

The Need for a Federal Prompt Payment Act

Payment delay problems are systemic in Canada's construction sector. This includes construction work tendered and procured by the federal government. This is a significant problem for small businesses, families, workers and taxpayers that could be addressed simply and at a low cost. Fixing the issue of payment delay will reduce delays in federal construction projects, lead to greater employment and more openings for apprentices.

The problem is a factor of two key practices. First, delays in processing valid invoices for work that has been performed according to contract that is not in dispute are hurting contractors. Second, delays in payments down the sub-contract chain, even when valid invoices for completed work are submitted, are creating bottlenecks and delays in federal projects.

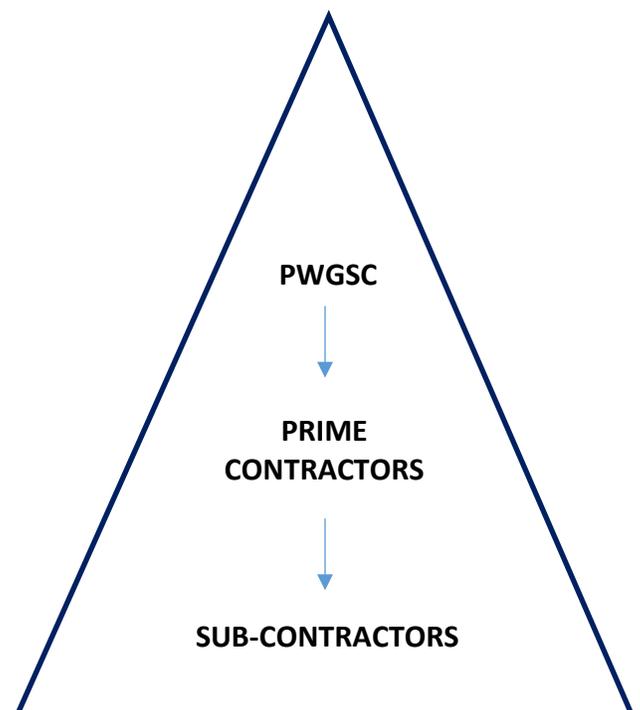
The United Kingdom, Ireland, Australia, New Zealand, and 49-of-50 states in the U.S. have enacted some form of prompt payment legislation. Canada has not.

Payment delays are the primary cause of recurring cash-flow problems in the construction industry. Cash-flow risks have forced many contractors out of business and discouraged others from investing in capital or hiring new workers. Economically this leads to a smaller pool of trade contractors bidding on work, fewer competitive tenders, less employment in the industry and reduced investments in apprenticeship training. Governments and businesses can no longer afford the status quo.

Over the past decade the late payment risk has increased, thus increasing adverse consequences for businesses that rely on contracted work and likewise governments as purchasers of construction services.

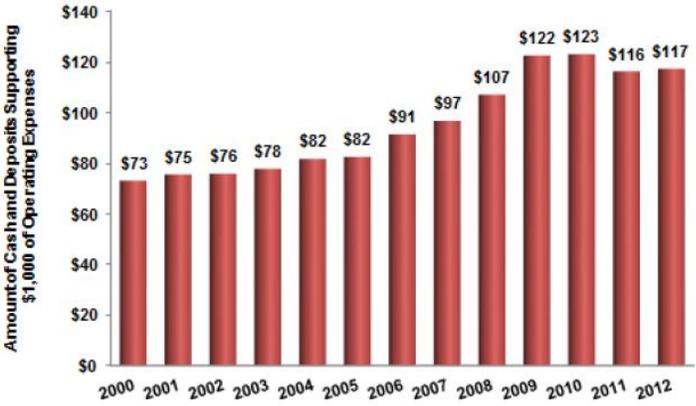
THE CONSTRUCTION PYRAMID

Trade contractors routinely function as sub-contractors in the pyramid model and they perform ***upwards of 80% of construction work on federal projects***. Their success, and the timely completion of projects, depends on funds flowing efficiently through the system. When timely payment is delayed at one level it delays payments to contractors and workers further down the pyramid. Trade contractors are contractually obligated to continue working even when payments owed to them have been delayed. In a pyramid structure, it is always in the interest of those who control the flow of work to delay payment to those further down the pyramid.



Trade Contractors are required to pay their employees weekly and are also required to pay taxes and contribute to the workers compensation system monthly, without delay. Materials and equipment rentals must also be made within 15 to 30 days, so there is no flexibility for trade contractors on the payables side of the ledger. This is the primary cause of business failure for trade contractors. In Canada, the lien system is relied upon to provide remedy in cases of payment default, but there is no remedy for systemic late payment.

Amount of Cash and Deposits Supporting \$1,000 of Operating Expenses in the Construction Industry, Canada, 2000 – 2012
 Calculations based on Statistics Canada, CANSIM Table No. 180-0003



In 2007 the average duration of a receivable in the construction industry was 62.8 days, by 2012 it had increased to 71.1 days, an increase of 13.2%. This was due to more receivables that were significantly delayed.

The increase in late payment risk has negative consequences for workers and the federal government:

1. Employment is lower because the amount of operating expenses that a trade contractor can support has been reduced by the increased in payment risk.
2. Some trade contractors have resorted to off-loading payroll risk by increasing the number of self-employed, independent operators in their workforce.
3. Fewer apprenticeships are created because of lacking willingness to make long-term employment commitments that are required to recoup the investment in training.
4. Increased payment risk leads trade contractors to make fewer investments in new machinery and equipment, reducing the long-term productivity in construction and raising costs overall.
5. Federal government construction costs are higher because trade contractors have incorporated the risk of late payment by general contractors into their bids, driving prices higher.
6. Federal government costs are also higher because increased risk reduces the amount of work trade contractors can afford to take on, thus reducing the bidding pool for projects.
7. The level playing field on which a healthy market depends is now undermined.

To alleviate these issues the federal government needs to bring Canada in line with our comparator nations and pass prompt payment legislation.