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Not So Fast: What to Consider Before Terminating Your General Contractor



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With the COVID pandemic seemingly winding down, and with much of the world starting to reopen to pre-pandemic levels, owners and contractors are eager, now more than ever, to complete their current projects and start new ones. Although many ongoing projects may have survived project closures and other pandemic-related hurdles during the past few years, problems still exist that may impact whether the project can get across the finish line.

Not only do labor issues, escalating material costs and supply chain bottlenecks persist, but general concerns with a contractor's ability to complete projects on time and reasonably close to budget are still an ongoing battle. It is not uncommon to hear stories about contractors who may have gotten in over their heads on projects that started during the peak of the pandemic, when work was less plentiful, and who now are having difficulties completing the work as agreed. In addition, contractors may be focusing on projects that are more lucrative at a time when demand for skilled contractors has skyrocketed as pandemic restrictions ebb.

While contract termination provisions are the obvious starting point for an owner considering changing contractors, several other factors must be considered by the owner. Not only must an owner abide by the relevant contract provisions, but they also must understand what implications the termination of one contractor, and the retention of another in its place, may have on the project. Before terminating a contractor, an owner should consider the following issues, among others:

Review Termination Provisions

Not surprisingly, one of the first steps an owner should take is to review the termination provisions themselves and any applicable notice requirements. Are you terminating for cause (i.e., the contractor is in default of the contract terms, etc.) or for convenience (i.e., the contractor has not breached the contract but the owner still wishes to terminate)? Depending on which type of termination you are pursuing, there may be differences in how easy the termination will be and what may be owed to the contractor, including a possible termination fee.

For cause, contract terminations require that the owner prove the contractor has breached the contract, but no such proof is required for a termination for convenience. What is owed for a for cause termination will be determined by a variety of factors, including the deduction by the owner of "damages" for additional costs necessary to repair existing non-conforming work or finish incomplete work that may now cost more.

Typically, a termination for convenience will require the owner to pay the contractor for any conforming work performed and materials properly purchased, before termination. Additionally, it is becoming more common for the owner to have to pay an agreed-upon termination fee to the contractor.

As a general rule, an owner cannot turn a termination for cause into a termination for convenience later in the process because cause was too hard or time consuming to prove. Therefore, the relative costs of both kinds of termination must be considered in

making the threshold decision to remove a contractor.

Insurance Coverage

Owners should also revisit insurance policy limits upon termination based on updated project scope and requirements to complete the work. In addition, if an owner is considering stepping into the role of de facto contractor (by not hiring a new contractor and instead acting as its own contractor), additional coverage may have to be purchased by the owner to substitute for coverage previously held by the contractor (i.e., worker's compensation coverage, etc.).

Review the New General Contractor's Capabilities

If a new general contractor is retained to take over the project upon termination, will it be able to maintain project completion dates? Consider the issues experienced by the existing general contractor (i.e., labor, supply chain, materials, pricing, etc.) and whether those same issues may still impact your newly chosen contractor. Does it still make sense to terminate given these constraints? If it does, should a new, more realistic schedule be prepared? Does the new general contractor have the skill, experience, depth of personnel and other capabilities to perform?

Existing Subcontracts

Similarly, an owner must determine whether it intends to utilize the existing subcontractors on the project following termination of the former general contractor. If yes, the assignability of those agreements must be reviewed within the underlying agreement. Additionally, will those subcontractors be willing to continue to work on the project and will they be managed by the new contractor or contracted directly with the owner? If the answer is the latter, the owner entity may be assuming certain liabilities, which may be brought through a direct contract with subcontractors, and the owner entity structure may need to be reviewed. Either way, discussions should be had with the subcontractors to assess their willingness and ability to keep working on the project. If new subcontractors will need to be hired, the cost and time impact of such hiring must be considered as well.

Project Documents

Complete project documentation is crucial when transitioning to a new general contractor. Prior to termination, an owner should ensure it has access to all drawings and specifications, including access to online data management software, that may contain necessary communications or revisions of drawings needed for a smooth transition. Before paying the terminated general contractor, all documents should be transferred to the owner or the new general contractor.

Payment

If applicable, and depending on the nature of the termination, before releasing final payment to your terminated general contractor, an owner should:

- Have a complete understanding of any existing or potential claims that may arise in the future based on previously completed work
- Confirm that all waivers and releases have been secured in exchange for payment
- Confirm that consideration has been given for the possibility of future claims against your general contractor and whether those claims can be pursued (i.e., warranty claims, defective work, etc.)
- Review all payments made to subcontractors for consideration when accepting assignment of said subcontracts and whether payments should be made directly to those entities
- Consider any additional lender requirements that may be applicable to the work. Without a complete financial picture before termination and replacement of the contractor, an owner may encounter serious project financial issues

Is the Grass Actually Greener on the Other Side?

The final and most important question is, after considering all of the information above, whether the grass is actually greener on the other side, or does it just appear that way? When assessing all costs and risks, an owner may be faced with the reality that sticking with the existing contractor, faults and all, may be the quickest and least expensive path to completion. If that is the decision, the owner and contractor may need to have a frank conversation and agree on better practices and communication for a more collaborative – and successful – future.

These are just a few of the considerations to review when addressing a potential general contractor termination on your project. If you have questions about any of the issues discussed in this article, please contact a member of Gould & Ratner's [Construction Practice](#).

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