

***RISK ALLOCATION
IN CONSTRUCTION
CONTRACT BIDDING***

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RISK ALLOCATION IN CONSTRUCTION CONTRACT BIDDING

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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.)

- Inadequate scheduling
- Inadequate documentation during construction
- 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

(cont.)

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

(cont.)

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