

Workshop H1

Thursday, October 12, 8:30 a.m. – 11:15 a.m.

MANAGING RISK BEYOND THE INSURANCE POLICY

Presented by



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Consulting Practice

Typical risk transfer vehicles only help contractors manage a portion of the risks that are inherent on a construction project. Other uninsured risks can be mitigated by focusing on several key areas, including the contract, the budget, the project schedule, changes, and the document management system. This presentation will review each of these key areas in detail and demonstrate techniques that owners and contractors can use to increase their ability to manage these risks.

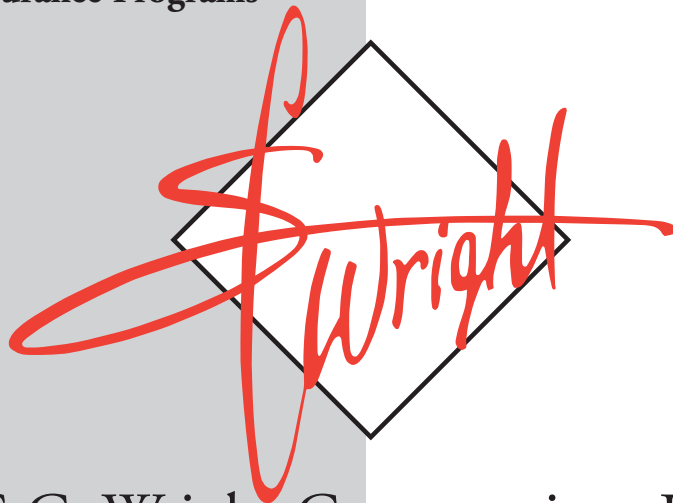
- Examines the impact of uninsurable risk on contractors' short-term and long-term performance.
- Provides strategies for mitigating uninsurable risks in a way that minimizes contract disputes and delays in performance.
- Provides tools for evaluating performance over a project life cycle, identifying problems, and taking corrective actions.

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Dirk Haire, Esq.
Partner
Holland & Knight LLP

Mr. Haire is one of the presenters for Workshop H1, "Managing Risk Beyond the Insurance Policy," on Thursday. He practices in the areas of construction law and government contracts, representing owners and contractors in virtually all phases of both the public and private sectors of the construction industry.

Mr. Haire's litigation experience covers numerous construction litigation actions ranging from standard two-party disputes to complex multi-party claims involving amounts in controversy totaling tens of millions of dollars. His experience includes representing contractors in bid protests against federal, state, and local governments; representing contractors and owners in private construction contract claims and disputes, including claims for changes, delays, inefficiencies, accelerations, defective work, and terminations; representing contractors in claims before numerous federal and state Boards of Contract Appeals; and representing contractors and owners in defense of a range of construction actions, including mechanic's liens, payment claims, toxic mold claims, and default terminations. Mr. Haire also regularly counsels and represents clients in various alternative dispute resolution proceedings, including mediation and arbitration.

Mr. Haire's construction and project administration experience covers the drafting and negotiation of construction contract documents and related documents for a range of project types and sizes, including multibillion-dollar EPC agreements for power generation facilities and various commercial, resort, mixed-use, and institutional building types. In addition to contract drafting and negotiation, Mr. Haire regularly advises and represents owners during the contract administration phase of large projects in connection with change orders, claims, and related project issues.

In the industry, Mr. Haire is a member of the Board of Directors of the Associated General Contractors of America's Maryland Chapter. He also serves on the AGC's National Mold Litigation Task Force and has represented the AGC on the American Bar Association's task force that revised and reissued the ABA's National Model Procurement Code. In addition, Mr. Haire has been an author and/or lecturer on various construction industry topics for a range of organizations, including the AGC, Building Owners and Managers Association International, Construction Owners Association of America, International Council of Shopping Centers, National Association of Home Builders, National Association of Industrial and Office Properties, and U.S. General Services Administration.

Prior to entering private practice, Mr. Haire was a senior director with Associated General Contractors of America, the nation's largest commercial construction trade association with over 34,000 member companies.

Mr. Haire is admitted to practice before the Indiana Supreme Court, Minnesota Supreme Court, District of Columbia Court of Appeals, Maryland Court of Appeals, U.S. District Court for Maryland, U.S. Court of Appeals for the 4th Circuit, and the Court of Federal Claims.

Mr. Haire received his bachelor's degree *cum laude* in history and political science in 1990 from Ball State University and earned his law degree in 1993 from George Washington University Law School.

Ted Scott, P.E.
Senior Vice President
Marsh

Mr. Scott is one of the speakers for Workshop H1, "Managing Risk Beyond the Insurance Policy," on Thursday. He is a Senior Vice President and co-practice leader of Marsh's Construction Consulting practice. As a leader of the practice, Mr. Scott directs a team of highly experienced professional engineers, CPAs, project managers, and other construction professionals who provide expert dispute resolution, claim preparation, and project advisory services to a global client base.

He is a licensed engineer and has over 15 years of experience in the construction industry working on a variety of large-scale infrastructure and commercial projects for multinational owners, developers, contractors, lenders, insurers, and attorneys. Specializing in scheduling and project controls, he has prepared delay analyses, damage assessments, productivity studies, and cost estimates for his clients and has been appointed as a scheduling expert on numerous disputes. Mr. Scott has also utilized his experience in disputes to help his clients avoid and/or mitigate potential claims. Some of his relevant engagements include:

- Served as the appointed schedule expert on a variety of projects including commercial office buildings, distribution centers, medical laboratories, resorts and hotels, casinos, and universities. The total construction value for these projects exceeds \$1 billion.
- The preparation and analysis of numerous complex construction claims on an assortment of large-scale projects including power plants, petrochemical and process plants, hospitals, stadiums, manufacturing facilities, commercial office buildings, detention and correctional facilities, universities and public schools, highway and bridges. Services included detailed schedule analyses, loss of productivity studies, disputed extra work evaluations, termination defense, and litigation support. The total construction value for these projects exceeds \$3 billion.
- Provided project oversight and advisory services including the review of design documents, contract specifications, construction estimates, cost controls, and project schedules. Also monitored project progress during the course of construction.

Mr. Scott received both a Bachelor of Science degree in Civil Engineering and a Master of Business Administration from Virginia Tech. He is an author and frequent speaker on a variety of construction-related topics. He also serves on the Schedule Impact Analysis subcommittee for the Project Management Institute's College of Scheduling, whose mission is to develop widely recognized and generally accepted guidelines for conducting schedule impact analyses. His other memberships include the National Society of Professional Engineers, the American Society of Civil Engineers, the Association for the Advancement of Cost Engineering, and the American Bar Association's forum on the Construction Industry.

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Managing Construction Risk Beyond Your Insurance Policy

IRMI Construction Risk Conference

Ted Scott, PE
Dirk Haire, Esq.

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Agenda

- Risk Management – A Broader Perspective

- Common Methods of Risk Allocation:
 - Insurance Contracts
 - Tort System
 - Construction Contracts
 - Company Operations/Organization



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Risk Management versus Insurance Management

Risk Management

- Active
- Dynamic
- Risk/protection oriented
- Seeks responsibility
- Broad based – includes safety, claims analysis, insurance
- Creative
- Must be involved in the construction activity of the company

Insurance Management

- Reactive
- Passive
- Security oriented
- Administratively oriented
- Seeks safety
- Narrow in scope
- Responsive to others
- May be involved or may rely on others

Conclusion: Simply writing forms in an office is often not the best method of managing risk.

Source: Davis, Steven and Prichard, Ron. Risk Management & Insurance Bonding. AGC, 2000: p. 5.

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Risk Management – A Broader Perspective

The Project Risk Radar

Financial Risk

Project Cost
Cost of Debt
Equity
Participation
Economic Volatility
Project
Performance



Strategic Risk

Project Delivery
Pricing/Contract
Award
Project Risk
Evaluation
Geopolitical/
Regulatory Risk

Hazard Risk

Third-Party Exposure
Environmental
Completion
Property/Liability
Delay in Start-Up

Operational Risk

Contract Reviews
Contractual Obligations
Subcontractor
Management
Safety Programs
Estimating

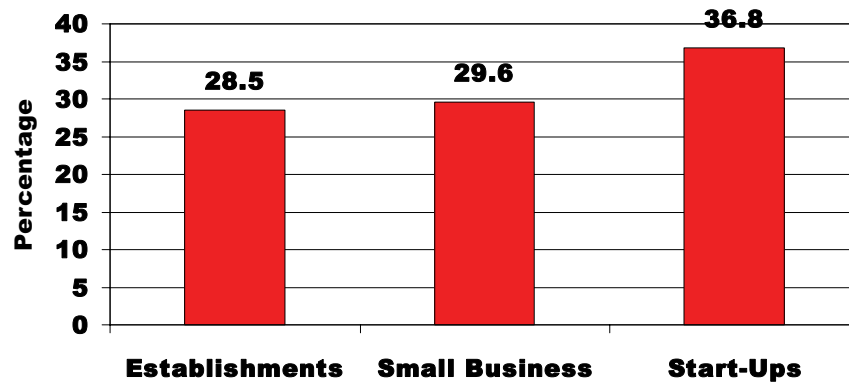
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Construction is a Risky Business

Combined Failure Rates

- Today's construction environment can be defined by one word –

Risk

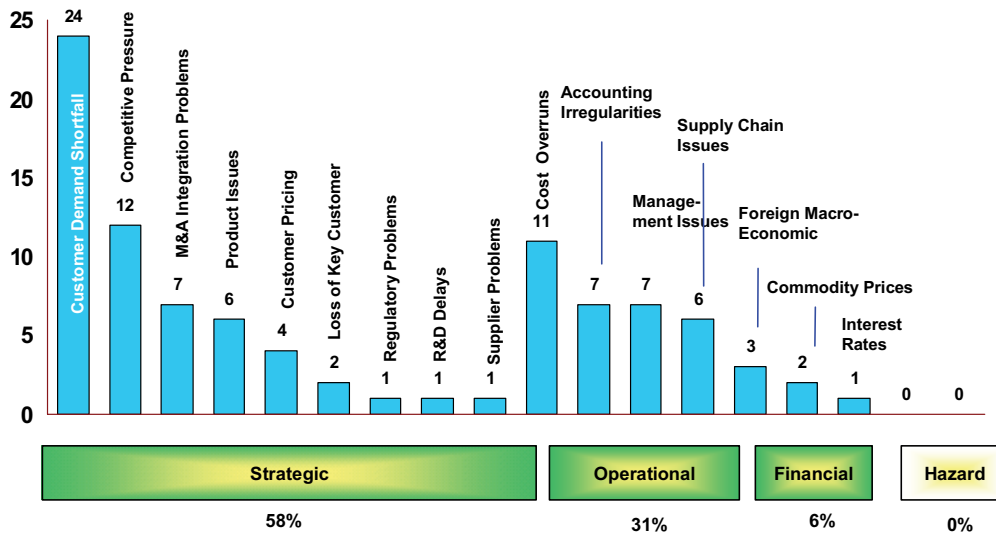


Survey by Bizminer of the US construction market

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Risk Management

Attributable Causes of Declines in Shareholder Value

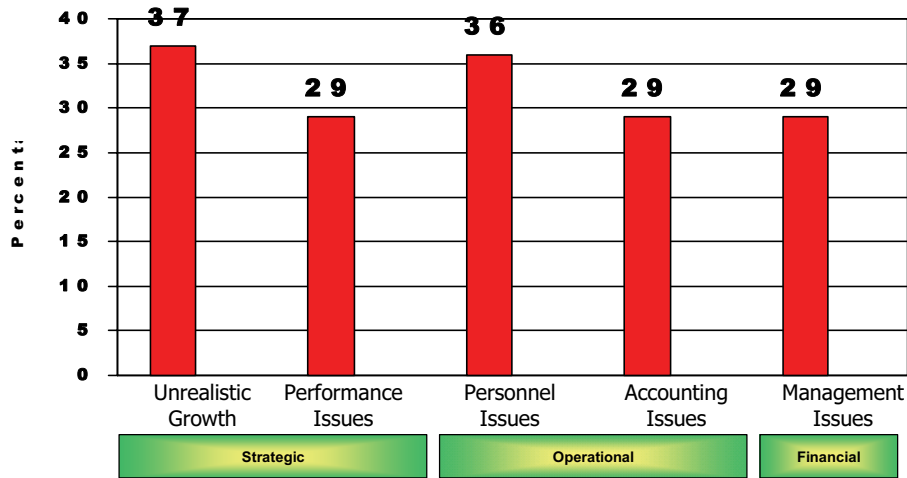


Source: Five-year study performed by Mercer

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Risk Management

Why Contractors Fail

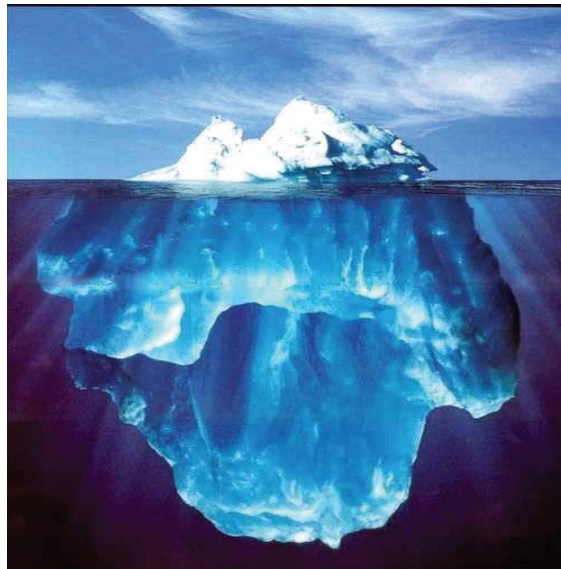


Source: Surety Association of America

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Risk Management – A Broader Perspective

Our Responsibility is Not Only to Understand What is On The Surface But To Understand and Appreciate That Which Is Not So Obvious and Manage The Risks That Are Inherently Created



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Uninsured Risks

How do uninsured risks frequently arise?

CLAIMS

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Claims – A Way of Life

More Bad News

- Between 40% and 50% of all construction projects are behind initial schedules
- Only 26% of construction projects finish within their original budget
- Time & money – The heart of all construction claims



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Claims – A Way of Life

Recognizing Claims

- Claims Arise from Change
 - Change in the Design
 - Change in Conditions
 - Change in Expectations
 - Change in Behavior
- Must be able to recognize change
- In order to recognize change, you must know what the original plan is—or “baseline”



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Claims – A Way of Life

How to avoid them

- Every project has change; every change has the potential to become a claim
- Many of these claims are for uninsurable risks
- Many uninsurable risks can be mitigated or avoided by proactively managing five key factors as part of a continuous project monitoring program:
 - Contract
 - Document Management
 - Cost
 - Changes
 - Project Schedule



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Continuing Project Monitoring

Cradle to Grave

Bid Process

Negotiations Mediation

Contract Award

Contract Close Out

Project Performance

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Project Monitoring

The Contract

- The contract stipulates performance on the project and is therefore essential in assigning risk
- Clear
 - Do the work up front
 - Do not leave issues until later in the project
- Useable
 - The contract is the project handbook
 - Must be understandable by those using it (not just the lawyers)



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Project Monitoring

The Contract Cont'd

- Fair
 - Unbalanced contracts nearly always end in dispute
- Addresses the requirements of owner and contractor(s)
 - Policies and procedures
 - Payment process
 - Safety program
 - Change orders and claims process
 - Testing and commissioning process
 - Punch list
 - Substantial completion/closeout process
 - Warranties
 - Indemnities
 - Damages (actual/consequential/liquidated)



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Project Monitoring

The Document Management System

- Goal: Document the “Project Record” to mitigate risk and enhance communication
 - Reduces subjectivity of opinions
- Clear understanding of what’s included:
 - Daily Logs
 - Meeting Minutes
 - RFIs, Bulletins, Addenda
 - Shop Drawings
 - Correspondence
 - Electronic Communications
 - Electronic Models (BIM)



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Project Monitoring

The Document Management System Cont'd

- Safeguard the records!
 - Where are they maintained?
 - Electronic or paper?
 - What does the contractor retain and what does the owner receive upon completion?
- Send notices early and often
- Don't assume that other parties share your understanding of events or contractual requirements



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Project Monitoring

Project Cost (Pre-Construction)

- Accurate cost estimate, tied to schedule of values
- Determine the methods to track and report progress, and the frequency of updates and distribution
 - Job Cost Reports
 - Earned Value Reports
- Clear delineation of change order procedures
- Determine payment application process and documentation



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Project Monitoring

Project Cost (During Construction)

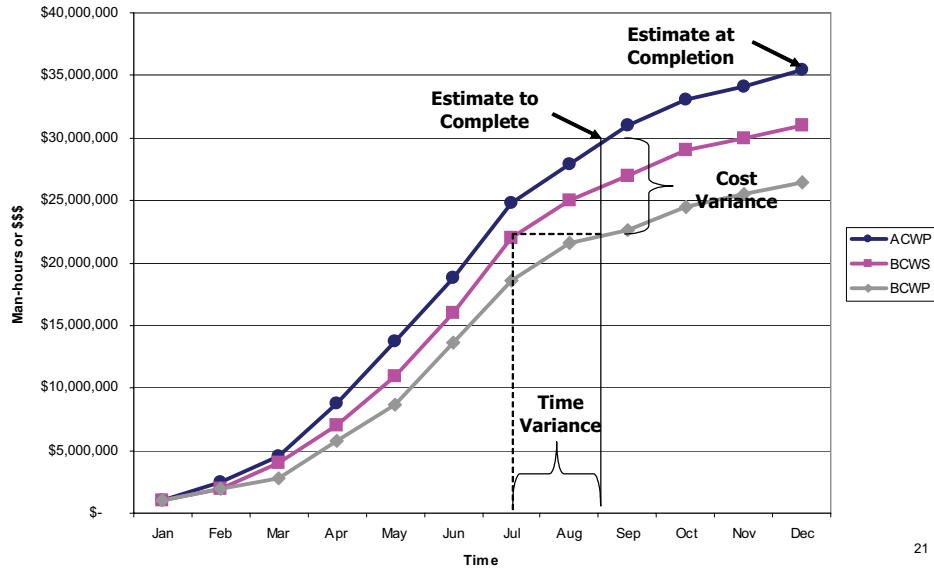
- Monitoring involves auditing
 - Identify potential issues before they become significant issues
- Payment application reviews
 - Accurate, consistent with the contract
 - Review rates (labor, equipment), third-party invoices, markups, profit, overhead, changes, subcontracts, etc.
- Examine contractor accounting reports/accounting system
- Consider contract price type



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Earned Value

How is this Project Doing?



Project Monitoring

Project Cost (During Construction)

Determine the probability, cause and magnitude of cost overruns (unresolved change orders and claims)

- Potential Change Order Logs (PCOs)
- Create the "Audit Mindset" among the project participants
 - Promotes diligent behavior



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Project Monitoring

Changes – The Good, the Bad & the Ugly

- The Good:
 - Additional Revenue
 - Potential Profit
 - Possible Follow-On Work
- The Bad:
 - Extra Work without Pay
 - Extra Cost to Contract
 - Strained Relationship
- The Ugly
 - Litigation!



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Project Monitoring

Changes – Make them work for you

- Define the change, scope of work
- Identify changes ASAP
- Establish separate cost collection
- Add schedule activity
- Monitor progress against the definition
- Do not work without authorization
- Reserve rights



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Project Monitoring

The Project Schedule

- The schedule should be updated frequently and accurately
- When changes occur, a “fragnet” should be developed and inserted into the schedule
- Should include actual contractor performance
- Impacts to project duration should be identified
- It is not uncommon for the schedule to be compressed to recover lost time



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How can Continuous Project Monitoring help in an uninsured claims situation?

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Project Claims/Dispute Resolution

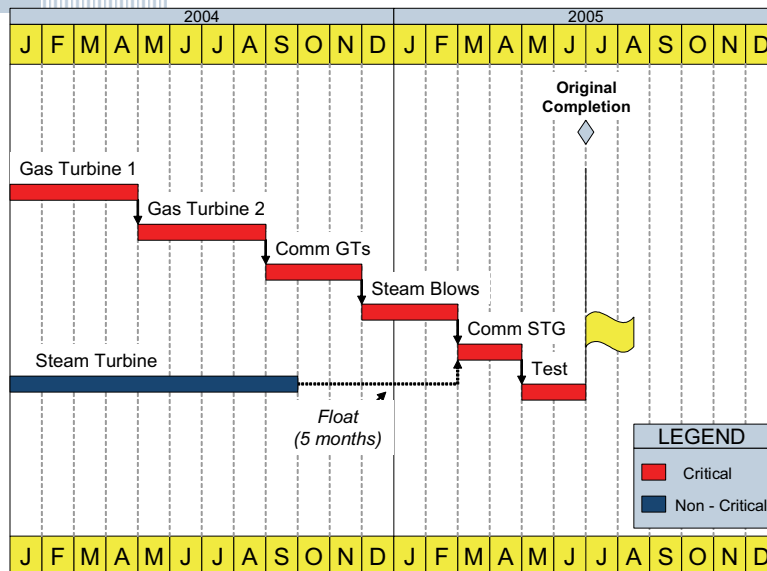
Insured or Uninsured?

- Majority of delaying events uninsured
 - Uninsured events
 - contractor delays, weather, owner changes, force majeure
 - Insured events
 - delay in start-up, physical loss or damage (e.g., delay caused by faulty turbine during commissioning of Power Plant)



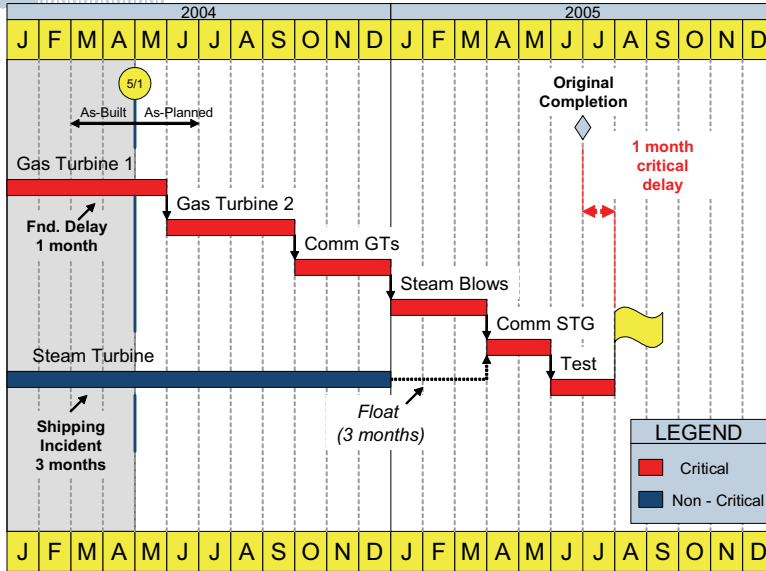
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COGEN PLANT Delay Analysis – Baseline Schedule



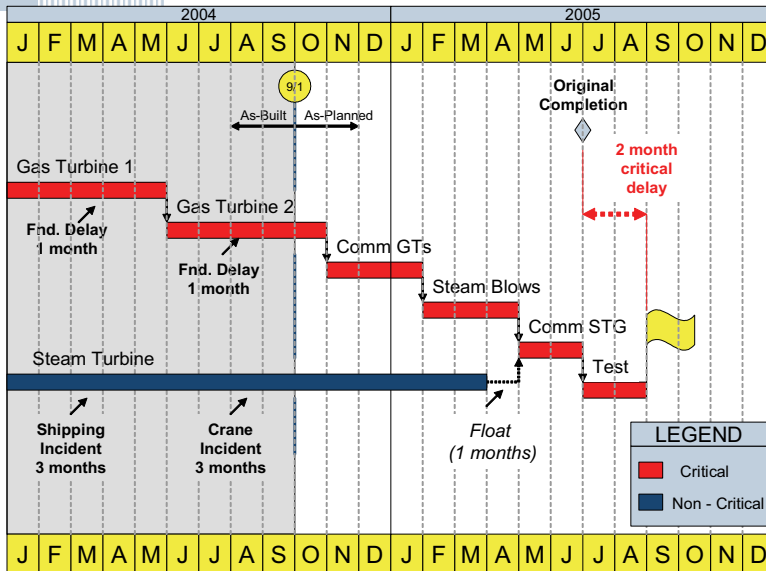
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COGEN PLANT Delay Analysis –Schedule Update 4



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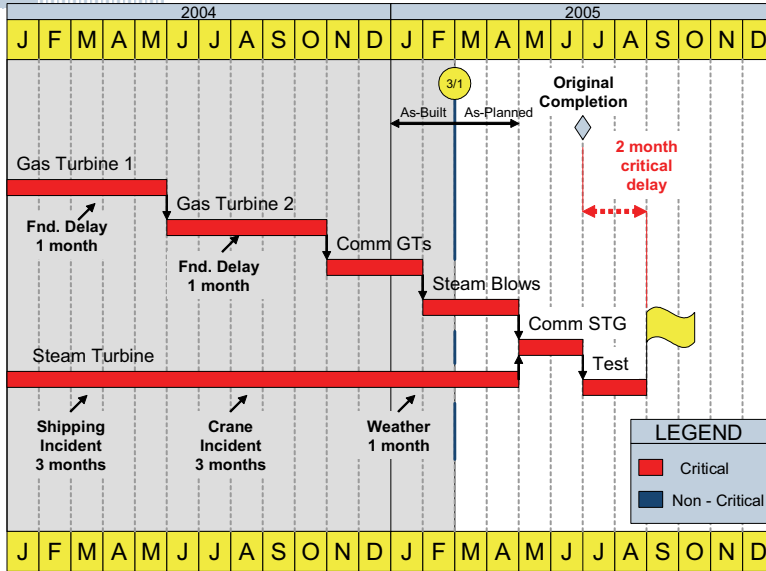
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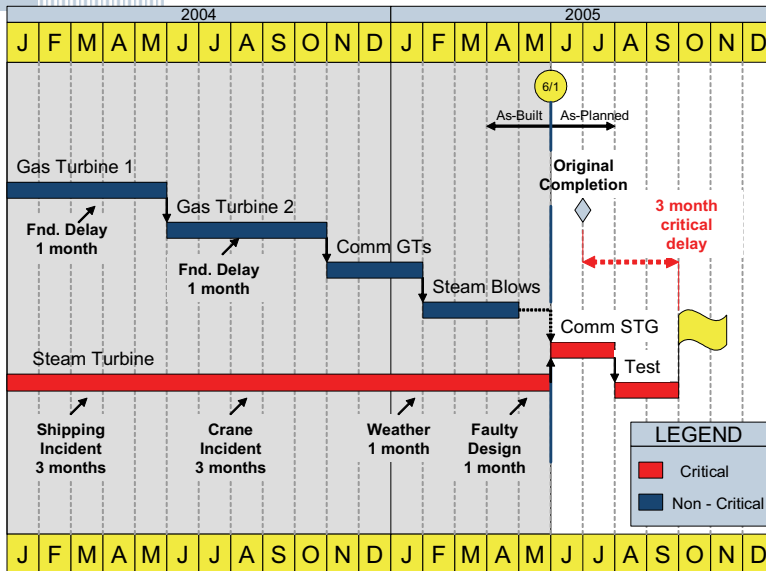
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COGEN PLANT Delay Analysis –Schedule Update 17



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Conclusion

- If done consistently and correctly from the beginning, project monitoring will identify changes early and will minimize losses
- By examining the actual contract cost against the baseline, the contractor can use the analysis to recover in a contract claim
- The Project Schedule and progress measurement can give important evidence of how the project was managed

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Notes

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