

Approved: 3/1/10
Date

MINUTES OF THE HOUSE COMMERCE AND LABOR COMMITTEE

The meeting was called to order by Chairman Steve Brunk at 9:05 a.m. on January 28, 2010, in Room 784 of the Docking State Office Building.

All members were present except:

Representative Dan Kerschen- excused
Representative Bill Wolf- absent

Committee staff present:

Art Griggs, Office of the Revisor of Statutes
Renaë Jefferies, Office of the Revisor of Statutes
Jerry Donaldson, Kansas Legislative Research Department
Dennis Hodgins, Kansas Legislative Research Department
Stephen Bainum, Committee Assistant

Conferees appearing before the Committee:

Bill Miller, American Sub-Contractors Association
Ken Keller, Retired Controller of Western Extralite Company
Eric Stafford, Associated General Contractors of Kansas
Neal Angrisano, Johnson County Government
Mike Taylor, Unified Government of Wyandotte County
Robert Vancrum, Valley School District
Tom Krebs, Kansas Association of School Districts
Eric King, Kansas Board of Regents
Diane Gjerstad, Wichita Public Schools
Trudy Aaron, American Institute of Architects

Others attending:

See attached list.

HB 2238 **Amending the fairness in private construction contract act and the fairness in public construction contract act regarding retainage.**

Art Griggs read an explanation of the changes to the statutes in the bill (Attachment 1).

Bill Miller, addressed the committee as a proponent of the bill (Attachment 2). He said that the bill was heard last year and that they have now solved most of the problems. The purpose of the bill is to allow contractors and subcontractors to be able to use the funds that they have earned for operating capital.

Representative Brunk commented that the subcontractors and contractors had worked out their differences in the bill during the summer. However those meetings did not include the owners.

Representative Schwab asked that if they can agree on the legislation then why can't they agree in their contracts. Bill said that at the subcontractor level you have no ability to be involved with an agreement with an owner or general contractor.

Representative Quigley asked if they had three options, 10%, 5% or alternate security. Bill said no, the bill requires 5% retainage unless there is good reason to increase it to 10%.

Representative Ruiz asked of the owner always knew the subcontractors. Bill said that depended on the owners.

Representative Suellentrop asked what the customary retainage was now. Bill replied that it was 10% now and they wanted to reduce it to 5% where most of the other states were.

Ken Keller presented testimony as a proponent of the bill (Attachment 3). He said that the purpose of the bill is to bring Kansas into the 20th century. A summary of the retainage laws in all 50 states reports that 30 states have retainage of 5% or less. A Clemson University study discovered that the time lag for the retainage to

1/28

CONTINUATION SHEET

Minutes of the House Commerce and Labor Committee at 9:05 a.m. on January 28, 2010, in Room 784 of the Docking State Office Building.

be paid after the completion of the job was 167 days. This legislation would correct this.

Representative Pottorff asked if the Clemson study was broken down by states. Ken replied that it was a national average.

Eric Stafford presented testimony as a proponent of the Grange amendment to **HB 2238 (Attachment 4)**. He also presented an AGC Balloon Amendment adding the word "irrevocable" on page 1, line 16 and adding the sentence "Provided however, "Alternate Security" shall not include performance and payment bonds." at the end of page 1, line 18 (**Attachment 5**). We feel that we came up with a good compromise with language in place that protects both the owner and the general contractor.

Representative Grange asked who gives the final authority for the subcontractor to get his money. Eric replied that it was the architect. And who does he work for? The owner. It's all about cash flow and keeping good subs in business.

Representative Grant asked what the procedure was for raising the retainage to 10%. Eric replied that Section 2 required the owner or general contractor to determine if there was a problem requiring a higher rate of retainage.

Neal Angrisano, The Board of County Commissioners of Johnson County presented testimony in opposition to **HB 2238 (Attachment 6)**. He said that these terms are best determined between the parties to the contract. Alternative security in lieu of retainage has a number of problems.

Representative Suellentrop asked if substantial completion applied to each subcontractor or the total project. Neal said that it was usually when the building was ready for the owner to use for its intended purpose.

Mike Taylor, Unified Government of Wyandotte County gave written only testimony in opposition to **HB 2238 (Attachment 7)**. It indicated that the bill would result in owners reluctance to grant substantial completion and would cause more jobs to end in dispute.

Robert J. Vancrum, Blue Valley School District testified as an opponent of **HB 2238 (Attachment 8)**. For the most part the problem is different interpretations of when "substantial completion" has occurred.

Tom Krebs, Kansas Association of School Boards, appeared in opposition to **HB 2238 (Attachment 9)**. The bill will reduce the leverage a school district has in ensuring work contracted is done in a timely and appropriate fashion.

Eric King, Kansas Board of Regents, gave written only testimony in opposition to **HB 2238 (Attachment 10)**.

Diane Gjerstad, Wichita Public Schools, presented testimony opposed to **HB 2238 (Attachment 11)**. This bill will place restrictions on an owner's ability to create adequate assurances the project will be completed to the satisfaction of the owner.

Representative Suellentrop asked how subcontractors are impacted by change orders. Diane said that was controlled by a contract between the General and subcontractors.

Representative Brunk asked how long building projects take. There will be quick projects that take about 6 months and large projects that take about three years.

Trudy Aaron, American Institute of Architects, testified in opposition to **HB 2238 (Attachment 12)**. AIA opposes the bill because it removes most incentives for the completion of the work by contractors and subcontractors. The Architects were surprised that they were not invited to any of the meetings called to work out the differences on the bill.

Representative Worley asked if their opposition was to the public section or to both. Trudy replied that it was to both. Have your members testified in the other 30 states where retainage has been reduced to 5% in the

CONTINUATION SHEET

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vast majority of the states? Trudy replied that she did not know.

Representative Grange commented about contacting different groups about changes in the bill. He asked if the Architects had ever contacted the subcommittee. Trudy said they assumed they were welcome to the meeting if they were invited.

Anyone left on the list to testify can come prepared to testify Monday morning at 9:00 a.m.

The next meeting is scheduled for February 1, 2010.

The meeting was adjourned at 10:35 a.m.

COMMERCE & LABOR COMMITTEE

DATE: 1-28-10

| NAME | REPRESENTING |
|------------------|--|
| Bill Miller | AMERICAN SUBCONTRACTORS ASSOC. |
| Ken Keller | American Subcontractors (Western Extra Lite) |
| Tom Burgess | ASA |
| Denny Burgess | ASA |
| Scott Heidner | ACEC |
| Diane Gjerstad | USD 259 |
| Megan Bottenberg | KDOL |
| Mark Schweiker | Westar |
| DARRELL ELLIS | WESTAR |
| Phyllis fast | DEM - state of KS |
| TED HENKEL | CAPITOL STRATEGIES. |
| Kelli Kirkwood | KLA |
| Bob Vanerum | Blue Valley, USD 229 |
| Tom Krebs | KASB |
| Stuart Little | Johnson County |
| Berend Koops | Hein Law Firm/ABC |
| Dane HOLTMAUS | KEC |
| Carey Peterson | AGC of KS |
| Eric Skifford | AGC of KS |
| Dan Morgan | Builders' Assn. / KC AGC |
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Office of Revisor of Statutes
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MEMORANDUM

To: House Committee on Commerce and Labor
From: Renae Jefferies, Assistant Revisor
Date: January 28, 2010
Subject: HB 2238

HB 2238 amends statutes relating to retention in public and private construction contracts.

Section 1 amends K.S.A. 16-1802 of the Kansas fairness in private construction contract act by adding a definition for alternate security and substantial completion and amending the definition of retention.

Alternate security means "a retainage bond, bank letter of credit, certificate of deposit, cash bond or other mutually acceptable items of value equal to or exceeding the amount of retained funds" by the owner, contractor or subcontractor.

Substantial completion means, "for the purpose of release of retention, the stage of a construction project where the project, or a designated portion thereof, is sufficiently complete in accordance with the contract so that portion thereof, can be used for its intended purpose."

The definition for retainage "or retention" was amended to mean money earned by a contractor or subcontractor but withheld to ensure proper performance by the contractor or subcontractor "for the remainder of such contractor's or subcontractor's work on the project."

Section 2 amends K.S.A. 16-1804 of the Kansas fairness in private construction contract act to require that an owner, contractor or subcontractor:

- (a) Shall not withhold more than 5% of the amount of a contract as retainage;
- (b) may withhold retained amounts incrementally from each monthly payment as 10% of the first 50% of the contract or as 5% of the total contract;
- (c) shall release retained amounts within 45 days after substantial completion of the contract as a part of the regular payment cycle;

(d) shall not withhold more than 150% of the value of incomplete work provided that the incomplete work is not the fault of the subcontractor. Any amounts retained for incomplete work shall be paid within 45 days after work is completed as part of the regular payment cycle; and

(e) shall not retain any funds from any party to the contract who has provided a 100% payment/performance bond for that party's work on the project.

Additionally, a contractor or subcontractor may provide alternate security at any stage of the contract. If the alternate security is provided before work has begun, no retainage shall be withheld. If the alternate security is provided after the first payment cycle, any retained shall be paid with the next regular payment.

Section 3 amends K.S.A. 16-1902 of the Kansas fairness in public construction contract act which mirrors the language in K.S.A. 16-1802 with the exact amendments that were provided in section 1 of the bill.

Section 4 amends K.S.A. 16-1904 of the Kansas fairness in public construction contract act with amendments similar to the amendments in section 2 of the bill.

The effective date of this bill is upon publication in the statute book.

The fiscal note shows no fiscal effect on the state general fund.

BUILDING ERECTION SERVICES COMPANY

15585 S. KEELER • P.O. BOX 970 • OLATHE, KANSAS 66051-0970
(913) 764-5560 • FAX (913) 764-2317

January 28, 2010

Kansas House Committee on Commerce and Labor
Chairman Steven Brunk and Vice Chairman John Grange

My name is Bill Miller. I am here representing myself and the American Subcontractors Association. I am the owner of Building Erection Services Co. with offices in Olathe and Topeka, Kansas, and in St. Joseph, Mo. ASA is an association of subcontractors and suppliers in Western Missouri and Eastern Kansas. I am speaking in favor of HB2238.

Retainage is a portion of money that has been earned by the contractor or subcontractor that is withheld from the regular monthly payment. It is withheld to ensure future performance by the party that the funds were withheld from as a form of protection for the owner or contractor. It is important to realize the distinction between future performance and warranty work.

Webster's definition of the word warranty is "A written guarantee of the integrity of a product and the maker's responsibility for the repair or replacement of defective parts."

Retainage by definition in Kansas law is as written in HB2238. Money earned by a contractor or subcontractor but withheld to ensure proper performance by the contractor or subcontractor *for the remainder of such contractor's or subcontractor's work on the project.* THIS HAS NOTHING TO DO WITH WARRANTY.

This distinction is very important. The warranty is a continuing obligation for a specific period of time AFTER THE PROJECT IS COMPLETED. Retainage should be paid AFTER THE WORK IS COMPLETED not months or in extreme cases, years after the work is done.

There are a number of compelling reasons that the ongoing problem of prolonged withholding of the contractor or subcontractors money needs to be corrected by this Legislature. I will outline the most obvious.

1. Subcontractors perform 85% or more of the work in today's construction market. As a result, the financial burden imposed by retaining funds that have been earned is disproportionately imposed on subcontractors. Especially on those that finish early in the project. Banks will not loan on retained funds. A profit margin for subs is in the range of 4% to 6% in good times. In difficult times such



Certified Steel Erection

House Commerce & Labor
Date: 1-28-10
Attachment # 2

as we are currently in, the margin is less and often negative. Lack of cash flow is the number one cause of subcontractor failure.

2. Suppliers do not allow retainage. A sub or general contractor is required to pay the supplier in 30 days or they are placed on COD or denied material or supplies at all. This puts the sub or GC in the position of financing the project for no compensation and forces them to borrow from their operating capital line in order to proceed with the work.

3. Lien law in Kansas requires filing within 90 days. An extension for an additional 60 days is granted if a notice is properly filed with the county. A lien must then be filed or lien rights are lost. The lien must be enforced within one year from filing or again, lien rights are lost. The early finishing subs are forced into the position of filing suit against their contractor before the project is completed, and the contractor has not yet been paid. Just the filing creates animosity between the owner, contractor and the sub.

Passage of HB 2238 will solve most of the problems that we in the construction industry have with the abusive practice of retainage. 74% of the states have decreased retainage to 5% or less with one at 0% and seven with 2.5%. Kansas is far behind in correcting this problem that is only getting worse with subcontractors suffering the brunt of the abuse.

HB2238 still provides the protection for the owner and general contractor that retainage was designed originally to do. It allows 5% retainage that is the high end compared with 74% of the other states that are at 5% or less. This is more than adequate in that subs are no less than 30 days behind in receiving payment for their work based upon the payment cycle required under Kansas law. HB2238 provides for 2 methods of withholding so long as no more that 5% of the total contract is withheld and no more than 10% of one any payment .

HB2238 establishes alternatives for the subcontractors that protect cash flow and in many cases, assure that the retained funds are not used to fund under funded projects or simply used by owners to finance the project.

An alternative security may be used in lieu of retention. This still provides the same protection that retained funds would, but prevents the abusive practice of holding retainage long past the completion of the work for which funds were withheld.

It is interesting to note that the Federal Government does not hold retainage from either contractor or sub on their construction projects. Federal Acquisition Regulation 32.103 says that "Retainage should not be used as a substitute for good contract management, and the contracting officer should not withhold funds without cause."

AGC 200(2000) General Conditions Between the Owner and Contractor, sections 9.2.4 and 9.6.4 state that "once an early finishing sub has satisfactorily completed its work, the owner may release retainage for that portion of the Work. After the project is 50% complete, the owner is to withhold no further retainage. Upon substantial completion, owner pays the retainage balance LESS 200% OF ESTIMATED COST TO COMPLETE ALL WORK. In lieu of retainage, the contractor may furnish securities, with interest on these going to the contractor."

The national trend is to reduce retainage and actually do away with retainage all together in some cases. No other industry has this awful practice.

There is no negative fiscal note to the State. It can only be positive if businesses survive and keep people employed.

I ask that you recommend this bill for passage.

Bill Miller

Government Relations Chair
American Subcontractors Association
President
Building Erection Services Co.

Jan. 28, 2010

To: The House Commerce and Labor Committee
Chairman Steven Brunk and Vice Chairman John Grange

Mister Chairman

Thank you for allowing me to address you today in support of **HB2238** relating to retainage on public and private construction jobs. I'm **Ken Keller**, retired Controller of Western Extralite Company. I served in that capacity for 21 years. Western Extralite Company is an electrical supply house with a large portion of its business derived from the construction industry. We have 19 locations, 8 of which are in Kansas. In addition I represent the American Subcontractors Association, National Association of Credit Managers, the Electric League of Greater Kansas City and other interested parties.

The purpose of this legislation is to bring Kansas into the 21st century as it relates to our retainage laws. But first, for those on the committee who may not be familiar with the construction industry, retainage is an amount withheld from the contractor and subcontractors on monies earned on the construction project. The process is: monthly, the subcontractor submits a bill for work performed in the current month. These requests for payment are approved and paid less a percentage, normally 10%. This 10%, is retained by the owner and general contractor as leverage to insure your work is completed on time. When the job is completed the retainage is paid to the subcontractor.

This practice as it is currently being used in Kansas is antiquated. I have a Summary of Retainage Laws In the Fifty States published by the National American Subcontractors Association, which reports over 30 states that have their retainage fixed at 5% as we are proposing in this bill or less. One state has excluded this practice altogether. Why do we care? First, many of the jobs are taken at less than 10% profit so the subcontractor is losing money until he receives his retainage. His monthly payout is greater than the money he receives. To handle this many subcontractors have operating loans from their bank to cashflow the job. The bank will loan you money as long as you have adequate collateral to support the loan. The main asset used to collateralize your loan is your accounts receivable. The problem is the bank won't let you use receivables over 90 days old as collateral. They question their collectability. Most of your retainage is over 90 days old and can't help you with your cashflow. Reducing the retainage to 5% as proposed will be an enormous help.

Allowing you to use an alternative security in lieu of cash retainage would be an even larger help. This would provide the same protection but not tie up your working capital. The entire amount of the monthly request would be paid 100% and the general and sub contractors could cover their cost on an ongoing basis without having to borrow money to do so thus reducing the cost of the job to the owner and himself. Currently thirteen states provide for this solution.

A few years ago Clemson University did a nationwide study on retainage and discovered the time lag for the final retainage figure to be paid from the completion of the job was 167 days, and 10.4% was not paid in its entirety or at all. This is grossly unfair and needs to be corrected.

Our proposed legislation would correct this. Retainage would be payable in the normal payment cycle within 30 days of substantial completion. This would be subject to interest at 18% per annum from the due date.

I urge your support in correcting these problems. Passage of HB2238 will accomplish that.

Kenneth R Keller
Retired Controller
Western Extralite Company

House Commerce & Labor

Date: 1-28-10

Attachment # 3



Building a Better Kansas Since 1934
200 SW 33rd St. Topeka, KS 66611 785-266-4015

**TESTIMONY OF
ASSOCIATED GENERAL CONTRACTORS OF KANSAS
BEFORE HOUSE COMMITTEE ON COMMERCE & LABOR**

HB 2238

January 28, 2010

By Eric Stafford, Associated General Contractors of Kansas, Inc.

Mister Chairman and members of the committee, my name is Eric Stafford. I am the Director of Government Affairs for the Associated General Contractors of Kansas, Inc. The AGC of Kansas is a trade association representing the commercial building construction industry, including general contractors, subcontractors and suppliers throughout Kansas (with the exception of Johnson and Wyandotte counties).

The AGC of Kansas supports the Grange amendment to House Bill 2238 and asks that you recommend it favorably for passage.

Last year at this time, AGC opposed HB 2238 and requested that the committee delay action over the summer months to allow interested parties to try to work out an agreement outside of the statehouse. After several rounds of negotiations between AGC and ASA members, AGC is pleased to report that a compromise was reached.

AGC respectfully asks for your support of the Grange amendment to HB 2238. This language offers protections for both the owner and the general contractor with regard to retention and alternate securities, while also offering assistance to pay subcontractors retainage in a fair and timely manner.

AGC does have an additional balloon amendment it would like the committee to consider that makes two small changes. ASA has seen these changes and has stated they have no objection to the AGC balloon.

Again, the AGC of Kansas respectfully requests that you recommend HB 2238 with the Grange and AGC amendments favorably for passage. Thank you for your consideration.

House Commerce & Labor
Date: 1-28-10
Attachment # 4

AGC Balloon
Amendment
1/28/10

AN ACT concerning construction contracts; relating to retention in public and private construction contracts; amending K.S.A. 16-1802, 16-1804, 16-1902 and 16-1904 and repealing the existing sections.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 16-1802 is hereby amended to read as follows:
16-1802. As used in this act:

(a) ***“Alternate security” means a retainage bond, an irrevocable bank letter of credit, certificate of deposit, cash bond or other type of asset or security of value equal to or exceeding the amount of retained funds. Provided however, “Alternate Security” shall not include performance and payment bonds.***

(b) *“Construction” means furnishing labor, equipment, material or supplies used or consumed for the design, construction, alteration, renovation, repair or maintenance of a building, structure, road, bridge, water line, sewer line, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation.*

(c) *“Contract” means a contract or agreement concerning construction made and entered into by and between an owner and a contractor, a contractor and a subcontractor or a subcontractor and another subcontractor.*

(d) *“Contractor” means a person performing construction and having a contract with an owner of the real property or with a trustee, agent or spouse of an owner.*

(e) *“Owner” means a person who holds an ownership interest in real property.*

(f) *“Person” means an individual, corporation, estate, trust, partnership, limited liability company, association, joint venture or any other legal entity.*

(g) *“Retainage” or “retention” means money earned by a contractor or subcontractor but withheld to ensure proper performance by the contractor or subcontractor.*

(h) *“Subcontractor” means any person performing construction covered by a contract between an owner and a contractor but not having a contract with the owner.*

(i) ***“Substantial completion” means the stage of a construction project where the project or a designated portion thereof, is sufficiently complete in accordance with the contract, so that the owner can occupy or utilize the constructed project for its intended use.***

Sec. 2. K.S.A. 16-1804 is hereby amended to read as follows:
16-1804. (a) ***Retainage shall not exceed five percent of the value of the contract or subcontract unless the Owner, Architect or General Contractor determine that a higher rate of retainage is required to ensure performance of the contract. Retainage, however, shall not exceed ten percent of the value of the contract or subcontract.***

(b) If the General Contractor or Subcontractor has failed to meet the terms of the contract, is not performing according to schedule, there is a problem with workmanship or other issues, the Owner and Architect may increase retainage up to 10%.

(c) An owner must release the retainage on any undisputed payment due on a construction project within 30 days after substantial completion of the project; however, if any subcontractor is still performing work on the project under its subcontract, an owner may withhold that portion of the retainage attributable to such subcontract until 30 days after such work is completed.

(d) An owner, contractor or subcontractor shall not withhold more than 150% of the value of incomplete work provided that the incomplete work is due to no fault of the subcontractor. Any amounts retained for incomplete work shall be paid within 45 days after completion of the work as a part of the regular payment cycle.

(e) Prior to commencement of work, a General Contractor or Subcontractor may provide an alternate security in lieu of retainage.

(f) If a General Contractor or Subcontractor requests the use of an alternate security, as defined in section 1(a) above, in lieu of retainage one must be accepted. However, the Owner or General Contractor who would otherwise withhold the retainage shall have the right to determine which type of alternate security, as defined in section 1(a) above, shall be accepted.

(g) An owner, contractor or subcontractor may withhold no more than 10% retainage from the amount of any undisputed payment due.

(h) If an owner, contractor or subcontractor fails to pay retainage, if any, pursuant to the terms of a contract for private construction or as required by this act, the owner, contractor or subcontractor shall pay interest to the contractor or subcontractor to whom payment was due, beginning on the first business day after the payment was due, at a rate of 18% per annum.

(i) Nothing in this section shall prevent early release of retainage if it is determined by the owner, the contractor and the project architect or engineer, that a subcontractor has completed performance satisfactorily and that the subcontractor can be released prior to substantial completion of the entire project without risk or additional cost to the owner or contractor. Once so determined, the contractor shall request such adjustment in retainage, if any, from the owner as necessary to enable the contractor to pay the subcontractor in full, and the owner shall, as part of the next contractual payment cycle, release the subcontractor's retainage to the contractor, who shall, as part of the next contractual payment cycle, release such retainage as is due to the subcontractor.

(j) An Owner, Contractor or Subcontractor may withhold retained amounts from each monthly payment as 10% of the first 50% of the contract or as 5% of the total contract.

Sec. 3. K.S.A. 16-1902 is hereby amended to read as follows: 16-

1902. As used in this act:

47 (a) *“Alternate security” means a retainage bond, bank letter of credit, certificate of deposit, or cash bond or other type of asset or security of value equal to or exceeding the amount of retained funds.*

(b) *“Construction” means furnishing labor, equipment, material or supplies used or consumed for the design, construction, alteration, renovation, repair or maintenance of a building, water or waste water treatment facility, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation of a building. “Construction” shall not mean the design, construction, alteration, renovation, repair or maintenance of a road, highway or bridge.*

(c) *“Contract” means a contract or agreement concerning construction made and entered into by and between an owner and a contractor, a contractor and a subcontractor or a subcontractor and another subcontractor.*

(d) *“Contractor” means a person performing construction and having a contract with an owner of the real property or with a trustee or agent of an owner.*

(e) *“Owner” means a public entity that holds an ownership interest in real property.*

(f) *“Public entity” means the state of Kansas, political subdivisions, cities, counties, state universities or colleges, school districts, all special districts, joint agreement entities, public authorities, public trusts, non-profit corporations and other organizations which are operated with public money for the public good.*

(g) *“Retainage” or “retention” means money earned by a contractor or subcontractor but withheld to ensure timely performance by the contractor or subcontractor.*

(h) *“Subcontractor” means any person performing construction covered by a contract between an owner and a contractor but not having a contract with the owner.*

(i) *“Substantial completion” means the stage of a construction project where the project or a designated portion thereof, is sufficiently complete in accordance with the contract, so that the owner can occupy or utilize the constructed project for its intended use.*

(j) *“Undisputed payment” means payments which all parties to the contract agree are owed to the contractor.*

Sec. 4. K.S.A. 16-1904 is hereby amended to read as follows: 16-1904. *(a) Retainage shall not exceed five percent of the value of the contract or subcontract unless the Owner, Architect or General Contractor determine that a higher rate of retainage is required to ensure performance of the contract. Retainage, however, shall not exceed ten percent of the value of the contract or subcontract.*

(b) If retainage has been set at 5%, and the General Contractor or Subcontractor has failed to meet the terms of the contract, is not performing according to schedule, shows poor workmanship or other issues, the Owner and Architect may increase retainage up to 10%.

(c) An owner, contractor or subcontractor shall not withhold more than 150% of the value of incomplete work provided that the incomplete work is due to no fault of the subcontractor. Any amounts retained for incomplete work shall be paid within 45 days after completion of the work as a part of the regular payment cycle.

(d) Prior to commencement of work, a General Contractor or Subcontractor may provide an alternate security in lieu of retainage.

(e) If a General Contractor or Subcontractor requests the use of an alternate security, as defined in section 1(a) above, in lieu of retainage one must be accepted. However, the Owner or General Contractor who would otherwise withhold the retainage shall have the right to determine which type of alternate security, as defined in section 1(a) above, shall be accepted.

(f) An Owner, Contractor or Subcontractor may withhold retained amounts from each monthly payment as 10% of the first 50% of the contract or as 5% of the total contract.

(g) An owner, contractor or subcontractor must release the retainage on any undisputed payment due on a construction project within 30 days after substantial completion of the project; however, if any subcontractor is still performing work on the project under its subcontract, an owner may withhold that portion of the retainage attributable to such subcontract until 30 days after such work is completed.

(h) If an owner, contractor or subcontractor fails to pay retainage, if any, pursuant to the terms of a contract for public construction or as required by this act, the owner, contractor or subcontractor shall pay interest to the contractor or subcontractor to whom payment was due, beginning on the first business day after the payment was due, at a rate of 18% per annum.

(i) Nothing in this section shall prevent early release of retainage if it is determined by the owner, the contractor and the project architect or engineer, that a subcontractor has completed performance satisfactorily and that the subcontractor can be released prior to substantial completion of the entire project without risk or additional cost to the owner or contractor. Once so determined, the contractor shall request such adjustment in retainage, if any, from the owner as necessary to enable the contractor to pay the subcontractor in full, and the owner shall, as part of the next contractual payment cycle, release the subcontractor's retainage to the contractor, who shall, as part of the next contractual payment cycle, release such retainage as is due to the subcontractor.

Sec. 5. K.S.A. 16-1802, 16-1804, 16-1902 and 16-1904 are hereby repealed.

Sec. 6. This act shall take effect and be in force from and after its

publication in the statute book.



**Testimony Before the
House Committee on Commerce and Labor**

In Opposition to House Bill 2238

**Presented on Behalf of
The Board of County Commissioners
of Johnson County, Kansas**

**By Neal Angrisano, AIA
Deputy Director of Facilities**

January 28, 2010



Good Morning, my name is Neal Angrisano. I am the Deputy Director of Facilities for Johnson County Government, and I appear here today on behalf of the Board of County Commissioners of Johnson County. I am a registered Architect with 22 of years experience in the public and private sector, primarily in the State of Kansas. *I am also a past president of both the American Institute of Architects Kansas City and State of Kansas Chapters. Additionally, I am an adjunct professor of architecture at the University of Kansas.* I appreciate the opportunity to appear before the Committee and to present testimony in opposition to House Bill 2238.

Johnson County undertakes a wide variety of construction projects; new buildings, renovations, sanitary and storm sewer systems, roads, bridges, airport runways, etc. Our projects are all competitively procured and provide for consistent and extensive contractual protections for all parties, all under the oversight of our elected County officials.

We have productive relationships with contractors in the community that are beneficial for the construction industry while ensuring the expectations of the taxpayers are met and their investments protected. HB 2238 endeavors to establish important terms and conditions between parties in the execution of construction projects. Fundamentally, we believe those terms and conditions are best determined between the parties to the contract; be that the owner and contractor or the contractor and sub-contractor. This includes the form of retainage acceptable to the parties, the amounts to be retained and the method of payment of the retained amounts. These issues should be terms that are negotiated and contained in the project contracts.

Mandating the option of alternate security in lieu of retainage has a number of problems for the following reasons:

- Project costs will increase for the taxpayers because this added layer of complexity will result in added management time and overhead.
- Taxpayer investments will be unnecessarily placed at risk-
 - reliance upon alternative securities are simply not secure, especially in these financial times.
 - bonding instruments are not reliable and rarely if ever timely
 - reliance on a payment bond in lieu of any form of retainage could result in project delays and significant additional costs to the taxpayers

Requiring a maximum of 5% retainage is a significant problem for Johnson County for the following reasons:

- We have a number of projects types that are unique and require significantly different retainage structures in order to be successful. Projects providing sewers to septic tank neighborhoods are one example where we typically require 30% retainage in order to assure

6-2



that any damage to lawns, landscaping, driveways and roads are adequately repaired at project completion.

- The process described in HB 2238 of withholding 10% until a project is 50% complete is a practice we often follow, but it is extremely important that the decision to begin reducing retainage is based upon performance and other contractual responsibilities. One size does not fit all situations.

Finally, Johnson County believes matters of prompt payment and penalties are addressed thoroughly by existing statute and should not be included in HB 2238.

It is in the best interest of the taxpayers and local governments to establish and maintain strong and mutually beneficial relationships with the construction industry in our community. We do so with fair and balanced contracts that are thoughtfully prepared to assure the greatest chance of success on a given project and by administering those contracts equitably. Our contracts and our projects are entered into and managed in the public eye for the public good. Ultimately, our ability to complete projects in a timely manner and with adequate security for the public investment is significantly weakened by HB 2238.

Johnson County believes that current statutory and contract law provide an adequate structure for fair and equitable construction contracts and successful construction projects for the public. We request that you not recommend House Bill 2238 for favorable passage.

Thank you for your time and I will be happy to answer any questions you may have.

6-3



Testimony

Unified Government Public Relations
701 N. 7th Street, Room 620
Kansas City, Kansas 66101

Mike Taylor, Public Relations Director
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House Bill 2238
Fairness in Public Construction Contracts
Delivered January 28, 2010
House Commerce and Labor Committee

The Unified Government of Wyandotte County/Kansas City opposes House Bill 2238. Three predictable consequences will result if House Bill 2238 is passed:

- 1) Owners will be more reluctant to grant substantial completion and the time limits on contracts will become more contentious. Arguments over retainage would become arguments over liquidated damages. The result will be more lawsuits.
- 2) Performance bonds will be called more often, the sureties will be more involved and the number of construction related lawsuits will climb. Almost every project will begin with the presumption it will end in a dispute.
- 3) Costs for performance bonds in Kansas will go up.

Retainage is used to keep the contractor's attention focused on a project where otherwise managers and crew chiefs might be sent to new projects and completion work assigned on a catch as catch can basis. The 10% reduced to 5% is in line with the Unified Government procurement code and practice. The UG limits retainage to a maximum of 10% , which may be reduced to 5%, once the project is 50% complete based on the contractor's history of performance. In practice, once the project is substantially complete we often reduce the amount even further to more nearly reflect the cost to complete.

Since retention is important to ensure compliance after substantial completion, a time limit of 45 days to pay retention after substantial completion would encourage delay. The contractor could simply "run out the clock" and avoid completion. The owners' response will be to withhold designation of substantially complete, instead demanding specific performance on construction time to include punch list items, thereby increasing liquidated damages disputes.

The 150% limit does not account for the additional design costs to define the scope or work remaining, nor the administrative costs of procuring a second contractor, nor does it account for the sometimes much higher multiple of small quantities of work, nor for additional restoration on an otherwise complete site. For example, consider retainage held for a small quantity of defective concrete flatwork. The bid cost may be \$5,000 dollars for work done in quantity and in the right sequence with respect to final restoration. Indirect costs will be perhaps 8-12 hours consultant time at \$120/ hr to draw up a scope of work for a bid, an additional 12 - 20 hours of staff time at \$50 to add the front end, call the bidders, hold a pre-bid meeting, read and tab bids, and execute a purchase order. The change in scale of the project may add 25-35% to the unit prices and the need to add restoration of newly placed sod and pavement disturbed to do the work may double the cost. For small punch lists a factor of 3 or 4 is a more appropriate limit on remaining work. A limit of 150% will promote abandonment of the project.

Regarding alternate security, it is difficult to say what alternate security would be acceptable. Cash bonds seem to be less favorable to the contractor than retainage. Liens on real property or equipment of the contractor will be an administrative nightmare for the owner, and will cloud the distinction between owner and surety. The proposal to prohibit retainage when a performance bond is in place will result in many more claims on sureties. Sureties are reluctant to payout so more claims will result in more lawsuits. More claims will result in higher rates for performance bonds in Kansas.

House Commerce & Labor

Date: 1-28-10

Attachment # 7

Testimony to House Commerce Committee on HB2238
Robert J. Vancrum, Government Affairs Specialist
Blue Valley USD 229

January 28, 2010

Chairman Brunk and Other Honorable Representatives:

I am here to testify on behalf of the Blue Valley School District as a opponent of House Bill 2238. This bill would once again make significant changes in the Fairness in Private Construction Act, enacted in 2005, and the Fairness in Public Construction Act, enacted in 2007. Frankly both are limitations upon the free right of contract which should be expanded not restricted.

However, I was part of a group of public owners and building construction contractor and subcontractor organizations that met both before and during those sessions in attempts to hammer out what I thought most people felt was a fair compromise, recognizing that some government regulation might not be a bad thing.. Both acts impose an 18% penalty on the owner for not paying within 30 days of substantial completion of the project!

Retainage and performance bonds were both extensively discussed in those meetings. The real problem is not retainage, and performance bonds are not an adequate substitute for retainage. The purpose of retainage is to protect the owner by assuring that those contracting will come back and complete the job and not leave the owner with an incomplete building that won't open at the time promised, because the contractor will not come back.. The purpose of a performance bond is to make the owner whole financially, if the contractor or subs *cannot* complete the job – bankruptcy , death, natural disasters, etc.

For the most part the problem is different interpretation of when “substantial completion” has occurred. It should be solved by better definitions of this in the contract. No legislation is going to solve that issue for all situations.

Blue Valley's Facilities and operations director also set for the attached thoughts. He regrets he couldn't be here today.

House Commerce & Labor
Date: 1-28-10
Attachment # 8

Retainage—Usual Practice in Construction Projects Retainage has been required on virtually all construction contracts for over one hundred years representing subcontractors have sought legislation to prevent owners on public and private jobs from including a retainage provision in their contracts.

The Benefits of Retainage to Owners

- It Provides a Strong Financial Incentive to Complete a Project - Withholding retainage gives the contractor an economic incentive to stay on the job, work until completion, and correct any remaining details. Near the end of a project, without retainage the contractor may find that it will cost more to complete the work than the remaining contract funds. The retainage is only a small percentage of the payments made to the contractor as the work progresses, but by the end of the job it provides a strong economic incentive to complete the project.
- It Provides Readily Available Funds to Remedy a Default - If a general contractor fails to complete a project, retainage provides an immediate source of funds for the owner to use to cure the performance default, particularly if it occurs at the latter stages of the project. Subcontractors and suppliers also benefit because retainage can be used to pay them if the contractor defaults.

Is Retainage Needed When Performance Bonds are in Place? – The Surety & Fidelity Association of America (a trade association consisting of companies that collectively writes the majority of surety and fidelity bonds in the United States) supports the judicious use of retainage in all public construction contracts, both at the general contractor and subcontractor levels.

Bonds are not a Substitute for Retainage. The point of retainage is to give the contractor an incentive to finish the project, and to give the owner cash-in-hand to use to complete minor items. Surety bonds are not an incentive for the contractor. The owner calls on the surety only after the contractor has defaulted. Surety bonds protect the owner, and subcontractors and suppliers on the project, from contractor defaults, but the cost of surety bonds is reduced by retainage. Surety premiums ultimately depend on surety losses, and retainage decreases such losses because the retainage becomes part of the contract balance held by the owner at the time of default and paid to the surety as it performs. Elimination of the benefits of retainage is not the answer.

“Substantial completion” can be an elusive term. With many different stakeholders at various levels, a construction project is a complex process. Subcontractors may not receive their final payments until after the owner releases the general contractor’s retainage. These problems should be fixed with clear definitions of “substantial completion” and specific timelines for acceptance of a completed work and release of retainage. Elimination of the benefits of retainage is not the answer.

What is Needed to Make Retainage Work for all Concerned?

- Retainage should be 10% of the total value of a contract. If the retainage falls below this amount there can be more economic incentive to move on to a new project than to finish the final items on an existing contract.

• Owners should be required to state their expectations related to retainage prior to bid. This places all bidders and subcontractors on an even playing field.

• General contractors should pay subcontractors their retainage when the public owner releases retainage to the general contractor for the subcontractor's work

Dave Hill, AICP, REFP
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"Education Beyond Expectations"

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Testimony before the
House Commerce and Labor Committee
on
HB 2238

by
Tom Krebs, Governmental Relations Specialist
Kansas Association of School Boards

January 28, 2010

Mr. Chairman, Members of the Committee:

Thank you for the opportunity to testify. We appear today as opponents of **HB 2238**.

Simply put, the bill narrows the leverage a school district has in ensuring work contracted is done in a timely and appropriate fashion. We believe that goes against the district's need to ensure all resources the public has entrusted to it are well spent.

Here's one of our member's thoughts:

"Our concerns regarding HB 2238 are centered on Section 4 (d) and (e), where contractors who provide "alternate security" (d) and contractors providing 100% "payment performance bond" (e) will have no retainage held against their work.

The result of this language for municipalities and school districts leaves all responsibility and leverage compelling the completion of contracted work to a bonding/insurance company. While a bonding company can apply pressure for contractors to perform immediately, the language in the American Institute of Architect's Standard Performance Bond we currently employ (AIA Document A312) requires/allows a total of 35 days for a contractor or the bonding company to respond to a claim of default against the bond.

In school construction, remodel projects are often scheduled beginning June 1 with a completion date of August 1. A thirty-five day delay allowing a contractor or bonding company to cure a potential default would certainly ruin the start of a school year, and would likely generate significant legal expenses associated with declaring default against a contractor.

House Commerce & Labor

Date: 1-28-10

Attachment # 9

Holding 10% retainage, or even the threat of holding such retention until the contractor achieves "substantial completion," is a much more effective way to keep contractors accountable for completing publicly funded projects, especially in this bidding market where much if not all of a contractor's profit margin is likely tied up in the 10% retainage amount. Leaving this accountability measure to bonding/insurance providers will most certainly add delay and expense to any municipality or school district experiencing performance problems with a contractor.

As a result, I remain personally and professionally opposed to House Bill 2238."

*Bill J. Miller
Director of Operations
Gardner Edgerton USD 231*

We believe Mr. Miller's comments capture accurately a serious reservation with the proposed changes.

The KASB Board of Directors in December voted as a priority the following statement as part of its beliefs regarding local decision making: "School districts should have more ability to make decisions regarding the most effective use of resources in meeting the needs of their community."

Proposed changes give districts less flexibility by shifting to contractors and sub-contractors more say in how the business between the two will be conducted. We do not believe this shift is in the best interest of our members' constituents.

Thank you for your consideration.



KANSAS BOARD OF REGENTS

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January 28, 2010

Representative Steven Brunk, Chairman
House Commerce and Labor Committee
Statehouse, Room 166-W
Topeka, KS 66612

Representative Louis Ruiz, Ranking Member
House Commerce and Labor Committee
Docking State Office Building
Topeka, KS 66612

Dear Chairman Brunk and Ranking Member Ruiz:

On behalf of the Kansas Board of Regents, I write to you in opposition to House Bill 2238, legislation that alters the retainage on state construction projects, which would include state university construction projects, and allows alternate security.

The intended purpose of retainage is to safeguard the interests of state university/State of Kansas projects by ensuring that the contractor completes contracts per plans and specifications in a timely manner. Reducing the maximum retainage outlined in the bill from 10% to 5% would significantly diminish the incentive or leverage required at times to ensure proper performance of construction contracts.

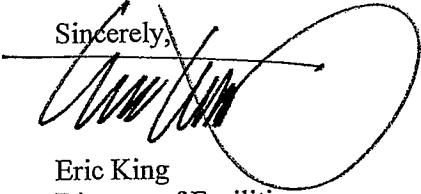
The bill limits retainage withheld to 10% of the first 50% of the contract or 5% of the total contract. Additionally, the bill requires that retainage be released within 45 days of substantial completion. Any owner will tell you that the latter stage of a project is often the most difficult to manage in terms of wrapping up countless loose ends. Often, the contractor's main work force has left the site, leaving only a skeleton crew to complete the punch list. To pay the contractor within 45 days of the Substantial Completion stage would leave the owner without any options to ensure final completion.

The bill also includes provisions for an "alternate security," specifically, a retainage bond, bank letter of credit, certificate of deposit, cash bond or other mutually acceptable items of value equal to or exceeding the amount of retained funds. While arguments could be made that certain securities would be acceptable and others not, the larger issue is the burden placed on the contractor and owner in evaluating and making decisions on these requests.

Current practices protect the owner while attempting to be as fair as possible to the contractor. Countless state projects have been constructed using these methods - they have stood the test of time.

The Board of Regents respectfully opposes the bill. Thank you for your consideration.

Sincerely,


Eric King
Director of Facilities

House Commerce & Labor
Date: 1-28-10
Attachment # 10



House Commerce & Labor
Representative Brunk, Chair

H. B. 2238 – Private and Public Construction Contracts

*Submitted by Diane Gjerstad
Wichita Public Schools*

January 27, 2010

Mr. Chairman, members of the Committee:

In recent sessions the legislature placed restrictions on an owner's ability to contract by limiting retainage to 10% and regulating payment criteria. This bill would place even greater restrictions on owners – both private and public – by limiting retainage to 5%. H.B. 2238 restricts an owner's ability to create adequate assurances the project will be completed to the satisfaction of the owner – whether private or public.

Mr. Chairman, we would urge this committee to not further restrict an owner's ability to negotiate a contract appropriate to protect the public or private owner's investment. Setting lower retainage caps restricts the owner's ability to enter into a contract which reflects a retainage amount appropriate for the size and scope of the job.

Mr. Chairman, we would urge the committee not to take action on this bill. Owners – both private and public – need the ability to enter into contracts which protect their interests to have the project completed in a timely manner and to their specifications.

Thank you for considering our views.

House Commerce & Labor
Date: 1-28-10
Attachment # 11

February 10, 2009



AIA Kansas

A Chapter of the American
Institute of Architects

TO: House Commerce and Labor Committee
FROM: Trudy Aron, Executive Director
RE: Opposition to HB 2238

Good Morning, Chair Brunk and Members of the Committee. I am Trudy Aron, Executive Director, of the American Institute of Architects in Kansas.

AIA Kansas is a statewide association of architects and intern architects. Most of our 700 members work in over 120 private practice architectural firms designing a variety of project types for both public and private clients. Our members are designing tomorrow's buildings today, aiming to meet the "triple bottom line": economy, healthy people and environment.

AIA Kansas opposes HB 2238 because it removes most incentives for the completion of work by contractors and subcontractors. The retainage is the owner's assurance that work will be completed satisfactorily. Release of retainage before substantial completion of a project is at the owner's option and is often done.

The most frustrating time for the owner and architect can come at the end of a project when the architect goes through the building to see what needs to be finished. While the remaining items do not affect the occupancy and hence substantial completion, they do remain to be finished in order to achieve final completion. Let me give you some examples of problems that occur after substantial completion when the contractor has been paid for their work, except for retainage:

- Painting and base – there may be numerous places where painting needs to be touched up and cove base installed.
- Tile Work – at substantial completion, the tile work is completed except for damaged tiles that need to be replaced
- Carpet – there is a flaw in the carpet and it needs to be replaced
- Electric wall cover plates are not installed

In all of these cases, some work remains to be finished and the contractor has been paid for the work except retainage. If the owner cannot withhold the retainage due on the entire contract, the owner has no certainty that the contractor will finish the job. In that case, the owner has two choices – hire someone else to finish (often at a much higher cost) or try to get the bonding company to get the original subcontractor back on the job.

HB 2238 would allow the owner to withhold only 150% of the remaining work. All the items above have little monetary value, so the only incentive to get the job completed is the entire retention.

These statutes were passed just two years ago. At that time my testimony on the final bill was: " This bill has been a long time in the making and I would like to thank those who have worked so hard to come to a consensus ... Not everyone got what they wanted, but we believe this bill serves everyone on the construction team – owners, architects, engineers, general contractors, subcontractors and material suppliers."

AIA Kansas firmly believes the current statutes are appropriate. We urge you to oppose HB 2238. I'll be glad to answer questions.

President
David S. Heit, AIA
Topeka
President Elect
J. Michael Vieux, AIA
Leavenworth
Secretary
Hans Nettelblad, AIA
Overland Park
Treasurer
Nadia Zhiri, AIA
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Richard Brown, AIA
Wichita
Christie Carl, AIA
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Randle L. Clark, AIA
McPherson
Keith Diaz-Moore, AIA
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Dale R. Duncan, AIA
Olathe
Gwenda S. Gigos, AIA
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Lawrence
Peter Magyar, Assoc, AIA
Manhattan
Katherine Nichols, Assoc. AIA
Gary Nevius, AIA
Overland Park
C. Stan Peterson, FAIA
Topeka
Daniel Sabatini, AIA
Lawrence
Charles Smith, AIA
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House Commerce & Labor

Date: 1-28-10

Attachment # 12