



Government-Industry Working Group

Prompt Payment Initiative

Engagement Strategy



PROMPT PAYMENT INITIATIVE ENGAGEMENT

STRATEGY

Introduction

This document outlines the issues and stakeholders involved in the development of the engagement strategy for prompt payment. The strategy was prepared in collaboration with the Canadian Construction Association, Public Services and Procurement Canada, Defence Construction Canada and is based on the current environment.

Background

At the 50th annual joint meeting of the Canadian Construction Association (CCA) and the Government of Canada on April 11, 2016, the CCA raised the issue of “Prompt Payment”. Included in these discussions were the costs to both the Government of Canada and industry related to the current payment structure, as well as potential contractual and non-contractual solutions to address prompt payment issues.



The Government of Canada was asked to:

- Take, and be seen to be taking, a leadership role;
- Engage in dialogue with CCA to identify, assess and implement possible improvements;
- Establish a Government-Industry Working Group.

It was agreed that a Government-Industry Working Group would be established and would meet regularly on this topic with a view to reporting back to Public Services and Procurement Canada (PSPC) by October 2016.

On April 13, 2016, a new bill (Bill S-224) was introduced in the Senate. The Act states that it aims to strengthen the stability of the construction industry and lessen the financial risks faced by contractors and subcontractors by providing timely payments to them under construction contracts involving federal government institutions. For more information, progression of the bill can be viewed on the following parliamentary website:

<http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&Bill=S224&Parl=42&Ses=1>

Government of Canada Construction Contracts vs Real Property Services Management (RP-1, RP-2, RP-n) Contracts

There is a deep perception within the construction industry that construction companies working on federal sites are working for the Government of Canada. This would then lead to

the belief that prompt payment solutions identified for Government construction contracts would equally apply to all construction activities on federal sites. In fact, Real Property Services Management contracts (e.g. RP-1, RP-2) procured by PSPC are for the management and delivery of a comprehensive range of real property services (including Property Management and Project Delivery Services) of numerous federal sites and projects across the country and therefore should not be designed and treated as construction contracts.



As the RP Contractor prepares to deliver the Project Delivery Services to the Government of Canada, the Contractor may procure some or all of the following services: planning, architectural and engineering, project management, construction, commissioning, project evaluation, etc. The RP Contractor is not engaged to perform any public procurement on the Government's behalf; rather, any subcontracting undertaken by the Contractor is done on its own account. The Contractor alone determines if any

portion of the required services could, or should, be subcontracted and is fully responsible for any decisions about how subcontractors are selected; how tenders are issued; and which terms (including payment) are included in subcontracts.

Problem Definition

Delayed payment throughout the payment chain on federal construction projects erodes Government buying power, increases financial risk and cost for construction enterprises and stifles economic growth. It is believed that although construction projects may be completed as intended, the money invested may not have generated the intended socio-economic benefits.

While the Government of Canada maintains a good payment record, in some cases inconsistent contract terms and payment delays further down the chain drive the cost of construction up and drive growth, innovation and employment down.

From the perspective of CCA's membership, which includes thousands of small- and medium-sized enterprises, along with some of the largest construction organizations in North America, timely cash flow throughout the construction payment chain is fundamental to a healthy construction industry. Delay in payments anywhere in the supply chain on construction projects reduces profit and the creation of capital. This restricts innovation, and investment in plant, machinery and equipment.

Payment delay also increases the cost for companies to finance their operations and drives up the cost of construction overall, which in turn reduces the buying power of government. The impact of payment delay on small- and medium-sized enterprises can be disproportionately severe, and even a minor delay in payment of one or two invoices can put smaller businesses under severe financial stress.

Timely payment throughout a construction chain enables companies to realize the competitive profit margins necessary to fuel growth, employment and to create the capacity in Canadian firms to build the infrastructure that is critical to the economic prosperity of Canada.

Working Group Scope

The Working Group will strive to identify possible solutions to the payment problem. It will focus initially on whether a given solution, if implemented, would likely improve the timeliness of payment throughout the payment chain and meet the needs of the industry. Then, for those solutions thought to generate the best results, the Working Group will consider an implementation plan, assessing the costs, feasibility/sustainability and constraints of these potential solutions against the expected benefits.



As solutions are developed the Working Group will, as a first or “pilot” phase, prioritize those solutions that can be implemented within the program of construction contracts having values over \$100,000 and which are managed directly by PSPC or Defence Construction Canada (DCC).

As a second phase, the Working Group will consider whether and how any of these solutions could also be implemented or be modified to allow implementation in other contracts including: construction contracts

issued by other government departments, future cycles of RP-n procurements, etc.

The Working Group acknowledges the integrity of existing contracts, and agrees that the scope of the Working Group does not extend to changes or even recommended changes to any existing Government of Canada contract, and potentially related policy or regulation.

Working Group Objective

To jointly explore possible actions by the Government of Canada and/or industry to improve payment terms and practices within federal contracts, at all level of the supply chain including the Government of Canada, the prime contractors, subcontractor, sub-subcontractor and suppliers.

There is consensus in the Working Group that a well-functioning market that enjoys timely payment on federal construction projects would have at least the following characteristics:

- Contractual payment terms throughout the federal construction project supply chain/pyramid that are fair. The CCA has proposed that the benchmark for fairness should be industry standard contract/subcontract documents endorsement by CCA and the Canadian Construction Documents Committee (CCDC).
- Undisputed amounts, including holdback amounts, throughout the construction project supply chain/pyramid are paid in accordance with fair contract/subcontract payment terms.

- There is sufficient transparency around the dates on which payments and holdback amounts are made/released to enable stakeholders within the payment pyramid to exercise remedies in a timely manner.
- The Government of Canada continues to manage fair and efficient payment processes within its contractual control, and where it does not have control, leads by example to influence good payment practices throughout the payment chain.
- The construction industry at all levels is knowledgeable about available contractual and legal mechanisms, and acts with confidence to ensure timely cash flow throughout the industry.

Current Industry Environment

The contractual relationships among the many stakeholders in any construction project are complex and hierarchical. An owner awards a contract to a prime contractor who will in turn engage a number of subcontractors, who will then engage sub-subcontractors and suppliers, resulting in a multi-tiered structure where the owner is not always aware of all the organizations who worked on the project, nor under which conditions. The Government of Canada has a long-standing position of keeping arm's length with subcontractors and refraining from being involved between the prime contractor and subcontractors or any lower tier supplier.



According to the CCA, the challenges around prompt payment in the federal context can be thought of in two broad categories:

1. How to ensure agreement on contractual payment terms at all levels (prime, subcontract, sub-subcontract and supply) that are fair, and that reduce cost to the Government of Canada and industry by reflecting the shortest reasonable commercial payment periods; and
2. How to ensure that payers at all levels, including the Government of Canada, prime contractors, subcontractors and sub-subcontractors, honour agreed payment terms and related contract administration requirements affecting payment, and act with a sense of urgency around the issue of prompt payment.

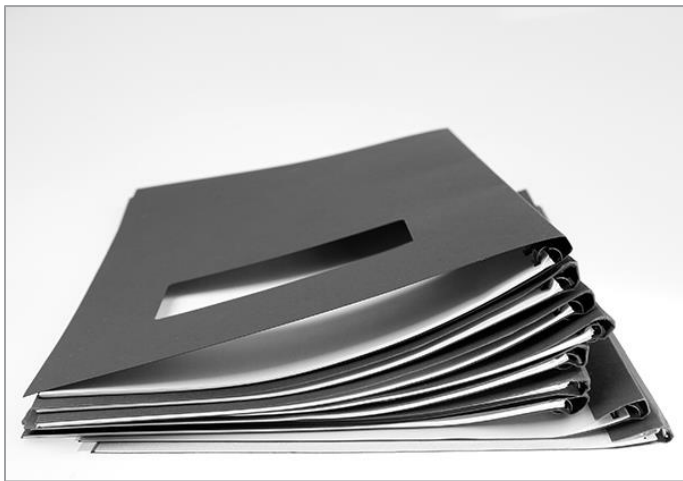
The CCA would like the federal government to “lead by example”, by both continuing to honour contractual payment terms with its prime contractors, and by communicating to stakeholders the importance of prompt payment at all levels of the payment chain and by taking other reasonable steps to inspire and motivate prompt payment practices on federal contracts.

The CCA recognizes that the Government of Canada is bound by the terms of existing contracts and, in the context of this Working Group, the CCA is not asking the Government of Canada to amend the payment terms of existing federal contracts. To the extent that the Government of Canada itself may decide to leverage from the work of this Working Group and to initiate dialogue with any of its existing prime contractors with a view to shortening payment periods throughout the payment chain on those contracts, this would be considered by CCA to be a very positive step.

The National Trade Contractors Coalition of Canada (another construction industry association) produced a report on "*The Need for a Prompt Payment Act in Federal Government Construction, April 2015*" advocating that the current status quo is not acceptable. Their report states that more than 80% of construction work is performed by trade contractors and, that the problem is two-pronged: delays in federal authorities in processing valid invoices and, delays in remitting payments down to the sub-contract chain.

Resolving this issue is a shared responsibility given the multi-tiered contractor/subcontractor environment. The government will need to look at the possibility of improving timelines for payments to the prime contractors however, it has currently limited control over the payment period by the prime contractor to subcontractors, or to any sub-sub contractors/suppliers further down the supply chain. To be successful, every trade (organization or individual) involved in a construction project would have to follow the same principles so that payments can flow down through the entire contractors' supply chain.

In Canada, several construction associations in the provinces (i.e., Ontario, Manitoba, Alberta, BC) have been lobbying for prompt payment legislation. The Province of Ontario has released its Expert Review on the Construction Lien Act and is proposing to introduce legislation in



spring 2017. The Province of Quebec is also considering the introduction of new payment rules by spring 2017 in response to the recommendations of the Charbonneau Commission Report. Other countries such as United Kingdom, Ireland, Australia, New Zealand and the United States (49 of the 50 states) have enacted prompt payment legislation. In its leadership role on the Prompt Payment initiative, the Government of Canada recognizes that it will need to take into consideration rules and legislation under provincial jurisdiction which impacts the construction industry.

Industry Considerations

Instances of payment delay occur at a granular, invoice-by-invoice, level throughout all sectors of the construction industry. It is a challenge to create reliable data at this level about the scale and impact of delayed payment.

According to the CCA, it is estimated that some \$46 billion in payments remained unpaid after the conventional 30-day period which represents about 16% of the estimated \$285 billion in construction put in place nationally in 2015.

While the data is necessarily high level, and there can be many valid reasons for payments to extend beyond 30-days in specific circumstances, in orders of magnitude, it does indicate a problem that is having a very significant negative impact on the ability of the construction industry to continue to thrive, grow and contribute to our prosperity.

Measuring an improvement in payment practices throughout a construction payment chain will, similarly, be difficult at a granular level. There is an opportunity for industry and Government to work together through the Working Group to identify meaningful metrics that can help all stakeholders understand the condition of payment practices objectively, and to identify areas of weakness and opportunities for ongoing improvement.

Government of Canada Considerations



The Government of Canada is only one of the industry's many commercial construction "clients" and represents a very small percentage (1%) of the overall industry business volume.

The Government of Canada strives to follow industry best practices where possible.

As the Government expends taxpayer dollars, significant oversight and due diligence must be exercised when making payments. The Government must therefore determine what is an acceptable and achievable timeframe to authorize payment, without compromising its due diligence.

Invoices for payments are processed on a project basis and involve a multitude of touch points for validation and certification. For example, the invoice payment process includes validation to certify completion/delivery of work, clarifications and follow-up with suppliers for invoice

errors/discrepancies, oversight requirements, processing in financial systems, cheque issuance, etc.

The Government currently pays for work done and goods delivered to site. Payment is made on time, almost always, as per government policy (*Directive on Payment Requisitioning and Cheque Control*). In addition, should the Government disagree with a submitted invoice, payment will be made on the amount not in dispute within the payment period and measures are taken to resolve the dispute for the outstanding amount as quickly as possible.

In accordance with Treasury Board Policy, the Government makes payment at 30 days, and then pays interest beyond that timeframe unless otherwise specified in the contract.

PSPC does in excess of \$1.9 billion of business annually with the private sector, and approximately .013% of late payment interest has been paid on this business volume (2015-16 data).

PSPC is the largest procurer of construction services for the federal government by value (75.6%); however, PSPC would need to engage with several other stakeholders to look at the current processes, examine potential options and ensure that other federal real property custodians support any proposed solutions.

Working Group Membership

| STAKEHOLDER ORGANIZATIONS | PARTICIPANTS |
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| Public Services and Procurement Canada (PSPC) | Real Property Services Acquisitions Branch Finance and Administration Branch |
| Defence Construction Canada | National Service Line Leader, Construction Services Operations Division |
| Canadian Construction Association (CCA) | Canadian Construction Association Office President, CCA Task Force Chair and Members |

Next Steps – Action Plan

The Working Group is developing an Action Plan to assess and address some of the issues related to prompt payment. Both the CCA and the Government of Canada are looking at actions that can be taken in the current environment and that would generate the greatest impact for the industry. This Action Plan will be complementary to the Engagement Strategy.