

THE ACADEMY OF ELECTRICAL CONTRACTING

Paper presented by

Thomas A. O'Dwyer, Fellow

Do You Want to Stay in Our Business?

April, 1982

PRELUDE

When asked to present a paper to the Academy on a subject of my choice of interest to the Industry, I racked my brain for the one subject of highest priority. Given the depth and breadth of this group, it was hard to choose between labor's attitude in combating the merit shop or the rigors of finance in doing business as a sub or prime contractor. I finally chose the latter as the most significant item today and arrived at the provocative title, "Do You Want To Stay In Our Business?"

The growing lack of liquidity in the balance sheets of most of the contractors in this country today has become most alarming. This downward trend will not be reversed unless we become involved in our own state and/or the federal government when it comes to politics and construction laws.

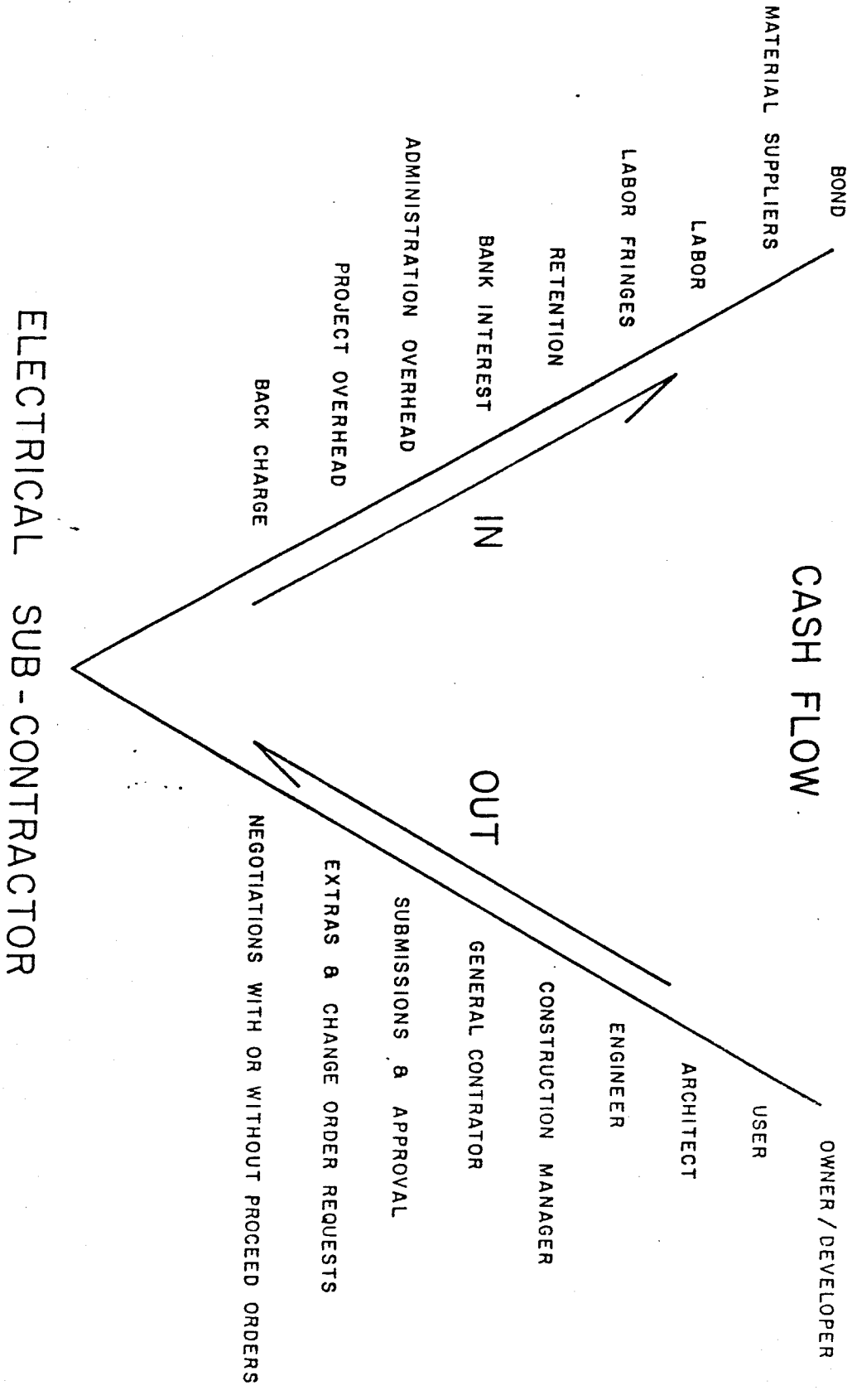
Today, it is not enough for us to be electrical engineers, ambitious former electricians or children of 'dad's business', to continue operating as an electrical contractor. It is now imperative that we read, (or cause to be read), understand, and properly cover ourselves for heretofore unrecognized risks in order to keep our doors open. We must have ready access to state and federal protective devices already in place for our use. These constantly are being up dated. In order to be better informed we must be ever ready to comply with the wishes of our trade association, NECA, as well as such organizations as ASC (American Specialty Contractors) and ASA (American Subcontractors Association) when called upon to besiege our legislators or talk before industry groups.

Paranthenetically here, I must say, if there are any petty jealousies that exist among these three organizations, they should be buried immediately in light of the resounding affect they can collectively have on the legislatures, state and federal, as well as the agencies that constantly have an affect on our continued business health.

Hopefully, you will find the brief message that follows both interesting and challenging. We as an industry have finally achieved a degree of credibility that enables us to help ourselves with legislation and contract forms that can make our business both enjoyable and profitable. I would ask each of you to make an avowed promise to yourself, and your industry, that you will lend your time and efforts personally to congressmen who are willing to submit "our" bills and to associations staff people, who spend endless hours on research and lobbying on our behalf.

PERFORMANCE

BUSINESS ACQUISITION



payment, i.e., negotiations to follow. All of these items and others affect your income.

Now, on the other side of the V, let us look at your "obligations" in performing the subcontract you have acquired regardless of the actions taken by the elements on supply side. Payrolls must be made weekly, as well as applicable reports and fringes. Material suppliers have lobbied themselves into a position of protection by the filing of 36-day, 90-day or 120-day notices. (These vary with the type of material service you receive). Equipment rentals must be paid monthly or, in some cases, weekly. Interest @ 15% to 20% on borrowed funds, if you happen to be in the 63% of our group who have to use outside financing, must be paid and this cost comes right off the top. If these items are not enough to curl your hair, add to them the additional insult of having 10% of your earned money retained until you are 50% complete, then 5% for the balance.

The net result is chaos. Your cost of doing business is increased by 8% to 15%, depending on which of these "performance" side characteristics affect you. Chances are you are lucky if you were able to build in 12 1/2% to 15% gross margin on your contract to begin with. Unfortunately, in many areas of our country, numbers like 12 1/2% are only dreams and we see margins of 5% to 8%. Is there any wonder why the bankruptcies?

For years we have been helpless but, at last, we can see the light at the end of the tunnel. With our combined efforts, we can realize some relief and insure that that light does not turn out to be an oncoming train.

NECA has taken a prominent leadership role in meeting some of the problems. Until Tom Dailey, AGC President, abruptly called off the joint Co-op effort of ASC (Associated Specialty Contractors) and ASA (American Subcontractors Association), it was felt that progress had taken a giant step. Now it seems that it will be a longer, harder task. Perhaps each of you know of General Contractors in your area who have found or invented reasons for holding your monthly progress estimates for weeks and months. I can relate to one particular contractor who held over \$800,000 from my firm for seven weeks (49 days). I happened to be in the bank at that time, so that \$800,000 @ 21% cost me \$460.00/day or \$22,540.00. At the same time, that firm had the \$800,000 in the

money market and Euro-dollars, yielding him 18% to 19% or \$400.00/day or \$19,600.00. That, in simple arithmetic, shows how the subcontractor V had a \$40,000.00 impact on me. I threatened to sue in a registered letter, sending a copy to the owner, and was paid in three days. Should that foolishness be necessary? How many of our smaller contractors are in a position to take on the additional burden of legal expenses? Here I would have to ask how many of you include in your takeoff or estimate an item of expense called "legal fees"?

As a by-line item, here, I might mention that the Wall Street Journal says that in 1980 - interest expense rose to 45% of net profits before taxes - up from 14% in the 60's.

Now we are beginning to see more and more articles entitled, "subcontractor rights". These rights can be found in states as well as the federal government. However, it is up to you and your counsel to discover the pertinent law in your particular state or the state the project is located in. You must educate yourself in proper notices (Appendix B), in Subcontractor Lien Law (Appendix C), and in mental toughness, which allows you to file against a 'friendly general contractor' if he is using you or your money. Chances are he will call you again if you are low. (Let me hasten to remind you, that your signing an intimidating, unfair waiver and release of lien form can nullify 90% of your rights.)

In order to keep your "subcontractor" rights available to you, education on your part about applicable "lien laws" in your State as well as Federal Government is necessary. You have lien rights if you "perfect" them in a timely manner. (Appendix C). In the vernacular of the legal fraternity, if you let the "Lien Perfection Window" close, you are out of luck.

With regard to retention, generally your best protection is to send the owner (or awarding authority), within 30 days of signing, a subcontract with a general, single notice that you have entered into such a subcontract and, in accordance with applicable lien laws in your state, you must notify owner of terms of retention. (Appendix B). He must be told that he may be liable and/or property being improved can be liened by you, should the agreement be breached. Usually it would smooth things out to mention that this notice in no way is intended to reflect on owner or general contractor credibility or responsibility, but is issued in

compliance with state law. You may send him notice any time contract is breached after this single original notice is filed - however, no later than 90 days after the date on which applicable Original Contract (Prime) has been completed, finally settled or abandoned.

With further regard to retention, you are encouraged to support Senator Lowell Weicker (R - Connecticut) in his bid to pass the "Small Business Contract Payment Procedures Act) A 1782 and HR 5022. (see copy of Retention Statement from Assistant Secretary of Defense 2/3/82). This bill, if passed, could totally eliminate retention on federal or civilian construction projects. (see copy of Floor Statement 10/28/81). Should any of you be sufficiently close to Senators or Representatives of your States, Weicker or his top aide, Kim Elliott, would love additional sponsors for the bill.

The past president of the American Subcontractors Association, Norma Mann, in a panel discussion May 11, 1981, before the National Association of Surety Bond Producers, stated emphatically that the 80's would see the end of retention and direct payments from the owner in all subcontracts. Believe it or not, the moderator, Dave Braden, a Dallas architect, as well as Bud Cianchette, Past President of AGC, agreed that this could become a reality with given safeguards. (I feel this is a distinct possibility and am committed to working for it).

I suggest that each of you return home and research your state's construction laws. I would presume that most states have legislation already on the books pertaining to your "subcontractor "rights with regard to liens and waivers that allow you to collect your just receivables. You must understand them and broaden them if they do not now give you the protection you need.

Next you need to volunteer your help to organizations such as our own NECA in their constant fight in Washington to improve the climate of our business opportunities. Examples of our particular NECA involvement today, or in the recent past are:

A. Success in getting passage of the "Prompt Payment Act" providing that interest will be paid at the prevailing treasury rates on any monies fifteen days past due on government projects.

B. NECA is currently testifying, on or about May 1 in favor of the "no retention" bill entitled "Small Business Contract Payment Procedures Act." The hearings have been set.

C. NECA has just completed testifying, on or about May 1, in favor of the Hatch Act, which amends some of the more stringent liabilities and demands of the Erisa Act (Employee Retirement Income Security Act).

D. Bob Wilkinson of the NEC staff has just recently testified jointly with John Halecky, Jr. of Comstock on behalf of ASC's position in favor of retaining "completed contract" method of tax accounting.

On any of these items currently pending, you must stand ready to lend your help or particular expertise to the hearings when called upon.

The stage is now set. The audience, (our customers) are in their seats, the curtain is rising, thanks to NECA, ASC and ASA and now it's up to the actors - you and me - to make this business of ours the best, most successful production we can be involved in. We can do it. Good luck!

APPENDIX A
PARTIAL CHECK LIST PRIOR TO SIGNING SUBCONTRACT
WITH GENERAL CONTRACTOR

- 1) Checking on Owner's and General Contractors' financial ability to pay and financial stability of lender.
- 2) Read your subcontract.
Know what you are signing.

Areas to be wary:

- a) Scope of work
(insist on specificity)
- b) Time Extensions - Timely notice
(Owner caused, General contractor caused,
or either party caused)
- c) Delay Damages
(caused by whom and does subcontract
prohibit compensable relief)
- d) Withholding of progress payments and/or final payment
- e) Retention
(amount and terms of release)
- f) Changes and extra work
(authority for approval and payment)
- g) Concealed conditions
 - 1) **BEWARE OF GRANDFATHER CLAUSES**
 - 2) Assumption of others' liability
 - 3) Waiving of subrogation rights
- h) Release of Lien and/or Waiver of Rights clauses

APPENDIX ITEM B

**Hardeman Act
(applicable only in State of Texas)**

I. NOTICES

**A. General time limits used for notices;
(Examine type of notice for specific time limit used)**

1. Notice "36" -- Not later than thirty-six (36) days after the tenth day of the month next following the month in which the act occurred.
2. Notice "90" -- Not later than ninety (90) days after the tenth (10th) day of the month next following the month in which the act occurred.
3. Chart of time limits (Leap Year taken into account):

Month of Act or Occurrence	36 days after 10th of Month After Act or Occurrence	90 Days after 10th of Month After Act or Occurrence
January	March 18	May 10
February	April 15	June 8
March	May 16	July 9
April	June 15	August 8
May	July 16	September 9
June	August 15	October 8
July	September 15	November 8
August	October 16	December 9
September	November 15	January 8
October	December 16	February 8
November	January 15	March 10
December	February 15	April 10

B. Normal Retainage:

a. When required: Whenever a contract or agreement exists between you and whoever is paying you providing for retainage.

b. Who to notify:

i. Owner (if your agreement is with a general contractor.

ii. Owner and General Contractor (if your agreement is with a subcontractor)

iii. Surety company (if job is bonded)

c. Time limits: Notice "36"

i. Act or occurrence that starts time limit is the making of the agreement or contract.

d. Requirements and contents of notice:

i. Must be sent certified mail or registered mail; be sure to request a return receipt.

ii. Must be sent to correct addresses.

iii. Must state the sum to be retained.

iv. Must state the due date or dates if known.

v. Must indicate the general nature of the agreement.

JOHN DOE SUBCONTRACTORS, INC.
4318 Akard
Dallas, Texas 75201

CERTIFIED MAIL NO. -----
Return Receipt Requested

Rich F. Owner
14689 Commerce
Dallas, Texas 75201

Re: NOTICE OF RETAINAGE
Building Project (describe accurately, for
example: Warehouse located at 19000 N. Industrial,
Dallas, Dallas County, Texas)

Dear Sirs:

Pursuant to the requirements of the laws of Texas, you are advised that on February 8, 1982, the undersigned firm entered into an agreement with General Contractors, Inc. (or, Subcontractor, Inc., a subcontractor of General Contractor, Inc.) to furnish labor and materials for the above referenced project.

Our agreement provides: (Describe agreement, for example: for retainage on the contract price by General Contractors, Inc. of ten (10) percent - or at Owner's option after substantial completion of entire work a reduction of five (5) percent - of each billing. Total retainage to be due and payable upon completion of all our work, acceptance thereof by the Owner, our furnishing to Contractor of satisfactory evidence that all labor and material accounts in connection with our work have been paid in full, and receipt of final payment therefor by the Contractor from the Owner.)

Please understand the necessity of this notice from our position under state law. It is not intended to reflect upon the responsibility of you or your general contractor.

DATED this 8th day of February, 1982.

Yours very truly,

JOHN DOE SUBCONTRACTORS, INC.

John Doe, President

cc: CERTIFIED MAIL - Return Receipt Requested to General Contractor, Inc. (if
contract is with subcontractor)
CERTIFIED MAIL - Return Receipt Requested to Surety Company (if bonded
job)

APPENDIX C

**Hardeman Act Affidavits
(applicable in State of Texas only)**

A. Time Limits on Hardeman Act Affidavit

1. Affidavit "90" - Not later than ninety (90) days after the tenth (10) day of the month next following the month in which the labor was performed or the material furnished.
2. Affidavit "120" - Not later than one hundred twenty (120) days after the tenth (10th) day of the month next following the month in which the labor was performed or the material furnished.
3. Chart of time limits (Leap Year taken into account)

MONTH OF DELIVERY	90 DAYS AFTER 10TH OF MONTH AFTER DELIVERY	120 DAYS AFTER 10th OF MONTH AFTER DELIVERY
January	May 10	June 10
February	June 8	July 8
March	July 9	August 8
April	August 8	September 7
May	September 9	October 8
June	October 8	November 7
July	November 8	December 8
August	December 9	January 8
September	January 8	February 7
October	February 8	March 10
November	March 10	April 9
December	April 10	May 10

APPENDIX C (continued)
(applicable in State of Texas only)

LIEN NOTICE

a. When required: Whenever you have not been paid and wish to protect your lien rights.

b. Who to notify:

- i. Owner (if your contract is with a general contractor)
- ii. Owner and General Contractor (if your contract is with a subcontractor)
- iii. Surety company (if job is bonded)

c. Time limits: Notice "36" and Notice "90"

- i. Notice "90" to Owner **AND**
- ii. Notice "36" to General Contractor if your contract is with a subcontractor
- iii. Notice "90" to Surety (if job is bonded)

d. Requirements and contents of notice:

- i. Must be sent certified mail or registered mail; be sure to request a return receipt.
- ii. Must be sent to correct addresses.
- iii. Must contain a statement of account; billing or invoice in usual and customary form will do.
- iv. Must contain magic words:

"If this bill remains unpaid you may be personally liable and your property subjected to a lien unless you withhold payment from the contractor for the payment of this statement or unless this bill is otherwise paid or settled."

v. Should contain a demand for payment of the claim.

JOHN DOE SUBCONTRACTORS, INC.

4318 Akard

Dallas, Texas 75201

CERTIFIED MAIL NO. -----

Return Receipt Requested

Rick F. Owner

(address)

Re: NOTICE OF UNPAID ACCOUNT;

Building Project (describe accurately, for example:

Warehouse located at 19000 N. Industrial, Dallas

Dallas County, Texas)

Dear Sirs:

Please consider this formal notice under the laws of Texas that an unpaid account is due and owing to the undersigned firm from General Contractors, Inc., your general contractor on the above referenced project (or, Subcontractor, Inc., or subcontractor of General Contractor, Inc.) for labor and material furnished on the project during the month of December 1981.

Attached is a true and correct statement of the account that is due and owing (REMEMBER TO ATTACH THE STATEMENT OR INVOICE).

If this bill remains unpaid you may be personally liable and your property subjected to a lien unless you withhold payment from the contractor for the payment of this statement or unless this bill is otherwise paid or settled.

Demand is hereby made upon you for payment in full of this account.

DATED this 8th day of February, 1982.

Yours very truly,

JOHN DOE SUBCONTRACTORS, INC.

John Doe, President

cc: CERTIFIED MAIL - Return Receipt Requested to General Contractor, Inc.
(if contract is with a subcontractor)

CERTIFIED MAIL - Return Receipt Requested to Surety Company (if
bonded job)

SAMPLE LETTER COMPLYING WITH HARDEMAN ACT

CERTIFIED MAIL

RETURN RECEIPT REQUESTED

TO: (Owner)
(Address)

Re: (Reference to project and job site)

This notice is not to be construed as a reflection on the credit of anyone, but is forwarded to you merely to protect our lien rights. It is our practice routinely to send prompt notices to the owner of unpaid accounts.

The attached invoice describes work which we performed for _____, during the month of _____ 19__ in connection with the referenced project.

The amount of _____ Dollars (\$ _____) is currently due and unpaid on that account.

In order for the undersigned to preserve its lien rights under the Hardeman Act, we are required by law to advise you that if the attached invoice remains unpaid, you may be personally liable and your property subjected to a lien unless you take the precaution of withholding from your original contractor an amount sufficient to pay it, or unless the invoice is otherwise paid or settled.

Yours very truly,

(Signature of Claimant)

cc: (Original Contractor)

CERTIFIED MAIL

APPENDIX D
RECENT ACTIONS AFFECTING OUR BUSINESS

Item 1 /

Floor Statement of Senator Lowell Weicker, Jr. on the Introduction of
"Small Business Contract Payment Procedures Act of 1981"

October 26, 1981

Mr. President, today I am introducing the Small Business Contract Payment Procedures Act of 1981, a bill to eliminate "retainage" for small business construction contractors under certain circumstances.

This bill which is designed to benefit more than 100,000 small business and contractors, would free up more than \$4 billion now sitting idle in federal ledgers and make it available for investment in business growth and job creation.

Mr. President, this bill would not require the appropriation of a single penny from the U. S. Treasury. It would simply authorize the removal of redundant, duplicative and currently counterproductive restrictions on small construction firms in some situations.

Retainage is the practice of withholding a percentage of a construction contractor's progress payments pending satisfactory completion of all required contractual work. Generally, according to federal procurement regulations the government retains ten percent of each progress payment on a construction job, although currently each contracting officer can eliminate or reduce the amount of retainage if the work is being completed in a satisfactory manner. However, this is seldom the case, especially when a small firm is involved. My legislation would give statutory authority to a contracting officer to waive retainage if he determines the work is being performed satisfactorily and on schedule. The Act would likewise eliminate the withholding of retainages from small business concerns, provided the firm posts an adequate performance bond.

Mr. President, the impact of retainage on small business construction firms is staggering. According to a recent study of construction firms, conducted by the American Subcontractors Association, small contractors must cover an average of

\$200,000 annually in outstanding retainages. Like the government late pay problem, the retainage situation causes severe cash flow problems for small firms. Specifically, by slowing the flow of money to those performing the work, retainage often delays construction and thus drives up costs due to inflation.

Contractors and subcontractors must borrow money - at today's high interest rates - to cover outstanding retainages and maintain an adequate cash flow. The cost is then factored into their bids and passed along to the end user. I need not point out that on government jobs, the end user is the American taxpayer.

In fact, it is a curious paradox that retainage today achieves exactly the opposite effect that it was initially designed to attain. Begun as a method to get contractors to finish the job quickly, today retainage actually encourages delay. With construction being performed by so many different subcontractors, the ones who complete the bulk of their work before the project is done have no incentive to finish the final details quickly because retainages are not released until the owner accepts the building. These subcontractors will instead commit their resources to concurrent projects where payment can be expected.

However, in my opinion, one of the most unfortunate aspects of retaining a portion of a contractor's payments to ensure adequate performance is that it is duplicative of other standard contracting procedures. For many years now, contractors and subcontractors have been required to take out performance bonds to guarantee completion of their work. Retainage then, is an unneeded "double protection" which hurts contractors and subcontractors, yet which affords no extra assurance to the government's interests.

Mr. President, this legislation will benefit small business contractors and subcontractors, who have a real need for more capital to finance improved productivity and increased growth. Therefore, I urge expeditious consideration of the "Small Business Contract Payment Procedures Act of 1981."

APPENDIX D (continued)

ITEM II

Office of the Assistant Secretary of Defense

Washington, D. C. 20301

February 8, 1982

Memo for the Assistant Secretary of the Army
Assistant Secretary of the Navy
Assistant Secretary of the Air Force

SUBJECT: Department of Defense Policy on Retainage

Interest on commercial construction loans remains high and we must expect that the carrying cost on retained payment will be included in contract bids. Current construction contract retainage practices are likely to add costs to our construction program, therefore, and do not necessarily improve the quality or utility of the project. By controlling retainage on our contracts, we should realize economic savings in Department of Defense construction. The objective of this policy statement is to reduce our construction program costs and still permit Construction agents to manage their contract effort in a businesslike manner.

As a matter of Department of Defense policy, retainage will not be routinely used throughout the term of contracts for construction projects which are on or ahead of schedule and otherwise substantially in compliance with contract requirements. Some level of retainage may be used as the contract approaches completion, however, to ensure that construction deficiencies are corrected promptly and that completion is timely. Further, in specific cases, where past unsatisfactory performance by a certain contractor has been experienced or there is another valid consideration relating to a particular contract, the Construction Agent may elect to withhold retainage throughout the term of the contract if that will be in the best interest of the government. Construction Agents are to exercise these options with discretion and for specific justification. Retainage will no longer be a routine administrative practice.

This policy on retainage must be complemented by prompt and positive final payment procedure after a contractor has completed all contract requirements. This should improve our perception as a preferred customer by the construction industry and tend to reduce our contract construction costs even more.

Robert A. Stone
Deputy Assistant Secretary of Defense
(Facilities, Environment, and Economic Adjustment)