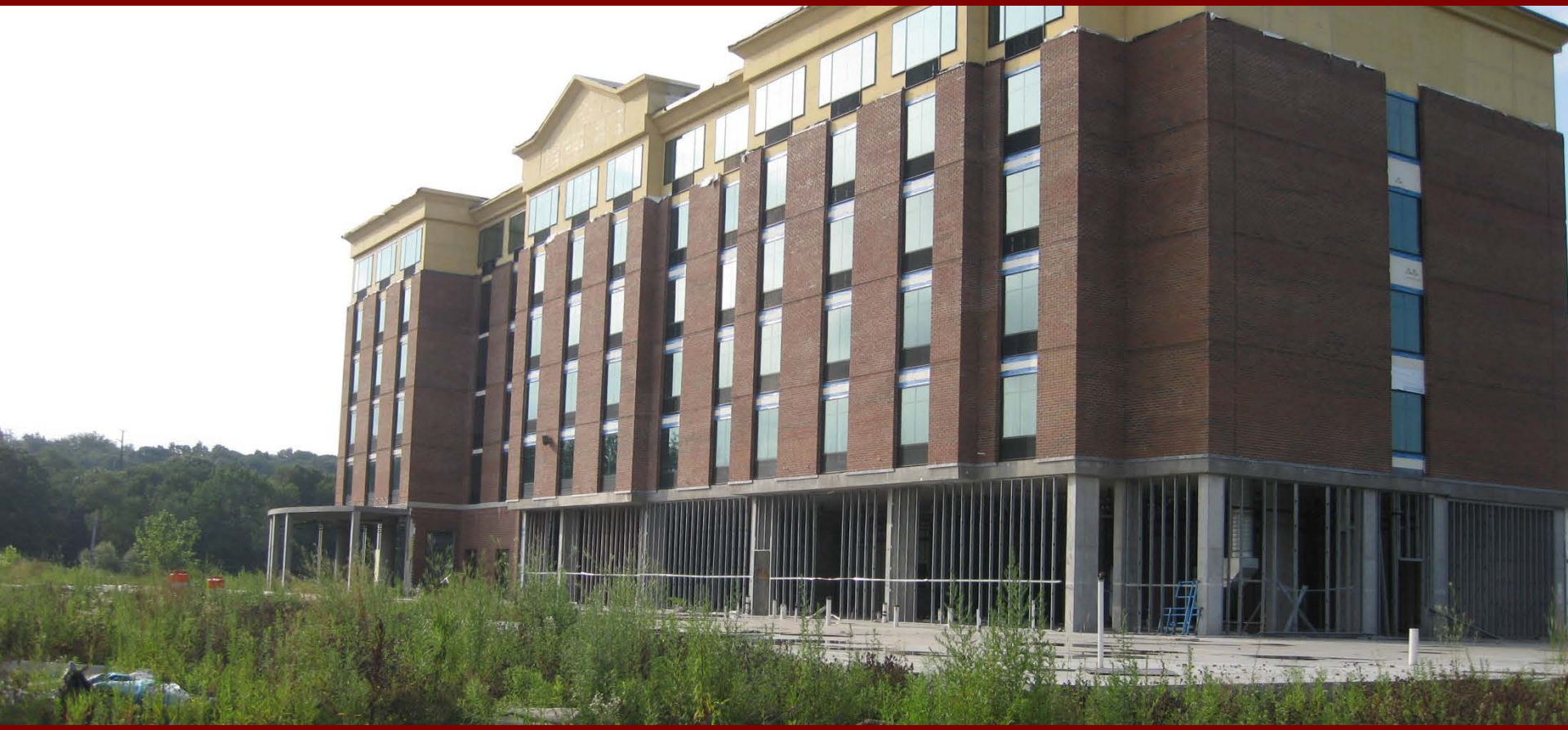
IMLA | Chicago, Illinois | September 11-14, 2011



Your Construction Project is at Death's Door!

Practical Strategies to Avoid a Date with the Devil

Why Discuss this Subject?



- Economic climate has caused a sea change in construction market
- Project risk increases as budgets tighten and balance sheets worsen

IMLA

What We Will Cover Today

- Early recognition of a distressed project
- Construction management strategies to save the troubled project
- Legal remedies for Contractor default
- Surety conduct in distressed projects
- Contractor bankruptcy
- Project Management for distressed projects
- Claims management

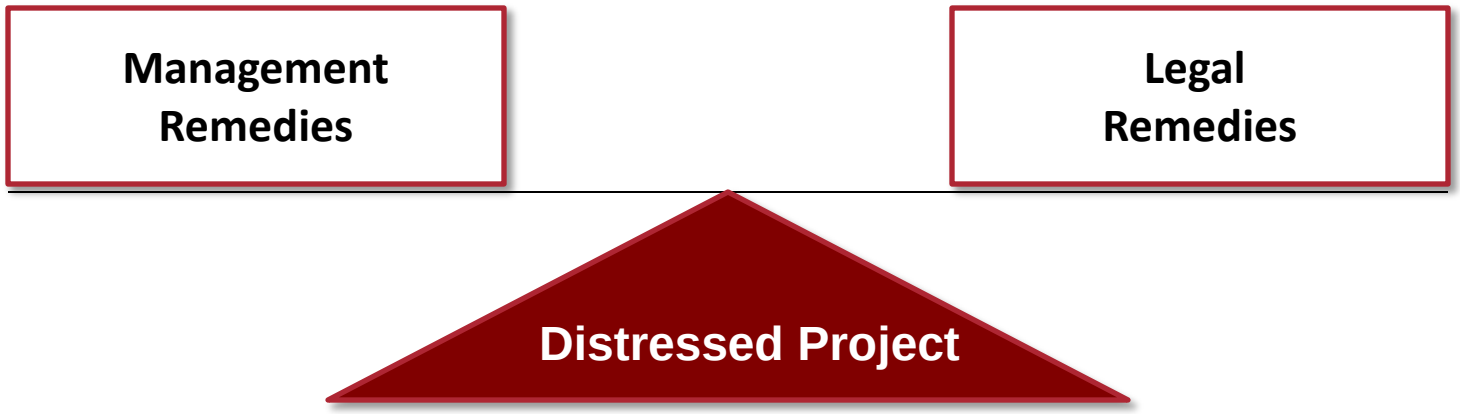
Recognizing the Distressed Project

1. Project delays
2. Payment claims
3. Subcontractor turnover
4. Loss of critical Contractor personnel
5. Numerous “no-shows”
6. Disputes between Designer and Contractor

Recognizing the Distressed Project (Continued)

7. Finger pointing
8. Contractor experiencing other troubled projects
9. Receive notice of cancellation of insurance (Accord form change)
10. Word on the “street”

Response to Distressed Project



Reasons to Pursue Construction Management Remedies

Management remedies focus on mitigating:

1. The increase in costs
2. Delays
3. Claims and litigation
4. Effect of the Owner's own "bad acts"
5. Time for beneficial occupancy

Owner's Construction Management Remedies



Construction as a human process

1. Engage an Owner's representative
2. Maintain a physical presence at project site
3. Attend Contractor's status meetings
4. Audit job costs and payment history
5. Interview Subcontractors
6. Proactively resolve disputes between Contractor and Designer
7. Investigate Contractor's problems on other projects

IMLA

Legal Remedies

1. Joint checks to Contractors and Subcontractors
2. Pay Subcontractors directly
3. Supplement Contractor's forces
4. Acceleration of Contractor's work
5. Suspend Contractor's work
6. Enforce Designer's construction management duties
7. Terminate Contractor
8. Assert claims in Court or Arbitration

Legal Remedies

Owner's Termination of Contractor

1. Honest evaluation of whether cause exists
2. Document cause(s)
3. Contingency plan for increased costs
4. Contingency plan for delayed beneficial occupancy
5. Comply with Owner's own contractual obligations
6. Initial decision maker certify cause exists
7. Proper notice to Contractor and Surety
8. Control project site
9. Plan to finish work

Legal Remedies



Consider the following insurance issues before terminating Contractor

1. Builder's Risk – Did Contractor secure the policy?
2. Controlled Insurance Program – Is project insured by a Contractor Controlled Insurance Program?

Legal Remedies



Owner May Terminate for Convenience (AIA A201 §14.3.1)

1. Contractor to cease operations upon certain date
2. Contractor to protect and preserve work
3. Contractor to terminate subcontracts
4. Contractor to receive payment

Termination for Convenience Checklist

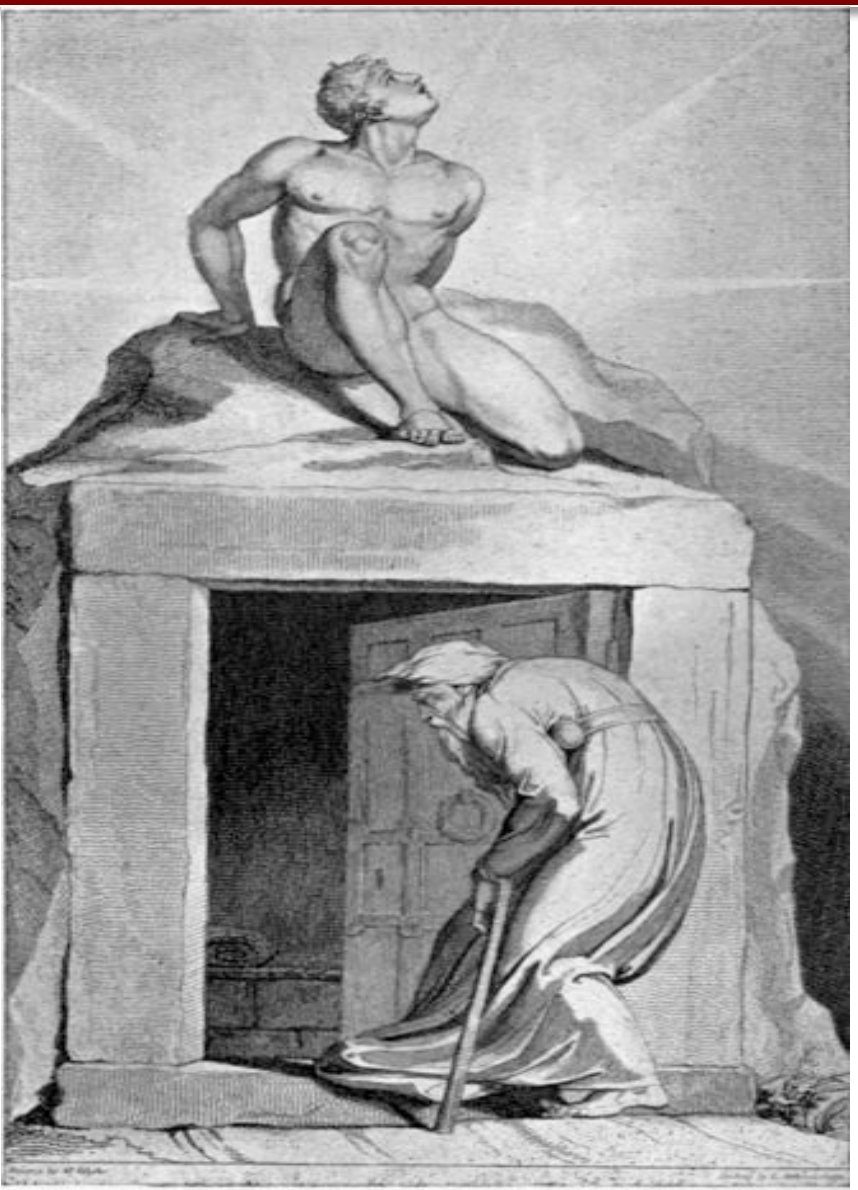
1. Reserve right to offset amounts Contractor owes for damages incurred
2. Formulate and institute takeover plan

Legal Remedies

Owner May Terminate Contractor for Cause (AIA A201 §14.2.1)

1. Fails to provide proper number of workers or proper materials
2. Fails to make payment to subcontractors "in accordance with the respective agreements between the Contractor and the Subcontractors"
3. Disregards applicable laws, statutes, codes, rules and regulations
4. Contractor guilty of substantial breach

Sureties and Contractor's Bankruptcy



- How do we deal with a project that is at death's door?
- How do we deal with sureties in that situation?
- How do we deal with a contractor that has filed bankruptcy?

Death's Door, Sketch by William Blake (1808)
Walt Whitman's inspiration for the design of his tomb

IMLA

Sureties and Contractor's Bankruptcy

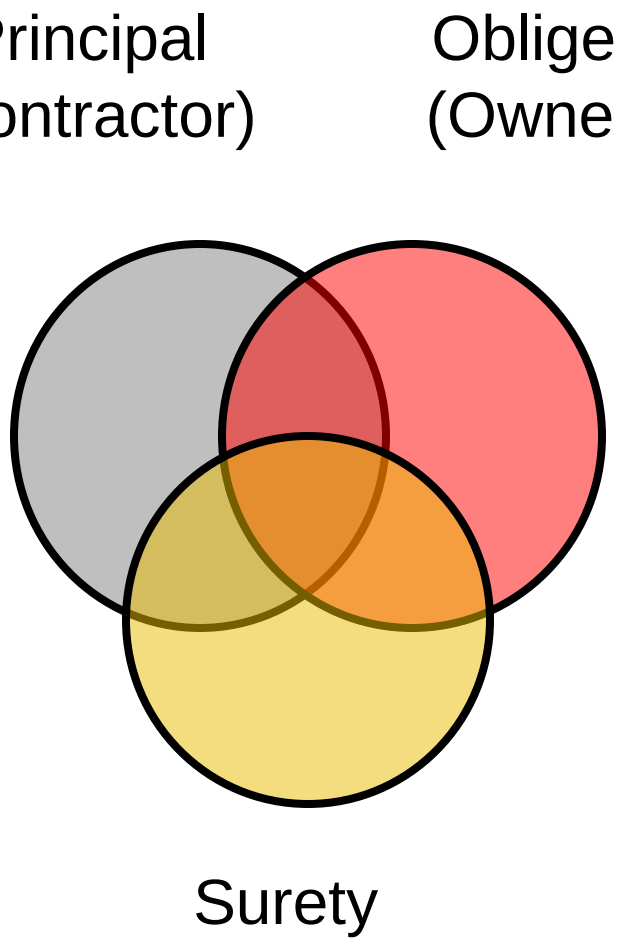


Walt Whitman Mausoleum

The Harleigh Cemetery - Camden, NJ

IMLA

Sureties



Surety Bond

- Tripartite agreement between a principal obligor, its obligee, and a surety
- Security for the payment of a debt or performance of an obligation
- Security in the form of a "Bond"
- Contractor has a separate indemnification agreement with Surety

Sureties

Sureties – Friend or Foe?

- Role of Sureties
  - "'Et tu Brute' Factor"



Sureties



Sureties – Friend or Foe?

- Minefields for the Owner
  - Defective or untimely notice to the Surety; *"What, I was suppose to tell the surety about the contractor's default?"*
  - Contractor not really in default; *"I swear the default was there a minute ago!"*
  - Release, Extension or Modification of the Contract; "…oh my!"
  - Impairment of surety's equitable subrogation rights*; "Oh no! Client what did you do!"*

IMLA

Sureties



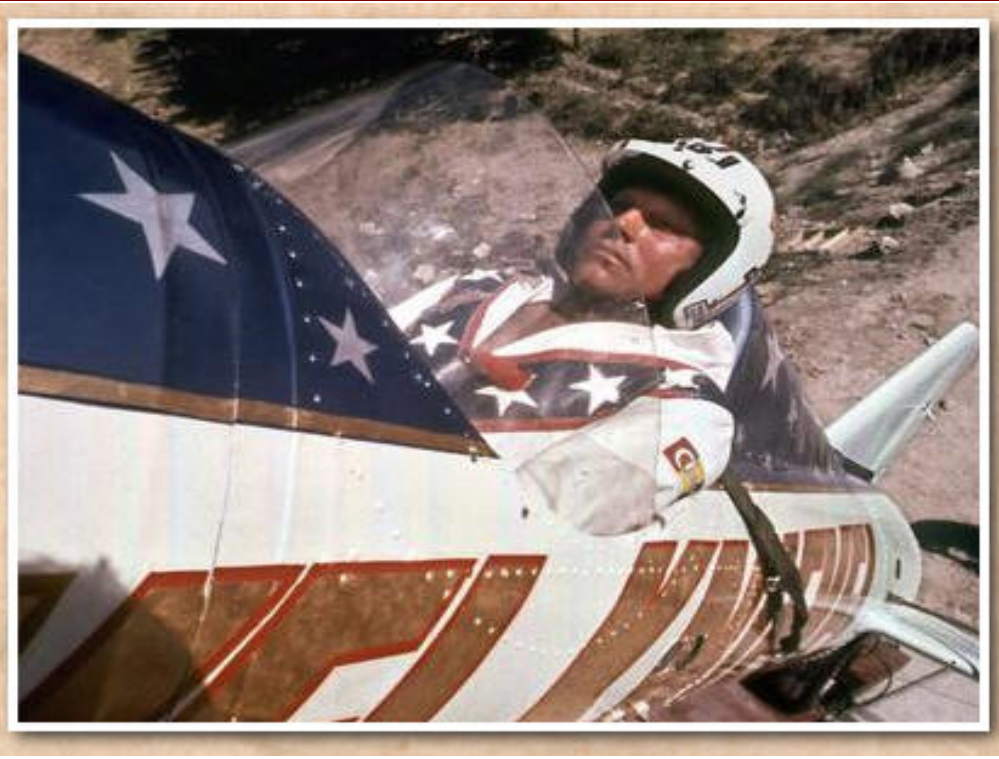
Untimely or improper default notice

- *L & A Contracting Co. v. S. Concrete Serv., Inc.*, 17 F.3d 106, 111 (5th Cir. 1994) (insufficient notice of default when owner's letters never mentioned the word "default")
- *Elm Haven Constr. Ltd. P'ship v. Neri Constr., LLC*, 281 F. Supp. 2d 406 (D. Conn. 2003) (insufficient notice when letters only complained about performance and financial status)
- *Balfour Beatty Constr., Inc. v. Colonial Ornamental Iron Works, Inc.*, 986 F. Supp. 82, 86 (D. Conn. 1997) (insufficient notice when letters only mention delay in performance)

IMLA

Sureties





Evel Knievel in his rocket motorcycle before his failed attempt at a 3/4-mile leap across Snake River Canyon in Idaho (September 8, 1974).

**Associated Press File Photographs*

IMLA

Sureties



Sureties – Friend or Foe?

- *"Look – I'm flying!"*
  - Make sure you go the distance and land safely
    - Release, Extension, or Modification of the Contract
    - *Restatement of the Law, Third, Suretyship and Guaranty, §§ 39-41*
    - *What does your bond say?*
    - *How are bonds interpreted in your jurisdiction?*

Evel Knievel crashing slowly!

**Associated Press File Photo*

IMLA

Sureties



- Impairment of the Surety's right of Equitable Subrogation
  - *Int'l Fid. Ins. Co. v. United States*, 25 Cl. Ct. 469, 473 (1992) *citing Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 141-42, 83 S. Ct. 232, 9 L. Ed. 2d 190 (1962)
  - *Pennsylvania Nat'l Cas. Ins. Co. v. City of Pine Bluff*, 354 F.3d 945 (8th Cir. 2004)

IMLA

Contractor's Bankruptcy



Chapter 7 and Chapter 11 - Good, Bad and Ugly!

- What does it mean to the project
  - Delay
  - Additional cost
  - Another contractor may have to finish the project
- Effect on debtor/contractor
  - Debtor may be going out of business
- Effect on owner
  - Surety becomes the only recourse for owner
- Effect on surety
  - Surety liable under the performance and payment bonds with limited recourse against the debtor
  - May or may not be a secured creditor depending on the agreement between the surety and the debtor

Contractor's Bankruptcy



What's an Owner to do?

- Dig for information about the bankruptcy case
- Attend the first meeting of creditors 11 U.S.C. §341
- Talk to the surety, lender, and subcontractors
- Find out why the contractor filed bankruptcy
  - What are the contractor's stated reasons
  - What are you hearing on the street

IMLA

Contractor's Bankruptcy



- Blood in the Water – Unsecured Creditors, Creditors Committees, Trustee, and other interested parties are circling for their piece of the contractor
  - What can they do in the bankruptcy case?
  - Why should we care?
  - Who is a friend or foe?

Contractor's Bankruptcy

Big issues in a Chapter 11

- Cash collateral
- Payment of disputed claims
- Debtor financing
- Executory contracts under 11 U.S.C. §365
- Automatic stay issues under 11 U.S.C. §362
- Confirmation of reorganization plan
- Implementation of reorganization plan



IMLA

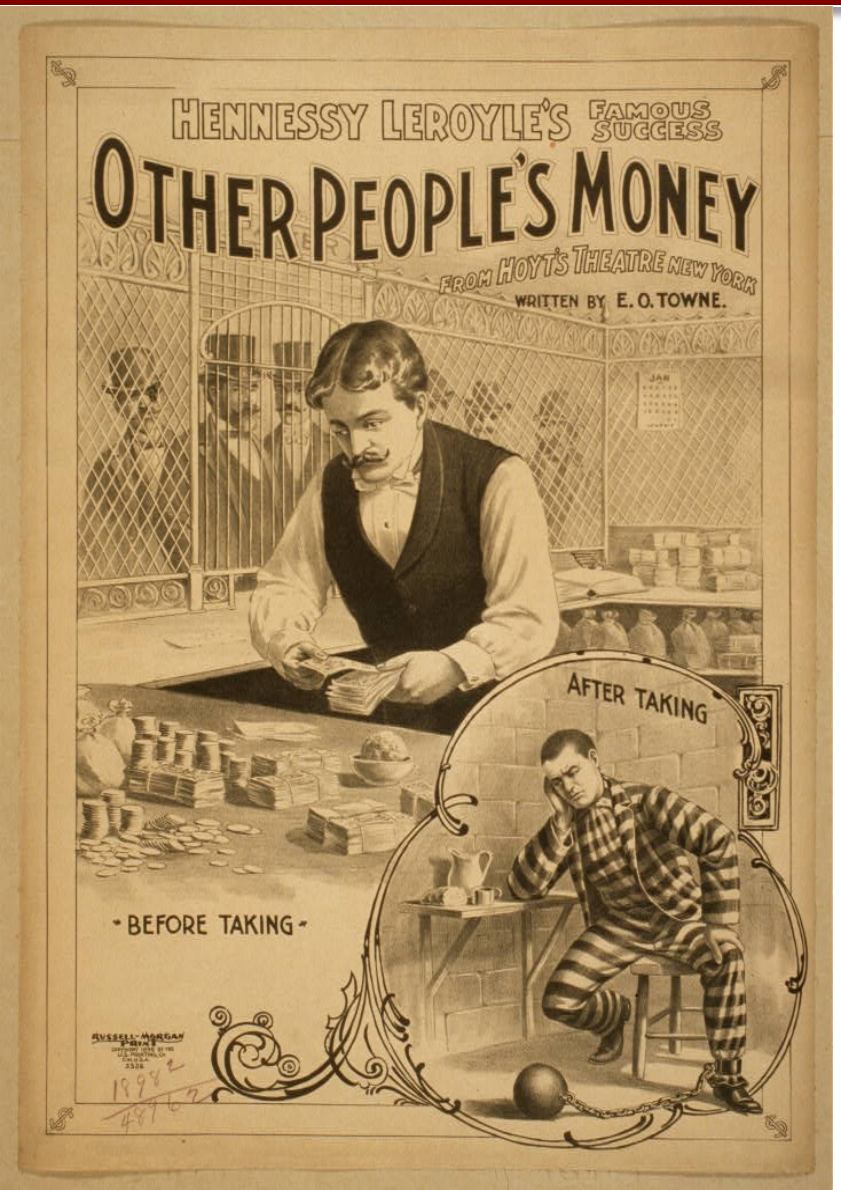
Contractor's Bankruptcy

Big issues in a Chapter 11 - cont'd

- Pesky trustees and preference actions – a/k/a, Let's chase the subcontractors away from the project
- Getting subcontractors and suppliers back to the project
- Don't forget about our friends at the IRS



Contractor's Bankruptcy



Surety issues in bankruptcy cases

- Surety's right of equitable subrogation
- Surety that undertakes the performance of the debtor's contract obligations is entitled to the remaining contract sum from the owner. *Pearlman v. Reliance Ins., Co.*, 371 U.S. 132, 137 (1962)
- The Supreme Court further held that the surety's right of subrogation was unaffected by the bankruptcy case and that the remaining contract funds were not property of the bankruptcy estate (11 U.S.C. §541)

IMLA

Contractor's Bankruptcy

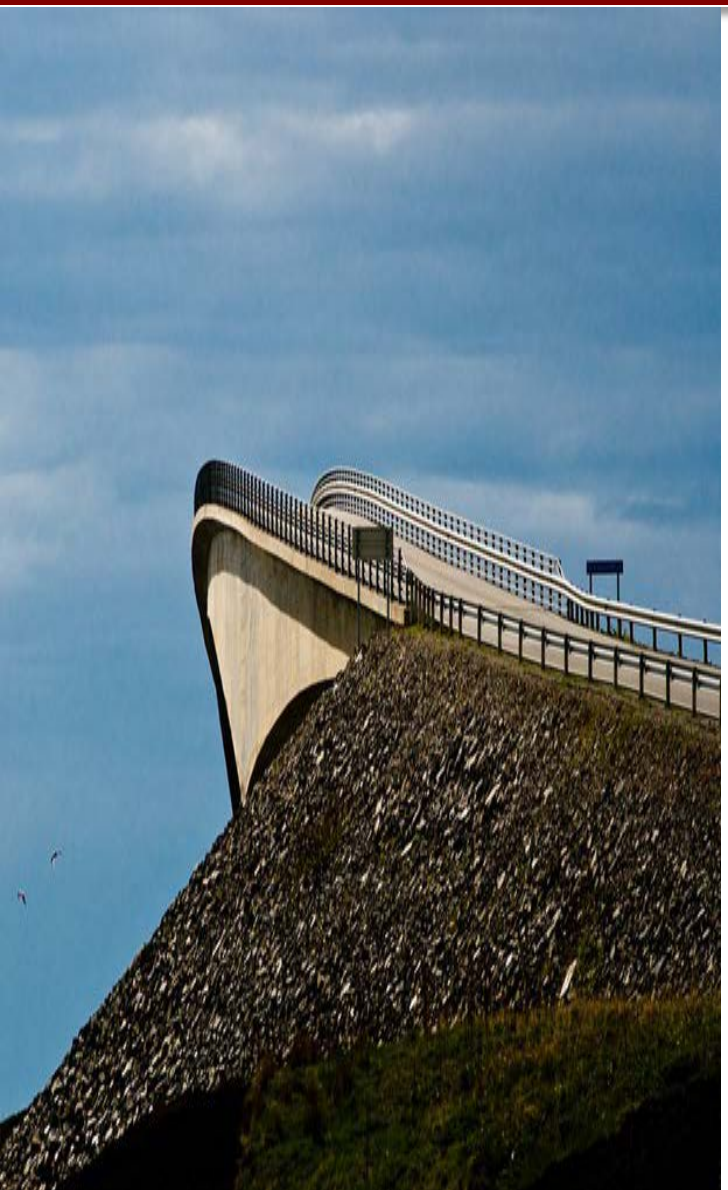


Surety v. Owner

- Why can't we be friends?
- Turnover Agreements
  - Parties
  - Key provisions
- *"Surety, you want the contractor to finish the work? Are you crazy?"*
  - *Pros and cons*

IMLA

Sureties and Contractor's Bankruptcy



- Case study – Contactor files bankruptcy
- July 19, 2011, Las Vegas-based Wiser Construction, LLC files for Chapter 11 protection in the U.S. Bankruptcy Court, District of Nevada (Las Vegas), Case No. 11-21295-BAM
- Wiser pulls out of a $8.4 million project which is only about half complete (Two flyover bridges linking the Mopac Expressway and US 290 in Austin, TX)
- Liberty Mutual Insurance (Surety) looking for a contractor to complete project
- *Sources KUT News, Austin, TX, July 18, 2011 and KXAN News, Austin, TX, July 18, 2011*

**Storseisundet Bridge, Norway*
"The Bridge to Nowhere"

IMLA

Contractor's Bankruptcy



- Case Study – Owner files bankruptcy
- In May 2006, Aspen Main Street Properties LP acquired the land and building at 625 E. Main Street in the heart of Aspen, CO for $5 million
- In February 2007, the Aspen City Council approved redevelopment of the property into a 27,000-sq.-ft., mixed-use building that would include office and commercial space, along with five free-market condominiums, five affordable-housing units, and 28 parking spaces
- Project was originally scheduled for completion in 2009, but construction was suspended in the winter of 2008

**Aspen Times, March 25, 2010*

IMLA

Contractor's Bankruptcy



- August 2009, Alpine Bank began foreclosure proceedings, claiming that Aspen Main Street Properties LP was delinquent on a $4.7 million acquisition loan
- Aspen Main Street Properties LP filed for Chapter 11 protection on March 15, 2010
- Court eventually authorized a sale under 11 U.S.C. §363 (sale free and clear of liens)
- Sale of property for $3.78 million is approved by the Bankruptcy Court on August 27, 2010
- Stalled redevelopment efforts
- Local creditors
  - Pitkin County Treasurer, $21,322 (for property taxes)
  - City of Aspen, water services , $16,430

Scheduling on Distressed Projects

- Documenting the failure to perform within the time allowed
  - Documented assessments of contractor schedules
  - Monitoring of actual performance and resources
  - Timely correspondence to the contractor about delays
  - Timely, factual and on target correspondence detailing owner positions on disputed issues
  - Recognition of excusable delays
  - Recovery schedules and plans- critical, documented owner review and performance monitoring
  - Critical, documented review of cure plan and cure period performance
  - Contract and bond compliance

Defendant's Exhibit

1

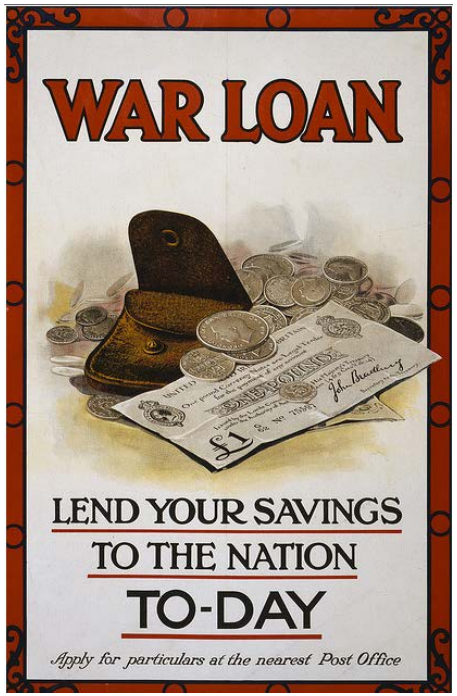
IMLA

Owner Claims on Distressed Projects



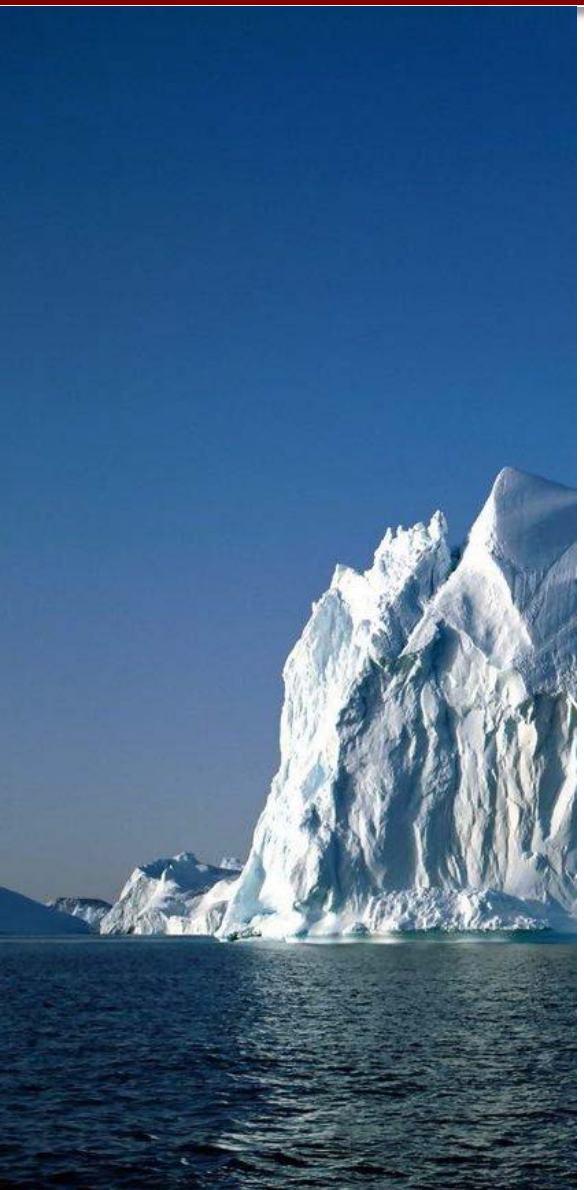
- Documenting owner claims in default terminations
  - Memorialize job status at termination
    - Pictures, videos, surveys, material not yet incorporated in work, to go/complete quantities, defective work
  - Keep track of and segregate costs / damages
    - Liquidated damages / delay damages
      - Additional contract administration, lost profits, temporary rentals, increased maintenance costs
    - Increased cost of completing contract work
      - Escalation, completion premium, re-bidding costs
    - Additional consulting/engineering/architectural fees
    - Temporary protection costs
    - Repair of defective work

Contractor Claims on Distressed Projects



- Contractor/surety terminations claims
  - Wrongful termination
    - Actual cost + expected “if completed” profit
    - Possible consequential damages
      - Home office overhead
      - Loss of future profits
  - Termination for convenience settlements
    - (Units complete x UP) + reasonable amount for partial units and cost of materials not incorporated
    - Actual cost + reasonable profit on the un-terminated portion of the contract

Default Termination Case Study



- February 2002 – Start $52 million, 3.5 mile highway widening project.
  - New concrete median barrier, 300+ drainage structures, 11 miles of underground pipe
- November 2005 – Consultant Inspector (CI) reports catch basin defects
- December 2005 – Owner reduces retainage
- February / March 2006 – Contractor financial problems arise, sinkhole develops, Owner directs detailed investigation by CI
- April / May 2006 – Owner hires Emergency Contractor(EC) to secure work and a Supplemental CI (SCI) to monitor construction and perform independent investigation of defects, Original CI provides its report of defects
- May 26, 2006 – Owner terminates Contractor for default. $55 million complete on $65 million contract.

Default Termination Case Study

- August 11, 2006 – Owner / Surety / Completion Contractor execute a Tender and Completion Agreement
  - $15.4 million GMP (contract balance from owner + delta from surety)
  - Scope included known defect repair & provisions to deal with disputed in/out of scope defects
  - One time GMP adjustment within 30 days
  - Waiver of LDs due to principal delay, new completion date
  - Partial release of surety
  - New duel obligee bond
- Late August 2006 – SCI issues expansive report of defective work. All parties notified.
- September 2006 - Owner terminates CI
- December 2006 – SCI and Claims Consultant issue repair estimates and proposed schedules ($27 million - $19 million)

Default Termination Case Study

Construction Calamity

New Drainage System Under New Highway Needs Extensive Repair

Extras Bloat Highway Contract

Now Bankrupt Contractor's Highway Contract Increased by $13.4M

Notice of Reject Pipe Use Ignored

Lawsuit Alleges that Construction Inspector Ignored Worker Complaints

Feds: You're Grounded

$5M Withheld Until State Addresses Highway Hazards

Governor's Report Condemns Contractors

Consultant concludes "Project was built by the Contractor with major flaws …. staff most likely observed the flaws, but did not report them"

Default Termination Case Study



- February 2007 - Owner / CI / Surety mediation
  - Owner seeks repair costs, emergency contractor costs, excess completion costs for remaining contract work, investigative costs, inspection costs
  - Surety pushes back on early release of retainage, alleged non disclosure of defects prior to Tender and Completion agreement (defects were not latent), and overpayment
  - $17.5 million Settlement reached with Surety. CI dispute still outstanding
- Spring 2007 and beyond –
  - Owner rebids completion / repair. $19.5 million low bid
  - Owner settles with CI

Default Termination Case Study

- Lessons
  - Don't pay for non-conforming work
  - Recognize the need for extra, independent, expert help
  - Good documentation is essential
  - Provide oversight to your consultants
  - CI exposure could be higher than policy limit



- Warning Signs
  - Difficulty getting a bond or insurance
  - Lack of experience with type, size, complexity of project
  - Unreasonably low bid
  - Character, Capital, Capacity

"A good beginning makes a good end." – Louis L'Amour



Questions

Presenters:

Roy J. Cooper, PE
Associate Vice President
ARCADIS
213 Court Street
Suite 700
Middletown, CT 06457
T: (860) 704-6100
F: (860) 704-6120
roy.cooper@arcadis-us.com

Christopher S. Dunn
Partner
Waller Lansden Dortch & Davis, LLP
511 Union Street, Suite 2700
Nashville, TN 37219
T: (615) 850-8687
F: (615) 244-6804
Chris.dunn@wallerlaw.com

John S. Rannestad, PE, LEED AP
Senior Consultant
ARCADIS
213 Court Street
Suite 700
Middletown, CT 06457
T: (860) 704-6100
F: (860) 704-6120
john.rannestad@arcadis-us.com

Ryan K. Cochran
Partner
Waller Lansden Dortch & Davis, LLP
511 Union Street, Suite 2700
Nashville, TN 37219
T: (615) 850-8778
F: (615) 244-6804
ryan.cochran@wallerlaw.com

John P. Markovs
Associate County Attorney
Division of Finance and Procurement
Office of the County Attorney
Montgomery County, Maryland
101 Monroe Street, 3rd Floor
Rockville, MD 20850
Office (240) 777-6725
Cell (301) 525-3643
Fax (240) 777-6706
john.markovs@montgomerycountymd.gov