

RISK ALLOCATION IN CONSTRUCTION BIDDING

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Effective management of projects requires rigorous attention to risk allocation and risk reduction strategies. All construction programs have the same objectives: (1) cost efficiency and avoidance of waste, (2) quality and programmatic content, and (3) timeliness of completion. Often referred to as the “three legs of the stool,” these project objectives are in constant competition with each other. Port Authority projects are no different. Adding quality and program content to the final product obviously adds cost and time. Advancing and accelerating project completion often (but not always) adds costs and certainly threatens quality.

I. Some Introductory Thoughts

There are several barriers to proper use of construction risk allocation and risk reduction strategies.¹ For example, it is well known that preconstruction services can be effectively utilized to evaluate risk, reduce risk, and allocate remaining risk. The preconstruction period prior to bidding is obviously the best time to reduce construction-phase risk. Unfortunately, the addition of preconstruction services has the appearance of adding cost to a project. We urge that project owners avoid the fallacy of measuring the desirability of expenditures against initial budget. Often adding pre-construction services, for example, tends to increase cost as that figure appears in budgetary projections, even though it is well recognized that some of these same pre-construction services deliver value and reduce costs for a fixed project outcome. In our experience, the “return on investment” for preconstruction services is often high multiples of the fees involved. Depending upon the particulars of your construction program, there may be other barriers to efficient, high quality and timely construction projects.

Next, watch out for problems arising from terminology. Definitions are a problem in the construction world. It is very common for the same term to mean different things in different contexts or different things to different people. Here are the meanings we ascribe to commonly used terms and will use here:

- Program – content, quality, functionality of the project.
- Design Review – an independent undertaking performed by third-party design professionals.

¹ The “risk” about which we are concerned here is construction contract risk of course, not third-party personal injury and property damage risk.

- Construction Manager – at risk or “agency” CM.
- Bidding or Strict Bidding – pricing by a qualified contractor on the basis of a fixed design and delivery date and award to the lowest bidder.
- Negotiating – discussion of and changes to scope of the work and its cost prior to award.
- Risk “management” – the adoption of strategies for construction contract risk reduction.
- Risk allocation – the explicit assumption of an unavoidable construction contract risk by a participant in the project.
- Scope – the proper use of this term is limited to the description of a project that will determine whether a change can be ordered by the owner or whether instead the change would be a “cardinal change” that cannot be compelled. Use of this term to define what work or services need to be provided is a source of confusion and engenders disputes.²

With these definitions in mind, let us look at risk allocation and reduction.

Risk allocation and risk reduction efforts depend upon making explicit what is often unarticulated by the parties. Formation of a contractual relationship requires trust. It is quite common for there to be elements of the relationship that are not reduced to writing. Some of us are old enough to remember the days when projects were designed and constructed with the minimum of formalities. The handshake that ended the negotiation was ordinarily the most important element of the relationship; little attention was paid to the contract formalities and claims were uncommon.

All projects need clearly articulated provisions to deal with risk. For larger and more complex projects and for all public work, greater formality is essential. Most private projects are, of course, negotiated in the broad sense of that word. On private projects, even if the parties speak of “bidding,” it is customary that “bidding” in the strict sense of submission of a price based on a fixed design is just the beginning of the interaction, and is followed by negotiating price and “scope” before the understanding is finalized.

On public projects, “strict bidding,” in the sense of submission of a price for a fixed design and fixed delivery without pre or post-bid negotiations, is the norm. Even in public work, where strict bidding is applicable, there are nevertheless significant elements of the relationship that often exist outside of the contract documents. Instances where projects proceed without explicit, clearly articulated provisions for risk reduction and risk allocation, reflect missed opportunities to make the construction process more efficient and cost effective.

² See *infra* note 20.

II. Contract Documents as an Afterthought

The informality of contractual relationships in the design and construction of projects often extends to the frequently disastrous commencement of work without a final set of contract documents. This is rarely advisable, of course, since so much in the relationship between the project owner or developer on the one hand and design professional on the other, or in the relationship between project owner and construction contractor, is in the detail. Indeed, it is only in the detail that there is, or at least should be, adequate attention to risk allocation and risk reduction strategies. The informal discussions that precede private negotiation, and, of course, the informal discussions that occur prior to bidding on public work, ordinarily do not address the detail of risk allocation and risk reduction but should.

Ideally of course, contract formation should be accompanied by a comprehensive and tailored set of contract documents – writings that incorporate elements of the informal discussions and understandings, custom and usages that are being adopted, and risk allocation and reduction strategies that are appropriate. The writing cannot properly be an afterthought, meaning something that trails pricing and scope. Risk allocation and risk reduction strategies are an essential part of the pricing and quality discussions and therefore an essential part of a comprehensive set of contract documents. While it is rare for a public project to proceed without a project manual and the necessary “front-ends,” it is unfortunately common on public projects for the contractual provisions upon which the bids are based to be inadequate.

III. Traditional Approaches to Written Agreements

Traditional approaches to the written documentation for the design and construction of projects have been inadequate. There is no better proof of this than the plethora of construction litigation in administrative forums, in arbitration and in court. We think that the frequency of disputes is first a function of a common and widespread misunderstanding of what written agreements are intended to accomplish and, secondly, a function of the failure to allocate risk and employ risk reduction strategies effectively.

For what purposes are construction clauses written? We think, unfortunately, that clauses are too often drafted for the purpose of providing the most extreme position for use in the context of litigation in court or in arbitration. By drafting clauses that are believed to be the strongest, the conventional wisdom goes, the party possessing the strong clause will have the strongest position. Drafting in anticipation of litigation is undesirable. First, this approach assumes that there will be litigation, an undesirable outcome from the perspective of all but construction litigators. Secondly, taking this approach deflects the parties from evaluating how to improve their contractual relationship, reduce risk, and allocate the risk that remains.

Instead, we think that clauses that work best in the field and accurately describe the relationship between and among project participants are the most effective because they accomplish the most in securing efficient construction with the greatest quality and the most timely project delivery.

Clauses that courts, mediators, and arbitration panels will actually respect and enforce should be the objective, not clauses that look powerful. It does little good to have a strong clause if that clause is seen as an unreasonable attempt to shift risk, since these courts, mediators and

arbitration panels often will not enforce unreasonable clauses.³ Put aside the theory. In the real world clauses that vary from the way that parties actually perform construction contracts may not be enforced.

The problem with the frequency of construction litigation cannot be tied to the absence of form agreements – we have many to choose from. Various professional organizations, including the American Institute of Architects,⁴ the Associated General Contractors of America,⁵ and the National Society of Professional Engineers Joint Contract Documents Committee⁶ provide form construction contracts. Form agreements are also available for some owners, developers, design professionals, and construction contractors from internal sources. And, of course, attorneys are also a commonly used source for good “boilerplate.” For each and every one of these sources, our fear is that the use of form agreements can be unthinking and uncritical. All too often, use of a form agreement suggests the absence of comprehensive treatment of the real-world elements of the contractual relationship, a real-world allocation of risk, and a real-world discussion of risk reduction strategies. In our review of port authority construction agreements we found that most were tailored documents, and this is the correct approach.

It is true that use of form agreements makes litigating easier. A clause that is “standard” will often be interpreted in several decided cases, thereby making research convenient. The question is this: why would anyone want to use a clause that is being litigated often enough to end up in court? Moreover, why would anyone want to use a form so that when litigation happens it can be conveniently researched?

We have no doubt that use of form agreements can be cheap. But the failure to allocate risk and adopt risk reduction strategies is invariably expensive in the long run. Use of form agreements without more is all too often “penny wise and pound foolish.” Forms can be useful as a starting point, but supplementation – ordinarily extensive supplementation – is necessary to reduce and allocate risk.⁷ Form agreements, by themselves, may not serve the parties’ interests.

Finally, we have no doubt that the professional organizations that create form agreements, and the internal sources for such forms (and we have to say the lawyers too), all have great incentives to create forms that make all of the “close calls” their way. What

³ See *Germantown Mfg. Co. v. Rawlinson*, 491 A.2d 138, 146 (Pa. Super. Ct. 1985) (“If the terms of [a] contract suggest a reallocation of material risks, an attempted reallocation may be so extreme that regardless of apparent and genuine assent, a court will not enforce it,” quoting John E. Murray, Jr., *MURRAY ON CONTRACTS* § 353 (2d ed. 1974)).

⁴ See The American Institute of Architects: Contract Documents, http://www.aia.org/docs_default.

⁵ See The Associated General Contractors of America: About Contract Documents, <http://www.agc.org/page.wv?section=Contract+Documents&name=About+Contract+Documents>.

⁶ See National Society of Professional Engineers: Engineers Joint Contract Documents Committee: Standard Contract Documents, <http://www.nspe.org/ejcdc/home.asp>.

⁷ See generally James D. Gordon, III, *Common Enterprise and Multiple Investors: A Contractual Theory for Defining Investment Contracts and Notes*, 1998 COLUM. BUS. L. REV. 635, 668 (suggesting that standardized form contracts do not allocate risks between the parties, as negotiated contracts do).

professional does not want contentious and difficult issues framed in a way that maximizes the professional's position, were there to be a disagreement. But again, why have an understanding on a provision that only becomes useful in a dispute?

What is missing in the use of forms without adequate supplementation, is the intensive discussion that needs to occur between and among all of the participants in a construction project. In a public contracting setting, that discussion can occur, albeit ordinarily without direct participation by prospective bidders, in the course of formal or informal "workshops" with design professionals and project managers, and even attorneys, present and actively engaged. Other than advisory committees for larger construction programs, ordinarily at the state or federal level, integrating the construction contractors in these workshops on public work has very real impediments, both practical and legal in nature. No such impediments exist, in the private sector, however, because there all the participants can participate fully in these discussions.

The topic of the discussion, without regard to the identity of the participants, is and always must be how to minimize and reduce risk and how to allocate the risk that cannot be eliminated. We always start this process with a review of outcomes.

1. Outcome-Based Risk Analysis

An outcome-based risk analysis consists of, first and foremost, reducing risk through use of risk-reduction strategies and thereafter an allocation of risk that cannot be eliminated. We began this process in the early 1990s with the obvious lessons that arbitration decisions and decided cases provided to us as practicing attorneys. We looked at the literature but found that most articles supposedly dealing with risk management were really about managing claims once they arose.

Reduction of risk requires attention to what can go wrong and finding a strategy to at least reduce, if not eliminate, that risk. Not every risk is present in every project. It would be a waste of resources to try to address in every project every conceivable risk. The best return for the expenditure of resources results from identification of those particular risks that are more likely to arise. This focus should occur as early as possible, during program development, as early as possible in design, and certainly no later than contract formation.

Reported cases are of course a good starting point. Each arbitration decision or decision rendered by a court represents a failure on the part of the contracting parties collectively either to reduce risk or, if not susceptible of complete elimination, to allocate risk clearly.⁸

Besides formal sources, experience is a great teacher as well. Your own program and other on-going construction programs in your state can teach much that can be used in subsequent projects. The experience of one similarly situated public entity in connection with its major projects can provide important and useful information on your up-coming project. No one is suggesting that project participants need to emphasize in particular their experiences on their very last project. But what is essential is that participants learn from a wide range of prior projects, whether their own or the projects of other similarly situated entities.

⁸ See, e.g. *Wilson Area Sch. Dist. v. Skepton*, 895 A.2d (Pa. 2006).

Clearly, some risks are beyond our technical capacity to reduce entirely. Construction projects are complex undertakings with as many variables and uncertainty as Mother Nature and human nature can provide. Our point here is, however, that those who fail to study history (of construction projects) are doomed to repeat it.

As to those risks that cannot be eliminated, there must be a conscious and explicit allocation to parties in the project of the risk that remains. The particular role of a project participant should not carry with it an automatic allocation of the risk. For example, risk of incomplete design could be allocated to the design professional, to the owner, and conceivably to the construction contractor.⁹ Risk of undisclosed subsurface or site conditions could be allocated to the construction contractor or to the owner.¹⁰

Our approach is to allocate risk that remains to the participant in the project who is best able to manage that risk.¹¹ Our belief is that the assumption of a risk by a project participant should be accompanied by legal “consideration” - money.

By way of illustration, we believe that owners and developers are in the best position ordinarily to manage the risk of subsurface conditions.¹² Under this analysis, it is a mistake to use clever drafting in owners’ clauses to attempt to shift that risk to construction contractors.¹³ For the assumption of this risk, the owners and developers should receive financial consideration in the form of more favorable pricing.

As another example, we note that construction contractors are in the best position to assure that work is performed in a manner that minimizes the risk of delays and interferences arising from “stacking of trades,” work out of sequence, and the like. Thus, owners and developers should never be allocated or otherwise assume the risk of scheduling and coordination conflicts, even in multiple-prime construction.

⁹ See Rodrick W. Lewis, *Design Professional Liability for Construction Defects Under Standard Form Contracts*, 14 Constr. 3 (A.B.A. SEC. LITIG.) (Spring 2005) (describing American Institute of Architects and Engineer’s Joint Contract Documents Committee form contracts as “limiting design professional liability for construction defects.”).

¹⁰ See, e.g. Hazel Glenn Beh, *Allocating the Risk of the Unforeseen, Subsurface and Latent Conditions in Construction Contracts: Is There Room for the Common Law?*, 46 KAN. L. REV. 115, 116 (1997).

¹¹ See *Nicolet Instrument Corp. v. Lindquist & Vennum*, 34 F.3d 453, 456 (7th Cir. 1994) (“It is not a novel idea that an essential function of contracts is to allocate particular risks to the parties best able to bear them,” citing Oliver Wendell Holmes, Jr., *THE COMMON LAW* 300 (1881)).

¹² Cf. Beh, *supra* note 9, at 137 (“The allocation of risks for unknown site conditions to the owner may be appropriate for the large owner with extensive knowledge or ability to obtain data about its site.”).

¹³ See *id.*, at 138 (“[C]ontractors that find themselves in financially losing contracts due to unanticipated conditions may attempt recovery through indirect and improper methods.”).

By assessing who is in the best position to manage risk, risk can be properly allocated to the project participant.¹⁴

2. **Known Risks: A Checklist of Recognized and Unnecessary Costs, Change-Orders, and Claims**

With a little thought and a little research, a keen observer of construction cases arising in the courts and in arbitration can categorize the types of risk encountered in construction projects, even if somewhat arbitrarily. By re-defining some of these categories, the list could easily be made larger or smaller. Our checklist of unnecessary costs, change orders and claims is a litany of situations that all will recognize. Although framed as a cost or loss to an owner or developer, each represents a category of real cost that first experienced by the contractor.

- 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.
- 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.

¹⁴ Cf. Todd J. Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551, 1623 (2003) (suggesting parties can contract around inefficient legal rules by reallocating the risk to the party who is in the best position to bear the risk).

- Owner's direction of means, methods, durations, sequences and approval of the detailed construction schedule.
- Inadequate scheduling.
- Inadequate documentation during project.
- Delays, inefficiencies, and impacts caused by other Contractors.
- Failure to assign and delegate decision-making responsibilities.
- Acceleration or delay of project completion at owner's direction.
- Failure to respond to change orders, claims for damages and requests for time extensions on a timely basis.
- Requirement that contractor perform work not specified in contract documents or work differing from that specified.
- 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.

These risks are potentially applicable to all types of construction. Indeed, we have used a version of this list for other types of complex undertakings (e.g., technology contracts).

Not all risks are equally likely to occur in any given project. Instead, the potential for some risks on a particular project will be significant, while the risk of others occurring, will be remote. Each of these known risks, however categorized, has a preventative or prophylactic measure that can be taken that will either eliminate or reduce the risk involved. The concept is to find the risks that are most likely to occur on your project and either apply the preventative measure that is appropriate or allocate the risk to the appropriate party in the best position to handle it.

3. **Hidden Risks: A Checklist of Hidden and Unnecessary Costs and Inefficiencies**

A little more experience in construction projects reveals a darker side – costs and inefficiencies that never become reported cases or arbitration decisions, and are therefore in a sense “hidden” from observation. These risks are hidden, but are just as unnecessary and just as burdensome as those that are readily recognized. Here is our list of hidden 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.
- 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.
- 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.

Although "hidden," these risks also exist regardless of the type of construction involved. Again, not all risks are equally likely to occur in any given project. Some of these risks create recognized costs as well. Each of these hidden risks has a preventative or prophylactic measure that can be taken that will either eliminate or reduce the risk involved.

IV. Use of Risk Analysis During Strict Bidding

In strict bidding, defined as pricing on the basis of a fixed design and fixed delivery without negotiation (the process ordinarily employed for public work), the opportunities to reduce risk and allocate risk that remains are limited to efforts made during the programmatic and design stages of the project.

Even without the direct participation of the construction contractors, an effective allocation of risk and an effective reduction of risk can be accomplished. Owners and design professionals can interact with contractors outside the confines of a specific solicitation. For larger programs, contractor input can be secured through trade associations and informally constituted committees. Smaller programs can benefit from informal lines of communication existing between the contractors and owner's representatives.

Strategies to reduce risk are not rocket science. We have spent considerable time talking to contractors, construction professionals, and design professionals about what is "wrong" on construction projects in general ways, all of which can be incorporated into risk reduction strategies.

To repeat, not all risks are equally likely to occur. The resources allocated to formulate risk reduction strategies should be those commensurate with the risks that predominate and the risks with sufficient potentiality to warrant their reduction.

The allocation of remaining risk should be done in a way that is not merely satisfying from a professional perspective to the drafter but is workable, realistically reflects the custom and usage and the discussions during the formation of the contract, and is reasonable and therefore enforceable.¹⁵ The key principle: remaining risk should be allocated to the party that is in the best position to control and minimize it.

¹⁵ See Mitchell Stocks, *Risk of Loss Under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods: A Comparative Analysis and Proposed Revision of UCC Sections 2-509 and 2-510*, 87 NW. U. L. REV. 1415, 1447 (1993) (suggesting that one way to "define fairness" is to consider whether a provision's allocation of risk approximates commercial reality as evidenced by custom or trade usage); see also *Germantown Mfg. Co. v. Rawlinson*, 491 A.2d 138, 146 (Pa. Super. Ct. 1985) (explaining that if risks are

Risks that cannot be eliminated can be assumed by the owner for the purpose of creating a uniformity among the bids and proposals. If so, the owner's assumption of that risk must be unequivocal and explicit; the owner wants all bidders to have equal awareness of this risk assumption.

The owner's interests are best served by fully considering the position of the contractor. Risks that cannot be eliminated must be allocated. Notwithstanding the absence of the construction contractors during the preparation of the bidding documents for public work, it is for a variety of reasons in the interests of those project participants who are "at the table" that they nevertheless consider the position of the construction contractors. From a purely selfish perspective, owners and developers do not want construction contractors to bid on contract documents that have unreasonable risk allocations. Such unreasonable allocations necessarily translate into contingencies in the bidding.¹⁶ If a loss is significant enough, a misallocation of risk, or an unreasonable one, can equate to a claim.

The classic example is an undisclosed site condition. By attempting to allocate the risk of an undisclosed site condition to a construction contractor, owners are running a gamble that they may well lose. The owners lose when the successful bidder includes contingency¹⁷ for this risk, and then pursues a claim when the contingent event occurs.

A second example is found in the "clever" drafting of no-damages-for-delay clauses. These clauses are pleasing to owners and their draftsmen. Unfortunately, courts and arbitration panels ordinarily do everything under the sun to avoid having to enforce them.¹⁸ Rare is the contractor claimant who cannot find a potentially applicable "exception" to the no-damages-for-delay clause.

Fairness to the construction contractors is in the interest of the owners and developers because fairness yields better pricing and fewer claims.¹⁹ It is one thing to allocate to the construction contractors a risk that they can and should manage themselves. It is quite

allocated in a manner in which the parties should have reasonably expected, the contract will be found enforceable and quoting John E. Murray, Jr., MURRAY ON CONTRACTS § 353 (2d ed. 1974)).

¹⁶ Beh, *supra* note 9, at 133 ("Padding' of the contract may occur when the contractor attempts to allocate some of the risk for delays or increases in costs of performance due to any latent or subsurface conditions discovered during performance of the contract which were generally not accounted for in the original bid estimate," quoting Youngdale & Sons Construction Co. v. United States, 27 Fed. Cl. 516, 527 n. 19 (1993)).

¹⁷ Cf. Beh, *supra* note 9, at 151 (suggesting that when an owner assumes the risk of subsurface conditions, the contractor is encouraged to "bid a fair price without building in the risk of contingencies.").

¹⁸ See, e.g. Gasparini Excavating Co. v. Pennsylvania Tpk. Comm'n, 187 A.2d 157, 161 (Pa. 1963) (refusing to enforce a no-damages-for-delay clause).

¹⁹ Cf. Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 290 (Pa. 2005) (Cappy, C.J., dissenting) ("The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract," quoting Berschauer/Phillips Construction Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986, 992 (Wash. 1994)).

something else to allocate to them risks that are either able to be managed by the owners and their design professionals or risks that are not technically susceptible of being eliminated from the project.

Fairness, practicality, and real world enforceability should govern risk reduction strategies and risk allocation determinations in public bidding.

V. Use of Risk Analysis During Negotiation

Risk analysis also has a place in most private projects and any public project where negotiation as to “scope”²⁰ and pricing is permitted.

In private projects and other types of projects where negotiation is permitted, clarity with respect to risk allocation and mutually beneficial risk reduction strategies can be discussed directly with the construction contractors. Indeed, that is or should be the entire point of the negotiation. Whatever limitations may exist on the participation of the construction contractors in the public bidding context evaporate when direct negotiations are permissible.

Commit the necessary resources to this effort. All the ills of the traditional approach to contract formation and the preparation of written agreements need to be addressed here and now. The temptation to adopt a form without full and complete discussion amongst project participants must be resisted. All efforts must focus on the developments of a comprehensive and tailored writing.

VI. Examples of Improved Outcomes

Litigation is not the inevitable consequence of construction projects. The conventional wisdom that litigation is inevitable is just plain wrong. Over the last twenty years or so while dealing with public and private construction programs in a variety of contexts, we have seen successful programs dramatically reduce litigated construction claims.

A state agency involved in building programs in the mid-to-late 1980s with the annual construction expenditures approximating \$150 million was experiencing a crushing load of claims litigation. The agency had three full time attorneys handling construction claims. This was in addition to the lawyers were involved in the litigation cases during preliminary, administrative stages. In addition, the annual outside counsel budget approximated one million

²⁰ The term “scope,” although widely used to describe requirements as to quality and timeliness of construction, is, in our view, a complete misuse of that term. Properly used, “scope” only should refer to the general nature of the project so as to define the ambit within which changes can properly be made by a project owner. *Cf. Black’s Law Dictionary* 1374 (8th ed. 2004) (defining “scope-of-work clause” as a “contractual provision that highlights in summary fashion what work is to be performed under the contract.”). For example, an owner cannot compel a construction contractor to change a three-story building to one with six stories. That would be a cardinal change and a breach of contract. Changes (with compensation) can be made to the dimension of rooms, since changing room dimensions is within scope. Scope does not define what is compensable or not, and this is where misuse of the term arises. A change in room dimensions may be in scope but it is compensable because it is a change in the work. Use of the term “scope” should be limited to only the most generalized description for the ambit of a project. A change is due when work is added or deducted to a project, and describing a change as being “out of scope” is a misuse of that term.

dollars. Millions of dollars were being paid annually in settlements and judgments. To deal with this situation, the program, in effect, was audited by a three-person team, including the undersigned. Three changes were made to agency's program: (1) the responsibility for coordinating multiple prime contractors was delegated to a lead contractor; (2) critical path method scheduling was required; and (3) the owner assumed responsibility for equitable adjustment for unexpected subsurface conditions. Within five years, as projects moved through the "pipeline," the staff of in-house claims lawyers was reduced from three to one part-time lawyer (the lawyers were reassigned to other agency duties) and the budget for outside counsel was eliminated in its totality.

We have been providing what we have loosely termed "project planning" legal services for approximately 17 years for local governmental entities with projects valued roughly from \$5 million to \$50 million each. For this period and for projects where a risk allocation and a risk reduction strategy were both in place, the local government owners completed their projects on time, at or under budget, and without construction claims in arbitration or court.²¹

No assertion is made here that disputes need not arise. To the contrary, disputes are inevitable. What is not inevitable is inefficiency in the construction processes, untimely delivery of projects and the waste and inefficiency that accompanies claims litigation.

VII. Some Exercises in Risk Allocation

Arriving at risk reduction strategies and, where risk cannot be eliminated and the adoption of reasonable and enforceable risk allocation that facilitates efficiency and lower project costs are matters of common sense.

Take your next project: of the list of recognized, unnecessary claims, which are likely to occur? What should be done to reduce the potential for these risks to occur on your project? All the categories as we have defined them have risk reduction strategies.

In connection with recognized claims, the allocation of remaining risk can be varied, sometimes allocated to the owner or developer and sometimes to the contractor. Allocation of risk should not depend on the bargaining power of the parties but rather upon identity of the party in a position to mitigate the threat.

Note that the unrecognized and hidden costs, and the risks thereof, are always the owner's. The very nature of these items requires action by the owner or developer. Just like the recognized risks, however, each has a risk reduction strategy.

VIII. Enforcing Risk Reduction Strategies and Risk Allocation

Contract clauses do not enforce themselves. All too often the person performing the role of draftsman does not see him or herself as having responsibility for compliance. We view this differently. Part and parcel of our job as contract lawyers is to see that the parties live up to their agreements. Especially where the client is a public owner, there is a clear responsibility to honor

²¹ There have been two claims during this period, one following a default of the contractor-claimant that was in our view richly deserved, and one occurring after a contractor inexplicably failed to make an inspection of a fill area.

commitments as a matter of public integrity and as a matter of long-term, enlightened self-interest.

Risk reduction strategies and risk allocations that are not traditional in the construction market where the project is located must be explained to all the project participants in clear and unambiguous terms. It is not enough to rely on the presence alone of specially tailored and crafted provisions in the project manual. Old habits die hard. If new approaches are to be followed, a special effort must be made at identifying the new approach at the earliest possible point in the project's timeline. For public work, we recommend "calling out" special provisions in the advertisement or at least in the instructions to bidders, and often make presentations at pre-bid meetings to discuss specifically new and unfamiliar provisions.

Actions contrary to contract document provisions must be addressed promptly. It does little good to say at the end of the project, after the project's CPM provisions have been disregarded, that contract documents have been violated. The harm has been done. The litigation will merely determine who has lost the most, and no one will be made whole. Clearly, the danger here is in acquiescence in noncompliance. Contractors have a right to insist upon performance of the owner's obligations, and vice versa.

IX. Conclusion

The identification of risk, the adoption of risk reduction strategies, and the allocation of risk that is technically not susceptible of elimination will make projects more efficient, improve quality, and result in more timely project delivery. A proactive approach, at the earliest possible point in the project, and notwithstanding the added initial cost, will return substantial benefits.

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