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RISK ALLOCATION
DURING THE BIDDING AND CONSTRUCTION PROCESSES

Municipalities and Municipal Authorities

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.[1] While disputes are not inevitable, they do occur notwithstanding the best efforts of municipal counsel. In response, municipal attorneys must take an aggressive approach in marshaling the facts, securing expert analysis, and managing the municipal response.

I. Some Introductory Thoughts

There are several barriers to proper use of construction risk allocation and risk reduction strategies.[2] 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 and their counsel avoid the fallacy of measuring the desirability of such expenditures against initial budget and fearing opposition to the appearance of a budgetary increase. 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 these same pre-construction services deliver value and reduce the costs that are ultimately realized. In our experience, the "return on investment" for preconstruction services is often high multiples of the expenses involved.[3]

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

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[1] For example, increasing quality tends to add cost and extend the duration of construction. Similarly, cost is increased and quality is diminished when the construction duration is shortened. We once had the duration for design and construction of a performing arts center cut in half and construction cost increased from $8 million to $12 million.

[2] The "risk" about which we are concerned here is construction contract risk of course, not third-party personal injury and property damage risk.

[3] We call this the fallacy of the budget. The cost of preconstruction services is added to the budget projections, but the associated savings are not deducted.

contexts and different things to different people. Here are the meanings we ascribe to commonly used terms and will use here:

- Program – content, quality, and functionality of the project.
- Design Review – an independent undertaking performed by third-party design professionals.
- Construction Manager – either at risk CM (i.e. holding contracts) or "agency" CM (i.e. serving only as an advisor or consultant).
- Bidding or Strict Bidding – pricing by qualified contractors on the basis of a fixed design and delivery date and award to the lowest bidder.
- Negotiating – discussion of and changes to 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 should be limited to the general 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.[4]

With these definitions in mind, let us look first at risk allocation and reduction in the pre-construction phase.

Risk allocation and risk reduction efforts during pre-construction 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 a negotiation was ordinarily the most important element of the relationship; little attention was paid to the contract formalities and claims were, relatively speaking, uncommon.

For larger and more complex projects and for all public work today, greater formality is essential. All public projects need clearly articulated provisions to deal with risk. 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

[4] Use of the term "scope," to define the specific construction work that needs to be provided is a source of confusion and engenders disputes. "Scope" is properly defined merely as the general nature of the work, and is not equivalent to the detailed statement of the work required by the drawings and specifications. Change orders are not required when an item is "out of scope," but rather when a change to the detailed statement of work is required.

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a price based on a fixed design is just the beginning of the interaction, and is followed by negotiating price and the particulars of the work 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, however, 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.

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, given that so much in the relationship between the public owner on the one hand and design professional on the other, or in the relationship between 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 and formal discussions that occur prior to bidding on public work ordinarily do not address the detail and specifics of risk allocation and risk reduction, but should.

Public 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 the process of estimating cost and preparing specifications. Risk allocation and risk reduction strategies are an essential part of the pricing, duration, 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 because of the failure to consider risk allocation.

III. Traditional Approaches to Written Agreements

Traditional approaches to the written documentation for the design and construction of projects have been proven to be 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. However, drafting with the expectation of litigation is undesirable. First, this approach assumes that there will be litigation, an undesirable outcome from the perspective of all but

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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 improved quality and 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.[5] Put aside the theory. In the real world clauses that vary from the way that parties actually perform construction contracts may not be followed, let alone enforced.

The problem with the frequency of construction litigation cannot be tied to the absence of form construction documents – we have many to choose from. Various professional organizations, including the American Institute of Architects,[6] the Associated General Contractors of America,[7] and the National Society of Professional Engineers Joint Contract Documents Committee[8] provide form construction contracts. Form contracts 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 contract documents can be unthinking and uncritical. All too often, use of form documents suggests the absence of comprehensive treatment of the real-world elements of the contractual relationship, a real-world discussion of risk reduction strategies, and a real-world allocation of the risk that remains.

It is true that use of form documents 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?

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[5] *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)).

[6] *See* The American Institute of Architects: Contract Documents, http;//www.aia.org/docs_default.

[7] *See* The Associated General Contractors of America: About Contract Documents, http://www.agc.org/page.ww?section=Contract+Documents&name=About+Contract+Documents.

[8] *See* National Society of Professional Engineers: Engineers Joint Contract Documents Committee: Standard Contract Documents, http://www.nspe.org/ejcdc/home.asp.

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We have no doubt that use of form documents can be cheap. But the failure to allocate risk and adopt risk reduction strategies is invariably expensive in the long run. Use of form documents 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.[9] Form documents, by themselves, may not serve the parties' interests.

Finally, we have no doubt that the professional organizations that create form documents, and the internal sources for such forms (and we have to say, the lawyers drafting contracts), all have great incentives to create forms that make all of the "close calls" their way. What professional does not want potentially 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 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. But such discussions can occur outside of a specific bid on a project.[10]

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 on behalf of an active state construction agency and thereafter for local public entities in the late 1980s and early 1990s, using the obvious lessons that reported 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 is more likely to 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

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[9] *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).

[10] We know this, because we have been a party to discussions of this nature.

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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.[11]

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. Indeed, fighting the last war usually doesn't work well. 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.

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.[12] Risk of undisclosed subsurface or site conditions could be allocated to the construction contractor or to the owner.[13]

Our approach is to allocate remaining risk to the participant in the project which is best able to manage that risk.[14] Our belief is that the assignment of a risk to 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.[15] Under this analysis, it is a mistake to

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

[12] *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.").

[13] *See generally* 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).

[14] *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)).

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use clever drafting in owners' clauses in order to attempt to shift that risk to construction contractors.[16] 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 rarely be allocated or otherwise assume the risk of scheduling and coordination conflicts, especially in multiple-prime construction.

By assessing which entity is in the best position to manage risk, risk can be properly allocated to the correct project participant.[17]

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 the categorization is somewhat arbitrary; by re-defining some of the following 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 a public owner, each represents a category of real cost that is first experienced by the contractor and can create a claim.

- 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.

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[15] *Cf.* Beh, *supra* note 13, 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.").

[16] *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.").

[17] *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).

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- 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 multiple-prime contractors either through a 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, and sequences in a 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.

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- 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 adapted 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 party that is in the best position to control 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 may be hidden, but are just as unnecessary and just as burdensome as those that are recognized readily. Here is our list of hidden costs and 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 for subsurface conditions, no damages for delay, etc.).

- Contract documents which foster bid protests and litigation.

- Failure to provide adequate design, bidding and construction contingencies.

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- 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.
- Inadequate disputes resolution processes.

Although "hidden," these risks 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 (i.e. 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.

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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 public 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 that address, and are commensurate with, the risks that predominate and have sufficient potentiality to warrant attention.

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 therefore reasonable and enforceable.[18] The key principle: remaining risk should be allocated to the party that is in the best position to control and minimize it.

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.[19] 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

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[18] *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 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)).

[19] Beh, *supra* note 13, 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)).

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may well lose. The owners lose when the successful bidder includes contingency in its bid for this risk, [20] 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 often do everything under the sun to avoid having to enforce them.[21] Rare is the contractor-claimant which 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 because fairness yields better pricing and fewer claims.[22] It is one thing to allocate to the construction contractors a risk that they can and should manage themselves. It is quite something else to allocate to them risks that are either able to be managed better 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. 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 thirty years or so while dealing with public and nonprofit construction programs in a variety of contexts, we have seen successful programs dramatically reduce the number of construction claims that are litigated.

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 litigating construction claims. This was in addition to the lawyers who were involved in the disputes during preliminary, administrative stages. In addition, the annual outside counsel budget approximated one million dollars. That used to be a lot of money. Moreover, millions of dollars were being paid annually in settlements and judgments, a substantial portion of which did not go to project betterment.

To deal with this situation, the program, in effect, was audited by a three-person team, including the undersigned. Three changes were made to the agency's program: (1) the responsibility for coordinating multiple-prime contractors was delegated to a lead contractor; (2)

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[20] *Cf.* Beh, *supra* note 13, 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.").

[21] *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).

[22] *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)).

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critical path method (CPM) scheduling was required; and (3) the owner assumed responsibility for equitable adjustment for unexpected subsurface conditions. Within a few years, as projects moved through the "pipeline," the staff of in-house claims lawyers was reduced from three to one part-time lawyer (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 over 25 years for local governmental entities with projects valued roughly from $5 million to $450 million each. For this period and for projects where both a risk allocation and a risk reduction strategy were in place, the local government owners completed their projects on time, at or under budget, and without construction claims in arbitration or court.[23]

No assertion is made here that disputes need not arise. To the contrary, disputes are inevitable. What can be achieved is greater efficiency in the construction processes, timely delivery of projects and the reduction in the waste and inefficiency that accompanies claims litigation.

VI. Resolving Disputes

Notwithstanding best efforts, disputes will arise. Experience teaches certain lessons that are obvious to those of us who have been "blessed" with an active roster of litigation cases. Apologies to those for whom our suggestions here are nothing new, and to those who wanted an overview of legal principles in the context of construction projects like the ones they encounter.

A summary of the law governing construction disputes is of course beyond the scope of this article. Moreover, the lessons learned in handling public construction litigation have more to deal with the dynamics of the contractual relationship than with the precise nature of the construction or the existing caselaw. Building a prison or an elementary school presents the same process and relationship issues, notwithstanding the rather disparate nature of the projects. Precedent is meaningful only in the absence of contractual clarity.

First and perhaps foremost, the earlier the disputes can be addressed, the better. Take advantage of tight timelines that have been established for the assertion of the dispute. If your contract doesn't have a tight timeline for the assertion of a claim, provide one. And don't buy into the notion that damages are "continuing" and can only be asserted later. Instead, require that a claim be asserted at the time of the first occurrence of damage, accompanied by the initial costs. Contractors bid work every day with some substantial degree of accuracy or they wouldn't be in business. When there is an event, secure pricing as soon as possible. Putting aside entitlement, you are more likely to see a more realistic assessment of costs the earlier the claim is presented.

Keep the dispute process as informal as you can. There should be open lines of communication. Requiring formality in submissions will only encourage the use of claims consultants and litigation counsel. Their job after all is to "run up the tab." Keep this on a

[23] There have been three claims during this period. Two claims ended in judgments that were wins for the public owners, and in the third, the claimant was paid $80,00 on a claim that the owner valued at half that amount.

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business-to-business basis. Documentation of the claim in a manner similar to the documentation for a change order for money, time, or both is usually ideal.

Initial claims management by the public owner should be in-house. Escalating a claim to outside counsel before the contractor has engaged counsel is rarely a good idea. Contractors, even those with regular outside claims counsel, really don't want to involve lawyers if they can avoid doing so. The length of time that the dispute is kept in house is, of course, a matter of judgment. The more experienced the in-house legal staff is, the longer the claim should be handled there.[24]

Apply the procedures set forth in the disputes clause faithfully. As set forth in the last bullet point in the list of hidden costs *supra*, the failure to have a tailored, owner-specific disputes procedure could cost the public owner dearly. Our experience is that commercial arbitration unduly favors commercial interests.[25] The failure to provide an adequate disputes procedure is included on our list of hidden costs. An adequate disputes clause includes provisions for prompt claim assertion and prompt submission of supporting documentation to the owner, review by non-neutral owner personnel and a nonbinding administrative appeal, with the right to a de novo appeal to a court.[26]

Make a clear-eyed independent review of the facts early in the process. Claims often involve assertion of a public owner's responsibility for the acts or omissions of agents (architect, engineer, facilities manager, construction manager, etc.) and the agents don't like that. The truth is often clouded and there may be no one who is truly disinterested and objective.[27] When the facts are in doubt, retain an expert consultant.[28]

Avoid extraneous considerations. Politics are irrelevant of course.[29] "Kicking the can" to the next administration is rarely a good idea; this is on your watch.

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[24] On a $150 million dollar expansion of a state capitol building, a half dozen prime contractors and subcontractors presented claims for about $15 million dollars. The public owner had three in-house attorneys with full rosters of assignments, but the discovery and motion practice would be extensive and the decision was made to employ outside counsel.

[25] Speculating, we believe that public owners don't get a fair shake in arbitration. In one matter a construction manager received a full arbitration award, notwithstanding that he performed none of the duties assigned in his contract. Arbitrators sometimes relate better to contractors, architects and engineers, construction managers, etc. than public owners. And consciously or not, arbitrators have a sense that their prospects for future selection in arbitrated matters by private parties are better when the private parties win.

[26] Speculating again, we believe that courts have a better understanding of public owners and are more conscious of the impact of an unfavorable judgment.

[27] By definition, "agency" construction managers are more likely to be disinterested, especially when they have played a limited or nonexistent role in design, do not direct construction activities, and in general are the eyes and ears of the public owner, not a direct project participant.

[28] Expert consultants prove their value every day. An expert can ferret out outright fraud in a claim, such as a claim for "overbreak" in a tunnel project that was contradicted by contemporaneous job records, or can identify a cause for building leaks attributable to construction error that the design team had been prepared to accept as its responsibility.

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Finally, perhaps as a counter-intuitive suggestion, be fair. Your public client will have other projects. Whether this contractor-claimant returns to bid on a future project, other contractors may be influenced by the treatment afforded in this project.[30]

VII. Some Exercises in Risk Allocation

Arriving at risk reduction strategies and, where risk cannot be eliminated, 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 the best 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. And just like the recognized risks, 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 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 front-end or project manual. Old habits die hard. If new approaches are

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[29] In one state contract claim, a high-ranking legislator, who also maintained a law practice, sought to secure a favorable disposition of a significant claim filed by a contractor-constituent. He was heard out, and then ignored, a common response by an executive agency to a legislative intrusion into an executive matter. Of course, you want to be polite.

[30] In one large high school project, where specialty trade contractors cooperated fully with the owner, but were technically not entitled to an "early complete" bonus because the project as a whole did reach early completion because of the delayed work of the general contractor, the public owner paid a portion of the bonuses to the specialty trade contractors as a matter of good faith, to resolve open change order issues and to assist in final completion and warranty work. In our view, it was money well spent.

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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, for example after the project's CPM provisions have been disregarded by owner, architect, and contractor alike, 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, to contract preparation and dispute resolution, at the earliest possible time in the project, and notwithstanding the added initial cost, will return substantial benefits.

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