



Pay Up, Or . . . Pay Even More: Ohio's Prompt Pay Act Establishes Expeditious Payment Requirements With Serious Penalties

by Matthew D. Harper

Ohio's Prompt Payment Law (Act), codified in Ohio Revised Code 4113.61, establishes requirements for contractors, subcontractors and material suppliers to expedite payment to lower tier subcontractors and material suppliers after they have received payment. The Act is aimed at preventing contractors who have received payment themselves from wrongly delaying payment to lower tier subcontractors and material suppliers. The Act imposes severe penalties for failure to comply with its strict payment requirements.

The Act requires contractors, upon timely application or request for payment by a subcontractor or material supplier, to pay the subcontractor or material supplier their owed portion within 10 days of receiving payment from the owner. The Act places identical requirements on subcontractors and material suppliers who receive timely applications or requests from lower tier subcontractors or material suppliers, with regard to payments received from the contractor or other higher tiered subcontractor or material supplier.

Timely notice entails providing a request or application for payment "in sufficient time to allow the contractor [or subcontractor or material supplier] to include the application, request, or invoice in the contractor's [or subcontractor's or material supplier's] own pay request submitted to the owner [or contractor or higher tier subcontractor or material supplier]."

About the photo: Associate Patrick A. Sadowski at our new Findlay office.

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The payment owed to subcontractors or lower tier subcontractors is the percentage of completion of the subcontractor's contract permitted by the owner for the amount of labor performed. With regard to material suppliers, payment is the portion of the invoice representing the materials furnished by the supplier. The payments made may be reduced by any retainage provision in the contract or by any amount necessary to resolve disputed liens or claims with subcontractors and material suppliers regarding the work, labor, or furnishing of material. If a party obligated to make payment under the Act receives any final retainage, they are required, upon determining that the lower tier party has satisfactorily performed their duties, to pay the lower tier party their portion of the retainage within the shorter of 10 days after receipt of the retainage or a contractually designated time period, or they are subject to an 18% annual interest penalty on the retainage owed. The Act also requires contractors, subcontractors, and lower tier subcontractors to pay labor wages due within ten (10) days of receipt of payment from the owner, contractor, subcontractor, or lower tier subcontractor.

Whether a disputed claim justifies withholding funds depends on the facts. In *Creative Concrete v. D&G Pools*, the Seventh District Court of Appeals of Ohio held that a contractor did not have a good faith justification for withholding payment to a subcontractor on the basis of inadequate completion of the contracted work and upheld an award of prejudgment interest for a violation of ORC 4113.61. D&G Pools subcontracted concrete work to Creative Concrete for a pool and withheld payment after finding the finished product unsatisfactory. D&G Pools hired another subcontractor to redo the work. The Court held that a contractor must assert a good faith basis for withholding payment or a subcontractor is entitled to penalties under the Prompt Pay Act. In reaching its conclusion, the Court relied heavily on the testimony of the subcontractor that was hired to redo the work of Creative Concrete, who established that he believed the work performed by Creative Concrete was a "payable job" and that he informed D&G Pools of this opinion.

On the other hand, *Consortium Communications v. Cleveland Telecommunications, Inc.*, the Tenth District Court of Appeals of Ohio held that there was no violation of ORC 4113.61 where disputed additional charges regarding a construction project were withheld. In *Consortium*, the subcontractor submitted a quote including language that delay caused by conditions out of its control or causing return trips would result in trip charges. An employee of the general contractor accepted the quote and after several problems during construction, the work was completed. The subcontractor issued an invoice reflecting additional trip charges and the general contractor refused to pay the added charges. The Court relied on testimony by the vice president and chief operating officer of the general contractor asserting a belief that the charges were unwarranted, unauthorized, and against general policy in holding that the additional charges were legitimately disputed. The Court noted that just because the ultimate judgment regarding the additional trip charges was not made in favor of the general contractor, did not mean the contractor could not in good faith dispute the charges and withhold payment.

In *Masiogale Electrical-Mechanical, Inc. v. Construction One, Inc.*, the Supreme Court of Ohio held that breaching a lien-waiver clause in a construction contract does not create a disputed lien or claim regarding the work or labor performed or material furnished by the subcontractor under ORC 4113.61(A)(1). *Masiogale* involved a dispute between a contractor and subcontractor whereby the subcontractor requested payment for completed work and the contractor sought a reduction in the contract price as a result of alleged untimely and improper work performance by the subcontractor. The subcontractor responded to the reduction by filing a lien on the property in violation of a lien-waiver clause in the contract between the contractor and subcontractor. The contractor sought to withhold the amounts of bond premiums and anticipated attorney fees related to resolving the improperly filed lien by arguing that these amounts were "necessary to resolve disputed liens or claims involving the work." In reaching its conclusion, the Court reasoned that the lien-waiver provisions were procedural in nature and did not relate to the substantive aspects of work performance, labor, or supplying material under the contract and therefore, contractors were not permitted to withhold amounts relating to such breaches.

The Act imposes an 18% annual interest penalty on contractors, subcontractors and material suppliers who fail to promptly compensate contractors and lower tier subcontractors or material suppliers, in addition to the principal payment owed. The interest penalty begins on the eleventh day following the receipt of payment from the owner, contractor or higher tier subcontractor or material supplier, and finishes when full payment, including the interest penalty, is made. In *Smith & Johnson Construction Co. v. John K. Lehner Co., Inc.*, the Fifth District Court of Appeals of Ohio interpreted the 18% annual interest penalty on the "payment due" as requiring the 18% interest penalty to be owed on the unpaid portion of the principal and not the entire principal of the contract.

Additional penalties are imposed if parties obligated to make timely payments fail to comply with the Act within 30 days. If payment is not made within 30 days, the unpaid party may bring a civil action against the owing party for the owed amount, interest and reasonable attorney fees and court costs, unless attorney fees would be inequitable. In *Robert W. Setterlin & Sons v. North Mkt. Dev. Auth.*, the Tenth District Court of Appeals of Ohio held that an arbitrator was permitted to award prejudgment interest and reasonable attorney fees under the 30 day penalty portion of the Act when the parties to the dispute had an agreement to arbitrate in their construction contract.

A few final points are in order: Construction or improvement projects involving single-, two- or three-family detached dwelling homes are not covered by the Act. In *Soloman v. Excel Marketing, Inc.*, the Second District Court of Appeals of Ohio held that the Act applies to both private construction projects and public construction projects. Additionally, none of the rights created by the Act may be waived.

In order to avoid the potentially severe penalties imposed by the Act, contractors, subcontractors and material suppliers must strictly abide by the expeditious payment requirements set forth in the Act. Ensuring compliance with the Act, evaluating the potential exposure to liability, and assessing defenses in the face of possible penalties and claims all require a sophisticated legal analysis. When faced with such issues, the attorneys of Eastman & Smith Ltd. would be happy to help you properly analyze your particular situation and help you decide on the best strategy for your particular needs.



Mr. Harper is a member of the Firm. He represents owners, contractors, subcontractors and suppliers in complex, multi-party commercial construction disputes. He also provides representation to parties involved in residential projects as well as clients in disputes involving real estate, land use, and zoning and eminent domain. In addition, Mr. Harper advises clients regarding mechanic's liens. To contact Mr. Harper, please call our Toledo office (419-241-6000).

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