

Date of Hearing: April 25, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 547 (Chávez) – As Amended March 28, 2017

**SUBJECT:** California Prompt Payment Act: disabled veteran business enterprises

**SUMMARY:** Requires state agencies to pay properly submitted, undisputed invoices from certified disabled veteran business enterprises (DVBEs) within 30 calendar days of receiving the invoice.

**EXISTING LAW:**

- 1) Establishes the Prompt Payment Act, which requires the payment of undisputed invoices within 45 calendar days of initial receipt.
- 2) Permits a state agency to dispute an invoice for reasonable cause within 15 working days of receipt.
- 3) Requires a state agency to issue a payment request for an undisputed invoice to the State Controller's Office (SCO) within 30 days of receipt and requires the SCO to pay claimants within 15 days of receiving a correct claim schedule from a state agency.
- 4) Requires a late payment penalty to be paid to the claimant of an undisputed invoice that is not paid within 45 days. Two penalty rates are set in existing law, as follows:
  - a) 10% above the US Prime Rate for payment delays to a:
    - i) Certified small business;
    - ii) Nonprofit public benefit corporation;
    - iii) Small business that provides services or equipment under the Medical program; and
    - iv) Nonprofit organization that was awarded a grant or contract in an amount less than \$500,000.
  - b) 1% above the pooled Money Investment Account daily rate on June 30 of the prior fiscal year, not to exceed 15%, for payment delays for all other businesses.
- 5) Requires the cost of any late payment penalty be born by the state agency if it failed to submit the undisputed invoice to the SCO within 30 days and/or the SCO, if it failed to issue the payment within 15 days of receiving the undisputed invoice from the state entity.
- 6) Permits a state agency to dispute an invoice for reasonable cause, including a discrepancy between the invoice and the contract, a discrepancy between the invoice and what the contractor has delivered, lack of sufficient documentation supporting the invoiced amount, or an improperly executed invoice.
- 7) Requires the Department of General Services (DGS) to annually report on late payment penalties that were paid by each state agency.
- 8) Establishes a DVBE certification program, administered by DGS, and sets a 3% statutory goal for DVBE participation in state procurement activities. Defines a certified DVBE as a business that is at least 51% controlled by a person or persons who have been certified by the federal government as having a service-related disability of at least 10%, and is domiciled in California.

**FISCAL EFFECT:** Unknown

**POLICY FRAME:**

Small businesses play an essential role with California's \$2.4 trillion economy. Several studies show that net job growth is most significant among businesses with less than 20 employees. During recessions, small businesses are often the last employers to lay individuals off and the earliest to make new hires as the economy improves. California's targeted procurement programs for small businesses and DVBEs represent an important and cost efficient means for stabilizing and growing businesses.

These small size businesses face unique impediments in accessing capital through traditional financing institutions, and too often have to resort to high interest loans and factoring companies to raise working capital to complete state contracts. Existing law provides that all undisputed invoices are to be paid within 45 calendar days and sets a higher late payment penalty for a prime contractor that is a certified small business or a specified nonprofit, than for all other businesses.

This bill proposes include certified DVBE's within the group of businesses that receive the higher late payment rate, as well as creating a fast-track payment timeline for certified DVBEs of 30 days rather than the state's current standard of 45 days.

The analysis includes information on the California small business economy, the state and federal prompt payment requirements, and the state DVBE targeted procurement program. Amendments are suggested in Comment 6, which more closely align the author's intent with language in the bill.

**COMMENTS:**

- 1) **Small Business Procurement and Contract Act:** The Small Business Procurement and Contract Act (Small Business Procurement Act), administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. A DVBE component was added in 1989.

The Small Business Procurement Act states that it is the policy of the State of California that the state aid the interests of small businesses in order to preserve free competitive enterprise and to ensure that a fair portion of the total purchases and contracts of the state be placed with these enterprises. The statute further states that DVBE participation is strongly encouraged to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of California's disabled military veterans. Statute sets an annual 3% DVBE participation goal, and a 25% goal is set through executive order for small businesses and microbusinesses.

In 2015-16 there were 25,834 certified small businesses and microbusinesses and 1,736 certified DVBEs. A majority of DVBEs are small size firms with 75.4% of DVBEs holding a dual certification as a DVBE and microbusiness and 9.6% having a dual DVBE and small business certification. The remaining 15% of DVBEs operate with only a single DVBE certification and most likely represent larger size firms.

- 2) **Prompt Payment Program:** In 2015-16, 159 state departments reported entering into \$8.1 billion in state procurement activities. Approximately \$2.5 billion was awarded to contracts that included small business bidders as either a prime or subprime.

While the state constitution prohibits the advance payment for goods and services, state law requires invoices on delivered goods and services to be paid promptly, which is generally understood to be within 45 days. To encourage a state agency to "promptly" pay contracts, a late payment penalty is assessed for every day the payment is made beyond 45 days.

Reflective of the financial challenges smaller size vendor face in fronting the costs of material and labor to undertake a state contract, existing law sets a higher late payment penalty for contracts with primes that are a certified small business, small business Medical vendor, and nonprofits with contracts valued at under \$500,000. An undisputed invoice from these small business and nonprofit vendors are assessed at a penalty of 10% above the US Prime Rate, as compared to a rate of 1% above the pooled Money Investment Account for all other vendors. In 2016-17, this annual interest rate differential is 13.5% vs. 1.58%.

As an example: Under the higher penalty calculation for a small business and nonprofit prime vendor, an invoice for \$10,000 that is 90 days late would incur a penalty of **\$332.91**,  $[(\$10,000 \times 0.0003699) \times 90]$ . That same contract with another prime business would be **\$38.97**  $[(\$10,000 \times 0.000433) \times 90]$ .

These late payment penalties are required to be reported to DGS and aggregated into an annual report. State agencies that fail to report are also cited in the annual report. In 2015-16, 2,926 invoices were paid later than 45 days for a total of late payment penalties of \$377,635.09. This represents 0.0003% of all invoices processed in the fiscal year. Invoices from small businesses were significantly more likely to be paid late, representing 66% of all late penalty occurrences and 58% of dollars paid for late payments. Below is a chart displaying more detail on the 2015-16 late payments.

<b>Late Payment Penalties Paid by State Departments (FY 2015-16)</b>		
<i>Vendor Category</i>	<i>Number of Occurrences</i>	<i>Value of Late Payments</i>
Small Businesses	1,940	\$219,493.72
Other Businesses	986	\$158,141.37
<b>Total</b>	2,926	\$377,635.09

Source: DGS, Prompt Payment Report 2105-16

The chart above reflects a state agency response rate of 82%, 138 out of 168 state entities reporting. While 30 agencies did not report to DGS, the following 26 state agencies failed to report and are identified by DGS as having paid late payment penalties in 2015-16: California African-American Museum; California Arts Council; Commission on Asian & Pacific Islander American Affairs; Conservation Corps; Department of Conservation; California Energy Commission; Department of Finance; Fish and Game Commission; Department of Food and Agriculture; Energy Efficient State Property Rev FD, General Services; California Horse Racing Board; Department of Housing and Community Development; California Law Revision Commission; Legislative Counsel Bureau; California State Library; Office of the Lt. Governor; Managed Risk Medical Insurance Board; Department of Military; Commission on Peace Officers Standards and Training; Board of Pilot Commissioners; Office of Planning and Research; California Public Utilities Commission; State Public Works Board; Department of Social Services Foster Care; and Department of State Hospitals (Sacramento).

- 3) **Dividing the Payment Workload:** When a state agency receives an invoice from a vendor, the agency has a duty to ensure the delivered good or service meets the standard set in the initial order, plus any modifications. The state agency is given 15 working days from the receipt of the invoice, or delivery of property or service (whichever is later) to dispute the invoice and notify the vendor of any

deficiencies. If the invoice is disputed, the time clock for paying the invoice stops until the dispute is resolved.

In processing an undisputed invoice, existing law specifies that the state agency has 30 of the 45 calendar days to process the invoice and send appropriate documentation to the SCO, who is allotted the remaining 15 calendar days for the claim audit and warrant generation process.

As discussed above, existing law includes a cost deterrent for state agencies and the SCO in not meeting these deadlines with a late payment penalty beginning to accrue on the 46<sup>th</sup> day. The cost of the penalty accrues to which or both of the entities that fail to meet their deadline, 30 days for the state agency or 15 days for the SCO.

As an alternative, a state agency may elect to pay the undisputed invoice using a revolving fund process in order to take advantage of potential discounts or to avoid accruing late payment penalties. In this instance, the state agency may use the entire 45 day period themselves.

AB 547 provides that the state agency is required to pay a certified DVBE vendor within 30 days of receiving an undisputed invoice. Amendments are suggested in Comment 6 to clarify how this time is divided between the state agency and the SCO and as to the general applicability of other provisions in the Prompt Payment Act.

- 4) **Creating a New Prompt Payment Standard:** While state law sets a 45-day payment cycle AB 547 sets a 30-day payment cycle for DVBEs. This 30-day time period is consistent with the federal government payment cycle for all businesses. The federal government also has an accelerated payment policy of 15 days for undisputed invoices from small business vendors, among others.

Unlike the state Prompt Payment Act, the federal government sets a single late penalty rate for all vendors. The current federal rate is 2.5% and is regularly set for each six-month period by Secretary of the Treasury. For comparison, the 2016-17 state penalty interest rate is 13.5% for small business and certain nonprofits and 1.58% for all others.

Prior legislation, SB 983 (2008) and SB 159 (2007), added certified DVBEs to the list of vendors who are designated to receive the higher state late payment penalty. This bill not only proposes awarding the certified DVBE the higher penalty rate, it also calls for an expedited payment term.

In making this differentiation, the bill establishes a third category of prompt payment requirements. Some concerns have been raised as to whether this increases the complexity of the state payment process. Given that there were only 260 certified DVBEs that were not already certified as a small business in 2015-16, the financial impact to the state would likely be very limited.

- 5) **The DVBE Program:** The 3% DVBE procurement participation goal applies to the state agency or department's overall contracting activities in the given fiscal year and may be achieved by awarding state contracts to DVBEs as prime contractors or when DVBEs are used as a subcontractor.

Awarding departments have an option of including DVBE participation in every contract or making alternative arrangements, as long as the 3% objective is met at the end of the year. Each agency and department is required to designate a small business and DVBE contracting liaison to facilitate it in meeting the 3% DVBE goal and the 25% small business goal.

Departments also have the option of offering a 1% to 5% contracting incentive to strengthen the competitiveness of DVBE primes and non-DVBE primes that subcontract with DVBEs. Although not currently being utilized, statute includes authority for bidders that are unable or unwilling to include a DVBE in a contract to submit a utilization plan to DGS that commits the businesses to using DVBEs in the future. DGS is authorized to audit businesses that submit utilization plans to ensure compliance.

State departments that fail to meet the annual 3% goal can have their delegated contracting authority removed, although DGS has never removed program authority solely based on an agency or department's failure to meet its DVBE contracting goal.

DGS' has a range of responsibilities relating to the implementation of the DVBE Program including: Certification of DVBEs (2,043 DVBEs certified in 2015-16);

- a) Certification of small businesses and microbusinesses (25,824 small businesses and microbusinesses certified in 2015-16);
- b) Outreach to the potential bidders and the veteran community (191 events in FY 2015-16);
- c) Marketing of the DVBE program to state agencies;
- d) Partnering with CalVet on meetings with departments that are not meeting participation goals.
- e) Consulting with the California Procurement Contracting Academy on the DVBE training of state contracting staff;
- f) Preparation of an annual consolidated report on DVBE, small business, and microbusinesses participation within state contracting activities; and
- g) Program oversight to identify abuses by bidders and failures to preform by state agencies.

In a further effort to increase oversight and enhance small business and DVBE contracting activities DGS and the California Department of Veterans Affairs, met with 13 departments during 2015-16 that did not achieve one or both of their goals, including:

- o High spend state entities with over \$20 million in annual contracting: California High Speed Rail Authority; California Public Utilities Commission, and the Office of Systems Integration.
- o Small and medium-spend state entities with under \$20 million in annual contracts: Agricultural Labor Relations Board; California Housing Finance Agency; California Arts Council; California Human Resources/State Personnel Board; California Science Center; Delta Stewardship Council; Department of Managed Health Care; Governor's Office of Business and Economic Development; Office of Environmental Health Hazard Assessment; and the California Coastal Conservancy.

Below are charts displaying five years of DVBE participation rates. The charts include information on mandatory reporting entities and all reporting entities. Under both reporting metrics, it appears that the state is consistently meeting its DVBE procurement participation goals.

<b>DVBE Five-Year Contracting Activity – Mandated Agencies</b> (dollars in millions)				
<b>Fiscal Year</b>	<b>Total Contract Dollars</b>	<b>Total DVBE Dollars</b>	<b>Total DVBE Percent</b>	<b>Total DVBE Contracts</b>
2015-16	\$5,855	\$274	4.67%	18,638
2014-15	\$8,105	\$314	3.87%	16,192

2013-14	\$6,566	\$241	3.67%	12,777
2012-13	\$7,151	\$216	3.03%	14,907
2011-12	\$7,173	\$340	4.74%	16,246
<b>Average</b>	<b>\$6,970</b>	<b>\$277</b>	<b>4.00%</b>	<b>15,752</b>

Source: DGS Consolidated Reports for specified contracting periods

<b>DVBE Five-Year Contracting Activity – All Reporting Agencies</b> (dollars in in millions)				
<b>Fiscal Year</b>	<b>Total Contract Dollars</b>	<b>Total DVBE Dollars</b>	<b>Total DVBE Percent</b>	<b>Total DVBE Contracts</b>
2015-16	\$8,090	\$349	4.41%	21,739
2014-15	\$10,073	\$407	4.04%	18,228
2013-14	\$8,233	\$299	3.64%	14,305
2012-13	\$8,573	\$267	3.12%	16,776
2011-12	\$8,508	\$373	4.39%	17,835
<b>Average</b>	<b>\$8,695</b>	<b>\$339</b>	<b>3.92%</b>	<b>17776</b>

Source: DGS Consolidated Reports for specified contracting periods

While the year-to-year percentages are useful to review, it is also important to note that consistency among which agencies report or even which agencies believe that they are mandated to report varies. As an example, in 2011-12 86% of the mandatory reporting entities reported their contracting activity to DGS. For 2013-14, 2014-15, and 2015-16 only 80% of mandatory reporters provided the required data to DGS.

- 6) **Proposed Amendments:** The committee may wish to address a number of technical issues to clarify the operations of this measure. Staff suggested amendments are outlined below.
  - a) Modify legislative intent to reflect the new DVBE payment standard.
  - b) Specify that the penalty rate for a certified DVBE is the same rate as it currently provided to certified small businesses.
  - c) Specify that the state agency has 15 days to process the undisputed invoice and send appropriate documentation to the Controller, unless the state agency is directly paying the invoice.
  - d) Confirm that the Controller has the same 15 days to pay an undisputed invoice and the same conditions for paying the penalty as provided in existing law.
  
- 7) **Related Legislation:** Below is a list of bills from the current and prior sessions.
  - a) **SB 115 (Florez) DVBE Incentive:** This bill specifies that DGS is the administering agency of the California DVBE program and directs the department to prepare policies for the use of DVBE incentives for state procurement contracts. Status: Signed by the Governor, Chapter 451, Statutes of 2005.
  - b) **AB 170 (Papan) Prompt Payment Act:** This bill established the California Prompt Payment Act. Status: Signed by the Governor, Chapter 360, Statutes of 1997.
  - c) **SB 983 (Correa) Prompt payment Act of 2008:** This bill would have revised the definition of small business, for purposes of the Prompt Payment Act, to include a DVBE in order to make DVBEs eligible for the higher late payment penalties granted to small businesses. Status: Held on the Assembly Appropriations Committee's Suspense File, 2008.

- d) ***SB 159 (Wyland) Prompt payment Act of 2007:*** This bill would have revised the definition of small business, for purposes of the Prompt Payment Act, to include a DVBE in order to make DVBEs eligible for the higher late payment penalties granted to small businesses. Status: Held on the Assembly Appropriations Committee's Suspense File, 2007.
  
- e) ***SB 1517 (Dills) DVBE 3% Goal:*** This bill establishes the 3% DVBE participation goal in state procurement contracting. Status: Signed by the Governor, Chapter 1207, Statutes of 1989
  
- 8) **Double Referral:** The Assembly Rules Committee has referred this measure to the Assembly Committee on Accountability and Administrative Review (AAR) and the Assembly Committee on Jobs, Economic Development and the Economy. This measure passed AAR on a 7 to 0 vote.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

None on File

**Opposition**

None on File

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