



Julie A. Rishel

*Bill Analysis*  
Legislative Service Commission

## **H.B. 497**

126th General Assembly  
(As Introduced)

**Reps. Hagan, Buehrer, D. Evans, J. McGregor, Aslanides, Flowers, Brown, Mason, Miller, D. Stewart, S. Smith**

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### **BILL SUMMARY**

- Requires retainage withheld on specified public improvement projects be paid at a rate of *not less than* 92%, rather than at a rate of 92%, of the estimates prepared by the contractor and approved by the architect or engineer for the first 50% of the job.
- Limits the use of holding a retainage to a percentage-based system in the private sector that is similar to the system used for retainage withheld on specified public improvement projects.
- Prohibits the withholding of retainage for materials delivered to the site or otherwise approved by an appropriate party.
- Prohibits a contractor or subcontractor from withholding retainage at a higher rate than the amount being withheld from that contractor or subcontractor.
- Requires that interest be paid on retainage withheld.
- Modifies conditions for the release of retainage withheld for specified public improvement projects and establishes similar conditions for the release of retainage withheld for private sector construction projects, including a "line item release" by trade.
- Establishes penalties for the delayed release or unauthorized withholding of retainage for private sector construction projects.
- Except for contracts for residential construction, establishes criteria regarding the unauthorized withholding of funds that render a construction contract void and unenforceable as against public policy.

- Defines "retainage" and "schedule of values" as those terms apply to specified provisions governing public and private sector construction projects.

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## **CONTENT AND OPERATION**

### **Background**

Currently the law permits or requires various public sector contracting authorities to withhold a specified percentage of a contract price from contractors. This withheld amount is commonly referred to as "retainage." "Retainage," though not a defined term under existing law, is used in the construction industry to refer to a percentage of the contract price that is withheld from a contractor by an owner or withheld from a subcontractor or materials supplier by a contractor for a period of time, usually as a form of guarantee for work performed or materials supplied pursuant to a contract for a project.

### **Public Improvements Law**

The Public Improvements Law, R.C. Chapter 153., contains various provisions governing many construction-related improvements undertaken by public authorities at the state and local level. The law includes provisions concerning public notice requirements, submission of bids and plans, estimates of costs, separate bid requirements, bid guaranties and bonds, professional design services, and a number of other issues relevant to construction projects.

Under current law, contracts for the construction, reconstruction, improvement, enlargement, alteration, repair, painting, or decoration of a public improvement made by the state, or any county, township, municipal corporation, school district, or other political subdivision, or any public board, commission, authority, instrumentality, or special purpose district of or in the state or a political subdivision, or that is authorized by state law, must be executed in accordance with specific provisions, including retainage provisions. Under current law, partial payment to a contractor for work performed under a lump sum price must be based on a schedule prepared by the contractor and approved by the architect or engineer, who must apportion the lump sum price to the major components entering into or forming a part of the work under the lump sum price. Current law specifies that partial payments to a contractor for labor performed under either a unit or lump sum price contract must be made at the rate of 92% of the estimates prepared by the contractor and approved by the architect or engineer. All labor performed after the job is 50% completed must be paid for at the rate of 100% of the estimates submitted by the contractor and approved by the architect or engineer.

The bill specifies that partial payments must be based on a schedule *of values*, instead of a *schedule* under current law, prepared by the contractor and approved by the architect or engineer, who, under the bill, must apportion the lump sum price to the major components *of labor and materials* entering into or forming a part of the work under the lump sum price. The bill also specifies that the partial payments must be made at the rate of *not less than 92%*, rather than at a rate *of 92%* as under current law, of the estimates prepared by the contractor and approved by the architect or engineer for the first 50% of the job. The bill prohibits retainage from being withheld for materials delivered to the project site or otherwise approved by the architect or engineer. (Sec. 153.12(A).)

The Public Improvements Law currently specifies that, in addition to all other payments on account of work performed, the public owner of the project must pay the contractor a sum at the rate of 92% of the invoice costs, not to exceed the bid price in a unit price contract, of material delivered, provided that the materials are inspected and meet the specifications. The balance of the invoiced value must be paid when the material is incorporated into and becomes a part of the building, construction, addition, improvement, alteration, or installation. The bill eliminates this provision because the bill does not allow retainage to be withheld for materials. (Sec. 153.14.)

Currently, payment on approved estimates filed with the owner or the owner's representative must be made within 30 days. The unauthorized withholding of retainage or a failure to make timely payment results in an interest penalty on the money not timely paid. Under continuing law, interest is the average of the prime rate established at the commercial banks in the city of over 100,000 population that is nearest the construction project. The bill also allows the contractor to receive attorney's fees from the owner, which a court must award using the same factors the court uses to award attorney's fees under the Contractor Prompt Pay Law (see **COMMENT**; sec. 4113.61(B)(2) and (3)). (Sec. 153.14.)

For the type of contracts described above and for contracts for other similar public improvements, current law specifies that, from the date the contract is 50% complete, as evidenced by payments in the amount of at least 50% of the contract to the person with whom the owner has contracted, all funds retained pursuant to the Public Improvements Law for the faithful performance of work must be deposited in the escrow account established by public owners under that law.<sup>1</sup>

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<sup>1</sup> *The other similar public improvements to which this provision applies are: erecting, constructing, adding to or altering buildings and structures, or installing or supplying material for heating, cooling, or ventilating plants or other equipment therefor, the aggregate cost of which amounts to \$50,000, which are for the use of the state or any institution supported in whole or in part by the state, or in or upon the public works of the state, and administered by the Director of Administrative Services or by any other*

This requirement does not, however, apply in the case of contracts the total cost of which is less than \$15,000.

After the contract is 50% complete, existing law specifies that no further funds can be retained. When the major portion of the project is substantially completed and occupied, or in use, or otherwise accepted, and there exists no other reason to withhold retainage, existing law further specifies that the retained percentages held in connection with such portion must be released from escrow and paid to the contractor, withholding only the amount necessary to assure completion. Funds in the escrow account not already paid, with accumulated interest, must be paid to the person with whom the owner has contracted 30 days from the date of completion or either acceptance or occupancy by the owner. (Sec. 153.13.)

The bill retains the provision specifying that retained funds must be deposited in an escrow account but eliminates the timing provision requiring deposit from the date the contract is 50% complete and 50% paid. Additionally, the bill revises the standard for release of escrowed funds. It states that when each portion of the project, as identified in the schedule of values (see "**Retainage**" and "**schedule of values**" defined" below), is completed and accepted, the retained amounts held in connection with such portion plus a proportional share of interest earned on the retained amounts must be released from escrow and paid to the contractor or subcontractor, as appropriate, withholding only that amount necessary to assure satisfactory completion of that portion of the project. Thus, funds are released according to what the industry refers to as "a line item release." (Sec. 153.13.)

#### **Private sector construction contract provisions**

The bill establishes new provisions applicable to private sector construction that are similar to those described above for public sector construction. It specifies that at the time named in the contract for payment to the person with whom it is made, the owner or the owner's representative must prepare a schedule of values (see "**Retainage**" and "**schedule of values**" defined" below) and approve a full, accurate, and detailed estimate of the various kinds of labor performed and material furnished under the contract, with the amount due for each kind of labor and material, and the materials and amount due in the aggregate. This estimate must be based upon actual measurement of the labor and materials, and must give

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*state officer or state agency authorized by law to administer a project, including state universities and community colleges, the Medical University of Ohio at Toledo, and the Northeastern Ohio Universities College of Medicine (Sec. 153.01, not in the bill).*



the amounts of the preceding estimate, and the amount of labor performed and materials furnished since the preceding estimate. (Sec. 4113.63(A).)

Similar to the provisions governing retainage withheld on public improvement projects, if an owner or the owner's representative, a contractor, or a subcontractor chooses to withhold retainage, partial payments to a contractor or subcontractor for labor performed must be made at the rate of not less than 92% of the estimates prepared by the contractor or subcontractor and approved by the owner or the owner's representative. Under the bill, the owner or the owner's representative must deposit the amount retained into an interest-bearing escrow account. All labor performed after the job is 50% completed must be paid for at the rate of 100% of the estimates submitted by the contractor and approved by the owner or the owner's representative. The bill prohibits retainage from being withheld for materials delivered to the project site or otherwise approved by the owner or the owner's representative. (Sec. 4113.63(B).)

When each portion of the project, as identified in the schedule of values, is completed and accepted, the retained amounts held in trust in connection with that portion of the project plus a proportional share of interest earned on the retained amounts, must be paid to the contractor or subcontractor, as appropriate, withholding only the amount necessary to assure satisfactory completion of that portion of the project. Thus, similar to projects under the Public Improvements Law, funds are released according to a line item release (sec. 4113.63(C)).

Payment on approved estimates filed with the owner must be made not later than whichever of the following events occurs first: (1) 30 days after the owner's or owner's representative's approval, (2) 30 days after the issuance of a certificate of occupancy, or (3) the last day an affidavit for a mechanics' lien can be served. Upon the failure of the owner or the owner's representative to make the payment timely, or upon an unauthorized withholding of retainage, there must be allowed to the contractor, in addition to any other remedies allowed by law, attorney fees and interest on the money not timely paid in the amount of 18% per annum. Interest on the unauthorized withholding of retainage must be in addition to any interest earned in the escrow account. Under the bill, a court must award attorney's fees using the same factors described in the Contractor Prompt Pay Law (see **COMMENT**; sec. 4113.61(B)(2) and (3)). (Sec. 4113.63(C).)

### **Prompt Pay Law revisions**

The Contractor Prompt Pay Law, R.C. section 4113.61, establishes minimum requirements for payment deadlines and interest penalties for contractors, subcontractors, material suppliers, lower tier subcontractors, and lower tier material suppliers. If a subcontractor or material supplier submits an application or request for payment or an invoice for materials to a contractor in

sufficient time to allow the contractor to include the application, request, or invoice in the contractor's own pay request submitted to an owner, then the contractor, within ten days after receipt of payment from the owner, must in turn make appropriate payment to the subcontractor and material supplier. This provision applies the same way for lower tier subcontractors and lower tier material suppliers relative to payment they receive from subcontractors, material suppliers and other lower tier subcontractors and lower tier material suppliers.

The bill eliminates the condition requiring timely submission of an application or request for payment or invoice in order for the Prompt Pay provisions to apply. Thus, payment must be made within ten calendar days regardless of whether an application, request, or invoice is submitted. (Sec. 4113.61(A)(1) and (2).)

Currently, the Contractor Prompt Payment Law permits contractors to reduce the amount paid by any retainage provision contained in the contract, invoice, or purchase order between the contractor and the subcontractor or material supplier, and to withhold amounts that may be necessary to resolve disputed liens or claims involving the work or labor performed or material furnished by the subcontractor or material supplier. This same provision applies to subcontractors, material suppliers and lower tier subcontractors, and lower tier material suppliers relative to retainage withheld from the lower tier subcontractors and lower tier material suppliers with whom they contract. (Sec. 4113.61(A)(1) and (2).)

Additionally, the Contractor Prompt Pay Law currently specifies that if a contractor receives any final retainage from an owner for improvements to property, the contractor must pay from that retainage the proportion of the retainage owed to each subcontractor and material supplier, within ten calendar days after receipt of the retainage from the owner, or within the time period provided in a contract, invoice, or purchase order between the contractor and the subcontractor or material supplier, whichever time period is shorter, provided that the contractor has determined that the subcontractor's or material supplier's work, labor, and materials have been satisfactorily performed or furnished and that the owner has approved the subcontractor's or material supplier's work, labor, and materials. This provision also applies to subcontractors, material suppliers, lower tier subcontractors, and lower tier material suppliers when they receive final retainage. (Sec. 4113.61(A)(3) and (4).) Continuing law provides remedies for a subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier against a contractor or another subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier if the contractor, subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier fails to make a payment or pay retainage as required under the law (sec. 4113.61(A)).

Since, under the bill, retainage cannot be withheld for materials delivered to the project site or otherwise approved, the bill correspondingly eliminates the provision that allowed a contractor, subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier to reduce the amount paid by any retainage provision contained in a purchase order entered into between that contractor, subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier and another subcontractor, material supplier, lower tier subcontractor, lower tier subcontractor or lower tier material supplier. Additionally, the bill removes the remedies available to a material supplier or a lower tier material supplier if a contractor, subcontractor, material supplier, lower tier subcontractor, or lower tier material supplier fails to pay any retainage due. (Sec. 4113.61(A).)

The bill clarifies that a contractor, subcontractor, or lower tier subcontractor may withhold any amount necessary to resolve disputed *mechanic's* liens or claims against public funds pursuant to the Ohio Mechanics' Liens Law (R.C. Chapter 1311.) involving work or labor performed by a subcontractor or lower tier subcontractor, as applicable. The bill eliminates the requirement that a contractor must make payments within ten calendar days after receipt of any *final* retainage, and instead requires a contractor to make payments within ten calendar days after receipt of *any* retainage. This change also applies to subcontractors and lower tier subcontractors. (Sec. 4113.61(A).)

The bill adds a provision to prohibit any contractor, subcontractor, or lower tier subcontractor from withholding retainage from a subcontractor or lower tier subcontractor at a higher percentage amount than the percentage amount being withheld from that contractor, subcontractor, or lower tier subcontractor. (Sec. 4113.61(F).)

### **Retainage contract provisions**

The bill specifies that any provision of a construction contract, subcontract, agreement, or understanding is void and unenforceable, being against public policy if it (1) permits the holding of retainage from payments to contractors, subcontractors, or lower tier subcontractors in an amount exceeding the amounts allowed under the Public Improvements Law and the Contractor Prompt Payment Law, (2) permits the withholding of any other amount except for work identified as not completed or for liquidated damages, or (3) waives statutory remedies including payment of interest and fees. This provision, however, does not apply in the case of construction contracts, subcontracts, agreements, or understandings for work involving a single-, two-, or three-family dwelling house. (Sec. 4113.62(F).)

## Street improvements authorized by county commissioners

### Current law

With respect to certain improvements to roads, streets, and alleys authorized by boards of county commissioners, current law prohibits payment for those improvements that are made before the completion of the contract to exceed 90% of the value of the work performed to the date of that payment. Ten per cent of the value of the work performed must be held until the final completion of the contract in accordance with the plans and specifications, except under conditions described below (see "Exceptions"). In addition to payments for work performed, current law permits the county engineer to allow the contractor an estimate for materials, not to exceed 90% of the value of materials delivered on or near the site of the work but not yet incorporated therein, provided the materials have been inspected and found to meet the specifications. (Sec. 5559.14.)

Exceptions. When the retained percentage plus the difference between the contract price and estimates allowed exceeds by more than 15% the estimated cost of completing the work, as determined by the county engineer, the engineer may allow the contractor an estimate equal to all or any part of that excess sum, retaining not less than the estimated cost of completing the work, as determined by the engineer, plus 15%. (Sec. 5559.14.)

### The bill

The bill eliminates the exception described above and caps the amount of retainage allowable at the same percentage allowed under the Public Improvements Law and in private sector contracts (8%). Thus, under the bill, payment on account of the contract for any improvement must, before the completion of such contract, be not less than 92%, rather than not exceeding 90%, as under current law, of the value of the labor performed to the date of such payment. A maximum of 8% of the value of the labor performed must be held as retainage until 50% of the contract is completed in accordance with the plans and specifications, with no additional retainage withheld thereafter. In addition to the above payments on account of labor performed, the engineer also must allow the contractor an estimate that is not less than 100% of the value of material delivered, instead of not more than 90% as under current law, on the site of the work but not yet incorporated therein, provided that the materials have been inspected and found to meet specifications. (Sec. 5559.14.)

**Bill does not apply to existing contracts**

The bill applies only with respect to payment for labor or work performed or materials supplied pursuant to a contract, subcontract, agreement, or understanding that is entered into on and after the bill's effective date. (Section 3.)

**"Retainage" and "schedule of values" defined**

For purposes of the Public Improvements Law and the bill's new provisions applicable to private sector construction contracts, the bill defines "retainage" as "any undisputed amount withheld from any payment to a contractor or subcontractor pursuant to the terms of a contract until the occurrence of a specified event that is stated in the contract, and includes any holdback or set-off for satisfactorily completed work or valuation of an item of work in excess of the actual value of the uncompleted item." (Secs. 153.12(C)(1) and 4113.61(G)(8).)

It also defines "schedule of values" as an accurate and complete listing of each distinct segment of work pursuant to a contract or any agreement entered into subsequent to that contract, detailing at a minimum, all distinct materials, labor, or other work by each trade, subcontractor, or material supplier, listed in general sequence of completion, and itemizing the reasonable and accurate dollar value or unit price of each segment of work, the total value of which must equal the contract price. In a schedule of values, each distinct segment of work must not reflect any of the following:

- (1) More than 10% of the total contract price unless the segment is to be constructed in 30 days or less or unless otherwise agreed to by the affected subcontractor;
- (2) More than a single construction trade;
- (3) Excessive holdbacks on overvalued items. (Secs. 153.12(C)(2) and 4113.63(D).)

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**COMMENT**

Under the Prompt Pay Act, in making a determination to award attorney fees, a court must consider all relevant factors, including but not limited to, the following: (1) the presence or absence of good faith allegations or defenses asserted by the parties, (2) the proportion of the amount of recovery as it relates to the amount demanded, and (3) the nature of the services rendered and the time expended in rendering the services. A court must not award attorney fees, however, if the court determines, following a hearing on the payment of attorney

fees, that the payment of attorney fees to the prevailing party would be inequitable. (Sec. 4113.61(B)(2) and (3).)

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## **HISTORY**

ACTION	DATE
Introduced	02-01-06

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