

When Projects Go Bad: Articles 28, 29, and 54

March 3, 2022

2022 State Construction Conference



NC★DOA
Department of Administration
State Construction Office

When Projects Go Bad: Articles 28, 29, and 54

When and how to terminate a contract or take over work

James Bernier Jr.
Special Deputy Attorney General

Michael Ali
Assistant Director State Construction

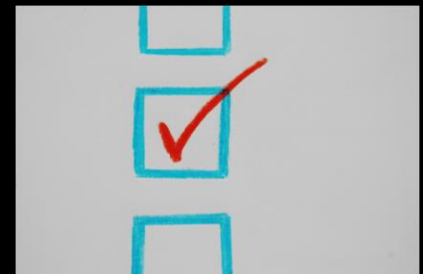
March 3, 2022

*This is not an opinion of the NC Attorney General's office, formal or otherwise. It has not been reviewed and approved in accordance with the procedures for issuing a formal Attorney General's Opinion.



Key Topics

- What contractual options exist when taking over work or terminating a contract?
- What to expect when these options are pursued.
- What should be done before taking over work or terminating a contract?



At the start of a project, everyone is excited and shares a common goal: deliver the project on time and on budget.



But something goes wrong!

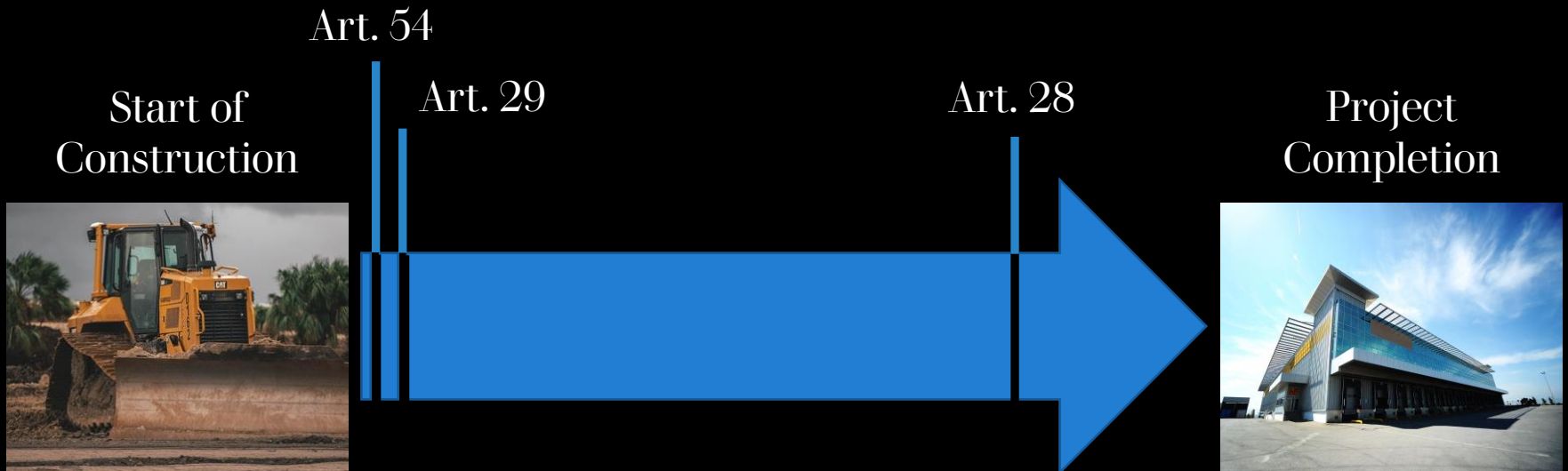
Disagreements ensue. The parties butt heads, frustrations grow, and the project becomes a dumpster fire!



What can be
done to finish
the project?

General Conditions (OC-15) 24th Edition, January 2013

- Article 28 – Owner’s Right to do Work
 - Article 29 – Annulment of Contract
 - Article 54 – Termination for Convenience
- All are options any time during the project!
- The requirements and effect of each is very different!
 - Each is best suited for different phases of construction.
 - These Articles are not usually a “clean break”.
 - Each demand the time and effort of the all parties involved.



Article 54 – Termination for Convenience

Owner may at any time and for any reason terminate Contractor's services and work at Owner's convenience. Upon receipt of such notice, Contractor shall, unless the notice directs otherwise, immediately discontinue the work and placing of orders for materials, facilities and supplies in connection with the performance of this Agreement.

Upon such termination, Contractor shall be entitled to payment only as follows: (1) the actual cost of the work completed in conformity with this Agreement; plus, (2) such other costs actually incurred by Contractor as are permitted by the prime contract and approved by Owner; (3) plus ten percent (10%) of the cost of the work referred to in subparagraph (1) above for overhead and profit. There shall be deducted from such sums as provided in this subparagraph the amount of any payments made to Contractor prior to the date of the termination of this Agreement. Contractor shall not be entitled to any claim or claim of lien against Owner for any additional compensation or damages in the event of such termination and payment.

FOLLOW THE REQUIREMENTS.

The owner must

- *Give Written Notice*
- *Define in the notice the work, if any, to be finished before termination.*
- *If there is no additional work, say so in the notice!*
- *Be clear in the written notice. Do not make assumptions!*



Article 54 - Triggers

- The Owner may terminate the Contractor
“at any time and for any reason”
 - A reason for termination does not need to be in the written notice. One can be included if it will help the contractor to understand and accept the termination.
 - If a reason is included, be prepared to support it!
 - Blaming the Contractor will result in a fight.
-

Think of Article 54 as a “no fault” divorce.

The Owner has realized that this construction relationship is not going to work and both parties should go their separate ways.

BUT, like a divorce, this will require money and compromise!

Divorce sucks and is hard work! Do I have another option?



If not, the important questions:

- How much will this cost me?
- What are my liabilities?

Article 54 – How much will it Cost?

The contractor is entitled to:

1. Actual cost of the work completed in conformity
2. Other costs actually incurred ... as are permitted
3. Ten percent (10%) of the cost of the work in place
4. Refunds of bond premiums go to the contractor and would not offset any payments from owner

Simplified Example:

- \$50,000,000 project
- \$10,000,000 of work completed
- \$50,000 in pending COs & GCs
- \$6,000,000 paid to date

The base termination payment to the contractor: \$5,050,000.

- \$4,000,000 (unpaid work and stored materials)
 - \$50,000 (for the “other costs actually incurred by Contractor”)
 - 1,000,000 (10% of the \$10 Mil.)
-

Article 54 – How do you know what work has been done and its cost?

Every project must have a
schedule of values per Art. 31!

The SOV is how the designer or
architect of the project
determines the progress and
completion of the work in
conformity with the Contract.

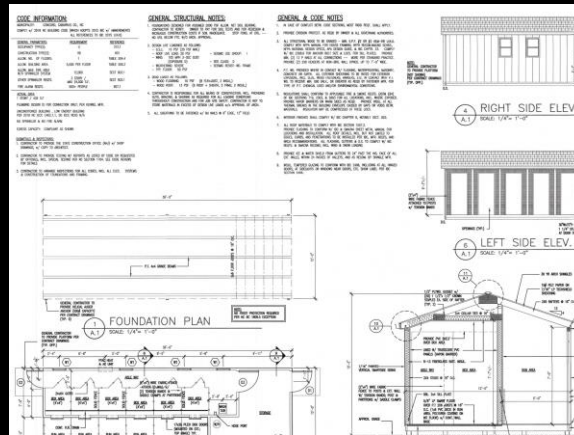


Make sure you have a schedule of values before you provide
a notice of termination!

Article 54 – How much will it Cost? Other Important Considerations



Can the schedule
tolerate it?



Just how much work
has been done?

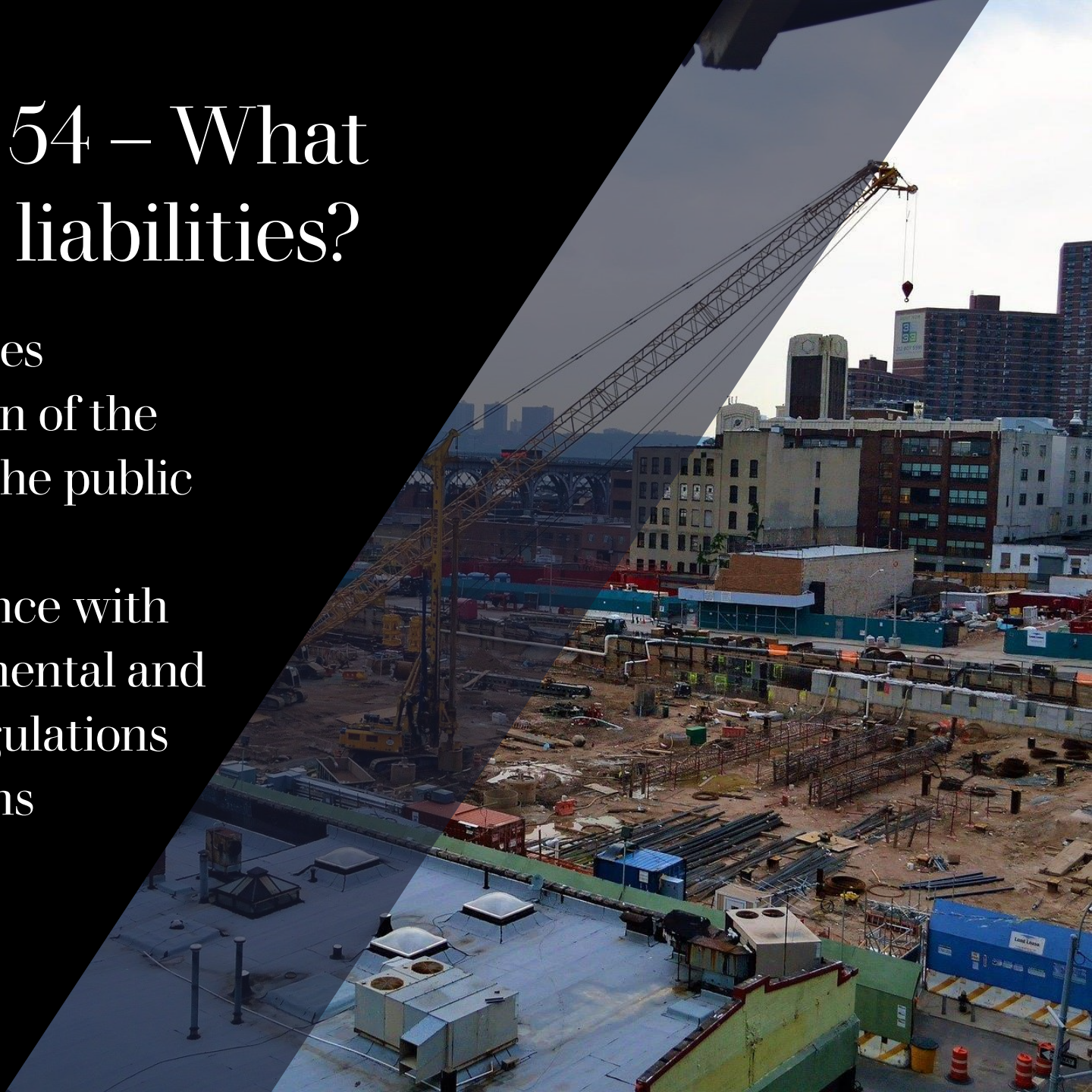


Is rebidding required?

Are there other
liabilities???

Article 54 – What are my liabilities?

- Warranties
- Protection of the site and the public
- Utilities
- Compliance with environmental and other regulations
- Unknowns



Article 54 – What to Expect

- Easier if executed before construction begins.
 - Some degree of project wind-down.
 - Disagreements on pending change orders and cost.
 - Prolonged negotiations if disagreements are severe.
 - Litigation if negotiations are unsuccessful.
-

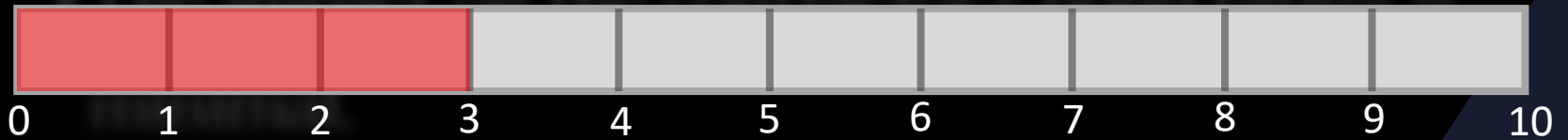
Article 54 – Final Thoughts

- It's convenient!!! The owner does not need a reason.
 - Costs are often less than termination for default, especially if you “lose”.
 - Disagreements can often be overcome through negotiations.
 - The impact on the contractor's bond rating is minimal.
-



Sorry for the Inconvenience

How bad can it get?



Art. 28: Owner's Right to do Work

If, during the progress of the work or during the period of guarantee, the contractor fails to prosecute the work properly or to perform any provision of the contract, the owner, after seven (7) days' written notice sent by certified mail, return receipt requested, to the contractor from the designer, may perform or have performed that portion of the work. The cost of the work may be deducted from any amounts due or to become due to the contractor, such action and cost of same having been first approved by the designer. Should the cost of such action of the owner exceed the amount due or to become due the contractor, then the contractor or his surety, or both, shall be liable for and shall pay to the owner the amount of said excess.

FOLLOW THE REQUIREMENTS.

The owner must

- *Give Notice in Writing*
- *Send it by Certified mail, return receipt requested,*
- *To the Contractor, from the Designer.*
- *Define the work being taken over.*
- *Give the contractor seven days to prosecute the work.*



Good Practice tip



Send the Art. 28 written notice to the surety as well.

The contractor or his surety, or both, may be liable for some or all of the work taken over.

Article 28 - Triggers

- Contractor fails to perform the work.
 - Performs the work poorly or defectively.
 - Contractor fails to comply with the contract.
 - Using materials inferior to the specifications.
 - Consistent failure to deliver a specific work item or items on schedule.
-

Article 28 – Important Considerations

- Do you have ample documentation?
 - Have you followed the contract?
 - Does the contractor have remaining work?
 - Is the remaining work clearly defined?
 - The contractor must be given an opportunity to right past wrongs.
 - Work taken over cannot impede original contracted scope of work.
-



Can we take the
high road?

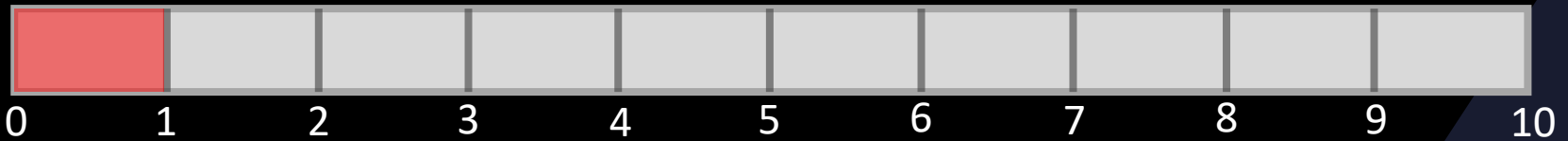
Art ~~28~~ *Deductive Change Order* – What to Expect

- A smoother road to completion.
 - Mutually beneficial
 - Possible disputes about cost
 - Preserves good working relationships.
 - Owner may incur additional expense but potentially less than other options.
-



A Walk in the Park

How bad can it get?



Article 28 – What to Expect

- Broken business relationships.
 - Disagreements about cost of work.
 - Disagreements about design.
 - Disagreements about money withheld.
 - Disagreements about who caused delays.
 - Dispute escalation. Time and money lost if it does.
-

Article 20 – Dispute Resolution Process

- Claim Review by Designer and Monitor
 - SCO Assistant Director – Art 20.c
 - Mediation (Optional) - NCAC 30.H (mediation may be sought if claim > \$15,000.)
 - SCO Director reviews as Formal Verified Claim– GS 143-35.3
 - Contested Claim – GS 150B QR Civil Action in Superior Court – GS 143-35.3(d)
-

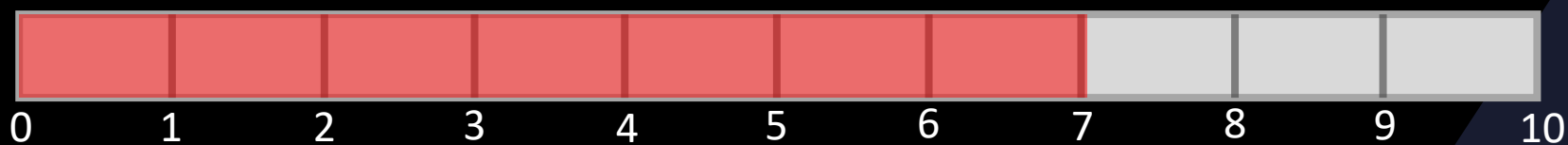
Article 28 – Final Thoughts

- Take a step back, put emotions aside, and impartially review of the situation.
 - Read the room. Is the dispute fervently contested?
 - There's a good chance it will cost more and take longer than you expect.
-



**It can be a
major headache!**

How bad can it get?



Art. 29: Annulment of Contract

If the contractor fails to begin the work under the contract within the time specified, or the progress of the work is not maintained on schedule, or the work is not completed within the time above specified, or fails to perform the work with sufficient workmen and equipment or with sufficient materials to ensure the prompt completion of said work, or shall perform the work unsuitably or shall discontinue the prosecution of the work, or if the contractor shall become insolvent or be declared bankrupt or commit any act of bankruptcy or insolvency, or allow any final judgment to stand against him unsatisfied for a period of forty-eight (48) hours, or shall make an assignment for the benefit of creditors, or for any other cause whatsoever shall not carry on the work in an acceptable manner, the owner may give notice in writing, sent by certified mail, return receipt requested, to the contractor and his surety of such delay, neglect or default, specifying the same, and if the contractor within a period of seven (7) days after such notice shall not proceed in accordance therewith, then the owner shall, declare this contract in default, and, thereupon, the surety shall promptly take over the work and complete the performance of this contract in the manner and within the time frame specified.

Art. 29: Annulment of Contract

In the event the surety shall fail to take over the work to be done under this contract within seven (7) days after being so notified and notify the owner in writing, sent by certified mail, return receipt requested, that he is taking the same over and stating that he will diligently pursue and complete the same, the owner shall have full power and authority, without violating the contract, to take the prosecution of the work out of the hands of said contractor, to appropriate or use any or all contract materials and equipment on the grounds as may be suitable and acceptable and may enter into an agreement, either by public letting or negotiation, for the completion of said contract according to the terms and provisions thereof or use such other methods as in his opinion shall be required for the completion of said contract in an acceptable manner. All costs and charges incurred by the owner, together with the costs of completing the work under contract, shall be deducted from any monies due or which may become due said contractor and surety. In case the expense so incurred by the owner shall be less than the sum which would have been payable under the contract, if it had been completed by said contractor, then the said contractor and surety shall be entitled to receive the difference, but in case such expense shall exceed the sum which would have been payable under the contract, then the contractor and the surety shall be liable and shall pay to the owner the amount of said excess.

FOLLOW THE
REQUIREMENTS.

The owner must

- *Give Notice in Writing*
- *Send it by Certified mail, return receipt requested,*
- *To the Contractor and its Surety,*
- *Of the trigger of default, AND*
- *Give the contractor seven days to fix the issue.*



FOLLOW THE
REQUIREMENTS.

*If the Issue(s) are not fixed, then
The Owner Shall:*

- *Declare the contract in default, and*
- *Notify the surety of default.*



Triggers for Art. 29

- Failure to Work
 - Failure to Keep on Schedule
 - Failure to Complete on Time
 - Poor Quality of Work
 - Contractor's Fiscal Status
-

Triggers for Art. 29

Failure to Work

1. If the contractor fails to begin the work under the contract within the time specified
2. If the contractor discontinues the prosecution of the work

Failure to Keep on Schedule

3. If the progress of the work is not maintained on schedule
4. If the contractor fails to perform the work with sufficient workmen, equipment, or materials to ensure the prompt completion of said work

Failure to Complete on Time

5. If the work is not completed within the time above specified
-

Triggers for Art. 29

Poor Quality of Work

6. If the contractor performs the work unsuitably
7. If the contractor fails to carry on the work in an acceptable manner for any other cause whatsoever

Contractor's Fiscal Status

8. If the contractor becomes insolvent
 9. If the contractor declares bankruptcy
 10. If the contractor commits any act of bankruptcy or insolvency
 11. If the contractor allows a final judgment to stand against him unsatisfied for a period of forty-eight (48) hours
 12. If the contractor makes an assignment for the benefit of creditors
-

The surety must

Promptly take over the work and complete the performance of the contract.

If the surety fails

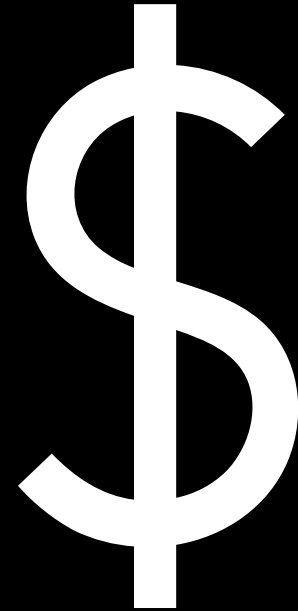
- to take over the work within seven days, AND
 - to notify the owner in writing by certified mail that it is taking over the work, AND
 - state that it will diligently pursue and complete the same
-

Then the owner shall have full power and authority to:

- take the prosecution of the work away from the contractor,
 - use any or all contract materials and equipment on the grounds as may be suitable and acceptable and
 - may enter into an agreement, either by public letting or negotiation, for the completion of the contract or use such other methods as in his opinion shall be required for the completion of the contract in an acceptable manner.
-

Expenses

All costs and charges incurred by the owner, together with the costs of completing the work under contract, shall be deducted from any monies due or which may become due to said contractor and surety.



Expense < Contract Balance

the contractor and surety shall be entitled to receive the difference.

Expense > Contract Balance

the contractor and the surety shall be liable and shall pay to the owner the amount of said excess



Should you terminate
for cause?

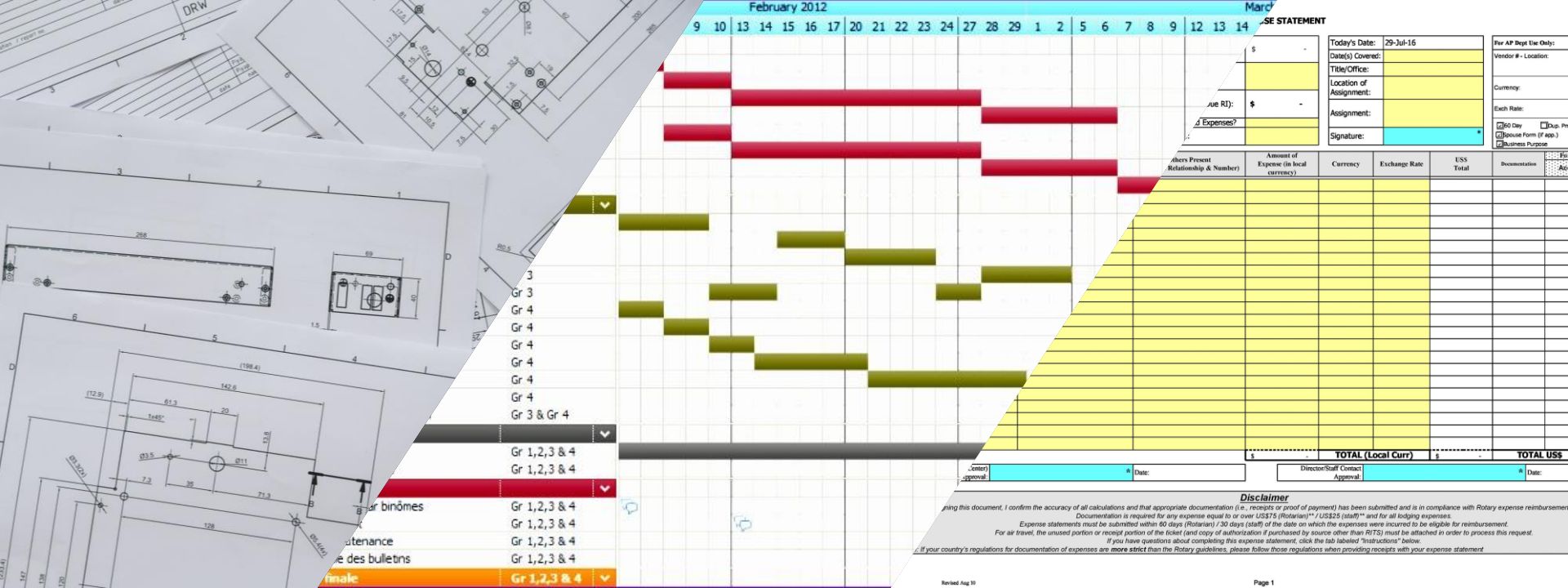
If not, then who?

Are your ducks in a
row?





ARE YOUR
HANDS CLEAN?



CONTEMPORANEOUS DOCUMENTATION IS KEY!

Contract

Schedules

Daily Reports

Meeting Minutes

RFIs

Letters

Specifications

Schedule Updates

Expense Reports

Payment Applications

Change Orders

Emails

Schedule of Values

Recovery Schedules

Regular Meetings

PCOs

Weather Reports

Etc.

Were the defaults documented?

- Contemporaneous documentation
- Via email or other written notes
- Schedules, daily reports, mtg. minutes, correspondence

Was a schedule in place?

- Were regular CPM schedules required? With each pay app?
- Did deadlines pass without you noting or addressing them?
- Was a recovery schedule required? Enforced?

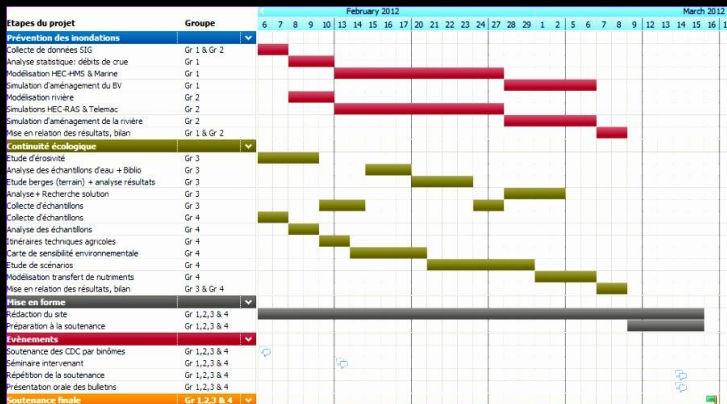
Were the defaults material?

- Was the issue considered or treated as minor?
- Did the issue appear urgent from the records?
- Was scheduling enforced?

What were the causes of delay?

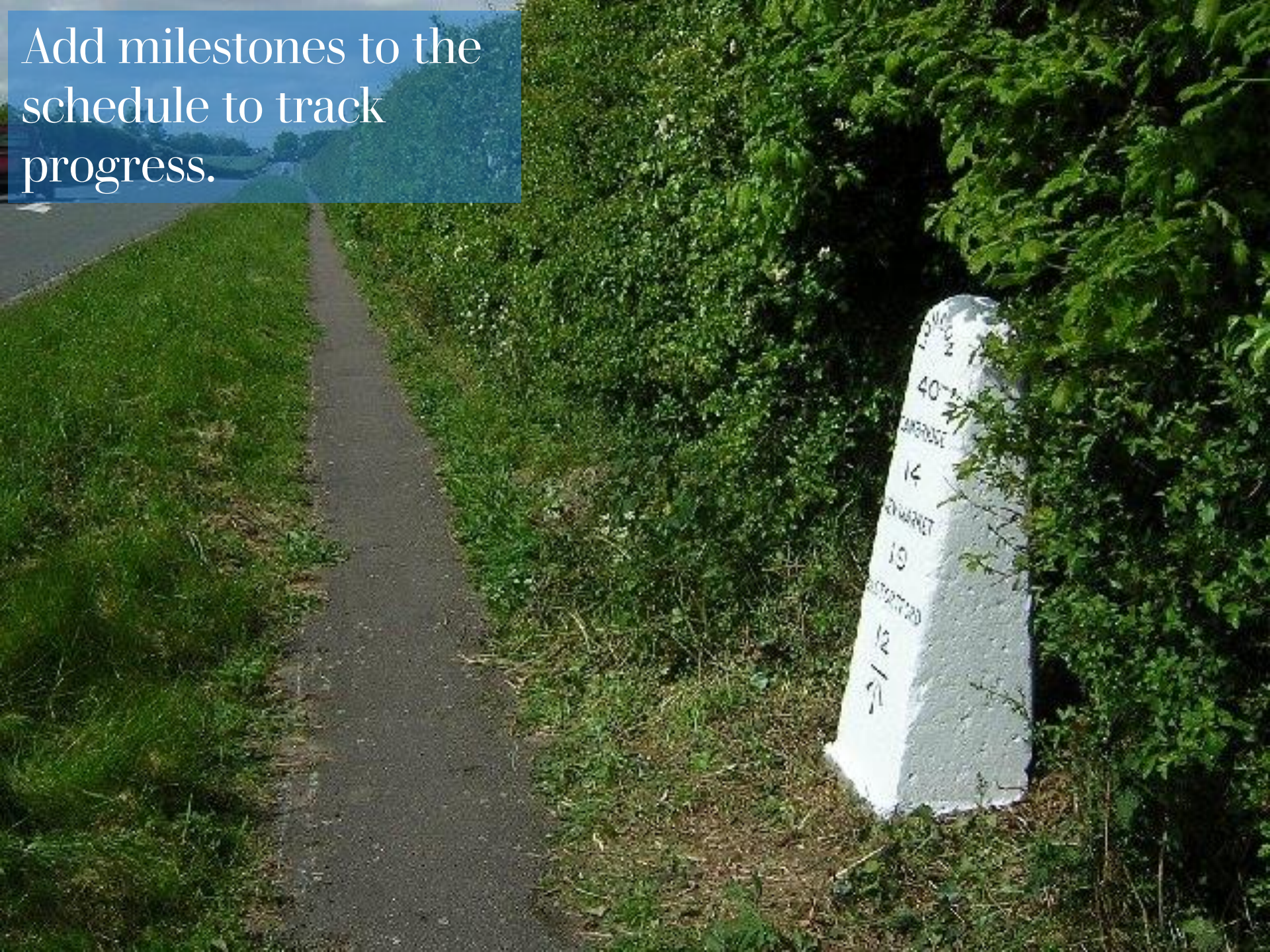
- Were RFIs and PCOs promptly addressed?
- Were requests for extensions promptly addressed?
- Were proposed schedules promptly reviewed and approved?
- Did the owner or architect issue any changes?
- Were there stop-work orders?
- Any other forms of possible owner delay?

The lack of a schedule is possibly the biggest issue preventing termination.



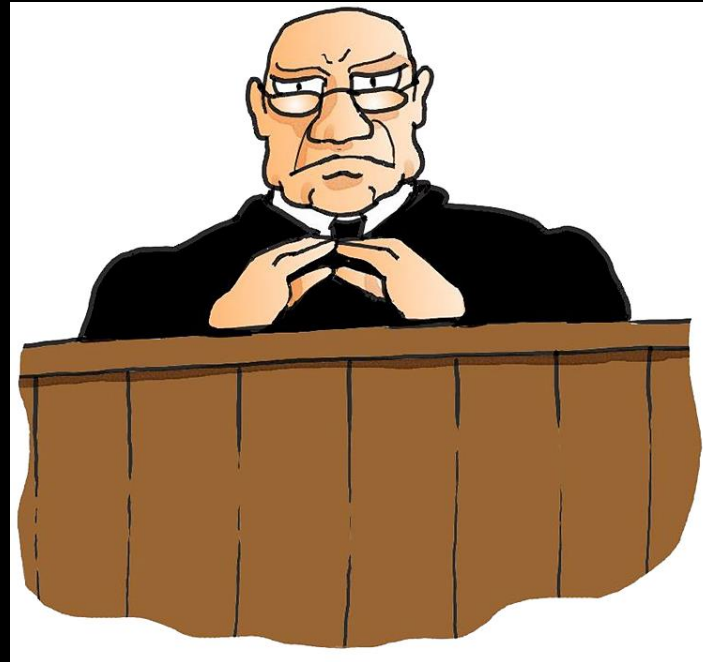
It is important to always have a schedule in place. If the owner does not think that the contractor can meet its own proposed schedule, document the disagreement and accept the contractor's schedule. With a schedule in place, the stage is set for a default for failing to meet a deadline.

Add milestones to the schedule to track progress.



How do courts view default termination?

- “Default-termination is a 'drastic sanction,' which should be imposed (or sustained) only for good grounds and on 'solid evidence.’ “
- Termination is a draconian and drastic remedy, constituting a species of forfeiture warranting strict judicial construction and enforcement of the breaching party's pretermination rights to notice and an opportunity to cure breaches deemed sufficiently material to warrant contract termination by the nonbreaching party



[This Photo](#) by Unknown Author is licensed under [CC BY-NC-ND](#)



Art. 29



Art. 28

Project
Completion



If the project is nearly complete, with a few punch items to be done, can we reasonably assert that any of those items, either individually or taken together, are material (i.e. go to the heart of the contract)? If not, then a termination for cause isn't supported.

Drawbacks to Art. 29 Default Termination

Terminating the contract may allow the contractor to proceed with the verified complaint process and suit under NCGS 143-135.3(c).

Thus, the owner will be defending a suit while completing its project.

Wrongful termination is heavily penalized.

1. Termination becomes a breach of contract by the owner,
2. Anticipatory repudiation,
3. May convert to termination for convenience under Art. 54,
4. May discharge both the contractor and its performance bond surety from all performance obligations,
5. Exposes the owner to liability to the contractor for lost profits and other damages due to wrongful breach, plus possible pass-through expenses,
6. Extracontractual damages where the termination decision is found not only to have been wrongful but made in bad faith, and
7. The owner may be liable for expenses and cost to the contractor and without the ability to offset its completion costs.

Numerous interdependent subcontractors and suppliers may be damaged, compounding the economic impact.

Article 29 – Who Finishes the Work?



Article 29



Before



After?

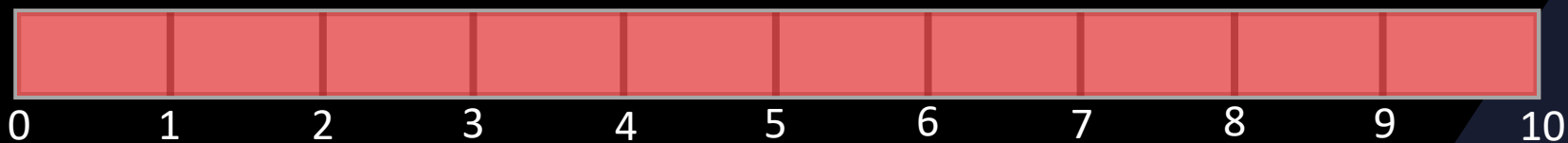
Article 28 – Final Thoughts

- It should not be used unless the conditions are right,
 - You can accept the risks, and
 - There are no other viable options.
-



Article 29 is the Nuclear Option!

How bad can it get?



THANK YOU!

James Bernier Jr.
Special Deputy Attorney General
jbernier@ncdoj.gov

Michael Ali
Assistant Director State Construction
michael.ali@doa.nc.gov



*This is not an opinion of the NC Attorney General's office, formal or otherwise. It has not been reviewed and approved in accordance with the procedures for issuing a formal Attorney General's Opinion.