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ASSEMBLY COMMITTEE ON COMMERCE AND LABOR

COMMENTS BY MARC JENSEN
REPRESENTING THE SOUTHERN NEVADA WATER AUTHORITY
IN OPPOSITION TO AB 393

March 24, 2003

Mister Chairman and Members of the Committee:

My name is Marc Jensen and I am the Director of Engineering for the Southern Nevada Water Authority ("Authority"). The Authority is opposed to AB 393 because it will severely reduce the public's protection against potential economic loss on public works construction projects. In addition, it will inevitably cause public agencies to seek other means of providing that protection to the public that could be more onerous to the contracting community.

The Southern Nevada Water Authority's Construction Experience

Since 1995 the Authority has been engaged in a two billion dollar Capital Improvements Program which provides for the construction of over 100 different projects to expand and improve the regional Southern Nevada Water System. These critical projects bring water to the Las Vegas Valley from Lake Mead. These projects offer significant, even vital, benefits to our community by assuring adequate water system capacity, enhancing water system reliability, and increasing drinking water quality. Among these projects have been the construction of a new water treatment facility, a new underwater intake in Lake Mead, and numerous very large pumping stations, pipelines and other associated facilities. The largest of these projects, the first phase of the new water treatment facility, had a construction cost of nearly 200 million dollars. The average project construction cost has been about 18 million dollars.

So far, over 70 projects have been constructed, all of them with good success. One of the reasons for our success is that the Authority continually revises its construction documents in response to "lessons learned" during construction. We believe our documents reflect a good balance between the public's need to have quality work satisfactorily completed in a timely and responsible manner against the Contractors' need for full and prompt payment for work performed.

To keep the lines of communication open between the Authority and contracting community, Authority representatives regularly attend monthly meetings of the Associated General Contractors (AGC) Las Vegas Chapter Public Works Committee. Recognizing that there is always opportunity to better fulfill our responsibilities, we also hold periodic meetings with Contractor representatives to discuss ways to improve the Authority's construction documents.

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Assembly Commerce & Labor
Date 3/24/03 Room 4100 Exhibit M
Submitted By: MARC JENSEN

The Purpose of Retention Monies in Construction Projects

In essence, retention (or retainage) is a designated amount of money to be withheld from payment to a construction contractor for work performed until the Owner is satisfied that the full project is satisfactorily completed. The retention of some money earned during construction to assure satisfactory completion of the work is a standard practice in both public and private construction and is a financially important aspect of a construction transaction.

Retention of a certain portion of funds that would otherwise be payable to a Contractor meets several real and very significant needs. Retention protects an Owner, including the public in the case of public works construction, from the following kinds of common construction problems:

1. Poor quality construction
2. Subsequently discovered defective work
3. Minor incomplete work
4. Late completion, resulting in payment of liquidated damages
5. Non-compliance with prevailing wage laws
6. Non-compliance with Project Labor Agreement provisions
7. Not receiving required documents, such as final as-built drawings

Sufficient retention provides a level of certainty that problems later discovered in work already performed and paid for will be corrected. Where Contractors and their subcontractors and suppliers already have been paid for work that should be corrected and very little money remains unpaid on the contract, we have seen that Contractors are much less likely to come back and fix those problems.

Nevada law currently provides that 10% of a Contractor's progress payments must be retained until 50% of the project is complete at which time further retention may cease if satisfactory progress is being made. If satisfactory progress is being made and retention ceases at 50% completion, the net result is that 5% of the contract value will be retained upon completion of the work. A review of other states' retention statutes indicates about 17 other states have laws similar to Nevada's.

The change to the retention law proposed by AB 393 would drastically reduce the protection currently afforded to the public, including public utility ratepayers and taxpayers. Under AB 393, $50,000 would be the maximum amount of money available for use by the public agency to pay for prevailing wage violations, compensate for violations of other laws or contractual requirements, complete unfinished work, and correct defective work.

Experience has shown that $50,000 would not be enough protection on the Authority's large dollar construction projects.For example, the Authority has had to rely on retention funds for the following actual incidents:

1. A subcontractor's alleged failure to make required payments to the workers' benefit funds in an amount over $200,000.
2. The recent assessment against a general contractor for liquidated damages for late completion in an amount of $75,000.
3. The use of retained funds to provide additional protection to assure project completion within budget after the bankruptcy and default of a general contractor.

If public agencies are not allowed to rely on a reasonable retention amount to deal with these kinds of issues, then public agencies will consider other measures to protect the public interest. Such measures might include defining in the contract a detailed schedule for the value of every required work activity instead of allowing the Contractor the latitude to suggest the value of his own work activities, being much more conservative in estimating the value of work performed, or other such measures not yet identified.

The Authority's Construction Projects Differ From Highway Construction Projects

The Authority has been advised that the $50,000 maximum amount of retention proposed in AB 393 derives from the statute providing for that amount of retention on projects constructed by the Nevada Department of Transportation. It is critical to note that the Authority's projects differ greatly from NDOT projects. Unlike highway construction, the Authority's projects involve work activities that are not easily broken down into discrete quantifiable units. For example, it is impractical to break down the work of installing and testing a complex computerized process monitoring and control system into small unit price payment items. In addition, NDOT projects do not typically involve facilities with large or complex mechanical and electrical systems which must be proven to be fully integrated and functional in the installed condition before full payment is made.

Bonds Cannot Substitute for Retention

Some have argued that performance and payment bonds provide the protection needed by public agencies to assure satisfactory performance and that retention in addition to these bonds is redundant. This argument is incorrect. Bonds provide completely different protection than that provided by retained funds. Payment bonds are in place to protect suppliers and subcontractors against non-payment by the general contractor. Performance bonds are an "instrument of last resort" and are only called upon in the event of a termination or default by the general contractor. Performance bonds are not intended nor are they useful to compel correction of defective work and do not provide funds to pay for prevailing wage rate or other labor violations.

Retention is a Flexible and Useful Construction Management Tool

Retention monies give public agencies the latitude needed to manage timely payments to contractors. In compliance with state law, the Authority promptly pays contractors for work performed each month. Before each payment, the Authority and the Contractor negotiate an approximate assessment of how much of the work is complete. If the retention is sufficient to cover any possible overpayment for such work, it is easier for the

Authority's construction managers to arrive at an agreement with the Contractor about an appropriate progress payment amount.

In order to process a Contractor's monthly payment application without excessive delay and with the knowledge that the retention will be sufficient to compensate for small discrepancies, the Authority's construction managers are willing to overlook apparent small discrepancies in the Contractor's assessment of construction progress. If sufficient retention were not available, the entire payment for the month could be delayed while those apparent discrepancies were analyzed and discussed.

"Withholdings" vs "Non-Payment for Work Not Performed"

Retention is a general withholding of money that would otherwise be due for work performed on the overall project. Paragraph 2(b) of Section 1 in the proposed AB 393 states that, with certain exceptions, a public body shall not "Withhold payment from the contractor in excess of retainage." In the Authority's discussion with the contracting community, there has been considerable confusion about the definition of "withholdings". The general withholding of funds as retention, or any other specific withholdings, should not be lumped in same category with other contractually designated payments for work performed. When a construction contract identifies a payment amount for completion of certain work activities, this is not a "withholding", even when the work activity is closely aligned with another work activity that may have been completed or a smaller subset of a larger work activity that is mostly completed. Examples of these instances are provided in the next few paragraphs.

The Authority and other public agencies involved in construction of facilities with large or complex mechanical and electrical systems will often designate that full payment cannot be made for certain systems until those systems have been proven to be fully integrated and functional in the installed condition. For example, a large pump and motor unit may cost one million dollars to manufacture and deliver to the job site, but has no real value to the Authority until it is installed, connected, energized, and integrated with the monitoring and control system. The value of the installation and integration work should not be paid until that work is satisfactorily completed. Just as importantly, the full value of the installed equipment or system should not be paid until the equipment or system has been proven to properly function in the installed condition in full compliance with the contract specifications. Some have argued that the general withholdings of money as retention are sufficient for that purpose; however, this confuses the purpose of retention with the concept of paying only for work actually performed.

As another example, sometimes the Authority's contracts state that there is a designated monetary value for documents necessary to operations and maintenance of the new facilities and that the money will not be paid until the O & M documents are furnished in acceptable form. Because this monetary value is currently expressed in our contracts as a percentage of the value of the total equipment or system, some have argued that this money is a withholding. In fact, the money is designated for work that is required to be performed under the contract and should not be paid until the work is actually performed. Perhaps the language of the contract could be clarified or otherwise revised to better

accomplish the principle and intent of the monetary designation. The Authority is open to dialogue with contractors or contractor associations to explore how the language of the contract might be improved.

Deductions to the Contract Price

The proposed bill AB 393 as introduced states that "The contract price for a public work may be increased or decreased during the term of the contract as a result of change orders approved by the public body..." (Paragraph 1 of Section 1) However, paragraph 2 in Section 1 of AB 393 prohibits a public body, with certain very limited exceptions, from making a deduction from the contract price. This prohibition is overly broad and severely encroaches on the rights of public agencies to protect the public with reasonable contract provisions.

It is difficult to predict how this proposed prohibition against contract price deductions will be interpreted or applied; however, one possible interpretation of this provision in AB 393 will make application of liquidated damages for a Contractor's unexcused delay in completing the work very difficult, if not impossible. Moreover, if a Contractor refuses to comply with a contractual performance requirement, how will the public agency be able to prevent the Contractor for making a claim for payment of the full contract price if the Contractor refuses to accept or acknowledge a change order?

This prohibition against deductions from the contract price is fraught with unknown complications and consequences.

Summary

The proponents of AB 393 claim that a radical reduction in the amount of retention that can be held by public agencies is needed to achieve more competitive bidding and therefore lower project costs. In fact, the opposite is likely to occur. Lowering the retention amount and prohibiting deductions as proposed by AB 393 would drastically reduce the public's protection against poorly performed work, resulting in more claims and disputes which drive up project costs. This will be especially true for the large, complicated and expensive project often pursued by the Authority.

AB 393 would unfairly favor construction contractors by reducing protections afforded to the public in ways that are not customary or reasonable in the construction industry. The public is already at a disadvantage compared to the private construction industry because public works must be awarded to the lowest bidder. To further hamstring public agencies in securing quality work and full performance from low bidders by reducing customary contractual protections is not in the best interest of the public.