

## Tennessee Legislature Amends Retainage Laws

### *Changes Add More Penalties for Improper Handling and Other Requirements*

Recent amendments to the retainage statutes, which take effect July 1, 2012, enhance the penalties for failing to properly withhold, deposit and release retainage on Tennessee projects. The changes also include new administrative and notice requirements for owners.

#### **New Penalties**

Under the current law, the maximum retainage that can be withheld on any project, public or private, is 5 percent of the contract amount. Generally, the owner must release and pay retainage to the prime contractor within 90 days of completion. Also, if the amount of the prime contract is \$500,000 or more, the retainage must be "deposited in a separate, interest bearing, escrow account with a third party." This escrow requirement is mandatory and may not be waived by contract.

Failure to comply with any of these requirements is currently a Class A misdemeanor, subject to consecutive fines of \$3,000 for each day of noncompliance. Further, if the party withholding the retainage fails to properly deposit it into an escrow account, that party is responsible for paying an additional \$300 per day to the contractor to whom the funds are owed.

Effective July 1, 2012, failure to comply with any of the foregoing requirements also subjects the offending party to court-ordered "restitution" payable to the contractor. In determining the appropriate amount of restitution, the court is required to use the "formula" established in the criminal statute concerning restitution as a condition of probation. This leaves the determination to the discretion of the court, taking into consideration the "financial resources and future ability of the defendant to pay."

There are no reported court opinions addressing any of the retainage penalty provisions, so it remains to be seen how these provisions and the new "restitution" requirement will be interpreted and applied by the courts. The legislature, on the other hand, by continuing to increase the penalties for noncompliance, has made it clear that the retainage laws are not to be taken lightly.

#### **New Administrative and Notice Requirements**

In addition to enhancing the penalty provisions, the amendments also add some new administrative requirements to the retainage escrow provisions. Not only must retainage be deposited into a separate, interest bearing, escrow account with a third party, as of July 1 the account "must be established upon the withholding of any retainage." As a practical matter, this means that no retainage can be withheld unless and until a proper escrow account has been

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opened. Failure to comply will subject the withholding party to the penalties discussed above.

As of July 1, the withholding party also will have an "affirmative duty" to provide written notice to the prime contractor that it has complied with the retainage escrow requirements. This notice must be provided "upon withholding" the retained funds "*from each and every application for payment.*" Each notice must include (1) identification of the financial institution with which the escrow account has been established, (2) the account number and (3) the amount of retained funds that are deposited in the account. As a result of this requirement, owners should consider updating payment application and certification forms or creating new notice forms to be submitted with each progress payment to the prime contractor.

These amendments continue a trend of imposing restrictions and requirements on construction owners and others who withhold retainage, both in Tennessee and around the country. At least one state, New Mexico, has abolished retainage altogether. It remains to be seen whether further limitations or requirements are on the horizon.

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