RISK ALLOCATION IN CONSTRUCTION CONTRACT BIDDING

American Association of Port Authorities
Port Administration and Legal Issues Seminar
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INTRODUCTION

- Background
- Audience Perspective
- Project Objectives
- Cost Of Preconstruction Services
DEFINITIONS

- Program
- Design Review
- Construction Manager
- Bidding
- Negotiating
- Risk “management”
- Risk allocation
- Scope
TRADITIONAL APPROACHES TO CONTRACT FORMATION

- Transactions Done On Handshakes.
  - Formalities Are the Reality
- Contract Documents As An Afterthought
- Comprehensive Contract Documents
TRADITIONAL APPROACHES TO WRITTEN AGREEMENTS

- Drafting In Anticipation Of Litigation
- Drafting To Reflect The Parties’ Understandings
- Drafting Clauses That Are Enforceable
- Form Agreements
- Form Agreements Are Convenient For Litigators
- False Economy
- Form Agreements May Not Serve The Parties Interests
- Written Agreements With Adequate Consideration of Risk
- Risk Reduction and Risk Allocation
OUTCOME BASED RISK ANALYSIS

- Risk Identification
- Reported Decisions
- Experience
- Complexity
- Allocation
- Capacity to Manage
**KNOWN RISKS**: A Checklist of Recognized and Unnecessary Costs Change Orders & Claims

- Undisclosed geotechnical site conditions
- Unexpected presence of environmental hazards and conditions
- Bidder inspection failing to disclose site condition
- Failure of Owner to disclose information within its control
- Estimated or anticipated quantities exceeded or not met
- Drawings and specifications with inaccuracies, inadequate detail, or inadequately coordinated
- Phasing or sequencing misrepresented or not fully described

(cont.)
KNOWN RISKS: A Checklist of Recognized and Unnecessary Costs Change Orders & Claims

- Drawings and specifications impossible to perform
- Denial of site access, lack of permits, and unavailable right of way
- Changes in Owner's requirements
- Delay in award of contract or delayed authorization to proceed
- Failure to coordinate contractors either through Lead Contractor or Project Manager
- Failure to review and approve shop drawings, to respond to requests for information, or to perform testing promptly
- Owner's direction of means, methods, durations, sequences and approval of schedule
**KNOWN RISKS:** A Checklist of Recognized and Unnecessary Costs Change Orders & Claims  (cont.)

<table>
<thead>
<tr>
<th>Risks</th>
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<tbody>
<tr>
<td>Inadequate scheduling</td>
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<td>Inadequate documentation during construction</td>
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<td>Delays, inefficiencies, and impacts caused by other contractors</td>
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<td>Failure to assign and delegate decision-making responsibilities</td>
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<td>Acceleration or delay of project completion at owner's direction</td>
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<td>Failure to respond to change orders, claims for damages and requests for time extensions on a timely basis</td>
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<td>Requirement that contractor perform work not specified in contract documents or work differing from that specified</td>
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Known Risks: A Checklist of Recognized and Unnecessary Costs
Change Orders & Claims (cont.)

- Requirement that contractor perform work in particular manner or method which differs from that originally anticipated through either express or implied conditions or interpretations of the specifications
- Owner's directive to perform work out of sequence
- Disruption or interruption of work or stop orders
- Joint occupancy during construction
- Additional work resulting from revised, amended, clarified or changed contract drawings or specifications
- Designer’s improper rejection of work

(cont.)
KNOWN RISKS: A Checklist of Recognized and Unnecessary Costs Change Orders & Claims

- Applicability To All Types Of Construction
- Each Project Will Be Vulnerable Only To Some Risks
- Preventative Measures
HIDDEN RISKS: A Checklist of Hidden and Unnecessary Costs & Inefficiencies

- Designing up to a budget based on financial capacity rather than programmatic requirements
- Failure to provide for independent design review
- Failure to provide other preconstruction services, including constructability review, pre-construction scheduling, and detailed cost estimating
- Adoption of proprietary specifications that reduce competition
- Excessive professional fees or fees that are inadequate for the design or project management services needed
- Reuse of design without sufficient revisions
HIDDEN RISKS: A Checklist of Hidden and Unnecessary Costs & Inefficiencies (cont.)

- Bidding documents which encourage inclusion of excessive contingency in bids and proposals (e.g., no equitable adjustment, no damages for delay, etc.)
- Contract documents which foster bid protests and litigation
- Failure to provide adequate design, bidding and construction contingencies
- A hidden downgrade in quality during construction
- Billing for quantities not provided
- Unjustified and excessive change orders
- Construction out of compliance with specifications or requiring subsequent modification (cont.)
HIDDEN RISKS: A Checklist of Hidden and Unnecessary Costs & Inefficiencies (cont.)

- A feature of the project that fails to function properly and cannot be modified
- Accelerated progress payments to the contractor
- Setting a construction schedule that is too compressed, too lengthy or otherwise unrealistic
- Contractor’s failure to pay or delay in paying subcontractor or supplier
- Contractor’s work not in compliance with specifications and not monitored
- Proceeding with high-priced change orders for finishes rather than using follow-on contractor
- Insufficient utilization of construction change directive process
HIDDEN RISKS: A Checklist of Hidden and Unnecessary Costs & Inefficiencies

- Applicability To All Types Of Construction
- Each Project Will Be Vulnerable Only To Some Risks
- Preventative Measures
USE OF RISK ANALYSIS DURING STRICT BIDDING

- Inability Of Contractors To Participate
- Risk Reduction Strategies
- Measure Likelihood
- Focus On The Purpose Of Contract Drafting
- Consider Fully The Position Of The Contractor
USE OF RISK ANALYSIS DURING STRICT BIDDING (cont.)

- Fairness To The Contractor Is In The Interests Of The Owner
- Fairness, Practicality, And Real World Enforceability
USE OF RISK ANALYSIS DURING NEGOTIATIONS

- Direct Discussion Of Risk Reduction Strategies And Risk Allocation
- Commit The Necessary Resources
EXAMPLES OF IMPROVED OUTCOMES

- State Agency Program
- Smaller Local Government Programs
- Expect Disputes
SOME EXERCISES IN RISK ALLOCATION

- Consider What Risks Your Next Project Is Likely To Have
- What Risk Reduction Strategies Make Sense
- How Should Remaining Risk Be Allocated
- For Owners, Identify The Hidden Costs Could Occur On The Next Project
ENFORCING RISK REDUCTION STRATEGIES AND RISK AUTHORITY

- Identifying The Strategy And Allocations Explicitly
- Administrative Oversight
CONCLUSION

- Identify risk
- Reduce risk
- Allocate risk