

Owner's Headaches

by Roland Richter and Stephen Rae



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WHAT CONTRACTORS SHOULD KNOW BEFORE PROJECTS GO SOUTH

At the start of every construction project, owners, contractors and surety companies all share the same goal: finishing the project on time and on budget. An owner wants the project completed correctly, on time, within budget and without liens. The contractor is looking to complete the work on schedule without defect, receive payment for his/her work and make a reasonable profit. The surety relies upon the contractor to complete the contract on time, without defect and to pay all labor, subcontractor and supplier expenses. Logically, the goal of all parties is the successful completion of the project.

But despite the common goal, contractors and owners can end up in difficult and even adversarial positions when it comes to successful project completion. In these situations, early dispute resolution procedures can prevent construction disputes from

bringing a project to a halt. Surety involvement plays an important role in the dispute resolution process, and the surety facilitates a mutually workable solution for the project. While the vast majority of contractors will never see a default on a project, sureties have significant experience working with contractors and owners to resolve construction disputes.

When a surety becomes involved in a construction project dispute, the source of the problem often depends on the source of the opinion. In other words, contractors and owners rarely agree on the source of the problem on a construction project.

Owners often cite the following reasons as the source of project problems:

- ▶ Incompetent project manager and/or jobsite supervisory personnel
- ▶ Inability to adhere to the project schedule due to poor coordination of subcontractors, failure to order material on time, especially long

lead time items and lack of skilled personnel and/or insufficient labor

- ▶ Failure to read, understand or interpret contract documents
- ▶ Disagreements on original scope versus change order work
- ▶ Quality control problems
- ▶ Mechanic's liens, whether filed by subcontractors and/or vendors
- ▶ OSHA and related safety problems

Contractors often cite the following reasons as the source of project problems:

- ▶ Contract reflects unrealistic terms and conditions
- ▶ Incomplete and/or flawed project designs and specifications (leads to numerous disputes affecting job progress, payments, extra costs, etc.)
- ▶ Owner's failure to provide timely payment (or provide payment at all)
- ▶ Failure of owner or representative

to respond timely to requests for information (RFIs), submittals and like documentation

- ▶ Owner's refusal to grant legitimate change orders and/or time extensions
- ▶ Over-inspection of project by owner representatives
- ▶ Failure of a construction manager to coordinate co-primes

A surety is required to balance its obligations to the owner and the contractor. Upon its investigation, a surety often finds a combination of many of the factors cited above and occasionally some additional factors that are likely unknown to the owner, including:

- ▶ Contractor estimating and costing systems are inadequate or poorly utilized
- ▶ Contractor lacks financial resources to cash flow backlog
- ▶ Contractor overextends by taking the largest job relative to prior work
- ▶ Contractor diversifies into new types of construction without the necessary experienced staff or resources to perform new type of work
- ▶ Contractor pursues work out-of-state or in new areas where he/she lacks experience with local labor issues, regulatory oversight and supply resources

Construction projects rarely proceed without any disputes, and therefore, contractors and owners should be prepared to address disputes when they arise. It is also rare that project difficulties are attributable to a single cause that sits solely with a contractor or an owner. In most situations, project difficulties are attributable to multiple causes with shared responsibility between contractors and owners.

Through partnering and good communication, owners and contractors can work together to develop achievable contract schedules, quickly identify and address emerging problems and collaboratively establish solutions to unanticipated challenges in project scope and design. Owners, contractors and sureties mutually benefit from having a process where project managers in real time promptly understand emerging problems, can communicate the issues between the parties and jointly develop efficient, workable solutions. If needed, the parties can engage the surety's broader resources if initial dispute resolution attempts are unproductive. Again, proactive dispute resolution allows the project to productively continue while disputes are resolved.

Contractors who quickly identify problems and offer solutions to get projects back on track increase the probabilities of avoiding defaults. Disputes will inevitably arise on projects, and good communication is critical to

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Initial Owner/Obligee Meeting—A Surety Perspective

Surety companies are frequently required to respond to a disgruntled owner/obligee's request for a meeting to review the contractor/principal's alleged lack of progress on a project and the owner's threatened termination of the contractor's contract. The owner typically wants to know how quickly the surety intends to step in and complete the project. The contractor will dispute most points raised by the owner and wants to know when the owner will release the withheld contact funds. The initial meeting can quickly deteriorate into a finger-pointing session. Despite this seemingly hostile and unproductive set of circumstances, the initial meeting is a unique opportunity to set the stage for a positive claim resolution.

During the initial meeting, the surety should have two primary objectives: 1) establish credibility with the owner and 2) gain an understanding of the owner. Gathering substantive information for the ultimate disposition of the claim occurs throughout the investigation process, but this is not the surety's overriding objective at the initial meeting.

Credibility

To establish the surety's credibility at the initial meeting, the surety needs to be fully prepared and appear neutral. In preparation for the meeting, the surety gathers information from multiple sources regarding the contractor, owner and the project. The surety's claim handlers will meet with the home office and field underwriters for the account, as well as the broker, if applicable, before the first meeting with the contractor. The surety then will meet with the contractor to review the contractor's supporting documents prior to the initial owner meeting. The surety will request that the owner provide a written list of the contractor's alleged deficiencies and the owner's supporting documents in advance of the meeting. This level of preparation allows the surety to ask probing and detailed questions during the initial meeting. Well-informed inquiries let the owner know that the surety is aware of the contractor's defenses and current issues on the project.

During the initial meeting, the appearance of neutrality derives from mediating any contractor/owner name-calling or finger pointing that may arise. Further, ques-

tions and comments demonstrate an objective of gathering information without passing judgment on the information as it is received. This initial meeting is not an oral argument that the surety is trying to win. It is an initial meeting that will set the tone for a successful resolution of the claim down the line.

Understanding

To understand the owner, the surety first must understand who is involved in the owner's decision-making process. In advance of the initial meeting, it is helpful to develop a flow chart of the individuals on the owner's team. This may include corporate officers, elected/appointed officials, design professionals, construction managers, attorneys and others. The contractor is a critical source of information regarding the owner. However, the surety also relies on its own internal resources to develop information regarding the owner.

During the initial meeting, it is important to pay particular attention to who is in charge of the meeting, who is providing the detailed factual information and who (or what group) is the source of the complaints voiced during the meeting. The surety also must weigh the potential bias of the individuals voicing the complaints (i.e., design professionals do not want to focus on design deficiencies). The flow chart can be used to track how the individuals provide information during the meeting and more importantly how they respond to the surety's questions. Once the surety understands the owner's decision-making process, the surety is able to efficiently present the appropriate information to the appropriate individuals on the owner's team.

The surety is not able to control the owner, but if the surety takes the time to understand the owner, then the surety will have a much better chance of managing the owner and thereby increase the likelihood of a successful claim resolution. If an issue is important to the owner, it is essential for the surety to fully understand that issue. Further, if the surety establishes credibility and an understanding of the owner, there is a greater likelihood that the surety can positively impact the dispute resolution process between the owner and the contractor.

effective dispute resolution. Contractors and owners should surface potential issues and problems early and work to find mutually-acceptable solutions. Ultimately, proactive dispute resolution prevents disputes from evolving into defaults. Sureties

play an important role in the dispute resolution process and stand prepared to help contractors and owners mediate disputes and thereby achieve the parties' shared goal: successful project completion. ■

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