

The Journal of

THE AMERICAN PROFESSIONAL CONSTRUCTOR

the American

Institute of

Constructors

In This Issue— —

- **AIC Goes to Washington**
- **Late Payments May Be Our Own Fault**
- **Academic Emergence of Construction Education**
- **When Does A Change Become Cardinal?**
- **The Need for A Ph. D. In Construction**
- **Associated Schools of Construction**

FEBRUARY 1989

Volume 13 Number 1

FORUM ISSUE

Late Payments May Be Your Own Fault

By Thomas C. Schleifer, AIC

Not getting paid on time takes some of the fun out of the construction business. It also adds to the risk.

Billing procedures in the construction industry are unique. The contractual arrangements guaranteeing and assuring the performance of the contractor and payment by the owner are one-sided, giving the owner more protection than the contractor. On public work and on a great deal of the larger private work, 100 percent and performance bonds are required. This effectively assures the owner that if the contractor is unable to finish the job at the agreed upon price, the bonding company will pay the difference.

However, the contractor on some projects has no assurance that the owner will have the money, or the inclination to pay in a timely manner. Public institutions have entered into contracts and then been unable to pay for them. And most contractors doing federal projects know of someone who performed signed change-order work and couldn't get paid because the owner or his representative didn't have the proper authorization.

Even with 100 percent surety guarantees, owners also withhold part of every payment as further guarantee that the contractor will do the job. Retainages of 10 percent are common, and only in recent years have some retainages been reduced to five percent, when a job is 50 percent completed (and acceptable). Finally, the federal government has begun to deal with the inequities of huge retainages on their projects.

Retainages are an expense to a contractor, which he, hopefully, passes on to the owner in his bid. But the assumption involved is that the contractor probably won't do his job unless he is forced to. Owners deny this. The authors of the contracts deny it. But no one wants to give up the practice. Its very usage sets the tone for the relationship between owners and contractors.

In the language of most contracts, and in the role (supposedly independent) of most

designers in the construction process, there seems to be the assumption that the contractor isn't going to do the job he's agreed to do unless someone holds a gun to his head. The environment in which contractors work is one of mistrust on the part of the designers and owners. Retainage helps to perpetuate that environment. Trying to get retainage released at the end of a project from designers and owners who deny any built-in bias or mistrust further perpetuates the environment.

When a million dollars of retainage is held for months awaiting \$50 thousand worth of punch list work, it becomes obvious that mistrust exists and that the contractual arrangements provide financial advantages to the owner. They're getting interested in the \$1 million retainage while contractors are paying interest on loans to compensate for high retainage.

The environment causes many contractors to feel they have very little power as far as their payments are concerned and that entitlement to their money is somehow clouded. Contractors want their money and some really go after it, but often they don't seem to have a strong feeling of entitlement. This condition is reinforced by the practice of walking a site with a designer or his representative at the end of a month to agree on the percentages of completion of the various line items of work. The designer's representative and the contractor's representative usually have a copy of the last month's payment requisition in front of them. They either agree, or debate and then agree, on what was done that month.

This practice is common on unit price jobs, but also very prevalent on lump sum projects. Some contractors don't do this. They send in their completed requisition, and if the designer disagrees, he sends it back marked with his changes (usually in red pencil), and the contractor retypes it, signs it, and sends it back to the designer. These practices demonstrate the payment environment in the industry and

demonstrate, for me at least, a problem with entitlement. These practices put contractors in the passive role of taking what they can get rather than the active role of invoicing their customers for services rendered.

The very word "requisition" suggests that they can only ask for their money. Furthermore, it suggests that there is some question as to their entitlement to it. I have had contractors tell me time and again that "this cooperative approach is the smoothest and most expedient way to get the requisition approved and into the hands of the owner for payment". They usually

Thomas C. Schleifer has been a contractor since age of 16. He received his formal education at the Newark College of Engineering and the Fairleigh Dickinson University Graduate School of Business.

Mr. Schleifer's experience includes serving as foreman, field superintendent, project supervisor, vice president of two construction companies, vice president and co-owner of Schleifer Brothers Construction Company.



From 1976-1986 he was president and then chairman of the largest international consultancy firm serving the construction surety industry. Currently, Mr. Schleifer spends his time advising contractors on organization, structure and strategic planning. He also writes, lectures, and teaches college courses.

His publications include: "Glossary of Suretyship and Related Disciplines," "The Prudent Underwriter" (videotape), "Construction Responsibility and Authority," and "A Contractor's Survival Guide."

add, "besides, the architect or engineer always treats me fairly." I suggest that in the name of fairness they have tolerated the attitude that they need to be controlled and that the designers have to protect the owners from them.

Fairness is a two-way street. It is not something that a party to a contract has to ask for or earn. If a contractor doesn't get it, it might be his own fault for not demanding what he is entitled to.

According to most contracts, the payment requisition is to be filled out by the contractor and approved by the designer. A contractor shouldn't need any help determining what work was performed during a month nor how much he wants to be paid for it. If the designer doesn't want to approve it, that's his prerogative. He can red pencil it and send it on to the owner along with the amounts he thinks should be paid. There's no need to retype it any more than a need to walk the site and bargain for the amounts. All that is established by doing those things is that the designer, and only the designer, decides what the contractor will be paid. Retyping means changing the request to say what the designer says it has to. What contractors do by these practices is place their monthly payment amount totally in the hands of the designer without even a right of appeal. Sure he can argue and cajole. But once he has agreed that only a clean, typed requisition can go to the owner, he must change his requisition to satisfy others.

Effectively what he has done is establish that he and the designer will agree on the amount before it is "approved" to be sent to the owner. This is ridiculous. It not only rewrites the payment provision of the contract, it leaves him in the one-sided position of trying to talk someone into agreeing on how much he should be paid. But the designers don't have to pay the suppliers, they haven't already paid for labor, and they aren't under any time constraints at all.

So why do some contractors get involved in these practices? Some have told me, "it's easier than arguing over payment, because arguing will only cause other problems with the designer." Others have said, "I don't want the owner to see a red penciled requisition, because he'll think I was asking for more than I should have." And still others say, "the owner's not going to pay except for what the designer approves anyway, so

what's the difference?"

The difference is that the practice gives the designers a disproportionate amount of control over the contractor during the construction process. As long as a contractor intends to live up to his end of the contract (including every item in the plans and specs as most designers insist they do anyway) they have nothing to fear from the designer.

There is no need to shelter the owner from payment requests. He should have an active role in the construction process and one of the few things the contract says he has to do is to pay, and there's no harm in clarifying that for him by involving him in the payment process.

If this sounds like I'm not in favor of cooperation, that's wrong. I'm just in favor of cooperation on sensible and businesslike terms, not cooperation that is one-sided to the point of that the contractor keeps quiet so the owner is always happy and the designer's boat isn't rocked. But it happens.

It starts with the payment process when a contractor doesn't stand up for his rights under one of the few sections of the contract that are favorable to him. He is supposed to requisition for work performed, and the owner is to pay within a specified period of time. If the designer doesn't approve the full request, the owner only has to pay the approved amount.

The contractor, in requisitioning, is simply doing what the contract calls for, as is the owner, in paying only the approved amount.

The designer, on the other hand, has stuck his neck out. If there are any consequences to his action of reducing the payment, the owner will end up paying for it. And most owners know that. Basically, contractors seem to believe that they are powerless in the payment process.

I once returned to an architect a red-penciled requisition which he sent to me for retyping, with a note to send it on to the owner as it was. I got a call from an incredulous architect saying that the firm had never sent an owner anything but a clean typed requisition. It was the first requisition on the project and I could only assume that the architect had reduced most of the quantities, out of habit or perhaps because he thought he should. As the amounts were all correct or, if anything, understated, and one line item requested nothing where

anyone could see that the work was obviously completed.

At any rate, he said that he wouldn't send the red penciled copy to the owner, and I would just have to change it, retype it and sign a new one.

I told him that I never retype a requisition and that I had sent the owner a copy of his penciled copy along with his letter telling me to change it and was waiting to see what the owner wanted to do.

The architect then proceeded to inform me that the contract stated that I could have no contact with the owner, except through the architect. I told him that he would have to explain that to the owner. He said, "What if I send the owner the copy of the marked up requisition and tell him not to pay any of it?" Both he and I knew he would have a hard time explaining that, and it sounded too much like discipline for me to even answer.

To make a long story short, the owner was advised not to pay. When the time ran out according to the contract, I gave three day notice for non-payment. That brought everything to a head and to a meeting at which the architect said: "I'm not sure exactly what was done by the last day of last month," which ended that.

I was paid immediately and before the tenth of every month for the rest of the project. Was the inspection on the job any more difficult than usual? I'm not sure. But I was sure that I wanted to be paid the correct amounts on time.

Slow pay and retainage held too long are an increasing problem in the construction industry. Too many people are allowing it to get worse by saying, "We can't do anything about it." Each contractor has to decide for himself what his approach to this subject should be after considering the impact of slow pay on his business.

If we added the interest paid on lines of credit required because of over-held retainage, we would be astounded. If we had the interest we could earn if we were just paid for the work on time, we'd be overwhelmed and out of debt.

One of the first things a contractor can do to collect his money faster, if not on time, is to prepare and send out his requisition on time.

I see bills go out on the 5th and 6th, even the 10th of the month when the contract specifically states: Bill for work completed as of the last day of the month, to be paid

no later than the 15th, (20th, 25th or whatever) of the following month. You can't expect owners and designers to begin the payment process until you get the payment application to them.

Begin the billing preparation well before the last day of each month. Have a tentative requisition done by the 26th or 27th, anticipating work that will be completed by the last day, and verify it by phone. In that way the requisition can be sent by fastest method on the 1st, even hand delivered, if practical. Phone to make sure the bill arrived and isn't sitting on someone's desk.

It's best to let people know that prompt and proper payment is important to you. They'll respect that. It's the sign of a good businessman. It's hard to change attitudes in mid-job after everyone's gotten used to a way of doing things. So you can't start pushing on existing projects, you need to start from the first requisition on the next job and be consistent.

There is nothing wrong with expecting to be paid for your work and asking for your money. Get it straight at the initial meeting. After everyone tells you what they expect or need, tell them what you need. Simply be up-front and say, "I want to talk about the payment process." It's not going to be important to anyone unless you make it important, unless you let everyone know you're not embarrassed about it and you expect it to be handled on time.

Payment is not a backroom discussion. Explain that your efficiency and productivity depend on paying your subs and suppliers on time and that you don't want to invest in the job—just build it. They should know that—they shouldn't need to be told, but they do. Remember, manage the process and keep it in the forefront of everyone's mind. No one else will do it for you.

After clarifying the payment procedures before the first requisition is due and making your needs and expectations known, it's a good idea to bill low at first. Submit a requisition for exact quantities of work completed. This way, if there is a problem with the designer, you can move with confidence right from the start, knowing he will be proven wrong if he red-lines your requisition. They'll get accustomed to taking your word for work completed. You'll get a reputation for fair rather than inflated requisitions. It's a fine strategy.

Almost all payment clauses say that payment is to be made by the 15th, 20th, or such, but many owners take the attitude that it's not due until the 15th or 20th. The immediate consequences of thinking payment isn't due until a certain date is to assume that it isn't overdue until some kind of grace period, like ten days after the date. There are a lot of owners who feel that way. "By" the 20th means just that. It will only continue to mean just that in the construction industry if we insist on it.

I talked to a public official once about getting payment for a job. He told me it was officially approved by the public body but that he did not have the authority to pay before it was due. We got the contract out and reviewed the payment section which said "By the 20th of each month". He said, "Then what is the due date?" I replied, "The payment is due upon approval of the designer, but no later than the 20th of the month." Without another word he authorized the check. I'm not suggesting that getting paid is easy by any means, but I am suggesting that we need to be aggressive in getting our money. Furthermore, we should read our payment provisions and explain them to the owners.

The cost of accepting late payments is obvious but the cost of late retainages may exceed even the interest we must pay for the wait. When a contractor gets stretched out and needs his retainage and when the amount of retainage far outweighs the value of the missing items, a lot of contractors give away the store to get paid. They either do work that they don't owe the owner or cut a deal forgiving part of the retainage in return for collecting the rest. The forgiven amounts are ostensibly for work not done, but they are usually pure concessions.

This happens even on jobs where a contractor cooperates throughout the project. Consequently, I strongly recommend that you stand firm on all payment requirements from the first requisition. If you don't get treated in a businesslike manner when it comes to getting paid, it may be because you haven't acted businesslike, and therefore can't demand businesslike treatment.

Not getting paid in a timely manner takes some of the fun out of the construction business. It also adds to the risk.

Cash flow is always a concern, but when a contractor's marketplace weakens and his

work slows down, cash flow problems can become critical very quickly. If all of a contractor's reserves are tied up in his receivables, he can be forced out of business. If many of the receivables are old retainages and slow payments, the contractor has to shoulder part of the blame for not demanding what was rightfully his. If the owner doesn't fulfill his end of the contract, a completed building is excellent collateral.

Don't go under because someone is failing to honor a contract that you've completed.

Department Chairperson, Nominations and applications are invited for the position of Chairperson, Department of Construction Management, College of Engineering and Applied Sciences, Florida International University. An earned doctorate is preferred in construction or related field, plus proven construction industry experience and administrative abilities, with achievements in teaching and research preferred.

Florida International University, South Florida's largest university, was founded in 1965. More than 16,500 students are enrolled in 167 programs of study in ten schools and colleges leading to degrees ranging from the baccalaureate through the doctorate.

The Department, one of 21 accredited programs in the U.S.A., has seven full time faculty and 350 students in undergraduate and graduate programs. The responsibilities will include: (1) administering the department; (2) teaching at the undergraduate and graduate levels; (3) conducting research and assisting in generation of external funding; (4) expanding industry-University relationships. Application accepted until April 20, 1989. Salary and rank will be commensurate with qualifications and experience.

Interested applicants who are U.S. citizens or permanent residents, should send complete resume, 3 letters of recommendation: Chairperson, Search and Screen Committee, Dean's Office, College of Engineering and Applied Sciences, Florida International University, The State University of Florida at Miami, Miami, Florida, 33199. FIU is an Equal Access/Equal Opportunity/Affirmative Action Employer.