Reducing Transportation Project Risk: Effective Use of Risk Transfer, Performance Guarantees, Surety and Insurance

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Goals for Today

When we finish you should be able to:

• Better Understand Risk Exposures and Impact of Differing Procurement Approaches
• Have a Framework for Evaluating Which Risk is Allocated to Which Party
• Understand Contractual Risk Allocation and Tools to Manage Risk
• Evaluate Issues that May Effect A Project Be They:
  • Procurement Method
  • Contractual Risk Transfer
  • Surety/Insurance
• Identify Key Insurance Coverages That Can Support a Successful Project
Why Are Owners Concerned About Risk Allocation, Performance Guarantees, Surety and Insurance?

• Increased Focus on Cost and Cost Control
  • Deliver On Time and On Budget

• Mega-Projects Create Larger/Longer Risk Profile
  • Heightens Importance of Contractor/Concessionaire Financial Stability

• Innovation Brings New or Different Risks
  • Sustainable Construction/New Products
  • Value Engineering
  • Performance Standards/Life-cycle Costs

• Protect the Public (and the Taxpayer)
Risk-Based Project Delivery Decisions

• Develop project goals and identify project constraints

• Evaluate the primary factors
  • Delivery schedule
  • Complexity & innovation
  • Level of design
  • Cost
  • Initial project risk assessment

• Evaluate the secondary factors
  • Staff experience / availability
  • Level of oversight / control
  • Competition and contractor experience
Procurement Affects Risk Allocation from the Get-Go!

Design-Bid-Build – Public owner retains the most risk
- *the construction price will exceed estimates, integration risk, risk of defects in design and latent construction defects risk and certain cost-overruns due to change orders*

Design-Build - Public Owner takes less risk
- *Private sector designs and builds the project, takes integration, design and patent construction defect risk*

P3/Concession – Public Owner takes least amount of risk
- *Private sector concessionaire designs, builds, finances, operates and maintains the project. Private sector retains project revenues and takes revenue risk*
Performance/Project Risks Include:

- Integration of design, construction, operations, maintenance
- Quality of work / defective work
- Constructability
- Developer-caused delay
- Completion risk
- Cost overruns
- Long term asset condition and performance, including at hand back
- Change in demand/usage
- Most permits and governmental approvals
- Most utility adjustment risks
- Contractor default
Protecting Against Performance Risk

Options Owners are Investigating or Using Include:

• Differing Procurement Methods
• Use of Performance Specifications vs. Prescriptive Specifications
  • Allows for Innovation/Opens Door to ‘Cost-Shifting’
• ‘Life-cycle’ Responsibility
  • Typically including Design, Construction, Operation and Maintenance
• Warranties and Guarantees (one year warranty period?)
• Performance and Payment Bonds
• Other (LOCs, Warranty Bonds, Parental Guarantees, Min. Net Worth Requirements)
Principles for Efficient Risk Allocation

• Perform project risk assessment before procurement
  ➢ Preliminary allocation between public and private parties
  ➢ Establish cost and time range for each risk
• Rate project risks according to likelihood and severity
• Avoid and mitigate significant risks pre-procurement
• Generate and disclose pertinent information for evaluating risk
• Identify insurance products to shift risks to insurers
• Assess strength of competition and appetite for risk transfer
• Compare:
  ➢ Estimated cost to retain risk
  ➢ Estimated pricing for risk transfer
  ➢ Value of price certainty
• Allocate the risks
Contractual Risk Allocation

• Private sector does not take risk; it MANAGES it!
  ➢ How will reducing the Project Owner’s risk impact the project goals?
  ➢ How much will it affect the project timeline?
  ➢ Will competition yield efficient risk pricing for the Project Owner?

• Allocate risk to party better positioned to manage it.
• Where neither party well positioned to manage a risk, share it to align interests and create adaptive management.
• Don’t foist on Contractor large unquantifiable risks it cannot or will not assume
• Where feasible, expand the risk management strategy to third parties (insurers, sureties, utility owners, property owners)
Contracting for Efficient Risk Allocation

Contract Provisions That Allocate Risk Include:

• Statement of Work/Scope of Work ("who is responsible for what?")
• Performance Specifications/Standard of Care/Quality of Work
• Warranties and Guarantees
• Indemnification Clauses
• Minimum Insurance Requirements (with requirements as to who is insured, etc.)

Areas Often Causing Concern:

Right of Way Acquisition; Utility Relocation; Natural Catastrophes/Force Majeure Events; Labor Strikes/Disruptions; Commodity Cost Increases; Hazardous Materials; Environmental Regulatory Risks; Differing Site Conditions; Changes in Law
Surety Bonds Play A Role In Risk Allocation

Surety Bonds Can Be Used To Shift Risk and Protect Project Owners:

- Bid Bonds
- Performance and Payment Bonds
- Warranty Bonds

Current Surety Issues:

- Liquidity
- Longer term commitments
- Multiple Obligees
Risk Allocation is The Starting Point - Insurable Risks

<table>
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<tr>
<th>Risk</th>
<th>Owner</th>
<th>Contractor</th>
<th>Lead Design Engineer</th>
<th>Subcontractors &amp; Subconsultants</th>
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<td>P</td>
<td>S</td>
<td>S</td>
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<tr>
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<td>P</td>
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<td>P</td>
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<td>P</td>
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<tr>
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<tr>
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<td>P</td>
<td>S/P?</td>
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<tr>
<td>Physical Damage to Project After Construction (Including Loss of Use)</td>
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<td>S</td>
<td>S/P?</td>
<td>S/P?</td>
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<tr>
<td>Physical Damage to Contractor’s Equipment</td>
<td>N</td>
<td>P</td>
<td>S</td>
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</tr>
</tbody>
</table>

Legend:  
P- Primary  
S- Secondary  
N- No Exposure
Using Insurance to Protect Project Risk

Insurance Can Be An Important Risk Transfer and Asset Protection Tool

Establish Minimum Insurance Requirements Contractually

- Types of Insurance
- Minimum Limits to be Carried
- Key Coverage Terms and/or Extensions
- Proof of Insurance

*Premiums of the Many; Pay for the Losses of the Few!*
Typical Project Insurance Requirements

Contractually Mandate that Contractor and/or Lead Design Firm carry:

- Workers Compensation and Employer’s Liability
- Commercial General Liability
- Automobile Liability
- Umbrella/Excess Liability
- Professional Liability
- Contractor’s Pollution Liability
- Builder’s Risk (potentially including loss of toll revenue?)

Additional Coverages That May Be Important:

Marine Liability/USL&H/Jones Act; Aviation Liability(Drones); Equipment Floater; Cyber/Network Security; Property Insurance
Additional Insurance Requirements

Authorized and/or Licensed Insurers Meeting Minimum Financial Standards

Minimum Terms and Conditions Including:

• Minimum Limits
• Additional Insured Status (Primary and Non-Contributory)
• Length of Time Coverage to Be Carried For Post-Project Completion
• Waiver of Subrogation
• Notice of Cancellation
• Cross-Liability/Severability of Interests
• Unintentional Errors & Omissions
Insurance Issues Getting Attention Today

- Use of Owner-Controlled or Contractor-Controlled Insurance Programs (OCIPs/CCIPs)
- Professional Liability Program Structure
  - Protecting the Owner (e.g. DOT) vs. DB Contractor or Concessionaire
  - Use of Owner’s Protective Professional Indemnity Policies (OPPI)
- Subcontractor Insurance Flow-downs
- Interaction of Insurance and “Relief Events”
Questions?

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