

BILL ANALYSIS

Bill No: AB 1705

SENATE COMMITTEE ON GOVERNMENTAL ORGANIZATION
Senator Lou Correa, Chair
2013-2014 Regular Session
Staff Analysis

AB 1705 Author: Williams
As Amended: March 28, 2014
Hearing Date: June 10, 2014
Consultant: Paul Donahue

SUBJECT

Public contracts: Retention of contract payments

DESCRIPTION

Limits the circumstances under which public agencies may withhold more than 5% of total payment amounts for time and materials on substantially complex public works projects. Specifically, this bill:

- 1) Requires a state agency that plans to withhold more than 5% of the contract price by making a finding, prior to the bid, that a project is substantially complex, to include in bid documents an explanation of the basis for that finding, and the actual amount above 5% to be retained by the agency during the project.
- 2) Specifies that if a local government agency intends to require a retention amount higher than 5% on a specific project, it must make the findings that the project is substantially complex during a properly noticed and scheduled public hearing prior to the bid.
- 3) Declares that public projects are not substantially complex if they are maintenance projects, or are projects that are regularly, customarily, or routinely performed by the agency or by licensed contractors.
- 4) Provides that in a contract between the original contractor and a subcontractor, and in a contract between a subcontractor and any subcontractor, the percentage of the retention proceeds withheld shall not exceed the percentage specified in the contract between the public agency and the original contractor.

EXISTING LAW

- 1) Prohibits state and local public agencies from retaining more than 5% of a contract price until final completion of a project, unless the public agency finds that the project is substantially complex pursuant to specified circumstances.

- 2) Authorizes a public entity to withhold more than 5% of the contract price if a project is deemed to be substantially complex under specified circumstances.
- 3) Prohibits retention amounts between contractors and subcontractors from exceeding the retention percentage specified in the contract between the public agency and the original contractor.
- 4) Repeals these provisions governing retention proceeds on January 1, 2016.

BACKGROUND

1) Purpose : The author states that AB 1705 will clarify what a substantially complex project is as it relates to retention proceeds in public works projects. In the event that a project is deemed substantially complex, AB 1705 requires that details explaining the basis of the finding be included in the bid documents.

In 2011, SB 293 (Padilla) limited the amount of retention proceeds to 5% of the costs of the contract, unless a project was substantially complex. According to the author and the sponsors of AB 1705, soon thereafter, many public entities, particularly school districts, started adopting resolutions setting forth the methodology by which ALL construction future projects will be designated as substantially complex. The author states that this practice is inconsistent with the original intent of SB 293 (Padilla), and unfairly exploits what was meant to be a reasonable exemption to the law.

2) Retention proceeds : In California and many other states, <1> a public entity is entitled to withhold from payment a specified amount so that the public entity can maintain financial control of the project. In 2011, special retention procedures were enacted into law in California, and public entities cannot now retain more than 5% of the costs of a contract, subject to the "substantially complex" exception. <2>

Before this law passed limiting retention on public works projects to 5%, the usual standard for public entities was 10%, although this was not set by statute. The only identified exception to the 5% retention limit is when a public entity approves a finding that a project is substantially complex during a properly noticed and regularly scheduled public meeting prior to bidding the project. In that case, retention proceeds may exceed 5%. Whether a project is substantially complex for purposes of requiring retention in excess of 5% must be analyzed and approved on a project-by-project basis. The finding and the designated retention amount must be included in the project's bid documents. This law remains in effect until January 1, 2016 and cannot be waived by agreement. It should be noted that the 5% limit on retention

proceeds in Public Contract Code § 7201 does not limit a public entity's ability to withhold funds for other purposes, including withholding 150% of the value for disputed work.

3) Overuse of the "substantially complex" exception :

According to the author and the supporters of AB 1705, many local public entities, particularly school districts, have circumvented existing law by adopting resolutions containing boilerplate language deeming essentially every school district project as a substantially complex one.

<1> The following states have capped retention rates at 5%:
Arizona, Delaware, Hawaii, Idaho, Iowa, Maine, Massachusetts, Minnesota, Mississippi, Missouri, Montana, New York (for bonded contractors), Oregon, Rhode Island, Utah, Virginia, and Washington.

<2> Public Contract Code § 7201

For example, supporters furnished a sample resolution for use by school districts in which substantially complex projects are those which are, among other things, subject to design approval by the State Architect (which happens to be every school construction or modification project), subject to higher safety standards than other public works projects (any maintenance, construction or modification done at school district property), and the like.

In a specific instance, Newport Mesa Unified adopted a resolution designating all of its school construction projects as substantially complex ones because they are, among other things, "designed to higher safety standard, including seismic, fire protection and ADA compliance." These resolutions are then routinely cited by the school board in advance of the bid in order to form a basis to support a 10% retention amount included on all of its school construction projects.

4) Support : The sponsors of the bill complain that the actions of public agencies have undermined the law, which is intended to apply to all projects unless a project is exceptionally unique, but the agencies and their attorneys have instead turned this substantially complex "exception" into the rule, and are routinely deeming simple projects "substantially complex" in order to withhold 10% instead of 5%. Supporters believe that AB 1705 will remedy this situation because it requires public entities to explain the reasons why a project is complex, as well as the project's retention rate.

5) Opposition : The opponents say that the construction contract companies should be focusing solely on school projects, where the substantially complex exception rule

has apparently been troublesome for construction companies. They would prefer this approach to one that seeks to define "substantially complex" by what is isn't - which is a counterintuitive approach that will only lead to additional litigation and further hinder the decisions that local agencies can make on behalf of their taxpayers and ratepayers.

6) Suggested amendment : In order to avoid another contentious fight in a little more than a year from now about retention proceeds, and the substantially complex exception to the 5% retention rule, the Committee or the author should amend AB 1705 to delete or extend the January 1, 2016 sunset clause that now exists in Public Contract Code § 7201.

PRIOR/RELATED LEGISLATION

SB 293 (Padilla), Chapter 700, Statutes of 2011. Among other things, prohibits a public entity from retaining more than 5% of a contract price until final completion and acceptance of a project, but allows retention of higher amounts when a project is deemed "substantially complex."

SB 802 (Leno), 2009-2010 Session. Would have prohibited the Department of General Services (DGS) from withholding more than 5% of a contract price until final completion and acceptance of the project. Would also have prohibited retention proceeds from exceeding 5% percent of a payment for all contracts entered into between an original contractor and a subcontractor, and between all subcontractors. (Vetoed)

SB 629 (Liu), 2009-2010 Session. Would have prohibited withholding of retention proceeds in private works of improvements from exceeding 5% of the amount otherwise due under the contract. (Died on Senate Inactive File)

AB 396 (Fuentes), 2009-2010 Session. Would have reduced the allowable retention proceeds on public works contracts to 5%. (Held in Assembly Appropriations)

SB 593 (Margett), Chapter 341, Statutes of 2008. Prohibits the Department of Transportation from withholding retention proceeds when making progress payments to a contractor for works performed on a transportation project. Repealed effective 1/1/2014.

SB 619 (Migden), 2007-08 Session. Would have prohibited retention proceeds from exceeding 5% of a payment for all contracts between a public entity and an original contractor and a subcontractor, and between all subcontractors. The bill would also have prohibited DGS from withholding more than five percent of a contract price until final completion and acceptance of the project. (Died on the Assembly Floor)

SUPPORT:

Air Conditioning & Refrigeration Contractors Association
Air Conditioning Sheet Metal Association
Air Conditioning Trade Association
American Subcontractors Association California
Associated Builders and Contractors - San Diego Chapter
Building Industry Credit Association
California Association of Sheet Metal & Air Conditioning
Contractors
California Chapter, American Fence Association
California Chapters of the National Electrical Contractors
Association
California Concrete Contractors Association
California Fence Contractors' Association
California Landscape Contractors Association
California Legislative Conference, Plumbing, Heating and
Piping Industry
California State Association of Electrical Workers
California State Council of Laborers
California State Pipe Trades Council
Flasher Barricade Association
Marin Builders Association
Plumbing-Heating-Cooling Contractors Association of
California
Sheet Metal and Air Conditioning Contractors' National
Association
State Building and Construction Trades Council
United Contractors
Western Electrical Contractors Association
Western State Council of Sheet Metal Workers

OPPOSE:

Association of California Water Agencies
El Dorado Irrigation District
La Puente County Water District
Newhall County water District
Pico Water District
Rowland Water District

FISCAL COMMITTEE: None