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CLIENT ALERT**CONTRACTOR PROMPT PAYMENT ACT****PRACTICE AREAS**

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On August 31, 2007, the Contractor Prompt Payment Act became effective, significantly impacting the duties and rights of parties throughout the chain of contracting for private construction in Illinois. It also provides many pitfalls for unwary owners or contractors who have accustomed themselves with the often laborious and slow-paced construction payout process. In some instances, the Act also creates new liability, even when a developer or contractor wishes to dispute invoiced work.

TIMING MECHANISMS

The Act (815 ILCS 603/1 *et seq.*) applies to all contracts entered into after August 31, 2007 for the design, construction, alteration, improvement, or repair of real property within Illinois. The Act has three timing mechanisms. The first mandates that when a contractor has submitted a payment application, and when that contractor has performed in accordance with its contract, the owner (or owner's agent) has twenty-five days to either approve or reject the application, in whole or in part. If the owner fails to either approve or reject the application within this time frame, then the application is deemed approved. If the owner wishes to reject the application in its entirety, it must notify the contractor in writing within the twenty-five days, and provide a reason for withholding payment. If the owner does not have a sufficient reason to reject the application in its entirety, but rather can only justify rejecting a portion of the application, then the

owner must provide the written statement for that portion it is rejecting, and pay the remaining portion.

The second timing mechanics concerns when payment must be made. The Act requires that, once the payment application (or that portion of it) has been approved, the owner must make payment to the contractor within fifteen days. If the owner fails to make payment within fifteen days, the owner becomes liable for the amount of the payment, with interest at ten-percent per annum.

Finally, the third timing mechanism provides that if payment is not made within fifteen days, then the contractor may lawfully suspend its performance until such time as payment is made, provided that the contractor first gives seven days written notice to the owner. The Act does not address at what point continuing non-payment might permit the contractor to terminate the contract. The Act also fails to specifically address whether the owner may be liable for actual or consequential damages during caused by or incurred during the suspension of performance.

NEW DUTIES REGARDING SUBCONTRACTORS

The Act also has downstream application. It imposes a duty on the contractor to pay its subcontractors the amounts due them under the payment application within fifteen days of the date the contractor receives payment from the owner, provided that the sub-

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CONTRACTOR PROMPT PAYMENT ACT

contractor has performed in accordance with its subcontract. Likewise, the subcontractor must make payment to its sub-subcontractors within fifteen days of the date it receives payment from the contractor. The Act does not expressly provide, however, that subcontractors have the right to suspend performance upon providing seven days' written notice for nonpayment, or that the general contractor is liable for interest on the late payment.

PAYMENT APPLICATION DEFINED

One particular issue that may catch an unwary owner (or contractor) by surprise is the Act's definition of "payment application." In many construction projects (particularly ones administered by an architect) the "payment application" is usually an AIA Form G702, or an equivalent, and the payment application process is formalized. The Act, however, provides an expansive definition of "payment application," and it includes invoices, bills, or any "other request" for periodic or final payment, or for the payment of change orders, or the release of retainage. An unwary owner or contractor could, therefore, be deemed to have accepted an invoice and become fully liable for it with ten-percent interest, unless it provides written notice of any dispute within twenty-five days. Given the often slow-paced nature of the construction payout process, this certainly has the potential to trap many developers and contractors who leave an unattended invoice sitting on a project manager's desk, intending to

submit it with the following month's payment application.

WAIVING REQUIREMENTS

Another issue of note is whether the contracting parties may waive the Act's requirements. The Act states that all construction contracts shall be deemed to include the Act's timing mechanisms, and it neither expressly permits nor forbids excepting its application by contract. Other statutes addressing the construction industry, however, such as the Public Construction Bond Act (30 ILCS 550/1 *et seq.*) contain provisions protecting certain persons, and the appellate courts have held that those provisions may be waived by agreement of the parties. *See, e.g., Carroll Seating Co. J.J.L. Inc. v. Verdico*, 369 Ill. App. 3d 724, 730 (1st Dist. 2006), *appeal denied*, 223 Ill. 2d 631 (2007). Although the issue certainly is not settled, prudent owners and contractors may wish to modify their standard downstream language to include a waiver of the protections afforded by the Contractor Prompt Payment Act.

APPLICATION TO DESIGN WORK

A final question that is immediately apparent is whether the Act applies to design services rendered by architects or engineers, either prior to or after the commencement of construction. Although entitled the *Contractor Prompt Payment Act*, the Act is expressly applicable to contracts for the design of real property. Moreover, the Act borrows the definition of "Contractor" from the Mechanics Lien Act, which liberally

defines a contractor as any person who contracts (whether express or implied) with the owner, or with the owner's agent, to improve real property. This, coupled with the expansive definition of "payment application," appears to mean that if an architect or design engineer submits an invoice or bill to an owner, the owner must take action on the invoice within twenty-five days, or be liable for the full amount of the bill along with ten-percent interest.

Developers and contractors need to be aware of these new rules governing the payout process and implement effective business safeguards to ensure that they do not incur avoidable liability. We also recommend that each developer and contractor modify their form contracts to include a specific downstream waiver of the Contract Prompt Payment Act.

Please contact KUBASIAK, FYLSTRA, THORPE & ROTUNNO, P.C. for further information on this Act or regarding the ever-changing landscape of Illinois construction law.

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