

Contracts and payment are tied together

When a project suddenly comes to a halt, a contractor needs to know what is included in the fine print

An unprecedented number of construction projects have been put on hold, both nationally and locally, as the result of the current economic troubles. Most dramatically, a number of high-visibility



CONSTRUCTIVE ADVICE

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projects have stopped midstream as expected financing has either failed to materialize or been withdrawn by skittish lenders. For every abandoned or mothballed project, participants have had to refer to the fine print of their contracts to learn their rights, remedies and obligations. As never before, contractual provisions relating to financial information, payments, suspensions and terminations are all vital to protecting the parties going into a project.

One of the first orders of business on any project is to assure adequate financing. Before committing to any project, both the owner and contractor should be satisfied that realistic financing is guaranteed. Developers are notoriously optimistic about the expected success of their projects, but the hoops required to obtain financing these days should make even the most sanguine person a skeptic.

In the past, contractors have often accepted an owner's assurance of financing and wherewithal without question. These days, such blind acceptance is irresponsible. The standard AIA A201 document provides that prior to construction the contractor can request "reasonable evidence" that the owner has made financial arrangements to fulfill its obligations under the contract, but the right to request information thereafter is limited. Contractors should insist that they have the right throughout the project to know the status of the owner's financing and ability to pay. In the absence of such a provision, the contractor may be required to continue work even though the owner's ability to pay may be evaporating. The contractor may ultimately be able to stop work if a payment is actually missed, but by then it may have already disastrously generated a significant account receivable. Remember, too, that lien rights for uncompleted projects are frequently not worth much.

Construction contracts usually are quite detailed when it comes to payment procedures. What varies significantly is how delays or failures in payment are handled. It is not atypical for contracts to have lengthy notice and cure periods for delayed payments, meaning that contractors may have to continue to work for significant periods when payments have been delayed or missed. While the owner's failure to make timely payments should normally be considered an event excusing the contractor's performance, contractors frequently make commitments in their contracts to limit or delay their right to stop work. Contractors should at least make sure that their contracts permit them to immediately suspend work if timely payment is not made.

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Many contracts give owners very liberal rights to suspend the design or construction of a project, with little recourse or remedy to the designer or contractor whose work has been halted. Some contracts permit virtually indefinite suspension of work, without the right of the suspended party to terminate the contract or to be fairly compensated if the project is reinitiated. Sometimes contractors are also saddled with ongoing security and maintenance duties for the suspended project. With more projects being suspended, contractual suspension provisions merit careful review and negotiation.

The ultimate resolution of a suspended project may be the invocation of a termination clause. Many contracts specify what justifies a termination "for cause." From the owner's perspective, these virtually always entail performance deficiencies by the contractor; for the contractor, the basis is almost always a failure to receive required payments.

Many contracts also contain termination-for-convenience clauses that give a party (almost always unilaterally the owner) the right to terminate the contract at that party's discretion. Owners who want to terminate or mothball projects will want to have a termination-for-convenience clause to invoke. If the owner is forced to stop a project without such a right, it may face breach-of-contract claims for lost profits from the parties with whom they have contracts for the project.

For contractors, a key consideration is how they will be compensated in the event of a "T for C." Many different variations exist in how the contractor is to be paid for work already performed, what termination and demobilization expenses are reimbursable, and whether overhead and profit will be paid for unperformed work. Contractors should also take care to ensure that their subcontracts and even major purchase orders have termination-for-convenience provisions in the event their prime contract is terminated. A contractor's nightmare is to have its prime contract terminated but still be obligated downstream to its subcontractors and suppliers.

In these interesting times, the unexpected must be anticipated. Be sure to think through the contractual provisions relating to suspensions and terminations.

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