



## Illinois' New Retainage Law

*ICIC Members,*

*A new law limiting the amount of retainage that can be withheld on private construction projects took effect on August 29. Below is an overview provided by attorney Jim Rohlfing.*

Effective August 20, 2019, Illinois law provides that a maximum of 10% retainage may be withheld from payments under private construction contracts and, after the contract is one-half complete, retainage must be reduced to 5% and kept at 5% for the remainder of the contract. With this new law, Illinois joins the vast majority of states that have enacted laws pertaining to retainage on construction contracts. Like almost every other state, Illinois' retainage restrictions are unique to Illinois and, therefore, parties to Illinois construction contracts should understand how the new law will impact their projects. This article will explain the law, discuss how to comply with it and give an example of its application.

When Governor J.B. Pritzker approved SB 1636 it became effective immediately as Public Act 101-0432. It is an amendment to a law known as the Contractors Prompt Payment Act, 815 ILCS 603/1 ("CPPA"), which governs the timing of payments to contractors on private projects in Illinois. The new law applies to contracts entered into after August 20, 2019, but not to contracts made before that date. Public Act 101-0432 provides:

No construction contract may permit the withholding of retainage from any payment in excess of the amounts permitted in this Section. A construction contract may provide for the withholding of retainage of up to 10% of any payment made prior to the completion of 50% of the contract. When a contract is 50% complete, retainage withheld shall be reduced so that no more than 5% is held. After the contract is 50% complete, no more than 5% of the amount of any subsequent payments made under the contract may be held as retainage.

The above provision can only be understood within the context of the CPPA. Moreover, the CPPA incorporates definitions from the Illinois Mechanics Lien Act (770 ILCS 60/0.01) (the "MLA") and, should be applied consistently with the MLA. The CPPA, including the new retainage section, applies to construction contracts with general contractors as well as those with subcontractors. It does not apply to contracts for the construction or improvement of residential properties of twelve or fewer units. Also excluded from its reach are contracts that require the expenditure of public funds, which, consistent with Section 23 of the MLA, should be understood as public improvements for either the State of Illinois or a local government. The CPPA provides that if full payment is not timely made, including retainage, ten percent interest is due on unpaid amounts, and the contractor is entitled to stop work until proper payment is

received. Importantly, the CPPA raises a presumption that invoices are valid if not objected to in writing within 25 days of receipt. The provisions of the CPPA are incorporated by law in all Illinois construction contracts to which it applies, even if its terms are not expressly included in the written contract.

The CPPA, which governs the timing of payments under construction contracts, apparently takes the view that 50% completion of a contract occurs when half of the price of the contract has been earned. The requirement under Section 5 of the MLA, as well as the common practice in Illinois, is that contractors must furnish sworn statements to owners before receiving payments. Among other things, the statements set forth the contract price, the amount paid to date, the amount being requested as part of the current payment application, and the amount that remains due to complete work under the contract. The same information must also be furnished for subcontracts. Sworn statements will be useful in determining when a contract is fifty percent complete, thereby requiring a reduction of retainage to five percent under the CPPA. Other evidence will be required for non-fixed price contracts or in situations when substantial and unpredictable change orders greatly increase the difficulty of measuring the 50% threshold. Careful contract drafting should lessen potential conflicts over inevitable unusual situations.

Consider the following hypothetical to illustrate how the law should work in practice:

- 1) an owner contracts with a general contractor to construct a commercial building for a fixed price of \$900,000, with payment applications to be submitted on the tenth day of every month until completion;
- 2) to date, the general contractor has submitted payment applications totaling \$400,000 and the owner has approved those applications;
- 3) retainage of \$40,000 (10%) has been held from approved payments, so the owner has made net payments totaling \$360,000 to the contractor; and
- 4) now, the general contractor is submitting a payment application with a sworn statement requesting an additional interim payment in the amount of \$100,000, less retainage.

Under this hypothetical, the general contractor's contract with the owner is now more than 50% complete (\$500,000 of work completed on a total contract price of \$900,000), so retainage must be reduced to 5% or a total of \$25,000, and a maximum of 5% retainage may be withheld from all future payments.

Therefore, the owner may withhold up to \$5,000 from the newly submitted payment application and credit the contractor \$20,000 for previously held retainage which is in excess of 5%. Thus, the owner would pay the contractor \$115,000 (\$100,000 minus \$5,000, plus a credit of \$20,000). The owner would then be holding retainage of \$25,000 (5% of \$500,000).

Each subcontract is considered separately for purposes of triggering 5% maximum retainage upon fifty percent completion. Thus, a general contractor typically will be restricted to withholding a maximum 5% retainage from payments to its demolition and excavation subcontractors before the general contractor reaches 50% completion under its own contract with the owner. In addition, the CPPA requires a contractor to remit to a subcontractor monies received from an owner for that

subcontractor's work (including retainage), within fifteen days of receiving payment from the owner. Thus, a contractor might request a provision in the general contract that the owner will not withhold retainage from the contractor money the contractor is by law required to pay to its subcontractors. If an owner is satisfied with a contractor or is otherwise secure that the contract work will be satisfactorily completed, reducing overall retainage to five percent would simplify the project accounting.

In practice, many Illinois commercial construction projects already have reduced retainage to less than 10%, and some large public projects in Illinois hold no retainage or a straight 5% retainage. In many other states, retainage is restricted on public and private contracts to amounts less than the maximum permitted by Illinois' new law. Some contractors and subcontractors believe the new retainage law does not go far enough, while some owners believe it does not allow them the security they require to guarantee job completion. Owners, lenders, title companies, contractors, subcontractors, sureties, and other participants in the industry all will need to grapple with the new law, and reach accommodations in the process.

If you have questions or concerns about modifying your construction contracts or otherwise protecting your rights under the new law, consultation with an experienced construction attorney is advised.

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