



**STRENGTHENING PENNSYLVANIA’S PROMPT
PAYMENT LAWS: UNDER PUBLIC AND PRIVATE
CONSTRUCTION CONTRACTS**

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I. INTRODUCTION

In September of 2018, the seasonally adjusted annual rate of public and private construction spending in the United States amounted to over \$1.3 trillion.¹ The construction industry is a leader in job opportunity, generating over seven million employment positions nationwide.² The physical construction process begins with a contract between a project’s owner and a general contractor; however, larger projects will regularly involve dozens of parties. Although late payments are problematic for any industry, the unique structure of contracting and subcontracting in

* J.D., 2020, Rutgers Law School, Camden, New Jersey. Thank you to *Rutgers University Law Review* for assisting in editing this Note.

1. United States Census Bureau, U.S. Dep’t of Commerce, Pub. No. CB18-168, *Monthly Construction Spending, September 2018* 1 (2018).

2. Bureau of Labor Statistics, U.S. Dep’t of Labor, Pub. No. USDL-19-0731, *The Employment Situations — April 2019* 29 (2019).

the construction industry tends to magnify the consequences of untimely payments. An interruption in cash flow may create tension between parties and result in serious consequences for both the project and businesses involved. Thus, the assurance of timely payments plays a major role in overall economic success.

In 1982, the federal government enacted the Federal Prompt Payment Act in response to widely reported delays of federal payments to general contractors.³ The Act requires federal agencies to pay general contractors in a timely manner and subject them to interest penalties when payments are made late.⁴ In 1988, the Act was amended to extend these same protections to subcontractors, requiring general contractors to pay subcontractors under similar circumstances.⁵ Not long thereafter, the states began to adopt similar payment obligations, ensuring consistent and reliable cash flow throughout the parties to a construction contract. Currently, every state except two has enacted prompt payment laws governing public construction work.⁶ Additionally, more than two-thirds of states have enacted prompt payment laws governing private construction work.⁷

Notwithstanding these legislative efforts, late payments are becoming an increasingly critical issue in the construction industry, resulting in severe cash-flow problems throughout the entire line of contracting. The issue of delayed payment constitutes a significant portion of disputes in the construction industry, resulting in billions of dollars of excess costs incurred by contractors and subcontractors annually and contributing to the insolvency and bankruptcy of many industry businesses. The purpose of this Note is to discuss the current state of Pennsylvania's prompt payment laws, propose statutory reforms to further mitigate payment disruptions, and improve overall project efficiency regarding public and private construction projects within Pennsylvania's jurisdiction. Part II of this Note will begin by providing a general understanding of construction. This Part will then provide a historical overview of payment laws pertaining to the construction industry, and will discuss Pennsylvania's prompt payment statutes. Part III will discuss the modern issues of payment delay in the construction industry. Part IV will propose amendments to Pennsylvania's prompt

3. KATE M. MANUEL, CONG. RESEARCH SERV., R41230, LEGAL PROTECTIONS FOR SUBCONTRACTORS ON FEDERAL PRIME CONTRACTS 4 (2014).

4. *Id.*

5. *Id.*

6. See *Prompt Payment State-by-State Map*, ASSOCIATED GEN. CONTRACTORS AM., <https://www.agc.org/prompt-payment-state-state-map> (last visited May 20, 2019).

7. *Id.*

payment statutes to strengthen payment obligations between parties. This Part will discuss reforming payment deadlines and penalties, and introducing work suspension provisions, rapid dispute resolution provisions, and partial change order payment provisions. Finally, Part V will provide a conclusion.

II. BACKGROUND

A. *Basics of Construction*

There are three primary businesses involved in the building phase of a construction project. These businesses include the project's owner, the general contractor, and any involved subcontractors. These entities create a line of contracting and subcontracting. The term *line of contracting* refers to the contractual privity that exists between each party. Initially, the project's owner begins building a construction project by contracting directly with a general contractor. In turn, most general contractors subcontract with separate businesses, known as subcontractors, for the performance of specific work.⁸

Due to the complexity of contracting and subcontracting between these parties, prompt payment laws were established to ensure progress payments flow in a timely manner throughout the building process.⁹ For example, if a project's owner fails to make timely payment to a general contractor, the general contractor cannot make timely payments to its subcontractors, and then the subcontractors cannot provide timely payments to its sub-subcontractors, and so on. Thus, it becomes difficult for lower-tier contractors to enforce owed payments against higher-tier contractors if there is no direct contractual relationship.

Project owners are the "driving force behind the construction industry," funding projects and providing construction-related businesses with a vast array of available work.¹⁰ An owner can be either a public or private entity. Public owners are government entities, such as federal, state, or local governments, and generally fund construction projects using public tax dollars.¹¹ Private owners may self-fund or

8. MANUEL, *supra* note 3 (finding that subcontractors reportedly perform more than eighty percent of the work on construction projects).

9. *Id.* ("Although working pursuant to a subcontract . . . subcontractors generally cannot enforce the payment . . . against the [owner] because there is no privity of contract, or direct contractual relationship, between the subcontractor and the [owner].").

10. BARBARA J. JACKSON, CONSTRUCTION MANAGEMENT JUMP START 10, 20 (2d ed. 2010).

11. *Id.* at 21.

gather funding from private sources to construct a project to suit their needs.¹² Construction companies enter into contractual relationships with an owner to build a project to required specifications. A contractor who enters into a direct contractual relationship with an owner is known as a prime contractor.¹³ In some projects, there will exist multiple prime contractors to conduct and manage specific work.¹⁴ However, for liability reasons, owners will generally retain a single prime contractor, known as the general contractor, to oversee the entirety of the construction project.¹⁵ The general contractor's most important duty is to construct the project in accordance with the contract.¹⁶ For larger projects, the general contractor will typically subcontract much of the work to smaller businesses.

The physical construction work requires a wide range of skill and expertise. Subcontractors play a vital role in the building process and generally perform up to ninety percent of construction work.¹⁷ A subcontractor is a business that legally contracts to furnish labor or materials for a general contractor or another subcontractor. Put simply, the general contractor retains separate subcontractors with specialized skills and knowledge for each trade involved in the project.¹⁸ The general contractor essentially delegates obligations to subcontractors while remaining responsible to the owner to perform as required, whereby subcontractors lack any direct contractual relationship with the owner.¹⁹ On larger projects a general contractor may retain upwards of fifty subcontractors to perform specified work.²⁰ Subcontractors may then separately contract portions of work to other subcontractors.²¹ Thus, there can exist many layers of contracting within a single construction project.²²

This basic overview is important as it provides a general understanding of the contractual relationships between construction parties. In sum, separate contracts exist between each party. Each contract delegates certain responsibilities for the overall success of the

12. *See id.* ("Funding [for private owners] comes from private sources such as banks, investment brokers, and venture capitalists.")

13. CONSTRUCTION LAW 18 (William Allensworth et al. eds., 2009).

14. *Id.*

15. *Id.* at 22.

16. *Id.*

17. *See* MANUEL, *supra* note 3.

18. CONSTRUCTION LAW, *supra* note 13.

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.* at 24–25.

project. Payments originate from the owner and then move down line of contracting. Prompt payment laws were enacted to ensure these payments flow reliably throughout the parties. Problems arise when contractors and/or subcontractors perform work but are not paid because cash flow is restricted by some other means. When cash flow is restricted, payments cannot be made down the line of contracting.²³ Therefore, modern issues of payment delay may lead to financial constraint for both the project and parties involved, and may even jeopardize the solvency of a company.²⁴

B. History of Construction Payment Laws

Early common law recognized the need to protect contractors from not being paid for their work.²⁵ However, while contractors and materialmen could file a mechanic's lien against *privately* owned construction projects, government owners were protected against such claims under the doctrine of sovereign immunity.²⁶ To eliminate such inequity, Congress enacted the Heard Act of 1894.²⁷ The Heard Act ensured contractors and materialmen some financial protection, but "was fraught with substantive and procedural limitations."²⁸

In response, Congress passed the Miller Act of 1935.²⁹ The Miller Act provided similar, but substantially more, protection to contractors and materialmen than the Heard Act and was generally favored by the courts.³⁰ As stated by the United States Supreme Court, the Miller Act

23. Kim Slowey, *Subs on \$1.5B Philadelphia Comcast Technology Center File Millions in Liens*, CONSTRUCTION DIVE (Feb. 4, 2019), <https://www.constructiondive.com/news/subs-on-15b-philadelphia-comcast-technology-center-file-millions-in-liens/547415/>. A dispute arose between the project owner and general contractor on Philadelphia's \$1.5 billion Comcast Technology Center tower. *Id.* One subcontractor filed a lien on the project claiming to be owed \$11.8 million. *Id.* A second subcontractor filed a lien claiming to be owed \$1.4 million. *Id.* The project itself is reportedly \$67 million overbudget. *Id.* This may foreshadow future struggles for payment between contractors on this project.

24. See Steve Reilly, *USA TODAY Exclusive: Hundreds Allege Donald Trump Doesn't Pay His Bills*, USA TODAY (June 9, 2016, 2:46 PM), <https://www.usatoday.com/story/news/politics/elections/2016/06/09/donald-trump-unpaid-bills-republican-president-laswuits/85297274/> (alleging hundreds of subcontractors were not paid on time during the construction of Donald Trump's Taj Mahal in Atlantic City, New Jersey, driving businesses into bankruptcy or out of business altogether).

25. Robert D. Wallick & John A. Stratford, *The Miller Act: Enforcement of the Payment Bond*, 29 LAW & CONTEMP. PROBS. 514, 514 (1964).

26. *Id.*

27. *Id.* at 515.

28. *Id.*

29. *Id.*

30. *Id.*

was able to provide “security to those who contribute labor or material for public works.”³¹ Ultimately, the Miller Act became normal procedure for resolving public construction payment disputes in “an industry famous for the size, frequency, and heat of its problems.”³² However, no one party—owner, contractor, subcontractor, or materialmen—was entirely satisfied with the Miller Act as interpreted.³³

In 1978, the Government Accountability Office (“GAO”) conceded that the federal government lacked a standardized method for paying invoices.³⁴ The report found that government agencies had a tendency to pay invoices late, early, and “sometimes without regard to contract terms.”³⁵ Thus, Congress enacted the Federal Prompt Payment Act of 1982.³⁶ Unless a contract provides otherwise, the Act establishes payment-timing provisions and requires federal agencies to pay interest fees when contractors are paid late.³⁷ After enactment, federal bill-paying performance substantially improved.³⁸ Excessively late payments were noticeably reduced and “hundreds of millions” were saved by enforcing timely payments.³⁹ Originally, the Act focused on payments made between federal agency owners and general contractors.⁴⁰ However, in 1988, the Act was amended to extend its applicability.⁴¹ New provisions were established requiring general contractors and subcontractors to abide by similar payment obligations.⁴² Thus, the legislative efforts shared a common theme—ensuring *timely* payments throughout the entire line of contracting for a construction project.

Soon thereafter, state legislatures began enacting their own variations of the Federal Prompt Payment Act. Currently, forty-eight states have enacted prompt payment laws governing public construction work.⁴³ Additionally, more than two-thirds of states have enacted prompt payment laws governing private construction work.⁴⁴ Generally, these

31. *Standard Accident Ins. Co. v. United States*, 302 U.S. 442, 444 (1938).

32. Wallick & Stratford, *supra* note 25, at 514–15.

33. *Id.* at 515.

34. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-86-69, PROMPT PAYMENT ACT: AGENCIES HAVE NOT FULLY ACHIEVED AVAILABLE BENEFITS 2 (1986).

35. *Id.*

36. *See* Federal Prompt Payment Act of 1982, 31 U.S.C. §§ 3901–3907 (2018).

37. *See id.* § 3902.

38. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 34.

39. *Id.* at 2–3.

40. MANUEL, *supra* note 3.

41. *Id.*

42. *Id.*

43. *See Prompt Payment State-by-State Map*, *supra* note 6.

44. *Id.*

laws provide legal recourse for contractors, subcontractors, and suppliers by penalizing those who fail to meet timely payment obligations. Some states have expressed reasoning for enacting such statutes, including the economic incentives of a state's construction industry; the financial consequences and subsequent effects on contractors and other businesses; the expectation of making payments in a timely manner; and the discouragement factor that may direct contractors away from doing business within the state.⁴⁵ Foreign jurisdictions have begun to follow suit, undertaking similar legislative efforts to mitigate construction-related cash-flow issues.⁴⁶

C. *Pennsylvania's Prompt Payment Laws*

Pennsylvania has enacted prompt payment laws governing public and private construction projects. In 1994, Pennsylvania enacted the Contractor and Subcontractor Payment Act⁴⁷ ("CASPA") as a way to "protect contractors and subcontractors . . . [and] to encourage fair dealing among parties to a construction contract."⁴⁸ In doing so, the Pennsylvania Legislature introduced disincentives such as accruing interest fees and other monetary penalties against parties who make untimely progress payments.⁴⁹ Pennsylvania applied similar protections to public construction projects after enacting the Pennsylvania Prompt Payment Act ("PPPA") in 1998.⁵⁰ The PPPA provided similar payment obligations and penalties in an effort to "level the playing field" between government agency owners and general contractors on public construction projects.⁵¹ Thus, both statutes were intended to provide remedies for contractors who were forced to resort to other means in order to collect owed payments for work performed.

In October of 2018, the Pennsylvania Legislature amended CASPA and strengthened its remedies for contractors, subcontractors, and

45. See COLO. REV. STAT. § 24-91-101(2) (2019); 42 R.I. GEN. LAWS § 42-11.1-1 (2019).

46. See generally PRISM, THE NEED FOR PROMPT PAYMENT LEGISLATION IN THE CONSTRUCTION INDUSTRY (2013), <https://mca.ca/wp-content/uploads/2015/03/PromptPaymentReport2013.pdf> (discussing Canada's need for prompt payment laws in its construction industry).

47. Contractor and Subcontractor Payment Act, 73 PA. CONS. STAT. §§ 501–516 (2019).

48. *Zimmerman v. Harrisburg Fudd I, L.P.*, 984 A.2d 497, 500–01 (Pa. Super. Ct. 2009) (quoting *Ruthrauff, Inc. v. Ravin, Inc.*, 914 A.2d 880, 890 (Pa. Super. Ct. 2006)).

49. *Id.* at 501.

50. Pennsylvania Prompt Payment Act, 62 PA. CONS. STAT. §§ 3901–3942 (2019).

51. *A. Scott Enters., Inc. v. City of Allentown*, 142 A.3d 779, 783 (Pa. 2016) (quoting *A. Scott Enters., Inc. v. City of Allentown*, 102 A.3d 1060, 1070 (Pa. Commw. Ct. 2014)).

suppliers.⁵² Admittedly, the statute was amended due to the persistent amount of ongoing contractor and subcontractor disputes within Pennsylvania.⁵³ Contrary to its intended purpose, the statute's enactment has allegedly "led to more . . . filing[s] of mechanic's liens to resolve payment disputes," as opposed to local parties utilizing the statute's payment provisions for making and receiving timely progress payments.⁵⁴ In an effort "to reduce reliance on the Mechanic's Lien Law," CASPA was significantly strengthened to further assist contractors and subcontractors in receiving progress payments for satisfactory work. Importantly, the revised statute now prohibits parties from waiving the protections afforded by CASPA,⁵⁵ expressly authorizes contractors and subcontractors to suspend work performance in the event of nonpayment,⁵⁶ and adheres to a reasonable standard on money withheld by owners while requiring a written explanation of the good faith basis for withholding such payments.⁵⁷

III. MODERN ISSUES OF PAYMENT DELAY

Notwithstanding the enactment of prompt payment laws, delayed payments are becoming increasingly problematic and constitute a significant portion of disputes in the national construction industry.⁵⁸ As conceded under CASPA's recent amendment, local contractors are underutilizing the payment provisions set forth by Pennsylvania's prompt

52. See Memorandum from James R. Santora, Representative, and Michael J. Driscoll, Representative, to All House Members on Contractor and Subcontractor Payment (Feb. 16, 2017), <https://www.legis.state.pa.us/cfdocs/Legis/CSM/showMemoPublic.cfm?chamber=H&SPick=20170&cosponId=22947> ("[CASPA] was originally passed to provide a means for contractors/subcontractors involved in construction work to resolve contract disputes. The problem is that these disputes are still happening.").

53. *Id.*

54. *See id.*

55. 73 PA. CONS. STAT. § 503(e) (2019).

56. *Id.* §§ 505(e), 507(e).

57. *Id.* § 506(b).

58. See Islam El-adaway et al., *Studying Payment Provisions Under National and International Standard Forms of Contracts*, 9 J. LEG. AFF. & DISP. RESOL. ENGINEERING & CONSTRUCTION 1, 1 (2017) ("Payment-related claims constitute the basis for significant number of disputes in the construction industry."); Kirsten Fields, *Rabbit Survey Estimates Slow Payments Cost Construction Industry \$64 Billion in 2019*, BUSINESSWIRE (Oct. 1, 2019, 8:00 AM), <https://www.businesswire.com/news/home/20191001005106/en/Rabbit-Survey-Estimates-Slow-Payments-Cost-Construction> (finding that general contractors and subcontractors incurred \$64 billion in excess costs in 2019 due to slow payments).

payment laws.⁵⁹ Increases in delayed payment issues cause severe cash-flow problems to construction businesses and ultimately affect the success of the entire industry by reducing employment, lessening industry investments, decreasing competition, increasing project costs, and eroding industry standards.⁶⁰ In an effort to encourage parties to a construction contract to adopt Pennsylvania's prompt payment statutes as a standardized method for payment obligations and rapid dispute resolution, this Note will propose a reformed statute for the purpose of providing consistent and reliable cash flow throughout the parties to public and private construction projects.

Many situations and specific circumstances contribute to the issue of delayed payment. In construction, it is not uncommon for payments to be withheld for months or even years.⁶¹ A party may have poor financial management and underestimate its ability to pay when obligated. A party may delay or withhold payment over a dispute of defective work that arguably fails to conform to a project's specifications. No matter the reason, these issues are generally further complicated by the industry use of contingent payment clauses, or *paid-when-paid* or *paid-if-paid* clauses, legally protecting higher-tier contractors from making payments down the line of contracting.⁶² Even under these circumstances, it is very typical in the construction industry that contractors will continue to perform work in the event of nonpayment. It is during these times that the consequences of late payments significantly increase. Without stable and predictable cash flow, businesses are left to finance accruing costs by lines of credit or by out of pocket payments.⁶³ These circumstances are

59. See Memorandum from James R. Santora and Michael J. Driscoll, *supra* note 52 and accompanying text.

60. See Islam El-adaway et al., *supra* note 58, at 112.

61. All Work and No Pay: Change Orders Delayed for Small Construction Contractors: Hearing Before the Subcomm. on Contracting and Workforce and Investigations, Oversight, and Regulations of the H. Comm. on Small Bus., 115 Cong. 1 (2017) [hereinafter Hearing] (statement of Hon. Steve Knight, Chairman, H. Comm. on Small Business).

62. Islam El-adaway et al., *supra* note 58, at 9 (discussing that higher-tier contractors use contingent payment clauses to insulate themselves from financial obligations to lower-tier contractors in the event of nonpayment by the owner). Since there is no privity of contract between many of the parties, such as a subcontractor having no contractual relationship to the project owner, it becomes difficult to enforce payments for work performed against the party that is causing a payment delay.

63. Hearing, *supra* note 61, at 1–2 (discussing that, during a period of delayed payment, contractors are often left to finance accruing costs out of pocket or rely on bank loans and lines of credit).

highly unsustainable and generally lead to the insolvency and bankruptcy of many construction businesses.⁶⁴

A recent study investigating United States construction projects concluded that excessive project change orders and time-consuming decision processes by project owners were the two leading factors causing project delays.⁶⁵ Construction projects are inherently imperfect, and unexpected changes are bound to arise throughout the design and building process.⁶⁶ A change order, or “any change to the scope of work of an already existing contract,” represents unknown and uncontrollable risks “that can have an enormous impact on the time of performance and cost” of a construction project.⁶⁷ When issues arise during the building process, “[t]he keys to mitigating that risk are to quickly identify the problem, [and] modify the contract as soon as possible so that performance issues can be addressed, fixed, and paid for.”⁶⁸ Unfortunately, when time is crucial to mitigate further financial risk, owners, especially government agencies,⁶⁹ are notoriously slow in providing the required financial support to contractors.⁷⁰ Project change orders represent a significant portion of the delayed payment issues and have “a ripple effect that extends beyond just the prime contractor,” greatly impacting small subcontractor businesses.⁷¹

Small businesses are vital to economic growth;⁷² however, they are also the most susceptible to the consequences of delayed payments. Statistics show that almost two-thirds of construction businesses fail

64. *Id.* (finding that delayed payments “create[] untenable situations and can result in financial distress, and in some cases, bankruptcy”).

65. Mohammadsoroush Tafazzoli & Pramen P. Shrestha, *Investigating Causes of Delay in U.S. Construction Projects*, 53 ASSOCIATED SCHS. CONSTRUCTION 611, 617–18 (2017).

66. Hearing, *supra* note 61, at 7 (“What happens, for example, when the contractor realizes that it cannot build what is depicted on the plans and specifications? Or a situation where the government decides to change the configuration of a room in the middle of performance? That is where the real risk lies . . .”).

67. *Id.* at 7, 27.

68. *Id.* at 7.

69. See H.R. REP. NO. 99-927, at 3 (1986) (discussing the routine complaints of the government’s inability to pay bills on time, disrupting cash flow, and resulting in unnecessary costs).

70. *Id.*

71. Hearing, *supra* note 61, at 9.

72. U.S. SMALL BUS. ADMIN., SBAHQ-10-M-0258, SMALL BUSINESS GDP: UPDATE 2002–2010 1 (2012) (finding that small businesses produce almost half of the United States’ gross domestic product). The construction industry is also a sector that is predominately made up of small business subcontractors. *Id.* These subcontractors perform eighty to ninety percent of direct construction work. Islam El-adaway et al., *supra* note 58.

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within their first five years due partly to cash-flow problems.⁷³ Unlike larger contractors, smaller contractors do not have the overhead margin to perform work for sustained periods of time without reliable progress payments.⁷⁴ Small contractors may feel pressured to stay on schedule and preserve ongoing business relationships, or stop work and risk terminating the contract for nonperformance.⁷⁵ Some small contractors will accept lesser amounts owed, feeling forced into alternate claims processes that it would otherwise not have the time or resources to perform.⁷⁶ Addressing the late payment issue under the circumstances of small businesses is an issue of great importance, considering that the construction industry strives to provide Disadvantaged Business Enterprises and Minority Business Enterprises the opportunity to establish and maintain successful businesses.⁷⁷ A practicing attorney in the federal construction industry recalled representing a disabled veteran business owner who was forced into bankruptcy by the untimely payments of the federal project owner with whom he contracted.⁷⁸ After performing hundreds of days over schedule and “a million dollars of his own money spent,” the contractor finally succeeded after two years of litigation.⁷⁹ Although the contractor recouped most of his money, the effects of nonpayment had already set in—his business was forced to close its doors.⁸⁰

Contractors serving as witnesses in the cited congressional hearing proposed solutions to the issue of delayed payment on federal construction projects—proposals that may be taken into consideration for any progress payment solution. The proposed solutions included standardizing change order documents to mitigate change order delays

73. See Savannah Richardson, *3 Reasons Why Construction Companies Fail*, NVOICEPAY (Sept. 6, 2017), <https://content.nvoicepay.com/blog/3-reasons-why-construction-companies-fail> (attributing the construction industry's low survival rate to cash flow issues and tight profit margins); Scott Shane, *Small Business Failure Rates by Industry: The Real Numbers*, SMALL BUS. TRENDS (Sept. 24, 2012), <https://smallbiztrends.com/2012/09/failure-rates-by-sector-the-real-numbers.html> (last updated Jan. 21, 2020) (finding that construction ranked the lowest in five-year survival rates amongst industry sectors).

74. Hearing, *supra* note 61, at 3.

75. *Id.* at 2.

76. *Id.* at 4.

77. *SBA Goaling Guidelines*, U.S. SMALL BUS. ADMIN., <https://www.sba.gov/document/report-sba-goaling-guidelines> (last visited Mar. 19, 2020) (discussing the federal government's procurement goal to direct spending dollars to socially and economically disadvantaged small businesses, service-disabled veteran-owned small businesses, woman-owned small businesses, and Historically Underutilized Business Zones).

78. Hearing, *supra* note 61, at 8.

79. *Id.*

80. *See id.*

by project owners, increasing the accountability and responsibility for meeting payment deadlines, increasing penalties against those who fail to meet payment deadlines, and increasing data collection and analysis by government agencies.⁸¹ Also mentioned was the recently proposed Small Business Payment for Performance Act, “a common-sense bill [that] recognizes that cash flow is the lifeblood of small business contractors.”⁸² If passed, the Act—an amendment to the currently enacted Small Business Act—focuses on correcting the issue of change order payment delays for federal construction projects by requiring federal agency owners to provide small contractors an interim partial payment of at least fifty percent of the estimated change order cost, paid within the timeframe established by the Federal Prompt Payment Act.⁸³

The construction industry is a complex structure of contracting and subcontracting that requires reliable progress payments throughout the life of a construction project in order to provide financial stability and perform efficient work.⁸⁴ The issue of delayed progress payments only further hinders businesses’ ability to thrive in an industry that is notorious for low success rates.⁸⁵ Contractors who opt to provide financing themselves when equity is tied up in delayed payment risk lower bonding capacity and high interest rates that affect the ability to bid future work.⁸⁶ In contrast, contractors who stop work performance are vulnerable to additional claims for nonperformance.⁸⁷ Both options are problematic and adversely impact the construction industry as a whole by decreasing bidding competition, inversely increasing project costs, and impacting party relationships.⁸⁸

IV. STRENGTHENING PENNSYLVANIA’S PROMPT PAYMENT LAWS

There is a general consensus that prompt payment laws improve the timeliness of progress payments.⁸⁹ A study performed by the GAO found that the Federal Prompt Payment Act noticeably reduced late federal

81. *See id.* at 14, 17.

82. *Id.* at 16.

83. *Id.* at 11, 16–17.

84. *Id.* at 9.

85. *Id.*

86. *Id.*

87. *Id.* at 2, 9.

88. *Id.* at 9–11.

89. *See, e.g.*, H.R. REP. NO. 99-927, at 5 (1986).

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payments.⁹⁰ These reductions of late federal payments generated hundreds of millions in government savings.⁹¹ Prior to the Federal Prompt Payment Act, an estimated twenty-four percent of federal payments involving \$7.7 billion were made after their due dates.⁹² In fact, the federal government should have paid approximately \$15 million in interest fees over the span of the study; however, the report found that only one in every six penalties owed were actually paid.⁹³ State and local construction spending is ten times greater than federal construction spending.⁹⁴ And private construction spending is even greater than public construction spending.⁹⁵ This GAO report helps put the purpose of prompt payment laws into perspective, being that “the full potential of the law has not yet been realized.”⁹⁶

State laws are “relatively new and are still evolving” to address modern issues.⁹⁷ Pennsylvania’s applicable prompt payment laws can be further reformed to ensure greater reliability in making and receiving payments between the parties to a construction contract. A more rigid and structured statute may incentivize local parties to utilize the provisions these statutes offer. The remainder of this Note will discuss hypothetical amendments for strengthening payment obligations. For

90. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 34, at 2–3 (“Passage of the act and its implementation led to substantial improvement in federal bill paying performance. These initiatives resulted in a noticeable reduction in excessively late payments (over sixty days late) and hundreds of millions in savings to the government by avoiding early payments.”).

91. *Id.*

92. *Id.* at 3 (“GAO estimated that twenty-four percent of federal vendor payments, involving \$7.7 billion, were made after the due date during its four-month test period. Some were extremely late. For example, GAO found that seven percent of the late payments in its sample were between forty-six and 150 days late and about 1.3 percent were more than ninety days late.”); *see also id.* at 2 (“The Prompt Payment Act expresses the Congress’ concern that federal agencies pay the private sector on time for the more than \$200 billion of goods and services provided annually.” (emphasis added)). It is worth noting that the breadth of the GOA’s report covered the entirety of federal vendors and not particularly the construction industry.

93. *Id.* at 3.

94. *Value of Construction Put in Place at a Glance: October 2018*, U.S. Census Bureau, <https://www.census.gov/construction/c30/c30index.html> (last visited Jan. 19, 2019) (calculated by viewing the total seasonally adjusted annual rate for Federal construction and comparing it to the total seasonally adjusted annual rate for State and Local construction).

95. *Id.*

96. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 34, at 3.

97. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/AFMD-89-33BR, PROMPT PAYMENT STATE LAWS ARE SIMILAR TO THE FEDERAL ACT BUT LESS COMPREHENSIVE 2 (1989).

reference, the below tables represent the current payment obligations set forth by the PPPA and CASPA:

Table 1⁹⁸

Payment Obligation	PPPA	CASPA
Owner to Prime	45 days after invoice	20 days after invoice
Prime to Subcontractor	14 days after payment	14 days after payment
Subcontractor to Lower Tiers	14 days after payment	14 days after payment
Interest Fee	Determined by State	12% per annum

Table 2⁹⁹

Statute	Owner	Work Suspension	Bad Faith Penalty	ADR	Partial Change Order
PPPA	Public	No	Yes	No	No
CASPA	Private	Yes	No	No	No

A. *Payment Deadlines, Penalties, and Work Suspension*

Naturally, the payment process begins at the owner level. Progress payments are paid to prime contractors for satisfactory work. Upon payment, prime contractors distribute progress payments to the various subcontractors, sub-subcontractors, and materialmen involved. When payments are delayed between owners and prime contractors, the subordinate parties suffer, although their work may be satisfactory.¹⁰⁰ As

98. 62 PA. CONS. STAT. §§ 3932–3933 (2019) (discussing payment obligations between parties under the Pennsylvania Prompt Payment Act); 73 PA. CONS. STAT. §§ 505, 507 (2019) (discussing payment obligations between parties under the Contractor and Subcontractor Payment Act).

99. 62 PA. CONS. STAT. § 3935 (2019) (discussing penalties for withholding payments “in bad faith” under the Pennsylvania Prompt Payment Act); 73 PA. CONS. STAT. §§ 505, 507 (discussing general contractors’ and subcontractors’ ability to suspend work performance in the event of nonpayment under the Contractor and Subcontractor Payment Act).

100. Islam El-adaway et al., *supra* note 58.

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previously discussed, these issues are further complicated by the use of contingent payment clauses that protect higher-tier contractors from having to pay lower-tier parties.¹⁰¹ Thus, strengthening the payment obligations between owners and prime contractors is a vital step for developing reliable cash flow throughout the entire line of contracting.

Pennsylvania's payment schedule between owners and general contractors is excessively long. Rather, the PPPA and CASPA should decrease the deadlines in which progress payments are due, increasing the frequency of payments between these two parties. For example, the PPPA allows government owners up to *forty-five* days to make a progress payment to a prime contractor after the invoice for payment is received.¹⁰² Although prompt payment statutes vary tremendously, other state statutes require payments two, even *three times*, as quickly between government owners and general contractors.¹⁰³ The payments between owners and higher-tier contractors are a vital aspect of stimulating cash flow throughout the line of contracting, since payment deadlines to lower-tier contractors are contingent upon the higher-tier contractors receiving payment first.¹⁰⁴ Although the above pertains to government owners under the PPPA, a similar increase in payment frequency should also be applied between parties on privately owned construction projects under CASPA.

To help implement increasing the frequency of payments to higher-tier contractors, the American Subcontractors Associations of Central Pennsylvania ("ASACP") released a recent letter opposing the 2018 amendments to CASPA, reasoning that the new provisions implemented "a series of notices and lengthy waiting periods" that, as of the amendment, cannot be contracted differently.¹⁰⁵ Under the amended provisions, a contractor or subcontractor must continue working for thirty days after payment is due before sending a notice to the nonpaying

101. See *supra* text accompanying note 62.

102. 62 PA. CONS. STAT. § 3932(b) (2019).

103. See, e.g., ARIZ. REV. STAT. ANN. § 34-221(C)(2) (2019) (requiring progress payments to be due "on or before fourteen days" after approval); ARK. CODE ANN. § 19-4-1411(a)(1)(A) (2019) (requiring a maximum of fifteen working days between the design professional and the state); GA. CODE ANN. § 13-11-4(a) (2019) (requiring that "the owner shall pay the contractor within 15 days"); IOWA CODE § 573.12(2)(a)(1) (2019) (requiring progress payments to be paid "fourteen days after receipt of the payment" and "not to exceed thirty days" if specified differently by contract).

104. Both statutes require contractors and subcontractors to make payment within fourteen days of receipt of a progress payment, assuming work is satisfactory. See 73 PA. CONS. STAT. § 507(c) (2019); 62 PA. CONS. STAT. § 3933(c) (2019).

105. Letter from Loni Warholic, Exec. Dir., American Subcontractors Ass'n of Cent. Pa., to Rep. Hon. James R. Santora (Feb. 6, 2018) (on file with author).

party for nonpayment.¹⁰⁶ If the contractor or subcontractor remains unpaid for thirty days after sending the first notice, then the party must send a second notice of nonpayment.¹⁰⁷ If, after ten days of the second notice the party remains unpaid, only then may the party suspend performance for nonpayment.¹⁰⁸ As argued by the ASACP, and as provided by CASPA, this requires the party to remain unpaid and continue working for a minimum of *seventy days* before suspending performance for nonpayment, after the payment was originally due and while the nonpaying party is almost certainly aware of its failure to pay.¹⁰⁹ During this time, the contractor or subcontractor must incur the costs associated with continuing work performance when in fact many subcontractors would have completed their contracted work within this time frame.¹¹⁰

Therefore, to help increase the frequency of progress payments between parties, the ASACP letter proposed an amended model of payment structure and work stop provisions.¹¹¹ Under the American Institute of Architect's ("AIA") model contract agreement, if an owner fails to pay a contractor within seven days of the payment due date, the contractor may send a notice to the owner regarding the nonpayment.¹¹² If the owner fails to make payment within seven days after the first notice, the contractor may suspend performance.¹¹³ The AIA model also applies between general contractors and subcontractors.¹¹⁴ Therefore, the AIA model proposes one notice and a waiting period of fourteen days after payment is due before a contractor may stop work, as opposed to requiring two notices and a minimum waiting period of seventy days without payment.¹¹⁵ In sum, the PPPA and CASPA should decrease the time period between parties for making progress payments (thereby increasing the frequency of payments) and implement the AIA model for halting work upon nonpayment and mitigating financial constraint.

In addition to the above proposed amendments, the fees and penalties associated with delayed payments should be further amended.

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* ("Furthermore, for a lot of subcontractors, having to continue working for 70 days after payment is actually due means that a lot of subcontractors will complete their work . . .").

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

The PPPA penalizes parties who are found to have withheld payments in bad faith.¹¹⁶ The PPPA defines bad faith as withholdings that are “arbitrary or vexatious” or, in other words, withholdings that have no good faith basis for being withheld, such as deficient work disputes.¹¹⁷ If a party is found to have withheld payments in bad faith, the PPPA institutes a penalty of twelve percent per annum on the amount withheld in addition to all other damages due, including attorney’s fees under some circumstances.¹¹⁸ When a party purposefully withholds payments in bad faith, the other party still incurs daily operational costs associated with the project. A one percent penalty on the payment owed may not be enough to cover the costs of the delay caused by this intentional dispute. Therefore, the costs of untimely payments may greatly outweigh the penalty imposed. Similar provisions should be included in both Pennsylvania payment statutes to further mitigate potential cash flow issues throughout the line of contracting.

B. *Rapid Dispute Resolution*

Each construction project is unique, encountering different variables throughout the building process. Each project is similar, however, in that all parties expect progress throughout. A project owner desires efficient progress and an accurate final result. Contractors desire steady production and minimal obstacles. Notwithstanding these desires, issues are an inevitable part of the building process. The uniqueness of construction brings with it complex claims and disputes.¹¹⁹ Over centuries, these complex claims and disputes have created an extensive area of law that often frustrates judges and confuses inexpert jurors.¹²⁰

Nonjudicial dispute resolution methods have become increasingly favorable over court litigation within the construction industry.¹²¹ Parties began adopting alternative dispute resolution (“ADR”) methods to reach a “rapid resolution” and facilitate ongoing processes.¹²² Modern forms of ADR focus on “resolving disputes as close in time to the

116. 62 PA. CONS. STAT. § 3935(a)–(b) (2019).

117. *Id.* A “good faith claim” for withholding payment is under deficient work disputes. *Id.* § 3934.

118. *Id.* § 3935(a).

119. Philip L. Bruner, *Rapid Resolution ADR*, 31 CONSTRUCTION LAW. 6, 7 (2011) (“The industry’s complexity in size, and uniqueness produce sizable numbers of complex claims and disputes.”).

120. *Id.* at 7–8.

121. *Id.* at 6.

122. Howard Toole, *Alternative Dispute Resolution Update*, 11 MONT. LAW. 8, 8 (1986).

underlying events giving rise to the dispute as possible.”¹²³ When a dispute arises that obstructs cash flow, the goal is to resolve the issue as promptly and efficiently as practical. Resolving disputes at the project level, without the intervention of third parties, results in minimal disruptions to the project and mitigates financial impacts.¹²⁴

A variety of modern ADR methods are accepted in the construction industry. These methods of rapid resolution range from informal discussions to formal structured negotiation provisions.¹²⁵ Naturally, informal discussions are the starting point of resolving any dispute.¹²⁶ Unfortunately, conflicting personalities and a lack of information tend to obstruct initial agreements in the construction industry.¹²⁷ Structured negotiations are the next step and are frequently included in modern construction contracts.¹²⁸ The purpose of structured negotiations is to impose a mandatory structured process of timely negotiation procedures. Negotiations begin at the project level and move up successive levels of higher management when required.¹²⁹ Ultimately, the goal is to resolve disputes at the project level without the introduction of third parties. The below sample illustrates a structured negotiation provision:

If the parties cannot reach resolution on a matter relating to or arising out of the agreement, the Parties shall endeavor to reach resolution through good faith direct discussions between the parties’ representatives, who shall possess the necessary authority to resolve such matter and who shall record the date of first discussions. If the parties’ representatives are not able to resolve such matter within [a number of] business days of the date of first discussion, the parties’ representatives shall immediately inform senior executives of the parties in writing that resolution was not effected. Upon receipt of such notice, senior executives of the parties shall meet within [a number of] business days to endeavor to reach resolution. If the dispute remains unresolved after [a number of] days from the date of first

123. Don W. Gregory & Peter A. Berg, *Construction Lawyer: Problem or Problem Solver? The Need for Cost-Effective Dispute Resolution in the Construction Industry*, 33 CONSTRUCTION LAW. 16, 19 (2013).

124. *Id.*

125. Bruner, *supra* note 119, at 10.

126. *Id.*

127. *Id.* at 10–11.

128. *Id.* at 11.

129. *Id.*

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discussion, the parties shall submit such matter to the dispute mitigation and dispute resolution procedures selected herein.¹³⁰

Structured negotiation provisions were implemented in Boston's \$15 billion "Big Dig" project, which included hundreds of prime contractors and subcontractors.¹³¹ When midway through the project it was revealed that thousands of claims—some almost a year old—remained unresolved, mandatory structured negotiations were implemented into the project's ADR process.¹³² The revised ADR method of structured negotiations and mediation was able to resolve half-a-billion dollars in claims.¹³³ Structured negotiation provisions may contain "a host of other provisions relevant to" negotiation processes, including interim payments, time schedule for moving negotiations forward, negotiation participants, and third-party meditation assistance.¹³⁴

Mandatory structured negotiation provisions can be implemented into Pennsylvania's prompt payment laws. A structured negotiation provision would offer means to resolve disputes that hinder payment flow, including payment withheld "in good faith."¹³⁵ A structured negotiation provision would require parties to meet within specific periods of time to resolve disputes that obstruct cash flow. Parties would be required to reach resolution through good faith efforts, beginning at the lower end of the project level. For example, agreements could be reached by parties' respective project managers through informal discussions on the job site or by email. If a solution is not reached within a short amount of time, higher-level managers would be required to meet more formally, such as at the next scheduled project meeting, to resolve the dispute. Essentially, the purpose is to exhaust all possible levels of resolving the dispute at the project level in a quick and effective manner before involving third parties for nonbinding mediation or binding arbitration, both of which would further delay progress payments to performing parties.

130. *Id.*

131. *Id.* at 9, 11.

132. *Id.* at 10.

133. *Id.*

134. *Id.* at 11.

135. *See supra* text accompanying note 117.

C. Partial Change Order Payments

As provided, construction projects are exposed to a wide array of variables.¹³⁶ Unforeseen changes arise that require alterations to the original contract. Project owners must amend the plans and specifications, and contractors must adapt to the new design. Subsequently, some form of equitable adjustment will occur. Here, the issue is not with the additional work. Instead, the issue rests with project owners who are slow at processing and paying contractors for the changed work.¹³⁷ These delays cause serious harm to the project and to the cash flow throughout the line of contracting.¹³⁸

Project owners and contractors may disagree as to whether the work is included in the original contract.¹³⁹ In contrast, both parties may agree that the work is not covered by the original contract and additional time and expenses are required to complete the project.¹⁴⁰ Contractors, however, including small businesses, “neither have the luxury of deep pockets to bear long periods of time without payment, nor can they generally handle such risk.”¹⁴¹ When these differing conditions arise, parties must address the issue in a time-structured and cost-effective manner as a way to *avoid*, let alone resolve, disputes. Disputes that do arise tend to result in delayed payment issues and, ultimately, lawsuits.¹⁴² Instead, contractors are inclined to “proceed with the work and do their best to account for the consequential costs . . . incurred.”¹⁴³ Small businesses find themselves financially distressed by these extra costs in part because they “are unable to anticipate prompt pay, or to receive prompt payment as guaranteed under the [relevant] Prompt Payment Act.”¹⁴⁴ This financial distress especially becomes problematic when, for some businesses, change order work results in a mere two-to-five percent profit rate.¹⁴⁵

136. See Hearing, *supra* note 61, at 26.

137. *Id.* (finding that “the concern rests with [owners] failing to . . . make payment” after directing contractors to perform changed work). As mentioned, *supra* Part III, change orders and time-consuming decisions by owners are the two leading factors of project delay. Tafazzoli & Shrestha, *supra* note 65, at 617.

138. See Hearing, *supra* note 61, at 26.

139. *Id.* at 29.

140. See *id.*

141. *Id.*

142. *Id.* at 40.

143. *Id.*

144. *Id.* at 40–41.

145. *Id.* at 41.

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Two federal bills were recently introduced that aim to amend change order issues on federal construction projects. The Small Business Know-Before-You-Bid Construction Transparency Act of 2017 aims to address the length of time it takes for federal owners to review and approve equitable changes.¹⁴⁶ The Small Business Payment for Performance Act of 2017 requires federal agency owners to provide businesses an interim partial payment of at least fifty percent of the estimated amount of the additional cost resulting from a change order.¹⁴⁷ As a provision to Pennsylvania's prompt payment statutes, similar guidelines would be established to accelerate change order decisions by project owners. The guidelines would also require interim change order payments to ensure cash flows through to the parties that incur these equitable changes as "such payment to a prime contractor would be required to flow through to subcontractors for their performance on such change order work."¹⁴⁸ Additionally, both parties would reserve the right to payment in cases where it is disputed as to whether the changed work falls within the original contract.¹⁴⁹ Therefore, the owner "does not prejudice its right to be reimbursed should it be determined that the disputed work was within the scope of the [w]ork," and the contractor "does not prejudice its right to receive full payment for the disputed work should it be determined that the disputed work is not within the scope of the [w]ork."¹⁵⁰ The excerpt below illustrates a sample provision for requiring partial change order payments:

The Parties shall negotiate expeditiously and in good faith
If there is a dispute as to the cost to Owner, Owner shall pay Constructor fifty percent (50%) of its actual . . . cost to perform such Work. In such event, the Parties reserve their rights as to the disputed amount Owner's payment does not prejudice its right to be reimbursed should it be determined that the disputed work was within the scope of the Work. Constructor's receipt of payment for the disputed work does not prejudice its right to receive full payment for the disputed work should it be

146. H.R. 2350, 115th Cong. § 15A(b) (2017); Hearing, *supra* note 61, at 42.

147. H.R. 2594, 115th Cong. § 15A(b) (2017); Hearing, *supra* note 61, at 42 (claiming that this bill would allow "contractors the ability to continue work without fear of withheld payments for change orders").

148. Hearing, *supra* note 61, at 49.

149. *Id.*

150. *Id.*

determined that the disputed work is not within the scope of the Work.”¹⁵¹

Adopting such a provision in a prompt payment law will help contractors avoid bearing the full costs of equitable changes up front without fear of subsequent payment delays or disputes. Furthermore, this provision would provide a structure to contested change orders while mitigating payment interruptions.

V. CONCLUSION

Late payments are a problem for any industry. However, these issues greatly impact the construction sector due to the complex structure of contracting and subcontracting between parties. The purpose of Pennsylvania’s prompt payment statutes is to “provid[e] guidelines” for ensuring timely payments.¹⁵² However, the question remains as to why the issue of delayed payment is persistent in construction. By reforming payment deadlines and penalties, and introducing work suspension provisions, rapid dispute resolution provisions, and partial change order payment provisions, these statutes can be restructured to strengthen payment obligations and provide rapid dispute resolution methods for when conflicts arise. As compared to Tables 1 and 2, the below tables represent Pennsylvania’s prompt payment statutes as if the proposed changes were implemented. With these proposed changes, any conflicts that arise will be dealt with in a timely manner and will not affect cash flow throughout the line of contracting, fostering a more productive and equitable construction industry.

Table 3

Payment Obligation	PPPA	CASPA
Owner to Prime	20 days after invoice	14 days after invoice
Prime to Subcontractor	14 days after payment	14 days after payment

151. *Id.* (quoting CONSENSUSDOCS, FORM 200: STANDARD AGREEMENT AND GENERAL CONDITIONS BETWEEN OWNER AND CONSTRUCTOR (LUMP SUM) (2017)).

152. *Imperial Excavating & Paving, LLC v. Rizzetto Constr. Mgmt.*, 935 A.2d 557, 563 (Pa. Super. Ct. 2007).

Subcontractor to Lower Tiers	14 days after payment	14 days after payment
Interest Fee	Determined by State	12% per annum

Table 4

Statute	Owner	Work Suspension	Bad Faith Penalty	ADR	Partial Change Order
PPPA	Public	Yes	Yes	Yes	Yes
CASPA	Private	Yes	Yes	Yes	Yes