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PROMPT PAYMENT BY MDOT

House Bill 4713 (Substitute H-1)
First Analysis (10-3-95)

Sponsor: Rep. Harold S. Voorhees
Committee: Transportation

THE APPARENT PROBLEM:

Public Act 279 of 1984 requires state departments to pay for goods and services from private enterprises within 45 days after they receive either the goods or services, a complete invoice for the goods and services, or a complete contract for goods and services, whichever is later. If a payment to a private enterprise for goods and services is past due, the state agency is required to pay an additional amount equal to 0.75 percent per month of the payment to the private enterprise.

According to some road building contractors, the Michigan Department of Transportation (MDOT) has a history of slow final payment on many road projects. They cite as an example a road project completed in July of 1989 in which final payment was not received until January, 1994. Road construction contractors have requested legislation granting their industry the same benefits accorded businesses that provide goods or services. In addition, some people believe the penalty for late payment on contracts by all departments should be increased.

THE CONTENT OF THE BILL:

Public Act 279 of 1984 currently imposes a late payment charge on departments that fail to pay on time of 0.75 percent per month of amounts paid late. The bill would raise the late payment penalty to 1.5 percent per month.

In addition, the bill specifically would require the Department of Transportation, unless otherwise agreed in writing, to ensure that payment for a construction project was mailed to the contractor within 45 days after either 1) the date the department determined the project had been completed or 2) the scheduled completion date of the project, adjusted for any approved extensions of time--whichever was earlier. The department would be subject to the bill's late payment penalty provisions for amounts that were paid late. The bill would apply to construction contracts awarded by the department after June 30, 1996.

MCL 17.51 et al.

FISCAL IMPLICATIONS:

The House Fiscal Agency says the bill's total fiscal impact to the state could approach $600,000 annually, which would be borne by all state agencies and particularly the Department of Transportation. The agency says MDOT's costs under the bill would depend on the amount of money retained by the department as a road project neared completion, which can vary from project to project, and the length of time before final payment was made. Based on a review of MDOT records, the agency estimates the average retainage amount on 360 current projects to be 1.04 percent of the contracted amounts, with about $525 million in construction contracts finalized each year. Assuming final payment on a project occurred four months after its completion, the bill would result in penalty costs for the two and one-half month period following the 45-day prompt payment period. Based on these figures, the agency says MDOT could incur penalty costs under the bill of about $250,000 annually (assuming compounding of the interest penalty), although actual penalties could vary depending on actual retainage rates and "finaling" periods. The HFA also says the bill would double the penalty costs incurred by state agencies on goods and services not paid for within 45 days. Fiscal year 1993-94 information suggests an additional $280,000 to $300,000 per year in penalties would be incurred under the bill. (10-1-95)

The Department of Transportation says total outstanding retainage at the end of August was approximately $1.6 million on a total of $213 million in contracts awarded. Assuming this were an average monthly retainage amount beyond 45 days, and compounding of the interest penalty for a 12-

month period, the bill would result in increased costs to the department of about $352,000 per year ($1.6 million x 0.22). (9-27-95)

The Department of Management and Budget says the cumulative amount of penalties paid by state departments due to late payments on goods and services contracts for the 1993-94 fiscal year was about $280,000. Assuming a similar payment pattern existed under the bill's provisions, these departments would incur twice this amount in annual penalty costs in future years. (9-29-95)

ARGUMENTS:

For:

Construction contractors and subcontractors have suffered due to slow payment or no payment on any road projects. This situation has been caused in part by uncompleted paperwork, disputes, and so forth. Some of these cases are several years old. The present system causes severe hardship for women and minority contractors, as well as smaller construction companies who often don't have the financial wherewithal or cash flow to wait for the final payment. Often these companies don't bid on road projects because of these financial considerations. The bill would provide the same fair treatment for construction contractors as provided to state vendors that provide goods and services by holding the bureaucracy accountable to businesses with whom they do business.

Against:

According to the Department of Transportation, contractors are audited and paid every two weeks during a project. The problem is the time it takes contractors to return documents to the state in order to finalize a project or their failure to respond to a state request for information needed to process the final payment. Completion of a project is often construed as the point the contractor physically completes work on the project. However, completing a road project often entails more than simply having the road open to traffic. Other requirements may need to be met, such as balancing of quantities, local or federal participation, waivers of lien statements, and other contract requirements. Balancing of quantities is a process in which projected quantities of materials (usually dirt) expressed in the contract must be verified as accurate. For example, if a contract called for a certain amount of dirt to be removed from a project, a survey crew would have to go to the job site and verify that the specified amount of dirt had been removed. Furthermore, many construction projects are shared between the state and a local governmental agency, while other projects involve the federal government. Often the final payment to the contractor on a project is held up until the state receives from another governmental entity outstanding paperwork or the local or federal portion of the funding for the project. Also, contractors' provision of waiver of lien statements and other contract requirements, such as ensuring proper signage or guard rails are in place, are necessary before the department may process a final payment. Enacting the bill would only force the department to make payments to contractors on time while it was waiting for other parties to a contract to meet their contractual obligations, and would punish the department when contractors were paid late even though it was for reasons beyond its control.

Against:

As originally introduced, the bill merely proposed making contracts between the transportation department and road builders subject to the act's provisions regarding prompt payment, where the department would pay an interest penalty of 0.75 percent per month on outstanding amounts owed after a given date. The House Commerce Committee, however, adopted a substitute for the bill which would double the interest penalty which applies to late payments for goods and services by departments from 0.75 percent to 1.5 percent per month, which translates into an effective annual rate of 18 percent (or 22 percent if the interest penalty is compounded monthly). Based on how the current penalty system is working, there appears to be no need to double the interest penalty. Moreover, it would make more sense to pick a penalty that was linked to an interest rate standard that changes according to existing economic conditions, such as the prime rate--which now stands at nine percent. Doubling the prompt payment penalty that currently applies to goods and services contracts (and would apply to MDOT road projects) is unjustified and could cost the state's taxpayers more than half a million dollars. Much of this cost would be borne solely by the transportation department, whose budget already is severely strained due to the huge need for road and bridge repairs and replacements throughout the state.

Against:
If the transportation department is going to be held to prompt payment and subject to late fees on road construction projects, it seems reasonable to also require contractors on those projects to warranty their work.

POSITIONS:

The Michigan Road Builders Association supports the bill. (9-27-95)

The Michigan State Building Trades Council supports the bill. (10-2-95)

Klett Construction Company, Inc., of Hartford supports the bill. (9-27-95)

The Department of Transportation opposes the bill. (9-27-95)