

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 487 w/CS      Local Government Prompt Payment Act  
**SPONSOR(S):** Reagan  
**TIED BILLS:**      **IDEN./SIM. BILLS:** SB 544

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Local Government &amp; Veterans' Affairs</u>	<u>18 Y, 0 N w/CS</u>	<u>Nelson</u>	<u>Cutchins</u>
2) <u>Education Appropriations (Sub)</u>	<u></u>	<u></u>	<u></u>
3) <u>Appropriations</u>	<u></u>	<u></u>	<u></u>
4) <u></u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

This bill revises provisions relating to prompt payment by public entities for construction services, and provides procedures for payment of retainage and for settling disputes. The bill redesignates part VII of ch. 218, F.S., as the "Local Government Prompt Payment Act" and creates the "Florida Prompt Payment Act" to apply to state projects.

The bill has an effective date of July 1, 2004.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

**STORAGE NAME:** h0487a.lgv.doc  
**DATE:** April 7, 2004

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. DOES THE BILL:

- |                                      |                              |                             |   |
|--------------------------------------|------------------------------|-----------------------------|---|
| 1. Reduce government?                | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes?                      | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. Expand individual freedom?        | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families?                 | 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. EFFECT OF PROPOSED CHANGES:

##### **Background**

##### ***Florida Prompt Payment Act***

Part VII of ch. 218, F.S., known as the "Florida Prompt Payment Act," was enacted in 1989. The declared policy of this state is that "payment for all purchases by local governmental entities be made in a timely manner. The purpose of the act is:

- to provide for prompt payments by local governmental entities and their institutions and agencies;
- to provide for interest on late payments made by local governmental entities and their institutions and agencies; and
- to provide for a dispute resolution process for payment of obligations.

The term "local governmental entity" is defined by the act to mean "a county or municipal government, school board, school district, authority, special taxing district, other political subdivision, or any office, board bureau, commission, department, branch, division, or institution thereof or any project supported by county or municipal funds."<sup>1</sup> The act establishes timely payment standards for construction and non-construction services.

##### ***Prompt Payment of Vendors by State Agencies***

Section 215.422, F.S., addresses prompt payment of vendors by state agencies and the judicial branch. Vouchers authorizing payment of an invoice must be filed with the Chief Financial Officer not later than 20 days after receipt of the invoice. The Chief Financial Officer is required to issue a warrant in payment of the invoice not later than 10 days after filing the voucher. Partial payments to contractors are authorized. Disputes over payments are to be resolved in accordance with rules developed and adopted by the Chief Justice for the judicial branch, and rules adopted by the Department of Financial Services or in a formal administrative proceeding before an administrative law judge of the Division of Administrative Hearings for state agencies.

Section 255.071, F.S., addresses disputes between contractors and subcontractors and suppliers for public works projects. When the contractor receives payments from the state or "any county, city, or political subdivision of the state, or other public authority..." for the construction of a public building, they are required to pay, in accordance with the contract terms, the undisputed contract obligations for labor, services or materials provided for the project. If the contractor fails to pay these undisputed obligations to the subcontractor or supplier within 30 days of the required payment date, the subcontractor or supplier is entitled to procedures and remedies provided in subsections (3) and (4).

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<sup>1</sup> See, s. 218.72(2), F.S.

## ***Payment and Performance Bonds***

Chapter 255, F.S., deals with public property and publicly owned buildings. Section 255.05, F.S., requires a payment and performance bond from any person who enters into a formal contract with the state or any local government or other public authority, for the construction of a public building, for the prosecution and completion of a public work, or for repairs on a public building or public work.

Section 255.05(2), F.S., provides procedures for subcontractors and suppliers to make claims against a payment bond. This section also provides an outline for a notice form, deadlines for action, and consequences for improper notice or failure to act within specified guidelines.

## ***Retainage on Construction Projects***

Retainage is a legitimate and common construction contracting practice whereby a certain percentage of compensation is withheld by the project owner from the general contractor and, in turn, by the general contractor from subcontractors until the project is completed satisfactorily. Retainage is established by contract between the builder and the entity contracting for the project. This practice supports phased payments to providers for completed work and project assurances for the owner, which includes contract compliance, quality and adherence to the project schedule.

## **HB 487**

Section 1: Amends s. 218.70, F.S., to redesignate the "Florida Prompt Payment Act" as the "Local Government Prompt Payment Act." The Florida Prompt Payment Act is reestablished in Sections 4-12 of the bill, and applies primarily to state government.

Section 2: Amends s. 218.72, F.S., to include "district" and "separate unit of local government created or established pursuant to law" in the definition of "local governmental entity," thereby making these entities subject to the Local Government Prompt Payment Act. The definition of the term "vendor" is amended to include "any person who provides waste-hauling services to residents or businesses located within the boundaries of a local government pursuant to a contract or local ordinance." The definition of "construction services" is amended to make the prompt payment provisions in the act available to any contractors performing services on local government projects (removing current language which restricts the applicability of the act to contractors who have licenses pursuant to ch. 489, F.S.). A definition of the term "contractor" or "provider of construction services" also is created. These terms mean "any person who contracts directly with a local governmental entity to provide construction services." The term contractor replaces the term "vendor" used throughout this part of ch. 218, F.S.

Section 3: Amends s. 218.735(6), F.S., to require that when a contractor receives payment from a local governmental entity for labor, services or materials furnished by subcontractors and suppliers hired by the contractor, the contractor must remit payment due to those subcontractors and suppliers within 10 days, rather than the 15 days provided in current law, after the contractor's receipt of payment. However, subcontractors have seven days, rather than the 15 days provided in current law, to pay their subcontractors and suppliers.

Creates subsection (7), to require each contract for construction services between a local governmental entity and a vendor provide for the development and review of a "punch list" or list of items required to "render complete, satisfactory, and acceptable" the construction services purchased. For construction projects that cost less than \$10 million, the list must be completed within 30 days after reaching substantial completion of the construction services as defined in the contract, or, if not defined in the contract, upon reaching beneficial occupancy of use.

If a construction project costs \$10 million or more, the list must be developed within 30 days, unless otherwise extended by contract up to 60 days, after reaching substantial completion of the construction services as defined in the contract, or, if not defined in the contract, upon reaching beneficial occupancy or use.

Paragraph (7)(b) provides that the list and time frame requirements also apply to construction contracts relating to construction services on more than one building or structure, or involving a multiphase project.

Paragraph (7)(c) specifies that failure to include any corrective work or pending items not yet completed on the list does not alter the responsibility of a vendor to complete all of the purchased construction services as defined in the contract.

Paragraph (7)(d) provides that the contractor may submit a payment request for the appropriate amount of retainage upon completion of all items on the list, or any such other time as defined in the contract. In the case of a good faith dispute relating to whether one or more items identified on the list have been completed, a local government is authorized to withhold up to 150 percent of the total costs to complete such items.

Paragraph (7)(e) provides that all items that require correction under the contract and that are identified after the preparation and delivery of the list remain the obligation of the contractor as defined in the contract.

Paragraph (7)(f) provides that warranty items may not affect the final payment of retainage.

Paragraph (7)(g) prohibits local governments or contractors from holding retainage to secure payment of insurance premiums under a consolidated insurance program or series of insurance policies issued to a public agency or a contractor for a project or groups of projects, and the final payment of retainage may not be delayed pending a final audit by the local governmental entity's or contractor's insurance provider.

Paragraph (7)(h) provides that if a local government fails to timely develop the required punch list, the contractor may submit a payment request for the appropriate amount of retainage. The local government is not required to pay the requested retainage if the contractor has, in whole or part, failed to cooperate with the local government in development of the list; failed to perform its contractual responsibilities, if any, with regard to the development of the list; or if paragraph (8)(f), which relates to disputes between the local government and the contractor, applies.

Creates subsection (8) to provide for interim release of retainage. At the start of a public construction project until 50 percent of the project has been completed, a local governmental entity may not withhold more than 10 percent of each progress payment to the contractor as retainage. After reaching 50 percent completion, the local government may withhold no more than five percent of future progress payments to the contractor as retainage. However, a municipality with a population of 25,000 or less, or a county with a population of 100,000 or less, may withhold as retainage up to 10 percent of each progress payment until final completion and acceptance of the project by the local government. The term "50-percent completion" means as defined in the contract, or if not defined in the contract, the point at which the local government has expended 50 percent of the total cost of the construction services purchased as identified in the contract together with all costs associated with existing change orders and other additions or modifications to the construction services provided for in the contract.

Paragraph (8) (c) provides, however, that the contractor may elect to withhold more than five percent retainage from payments to its subcontractors, after the project has reached 50 percent completion. The specific amount to be withheld is to be determined on a case-by-case basis and must be based on the contractor's assessment of the subcontractor's past performance, the likelihood that such performance will continue, and the contractor's ability to rely on other safeguards. The contractor must

provide written notice to the subcontractor, and may not request the release of such retained funds from the local governmental entity.

Paragraph (8)(d) provides that the contractor may submit a payment request for up to one-half of the retainage amount held by the local government, after reaching 50 percent completion. The local governmental entity must promptly pay the vendor, unless there is a "good faith" dispute between the contractor and the local government. If the local government pays retainage to the contractor, the contractor must timely remit payment of such retainage to the appropriate subcontractors and suppliers.

Paragraph 8 (e) clarifies that a local government may withhold retainage at a rate lower than 10 percent, and release such retainage at any point; the contractor is subsequently responsible for remitting such retainage to the subcontractors and suppliers.

Paragraph (8)(f) specifies that the section does not require the payment or release of amounts that are the subject of a good-faith dispute, of an action brought pursuant to s. 255.05, F.S., or of another claim or demand.

Paragraph (8)(g) reiterates that the timeframes set forth in the act apply to the payment of any payment request for retainage made pursuant to subsection (8).

Paragraph (8)(h) provides that this section does not apply to any local government construction project that is funded, in whole or in part, with federal moneys and is subject to federal grantor laws and regulations or requirements that are contrary to any provision of the Local Government Prompt Payment Act.

Paragraph (8)(i) provides that the section does not apply to any construction services costing less than \$200,000.

Section 4: Creates s. 255.0705, F.S., to establish the new "Florida Prompt Payment Act." This provision pertains primarily to state government or projects supported by state funds.

Section 5: Amends s. 255.071, F.S., to address payment of subcontractors, sub-subcontractors, materialmen and suppliers on construction contracts for public projects.

Subsection (2) currently provides that failure to pay any undisputed obligations for labor, services or materials within 30 days after such labor, services or materials were furnished and payment became due, or within 30 days after the date payment is received, whichever occurs last, entitles the person providing such labor, services or materials to the procedures for settling disputes and remedies. This provision changes the second deadline from 30 days to 10 days for contractors, and seven days for subcontractors.

Subsection (3) provides procedures for settling disputes between contractors and subcontractors and suppliers. Any person providing labor, services or materials for the construction of a public building, for the prosecution and completion of a public work, or for repairs upon a public building or public work improvements to real property, may file a verified complaint alleging, among other things, that the person against whom the complaint was filed has received payment on account of the labor, services or materials described in the complaint more than 30 days prior to the date the complaint was filed. This deadline is changed from 30 to 10 days for contractors, and seven days for subcontractors.

Section 6: Creates s. 255.072, F.S., to provide definitions for the Florida Prompt Payment Act. Except for subsections (2), (3) and (4), these definitions are adapted from the definitions in the current Florida Prompt Payment Act. Subsection (2) specifies that the definition of "construction services" does not include contracts or work performed for the Department of Transportation. Subsection (3) defines "contractor" as "any person who contracts directly with public entity to provide construction services."

Subsection (4) defines “public entity” as the state, a state university, or any office, board, bureau, commission, department, branch, division, or institution thereof.

Section 7: Creates s. 255.073, F.S., to address timely payment for purchase of construction services. This section is, with minor changes, adapted from the current Florida Prompt Payment Act. In this section, the term “public entity” is substituted for “local government entity.” In addition, the deadline for remitting payments to subcontractors is 10 days (and seven days for subcontractors to remit payments to subcontractors and suppliers), rather than the 15 days specified in the current law.

Subsection (1) provides that s. 215.422, F.S., which addresses prompt payment of vendors (primary contractors rather than subcontractors or suppliers hired by the vendor) by state agencies or the judicial branch, governs the timely payment for construction services by a public entity, except otherwise provided by the act.

Subsection (2) provides that if a public entity disputes a portion of a payment request, the undisputed portion must be timely paid.

Subsection (3) requires that when a contractor receives payment from a public entity for labor services or materials furnished by subcontractors and suppliers hired by the contractor, the contractor must remit payment due to those subcontractors and suppliers within 10 days after the contractor’s receipt of payment. Similarly, when a subcontractor receives payment from a contractor for labor, services or materials furnished by subcontractors and suppliers hired by the subcontractor, the subcontractor must remit payment due to those subcontractors and suppliers within seven days after the subcontractor’s receipt of payment.

Subsection (4) provides that all payments due under this section and not made within the specified time periods must bear interest at the rate of one percent per month or a rate specified by the contract, whichever is greater.

Section 8: Creates s. 255.074, F.S., to provide procedures for calculation of payment due dates. This section, with minor changes, is adopted from the current Florida Prompt Payment Act. In this section, the term “public entity” is substituted for “local government entity.”

Subsection (1) requires each public entity to establish procedures to mark each payment request or invoice as received on the date on which it is delivered.

Subsection (2) specifies that if the terms under which a purchase is made allow for partial deliveries, and a payment request or proper invoice is submitted for a partial delivery, the time for payment for the partial delivery must be calculated from the time of the partial delivery and the submission of the payment request.

Subsection (3) differs from the current Florida Prompt Payment Act in that the public entity must submit a payment request to the Chief Financial Officer for payment no more than 25 days after receipt of the payment request.

Section 9: Creates s. 255.075, F.S., to specify that a contract between a public entity and a contractor or a provider of construction services may not prohibit the collection of late payment interest charges allowable under the act. This section is, with minor changes, adapted from a provision in the current Florida Prompt Payment Act.

Section 10: Creates s. 255.076, F.S., to address improper payment requests and resolution of disputes. This section is, with minor changes, adapted from the current Florida Prompt Payment Act. In this section, the term “public entity” is substituted for “local government entity.”

Subsection (1) provides that in any case in which an improper payment request or invoice is submitted by a contractor, the public entity has 10 days after the improper payment request or invoice is received to notify the contractor that the payment request or invoice is improper and indicate what corrective action on the part of the contractor is needed to make the payment request or invoice proper.

Subsection (2) governs disputes between a contractor and public entity over payment of a payment request or invoice. Each public entity is required to establish a dispute resolution procedure to be followed in cases of such disputes. Such procedure must provide that proceedings to resolve the dispute be commenced not later than 45 days after the date on which the proper payment request or invoice was received by the public entity and be concluded by final decision of the public entity not later than 60 days after the date on which the proper payment request or invoice was received. Such procedures are not subject to ch. 120, F.S. If the dispute is resolved in favor of the public entity, then interest charges shall begin to accrue 15 days after the public entity's final decision. If the dispute is resolved in favor of the contractor, interest begins to accrue as of the original date the payment became due.

Subsection (3) provides that the prevailing party in a collection action under the act is entitled to recover court costs and reasonable attorney's fees under certain circumstances.

Section 11. Creates s. 255.077, F.S., to provide for project closeout and payment of retainage.

Subsection (1) requires each contract between a public entity and a contractor to provide for the development of a final "punch list" of all items required to "render complete, satisfactory, and acceptable" the construction services purchased. The contract must specify the process for the development and review of the punch list.

For construction projects with an estimated cost of less than \$10 million, the list must be completed within 30 calendar days after reaching substantial completion as defined in the contract, or if not defined in the contract, upon reaching beneficial occupancy or use.

For construction projects with an estimated cost of \$10 million or more, the punch list must be completed within 30 days (unless otherwise extended by contract not to exceed 60 calendar days) after substantial completion as defined in the contract, or if not defined in the contract, upon reaching beneficial occupancy or use.

Subsection (2) provides that the list and time frame requirements also apply to construction contracts relating to construction services on more than one building or structure, or involving a multi-phased project.

Subsection (3) provides that failure to include any corrective work or pending items not yet completed on the list does not alter the responsibility of the contractor to complete all the purchased construction services as specified in the contract.

Subsection (4) provides that upon completion of all items on the list, the contractor may submit a payment request for all remaining retainage. The public entity may withhold up to 150 percent of the total costs to complete any final punch list items, if a good-faith dispute exists.

Subsection (5) provides that all items that require correction under the contract and that are identified after the preparation and delivery of the final punch list remain the obligation of the contractor.

Subsection (6) provides that warranty items may not affect the final payment of retainage.

Subsection (7) provides that retainage may not be held by a public entity or a contractor to secure payment of insurance premiums under a consolidated insurance program or series of insurance

policies, and the final payment of retainage may not be delayed pending a final audit by the public entity's or the contractor's insurance provider.

Subsection (8) provides that if the public entity fails to timely develop the required punch list, the contractor may submit a payment request for the appropriate amount of retainage. The public entity is not required to pay the requested retainage if the contractor has, in whole or part, failed to cooperate with the local government in development of the list or failed to perform its contractual responsibilities, if any, with regard to the development of the list or if a good-faith dispute exists between the public entity and the contractor.

Section 12: Creates s. 255.078, F.S., to provide for interim release of retainage.

Subsection (1) provides that from the commencement of a public construction project that is subject to this act until 50 percent of the contract value has been earned, a public entity may not withhold more than 10 percent of each progress payment to the contractor as retainage.

Subsection (2) provides that the public entity may withhold no more than five percent of future progress payments to the contractor as retainage after 50 percent completion. The term "50-percent completion" means as defined in the contract, or, if not defined in the contract the point at which: the public entity has expended 50 percent of the total project costs identified in the contract, plus all change orders and other additions or modifications to the construction services provided for in the contract.

Subsection (3) provides that the contractor may withhold retainage payments to its subcontractors at a rate higher than five percent after 50 percent completion, to be determined on a case-by-case basis and based upon the contractor's assessment of the subcontractor's past performance, the likelihood that such performance will continue, and the contractor's ability to rely on other safeguards. The contractor must provide written notice to the subcontractor, and the reasons for making the determination. The contractor may not request the release of such retained funds from the public entity.

Subsection (4) provides that after 50 percent completion, the contractor may present the public entity with a payment request for up to one-half of the retainage. The public entity must promptly make payment to the contractor unless it has grounds, pursuant to subsection (6), for withholding the payment. If the public entity makes payment of retainage to the contractor, the contractor must timely remit payment of such retainage to its subcontractors and suppliers.

Subsection (5) clarifies that the public entity may withhold retainage at a rate lower than 10 percent, and release retainage to a contractor at any point. A contractor subsequently is responsible for remitting such retainage to its subcontractors.

Subsection (6) specifies that the section does not require the payment or release of amounts that are the subject of a good-faith dispute, an action brought under s. 255.05, F.S., or otherwise subject of a claim or demand by the public entity or contractor.

Subsection (7) reiterates that the timeframes in the act apply to the payment of any payment request for retainage.

Subsection (8) provides that subsections (1) through (4) do not apply to construction services purchased by a public entity, which are paid for, in whole or in part, with federal moneys and that are subject to federal grantor laws and regulations or requirements that are contrary to any provision of the Florida Prompt Payment Act.

Section 13: Amends s. 255.05, F.S., to provide additional guidelines or restrictions for a subcontractor or supplier when making claims against a payment bond. Provides that any notice of nonpayment served by a claimant who is not in privity (e.g., who does not have a contractual relationship) with the



contractor which includes sums for retainage must specify the portion of the amount claimed for retainage.

Adds subsection (10) providing that an action, except for an action for recovery of retainage, must be instituted against the contractor (or the surety on the payment bond or the payment provisions of a combined payment and performance bond) within one year after the performance of the labor or completion of delivery of the materials or suppliers.

An action for the sole purpose of recovery of retainage also must be instituted against a contractor or against the surety issuing a payment or performance bond within one year, but not until:

- the public entity has paid out that retainage to the contractor and the time provided for payment of that retainage to the claimant has expired;
- the claimant has completed all contracted work and 70 days have passed since the public entity received the contractor's final payment request; or
- the claimant has made a written request to the contractor for the retainage, and the contractor has not responded, in writing, 10 days after receipt of the request.

If none of these conditions can be satisfied and, consequently, an action for recovery of retainage cannot be instituted within the one-year limitation period, the limitation period is extended until 120 days after one of the conditions is satisfied.

Section 14: Creates s. 725.09, F.S., to prohibit an entity from entering into a contract for the purchase of construction materials or services which conditions payment for such materials or services on the receipt of payment from any other entity. Provides that any such conditional payment provision is void as a violation of the public policy of the state.

Section 15: Amends s. 95.11(2)(b), F.S., to correct a reference, resulting from changes proposed in Section 13 of the bill.

Section 16: Provides that neither the amendments to ss. 95.11, 218.70, 218.72, 218.735, 255.05 and 255.071, F.S., by the bill, nor s. 255.078, F.S., as created by the bill, applies to any existing construction contract pending approval, or to any project advertised for bid on or before the effective date of the act.

Section 17: Provides an effective date of October 1, 2004.

#### C. SECTION DIRECTORY:

Section 1: Amends s. 218.70, F.S., revising a popular name.

Section 2: Amends s. 218.72, F.S., redefining terms.

Section 3: Amends s. 218.735(6), F.S., relating to timely payment for purchases of construction services; creates new subsections (7) relating to the development of a "punch list" and (8) relating to interim release of retainage.

Section 4: Creates s. 255.0705, F.S., to provide for a popular name.

Section 5: Amends s. 255.071, F.S., to address payment of subcontractors, sub-subcontractors, materialmen and suppliers on construction contracts for public projects.

Section 6: Creates s. 255.072, F.S., to provide definitions.

Section 7: Creates s. 255.073, F.S., to address timely payment for purchase of construction services.

Section 8: Creates s. 255.074, F.S., to provide procedures for calculation of payment due dates.

Section 9: Creates s. 255.075, F.S., to specify that a contract between a public entity and a vendor or a provider of construction services may not prohibit the collection of late payment interest charges.

Section 10: Creates s. 255.076, F.S., to address improper payment requests and resolution of disputes.

Section 11: Creates s. 255.077, F.S., to provide for project closeout and payment of retainage.

Section 12: Creates s. 255.078, F.S., to provide for interim release of retainage.

Section 13: Amends s. 255.05, F.S., to provide additional guidelines for a subcontractor or supplier when making claims against a payment bond.

Section 14: Creates s. 725.09, F.S., to prohibit an entity from entering into a contract for the purchase of construction materials or services which conditions payment on the receipt of payment from any other entity.

Section 15: Amends s. 95.11(2)(b), F.S., to correct a reference.

Section 16: Provides that certain provisions of the bill do not affect existing construction contracts or projects advertised to bid before effective date of the act.

Section 17: Provides an effective date of October 1, 2004.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

#### **1. Revenues:**

None.

#### **2. Expenditures:**

The bill may require state government to provide more timely payments to contractors and subcontractors who provide services or supplies in the construction of public projects<sup>2</sup>.

### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

#### **1. Revenues:**

None.

#### **2. Expenditures:**

The bill may require local governments to provide more timely payments to contractors and subcontractors who provide services or supplies in the construction of public projects. More stringent requirements will require additional efforts to comply with the law.<sup>3</sup>

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<sup>2</sup> The Department of Management Services has commented that Consequences from reduced leverage by the public owners may result in acceptance in less than standard performance and unplanned costs related to retrofits, maintenance and future repairs. Earned interest on retainage involved in a contract performance dispute will require 12 percent APR return. Litigation may result from more stringent requirements on the parts of all parties involved: the contractors, subcontractors and the public owners.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill may result in more timely payments to contractors and subcontractors who provide services or supplies in the construction of public projects.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

None.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

**Comments**

The **Office of Program Policy Analysis and Government Accountability**, an office of the Florida Legislature, stated in a December 2000 report:<sup>4</sup>

- Retainage is a common construction contracting practice whereby a certain percentage of compensation is withheld by the project owner from the general contractor and, in turn, by the general contractor from subcontractors until the project is completed satisfactorily. Retainage is also used as leverage to assure timely completion.
- Proponents of this practice claim it is necessary as leverage to assure timely completion of construction projects. Opponents of retainage claim that payment procedures on large public projects can be lengthy and complex, and that final payment to the subcontractors can be delayed for months when problems with one aspect of the project remain unresolved.
- Florida's subcontractors, who felt that retainage often creates undue financial hardships, asked the 2000 Legislature to consider limiting the allowable percentage of compensation that could be retained. In response, the legislature requested OPPAGA to evaluate retainage and other construction practices identified by subcontractors.
- OPPAGA determined that limiting retainage may have the harmful unintended side effect of thwarting the development of new business or retarding the growth of existing businesses. In addition, owners and prime contractors may use other means to minimize risk, which may be less favorable than retainage.

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<sup>3</sup> Id.

<sup>4</sup> OPPAGA *Special Review: Inflexibility in Contracting and Retainage Practices Could Hurt Construction Industry*, Report No. 00-26, December 2000.

- The fiscal impact of retainage on subcontractors can be lessened through the payment of interest on their percentage of compensation that has been retained. Although the legislature could require payment of interest by law, ideally, this would be negotiated as part of the contracting process. Consideration of such legislation should take into account the fiscal impact to the state of Florida and other units of government.
- OPPAGA also recommends that the Department of Management Services identify and disseminate best construction practices that, if implemented, would facilitate final project completion and release of retainage.

**The Florida League of Cities**<sup>5</sup> has observed that over the past three legislative sessions, various subcontractor professional associations and trade groups have been working to amend existing laws relating to the policies and procedures affecting a public entities' procurement of personal property and services (ch. 287, F.S.). Specifically, the proposed revisions would impose strict timelines and requirements for a public entity to develop what is known as a punch list (items to be completed by the contractor), specify time periods within which certain contractors and subcontractors must be paid for services rendered, and also limit the amount of retainage a public entity could withhold during the course of a public construction project.

The League argues that the authority of municipalities to enter into flexible and fair contracts with providers of goods and services should be protected. This includes preserving the authority of municipalities to withhold adequate retainage, utilizing owner controlled insurance policies, and providing for flexibility in the types and forms of bonds utilized to ensure payment or performance for contracts. The Leagues position is as follows:

- The amount of retainage held by a public entity should be determined contractually—not legislatively.
- Construction project owners—whether public or private—should be able to negotiate the terms and conditions which a contract is let under and should be given sufficient flexibility to amend the terms and conditions of a contract based on the size, type and scope of a public construction project.
- Contractors bid on public projects knowing that retainage will be withheld by the public owner; the retainage amount is typically built into their bid price.
- Limiting the amount of retainage and requiring release of any portion of the retainage prior to completion of the contract could jeopardize the public's investment in a construction project
- The contract for a public project is between a prime or general contractor and the public entity. The public entity has no contract with the subcontractors. This proposal will create financial arrangements and liabilities for actions or inaction between parties where no contractual relationship exists.
- The number of claims for incomplete or unsatisfactory work will rise because the public entity has limited financial leverage to ensure the contractor or subcontractors return to the job to correct deficiencies.

**The Florida Association of Counties**<sup>6</sup> has indicated that it would support legislation that preserves a county's ability to require a contractor's participation in an Owner Controlled Insurance Program (OCIP) for certain construction projects and allows a county's use of payment retainage in construction contracts at a level that reflects both the scope and risks of the project.

The Association believes that the free market—rather than government regulation—should dictate the contractual relationship between the consumer and the person or industry providing the service. Specifically, the county places a significant amount of public funds at risk each time it embarks on a public works projects. That risk is heightened if the winning bidder has a less-than-perfect work history with either the county or another entity. In such a case, retainage may be the only leverage the county has to ensure the project is finished on-time and according to the provisions of the contact.

<sup>5</sup> C. Scott Dudley, Senior Legislative Advocate, Florida League Of Cities.

<sup>6</sup> Eric Poole, Governmental Relations, Florida Association of Counties

Conversely, a project that is less risky, which also includes a contractor with an impeccable work record, retainage may not be necessary and, therefore, not used.

As a take-off on this approach, Sarasota County has recently implemented a sliding scale retainage scheme, where retainage amounts are adjusted—up or down—based on whether the contract is on or behind schedule.

Additionally, the Association has considered the December 2000 OPPAGA study that concluded that any legislation that limits contractual flexibility could limit the entrance of new businesses and have a negative impact on the construction business as a whole. The OPPAGA study goes on to conclude that any adjustments to the industry would better occur through improved contracting practices rather than through a legislative mandate.

The **Florida Department of Management Services** has indicated that it has a number of general concerns re: HB 487:

- The bill would reduce the time for the government entity to process payment for the labor, services or materials from 30 to 10 days. Many projects involve a contracted agent such as an architect or construction manager to verify that the labor, services or materials have been provided as billed. This and other internal accounting controls require a reasonable amount of time to assure the public's interest as intended by the legislature.
- The Department of Management Services currently has provisions for reducing the retainage to five percent at 50 percent completion, provided the project is on schedule and the contractor's performance is in accordance with the contract documents. Reducing the retainage to five percent at 50 percent completion regardless of performance will diminish the public entity's leverage to bring the contractor into compliance.
- The bill states that when the "project is 50% complete," retention is reduced from the customary 10 percent to five percent. However, this does not align with how projects are constructed by subcontractors. This places the burden on early subs (civil site related, concrete foundation and wall framing) at 10 percent but later subs (electrical, painting, HVAC, landscaping, etc.) at five percent. If the owner has to track 50 percent complete of each subcontractor's trade, then the payment process would become even more cumbersome and the owner would be overstepping their contract with the privatized contractor as construction manager of the project.
- The bill has the potential to interfere with general contract chain of command procedures by involving the owner in the affairs of the general contractor's subcontractors and/or material suppliers. The public owner's contract with a general contractor clearly defines that the general contractor is in charge of the construction "means and methods" as a privatized activity. The bill will change the involvement of the public owners with the independent process of how the private sector general contractor and subcontractor perform under their agreements as well as how to build and schedule.
- The bill could possibly discourage general contractors from bidding on public projects since a parallel law is not imposed on their private sector bid projects. General contractors that do bid a public project would increase their price through a bid contingency to cover their costs of successfully completing a project since they no longer have adequate retainage leverage to obtain complete subcontractor performance.
- Paying interest on retainage is not an industry practice. The construction industry is market driven and operates much like the general competitive market of pay upon services rendered. If the state differs from the general market, it could interfere with the operation and growth of existing businesses and have a negative impact on the construction industry as a whole. It

would also serve to lessen the intent of the practice of retaining funds which is to ensure that the public's interest is equitable and executed as intended by the Legislature. Requiring deposit of retainage in an interest bearing account would add administrative costs and involve several state agencies to accomplish the process. At one percent interest per month, both government will be required to find interest accounts that produce a 12 percent interest rate or appropriate additional funds to resolve any performance related issues.

- An owner has their agent review and supplement the final punch list as prepared by the general contractor. However, by common practice the general contractors have not properly performed this obligation and the owner's agent, the architect/engineer, has stepped in and filled this role for the general contractor by default. A subcontractor punch list comes from the general contractor to their subs—not from the owner to the subs.
- The bill will require government entities to establish dispute resolution procedures that will force the public owner to jump their contract chain of command by working directly with a subcontractor instead of through their general contractor.

The **Florida Department of Financial Services (DFS)** has indicated that section 7 of the bill would appear to materially affect the DFS/Vendor Ombudsman Program as far as payments made or not made by public entities as defined in new language in Section 6 of the bill. This could be a problem for DFS since reference is made to the state universities, which are devolving. The interest rate set in subsection (4) of Section 7 is at odds with current practice for payment by state agencies to vendors where there have been violations of the prompt-payment requirements.

The **American Subcontractors Association of Florida**<sup>7</sup> has stated that they believe the current system of holding 10 percent retainage for an indefinite period of time is an outdated practice that strains relationships between the parties to a project, raises bids, and is often used in lieu of best management practices. Using money that is rightfully due to a party who has fully performed to guarantee the work of another party who failed to satisfactorily perform is harmful to the industry as a whole and does not promote completion of projects in a timely and successful manner

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES**

The Committee on Local Government & Veterans' Affairs adopted a strike all amendment at its meeting on March 31, 2004. This amendment:

- amends the definition of "local government" to utilize the definition currently in the public records statute;
- removes community colleges from the bill—they have recently adopted an aggressive uniform guideline for line item release of retainage that will be incorporated into all future community college construction contracts;
- creates definitions of "contractor" or "provider of construction services" and replaces the term "vender" throughout the bill with these terms;
- revises the time for development of a final punch list for larger projects from 90 days to 60 days;
- gives governmental entities flexibility to adopt procedures for the holding of less than 10 percentage retainage and/or incremental reduction of retainage pursuant to a schedule;
- allows claimants to make a written request for payment information to a general contractor;
- substantially changes the provisions that prohibit a claimant from initiating an action to recover retainage against the contractor or the payment bond until certain conditions are met, and tolls the statute of limitations to ensure that the time for filing suit does not expire;

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<sup>7</sup> Deborah E. Lawson, Executive Director.

- exempts from the retainage provisions of the bill construction services that are paid for with federal funds and are subject to grantor laws and regulations or requirements that are contrary to the provisions of the bill;
- exempts from the retainage provisions smaller projects of \$200,000 or less—these projects are typically short in duration and are often done with a purchase order rather than contract documents; and
- ensures that certain provisions of the bill do not affect construction projects that are pending approval by a local governmental entity or public entity, or to any project that was advertised for bid before the effective date of the bill.