

## **BANKRUPTCY INVOLVING A CONSTRUCTION PROJECT**

Business reorganizations, that include a construction project component, present many complicated business issues that require careful handling by the reorganization team. Most reorganization teams have little or no specific experience managing the added challenges that an “in progress” construction project presents. The reorganization team is quite often comprised of financial and legal experts from other cities and states unfamiliar with the local building officials and local construction processes. Therefore, it is crucial for the reorganization team to have a construction member that has reorganization experience, construction management experience and building licenses in the jurisdiction of the business.

*Preserving the value* created by previous construction activities is the primary objective of the construction member of the reorganization team. The following tasks are presented as brief examples of some of the more typical critical activities.

### **Preserve Active Building Permits**

It is critical that existing building permits be maintained in an “active” status. When building permits expire, it is extremely costly and time consuming to go back through plan reviews and permitting processes.

- Additional fees for design professionals to produce revised and/or additional plans.
- Additional fees to design and construction professionals who routinely have to meet with plans reviewers during the plans review process.
- Additional consultant costs to process the plans through local building departments.
- Costs for subcontractors to re-permit their sub permits.
- Additional management expenses to coordinate the permitting process.
- The risk of drawing revisions due to building code changes from prior permit issue date. Revisions to work in progress drive up the cost of construction by requiring field changes resulting in change orders and delays.

### **Assume Management Responsibility for Existing Design and Construction Team**

Identifying, qualifying, selecting and entering into contracts with contractors, design professionals and specialty consultants are extremely expensive. Existing relationships and contracts should be preserved if at all possible.

Ideally, an agreement is negotiated with the existing general contractor to stay active in the project and cooperate with the reorganization team through the process. Frequently though, this situation does not develop because the owner has run out of funds and can no longer pay the obligations of the

construction contract or it is a financial benefit to the business to renegotiate and/or cancel the prime construction contract.

If it is clear that the original general contractor will leave the project, it is critical that the reorganization team take immediate action to transfer the building permits to another licensed general contractor before they expire. Changing GC's is accomplished by executing a Change of Contractor form at the local building department. Since it is quite common to have to change GC's during reorganization, it is very beneficial to make certain that the company that the reorganization team hires to oversee the construction issues is a GC. This allows the reorganization team greater flexibility and control in executing the recovery plan.

### **Preserving Favorable Subcontracts**

Terminating a general contractor may be necessary or favorable to the success of the reorganization plan. However, terminating a general contractor should not automatically mean that all subcontractors are terminated. There may be economically favorable subcontracts that the original general contractor has entered into that the reorganization team may decide to preserve. Most industry standard prime construction contracts, such as American Institute of Architects (AIA) contracts, allow for assumption of the subcontracts by the owner or owner's designated representative.

Preserving existing subcontract ensures that the value of retainers, deposits and past progress payments is retained in the project. Preserving subcontracts also allows for a smoother transition to a new general contractor once the project comes out of reorganization.

### **Complete Key Portions of the Work**

There are usually components of the work in progress that the reorganization team will want to complete. Often there are portions of the work that may be required to be finished to comply with local building codes, such as the fire and life safety codes.

### **Preserve Key Financial Information**

The construction members of the reorganization team must move quickly to define the financial condition of the construction processes. Budgets to support the required construction activities during the reorganization process must be established and integrated into the overall reorganization plan. Producing accurate job cost reports, work in progress schedules and cost-to-complete budgets are critical components in determining the value of the construction project at its current completion state. Correlating the actual construction completed to date to the underlying job costs reports and budgets can help recognize hidden value in the project that may otherwise be lost.

## Related Tasks

Some of the other important tasks related to managing the reorganization of the construction project will include the following.

- Locate, organize and protect all construction documents
  - Drawings
  - Submittals
  - Inspection records
  - Permits; originals should be on the job
  - Inspection reports by design professionals
  - Testing and inspection reports
- Secure construction materials and inventory.
- Secure the construction site in a safe condition.
- Review and update the construction schedule.
- Assist the financial and legal reorganization team members in evaluating construction related claims.
- Prepare information for testimony related to construction claims or general bankruptcy proceedings.

Careful evaluation and management of the construction related issues during reorganization will protect project value and allow a smoother transition out of reorganization. In the event the asset is sold, the project will be much more attractive to potential buyers if the construction related issues are clearly defined and under control.