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As principal and co-president of Shapiro, Lifschitz & Schram PC, Judah Lifschitz has seen countless contractors fall victim to nonpayment and the toll these situations can take on an otherwise viable business. Lifschitz has extensive experience in construction related matters, including significant experience in power and energy construction representing clients with regard to EPC contracts as well as disputes. His trial experience includes winning one of the largest liquidated damages awards in the history of the construction industry and his transactional experience includes negotiating and drafting multibillion-dollar EPC contracts for new power plants and industrial facilities. Lifschitz took time to speak with *North American Builders* about how contractors can protect themselves.

What are common pitfalls a contractor encounters when an owner does not pay the contractor fully or timely?

If an owner fails to pay its contractor significant sums that are due, the contractor will unlikely be able to pay its subcontractors and suppliers fully or on time. As a result, subcontractors and suppliers will at some point file a mechanic's lien against the property or file a bond claim. Other negative consequences include delays to the work, shortage of material, and insufficient labor on the project. Typically, if the unpaid amount is significant enough and the delays persist long enough, it will result in major disputes on the project.

What typically causes an owner's nonpayment of money due to its contractor?

An owner's nonpayment can arise from any number of reasons. First, the owner may not have the necessary funds to pay for the construction. This is often due to an unrealistic budget. Or the owner's financial condition may be weak and unable to support the funding necessary for the project. A poor set of design documents can also give rise to changes which increase the cost of the project beyond what was originally contemplated.

Non-payment can also be due to the contractor or its subcontractors. For example, an unreasonably low bid estimate will almost always result in financial pressure affecting the contractor as the costs of performance exceed the contract price. Thus, a contractor may be receiving payment per the contract but such amount is insufficient to cause the contractor to achieve cost.

Other causes of contractor financial distress include unanticipated conditions for which contractor assumed the risk and general financial weakness of the contractor. Lack of an early warning system which identifies for the contractor problems early on will almost always result in financial losses for the contractor.

How can a contractor best protect itself from these situations?

Contractors should be vigilant from the outset. A contractor must ensure that the project is viable, that the owner has adequate financial resources, that the owner has a reasonable budget, and that the contractor has a reasonable bid estimate.

The contractor should ensure that the contract includes protections regarding payment. For example, the payment provisions should require timely and full payment for all work performed. If possible, the contract should include a right to stop work in the event of nonpayment. Since payment disputes invariably involve claims relating to other issues – for example, changes – the contract should contain a disputes resolution procedure that is timely, reasonable, and efficient.

During construction, the contractor should be proactive in pursuing legitimate changes, process changes timely, and create an accurate project record.

What practical advice would you provide a contractor that is not getting paid by the owner?

One of the most important pieces of advice I tell contractors is that you should never "walk off" of a project unless staying on the job will cause the contractor to go out of business. The moment a contractor walks off a job, the focus changes from the owner's nonpayment to whether the contractor had a right to terminate and whether the contractor breached the contract by walking off.

What can a weak financial condition do to a contractor's reputation?

A weak financial condition creates a vicious cycle – contractors known or suspected to be weak financially will typically not be able to obtain sufficient new work to sustain the company. Without new work it is only a matter of time before a contractor will go out of business.

