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With slowdown approaching, time to put up the guards

LAW

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The economy in general and the construction industry in specific have had a good run over the last several years. The bloom is not yet off, but there are increasing signs locally and nationally that a slowdown is approaching.

In addition to a general lower level of activity, economic slowdowns typically bring with them payment issues, increased bankruptcies, claims and litigation. Projects with tight margins all around are more apt to end up in lawyers' laps.

With an impending slowdown, it is time to go back to first principles to minimize risks. Consider these helpful reminders:

• Even in good times, the abilities, financial strength and integrity of project participants are crucial to success. But in slowdowns, these factors are even more important. Make sure the parties you decide to do business with measure up.

• Beware of bids or proposals that seem too good to be true. As work gets scarce, many are tempted to cut their prices to stay busy – some with the intent of recouping the difference on change orders and the like. Although the temptation may be great to snap up a low price, the risk is large that you will ultimately pay the full price one way or another.

• Contractual terms are central in avoiding and resolving the disputes that become more prevalent in tougher times. Take the care necessary to negotiate reasonable contractual protections. If a dispute arises, the first thing that will be checked is what the contract states.

• Lien claims proliferate as margins shrink. Carefully monitor payments to subcontractors and suppliers in order to identify the unpaid and potential claimants on all tiers. Also, insist on appropriate lien and claim releases in exchange for all payments. Nothing is worse than having to pay twice for the same work.

• Virtually all construction-related contracts have claims and notice procedures governing how claims can be raised and resolved. Make sure you fully comply with these procedures, both on the giving and receiving ends of claims.

• Resist the temptation to defer problems and claims until the end of the job. Rarely do issues get easier to resolve as time passes – particularly on tight-margin projects. More likely, problems will snowball and worsen.

• Get agreements and understandings in writing. Informality and handshakes work better when margins are good. Reduced margins tend to cause memory loss in some people.

• When times are tougher, owners tend to enjoy greater negotiating leverage. Contractual demands from contractors and design professionals magically lessen. Those with long-standing relationships and established contracts are obviously affected less by this phenomenon.

• Payment and performance bonds become more important as the risk of default increases. Consider requesting such bonds. If bonds are in place, make sure to comply with their notice requirements by notifying the surety when problems arise.

• As work subsides, many decide to venture into work areas where they are ill-equipped to succeed. Those who are trying to diversify should assess honestly the risks and address them in advance. Those who choose to, or must, do business with people chasing work in new areas should beware.

• As private or negotiated work becomes scarcer, contractors frequently pursue hard bid or public work. Many a contractor has learned to its dismay that the approach necessary to make hard bid work profitable is far different from its approach to the negotiated market.

Before the storm hits is a good time to reflect on the protections needed to avoid problems when the inevitable downtime arrives in full force. To some extent, the market has forgotten the lessons of past slowdowns. Those who identify the risks and put protections in place will be poised to capitalize in both the good times and the bad.

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