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Prompt Pay Act violation voids claim for recoupment

Judge rules that arbitrator exceeded his powers

■ KRIS OLSON

After a party is required to make a payment for failing to comply with the Prompt Pay Act, an arbitrator is not allowed to let the party seek recoupment of a portion of that payment, a Superior Court judge has decided.

Judge Keren E. Goldenberg's decision in *J.C. Cannistraro, LLC v. Columbia Construction Co.* addresses questions left open in the Supreme Judicial Court's ruling earlier this year in *Business Interiors Floor Covering Business Trust v. Graycor Construction Company Inc., et al.*

In *Cannistraro*, the arbitrator ordered a general contractor to pay nearly $1 million worth of applications for payment but allowed the company to file a counterclaim challenging the subcontractor's change order requests.

After the arbitrator found the contractor should get several hundred thousand dollars back, the subcontractor filed a motion to vacate the award, arguing that the arbitrator had made an error of law. Goldenberg agreed.

In keeping with the statute's purpose of ensuring that a subcontractor is not deprived of critical revenue while it litigates a construction dispute, the SJC in *Graycor* held that a party must first make the payment triggered by a Prompt Pay Act violation before pursuing any defenses in a subsequent proceeding, Goldenberg noted.

Under the *Graycor* rule, the contractor in *Cannistraro* was prohibited from seeking recoupment of its payment to the subcontractor, Goldenberg concluded. Instead of paying the amount due "prior to, or contemporaneous with, the invocation of any common-law defenses," the contractor had raised the defenses underlying its claims for recoupment two years before paying the subcontractor.

"Having failed to pay the plaintiff before, or contemporaneous with, raising its defenses, the defendant's defenses cannot be raised under the act," Goldenberg wrote, vacating the arbitrator's award.

The eight-page decision is Lawyers Weekly No. 12-044-24.

FURTHER GUIDANCE PROVIDED

At a hearing in October on the parties' motions to vacate the arbitrator's award, Goldenberg was focused on the "order of operations," said the plaintiff subcontractor's attorney, J. Nathan Cole of Boston.

J. Nathan Cole

First, Columbia Construction Co. violated the Prompt Pay Act, then it answered and raised affirmative defenses, then it was allowed to amend and assert an affirmative claim for recoupment.

Cole said Goldenberg's decision gives further guidance following the Appeals Court's 2022 decision in *Tocci Building Corporation v. IRIV Partners, LLC, et al.* and *Graycor*.

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>
> **— J. NATHAN COLE**

and construction lawyers have been wondering: Where a party violates the [Prompt Pay] Act, can it try to recover the funds it was required to pay under the act?" Cole said. "The answer is clear now: not unless it first complies with the Prompt Pay Act."

Cole argued that it is relatively easy to properly reject a payment application consistent with the PPA. The act also sets forth claw-back periods during which contractors can still fix the violations, he added.

"What an owner or contractor cannot do is violate the act, fail to pay, and then force a lower-tier party to fight," Cole said.

The defendant's attorney, Seth M. Pasakarnis of Boston, said his client plans to file a motion for reconsideration with the judge and will consider seeking further appellate review if that fails.

His client's position is twofold, Pasakarnis said. First, it respectfully disagrees with the judge's perception that the arbitrator committed an error of law. But it also believes that even if the arbitrator did get the law or facts wrong, the arbitrator's award should be upheld.

All that was missing from his client's letter rejecting the subcontractor's request for payment was a good-faith certification, Pasakarnis noted.

"Otherwise, it was timely, it had a contractual and factual basis for the rejection — in fact, they articulated all their defenses in that letter," he said. "They just didn't certify that it was made in good faith."

The Prompt Pay Act is silent on when payment must be made of a "deemed approved" payment application, Pasakarnis added.

How the arbitrator proceeded is consistent with *Graycor*, he contended.

Under *Graycor*, the PPA is "a payment-shifting mechanism whereby the contractor can't hold the money while the parties fight about whether the amount is due or not," Pasakarnis said.

"That's what we did," he said. "We weren't allowed to pursue those defenses until we paid. We did pay, and then we were able to pursue those defenses."

Andover construction law attorney Stanley A. Martin agreed with Pasakarnis on both points, though he allowed that *Graycor* left unresolved the question of whether a party can resurrect its right to its defenses, even if it pays belatedly.

"If you can raise your defenses and part of your defense is you've overpaid, and you can prove that to a factfinder, it seems to me that's consistent with the *Graycor* decision," he said.

Cannistraro is another reminder of the "pay to play" nature of the Prompt Payment Act, according to Boston attorney Bradley L. Croft.

"If an owner or a contractor has violated the statute but still wants to assert setoff claims or defenses to payment, it must pay the 'deemed approved' amounts at or before the time when it first seeks to assert such claims or defenses," he said.

Boston construction attorney William M. Hill agreed.

The Prompt Pay Act is a "blunt instrument" that tells parties: "If you want to assert a defense, you need to put your money where your mouth is. You rest on your rights, and you lose — that's what [*Cannistraro*] is really telling us," Hill said.

The case also offers a reminder that the good-faith certification is an essential element of a valid rejection, Croft added.

"Even if you submit a timely rejection meeting all of the other substantive criteria, leaving out those magic words alone can constitute a costly statutory violation," he said.

Boston construction law attorney Joseph A. Barra said he believed Goldenberg "technically" made the right decision interpreting the Prompt Pay Act.

"Nevertheless, the decision unfairly requires arbitrators to be clairvoyant about how the statute will be interpreted in the future," he said, noting that the arbitrator had issued his ruling before *Graycor* was decided.

For the contractor, *Cannistraro* is a "brutal decision … because it's the application of *Graycor*, to some extent, retrospectively," said Hill's colleague, Samuel M. Tony Starr, agreed.

The cases arising under the Prompt Pay Act are demonstrating the "real-life implications" of enforcing the PPA's procedures, leading to several "gotcha" scenarios, said Westborough construction attorney David L. Fine.

Savvy subcontractors in their dealings with general contractors and savvy general contractors in their dealings with owners have, to some degree, learned to "play the game," according to Fine.

"Where this is going at some point is that the courts eventually are going to create a requirement for real prejudice before enforcing the act or at least carving out exceptions to enforceability based on a reasonable review of the project records and communications," Fine said.

The decision illustrates the need for some "leveling out" of Prompt Pay Act relief, Fine said.

"The realities of how construction projects operate will make it difficult, if not impossible, for reasonable parties to strictly comply with these procedures, and not every failure to comply should warrant a forfeiture of these rights," he said.

FIGHT OVER PLUMBING, HVAC WORK

In 2017, Columbia Construction Co. entered a contract to construct and renovate an office and manufacturing facility in Walpole, a project subject to the provisions of the Prompt Pay Act, G.L.c. 149, §29E.

The next year Columbia and J.C. Cannistraro, LLC, entered two separate subcontracts for Cannistraro to perform heating, ventilation and air conditioning, and plumbing work on the project.

On Jan. 8, 2020, Cannistraro requested under the plumbing subcontract a change order totaling $391,500 from Columbia. On Jan. 23, it requested a $571,601 change order under the HVAC subcontract. Columbia purported to reject Cannistraro's change order requests by letter dated Feb. 5, 2020.

On April 9, Cannistraro applied for payment for HVAC work performed through April 30, which included a line item representing the HVAC change order work. On the same date, Cannistraro applied for payment for plumbing work performed through April 30, which similarly included a line item for the plumbing change order work.

Columbia then notified Cannistraro by email on April 24 that it was rejecting the change orders referenced in the April 9 payment applications, but it did not certify that its rejections were in good faith until nearly five months later.

Cannistraro filed suit in Norfolk Superior Court on Aug. 3, 2020, asserting breach of contract and other related claims. In its answer, filed on Sept. 2, 2020, Columbia raised various defenses, including that Cannistraro had inflated its claims.

The case was stayed while the parties made their first trip to arbitration. In his Aug. 9, 2022, order, the arbitrator found that Columbia had failed to provide a timely, written rejection that was certified as made in good faith. As a result, under the Prompt Pay Act, the unpaid applications for payment totaling $951,855 were deemed approved on May 1, 2020. On Sept. 9, 2022, Columbia paid that amount plus interest.

The arbitrator then allowed Columbia to file a counterclaim challenging the merits of Cannistraro's change order requests. That second round of arbitration confirmed that Columbia had violated the Prompt Pay Act, but the arbitrator found that Cannistraro had only incurred $375,000 worth of damages. As a result, the arbitrator allowed Columbia to recoup from Cannistraro $576,855, plus interest.

Cannistraro moved to vacate the arbitration award, while Columbia moved to confirm it.

'NARROW' REVIEW

Goldenberg described her review of an arbitration award as "narrow."

Unless the grounds for vacating, modifying or correcting the award can be found in §§12 and 13 of the state's Uniform Arbitration Act for Commercial Disputes, G.L.c. 251, she was otherwise "strictly bound by an arbitrator's findings and legal conclusions, even if they appear erroneous, inconsistent or unsupported by the record at the arbitration hearing," she wrote, citing the SJC's 2016 decision in *Katz, Nannis & Solomon, P.C. v. Levine*.

Goldenberg based her decision to vacate the arbitrator's order on §12(a)(3), which applies when the arbitrator has exceeded his powers.

Arbitrators exceed their powers "by awarding relief prohibited by law," Goldenberg wrote, quoting from the SJC's decision in *Plymouth-Carver Regional Sch. Dist. v. J. Farmer & Co*.

Arbitrators also may not award relief "which directs or requires a result contrary to express statutory provision," she added, citing the SJC's decision in *City of Lawrence v. Falzarano*.

Here, Goldenberg concluded that the arbitrator's award included relief "prohibited by" and "contrary to" the Prompt Pay Act.

J.C. Cannistraro, LLC v. Columbia Construction Co.

THE ISSUE: Can an arbitrator allow a party to seek recoupment of funds after that party was required to make a payment for failing to comply with the Prompt Pay Act?

DECISION: No (Superior Court)

LAWYERS: J. Nathan Cole of Kenney & Sams, Boston (plaintiff)

Seth M. Pasakarnis and Lindsey Peterson Black, of Hinckley, Allen & Snyder, Boston (defense)