

CLIENT ALERT

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CONSTRUCTION

AVOIDING THE TENNESSEE RETAINAGE REQUIREMENTS

by Kelly M. Telfeyan

In *Vic Davis Construction, Inc. v. Lauren Engineers & Constructors, Inc.*, the Tennessee Court of Appeals approved a contractor's use of closeout costs to "holdback" 5% of the contract price without complying with the retainage requirements of the Prompt Pay Act.

The subcontractor alleged that the general contractor withheld a percentage of payment in a line item that was designated as "Turn-over, As-Builts, Final Cleanup, Demobilize." The subcontractor noted not only that the amount of this line item (\$108,835.00) equaled five percent (5%) of the total contract price but also that \$108,835.00 was not representative of the cost of "Turn-over, As-Builts, Final Cleanup, Demobilize" as it related to the subcontractor's scope of work on the project. The subcontractor claimed that such work would cost less than \$20,000.00. What is more, at trial, the subcontractor's project manager testified that the general contractor referred to these amounts as "holdback" in pre-contract negotiations, that the initial amount proposed was ten percent (10%) of the total contract price, and that the amount was reduced only after the subcontractor told the general contractor that, under Tennessee law, retainage could not exceed five percent (5%) of the contract amount.

The Prompt Pay Act provides that "[w]henver, in any [construction] contract . . . , a certain . . . percentage of the contract price is retained, that retained amount shall be deposited in a separate, interest-bearing, escrow account with a third party which must be established upon the withholding of any retainage." Compliance with the foregoing provision is mandatory and cannot be waived by contract. More importantly, if a contractor fails to deposit retainage as required by the Prompt Pay Act, the contractor must pay the subcontractor "an additional three hundred dollar (\$300) penalty per day for each and every day that such retained funds are not deposited . . ."

On appeal, the Tennessee Court of Appeals held that "the trial court properly concluded that the escrow provision of the Prompt Pay Act did not apply." In affirming the trial court's decision, the Court of Appeals stated that "[t]he parties expressly agreed that invoices were not subject to retention," that it was not the court's role "to make a new contract for parties who have spoken for themselves," and that the courts "do not rewrite contracts to include protections that are not there." Finally, with respect to those pre-contract negotiations regarding a holdback, the Court of Appeals stated that such negotiations did not alter the outcome of the case because the subcontract included an integration clause and, therefore, "the parol evidence rule prohibit[ed] the use of evidence of pre-

contract negotiations in order to vary, contradict, or supplement the contractual terms of [the] fully integrated agreement."

The takeaway from the Court of Appeals' decision is that Tennessee courts will not create or rewrite a contract to include a retainage provision where no such provision is present and that general contractors and owners now have an avenue to hold funds back while avoiding the burdens associated with the Prompt Pay Act's retainage provisions – at least until such time as the law is changed. [Click here to read the entire opinion.](#)

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