

PUBLICATION

Important Changes in Tennessee Law for Owners and Contractors: Tennessee Retainage Accounts

February 6, 2009

In 2007, the Tennessee legislature mandated that the maximum percentage of a contract payment which an owner could withhold as retainage was five percent. T.C.A. §66-34-103(a). The 2007 legislature also established when the retained funds had to be paid to the contractor and then the subcontractor and suppliers. T.C.A. §66-34-103(b)

In 2008, the Tennessee legislature again amended the statute. The 2008 legislature enacted a new section containing a mandatory provision that retained funds on larger projects have to be deposited in a separate interest bearing escrow account with a third party. T.C.A. §66-34-104(a). The new section applies to all projects on which the amount of the prime contract is in excess of \$500,000. T.C.A. §66-34-104(g). The statutory escrow requirements also cannot be waived. T.C.A. §66-34-104(h)

In an effort to ensure compliance with these new retainage provisions, the 2008 legislature added a criminal penalty for non-compliance with the statute. (Previously, there was no such penalty in the statute.) Under T.C.A. §66-34-104(e), it is a criminal offense (Class A misdemeanor) to fail to comply with these provisions. Each day is considered a separate violation, subject to a fine of \$3,000. That penalty can become very significant, very quickly, as each day is treated as a separate offense.

To avoid the daily penalty of \$3,000, an owner must: (1) comply with the maximum retainage limit of five percent of the contract amount; (2) deposit the retained funds in a separate interest bearing escrow account with a third party; and (3) pay the retainage to the prime contractor within 90 days of substantial completion of the work.

To avoid the daily penalty of \$3,000, a prime contractor who withholds retainage from its subcontractors must: (1) comply with the maximum retainage limit of five percent of the contract amount; (2) deposit the retained funds in a separate interest bearing escrow account with a third party; and (3) pay the retainage to its subcontractors and suppliers within ten days of the owner's payment of retainage. Subcontractors also have to pay their subsubcontractors and suppliers within ten days of the receipt of the retainage.