



Lake County Contractors Association Professional Practice Report

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Due Diligence in Today's Market Economy

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The business failure of an owner or general contractor will have far reaching detrimental effects. The pre-qualification of the party with whom one is contracting, therefore, will go a long way to preventing financial disaster. In order to pre-qualify a contractor or determine the viability of an owner, one needs to know what questions to ask. The following issues should be addressed in order to lay the ground work for a successful project.

I. Purpose of Due Diligence - Pre-qualification provides a measure of assurance that the owner or contractor has the ability to meet its financial obligations and complete a project. There are numerous events, however, that may lead to a business failure:

- a) problems with accounting and financial management;
- b) inadequate costs and management protocols;
- c) problems with procurement or estimating problems; and,
- d) improper accounting practices.

Besides the above, there are other problem issues that may arise after a project begins. For example, a change in ownership or personnel can have an adverse effect upon a project. Any change in leadership of a company may change the focus of that company. In the event that ownership fails to have a transition plan in the event of death or disability, a project may suffer. Additionally, if key staff leaves a company, there may not be sufficient time to train new staff to complete a project successfully.

II. What type of construction work is done by the owner [general contractor]? - Owners and general contractors tend to specialize in particular types of construction, whether it is big box, hospitals, jails or

residential development. As a result of this type of specialization, the owner or general contractor may have insufficient experience in other types of construction. Bidding work to an entity that has never done a particular project may cause problems. If the owner or general contractor does not have experience in a particular type of project, the result may be a project that is:

- a) Not buildable;
- b) Does not have realistic schedules; and,
- c) Does not have experienced subcontractors.

III. What is the business structure of the owner or general contractor? - In the event a claim must be made, it is important to know the business structure of the entity against which a claim is to be made. The essential elements to determine the business structure of the owner or general contractor are:

- a) The correct legal name of the entity;
- b) The proper billing address which should not be a post office box number;
- c) Whether it is a corporation, partnership, sole proprietorship or limited liability company. If it is a joint venture, it is necessary to ascertain all of the parties to the joint venture and their respective business structures, including the responsibility of each party in the joint venture. If it is a general partnership, it is necessary to obtain the names and addresses of the general partner or partners. In order to obtain this information, one may ask for the document number and date of recording, and county and state in which the Articles of Partnership are recorded. If you are dealing with a limited liability company, it is necessary to secure the names and addresses of the general members and their respective business structure.

IV. Prior Names - It is not unusual for companies to go in and out of business. In order to avoid doing business with an unstable company, it is necessary to determine whether the company has operated under former names or previously filed for bankruptcy.

V. Authorization to Execute Documents. - It is of critical importance to determine who is authorized to execute documents on behalf of an owner or general contractor. This is especially true when submitting change orders and requests for extras. The mere signing of a work ticket by a site superintendent does not constitute an authorization that the work is either a change order or an extra. The person must be "authorized" to execute the change order.

VI. Project Financing - Determining who is the construction lender will enable one to determine the status of project financing. Additionally, you should determine whether the owner is using its own personal funds for the project. The more personal money an owner has invested in a project, the less likely there is for a default by the owner. You should also determine whether project financing has been confirmed. There is nothing worse than a project beginning construction before the project financing is in place.

VII. Prior Litigation - Certain owners or general contractors have reputations for slow pay and being involved in constant litigation. You should determine whether the owner or general contractor has been sued for failure to pay on prior projects. This would also include whether there are any judgments or arbitration awards, pending or outstanding, against the owner or general contractor. It is also a good idea to determine whether the owner or general contractor has filed any lawsuits or demanded arbitration with respect to a construction project in the past five years.

VIII. Mechanics Liens - The best time to obtain the information necessary to place a mechanics lien on a property in the event of non-payment is at the beginning of a project when the parties still like each other. The information that is required includes, but is not limited to:

- a) project address;
- b) legal description or property identification number;
- c) parties to the contract;

- d) ownership of the property; and
- e) bonding company and copy of the bond (if any).

IX. Due Diligence After The Start of Construction -

If you are able to bid a project after it starts, there are some indications if the job is in trouble. If a project gets off to a slow start, you can assume that there will be a rush to complete at the back end. This can lead to acceleration, poor coordination of the trades and excessive change orders. There are other warning signs that an owner or contractor is in trouble:

- a) Financial difficulties:
 1. Receivables are paid slowly;
 2. Bills are not paid on a timely basis; or,
 3. Vendors require cash upon delivery for supplies and materials;
- b) Bank lines of credit:
 1. The bank line of credit is fully used; or,
 2. Credit lines are not renewed.
- c) Poor Project Management:
 1. Inadequate supervision;
 2. Inability to process change orders on a timely basis; and,
 3. Turnover of project supervisors.
- d) Communication Difficulties:
 1. Disputes between the Owner and Contractor;
 2. Disputes between the Owner and Architect; and,
 3. Poor communication from field supervisors to in-house management.

Due diligence is not a guarantee of payment or successful completion of a project. It does, however, provide a framework for some protection. The old adage "forewarned is forearmed" is most appropriate before one bids a project. There simply is no substitute for knowledge.

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