC are all too common.

But, from the contractor's side, there are often punch list corrections or final adjustments to be made, and these are the legitimate responsibility of the subcontractor. Getting the sub to make that return trip can sometimes be tricky; having some retained payments in hand can be very persuasive.

Conditions that Cause Problems

Some retainage clauses are written so

that the subs are paid when the customer or the architect accepts the work. Legal buzz words include "acceptance" and "satisfactory completion," ordinary terms you often see. So, why would a subcontractor object to that?

Take the word "acceptance," for example. Clients and their architects have been known not to accept the work because of a dispute over something that had nothing to do with the sub. For example, the general contractor and the customer might be arguing about who's going to pay for the building inspector's extra framing requirement. In the meantime, the foundation subcontractor is completely finished and waiting for the check. If the foundation has been poured, why should the sub have to wait for the payment?

Substantial completion. The word "satisfactory" in the term "satisfactory completion" can also be a problem. What is satisfactory to one person may not be to another. "Substantial" completion is more easily measured and has a specific legal meaning. It means that the work is complete enough to be used in the way that the parties intended. In other words, if the sub has contracted to pour a foundation, that work is substantially completed when the contractor can start framing. The foundation sub should see the check for the work completed regardless of any subsequent framing dispute.

Payment upon completion is another frequently used retainage condition. Here the general contractor doesn't have to pay the sub anything

until the customer pays the GC. The potential for disputes with clients and incomplete work on the part of the GC is enormous and completely beyond the subcontractor's control. In fact, this provision has been deemed so unfair that it's not even enforceable in many states.

Rewording the Clause

As the general contractor, you should be reluctant to eliminate all retainage clauses from your contracts with subs. That wouldn't be in your best interests, because even the best long-term relationships between subs and general contractors can sour. You may find yourself in the position of paying twice to get one job completed, then wrestling with the first sub to get your money back

Compromise works. There is middle ground, however, that most subcontractors will accept. An updated version of your subcontract should include the following mutually acceptable assurances:


1. At least a majority of the money due for completed work shall be promptly paid upon substantial completion and preliminary acceptance of the work. If the work is to be completed in phases, such as electrical rough-in and finish, payment percentages could be tied to those phases.

2. Money retained after substantial completion of the work will not exceed 10% of the amount currently due, or some other mutually agreed upon number. This should also include a well-defined process for resolving disputes and a timeline for correcting deficiencies, such as failed building inspections.

3. The retained amounts of money shall never exceed more than the amount the owner has withheld from the general contractor. In other words, if the general contractor has received the draw covering the subcontractor's work, the subcontractor should be paid out of that money.

4. Any unresolved dispute between

the subcontractor and the general contractor will be handled by a mediator or an arbitrator, to avoid situations where a mechanic's lien is the subcontractor's only means of settling the issue. Mechanic's liens involve the property owners and get expensive in a hurry, putting both your money and your reputation at stake.

These clarifications should offer you some protection, while making the retainage clause more palatable to the subcontractors you work with. 

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