

PROMPT PAYMENT AND RETAINAGE

What must recipients do to ensure compliance with the requirement that subcontractors (which includes subconsultants) must be promptly paid for work performed on a U.S. Department of Transportation funded (DOT-assisted) contract?

- The recipient's approved DBE program plan should outline the steps it will take to address the barriers created by delays in payment to subcontractors. First and foremost, the DBE program plan must contain the prompt payment and release of retainage (where applicable) contract clause that must be included in every DOT-assisted contract. As required by the DBE program regulation, 49 C.F.R. § 26.29 (2016), the contract clause must obligate the contractor to pay the subcontractor for satisfactory completion of the subcontract no later than 30 days after the contractor receives payment from the recipient for the work performed by the subcontractor.
- Second, the recipient must implement appropriate mechanisms to ensure compliance with prompt payment and retainage requirements by all program participants. This means recipients must use legal and contract remedies available under Federal, state, and local law. See 49 C.F.R. § 26.37 (2016). The contract remedies to be used or available penalties or sanctions that may be imposed by the recipient in the event of a breach of the prompt payment or release of retainage contract clause should be set forth in the appropriate contract document. See 49 C.F.R. § 26.13(b) (2016). Other compliance mechanisms must be described in the recipient's DBE program plan, which is subject to approval by the appropriate DOT Operating Administration (OA).
- Some, but not all, of the mechanisms a recipient may use to enforce compliance with the prompt payment requirement are contained in 49 C.F.R. § 26.29 (2016). For example, recipients may require the contractor to obtain its prior written consent for good cause delays in or postponement of payment. The available remedies should be set forth in the DBE program plan, which is subject to approval by the appropriate DOT OA.
- The rule authorizes, but does not require, recipients to use the particular methods described in section 26.29. This does not mean, however, that enforcement of the prompt payment or release of retainage requirement itself is optional. Recipients are expected to enforce the terms of the contract that specifies what happens if this provision of the contract is breached. If the recipient does not choose to use the methods mentioned in the rule, then it must use other methods that are equally effective in achieving compliance. This information must be set forth in the contract and in recipient's DBE program plan document.
- Third, the DBE program plan also must describe the process used by the recipient, if any, to resolve disputes concerning the subcontractor's performance or indicate what happens in the event of a dispute (e.g., governed by the terms of the relevant prime or sub contract document). The appropriate OA is expected to review the DBE program plan to ensure the process is adequately described.

When are prime contractors required to return retainage to subcontractors?

- Withholding a certain percentage of the payment that is owed the prime contractor or the subcontractor until all the work of the prime contractor has been satisfactorily completed is known as “retainage.” The prompt payment provision of the DBE rule is intended to change when retainage is released. Prime contractors’ traditional practice of holding retainage until the recipient has made final payment to the prime contractor, even though the subcontractor’s work may have been satisfactorily completed months or years earlier, is not permitted.
- For example, suppose there is a prime contract that will take three years to complete. Subcontractor A satisfactorily completes its work at the end of year one. The prime contractor must pay the retainage it has held to Subcontractor A at the end of year one. The prime contractor cannot wait until the end of year three, when the entire prime contract has been completed and the recipient has paid its retainage (if any) to the prime contractor, to make this payment to Subcontractor A.
- Recipients that hold retainage must make incremental acceptances of portions of the prime contract as the work is completed so that retainage that covers that work is released before final payment for completion of the entire contract.
- If retainage is held by the recipient against the prime contractor or held by the prime contractor against the subcontractor, there must be a contract clause obligating the payment of retainage within 30 days of the recipient’s incremental acceptance of the work performed by the subcontractor (option three under 49 C.F.R. § 26.29(b) (2016)) or payment of retainage by the prime contractor (option two or three under 49 C.F.R. § 26.29(b) (2016)) within 30 days of satisfactory completion of the work performed by the subcontractor.

Does the prompt payment and release of retainage requirements apply only to DBE subcontractors?

- No. The prompt payment and release of retainage (where applicable) obligation is a race- and gender-neutral requirement that applies to DBE and non-DBE subcontractors alike. It is intended to apply to all subcontractors at all tiers.

When does the time period for payment or release of retainage begin to run?

- The 30-day time period for payment of subcontractors begins when the contractor receives payment from the recipient for satisfactory completion of the work. Satisfactory completion is defined by the regulations as “when all the tasks called for in the subcontract have been accomplished and documented as required by the recipient.” In the case of a second or third tier subcontractor, the 30-day time period begins to run when the 1st tier subcontractor receives payment from the prime contractor or when the 2nd tier subcontractor receives payment from the 1st tier subcontractor.
- As stated above, the incremental acceptance of a portion of a contract also will trigger release of retainage. The work of a subcontractor that is covered by the recipient’s acceptance of that

portion of the prime contract is deemed satisfactorily completed. For purposes of 49 C.F.R. § 26.29(b)(3) (2016), incremental or monthly progress payments for completed work may constitute incremental acceptance by the recipient.

- Contractors must submit the required documentation to recipients to begin the payment process. Similarly, subcontractors may be required to submit documentation to the prime contractor. In the interest of transparency, recipients are encouraged to share information regarding required documentation with subcontractors, to take steps to promote the timely submission by contractors of invoices for payment, especially when notified by a subcontractor that the work has been completed but payment has not been received, and to have adequate internal controls in place to facilitate timely payment at all tiers of contracting. Many state transportation agencies require at least monthly invoicing by the prime contractor. Delays by contractors of more than 30 days in submitting invoices for payment on completed work creates undue hardship on subcontractors and should be discouraged by recipients.

How does a delay in payment by the recipient affect the prompt payment obligation imposed on contractors?

- Because the regulatory requirement to promptly pay subcontractors is activated once the contractor receives payment from the recipient, a delay in payment by the recipient will have a direct impact on how quickly a subcontractor is paid for completed work.
- Like the Federal Prompt Pay Act that applies to contracts that are let by Federal government agencies, many state laws require state government agencies to promptly pay their contractors within a certain number of days (typically 7 – 30 days) of receipt of relevant documents (e.g., a proper invoice for the amount due and confirmation that the goods and services have been received and accepted by the recipient). Based on a search of state laws, all states have some kind of prompt payment law for public projects with one exception -- New Hampshire. This information is subject to change. Recipients that are covered by such state law requirements are encouraged to reference applicable prompt payment laws in their contract documents and their DBE program plan. This will assist program participants (e.g., prime contractors and subcontractors) in managing expectations.

What happens when there is a dispute over the satisfactory completion of the work performed by the subcontractor?

- The obligation to promptly pay subcontractors or to release retainage does not arise if there is a legitimate dispute over the subcontractor's performance. Recipients are encouraged to develop a dispute resolution process as a mechanism to ensure compliance with the purpose and intent of the prompt payment and release of retainage requirements. As stated above, the process used should be described in the DBE program plan and in the relevant contract document.
- A prime contractor may not withhold payment to a subcontractor that has satisfactorily completed work on the contract (contract A) as a means to address a dispute between the prime contractor on an unrelated contract (contract B). That would not constitute a legitimate dispute over the subcontractor's performance on contract A.

What effect does the absence of a direct relationship between the recipient and the subcontractor have on the obligation imposed on the recipient under the DBE program regulations?

- None. The prompt payment and release of retainage obligation is both a regulatory requirement that recipients are expected to comply with in administering their DBE program and a contractual obligation recipients are expected to enforce. Under the financial assistance agreement signed by the recipient, it is contractually obligated to implement a DBE program that complies with 49 C.F.R. Part 26 (2016), which includes the prompt payment requirement. The lack of a direct contractual relationship between the recipient and a subcontractor does not relieve the recipient of its obligation to ensure compliance with DBE program requirements by program participants as a condition of the recipient's receipt of DOT financial assistance.

Is the obligation to promptly pay subcontractors a material term of a DOT-assisted contract?

- Yes. Every DOT-assisted contract must include a commitment by the parties to carry out all applicable requirements of 49 C.F.R. Part 26 (2016) in the administration of the contract. See 49 C.F.R. § 26.13 (2016). This commitment covers the prompt payment and release of retainage requirements in 49 C.F.R. § 26.29 (2016). Failure by the contractor to honor this commitment is considered a material breach of the contract, subject to the penalties, sanctions, and remedies listed in section 26.13 and any other equally effective remedies the recipient deems appropriate. An effective remedy recognizes the importance of this obligation and seeks to correct the problem.
- The contractual commitment is a material term of the contract between the recipient and the prime contractor, and it is a material term of the contract between the prime contractor and the subcontractor under 49 C.F.R. § 26.13(b) (2016). The term "contractor" is defined to mean "one who participates, through a contract or subcontract (at any tier) in a DOT-assisted highway, transit, or airport program." 49 C.F.R. § 26.5 (2016). Consultants and sub-consultants (e.g., architecture and engineering firms) are contractors. All forms of contractual agreements (e.g., truck leasing agreements, task orders, etc.) are covered by the prompt payment requirement, which cannot be waived.

What are some of the contractual penalties that may be imposed by a recipient when a subcontractor is not promptly paid?

- Under 49 C.F.R. § 26.13(b) (2016), the penalties imposed by the recipient may include, but are not limited to, the following:
 1. terminating the contract,
 2. withholding progress payments,
 3. assessing sanctions,
 4. imposing liquidated damages,
 5. disqualifying the contractor from bidding on future contracts, or
 6. other remedies the recipient deems appropriate.
- DOT OAs are expected to ensure recipients enforce compliance with DBE program contractual commitments in DOT-assisted contracts.

How are prompt payment complaints processed?

- Complaints of non-payment should be submitted first to the recipient (i.e., the state or local transportation agency, transit authority, or airport that awarded the DOT-assisted contract).
- The recipient has an obligation to investigate the complaint and provide a timely response to the complainant. A timely response should be no more than the time required to promptly pay the subcontractor for completed work.
- If the recipient fails to respond to the complaint or otherwise fails to comply with DBE program regulations, the subcontractor may contact the appropriate OA providing financial assistance on the contract. The OA will investigate the complaint of noncompliance by program participants.
- The OA contact information is posted on the DOT DBE program websites hosted by the Departmental Office of Civil Rights, the Federal Highway Administration, the Federal Transit Administration, and the Federal Aviation Administration.

Is relying on complaints an appropriate means of enforcing the prompt payment and retainage requirements of the rule?

- No. Relying only on complaints or notifications from subcontractors about a contractor's failure to comply with prompt payment and retainage requirements is not a sufficient mechanism to enforce the requirements of section 26.29.
- Subcontractors are often reluctant to complain about contractors for fear that doing so will make it more difficult to get work in the future, despite the prohibition in the regulations against retaliation against individuals who file a complaint (49 C.F.R. § 26.109(d) (2016)). This may result in recipients not receiving complaints that would timely alert them to noncompliance by contractors.
- While this section does not mandate that a recipient employ a specific type of mechanism for monitoring prompt payment, recipients are expected to take affirmative steps to monitor and enforce prompt payment and retainage requirements. For example, posting prime contractor payment information on a recipient's website, database, or other place accessible to subcontractors may be effective in alerting small business subcontractors to the start of the 30 day clock. Using automated systems that require real time entry of payments to, and receipts by, prime contractors and subcontractors and that is regularly monitored is another example of a proactive compliance mechanism that flags late entries/acceptances for follow-up. Notarized certification from the prime contractor that payment was made to subcontractors and verification of that information also is a form of active monitoring.

What records should recipients and contractors retain to document compliance with the prompt payment requirement?

- To ensure compliance with the prompt payment provision, recipients may require prime contractors to provide information concerning payments to subcontractors and release of retainage where held. Data collected from contractors may include copies of cancelled checks. All participants in the Department's DBE program, including contractors, are required to cooperate fully and promptly with requests for information pursuant to 49 C.F.R. § 26.109(c) (2016).

The General Counsel of the Department of Transportation has reviewed this document and approved it as consistent with the language and intent of 49 C.F.R. part 26 (2016).