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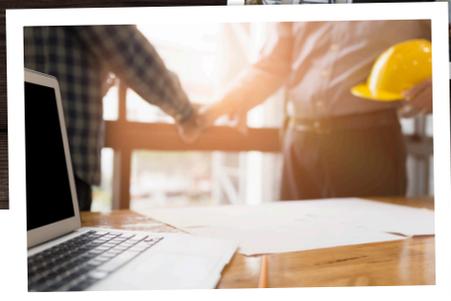
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NEW WASHINGTON STATE RETAINAGE LAW: WHAT DOES IT MEAN TO YOU?

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The interests of general contractors (GCs) and subcontractors (Subs) often align. Details such as a project design free of defects, a well-coordinated jobsite, and prompt payment from owners are all examples. However, sometimes their interests do not align. Project schedules, liquidated damages, and contractual clauses including retainage are all areas where interests can diverge and conflict can arise. House Bill 1538¹ passed by the Washington State 65th Legislature in April 2017 has the potential to change the dynamic between GCs and Subs, no doubt in ways both intended and unintended.

Previously, RCW 60.28.011 (6) allowed GCs on public projects to submit a bond for all or any portion of the contract retainage (generally 5%). The bond becomes subject to all claims and liens in the same manner and priority as set forth for retained percentages. When the bond takes the place of retainage, the released retainage funds not only belong to the GC, but ultimately will be owed to the Subs as well. If the GC posted a release of retainage bond on a public project, a Sub could in turn post a similar bond to the GC for their portion of contract retainage. In practice, however, it remains the exception and not the rule for GCs or

Subs to procure the release of retainage bonds. GCs have used this strategy more than Subs, but that is likely driven by the relative difficulty in navigating the surety's underwriting requirements for this kind of bond.

New language added to RCW 60.28.011 (6) allows a subcontractor to compel the GC to submit a bond to the public owner for that Sub's portion of the contractor's retainage. This is accomplished by the Sub providing a bond to the GC and agreeing to pay the premium of the bond posted by the GC relating to the Sub's portion. Only time will tell if the new feature of this law generates more use of bonds in practice, or is simply a distinction without a real difference.

For Subs, this new law should be viewed positively. Many Subs complete their work on a project well in advance of final completion, and oftentimes will wait months, sometimes years, before collecting their portion of retainage. Now, they have a more feasible alternative to that reality and, for those Subs that can procure these bonds, it may result in better cash flow. I think we can all agree that anything contributing to the financial health of the Sub community should be viewed as a good thing for everyone.

1. <http://lawfilesexternal.wa.gov/biennium/2017-18/Pdf/Bills/House%20Passed%20Legislature/1538-S.PL.pdf>

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For GCs the new law may generate some challenges and ambiguities. One challenge is the logistics of potentially dealing with multiple requests from multiple Subs for the release of retainage on any given public project. Moreover, timing of the requests could be at any point during the subcontract “prior to final formal acceptance of the project,” per the new law. As written, the Sub will fund the premium for the bond the Sub posts to the GC, and for that portion of the bond the GC posts to the owner to release retainage. In the language of the law, the GC “may withhold the subcontractor’s portion of the bond premium.” Time will tell if GCs prefer to respond individually to Subs and collect payment for each separate bond, or if a blanket approach is administratively more feasible. Pursuing claims against bonds may create more legal expense for GCs compared to the alternative of simply withholding retainage to cover disputed amounts. Owners, GCs, and ultimately sureties have all come to rely on the leverage that retainage provides. The loss of this leverage will change expectations and calculations up and down the contractual chain.

Significantly, the new law will require the cooperation of the surety industry. Retainage bonds, as mentioned before, have not been broadly used in the past. In the scenarios allowed by the new law, both the GC and the Sub will need to satisfy the higher underwriting requirements of release of retainage bonds. The purpose of these bonds is to enhance cash flow, and the primary underwriting consideration for these bonds is exactly the same thing – cash flow. Only the sufficiently liquid and well capitalized contractors will secure these bonds. Pricing will vary depending on creditworthiness, but assume a minimum of 1% and go from there.

We have only begun to consider the practical consequences of this new law. Specific scenarios will arise and need to be addressed with the assistance of a professional surety broker. Whether you’re a GC or Sub, **Parker, Smith & Feek** is ready and able to analyze your situation and help you find the best solution.