Early Warning Signs That Your Contractor Is in Financial Distress

Multi Family Executive Magazine

February 25, 2016

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How to spot trouble before it compromises your developments

This article originally ran in Multi Family Executive Magazine online. Click here to read the article in its entirety.

Working with contractors can be difficult as it is. But your project can suffer even more when your contractor is unreliable because of financial problems.

Unfortunately, your GC will rarely volunteer its financial difficulties until it's too late and the entire project has suffered. Staying alert for the early signs of trouble is a must.

Warning Signs

How can you spot the signals that your contractor is having financial problems? Here are some indicators:

Are supplies not being delivered? If they're not, it could mean your contractor isn't paying its creditors and suppliers. Major suppliers often have long-standing or personal business relationships with a company. Generally, they'll know how devastating a delivery stoppage would be to an operating business. So when a supplier threatens to terminate services, it's often due to frustration or extended debt. Sometimes the business relationship is so strained at this point that it's beyond repair.

A stoppage in deliveries can also indicate that your GC has decided to focus on paying only essential creditors, or creditors with aggressive collection tactics, in order to stay in business.

Is the GC being sued by its suppliers or other creditors? A sudden increase in lawsuits naming the contractor as a defendant could be a sign the company is in serious financial trouble.

Has the contractor's bank or secured lender threatened foreclosure or repossession? A bank or secured lender can effectively terminate a business by calling a defaulted loan due, entering judgment, or repossessing key equipment. Any of these actions can be devastating to an entire project.

Is there union instability? Has your contractor fallen behind on salary, benefit, or pension payments to its union employees? Such delinquencies could lead to work stoppages. To ensure you stay in the know, consider using Google Alerts to keep abreast of which unions your contractors are a part of. This free service is an easy and effective way to keep tabs on what's being said about GCs in the media by sending you real-time e-mail notifications about relevant news, such as union strikes, as soon as it happens.

Is the contractor having difficulty staying on schedule? Without the ability to perform contracts on time—or to perform them at all—a GC can't earn enough to continue its operation, many times triggering a ripple effect that can cause the entire project to be delayed, leaving all parties involved subject to potential damages and liability.

Understanding Your Contractor's Financial Structure

After you've detected the warning signs, try to get a grasp on your contractor's financial structure using public data and information. Running a Dun & Bradstreet report is one possible method. You could also try an inexpensive online service such as data-services firm Avention.

If possible, gain some insight into the contractor's assets and liabilities. What are the GC's basic asset categories? Does it own real estate or construction equipment? Is there any intellectual property or other intangible assets that can help the company survive? More importantly, what liabilities does the company face? Critical to the company's future is its relationship with its secured lender and its ability to pay local, state, and federal taxes.

Protecting Your Interest

Now that you've identified the warning signs, what can you do to protect your interests?

First, determine whether your contractor has taken one of the following steps to meet its debt obligations:

1. Is working out payment plans with its creditors on an informal basis;
2. Is renegotiating its bank debt or finding replacement financing; or
3. Is filing a bankruptcy proceeding.

Once your GC has reached this critical point, what can you do to protect yourself?

First, it's imperative to consult with your financial advisor and outside counsel to discuss your options and remedies. All parties have certain rights in each of these scenarios, and it's likely that the party that moves the most quickly will be afforded the most protection.

Second, take a close look at your contracts. Can you easily terminate the relationship? What are your remedies if you do? What's your exposure? For example, in a bankruptcy filing, a company may not be able to cure a breach of its contract with you if you properly terminated it before the bankruptcy case was filed.

What about the contractor's contract rights? Can it assign the work to another company without your approval, or do you have veto rights?

Finally, does it make sense to file a lawsuit? Many times, the first party to file gains an advantage over other creditors. However, this isn't always the best or most effective option, and you could end up spending more money than you could hope to recover.

If the contractor files for bankruptcy, your counsel's role becomes significant. He or she will address issues relating to the automatic stay, assumption, or rejection of existing contracts, and the priority and payment of claims.

To ensure your project doesn't suffer, be alert; act quickly when signs of financial distress arise; and seize the opportunity to save time and expenses before your options become limited.

About the Author:

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