

**SEVENTH ANNUAL
NORTHEAST SURETY AND FIDELITY CLAIMS
CONFERENCE
OCTOBER 24-25, 1996**

EVALUATING PUNCH LISTS

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PUNCH LISTS

Summary

Punch lists, What are they? If a problem arises involving a Surety bond, why it is important for the Surety to evaluate the remaining scope of work before making their business decisions?

The Surety is often approached by a principal, when one or more of their jobs are almost completed with the sad story that they cannot financially complete the remainder of the work. Typically, several of the jobs are in the "punch list" stage and principal readily points out to the Surety that they should support the contractor, because it is the least expensive way to complete this minimal amount of work on the project. The Surety finds itself in the uneasy position of having to quickly make a decision to support or not to support. Making a sound judgment on the status of the "punch listed" project(s) involves understanding how the "punch list" was created. Since there is no consistent and precise definition of what a punch list should consist of and there is often a wide variance in interpretation of the contract, some guidelines for interpretation are needed to make sound business decisions, which will minimize the Surety's cost and exposure.

1. INTRODUCTION

Ideally, the punch list is initially done by the G/C, then after the major items have been completed, the architect and/or engineer prepares the formal punch list. The Owner may participate in preparing that particular list or he may prepare his own list. It is at this time when Sureties often become involved. On problem projects, and of course all projects in which Surety becomes directly involved are labeled "problem projects", the completion of the "punch list", in order to obtain final payment and project close out, can be a most tedious undertaking.

The Punch list stage of a project is that time period between finishing trades and final acceptance. It can also be defined as "the time between substantial completion and final payment."

To begin with there is no set definition of what a "punch list" should be. AIA Contractor/Subcontractor Agreement (A401 1987) gives a broad definition as "items to be completed or corrected". The "completed or corrected" part is clear. However, the definition of "items" is not as clear. Who determines the nature and scope of each item, and who determines when an item is completed?

The amount due to the principal on the contract is often determined by the "value" of the outstanding punch list. A typical municipal contract in New York states "When the Work is substantially complete, as determined by the Architect, the retainage shall be reduced to an amount equal to the total of two (2) times the value of any remaining items to be completed ...". Who shall determine the value of this outstanding work and what circumstances shall be assumed for the completion? The variation in the magnitude of the estimated value can be a factor of 10 depending on what assumptions are used.

On problem projects the Obligee can also attempt to use the "punch list" to punish the contractor with whom he is not satisfied. Through a strict interpretation of the specifications he can develop extensive lists of "items" on the punch list and place a high value on each one to the extent that the total value will equal the remaining contract balance. Using this quantification as leverage, the Obligee tenders an offer to Surety, that the Obligee will simply keep the outstanding contract balance in exchange for the Surety not completing the punch list. The Obligee thus reduces the cost of the project by this amount and likely has its own maintenance personnel complete the items in the future or leaves them undone. It is a neat way to reduce the cost of the project by 5% to 10% and have Surety pay the subcontractors their balance under the payment bond.

Sureties have also experienced the situation when the Owner is not ready to accept the "handing over" of the project to them. In many instances the Owner's financing changes at this point, and the Owner finds that he can neither afford the re-financing nor the expense of occupying the facility.

Four problems thus exist with "punch lists".

1. "Punch Lists", what are they?
2. Quantification - How can the cost of completion be realistically estimated?
3. Punch list as a weapon:
 - a. Is the punch list being used to punish the principal (and Surety)?
 - b. Can the Owner afford to take occupancy? Is the Owner using the punch list to avoid doing so?

2. IDEAL "PUNCH LISTS", WHAT ARE THEY?

Ideally, the punch list is developed by a joint effort of the Obligee/Owner, or its representative and the contractor. The list has individually identified work items, each of a small scope, with the party responsible for completion identified and an estimate provided for the level of effort needed to complete the item.

The ideal punch list does not contain questions or investigative type items such as "the heating system does not work on the first floor, correct", or "it does not appear that the electrical contractor met code on the third floor installation".

The ideal punch list also does not contain items which require a sequence of work activities to complete such as "excavate and replace the leaking tank". This is obviously not a simple one step process.

The ideal punch list, additionally, does not contain work which must be done by interfacing several subcontractors such as "clean out area, acid wash surface, apply two coatings, paint and finish trim".

Finally, the ideal punch list does not contain undefined documentation items such as "missing all as-built drawings and manuals".

The ideal "punch list" is just that: "A list" with easily identifiable items, numbered for identification. Each item on the list should be able to be completed in a single step. If each item is clearly defined, there should be no problem determining the amount of time needed to complete them, the cost to complete each item, who will perform the work, and who will be responsible for final acceptance.

A project which has such an ideal list is indeed at the "punch list stage". An evaluation of a project at this stage would likely lead to the conclusion that the contractor and his subs should continue to clean up these last items and Surety support would be reasonable, if all of other Surety factors also favor support.

Surety claims personnel rarely see ideal punch lists. It is not to say that they do not exist. They exist on projects which are completed without Surety involvement, i.e. "good" jobs.

3. NON IDEAL "PUNCH LISTS"

What is normally presented to Surety claims personnel are not punch lists in the ideal sense. They are usually "problem lists", or "wish lists", prepared by the Obligee, rather than action items needed to complete the project. A project described as being at the "punch list" stage under these conditions is usually far from being complete. If the following questions cannot be answered affirmatively by the contractor, with the responses confirmed by the Obligee, then the status of the project should be investigated more closely:

1. Was the punch list developed as a joint effort by the contractor and the Obligee/Owner (agents) and was the punch list developed as set forth in contract documents?
2. Does the punch list uniquely identify individual action items of work needed to complete the project?
3. Is the punch list numbered and does each line item have the work described, the responsible party identified, and an estimate of the resources required?
4. Is there a date on the punch list and a cover letter or other document identifying it as the "official" (contractual) punch list for the project (or phase of the project)?
5. If the punch list has been revised, are there revision dates and identification of the issuing (reissuing) parties shown?
6. Are the number of items on the list reasonable for the size of the project?

4. Evaluation Steps

Simply because an ideal punch list is not presented to Surety by the principal or Obligee on the project, does not mean that the contractor has not done his job. It does, however, mean that more investigation should be performed to determine the exact status of the project and other information such as:

1. Has the relationship deteriorated between the contractor and the Obligee?
2. Do major quality or technical problems exist?
3. How is the subcontractor's relationship with subcontractors and vendors and what is their performance level?
4. What is the Owner's (Obligee's) financial condition and motivation at the time?
5. What is the contractor's experience and qualification in completing this type of project?

Upon investigating these items, the nature of the punch list will be more fully understood. These steps are necessary to determine the nature and scope of the items on the punch list. Where should the Surety's confidence be placed with regard to solutions for the problems presented? The investigation needs to be detailed or the Surety may expose itself to greater cost and expense.

5. QUANTIFICATION

A major problem is the conversion of a list of problems into a true action punch list. When the problems are of a complex nature, this conversion can be a very tedious and expensive process. This often has to be undertaken by the Surety, simply to determine its position. The process of quantification can proceed when the punch lists are organized and the unique action items are identified.

The quantification of the punch list is dependent to a large measure on who is to perform the work. If the party, who performed the work originally, completes the punch list, the quantification is usually rather simple. If that party is not available or cannot perform the work, then the simplest of tasks may become very expensive to perform, since the completing party will have to become familiar with all the preceding work and take responsibility for the finished product.

For example, if the items of work on the punch list is "a spot of touch-up paint" and the original contractor has the paint available and scaffold, etc. to do the work, the item may require one man hour to complete. However, if someone new must take over this task and must research the paint colors from the specification, procure the paint, bring in scaffold and perform the work, the item could easily take sixteen man hours to complete. There can be a wide variance in the results of the quantification of even the simplest punch list item, as demonstrated by this example. When items of a more complex nature exist, such as "provide warranty on windows per specification", the variance can be even greater than in the touch-up paint case.

The viewpoint taken in quantifying the punch list is critical to the total value determined and there can be more than one valid viewpoint. In most cases, when the Surety becomes involved, there is likely to be a wide divergence in the viewpoints with regard to punch list quantification. The Obligee, or its agent, is likely to push hard for a very high value to be placed upon the completion of the open punch list items. If quality questions have arisen on

the project, the punch list may be the means used to assure that no latent problems will be discovered which will require correction later.

A strong position should be taken by the Surety with regard to defining completion of the punch list items. With a clear definition and reasonable quantification of the punch list, the Surety (and Principal) can begin work to discharge their bonded obligations. This may include support for the contractor completing the open items, hiring a completion contractor, or tendering a financial settlement to the Obligee or denying coverage.

6. PUNCH LIST AS A WEAPON

We have seen efforts by the Obligee to use the punch list as a weapon to keep the principal from recovering the last 5 to 10% of the project contract balance. Lack of performance on the completion of the punch list by the principal is first used to find the contractor in default. An evaluation is then made by the Obligee and his agent which equates the value of the incomplete punch list to the remaining contract balance.

Sureties need to look at Obligee's ability to pay and/or assess Obligee's reasons, if the Obligee's/Owner's actions appear unreasonable.¹

DEFINING COMMON TYPES OF PUNCH LISTS

Tall Thin List

This list is composed of a large number of relatively small problems originated by the Obligee to impress the contractor and Surety. The intent may be to get the Surety to buy out of the job for an amount equal to the contract balance. This appears to be used in circumstances, such as schools, where the Obligee/Owner believes that they can justify keeping the contract balance if they create a long list which will overwhelm the Surety. The Surety pays the subs, the contractor is defaulted, and the Obligee keeps the last 10% of the original contract. This approach appears more common today. In this case the Surety can save money by performing a rigorous analysis of the punch list.

Short Fat List

This type of list is usually the product of a serious deterioration of the relationships between the contractor and the Obligee. The list may seem to contain only a few items but these items encompass major problems which are endemic to the whole relationship between the parties. Items such as "missing all as-builts", "lack of conformance to specified drawings", "correction

¹The reader must keep in mind that an obligee may be an owner or a general contractor while reading this material.

of major quality concerns" are indications that a major misunderstanding between the contractor and the Obligee has existed for some time. The Obligee is not even at the stage where a detail action list can be compiled. The project is not at the "punch list" stage. It is simply at an impasse, and a list is being used to convey this fact. In this case the Surety must carefully evaluate any support of the contractor since it will be difficult to improve relationships which have broken down.

Disorganized List

Punch lists originate in many ways. Some are developed on an area basis, some on a discipline basis, some on a contract breakdown basis. If the list appears to be redundant, unstructured, with no unique identification of each item, it is likely that it was created by only one party, i.e., the contractor, the AE, the CM, or the Owner/Obligee. If communication has broken down between the parties, it is likely that the existing list is slanted heavily in favor of the party which created it. This situation is difficult to evaluate until the list can be sorted through and reorganized. A complete investigation will likely save the Surety money in the long run in this case.

Incomplete List

Many complex projects are completed in phases. There may be a detailed punch list of action items for an early phase, while phases completed at a later time may have only a preliminary list developed. On projects of this nature, it is important to differentiate between the portion of the project which is actually in the "punch list" stage from that which has not reached this point. It may be that only a small portion of the job is actually punched out.

Changing Lists

Punch lists can increase in size. It is important to limit these increases, if possible. Getting the Obligee to agree that any list is the "final" list is difficult. The method is usually to complete items on the list and "whittle" it down in some geometric fashion, i.e., 200 items, to 100 items, to 50 items, to 25, to nothing. Rarely will all items be totally completed. No job is ever perfect and most Surety claim jobs are far from perfect. A buy-out on some items is often the simplest solution. In many cases a contractor in good standing might be forgiven on some punch list items of a minor nature upon the completion of the job. A contractor in bad standing, however, and thus its Surety, will not be given such consideration to get rid of the last few items. A small cash offer in exchange for a release will often minimize additional administrative costs for the Surety.

SUMMARY AND CONCLUSIONS

Controlling the size and managing the punch list completion is a very detailed and time consuming effort. With all these punch list scenarios it is necessary to work hard to get past the basics, which are to:

1. Carefully define and limit the scope of the items on the list.

2. Realistically quantify their value given the circumstances.
3. Eliminate the ability of the Obligee to use the punch list as a reason for not paying the contract balance owed on the project.

If these basics can be achieved, the project can normally be brought to a reasonable conclusion. Without these basic steps completed, it will be difficult to make reasonable and defensible decisions on the best course of action to take and forecast the cost to complete.

Surety will find itself in a situation where it has spent the original estimated cost to complete the punch list only to have a new one generated. The Surety can save itself the possible added expense of its consultant by insisting that the punch list is detailed, as set forth in this paper, from the outset. If the Obligee and contractor cannot reach closure on this type of list, the Surety will know early on that it has a different problem to deal with and will be in a better position to analyze how it wants to proceed on their "uncompleted" contract, when the Obligee/Owner makes a claim against the Performance Bond.