

JUST WHEN DO YOU PAY THAT BILL?

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The Question

This is a test. It's the kind of test that all people who spend other people's money should be able to score 100% on — but few probably will. Only one question.

The question is this. After you've ordered something on your agency's or institution's purchase order, when do you pay the bill ("paying" as used here, actually means "authorizing" because the act of approving an invoice is tantamount to actually spending the money)? You should note that, as you go through this article, almost everything here applies to your personal life as well. So, when do you pay the bill?

- 1) When you place the order.
- 2) When the order is shipped.
- 3) When the contractor calls for payment.
- 4) When the contractor screams loudly for payment.
- 5) In the next available accounts payable check run.
- 6) When the invoice is presented.
- 7) When you get the stuff.
- 8) After a 15 day trial period.
- 9) After a 30 day grace period.
- 10) After the next full moon when the dogs are at bay...

Have you chosen one? Go ahead. Chose one now. Mark it. Done? Well, you're wrong. The answer, of course, is none of the above. If you answered that, you get 100%. To understand why, you must know a bit about contracts.

All purchases are contracts, of course. We issue a purchase order (or negotiate a contract) and if the supplier of goods or services accepts the order (and/or signs the contract), a contract is formed and both parties have binding obligations resulting from the formation of that contract.

The Essence Of Contracts — Consideration And Performance

To be valid, contracts must have certain attributes. The essential elements of a valid (non-voidable) contract are an offer, an acceptance and consideration. Without those three elements, there is no contract ⁽¹⁾.

Consideration is also called the **price of the promise**. **Consideration** is what you give in return for the goods and services being furnished — usually this is money but not always, and sometimes it's money plus other things like the use of agency or institutional facilities for assembly, or computers for calculations, or temporary office space for work administration, or printing of manuals, or even guarantees of union support in return for no-strike agreements.

In most cases the consideration is fairly simple — it's the money. A contractor **performs** and we pay the money. **Performance** becomes the primary determinant in deciding when to pay and how much.

The Answer

Ergo, the answer to the multiple choice question above is, “You pay the bill when **performance** is complete — and not a moment before.” — no matter how much hemming and hawing, whining and bleating, belching and burping that your contractor visits upon you. **Consideration** is the reason that the contractor has agreed to **performance**. **Consideration** is also your only insurance that what you ordered, in its entirety, will be done to your satisfaction. Note that I said, **your satisfaction**, not someone else's. Not the contractor's. Not your mother-in-law's. Your's only (as the taxpayer's designated representative).

The Mantra

Consideration withheld is your only tool for compelling effective and complete performance. Read this sentence again and dwell upon it for a moment. Memorize it. Write it on your desk calendar or post it on your computer.

Contrary to television fantasy, multiple lawsuits, an abundance of collection companies, and even threats of violence will rarely, if ever, compel performance on a contract.

The Issue Of Trust

But, alas, you say, what about trust? What about goodwill? What about the inherent goodness of the nature of man?

Hogwash.

You can be kind and warm and friendly and caring but you do not surrender the taxpayer's money for anything less than absolute performance. Prepayment, payment in advance of performance, is done only when there is no other choice (see exceptions below). If you are an invoice-approving authority, it is your responsibility to ensure, to the best of your ability, that performance is completed as specified and if it is not, then **payment is withheld until it is**. Remember Lenin's Maxim, “*Reassurance is nice, Reinsurance is better.*” Consideration withheld is the best form of reinsurance — and it's free!

The Composition Of Performance

So you have your contractor's invoice in hand and accounts payable is ready to pay the bill. All that is needed is your signature and the contract is considered closed out (completed and unalterable). Now is your last chance, as your hand hovers above the approval line, to ask yourself, “What constitutes complete **performance** on this purchase contract?” Or, a more difficult but nevertheless answerable question, “What constitutes **performance** on this phase of a service or construction contract?”

Certainly it's easy to say that you have the widget on your desk (or the consultant's final report, or the new welding robot in the Engineering Lab or the parking lot striping is clearly complete). But, before you sign, ask yourself if delivery only comprises performance. Example. Does your widget actually work as specified, with all the right bells and whistles? Do you have all the necessary documentation (manuals, parts lists, operating procedures — this is especially important in the purchase of software and machinery)? Has the contractor returned all loaners (room keys, tools, rentals)? Has

the contractor signed off on all transfer documents such as titles, warranties, releases of liens and bills of sale? How about training? — is all implied or explicitly promised training completed? Do you have an itemized, crystal clear statement that this is the final invoice implying that the contract is complete for the amount indicated and that there will be no further invoices? (Nothing is more disconcerting than to pay what you thought was the “final bill” only to receive the “real final bill” a month later.)

If the answer to any of these questions is "No," do not sign. If you do not have **specific performance** on each and every obligation of the contract, do not pay.

What To Do? What To Do?

What do you do? You inform the contractor of the items you require in order to release final payment and you wait.

Sometimes you wait a long time.

Sometimes you will be subjected to many unfriendly challenges and downright disrespectful interrogatives. Disregard, and notify again, reiterating your “punch list” (list of deficiencies) — and you wait. Guaranteed you will get everything you need before you close out that contract. Experienced and reputable contractors expect a punch list and expect to have to tidy up loose ends to the owner’s satisfaction. Inexperienced and disreputable contractors just want the money (as quickly as they can get it).

Be especially wary of sob stories (money is needed to make payroll, to file back income taxes, to pay father-in-law’s hospital bills) — please pay now and for sure the punch list will be cleaned up next week. Never fall for these canards. Whenever I get an obvious prevarication, I annotate the file that the contractor is probably kiting bills (using our money to pay overdue bills that he’s unable to pay through normal cash flow) or is about to go bankrupt. Any contractor who has to tell a tear-jerker to get advance payment must be treated as being on the edge of non-performance and extra steps should be taken to secure the taxpayer’s position.

Pay in advance for any of your deliverables or requirements and hell fires will freeze solid before you obtain complete performance from your contractor.

The Teaching

The teaching is this. Before you sign over any of your agency’s money to any provider, make very sure you have total performance. Then, when you’re sure, pay the bill pleasantly and promptly.

I wish I could end here, but, like everything in our increasingly complex world, there are exceptions to the principle of **payment after performance**. Here are some.

Special Cases

The primary exception is:

- **Construction contracts** in which progress payments are made but on the basis of incremental performance, the rule being that you never pay for work which is not completed and you rarely pay for materials on hand but

not installed. In the same sense that owing more money on a car than the car is worth is called being “upside-down,” having paid more money on a contract than the value received, carries a similar connotation. You never want to be upside-down on a contract. It puts you at the mercy of the contractor and it’s very bad for your digestion;

Other exceptions are:

- **Credit card purchases** (in which you have no control)
- **Items which must be prepaid** (such as subscriptions and memberships)
- **Negotiated prepayments** (some contracts call for such payments)
- **Retainers** (as in retaining legal council)
- **Many intergovernmental arrangements** (such as joint participations)

There are yet other exceptions such as materials delivered but not installed (only if there is no other way)...

Materials On Site

Many contractors will request payment for materials on site (not installed). Common examples are construction materials delivered and stored on the construction site, sound equipment delivered to a language lab but still in its cartons, computer network systems fully installed but not yet operational, and even 20 truckloads of mulch creating a miniature mountain on a parking lot but not yet spread over the 65 open planting beds for which it’s intended.

In all these cases, the contractor may claim that the material portion of the job is complete — purchased, paid for and delivered — thus the agency has an obligation to pay for that portion of the contract represented by the materials.

Unless the original contract actually requires payment for materials in advance of their installation, emphatically resist the temptation to pay in advance (and if I am party to the negotiation of the contract, I invariably reject any proposed clauses which require payment upon delivery if there is any additional work to be done other than just plain delivering the commodity). There are a number of very good reasons for denial of partial payments for materials on site. They are:

- 1) Once you’ve paid for materials, it’s much more difficult to collect for any damage done to the materials during installation (once you own them, there is a natural tendency on the part of the contractor to take less care than if the contractor owns them).
- 2) Regardless of storage location, title to the materials, i.e., ownership, usually passes from the seller to the buyer upon payment and the owner (and its insurer) become responsible for those materials when payment is made. You don’t ever want to be in a position of owning a roomful of unmarked cartons containing computer equipment and explaining to your IT people that the contractor went bankrupt just after delivering the goods and, whether they like it or not, they own

all those nondescript cartons containing all that unidentifiable electronic equipment.

- 3) In each of the examples given in this article, **performance** requires that the materials be installed. Without installation (manuals, training, etc.) **performance** is incomplete.
- 4) In many cases, you may not have proof that the materials have been paid for by the contractor. If you pay the contractor for the materials and a month later you receive an invoice from the supplier for the same materials, long after the contractor has high-tailed it to the next county, you may well be in the unhappy position of paying for the same materials twice. You definitely don't want to be there, especially with the taxpayer's hard-earned dollars. {The issue of bonds will be discussed in a separate article.} If you do pay for materials, you may well have been hoodwinked into the oldest scam in the territory — akin to buying the Brooklyn Bridge — that is, buying something that doesn't belong to the seller! Not a very good item to add to the resume of a purchasing professional!
- 5) In actuality, uninstalled materials are not assets at all, they are liabilities. A bankrupt contractor leaving you with a load of structural steel to corrode on the site while you either have to pay for protection of the steel or negotiate a secondary contract in advance of rebidding the balance of the work, leaves you in a net deficit position. Bottom line — you don't want that steel. It's not yours and it will not become yours until it's installed, inspected and approved by the local building official. Likewise, sound equipment in cartons is of absolutely no value to language students and if you had wanted it to be delivered only, that's what you would have specified. Same with a computer network. And a mountain of mulch sitting on one or your parking lots for over two days will certainly invite the wrath of your parking administrators. And that welding robot mentioned earlier? — is nothing but an anchor of twisted metal and useless electronics until the lab instructors are fully trained in its use by the contractor.

Remember Rain Rule #17; A heap of uninstalled doorknobs or light bulbs, all neatly stacked in perfect rows with labels gleaming will shrink in direct proportion to the amount of security provided. It's an immutable law of physics. If you own the stack, you pay for its security — and if you don't, you will pay for the same stack again! Either way, if you own, you pay.

So, even a simple and seemingly harmless request for partial payment on materials is potentially an innocuous trap and must be critically questioned before any approval is given, if not denied outright.

Performance Is Paramount

Check on the contractual requirements for performance before considering approval of any invoice.

When an invoice is presented to you for approval, never assume it's acceptable. Always revisit the contract. Never assume that the contractor has paid for anything being invoiced. There are a number of ways to check on ownership, not the least of which is a simple phone call to the contractor's supplier.

A Closing Thought

We public purchasing folks spend a good deal of our time dealing with issues of fairness and equity — and not just on a philosophical level. We comprise one of the few professions which must implement these values on a daily basis, sometimes in complex and indeterminate situations⁽²⁾.

We spend so much of our time evaluating fairness that we may lose sight of the fact that we are agents of our taxpayers — first and foremost, advocates of our agency goals. As such, it is our responsibility to exact specific performance from those who would contract with our employers.

Withholding payment or other consideration may seem unfair, even cruel, especially when the contractor is a nice gal or guy and has tried to do a good job.

Fair or not, withholding consideration is the only reasonable method we have of compelling performance. And when contracts go south, it's not only our job to step in, swallow hard, and force the issue — it's our duty.

•----- End -----•

Footnotes and References

⁽¹⁾ **Offer**

The first step in forming a contract is an offer. An offer is a statement, written or spoken, by a party of his or her intention to be held to a commitment upon acceptance of the offer.

Acceptance

The second requirement for the formation of a valid contract is acceptance of the offer. In order for an acceptance to be effective, it must be made while the offer is still open.

We can intuitively understand offers and acceptances. One party makes an offer to perform some action, like perhaps to dig a ditch, sell a bicycle, or marry a cousin; the other accepts or rejects the offer. Offering, rejecting and counter-offering can go on for some time until there is an acceptance of the conditions by both parties. At that point, unless consideration has been included, there is still no contract.

Consideration

Consideration is a more difficult concept to grasp. The simplest definition of consideration is this:

Consideration is the price of the promise.

Consideration is a legal concept, which describes something of value that is given in exchange for performance or a promise to perform. The presence of consideration distinguishes contracts from gifts. Consideration can be a promise to do something there is no legal obligation to do, or a promise to not do something there is a legal right to do. Promises to exchange money, goods, or services are forms of consideration. All parties in an agreement must give

consideration in order to create a contract. The mere promise to pay money is one common form of consideration.

For more on her components of contract see my article entitled "Consideration" at ftp://130.85.57.71/wwwroot/Purchasing_Link/Commentaries/Apr2003_LR_Commentary.htm

- (2) Examples: Have all potential bidders had a fair and reasonable opportunity to bid on this project? Have all bidders had equal and fair access to information? Have we ensured that no bidder or contractor has received preferential treatment of any kind? Have we applied reasonable diligence to ensure that no one has been individually prejudiced by our actions? In matters of disagreement, have we ensured that all parties have had an opportunity to be heard? Have we administered this contract and interpreted its terms with the wisdom of Job and the temerity of Attila — objective, impartial, and firm? Tough questions in some cases.

Note: This article consists of my own opinions and has been prepared by me, a non-lawyer; thus, this commentary should not be construed as legal advice. If you are seeking legal advice of any kind, please consult your local Bar Association or your agency counsel, not my web sites or my articles.

This article was originally published in the HigherMarkets Newsletter, *Purchasing Pulse*, in February, 2001. This version is updated and extended; thus, it is considerably different from its predecessor.

I retired as Purchasing Director of Lane Community College in October, 2003 and am now the principal of Lloyd Rain Associates; my firm provides solicitations for public agencies (www.rainassoc.com).