

Retainage

As the Department noted in the preamble to the February 1999 final rule, delays in payment have long been one of the most significant barriers to the competitiveness, and in some cases the viability, of small subcontractors. One of the delays in payment which subcontractors have been most concerned about is the payment of retainage. Subcontractors have told us they often finish their work on a contract months or years before the end of the project on which the prime contractor is working, but the prime contractor does not pay them fully until after the recipient has paid retainage to the prime contractor at the end of the entire project. To help surmount this barrier, the 1999 final rule requires prime contractors to pay retainage to subcontractors promptly after the subcontractors satisfactorily complete their work.

Many states and other recipients have responded creatively to this provision, taking such measures as making incremental payments to prime contractors or eliminating retainage altogether. Where recipients have not taken such measures, however, prime contractors have complained that the requirement to pay subcontractors fully before the recipient pays retainage to the prime contractor is a financial hardship on prime contractors.

In order to address the prime contractors' concerns without diminishing the benefit of the existing provision to subcontractors, the Department proposed three approaches: (1) A recipient could eliminate retainage entirely, neither retaining funds from prime contractors nor permitting prime contractors to hold retainage from subcontractors; (2) a recipient could decide not to retain funds from prime contractors, but give prime contractors discretion to hold retainage from subcontractors (the recipient would require prime contractors to pay subcontractors in full after satisfactory completion of the subcontractor's work); or (3) the recipient could hold retainage from prime contractors but make incremental inspections and approvals of the prime contractor's work at various stages of the project (the recipient would pay the prime contractor the portion of the retainage based on these approvals), and the prime contractor, in turn, would be required to promptly pay all retainage owed to the subcontractor for satisfactory completion of the approved work.

We received eighty-four comments on the issue of retainage. Several commenters favored the proposed

changes, with most agreeing that options (1) and (3) are best, so long as they would not conflict with state law. A majority of commenters favored the proposed changes with modifications. Several commenters noted the difficulty on prime contracts in implementing the three options when it may be difficult to evaluate the quality of each subcontractor's work in situations where the result of the subcontractor's work may not be known until other work is performed on top of it. In twenty-two letters submitted, option (3) was pointed out as the best because commenters said, of the need for prime contractors to have the flexibility to hold retainage until the state accepts the portion of the work performed by the subcontractor. Another commenter recommended a fourth option: all retainage amounts must be returned within fifteen business days of satisfactory completion of the work, regardless of whether the prime contractor was paid.

Several commenters requested a definition of "satisfactory completion." For purposes of this provision, we have defined satisfactory completion of a subcontractor's work as when all the tasks called for in the subcontract have been accomplished and documented as required by the recipient. When a recipient has made an incremental acceptance of a portion of a prime contract, the work of a subcontractor covered by that acceptance is considered satisfactorily completed.

Twenty-three commenters disagreed entirely with the proposed changes, including eleven State DOTs. Many of these commenters were concerned that one or more of the options could conflict with state laws, or force recipients into a "cookie cutter" solution. Others found option (3) unworkable, costly, or in need of a phase-in period for implementation. A few commenters recommended the complete elimination of retainage. They pointed to the root causes of difficulty in recouping retainage—such as inspector delays and inefficiency—that lead to the contractors being unduly penalized.

The Department wants recipients to have flexibility in their implementation of retainage. The Department believes that it is best to implement solutions that minimize difficulties for both subcontractors and prime contractors. Current § 26.29 addresses the difficulties caused by retainage for subcontractors, but does so in a way that prime contractors were concerned shifted too much of the burden to them. The purpose of the amendments to § 26.29 is to mitigate the problems

raised by prime contractors while retaining the benefits of the section to subcontractors. The Department also believes that recipients should have flexibility in their implementation of this section. For these reasons, we are adopting the proposed amendments and permitting recipients to choose which of the three options to use. Whichever option the recipient chooses, it must apply it uniformly to all contracts. We are defining "prompt" as no later than thirty days. Based on our experience in program review thirty days was the most common length of time suggested by recipients. The Department believes that this is a sensible amount of time for payment of retainage.

Size Standard

One of the purposes of the DBE rule is to make it possible for small firms to grow. This includes the opportunity for subcontractors to become able to compete as prime contractors. To be able to perform prime contracts, companies often need to be larger and have more resources than they had as subcontractors. Frequently, firms attempting to grow will perform both prime contracts and subcontracts. This may create a dilemma for DBE firms in some instances. In order to work as prime contractors, firms may need to grow beyond the limits of the SBA size standards applicable to their subcontracting field. If they do, then recipients may decertify the companies because they no longer qualify as small businesses. A number of firms have expressed concern that this situation penalizes success and impedes achievement—an important objective of the DBE program.

We have issued guidance stating that recipients should not totally decertify a firm because it exceeds the size standard for one or more of its activities. Under § 26.65(a), if a firm meets the size standard for one type of work (e.g., as a general contractor), it should continue to be certified and receive DBE credit for that type of work, even if it has exceeded the size standard for another type of work (e.g., as a specialty subcontractor). When its specific section exceeds particular size standards, the firm will not remain eligible and receive DBE credit for this type of activity, but will retain its certification for its other areas that remain DBE eligible. It is important for recipients to make these distinctions, as it is not appropriate for a recipient to decline to certify a firm for all purposes when the firm meets SBA size standards with respect to some of its activities. However, recipients must be careful to award DBE credit to a firm