

CONSTRUCTION ALERT: CONTRACTOR DEFAULTS ON THE HORIZON

It has been a very tough time for contractors over the past few months. Private jobs have dwindled to virtually nothing. Public works jobs are not being flooded with bidders, bringing the price bid down to absurd levels. The lack of work combined with the highly competitive environment is a prescription for contractor defaults. Owners, subcontractors and suppliers should take immediate action to maximize protection. Here are a few tips on what to do.

1. Maintain Your List of Potential Claimants. Whenever you receive a twenty day preliminary lien notice, put it into a single file, and have a list on the front page with the contact information for each potential claimant. This will provide you with a list that you can readily access to ensure that you are receiving lien releases from anyone who may be a potential claimant. This is also a good way to have an easy way to check on subcontractors and material suppliers to make sure they are getting paid.

2. Obtain timely progress payment releases. Obtaining conditional and unconditional releases from all potential claimants who have provided 20 day preliminary lien notices is a good way for owners to manage liability exposure on projects. Here is the right way to do it. When the contractor submits the first progress payment, attached should be conditional lien releases on progress payment in the statutory form that is prescribed by Civil Code section 3262. Check the conditional lien releases against your list of potential claimants in your 20 day preliminary lien notice file. If there are any conditional lien releases that are missing, follow up with the contractor and the subcontractor or material supplier to find out why a lien release has not been supplied. Be sure to keep written notes of your discussions with the contractor and potential claimants. Also check to make sure that the dates listed on the lien release match with the progress payment request. On the following progress payment, you should receive unconditional lien releases from the claimants who sent you conditional lien releases on the prior progress payment request, and conditional lien releases on the current progress payment request. By following this method through the end of the project, owners can contain their liability exposure in the event of a contractor default.

3. Contact subcontractors directly to verify they are getting paid. In these uncertain times, just obtaining lien releases is not enough. Contractor defaults can happen in as little as 60 to 90 days. The usual payment cycle can easily put owners behind in getting lien releases. Owners should make a point of contacting subcontractors ten to fifteen days after making payment to the contractor to ensure that payments are flowing down to the subcontractors. This is particularly a wise step to take when a particular subcontractor or material supplier represents a substantial portion of a particular progress payment.

4. Stop Notices and Mechanic's Liens Require Immediate Attention. Stop Notices place a hold on construction funds that are due or will become due to the contractor. Mechanic's Liens place an actual lien upon the real property receiving the work of

improvement. Whenever you receive a stop notice or a mechanic's lien, it should be treated as an emergency situation, requiring immediate action. Upon receipt of a stop notice or mechanic's lien, call the claimant. Get details about how much is claimed to be owed, how long it has been since the last payment was received. The next step is to call the contractor to set up a meeting to discuss the problem. Bring to the meeting all of your records of payments to the contractor, to make sure that there have been no errors on your part. Obtain a specific plan from the contractor as to how the contractor will remedy the payment issue. You may want to consider entering into a joint check agreement with the contractor to provide additional protection. At your meeting with the contractor, obtain a commitment that the contractor will contact the claimant immediately. Follow up with the claimant to make sure that the contractor has made his promised contact. Continue to be involved until there is a recorded release of mechanic's lien or a stop notice release in your hands. Alternatively, if the issue of payment is disputed, have the contractor obtain a mechanic's lien release bond.

5. Check your bonding. Owners should consider being more conservative, and requiring performance and payment bonds on projects that perhaps they would not have considered bonding in the past. The premium paid for these bonds is well worth the diminished risk of a contractor default. A performance and payment bond, however, is only as good as the surety that is backing it. Be sure to check through an independent rating services, such as A.M. Best, the financial stability and size of the surety.