

**STORAGE NAME:** h0715.brc

**DATE:** February 21, 2000

**HOUSE OF REPRESENTATIVES  
COMMITTEE ON  
BUSINESS REGULATION AND CONSUMER AFFAIRS  
ANALYSIS**

**BILL #:** HB 715

**RELATING TO:** Prompt payment and retainage reform

**SPONSOR(S):** Representative Jeff Miller

**TIED BILL(S):**

**ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:**

- (1) BUSINESS REGULATION AND CONSUMER AFFAIRS
  - (2) COMMUNITY AFFAIRS
  - (3) GENERAL GOVERNMENT APPROPRIATIONS
  - (4)
  - (5)
- 

**I. SUMMARY:**

The bill provides that contractors who have completed their work will be paid in a more timely fashion.

The bill deals with two separate, but related, issues: (1) Modifying existing prompt payment laws for both public and private construction, generally shortening timetables for payment and eliminating some provisions which had provided local government relief (in some instances) from being subject to a strict timetable; and (2) Limiting the amount of retainage (money held back from progress payments) allowed, and establishing timetables for payment of same.

Representatives of local governments have expressed a concern that shortening the timetable for payments may in some instances turn out to be "unreasonable." See "Comments" section for comments by state agencies.

At the time of publication, no data has been received indicating a quantifiable fiscal effect on local or state governments.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- |                                   |                              |                             |   |
|-----------------------------------|------------------------------|-----------------------------|---|
| 1. <u>Less Government</u>         | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u>             | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u>      | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u>      | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

THE CONSTRUCTION INDUSTRY:

According to a 1992 study, Alternatives to 10% Retainage, conducted by Florida International University's Department of Construction Management and funded by the Building Construction Industry Advisory Committee (BCIAC), the construction industry is one of the largest industries in the United States in terms of gross national product. As stated in the report, public construction nationally represents about 26% (1992 projected figures are \$100 billion out of a total of \$381 billion, in terms of 1987 dollars) of the total volume of construction as opposed to 33% (1992 projected figures are \$118 billion out of a total of \$381 billion, in terms of 1987 dollars) for private nonresidential construction.

A 1995 staff analysis on HB 445 states that cities and counties in Florida had \$3.6 billion in public construction purchases in 1992 (no figures were given for private).

Figures provided by the Florida Legislature's Office of Economic and Demographic Research indicate that in Fiscal Year 1998-99, Florida had:

\$ 5.7 billion in public construction;	(18%)
\$ 9.2 billion private non-residential; and	(29%)
<u>\$16.6</u> billion private residential	(52%)
\$31.5 total construction in Florida (FY 1998-99)	

PROMPT PAYMENT:

Part VII of chapter 218, F.S., known as the "Florida Prompt Payment Act," was enacted in 1989 to provide for prompt payments by local governmental entities to private vendors. The act was substantially modified in 1995, and provisions specifically relating to construction services were placed in s. 218.735.

The act provides that the time at which payment is due from a local governmental entity for construction services shall be determined as follows:

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- 1) If the project architect or engineer must approve the invoice prior to the invoice being submitted to the local government, payment is due 20 business days after the invoice has been approved by the project architect or engineer and the invoice has been stamped as received.
- 2) If the project architect or engineer does not need to approve the invoice prior to the invoice being submitted to the local government, payment is due 20 business days after the invoice is stamped as received.

The local government may reject the invoice within 20 days after the date the invoice is stamped as received, but the rejection must be written and must specify the deficiency in the invoice. When the contractor submits a corrected invoice, it must be paid or rejected no later than:

- 1) Ten business days after the date the corrected invoice is stamped as received; or
- 2) The first business day after the next meeting of the governing body, if the governing body must approve the invoice.

Bill proponents indicate that although improvements were made in the statute in 1995, with specific time periods for processing payment for construction materials and services being incorporated, there are still some problems processing these types of payment requests. The statute provides specific time periods within which a local governmental entity must process an invoice. However, in most instances, a local governmental entity requires an architect or engineer to approve the invoice before processing. Under the current statute there are no time periods for this to occur, often causing substantial delays in the payment process, according to bill proponents.

A similar problem is that the current statutes provide for "working days" to be used in the calculation of time periods. Because legal holidays vary from one governmental entity to another, these time periods can be difficult to calculate.

Another problem is that construction contractors do not actually use an invoice similar to other types of services. In the construction business, the submission of written "payment requests" are typically utilized which request payment for work performed and materials furnished through a date certain.

An additional problem is that a provision also exists which causes interest on late payments to cease after one year. Bill proponents indicate that they have been unable to ascertain why a local governmental entity would not be required to pay interest on a payment that is past due for more than one year. This provision seems to remove some of the incentive to make payment that was intended by the inclusion of interest on late payments.

Section 715.12, F.S., the Construction Contract Prompt Payment Act, was enacted in 1992 to set guidelines for payment of construction services and supplies on private construction projects. Proponents of this bill point out that the only penalty remedy in this statute is a requirement that the owner pay interest on funds held impermissibly long. Yet, the statute also explicitly provides that the section does not establish a separate cause of action (the ability to sue) to recover unpaid interest. This, according to the bill proponents, renders the section ineffective, because it allows a contractor no capacity to recover interest that the owner does not willingly remit to him or her.

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RETAINAGE:

The 1992 study, Alternatives to 10% Retainage, stated that the practice of retainage is unique to the construction industry. Retainage consists of holding back a stipulated percentage of each progress payment, with this retainage to be paid upon completion of the contractor's work or upon completion of the entire project. As stated in the study, this retainage (typically 10%) is considered a financial guarantee that the contractor will:

- complete the work;
- correct defects; and
- be capable of financing the project.

Contractors and subcontractors see retainage as having such disadvantages as:

- Increasing the cost of construction (the contractor often must borrow money to stay afloat, waiting for retainage payments);
- Affecting cash flows adversely;
- Increasing project duration and reducing productivity;
- Affecting workmanship and quality adversely; and
- Forcing contractors/subcontractors to front-load progress payment requests.

According to the finding of the 1992 report, owners, both public and private, tend to believe that they cannot get all the necessary work items completed without holding retainage. The report states:

They (owners) are concerned that contractors might walk off the job before completion if no retainage is held or if retainage amount comes close to cost of work to complete project. Owners do not see without retainage, how contractors can be held responsible for items, such as: work not done, poor work that must be corrected, code compliance, delivery of warranties, guarantees, operating instructions, parts information, compliance with mechanics lien law, occupancy and other permits, inspection reports, as-built drawings, etc. Owners do not think that bonds can be effectively utilized to address these concerns.

As stated further in the report:

General contractors and Builder/developers feel that 10 percent retainage amount is unrealistically high and by holding this amount owners are actually forcing them to finance part of the project. Contractors feel that owners should not be earning interest on retainage. Their major concern is that it hurts their cash flow. They tend to think that owners are being doubly protected, by bonds and by retainage. Contractors also worry that owners would use (or abuse) the retainage fund against back charges.

The report found that It appears that subcontractors and suppliers/vendors are more adversely affected by retainage than the contractors. If the owner holds 10% retainage, the contractor typically also holds 10% retainage from each of his or her subcontractors. This means that even the first subcontractor on the project who has completed all of his or her work to the owner and contractor's satisfaction will wait until the project is fully complete to receive the balance of the monies owed under his or her contract. On larger projects, this time period can take several years. The average profit margin in the construction industry is currently estimated to be substantially less than 10%, often running as low as 5-6%,

which means that unless and until retainage is released, the subcontractor has no profit in the job, and may, in fact, be financing the job until completion. In addition, contractors and subcontractors must pay in full for materials purchased. The report stated:

The existence of the retainage practice is a cost factor to the subcontractors. Particularly where a subcontractor posts a performance bond, there would appear to be no persuasive reason for the subcontractor to have to be subjected to the retainage provision. Whatever the retainage, it should be paid within a reasonable time limit. If the subcontract provides that the retainage be withheld until completion of the entire project, it is especially unfair to such subcontractors as the excavator and the steel erector whose work is completed early in the course of construction. Such provisions create very severe hardships on subcontractors.

The Florida Department of Management Services (DMS) is the state agency that has the primary responsibility for construction and maintenance of state buildings. The DMS indicated that it has a policy of charging 10% retainage on the first half of the project, and 5% on the remaining portion.

The 1992 BCIAC study found that most public agencies, including Federal Government Services Administration (GSA), had revised their traditional 10% retainage policy. The prior standard of 10 percent throughout had been reduced. Many public jobs require only 5 percent. The Department of Defense and GSA have adopted the policy that retainage should be withheld only for specific reasons, such as failure to maintain schedules.

The underlying principle of the GSA policy is that retainage should not be used as a substitute for good contract management, and contracting officers should not withhold funds without cause. GSA form 3506 (Rev. 10-90) states:

If the Contracting Officer finds that satisfactory progress was achieved during any period for which a progress payment is to be made, the contracting officer shall authorize payment to be made in full. However, if satisfactory progress has not been made, the Contracting Officer may retain a maximum of 10 percent of the amount of the payment until satisfactory progress is achieved. When the work is substantially complete, the Contracting Officer may retain from previously withheld funds and future progress payments that amount the Contracting Officer considers adequate for protection of the Government and shall release to the Contractor all the remaining withheld funds. Also, on completion and acceptance of each separate building, public work, or other division of the contract, for which the price is stated separately in the contract, payment shall be made for the completed work without withholding of a percentage.

The report noted that almost all public construction is bonded. They further noted that the private construction industry could also adopt some of the revisions being practiced in the public construction sector if bonding became accessible to most of the contractors or if a majority of the contractors could qualify for bonding.

**C. EFFECT OF PROPOSED CHANGES:**

The effect of this bill is to provide that contractors who have finished their work will get paid sooner.

Significant changes to the existing prompt payment laws include changing the existing time period within which payment to the contractor must be made by a local government, subsequent to a payment request, from 20 business days to 20 calendar days. Additionally, the bill removes two exceptions which had provided local governments relief from the existing 20 day prompt payment requirement. The exceptions being removed allow the local government to delay payment if it has a requirement that its project architect or engineer approve payment, or if the local government has a law that requires the local government body to approve the payment. The bill also provides for conditions and time periods for rejecting a payment request.

The bill specifically provides that contracts for bonded public or private projects may provide for a retainage of no more than 5% of the progress payment (a progress payment is a payment to be made at certain times as the construction progresses, as stipulated by contract). The bill provides circumstances in which the retainage may, or may not, be held and provides a timetable under which it must be released to the contractor. The bill also requires contractors and subcontractors to pay retainage owed to their subcontractors and material suppliers within 10 days of receipt of payment from the owner. The bill provides that public or private entities retaining funds from payment to the contractor shall owe interest on those funds if they are more than 10 days overdue. If they are 10 days overdue, the interest is calculated from the date the payment was due to the contractor.

On both the prompt payment and the retainage issues, the bill provides that the prevailing party is entitled to recover attorney's fees at trial and on appeal.

**D. SECTION-BY-SECTION ANALYSIS:**

Local Government Prompt Payment Law:

Section 1. Amends s. 218.72, F.S., providing definitions for "payment request" and "agent," and clarifying existing definitions.

Section 2. Amends s. 218.73, F.S., clarifying that the section applies to timely payment for nonconstruction services.

Section 3. Amends s. 218.735, F.S., eliminating exceptions and making other changes in the existing local government prompt payment law. The exceptions being removed allow the local government to delay payment if it has a requirement that its project architect or engineer approve payment, or if the local government has a law that requires the local government body to approve the payment. Also changes the time period within which payment must be made from 20 business days from receipt to 20 calendar days from receipt, and changes the time period from 20 business days to 10 calendar days within which the local government has the opportunity to reject the payment request. Provides that if a local government disputes a portion of a payment request, the undisputed portion shall be paid in a timely fashion. Provides that payments not made on time shall accrue interest of 1% per month (as under current law) or at the rate specified in the contract, whichever is greater.

Section 4. Amends s. 218.74, F.S., allowing a payment request to suffice in lieu of an invoice; clarifies that the section applies to the purchase of goods and services other than construction services.

Section 5. Amends s. 218.75, F.S., providing that no contract may prohibit the collection of monies for late payment, at allowable interest rates.

Section 6. Amends s. 218.76, F.S., providing that the prevailing party is entitled to recover attorney's fees at trial and on appeal.

Public Buildings (Both State and Local Governments):

Section 7. Amends s. 255.049, F.S., applying its provisions to all bonded local government and state government construction projects (with the exception of Department of Transportation road and bridge construction and maintenance). Requires progress payments monthly, unless required more frequently by contract. Limits the money that the government entity can temporarily retain from progress payments to 5% or less. Requires release of subcontractors' retained funds within 90 days after the date a notice of completion has been received and approved. Requires final payment of all retained funds, barring a good faith dispute, within 30 days after final acceptance of the project. Prohibits the prime contractor from retaining a greater retainage percentage from subcontractor payments than the governmental entity is retaining from prime contractor payments. Provides that if payment is not made when due, interest accrues starting 10 days after the payment due date, and extending until the date of payment. Provides basis for withholding payments due to a "good faith dispute."

Private Construction:

Section 8. Amends s. 715.12, F.S., providing that payments are due within 10 days after the date of a written payment request and after meeting several other conditions, and that payments not made on time shall accrue interest of 1% per month or at the rate specified in the contract, whichever is greater. Changes the time period an owner has to dispute a payment request from 14 days to 10 days. Provides that an owner or prime contractor may not withhold any part of full progress payments for work that is covered under a warranty. Provides that an owner must release retainage held against a subcontractor's work within 20 days of completion of the subcontractor's work. Requires final payment on all retained funds, barring a good faith dispute, within 20 (up from 14) days after final acceptance of the project. Provides basis for withholding payments due to a "good faith dispute." Prohibits the prime contractor from retaining a greater retainage percentage from subcontractor payments than the governmental entity is retaining from prime contractor payments. Strikes language prohibiting a basis for a civil suit to collect unpaid late payment interest.

Section 9. Provides that the bill shall take effect July 1, 2000, and that it applies to contracts entered into on, or after, that date.



III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See comments section.

2. Expenditures:

See comments section.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

Local governments have not, to date, furnished any quantifiable data or estimate on fiscal impact. They have, however, commented that some of the changes in the prompt payment time frames may turn out to be unreasonable in some instances.

2. Expenditures:

See above.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The fiscal effect upon the private sector should be positive. Contractors, subcontractors, and material suppliers will receive payment in a more timely fashion for services performed and materials supplied.

D. FISCAL COMMENTS:

See comments section.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill may require counties or municipalities to spend funds or to take an action requiring the expenditure of funds. The expenditure of funds would occur if the new time lines on prompt payment cannot be met, and the local government had to pay interest. In addition, interest would be assessed if local governments hold retainage impermissibly long. Since the number of instances in which the local government would fail to meet the time frames for payment cannot be known, the amount of interest which could be assessed cannot be projected. However, the fact that local governments have not, to date, chosen to make that argument or provide any quantifiable data alleging adverse fiscal impact supports the

conclusion that whatever the aggregate amount of interest payments this bill might cause, it would not meet the "significant fiscal impact" standard of \$.10 times the population of Florida, or \$1.5 million based on 1999 census estimates. Therefore, this analysis concludes that the bill falls under the "insignificant fiscal impact" exemption under the mandates provision.

**B. REDUCTION OF REVENUE RAISING AUTHORITY:**

This bill does not reduce the authority that counties or municipalities have to raise revenue in the aggregate.

**C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:**

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

**V. COMMENTS:**

**A. CONSTITUTIONAL ISSUES:**

None.

**B. RULE-MAKING AUTHORITY:**

None.

**C. OTHER COMMENTS:**

The Department of Education offered the following comments:

Agencies unable to meet time lines for prompt payment would accrue penalties for late payment. Procedures could be developed and implemented to preclude such penalties, however, school districts which close business offices for extended periods of time (i.e., December holidays) could have difficulty meeting time lines unless provisions are made to add "business" days to required time lines.

The Department of Management Services (DMS) offered the following comments:

The proposed bill imposes a retainage limitation of 5% on all bonded contracts. State agency experience teaches that a 5% retainage will not provide enough incentive for some subcontractors to remedy defective work and accomplish final completion in a timely manner. This agency required a 10% retainage until the project is 50% complete, at which time the retainage is reduced to 5%.

The bill places a completely new level of responsibility on a state agency in the administration of its construction contracts. It will require the state agency to administer the payment provisions of a contractor's contracts with its subcontractors. Separate tracking will be required for each subcontract, a responsibility currently of the contractor. A new procedure will be required for the newly created Notice of Completion for subcontract items, rather than relying on the industry standard Notice of Completion currently in place. The

bill also changes the relationship between an owner and its contractor with regard to final payment. The bill creates a new definition of final acceptance as being the issuance of the architect/engineer's certificate of substantial completion or the owner's actual use of the property. The effect of this is that final completion will now be deemed to have occurred prior to the completion of punch list items that are identified in the normal substantial completion inspection. It also requires the owner to release the retainage, even in the face of possible warranty items that a contractor or subcontractor may not have completed.

Regarding section 255.049(6) & (8): These sections of the bill are in conflict. (6) requires the release of retainage by the contractor within 10 days of receipt of the retainage from the owner, whereas (8) establishes a procedure for withholding retainage. Not only that, but the bill apparently requires that the state agency directly notify a subcontractor of why that subcontractor's retainage is being withheld. Again, this attempts to create a relationship between a state agency project owner and a subcontractor which is not currently in existence. Once this privity is established, the subcontractor may be able to maintain an action directly against the state agency in the absence of a contract.

The proposed bill also places unrealistic time constraints on a state agency which performs construction projects for other state agencies and units of government. The new section 255.049(7) would require payment to a subcontractor within 10 days of the contractor's application for payment. Since the application for payment first goes to the project architect for approval, then to the state agency project manager for approval, then to the agency for which the project is being built for processing, then to the Comptroller, many pay requests would result in an interest penalty being imposed.

255.049(9) changes one of the purposes of retainage, and that is to insure that the work is completed in accordance with the contract document, one provision of which is warranty. If it becomes apparent during the progress of the work that there is a warranty problem, this section precludes withholding the retainage until the warranty issue is resolved.

The bill changes the balance of power, so that subcontractors are strongly favored, and the state agencies put at a disadvantage. Although the bill is apparently drafted to insure prompt payment to subcontractors, this agency is unaware of any such problems on its projects. This agency is concerned that the broad reach of this bill will result in a complete revision of the way a state agency manages its construction contracts, and will of necessity, result in additional project costs and the increased likelihood of litigation. If the problem that the bill is aimed at is local government contracting, perhaps state agencies should be exempted from this section as was the Department of Transportation.

**VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:**

None.

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VII. SIGNATURES:

COMMITTEE ON BUSINESS REGULATION AND CONSUMER AFFAIRS:

Prepared by:

Staff Director:

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Gip Arthur

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Rebecca R. Everhart