Massachusetts Prompt Payment Act: Why Every Owner and Contractor Should Pay Attention to the SJC's Decision in Business Interiors v. Graycor

By Bradley L. Croft on June 20, 2024



On Monday, the Massachusetts Supreme Judicial Court released its decision in *Business Interiors Floor Covering Business Trust v. Graycor Construction Co., Inc*., SJC No. 13507, 2024 WL 3016128. Commercial real estate and construction lawyers as well as the construction industry eagerly awaited the decision with hopes that the SJC would clarify a few questions about the practical interpretation of the Massachusetts Prompt Payment Act, MGL Chapter 149, §29E, which were left unanswered by the only other appellate decision interpreting the statute, *Tocci Building Corp. v. IRIV Partners, et al*., 101 Mass.App.Ct. 133 (2022).

Graycor indeed answers many of these open questions. The SJC's 30-page decision spells out how contractors can avoid waiving potential defenses to payment of disputed invoices, even where they may have failed to properly reject the invoices in compliance with the Prompt Payment Act. In doing so, the SJC likely also provided a roadmap for project owners to follow in order to preserve their rights to bring claims against a general contractor even if they failed to act within the timeframes and format requirements of the law.

The Prompt Payment Act, which applies to construction contracts primarily on private commercial projects having a contract value of $3 million or more, mandates requirements that must be met in order for a periodic payment application or change order request to be validly rejected. It applies to owners as well as contractors. A rejection must be "made in writing" and "include an explanation of the factual and contractual basis for the rejection," and contain a certification that the rejection was made in good faith. If any of those timing, substantive, and certification requirements are not met, then the payment application is "deemed approved."

Prior to *Tocci*, no appellate court had determined the consequences of violating the Prompt Payment Act. *Tocci* established that, unless all of the requirements for rejection of a payment application are met, the non-paying party will be considered in material breach of contract and must make the deemed-approved payment. In *Graycor*, the SJC shed light on a question left unanswered by the Appeals Court in *Tocci*: does a party's failure to pay a "deemed approved" invoice bar that party from asserting affirmative claims for breach of contract (not simply common law defenses) against the party seeking payment?

In *Graycor*, a subcontractor obtained summary judgment on its breach of contract claim on the basis that the general contractor had violated the Prompt Payment Act by failing to reject its payment applications within the time and in the format required. On appeal, the general contractor argued, among other things, that the common law defense of impossibility should bar the subcontractor's claim because the owner's inability to make payment to the general contractor due to the COVID-19 pandemic meant that the funds for the subcontractor's work were unavailable to the general contractor. Even though it was

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technically in violation of the Prompt Payment Act and the amounts sought by the subcontractor were "deemed approved," the general contractor argued that it should still not have to pay.

In a highly unusual split decision, the SJC held that where a general contractor fails to make payment of a deemed-approved invoice as a result of violating the Prompt Payment Act, it waives its common law defenses to avoid payment unless it first makes the disputed payment "prior to, or contemporaneous with, the raising of the defenses" "in a subsequent proceeding related to the invoices." In other words, unless a general contractor makes the disputed payment before or with its invocation of its defenses to making such payment, those defenses are forever waived. The SJC reasoned that if the general contractor could withhold payment of the "deemed approved" invoices and still assert defenses to payment, then a violation of the Prompt Payment Act would have no real consequences:

> The Legislature's determination — that the failure to accept or reject a periodic payment application within the defined time requirements is deemed an approval of the payment — must have meaningful consequences. Allowing common-law defenses to be raised and pursued without paying the now "deemed to be approved" invoices would render this approval to be of no import.

Although *Graycor* involved claims between a general contractor and a subcontractor and focused on the waiver of common law defenses and not affirmative claims for breach of contract, it's reasonable to expect courts may apply similar reasoning to claims between an owner and a general contractor. Unless the owner makes payment of the deemed approved amount prior to or contemporaneously with its raising such claims in a proceeding (arbitration or litigation), then the owner will likely have forever waived the right to bring such claims and, as in *Graycor*, any common law defenses to payment.

Applying the SJC's analysis, there would be no "meaningful consequences" for an owner's violation of the Prompt Payment Act if it can fail to follow the rejection requirements, withhold the subject payments, and still pursue its own contractual claims against the contractor. Why would an owner (or a contractor) ever heed the Prompt Payment Act's requirements if it could ignore them without any downside?

Requiring the timely payment of the disputed amounts, as outlined by the SJC, gives the statute teeth and furthers its purpose to keep funds flowing downstream on construction projects while still preserving the paying party's rights to recoup the disputed payments. The SJC's interpretation of the statute is not without potential collateral damage, of course. As in *Graycor*, where the contractor received no benefit from the subcontractor's work (because the owner did not pay for it), is it reasonable for the contractor to still have to pay out of its own pocket for that work simply because it failed to process the subcontractors' invoices in a timely manner?

That and similar questions may need to be addressed by the Legislature. For now, the SJC has clarified the rules governing compliance with the Prompt Payment Act and, importantly, the potential consequences for violations.

So how can an owner (or a general contractor facing a disputed subcontractor invoice) avoid waiving its claims and/or defenses?

- **Pay Attention** Put systems in place to timely review and respond to payment applications and change order requests within the time limits and according to the format required by the Prompt Payment Act. Create and distribute a "cheat sheet" with the requirements so that all of your project participants are aware of what needs to be done and when. Create and use templates for rejections which include a "factual and

contractual basis" section and the words "Certified as Made in Good Faith." Remember – the basis for the rejection does not ultimately have to be correct, it just needs to be asserted in good faith in order to comply with the Prompt Payment Act.

- **Pay & Preserve** Although counterintuitive and potentially painful, owners and contractors who have clearly violated the Prompt Payment Act's requirements but want to preserve the right to recoup disputed payments must process the payment before or at the time they assert such recoupment claims.
- **Communicate** Hopefully most contractors and subcontractors are not looking to get something for nothing or to cash in on a technicality. If the clock has expired and invoices have become "deemed approved," reach out to the other party and discuss the underlying issues, pay any undisputed amounts immediately, and attempt to negotiate a prompt resolution of the disputed issues or agree to participate in an expedited and binding arbitration or other adjudication. The value of preserving the relationship and trying to resolve a dispute may have a greater long-term upside than receiving a disputed payment and then defending claims in a multi-year legal proceeding and potentially having to pay the money back.

Bradley L. Croft is President and Chair of the **Litigation Department** at RIW. In his construction practice, he represents owners, general contractors, and subcontractors in all aspects of construction disputes and transactions. Mr. Croft was lead counsel in the landmark 2022 case *Tocci Building Corp. v. IRIV Partners*, in which his client won a $7 million judgment under the Massachusetts Prompt Payment Act, the first time that statute was successfully litigated. He can be reached at **bcroft@riw.com**.

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