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## Ten Ways Owners Can Avoid or Mitigate Construction Risk

Successful risk management is both a mind-set and a process. This article presents several techniques involving both.

The most effective way of managing risks is to avoid or mitigate them to the greatest extent possible. Owners and their counsel can take the initiative in this effort in several important ways – some of them obvious, some not. Here are 10 of the best:

### **1. Ensure the adequacy of project funding.**

Certainly, all parties have a legitimate concern that there will be sufficient funds to design and construct the project. Owners also need protection against the risk of running out of money, such as that provided by a termination-for-convenience clause that expressly limits or precludes recovery of anticipated but unearned profits.

Furthermore, owners need to understand, in advance, that changes and cost increases are virtually inevitable. Accordingly, a reasonable contingency should be incorporated into the budget to deal with inevitable changes and unexpected omissions.

### **2. Obtain more geotechnical information.**

It should go without saying that the more information a contractor has about subsurface conditions, the more accurate the bid – and less likely will be claims for differing site conditions. There is a decided trend toward (1) investing a little more money during project planning and design for the purpose of obtaining more

geotechnical information and (2) making all of the geotechnical information available to contractors.

Some owners and their counsel will argue that this open disclosure will lead to claims if the geotechnical information is wrong. This misses the basic point that if the bid was based on less-than-complete information, that becomes the bargain. Accordingly, if the actual underground conditions are worse than the geotechnical information provided, the owner should pay because, if the contractor had been advised of the more severe conditions, it certainly would have increased its bid.

### **3. Conduct constructibility reviews.**

Contractors sometimes complain that the designs they are required to follow are not constructible or practical. If this is the case, there may be delays and additional costs incurred in coming up with alternatives. Even if the design is constructible, the owner may have to pay more to get the same results. By having the plans and specifications reviewed for “constructibility” before contractors bid on them, owners have been able to modify the designs and thereby make construction easier.

### **4. Set realistic contract performance times.**

If the contract performance time is insufficient, either it will cost more to do

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the work or the contractor will finish late. Either scenario is disadvantageous to the owner. Owners are avoiding these problems by obtaining contractor advice and input on setting a realistic time to allow for construction of a given project.

**5. Work and rework cost information.** The owner can require, as a contract obligation, that the contractor make full disclosure of its cost estimates for all aspects of the work, i.e., procurement of materials, subcontractors, self-performed work and even overhead and profit. In doing so, the owner and its staff can better assure themselves that no significant mistakes have been made in pricing the work and that allowances and alternatives are reasonable.

**6. Introduce phased pricing.** As the design is being developed, each phase of the design can be provided to the contractor for review, analysis and submission of progressive cost estimates. Obviously, contractors may balk at this intrusion into their pricing domain. However, in order to win the project, the contractor will be more likely to agree to this process, which, in the end, will reduce the likelihood for cost-overrun claims.

**7. Pre-plan for permits, utilities and zoning.** Given the various regulatory requirements that have to be complied with in the course of designing and constructing a project, it is obvious that, if these requirements are not known and considered in advance, delays will result. To avoid this, astute owners and their engineers are now beginning to specifically identify permitting requirements in advance of bidding and signing the contracts.

**8. Pre-define rates, equations and procedures.** In order to eliminate many issues from the contract administration phase, smart owners will specify clear and accurate formulae or methods to predetermine values for disputable items. Home office overhead rates, although subject to wide variation within the industry, can be preset and a contract

provision can be included to establish a generally accepted manual for determining the equipment rates to be used in pricing change orders. It is equally important for the contract to contain very clear provisions with respect to how change orders will be processed and what information should be included in a request for change orders. The same is true for force account provisions, which would enable the contractor to be paid on a timely basis for disputed work, pending negotiation of a change order modification. Also give some consideration to including, as a unit price, a per diem value for extended project time. In the event of an owner-caused delay, this value could be included in any change order carrying with it entitlement to an extension of time.

**9. Use experienced project personnel.** No matter how enlightened the management and allocation of risk, the project personnel (i.e., people) will still have to design, build and administer the project. Experience counts, particularly for big projects.

With a construction boom underway, design and construction firms are often maxed out in terms of experienced project managers and superintendents. Notwithstanding this reality, no design firm or contractor wants to lose a good job. Consequently, many projects are being led and managed by inadequately trained and inexperienced personnel, which inevitably leads to problems, claims, disputes and terminations. No owner, who has the leverage in a mega-project to do so, should pass up the opportunity to investigate the credentials and backgrounds of the key parties' personnel and require, as a matter of contract, that only experienced project managers and superintendents will run the high-profile project.

**10. Use the contracting process as a risk avoidance measure.** The contract documents are an early opportunity to anticipate, define and deal with potential issues and thereby avoid disputes. Essentially, the contracting process is a

"what if" exercise, whereby the parties attempt to determine what may go wrong, what issues may arise between the parties, and the best way to resolve these challenges, in advance, by informed and enlightened risk allocation. This approach is, of course, the American way of doing things, and at least two downsides to a comprehensive contract are typically a lengthy document and sometimes lengthy negotiations.

There are, of course, other approaches, such as project alliancing where the parties essentially contract as if they were a single-purpose entity, sharing risks and rewards. And, in other cultures and countries, construction agreements take on a more philosophical approach, whereby responsibilities and risks are assigned in a more general fashion with an expectation that any issues arising during the course of the job will be resolved in a cooperative way.

That said, and while not discounting the potential value of partnering, project alliancing and a more philosophical approach to contracting, as an advocate representing a party facing a significant claim, it is always comforting to be able to go to the contract and find there clear and explicit terms and conditions that deal with the issues in question – hopefully, in the client's favour. With such strong contractual support, issues are usually more easily settled, without litigation or arbitration.

#### A Science and an Art

The proper objectives of enlightened risk management and contract risk allocation are not to embrace or identify oneself with a particular philosophy or contracting format. Each project will necessarily present a different spectrum of risks, many of which will be common to all projects while some will be unique. Thus, there is and can be no "best practice" standard for risk allocation on a high-profile project or for that matter, any project.

Instead, successful risk management is a mind-set and a process. The ideal mind-set is for the parties and their representatives to, first, be intentional about identifying project risks and then to proceed to develop a systematic and comprehensive process for avoiding, mitigating, managing and finally allocating, by contract, those risks in optimum ways for the particular project. This process necessarily begins as a science and ends as an art.

# Construction

B r i e f i n g

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