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***THE SURETY'S REVIEW OF:
WHAT THE OWNER SHOULD - AND SHOULD NOT - DO
(Tools of Negotiations for the Claims Professional)***

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Introduction

Construction is not a zero sum game. We rarely see winners and losers. Among the major players, when one party loses, they all tend to lose. The surest way to a successful project is for the owner, designer and contractor to win. It's either win-win or lose-lose. When a job is delayed or disrupted, everyone suffers, particularly the contractor and often its surety as well.

In view of the severe penalties for delay, why do contractors permit themselves to fall behind schedule? The only way for contractors to make money in this business is to get in and get out! Extended costs and liquidated damages can quickly eat up the contractor's profits and put it into a loss situation. Why don't contractors simply accelerate the construction program and bring the project in on time? The costs of acceleration are usually much less than the damages caused by delay.

The answer is because the seriously delayed contractor is usually unable to recover, either because it lacks the resources to do so or because it cannot control the events which are causing the problem.

If insufficient resources are the problem, it's usually the contractor's excessively low bid, or a very tight labor market, or an owner that is cutting or withholding payments.

If the contractor cannot control the events which are causing an inexcusable delay, the cause is often due to the actions of the owner or the owner's agent, the designer. In summary, unless the contractor bid the job too low, project delays are usually triggered, directly or indirectly, by the owner.

We tend to assume that the owner, designer and contractor have a common interest in avoiding delays, and will strive equally to maintain the schedule. This is often not the case. In order to better appreciate the relative importance of avoiding delays, we will begin with a discussion of the damages caused by delays and disruptions to the major players on the construction team.

Delay and Disruption Damages

To the Owner

The private owner will almost always suffer additional financing costs when its projects are delayed. This may or may not be a problem for a public owner using appropriated funds. The same is true for lost revenue, a serious problem for the private owner and sometimes for the public owner as well, but not always.

Occasionally the facility is not needed by the contract completion date because other, related, projects are not yet ready or because the staff has not yet been hired and trained. The owner, in that case, may not share the determination of the others to avoid delays and disruptions.

To the Architect

Architects these days are usually working on a relatively fixed price basis. A delayed project requires additional services which may not be compensated and will always tie up members of the architect's staff. This is the theory behind the architect's claims for delay damages. In actual practice, however, the architect will often have a construction representative who will provide whatever extended services are required. The architect's real delay damage may be the cost of only one man, while the contractor may be carrying a substantial payroll during the delay period.

To the Contractor and its Surety

The contractor will suffer from both delays and disruptions while the other parties will only be affected by delays. In any event, the big loser will be the contractor and when that loss becomes overwhelming, the surety is usually called upon to remedy the situation. The cost of such remedies can be quite large.

A contractor's costs may be viewed as direct and indirect. The direct costs, such as labor and material, will vary as a function of how much work is done. The indirect costs, on the other hand, tend to be fixed with respect to the work but vary as a function of how long the contractor is mobilized. Home office costs such as salaries and insurance premiums and site overheads such as supervision, power and water, office trailers, etc. are all examples of indirect costs. These costs run on, regardless of how much work is done, even if the contractor is performing no work, and they form a major component of the contractor's loss.

Liquidated Damages paid by the delayed Contractor to the Owner are another source of concern for the contractor, however the owner may view liquidated damages as a benefit rather than a cost, a win-lose proposition. Liquidated damages serve a useful purpose in creating incentives for the contractor to complete on time, however, once liquidated damages are actually imposed, the site contractors become concerned that there will not be enough money, after LD's are deducted, to pay for their work. Disputes and slow downs break out and the project may be heading for a default. The delayed general contractor will also be faced with delay claims from its sub contractors. .

When a project is delayed, the contractor will often encounter cash flow problems because payments are delayed and liquidated damages are withheld. The delay may also affect the release of retainage from the owner and this will create problems with the early subs who completed their work many months ago and cannot get paid in full.

During periods of high inflation or new wage agreements, project delays will cause the contractor's costs to escalate well beyond the bid estimate.

Disruptions will also impact the contractor although, as mentioned earlier, this may not be a problem for the owner and architect. Disruptions, such as interference, blocked access, delayed clarifications, suspensions, etc. will cause a loss of productivity and an increase in direct labor costs which may be much greater than the indirect cost impacts of a delay. The disruptions which often accompany a delay may prove to be more harmful to the contractor than the delay itself.

To the Entire Team

In addition to all of the impacts mentioned above, delays and disruptions may have a corrosive effect on the entire building team. This will appear as a loss of confidence in the group's ability to successfully complete the project, and a loss of moral within the building trades when they conclude that they will not be permitted to do a job which they can be proud of.

When schedule commitments cannot be met for reasons beyond the control of the subcontractors, those commitments are undermined and the schedule loses its usefulness as a target and a guide.

When a contractor is delayed, by its own actions, or by the actions of an owner or architect which will not own up to its responsibility for the delay, bitter disputes arise between the parties. General contractors threaten to share the liquidated damages with offending subs and subcontractors decide that the general facing deducted damages and withheld payments will not be able to pay them, so they shift their forces to jobs that will be able to pay them. A lose-lose situation develops which may quickly spiral out of control.

Here's What the Owner Should Do

Changes

Design changes are perhaps the greatest single contributor to construction delays. The owner is responsible for providing accurate plans and specifications and the contractor is entitled to rely on the design documents as being adequate to produce the desired result. This is an implied warranty by the Owner, and has been recognized since the 1918 Spearin case.

The Owner needs to do more than hire a good architect to meet its obligations under the Spearin Doctrine, although getting a good architect is certainly the most important step in that direction. In addition, the Owner should:

Review the Design

This doesn't mean reviewing the engineering, although some owners will check critical calculations. I'm talking about those details which the owner traditionally directs and reviews such as the usefulness of the lay out and the selection of finishes. These things will be evaluated at some point in any event. The problem arises when this evaluation takes place when the facility is nearly completed, rather than before the design is put out for bid.

Coordinate the Disciplines

We often see examples of designs which were not coordinated between the architectural, structural, mechanical, electrical etc. disciplines. This coordination cannot be done by the owner, however the owner must insure that it gets done by the design professionals.

Perform a Constructability Review

The larger design offices will have a construction expert on staff to insure that the design can be understood by contractors and constructed economically. If the A/E doesn't already perform this function, the owner should insist that it be done or do it themselves. Costly confusion and delays can be avoided by this review. This is the time to value engineer your project. Last minute value engineering by contractors can lead to misunderstandings, unapproved substitutions and mischief of many sorts.

Perform a Tenant Review

Many owner organizations build for a separate tenant agency, so the owner's design review described above may not involve the ultimate user, and yet the facility must eventually be "sold" to the tenant. This can cause last minute changes, sometimes after substantial completion has been certified. Changes late in the project are almost always on the critical path and can be particularly disruptive because contractors may not have other areas in which to work while waiting for the change to be implemented.

Resist Late Changes

"Late" in this context means anytime after the award. Owners need to be firm in dealing with any party attempting to introduce unnecessary changes. Unless the change is essential or will result in significant savings, sufficient to outweigh the cost of delays and disruptions, it is usually better for the owner to let the contractor complete according to the original design and make the change later with its own forces or with a new contractor.

Standardize

The best way to avoid costly changes is to adopt standardized designs. When the design has been built before, the building team knows exactly what needs to be done, how much it should cost and how long it will take. The contractor bids a known scope of work. Delays and disruptions are few and no one has to deal with sureties and claims consultants.

Change Management

Process

Many owners recognize the unhappy cost and schedule consequences of change orders, and attempt to control the situation by establishing elaborate procedures for processing changes. New controls get inserted into the process over the years to the point that it become impossible to manage.

Timeliness

A prospective change creates an immediate dilemma for the contractor. In addition to the obvious need to price the change and coordinate the inputs of the various subcontractors and suppliers, the contractor often needs to decide whether to hold work that could be impacted by the change or to continue in accordance with the original design. Stopping work will cause a delay which may not be treated as compensable, and continuing will be viewed as wasteful.

Changes must be implemented in a timely fashion to reduce the impact on unchanged work. If the owner must make a change that will affect following trades, it should own up to the delay and disruption consequences of the change.

Pricing

Some contractors will take advantage of the essentially uncompetitive nature of change order negotiations, and some owners will take advantage of their right to order disputed changes. Change Orders should be priced reasonably and fairly to both parties. That is usually not difficult with respect to the direct cost of the change. Assessing the future impacts of the change on subsequent activities can be very difficult. That assessment appears as the delay and disruption component of the change order pricing.

Most contractors are unable to predict the extent of the delay and the cost impacts of a change order delay. They will simply request an extension in time equal to the time it will take them to do the change order work, without regard for the concurrency or criticality of the delay, and they will not provide at all for the cost impacts of the delay. Their mark up on the direct cost of the work will cover the overhead and profit on the changed work, but they will charge nothing for the impact of the change on their unchanged work. The owner or architect will usually slash the requested time extension, again without regard for the concurrency or criticality of the delay, and the contractor will refuse to accept the change order. The changed work and the impacted but unchanged work are put on hold and a delay dispute begins.

The best way to avoid these problems is to not change anything. The next best way is to establish and follow a change order process that recognizes and fairly compensates for the true delay and disruption consequences of changes. There are a number of ways that that can be done, and all of those ways are imperfect, some much more so than others.

Approvals

A contractor needs the approval of many parties to get its work done, and the owner directly or indirectly controls many of those approvals.

Before the work begins, the successful bidder may offer substitutions and design changes to reduce the owner's and contractor's costs. If the constructability and value engineering reviews had not been done earlier, they will be done now. It is vitally important that any such changes be properly documented in contract addendums or executed change orders. Too often the contractor's recommendations are directed toward lower costs for the contractor and lower quality for the owner, and the owner's acceptances are undocumented and never implemented. If the work goes ahead on that basis, bitter disputes will erupt within a few months.

The contractor is usually responsible for getting the building permits, etc. however many other governmental approvals, such as zoning, rights of way, regulatory matters, etc. must be obtained by the owner. Failure to secure these approvals in a timely manner will expose the owner to well founded claims and may establish a pattern of delays and disruptions. If a job starts with these kind of problems, morale, trust, and well planned programs are quickly discarded.

The owner needs to monitor the architect's response to contractors requests for information (RFI's) and requests for clarifications (RFC's). These requests may have different names but the function will be the same and every job needs a system to formalize and record this process. When a contractor asks a design question, work is usually delayed or disrupted while awaiting an answer. On a standardized design project, most of the questions have been asked before and can be readily answered over the phone. There may only be a few dozen formal requests for information. In other cases they will often be hundreds of such requests, and I have worked on a job that recorded over ten thousand such requests. If these questions are not answered properly and quickly, the job will be delayed. Monitor the quality of the questions and answers and the turnaround times.

Payments

An underfinanced owner will sometimes withhold payments and deny legitimate claims to the point of driving its contractors into bankruptcy. This problem is rarely seen in the public sector, however "bond 'em and bust 'em" owners and developers can still be found in private practice.

Under-payments and late payments continue to be a problem in both sectors. Most contractors live close to the edge in a harsh, cash flow driven, world. Reduced and delayed payments force them to interrupt the flow of money to their subs and suppliers, who, in turn, reduce the flow of men and materials to the job. Schedule performance begins to suffer almost immediately.

Coordination

The owner is responsible for more than workable designs and timely payments. The most significant other responsibility is the coordination of multiple prime contractors. This multi

prime responsibility is often delegated to a construction manager, however the owner will retain all or much of the risk of any failure to properly support and coordinate.

The owner has other responsibilities such as issuing a notice to proceed, and, in Florida, fulfilling all of its obligations under the Florida lien law such as a notice of commencement and the making of “proper” payments. More to the point of avoiding delays, the owner will often take on responsibility for provided special equipments, surveys, locations of existing utilities and specialty contractors. The owner may also need to hire and train the staff to operate the facility and must be prepared to take over the completed project. Failure to perform in any of these areas may cause serious delays to the project schedule.

Here’s What the Owner Shouldn’t Do

Interference

The contractor is traditionally responsible for, and in control of, the “means and methods” of performing its work. The owner has an implied duty to not interfere with the contractor’s “means and methods.” There are many ways in which the owner can interfere with the contractor’s work. Some of these ways are not very obvious, however they all carry a strong potential for delaying the project, for example:

Extensive Change Orders

In addition to the delays and disruptions caused by each change order, the total impact of all the change orders taken together is a form of owner interference. This factor is so pronounced that studies have revealed significant productivity losses as a factor of the total change order cost compared to the contract value. When the dollar value of change orders exceeds 10% of the original contract value, the impact of the changes on unchanged work starts to compound.

Late Change Orders

Change orders that hit a job late in the game, such as during the punch list phase, will have a much greater delay and disruption impact than might be expected and are another form of owner interference. The contractor’s ability to “work around” a disruptive event is practically nil at this point. Large portions of the work can come to a standstill with no place else to deploy resources.

Restricted Access

The contractor must have access to its work in order to control the means and methods of construction. It is not enough to get the trades to the specific work site, they must have room to work and store material, adequate light, dry, dust free conditions, etc. The general contractor, construction manager or whoever is coordinating the work is responsible for most of those factors, however the owner may interfere by engaging separate contractors in the same area, or by blocking access to the job site, or by permitting user personnel to begin setting up spaces before the contractor has handed over the area.

Over Inspection

Quality standards are established by the contract documents and the customs and practices of the contractor's trade in the area. Owner interference results if the owner or the architect require higher standards of performance than are called for in the drawings, specifications, codes, standards and customs of the trade. This situation will usually arise during the final inspection phase and the impacts can be the same as described above in the section on late change orders.

Acceleration

Forcing a contractor to complete ahead of schedule is an obvious example of owner interference leading to disruption but not delay. "Constructive" acceleration would be a less obvious example of owner interference. When a contractor suffers an excusable delay, but the owner refused to extend the contract completion date, we have a case of constructive acceleration. In addition to the impacts of a delay which was not the contractor's fault, the contractor is faced with costs in the form of extended work days, holiday work, hiring and training additional trades, etc.

Beneficial Use

Using a facility prior to final acceptance and handover is a form of owner interference which can cause delays to the contractor while avoiding delays to the owner. Owners and contractors which enjoy a strong partnering relationship can bring a project in on time, despite earlier delays, by this means. Unfortunately, strong partnering relationships between owners and contractors are rare in the private sector and essentially precluded in the public sector. Beneficial Use will therefore usually create delays and disruptions to contractor even though the owner may benefit from the practice.

Conclusions

Although the architect and the owner may also suffer, the contractor and/or its surety usually bear the major consequences of a delayed or disrupted project. Contractors have an enormous stake in completing on time. The extended costs and liquidated damages associated with delayed projects can, and often does, destroy the contractor. When this happens we usually blame the contractor, and sometimes the contractor is at fault - but more often the culprit is the owner.

The “golden rule,” you know, the one that says that whoever has the gold makes the rules, operates so powerfully in construction that the unclothed emperor (owner) is rarely held accountable for its role in the destruction of your principals.

The claims handler, faced with an all out assault by a bond obligee, will be in a position to negotiate a more favorable resolution of the claim by analyzing the steps set forth in this paper. A good claims consultant will be able to quantify the damages sustained by the contractor so the claims handler will be in a position to set off the damages being claimed by the obligee.