

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 509  
**SPONSOR(S):** Reagan  
**TIED BILLS:**

Prompt Payment for Construction Services

**IDEN./SIM. BILLS:** SB 632

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Governmental Operations Committee</u>	<u>4 Y, 0 N</u>	<u>Luppert</u>	<u>Everhart</u>
2) <u>Local Government Council</u>	<u>7 Y, 0 N</u>	<u>Nelson</u>	<u>Hamby</u>
3) <u>State Administration Appropriations Committee</u>	<u>7 Y, 0 N</u>	<u>Dobbs</u>	<u>Belcher</u>
4) <u>State Administration Council</u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

This bill re-designates the "Florida Prompt Payment Act," which currently applies to local governments, as the "Local Government Prompt Payment Act," and creates a new "Florida Prompt Payment Act" to apply to state projects.

The bill reduces time frames during which contractors and subcontractors must issue payments to their subcontractors and suppliers. It also restricts the percentage (retainage) state and local governments may withhold from each payment to contractors during construction. Upon substantial completion of construction projects, the bill requires state and local governments to develop a list of items (a punch list) for final acceptance of construction services purchased.

This bill will have a minimal fiscal impact on governmental entities.

The bill provides an effective date of October 1, 2005.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

##### **Safeguard Individual Liberty**

This bill may limit the flexibility of contractors on public projects to negotiate the terms and conditions of their contracts.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Present Situation**

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

Part VII of ch. 218, F.S., known as the “Florida Prompt Payment Act,” was enacted in 1989, and applies to local governments. The Florida Prompt Payment Act states that it is the policy of this state 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;
- interest on late payments made by local governmental entities and their institutions and agencies; and
- a dispute resolution process for payment of obligations.

“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 subdivisions, or any office, board, bureau, commission, department, branch, division or institution thereof or any project supported by county or municipal funds. The act does not apply to community colleges.

The Florida Prompt Payment Act provides for timely payment for construction and non-construction services, procedures for calculation of payment due dates, payment of interest at the rate of one percent per month (or the rate specified by contract, whichever is greater) and resolution of disputes. Local governmental entities must provide payment for construction services no later than 20 business days after the date on which the invoice is received, or within 25 business days if the invoice is subject to agent approval. Current law allots 15 days for both contractors and subcontractors to pay downstream to their subcontractors and suppliers once they have received payment from local governments.

At present, Florida law does not address the prompt payment of construction services by state agencies.

##### ***Retainage***

Retainage is a common construction contracting practice whereby a certain percentage of payment is withheld by the project owner from the general contractor and, in turn, by the general contractor from the subcontractors, to ensure satisfactory completion of a project. Payments for construction services usually are made incrementally, with a certain percentage withheld. Retainage is established by contract between the contractor and the entity contracting for the project.

Current law does not provide a limit on the amount of retainage state or local governments may withhold from payments for construction services. The standard amount of retainage throughout the construction industry is 10 percent.<sup>1</sup>

## ***Public Works Projects***

Section 255.071, F.S., addresses payment and disputes between contractors, subcontractors and suppliers for public works projects. When contractors receive payments from the state or “any county, city or political subdivision of the state, or other public authority” for the construction or repair 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 a contractor fails to pay these obligations to the subcontractor or supplier within 30 days of the required payment date, the subcontractor or supplier is entitled to certain procedures and remedies.

## ***Bonds of Contractors on Public Buildings***

Payment and performance bonds are contracts in which a surety company is paid a premium by a principal, e.g., a general contractor, to stand in the place of the principal in the event of default either as to performance of the contract or as to payment of its subcontractors/suppliers.

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 or repair of a public building. 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.

## **Effect of Bill**

This bill revises the title of part VII, ch. 218, F.S., from the “Florida Prompt Payment Act,” to the “Local Government Prompt Payment Act.” This act applies strictly to local governments. The bill creates the “Florida Prompt Payment Act,” within ch. 255, F.S. This act applies strictly to state government. The provisions of this bill do not apply to existing construction contracts, contracts pending approval, or contracts advertised for bid on or before October 1, 2005.

## ***The Local Government Prompt Payment Act***

### **Definitions**

The bill deletes from the definition of “local governmental entity” any project which is “supported by county or municipal funds.” The definition of the term “vendor” is amended to specify that the term includes a person who provides waste-hauling services 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 all contractors performing construction services, not just those who are licensed under parts I and II of ch. 489, F.S.<sup>2</sup> A definition for the term “contractor” or “provider of construction services” also is added. These terms mean “any person who contracts directly with a local governmental entity to provide construction services.”

### **Timely payment for construction services**

The bill addresses the time period within which contractors and subcontractors must remit payment to their subcontractors and suppliers for construction services once the contractor has received payment from a local government for construction services. The bill reduces the period from 15 days to 10 days for contractors, and from 15 to seven days for subcontractors. Also, the bill deletes language which provides that, in the event of a dispute, the contractor or subcontractor may withhold the disputed portion of a payment.

### **Development of final punch list**

The bill creates a new section in the Local Government Prompt Payment Act which requires local governments to devise a list (generally known as a “punch list”) of items required to render the construction services purchased “complete, satisfactory, and acceptable.” The contract between the

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<sup>2</sup> Parts I and II of ch. 489, F.S., address regulation of construction contracting and electrical and alarm system contracting.

local governmental entity and a contractor must provide for this list. Timing for the development of the list is as follows:

- for construction projects having an estimated cost of less than \$10 million, within 30 calendar days upon reaching substantial completion; and
- for construction projects having an estimated cost of \$10 million or more, 30 calendar days, unless otherwise extended by contract not to exceed 60 calendar days, upon reaching substantial completion.

If the term “substantial completion” is not defined in the contract, the standard which is used is “upon reaching beneficial occupancy or use.” The list and time frame requirements also apply to contracts relating to construction services on more than one building or structure, or involving a multiphased project. Failure to include any corrective work or pending items on the list does not alter the responsibility of the contractor to complete all the purchased construction services as specified in the contract.

### Retainage

Once all items on the list have been completed, the contractor may submit a payment request for any retainage being withheld by the local government. If a good-faith dispute exists as to whether any items identified on the list have been completed, the local government is authorized to withhold up to 150 percent of the total costs to complete any such items. Warranty items may not affect the final payment of retainage.

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. However, if the contractor has failed to cooperate in the development of the list, failed to perform his or her contractual obligations, or if there is a good faith dispute, the local government is not required to make payment or process retainage.

The bill creates a limit on the amount of retainage that a local governmental entity may withhold from each progress payment. Until 50 percent of the contract value has been completed, a local government may not withhold more than 10 percent from a payment as retainage. After 50 percent completion of the construction services, the local government can withhold no more than five percent. Municipalities with a population of 25,000 or less, and counties with populations of 100,000 or less, are authorized to withhold retainage up to 10 percent until the project is completed and accepted by the local government.

For the last half of the project, a contractor may elect to withhold retainage from payments to its subcontractors at a rate higher than five percent, upon written notice. The amount to be withheld is to be determined on a case-by-case basis, and is based on the contractor’s assessment of the subcontractor’s performance.

After half of the project is completed, a contractor may submit a payment request for up to one-half of the retainage being held by a local government. Once the local government makes payment to the contractor, the contractor must remit payment in a timely fashion to his or her subcontractors and suppliers. “Timely,” as used in the bill, is not defined.

A local governmental entity is not required to pay or release any amounts that are the subject of a good-faith dispute, an action brought under s. 255.05, F.S.<sup>3</sup>, or the subject of a claim or demand. The retainage limits do not apply to federally funded projects or construction projects with a total cost of \$200,000 or less.

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<sup>3</sup> Pursuant to s. 255.05, F.S., claimants filing suit for recovery of retainage must take action within one year after the “performance of the labor or completion of delivery of the materials or supplies.”

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

The new Florida Prompt Payment Act created by the bill applies to the state and its various agencies, boards and commissions. The act corresponds to the current Florida Prompt Payment Act, and new provisions in the proposed Local Government Prompt Payment Act. The act also:

- Revises s. 255.071, F.S., to address payment of subcontractors, materialmen, and suppliers on construction contracts for public projects. This section currently provides that failure to pay any undisputed obligations for labor, services or materials within 30 days after such labor, services or materials are furnished and payment became due (whichever last occurs), entitles the person providing such labor, services or materials to procedures for settling disputes. The second deadline is changed, by reference, from 30 days to 10 days for contractors, and seven days for subcontractors. If a public entity disputes a portion of a payment request, the undisputed portion must be timely paid.
- Specifically excludes contracts or work performed for the Department of Transportation from the definition of “construction services.”
- Provides that payments for construction services not made within the established time period are subject to the interest rate specified in s. 215.422, F.S.<sup>4</sup> The bill requires that after July 1, 2006, such payments bear interest at the rate of one percent per month.<sup>5</sup>
- Requires that the public entity must submit a payment request to the Chief Financial Officer for payment no more than 20 days after receipt of the payment request.
- Addresses court costs and attorney’s fees in actions resulting from disputes over payment requests, but does not incorporate the notice of improper payment request provision nor the dispute resolution process provision of the current Florida Prompt Payment Act.
- Amends s. 255.05, F.S., to provide additional guidelines or restrictions for a subcontractor or supplier when making claims against a payment bond, by requiring that any notice of nonpayment served by a claimant who is not in privity with the contractor which includes sums for retainage must specify the portion of the amount claimed for retainage. Also, provides new language to prohibit a claimant (a subcontractor or supplier) from initiating an action for the sole purpose of recovery of retainage against the contractor or against the surety providing a payment or performance bond until certain conditions are satisfied. If none of these conditions can be satisfied and, consequently, an action for recovery of retainage cannot be instituted within a one-year limitation period, the limitation period is extended until 120 days after one of the conditions is satisfied.

### **C. SECTION DIRECTORY:**

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

Section 2: Revises s. 218.72 (2), (6), (7), and adds (10), F.S., to amend definitions.

Section 3: Amends s 218.735 (6), F.S., to reduce the time period for contractors and subcontractors to remit payment; Redesignates (7) as (9); Creates a new (7) to establish requirements for a final punch list; and Creates (8) to establish retainage cap and requirements/restrictions applying thereto.

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

Section 5: Amends s. 255.071(2) and (3) F.S., to add time limitations.

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

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<sup>4</sup> s. 215.422, F.S, refers to the rate established by the Chief Financial Officer pursuant to s. 55.03(1), F.S.

<sup>5</sup> Before January 1, 2007, interest rates are one percent per month to the extent that the Chief Financial Officer’s replacement project for the state’s accounting and cash management systems is operational for the particular affected public entity.

Section 7: Creates s. 255.073, F.S., to reduce the time period for public entities to remit payment, and address interest on late payments.

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 provide for mandatory interest charges.

Section 10: Creates s. 255.076, F.S., to provide for court costs and attorney's fees.

Section 11: Creates s. 255.077, F.S., to establish final punch list requirements, and payment of retainage.

Section 12: Creates s. 255.078, F.S., to provide for public construction retainage.

Section 13: Amends s. 255.05, F.S., to add time periods, and requirements for claimants filing suit.

Section 14: Amends s. 95.11, F.S., to change statutory reference.

Section 15: Creates unnumbered section to provide that the act does not apply to existing contracts.

Section 16: Provides for an effective date of October 1, 2005.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

None.

#### 2. Expenditures:

Minimal, but indeterminate. See D. Fiscal Comments..

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

None.

#### 2. Expenditures:

Minimal, but indeterminate. See D. Fiscal Comments..

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

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

### D. FISCAL COMMENTS:

The bill could have a fiscal impact on state and local governments. The expenditures could occur when filing suit to enforce the provisions of this bill<sup>6</sup> or from interest payments required when governments do not act in accordance with new timelines for payment of construction services.<sup>7</sup> Since the number of instances governments would fail to meet the established payment timelines cannot be predicted, neither can the amount of interest that would accumulate. Governments may also lose the ability to earn interest when conforming to the reduced payment timelines and the early payment of retainage

<sup>6</sup> Department of Management Services 2004 Substantive Bill Analysis

<sup>7</sup> Department of Management Services 2004 Substantive Bill Analysis

and reduction of retainage after 50-percent completion of the construction services. However, that value is not measurable.

Because the bill establishes a new rate of interest for late payment of construction services after July 1, 2006, the Department of Financial Services has estimated a cost of \$22,000 for modifying business documents, changing system programs, and testing program changes, as well as the number of work hours necessary to complete these changes.

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

The bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds. The bill does not reduce the percentage of a state tax shared with counties or municipalities. The bill does not reduce the authority that municipalities have to raise revenue.

##### 2. Other:

None

#### B. RULE-MAKING AUTHORITY:

None.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

##### **Drafting Issues**

While the term "vendor" is defined by the bill, it is not subsequently used in the bill.

##### **Other Comments**

The American Subcontractors Association of Florida<sup>8</sup> has stated that it believes 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 in order 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.

The Florida Department of Management Services states:<sup>9</sup>

- Contractors will have no incentive to complete any punch list items when they know that the State must pay them anyway under the revised provisions of s. 255.072 – 255.076, F.S. The public interest will have no leverage and contractors may find it to be more cost effective to give up the five percent retainage than to go back and correct extensive punch list items.
- 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.

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<sup>8</sup> Deborah E. Lawson, Executive Director

<sup>9</sup> Department of Management Services Substantive Bill Analysis

The **Office of Program Policy Analysis and Government Accountability**, an office of the Florida Legislature, stated in a December 2000 report: *Special Review: Inflexibility in Contracting and Retainage Practices Could Hurt Construction Industry*.<sup>10</sup>

- 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.
- 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.
- 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 recommended 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>11</sup> has observed that over the past four legislative sessions, various subcontractor professional associations and trade groups have been working to amend existing laws relating to the policies and procedures affecting 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 a punch list, 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 League's 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 typically is 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.

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<sup>10</sup> OPPAGA *Special Review: Inflexibility in Contracting and Retainage Practices Could Hurt Construction Industry*, Report No. 00-26, December 2000.

<sup>11</sup> C. Scott Dudley, Senior Legislative Advocate, Florida League of Cities.



- 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>12</sup> has indicated that it does not oppose the bill, as currently written.

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

None.

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<sup>12</sup> Eric Poole, Governmental Relations, Florida Association of Counties.