

RHarper Consulting Update

What to Do When Things Go Bad With Your Contractor - Part I

The recent uptick in construction activity over the past two years, in addition to yielding many new projects, is also creating its fair share of projects in trouble. Owners are realizing that the contractor they engaged at an unbelievably low price is now leading them into a nightmare of change orders, missed completion dates, and costly claims. Many Owners have never experienced a project in crisis.

This two-part series will first deal with the early warning signs of a project in trouble, while the second part will address actions owners should take when it becomes apparent that the project is headed in that direction. We will also provide some helpful hints on how to prevent projects from going bad.

Ounces of Prevention

Here are some of the actions the Owner's team should take in the selection process to prevent, or at least minimize, risks as the project progresses:

- References - in addition to references provided by the Contractor, check with other Owners you may know who have used the Contractor previously. If that is not available to you, then cold call some of the Owners on the Contractor's qualification statement. Always ask about claims, liens, schedule compliance and change orders.
- Financials - Request audited financials as part of the qualification package from the Contractor. Ask your accountant to perform a simple ratio analysis to assess liquidity and financial capabilities, and to look for ways the statement may have been manipulated to artificially inflate certain aspects.
- Contract - Have a competent construction attorney draft the construction contract and general conditions. Do not allow the Contractor to draft the contract. Ideally, make the contract form and modified General Conditions a part of the initial qualification package. Your greatest leverage is prior to award of the Contract - make good use of it.
- Schedule - Make a detailed schedule, including manpower planning, a contract requirement. If the Contractor falls behind, this will provide some contractual language to leverage the Contractor to staff the Project adequately for recovery.
- Applications for Payment - Establish the documentation and detail to be provided with each application for payment. Include lien waiver and stored material payment provisions as well.

Warning Signs

These are usually part of an incremental, creeping process which leads to the Owner, at some point in the project, waking up and realizing that he/she is in trouble. Only rarely will there be a single, obvious event.

Early warning signs include:

- Project progress - if the Contractor starts to miss milestones, fails to provide or maintain a recovery plan, or the manpower on the Project is not sufficient to maintain the schedule, there is cause for immediate concern and corrective action by the Owner.
- Lien notices – Notices of liens from subcontractors or suppliers are obvious indicators of trouble. While there may be valid reasons for a payment dispute between the General Contractor and the subcontractor/supplier, the Owner should take action to deflect spurious payment claims.
- Change orders and requests for time extensions - Another warning sign, if they lack proper foundation or documentation.
- Applications for Payment - If the documentation on the monthly applications for payment doesn't reconcile, or if the percentage of completion shown on the application does not jibe with the actual completion of the project, the Owner should immediately commence an audit and make adjustments on subsequent applications.
- Personnel turnover - frequent turnover of the Contractor's team, or churning of subcontractors or suppliers, certainly warrants further review by the Owner.

The reality of a project in trouble is often very hard for an Owner to recognize and accept. Every problem that occurs on a project does not constitute a true warning sign that the Contractor is failing. The circumstances have to be considered as a whole, and the Owner has to carry out contractual requirements as well.

In part two of this article, we will discuss what to do when the project is genuinely in trouble – and how to get it back on track.



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