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New Jersey's Amended Prompt Pay Act: One Year Later

by Robert S. Dowd, Jr..

INTRODUCTION

On September 1, 2006, amid much fanfare and political self-congratulation, New Jersey joined a growing list of states that have enacted laws seeking to ensure that construction contractors receive timely payment for their work and materials. Based on anecdotal evidence, however, the promise of the New Jersey Prompt Pay Act ("PPA") remains largely unfulfilled, at least in the private sector. In most cases, the stepped-up interest rate of prime +1% mandated by the PPA for approved payments not made within 30 days does not appear to have exerted sufficient pressure on owners to trigger prompt payment. The PPA, however, is not toothless and the careful practitioner can use the other potentially more significant provisions of the PPA to advantage.

Counsel for owners and contractors alike, therefore, would be wise to reacquaint themselves with the provisions of the PPA, the risks that it poses to owners and the opportunities it presents to contractors, especially prime contractors. For example, owners who have not adjusted their administrative procedures in light of the PPA face the prospect of having the validity of the prime contractor's billing deemed approved and certified if the owner has not provided the required written notice disputing the billing to the prime contractor within 20 days. Moreover, the PPA permits unpaid contractors to avail themselves of the potentially very effective yet risky remedy of suspending work on the project without penalty for breach of contract under certain circumstances. In addition, the PPA mandates an award of attorneys' fees and

costs to contractors who successfully prosecute an action in court to collect amounts owed under the PPA.

GENERAL DESCRIPTION AND APPLICABLE SCOPE OF LAW

The PPA was introduced in the New Jersey Legislature on March 21, 2006 and enacted on September 1, 2006. The proposed bill was substantially amended in the process. The PPA applies to all contracts entered into on and after September 1, 2006. It amends a law enacted in 1991 that attempted to secure prompt payment of sub and subsubcontractors on public and private projects. The PPA also supplements the 1987 state agency Prompt Payment Act, which had required New Jersey state agencies to pay prime contractors interest at a rate established by the state treasurer for all invoices not paid within 60 days. The state agency Prompt Payment Act was amended in 1991 to try to ensure that prime contractors, in turn, remitted the payments received from state agencies down the contracting chain.

The PPA imposes, for the first time, prompt payment obligations and corresponding sanctions on all New Jersey public and governmental entities¹ and on all persons with an interest in the real property being improved, such as property owners, landlords, developers and their respective agents (collectively "Owners").² The PPA would not seem to apply to sureties since they do not have an interest in the property and therefore fall outside of the statutory definition of an "Owner".

Although the NJDOT was not successful in exempting itself from the PPA, certain transportation projects that receive federal funding and involve a financially high risk Owner or an Owner whose financial management systems do not adhere to federal guidelines are excluded from some or all of the PPA's provisions.

The PPA is intended to supplement the rights that prime contractors and those down the contracting chain possess under other statutes, but is not to be construed as restricting any rights that a resident homeowner or purchaser has regarding the improvement of their property.

PPA'S REQUIREMENTS AND IMPACTS

The PPA requires an Owner to pay the "Prime Contractor" (a person or entity who has a direct contract with an Owner to improve the real property³) within 30 days of the billing date or, for periodic billing, the periodic billing dates specified in the contract. This obligation extends to any periodic payment, final payment, written approved change order or request for release of retainage. This obligation is only

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In the event that the Billing for the work is not entitled to approval and certification by the Owner or its authorized approving agent, then the Owner must provide the Prime Contractor with a written statement of the amount withheld and the reason for withholding payment within 20 days after the billing date. Public and governmental entities that are required to vote on payment authorizations are permitted until the next scheduled public meeting to take such action, with payment required during that entity's subsequent payment cycle. Public and governmental entities are entitled to this extra time only if this payment authorization procedure has been set forth in the bid specifications and contract documents.

An Owner faces significant consequences for failing to either pay the Prime Contractor within 30 days or provide the Prime Contractor with the required written notice within 20 days. First, the owner is liable to the Prime Contractor for interest at the rate of 1% over prime until payment is made to the Prime Contractor. This rate is between 3-5% higher than the New Jersey pre-judgment interest rate usually applied to contract claims in the absence of a contractually mandated interest rate. Perhaps more significant, however, is the PPA's stipulation that an Owner's failure to send the required written notice to the Prime Contractor within 20 days of the billing date results in the Billing being **deemed approved and certified** by the Owner. This raises the danger that an Owner would be bound in any subsequent litigation by Billing that is deemed approved and certified under the PPA, thereby preventing the Owner from raising defenses to its non

payment of the Prime Contractor based on prior defects or delays in the Prime Contractor's work on the project.⁴

In addition, the failure of the Owner to pay the Prime Contractor within 30 days or provide it with a written notice disputing payment within 20 days enables the Prime Contractor to, upon 7 days written notice, **suspend performance of the contract until payment is made, without penalty for breach of contract**. The Prime Contractor only has the right to suspend performance under the PPA, however, if the Owner is not making a good faith attempt to resolve the disputed payment issue. Finally, all lawsuits to enforce this law must be brought in the New Jersey Courts with a contractor collecting payments under the PPA entitled to a mandatory award of its reasonable attorneys' fees and costs.⁵

The PPA provides that all New Jersey construction contracts shall have a section permitting parties to refer disputes to a process of alternative dispute resolution. Alternative dispute resolution processes include binding arbitration and non-binding procedures such as mediation and advisory arbitrations or mini-trials. If the contract mandated a non-binding alternate dispute resolution process, a party could prosecute the claim in court if and when the non-binding process was unsuccessful in resolving the dispute.

The biggest effect of the PPA thus far seems to have been to accelerate payments due from governmental or public entities to Prime Contractors.⁶ Prior to the enactment of the PPA, state agencies had 60 days from invoice receipt to pay Prime Contractors. Prior to the enactment of the PPA, no statute required local public and governmental entities to remit prompt payment to Prime Contractors and they were notorious in the construction industry for the extended tardiness of their payments.

This PPA also imposes substantial administrative and logistical burdens on the Owner and its approved authorizing agent (*i.e.*, architect or construction manager) to review an invoice and contest it within 20 days of receipt. This 20 day time period represents an improvement for Owners over the ten days in the initial version of this bill.

The biggest winners under the PPA are Prime Contractors.⁷ Although many of the public statements accompanying the passage of the PPA touted its effect on organized labor and "the little guy," the PPA does not confer many of its benefits to subcontractors and subsubcontractors.⁸ For example, the PPA keeps a provision from the prior 1991 law applicable to sub and subsubcontractors that permits Prime Contractors and subcontractors to contractually delete the entitlement of those down the contracting chain to interest on late payments at prime plus 1%. The PPA does not have a similar provision permitting Owners to contractually vary the protections the law affords to Prime Contractors. The PPA also does not deem invoices from sub and subsubcontractors to be approved and certified if the Prime Contractor or subcontractor up the contracting chain does not provide a written statement of

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In sum, the main effect of the PPA on sub and subsubcontractors and others down the contracting chain seems to be the indirect benefit of an acceleration of the flow of monies from Owners to Prime Contractors. Moreover, although the section of the prior law applicable to sub and subsubcontractors requires payment within ten calendar days, there is a major loophole with respect to ongoing work for which partial payments are made, since this obligation does not arise unless the billing entity is performing “to the satisfaction of the Prime Contractor or subcontractor, as applicable.”

CONCLUSION

A thorough knowledge of the PPA can avoid some unpleasant surprises for counsel for Owners and present some significant opportunities for counsel for contractors, especially Prime Contractors.

¹ In the absence of the enactment of a corresponding statute in New York or Pennsylvania, this law probably does not apply to any bistate agencies, including the Port Authority of New York and New Jersey.

² Lenders who take over construction projects and contract for real property improvements would also be within the statutory defini-

tion of an Owner, assuming the lender held a mortgage on the property.

³ Prime Contractors therefore should include architects, engineers, construction managers and land surveyors who have contracted directly with an Owner.

⁴ See Robert C. Epstein, Esq.’s excellent discussion of inadvertent invoice approval and other challenges faced by owners under the PPA in “Approval By Default” *New Jersey Law Journal*, March 23, 2007.

⁵ An award of attorney’s fees would not apply to a contractor prosecuting a successful claim in arbitration, unless the arbitration clause or the contract provides for such an award. The PPA also does not require that arbitrations be conducted within the State of New Jersey.

⁶ The New Jersey Department of Community Affairs, Division of Local Government Services, issued a Local Finance Notice on November 1, 2006 explaining in detail the impact of the PPA on municipalities, schools, counties, fire districts, local authorities, etc. and urging these public contracting units to revise their payment procedures, bid specifications and contracts in light of the provisions of the PPA.

⁷ Governor Corzine’s press release declared that the new law holds Owners to the same responsibilities and penalties previously required of Prime Contractors and subcontractors. In fact, the PPA imposes significantly greater responsibilities and penalties on Owners than are applicable to Prime Contractors and subcontractors.

⁸ Note that the PPA only protects subcontractors and suppliers within the first three tiers of contracting. ♦

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