

Testimony by Jim Stephens, President

11400 Inc.

Board Member of Keystone Chapter Associated Builders and Contractors, Inc.

Good morning Chairman Ellis, Chairman Thomas, and members of the House Commerce Committee. My name is Jim Stephens. I am currently President of 11400 Inc., a company focusing on food service equipment, mostly on publically funded projects. I hold a Bachelors of Architectural Engineering, with a specialty in construction management from Penn State. Additionally, I have nearly 25 years of experience in the construction industry which includes time working as a general contractor, a sub-contractor and a supplier. I am also a member of the board of directors of the Keystone chapter of the Associated Builders & Contractors. While the company I currently lead focuses on publically funded projects, I have extensive experience working on projects in both the public and private sectors. Today, I would like to help the committee better understand the uniqueness that is the construction payment process.

In order to fully understand the commercial construction payment process there are two key points. First, it is rare to have money paid up front or at the time of delivery. Most projects involve some form of invoicing and delayed payment. Second, retention is almost universally utilized. Retention is a somewhat unique concept of with-holding a pre-designated portion of the payment until the project is complete. As an example, I like to compare it to purchasing a car. If I was going to buy a \$10,000 car from you under the same payment terms as are common in construction; I would arrive at your dealership, you would had me the keys to the car and an invoice for \$10,000. In 20 days, I would send you a check for \$9,000. Then, after the first oil change, if there are no problems I would send you the remaining \$1,000.

As noted by Ms. McCaslin, because of the uniqueness and complexity of the construction payment process the Pennsylvania's Contractor and Subcontractor Payment Act (CASPA) was signed into law in 1994. CASPA currently establishes a timeframe for payment from owners to parties directly contracted for construction work of 20 days. This 20-day limitation, however, is only enforceable in the absence of a construction contract containing payment terms. I can assure you as a professional that is involved in construction contracts on a daily basis that it is exceptionally rare for a construction contract to not include payment terms.

In fact, equally rare are payment terms that come close to 20 days. It is now common for owners, particularly larger multinational corporations to require General Contractors to accept payment terms of 90 or more days. This extended pay schedule naturally affects everyone else on the project.

To demonstrate the practical application of these increasingly extended payment terms by project owners and how those terms can dramatically affect construction companies, I would like to walk you through a theoretical billing process. If we assume that a subcontractor who is contracted for work on a construction project begins with a labor cost of \$10,000 on February 10th. On that day the subcontractor pays their employees the full \$10,000. The subcontractor would bill the general contractor – for whom he or she is performing work – for the same \$10,000 on February 24th, the theoretical end of the billing period. The general contractor would then receive that invoice and submit a bill for \$10,000 to the owner one week later on March 1st. The owner would then wait 90 days, (the time allotted by example in this testimony), to authorize payment, however the owner would withhold 10% in retention. This means that on May 29th, the owner would authorize a payment for \$9,000 to the general contractor, from whom he or she received the invoice. The general contractor would then issue that payment back to the

original subcontractor on June 12th, fourteen days after receiving payment from the owner. In this example, which is an industry standard in many areas, the original subcontractor has now waited 122 days – over 4 months -- to receive 90% of the payment they already paid for his or her services. And, that's just one project. Multiply that amount by dozens of projects a subcontractor may have underway, and you have an idea of the magnitude of this problem, and the very detrimental effects it has on cash flow and ultimately on a contractor's ability to succeed.