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CHALLENGES OF A UNIT PRICE CONTRACT RE-LET

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CHALLENGES OF A UNIT PRICE CONTRACT RE-LET

The unit price contract, unlike a fixed price or lump sum contract, is based upon estimated measurable quantities of work that will be performed in order to complete the entire project. The bid consists of costs assigned to each unit for a specific scope of work. Upon completion of the project, it is usual for the existence of quantity overrun and underrun. Unit price contracts are typically road work, bridge work, underground sewer and water facilities, and other similar infrastructure utilities performed for Federal, State, County, and local municipalities.

Sureties face major challenges when called upon to re-let a partially complete unit price contract as a result of the default of its bonded contractor. Sureties must struggle against becoming the victim of savvy completion contractors knowledgeable of how to manipulate their bid to maximize their profits at the expense of the Surety. A Surety must consider taking a pro-active position during the re-let process to procure responsive bids and mitigate the losses. All too often, the Surety's claim department is surprised by the substantial cost overrun for the unit price contract re-let, but with a knowledgeable construction consultant providing a complete and concise assessment these cost overrun may be controlled.

The pro-active Surety will be mindful of several issues during the re-let process. First, the Surety must clearly understand the "footprint" of the bonded project so any and all agreements with the Obligee will include only completion of the intended original scope of work. Next the Surety should request that a final payment application be prepared based on the actual work in place as of the default and termination date of the bonded contract. An inventory of stored materials should be performed to include materials paid and unpaid by the Obligee. The Surety should consider the role of the Obligee's Engineer and their relationship with potential completion contractors, in order to ensure the completion contractor will work with both Surety and Obligee in a successful partnership. Lastly, the Surety, with the assistance of the construction consultant, must perform a comprehensive review of the bids procured for completion of the unit price contract.

Footprint

A clear and concise understanding of the "footprint" of the originally contracted work to complete, is essential for the Surety's position when advising the Obligee of what obligations exist under the performance bond. For example, when dealing with a local municipality contract, know what specific streets and neighborhoods were to benefit from the contracted improvements. If the original contract included unit pricing for asphalt paving and the square yard units are not used within the original estimated "footprint" of the bonded work, do not be surprised to find the "unused" units appearing on streets of local public officials, obviously not within the original footprint.

Most municipalities receive some form of Federal, State, and/or local grants to fund utility and road projects. These grant dollars may be lost if they are not spent. In as much as it is common to see unused quantities placed in an area outside the original footprint, dollars from one unit price line item may be moved to another line item in order for the

Obligee to take advantage of the full grant, i.e., paving dollars moved to landscaping. Early in the re-let process, the Surety should consider addressing these issues when meeting with the Obligee and their Engineer. Depending on the percentage of completion of the project at the time of default, the Engineer may be able to identify those scopes of work likely to be a quantity over or under run. Although the Surety can be sensitive to Obligee's desire to spend all the grant money to improve the community, they will need to make it very clear that Surety will contest work done outside of the original footprint. Knowledge and understanding will encourage the cooperative efforts between the Obligee and the Surety to eliminate future litigation.

The Surety's clear and concise understanding of the work to be performed under the original bonded contract and the anticipated over and under run items, may become of great importance during the review of the bids, discussed in a later section of this paper.

Stored Materials

An inventory of stored materials at the project site should be performed early in the Surety's investigation. The inventory of the stored materials previously paid for by the Obligee, but not yet converted into work in place, should include a description, the location, the value, and if possible the supplier's invoices for the materials. Stored materials on the project not yet paid for by the Obligee, presumably delivered since the cutoff date of the last submitted payment application, should be inventoried in the same manner. For both paid and unpaid stored materials, it is important to determine that the materials are applicable to this project and are properly secured and stored.

Efforts by the Surety to obtain an inventory of stored materials may contribute to ultimately mitigating the loss. The list of stored materials can be provided to the bidders in the request for quotation. Materials previously paid for by the Obligee were paid from contract funds. If these materials are made available for the completion contractor to use in execution of the contract, their bids should reflect an adjustment of the unit price for the scopes of work for which materials are available. The inventory of stored materials will assist the Surety in their investigation of payment bond claims. Further, the Surety can include additional stored materials in the final payment application discussed in the next section.

Payment Application

When the Surety receives demand to complete a bonded project, most would agree it is highly unlikely that all work in place has been billed by the Principal to the Obligee. Surety should request the Obligee and the Engineer to prepare a final work in place, or a pre termination payment application. The need for this final payment application as a part of the re-let process becomes very apparent to a Surety when they have had to pay for work billed by the completing contractor that was actually performed by their Principal. The Surety's construction consultant can work with the Obligee's Engineer in establishing the final work in place quantities. The request for quotation provided to the bidders should include this final reconciliation of work in place. For clarification purposes, consider the following example related to sewer manholes. The description for this unit price work is as follows:

> "5"- foot diameter sewer manhole, furnished and installed, complete in place as shown on plans to include all interior coatings or linings as indicated with manhole ring and cover."

A manhole that is not completed, based on the above description, will not appear as work in place on the payment application. Further, considering that most of the manhole material is in place but not completely installed, it will not appear as stored materials. Surety, however, will receive payment bond claims from the subcontractor who performed part of the work or the supplier of the manhole covers. Surety may face a considerable loss due to this "gap" between stored materials and their conversion into measurable and billable work in place. The savvy bidder will recognize that with a minimal amount of work, he can complete the installation of the components and then bill the entire unit price for the line item. The request for quotation should consider an adjustment reflecting a credit to the Surety or a separate lump sum bid for completion of these "gap" items.

Whether it is a contributing factor in the termination of the Principal or as a result of the Surety requesting the Obligee to provide a final payment application, the issue of defective work in place may surface. A clear understanding, as provided by the Surety's construction consultant, of the extent of defective work will enable the Surety to ensure the most cost effective bids are procured.

"Friendly" Completing Contractors

The Surety's understanding of and actions taken up to this point in the re-let process of the unit price contract are meaningful toward mitigating their losses. Surety's have often had to learn about some of the "behind the scenes" activities the hard way. The Obligee's Engineer often suggests the names of contractor(s) they like working with to the Surety. At face value, this can serve to create a positive working relationship between the Obligee, Engineer, Surety, and completion contractor. However, the very nature of this business involves considerable negotiations between the Engineer and their site and utility contractors. Long-standing relationships likely exist that have in the past allowed for work performed outside the original footprint to be billed for as work that was within the original scope. The Engineer may provide specific details about the project to the "friendly" bidders that may skew the bids in their favor.

The Surety may best be protected from what some may perceive as unscrupulous practices, by allowing their construction consultant to meet with the Engineer on more than one occasion, participate in all pre bid meetings and by visiting the project several times. One other option available to the Surety is to consider contracting completion with a local unit price contractor used previously on other defaulted projects. Costs to complete may be reduced provided 1) the prior interaction included mutual respect, 2) the contractor has the construction expertise to complete this project, 3) the bid reflects fairness in the pricing.

Review bids

The Surety faces many challenges during the re-let process of a unit price contract. Perhaps the most challenging is the review and analysis of the bids for completion that are received. Understanding the original footprint of the contract, quantifying the work in place, the reconciliation of stored materials, and the dynamics of the relationship of the bidders to the Engineer, are critical as the Surety chooses the best qualified bid. Experience in the analysis process clearly indicates that the submitted low bid may actually be the highest bid.

The request for quotation should include a price from the bidders for all the line items included in the original bid, as presented in the payment application. On a case by case basis, the request for quotation should clearly state whether the bidders should price the repair of patently defective work as a lump sum or on a time and materials basis. Incomplete work, as described in the Payment Application section of this paper, should be included in the request for quotation to be bid either as a lump sum, time and materials basis, or with some stated credit for work and materials already in place.

The Surety's exposure will be the difference between the bidder's price per unit and the Principal's price per unit. If the bidders' price is less than the Principal's price, the Surety should receive a credit to set against other line items. Surety is advised to analyze each individual line item scope of work and the unit price bid for each item. Although somewhat speculative, the construction consultant should focus on the line items that are likely to be quantity overrun, underrun, or deleted scopes of work. Analysis of the bids should include review of:

- ❏ Unusually high unit price bids of a particular line item as they relate to the remaining quantities. For example, a line item with only two remaining quantities for completion bid at a very high unit price may be nothing more than the bidders recognizing that the particular item is going to require not one or two additional units, but a substantial overrun of up to 20 to 200 additional units.

- ❏ Line items for which a very low price or even a unit price of $0.00 or per unit is bid. A unit price contract bid typically includes line items that likely will never be used. The Obligee's Engineer has included these items to cover unforseen conditions. For example, the Engineer anticipates only 6' to 8' cuts of pipe will be needed for the project. However, included in the original bid are a few quantities of 12' to 14' cuts. The savvy bidder, from their experience on similar projects in the community, recognized that 12' to 14' cuts will not be used and in order to remain competitive, bid a very low unit price. The real value of the 12' to 14' cut is reallocated to a different item, typically one they anticipate significant quantity overrun will be utilized. This type of pricing can result in the final bid price having the appearance of being competitive, at a minimum, if not in fact the low bid.

- Pricing for items that may be removed from the scope of work. On occasion the construction consultant may become aware of certain scopes of work the Obligee may delete from the contracted work. No final determination has been made, therefore, the request for quotation should still include the pricing for those items. Although only speculative, these items should be considered in the analysis to determine the impact their deletion would have on the overall bids.

After the bids have been analyzed based on the criteria described above, any clarifications should be sought from the bidders. The Surety and their construction consultant then will move forward to determine what items are to be adjusted and to accurately reflect the lowest responsible bidder.

Other considerations

The Surety, on occasion, should consider ordering an independent survey on the quantities of work in place on the project. The survey serves to provide a more clear and concise understanding of the actual remaining line item quantities to perform for project completion, and may minimize the risk that the bidders will take advantage of the situation.

The Surety's construction consultant and the Obligee's Engineer should discuss possible redesign issues that may have been identified during the administration of the contract. For example, easement issues, not previously considered in the original bid, may require the redesign of hundreds of feet of work to be performed on the project. Material changes to the contract originally bid by the Principal, should be deleted from the re-let of the project.

Sureties face major challenges when called upon to re-let a partially complete unit price contract as a result of the default of its bonded contractor. The pro-active Surety, along with their construction consultant take on the challenges, one at a time, to procure a responsible completion contractor and ultimately reach their goal of mitigating the loss.

Without thorough review and analysis of the bids, awarding a unit price contract re-let to the apparent low bidder can be compared to walking through a field of land mines ready to be triggered!!