

CONSTRUCTION AND THE LAW IN TEXAS

Point/Counter-Point: Retainage

On virtually all public and private construction projects, with the exception of TxDOT-owned jobs, retainage is a contract requirement. In this article, I will extend this series of point/counterpoint discussions to the topic of retainage and look specifically at the release of retainage as jobs near completion. In the current construction industry, holding of retainage has become somewhat contentious and the decisions and acts regarding the release of retainage are often misunderstood.

For owners on private projects, retainage serves a very valuable purpose of protection against liens. On most private projects, 10 percent retainage is standard. Typically, the accumulated funds, along with fund-trapping, can protect an owner in the event contract funds paid to a contractor do not get paid to the subcontractors or suppliers. Because contractors on private projects are not required to provide payment bonds, the retained funds are the only security owner's have to protect themselves against liens.

Public projects, on the other hand, are subject to the provision of Chapter 2253 of the Texas Government Code which require payment bonds on all projects of any significant value. Because of prohibitions against filing liens on public property, payment bonds provide similar protections on public works as retainage and lien rights provide on private projects.

Accordingly, the question arises as to the need for retainage on public projects. The "point" for owners is to have some finan-

cial protections in place for risks other than lien protection. The "counterpoint" for contractors is that there are statutory and contractual protections in place for nonpayment so retainage should either not be withheld or it should be reduced.

From a public owner's perspective, retainage provides protections against risks other than lien filings. Having retained funds provides financial leverage to help ensure compliance with contractual requirements and protection in the event of risks such as nonconforming work, failure to complete, abandonment, termination and delay, among others. In the event a contractor fails to perform in any of these regards, the owner has some amount of retained funds, usually 5 percent of earned dollars, to help compensate or overcome the issues that arise as a result of these types of events.

Contractors, on the other hand, view retainage as an unnecessary protection, in many regards, on public work. The contractor is paying for a payment bond to protect against lien and nonpayment claims. As a contractor who has signed a general indemnity agreement with a surety to obtain that bond, the contractor and its assets are ultimately on the hook to guarantee payments are made to lower-tier subcontractors and suppliers. From that viewpoint, the contractor has accepted and is protecting the owner against the risk on nonpayment.

Generally, contractors accept the other risks listed above as a mechanism of contract. Additionally, if any of the above-listed

risks materialize, public owners also benefit from the protections provided by a surety under a performance bond. If the contractor defaults and cannot or will not perform to the requirements of the contract, the surety has guaranteed performance of the contractual obligations at no additional cost to the owner. While surety performance is typically a highly complex area worthy of a much lengthier discussion, for the purposes of this article and the conceptual discussion herein, it can be left as a broad reference to a guarantee of performance.

Given that public owners have the protections in place from surety bonds for both nonpayment and nonperformance, why then must they require retainage? The simple answer is "belt and suspenders". Surety guarantees are often not absolute and failure to get surety performance for either obligation can significantly impair a project's chances of success. Also even if a surety is engaged, retained funds provide the owner with additional tools and resources to resolve disputes and push the project forward. Without the financial leverage provided by retainage, that ability may not exist.

From the other perspective, contractors are typically willing to live with the retainage requirement, but do not like becoming a bank for the project when an owner refuses to release retainage. In the situation of delayed release or refusal to release, the contractor often has paid or will have to pay its subcontractors their retainage to protect those relationships and avoid disputes. In that situation, the contractor will find itself in a position of having its funds tied up in a job with little or no leverage to force the release absent filing suit. In a competitive environment where a contractor's reputation matters, filing suit against its clients is not a decision that is to be taken lightly.

Thus, contractors should seek opportunities for a reduction in retainage after a project has achieved substantial completion. As a project nears final completion, the risks facing an owner are greatly diminished. Further, the provision of bills paid affidavits and releases of liens from subcontractors should be provided to put an owner at ease with the request for releasing or reducing retainage. Owners should be willing to accommodate the request because the contractor has earned that money and, with little discomfort that the job will be subject to claims, the owner has no real need to hold the contractor's money.



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A Balanced Approach to Construction Law.

In order to appease both parties' interests while serving the best interests of the project, owners should be willing to add release of retainage provisions to their contracts. Contractors, on the other hand, should recognize that in many of the procurement methods in use throughout the industry today, there is both statutory authorization and willingness by owners to negotiate certain non-monetary terms with owners after the award of a project but before execution of the contract.

If the parties can agree, conceptually, on the purpose and need for retainage, then a mutually agreeable term governing its release can be included in the contract. If the contract provides a mechanism for release, contractors will have a much easier time getting owner compliance than voluntary, extra-contractual owner cooperation absent such a provision. ☛

