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What is the Current Environment for Procuring Large Public Projects?

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The Contracting Environment for Big Projects: 2003 to Early 2008

- Superheated demand for E&C services
 - Oil and gas sector
 - Transportation and public/private partnerships
- Strong financial performance by major E&C contractors
- Substantial increase in the size and complexity of projects
- Commodity price volatility and labor shortages

The Impact on Public Sector Procurement and Contracting

- Legislative changes (PPP and design-build) made it easier to authorize large projects
- Design-bid-build no longer the “norm”
 - Owners struggle with appropriate best practices
 - Concern over price/technical tradeoffs for selection of contractors
- Owners much more reliant on private sector for managing their projects
 - Project management consultants
 - Staff augmentation and integrated owner teams
- Contract terms become very similar to large private sector projects (e.g., limitations of liability)

The Contracting Environment for Big Projects:

Where Are We Right Now?

- Uncharted territory
 - Collapses of commodity and credit markets
 - Project cancellations
 - Recession and impact of federal intervention
- Contracts currently under negotiation do not seem to reflect the “bottom falling out” scenario
 - Projects still have inherent procurement and execution risks
 - Geopolitical, currency, commodity prices, labor availability, subcontractor performance
 - Contract guarantees and performance obligations
 - Financing risks
 - Contractors still negotiating in the paradigm of past 5 years
 - Impact of years of unbalanced contractual risk allocation
- Mistrust and skepticism



Public Sector Procurement and Contracting Challenges on Big Projects

- Major political issues are generally present
 - Do we need the project?
 - Is there a better way to spend public's money?
 - Who is the political champion?
- Pragmatics involving the pool of qualified candidates for developing project
 - Limited group of players
 - Limited tolerance for risk
- Strong public distrust over perceived “non-competitive” selection processes
- “Optics” may not look great to those who are not familiar with construction



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Dulles rail project clinging to life

■ Rumors, uncertainty fill the void left by teetering Metro project

By **MONTY TAYLOR**
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In the wake of FTA's denunciation of the Dulles Metrorail project, the natural question for the entire region is "What happens next?"

For most parties, the answer still seems to be a rail project, with FTA Administrator James Simpson's opinion on the Dulles rail project to the contrary.

As Gov. Tim Kaine (D) works on a response to the FTA's denial of funding, work crews continue to labor in the center of Tysons Corner, relocating utilities to make way for a rail project that could be almost a billion dollars short.

"Our position is that we don't want to fall behind schedule. That's why utility relocation began, to maintain the schedule," explained Metropolitan Washington Airports Authority



Courtesy Rendering

■ Officials focus more on saving project than on placing blame

By **MONTY TAYLOR**
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After 40 years of planning, the Dulles rail project currently sits suspended, as Northern Virginia waits for Gov. Tim Kaine (D) and the area's congressional delegation to make headway in negotiations with the Federal Transit Administration and the U.S. Department of Transportation.

As officials fight to resurrect the troubled project, various parties pointed fingers at the state, the FTA and tunnel advocates for the project's near collapse last week.

Last Thursday, the FTA cited the rail project's price tag and management as creating likely insurmountable problems for the project's design approval, which allows it to qualify for \$900 million in federal funding.

According to FTA Administrator James Simpson, \$300 million in cu

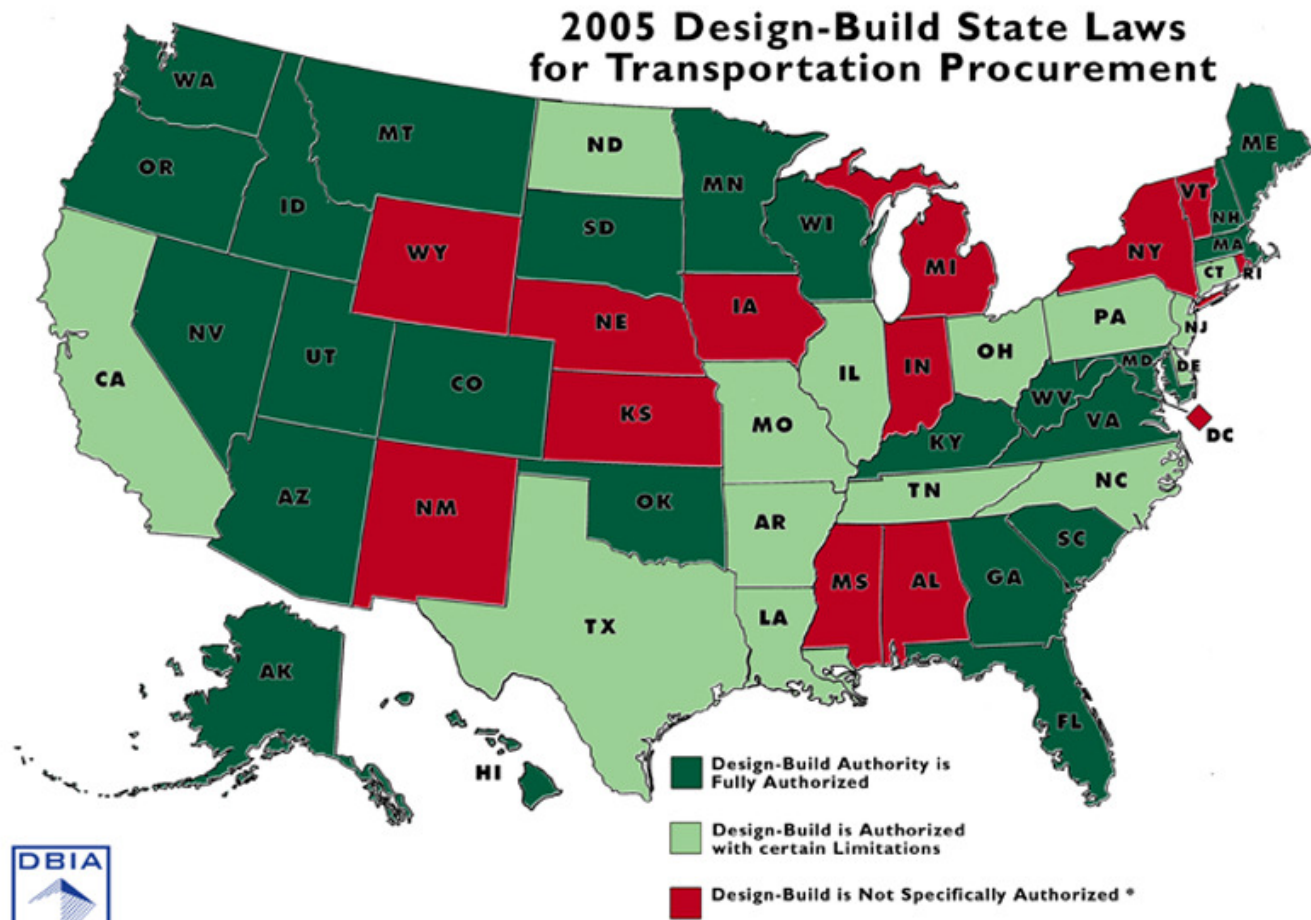
Key Procurement Issues

- Selecting the right delivery system
- Dealing with the public's need for transparency
- Implementing an effective selection process
- Managing funding partners and stakeholders
- Handling estimates vs. final pricing
- Subcontractor pricing and involvement
- Implementing a bonding program
- Dealing with funding delays

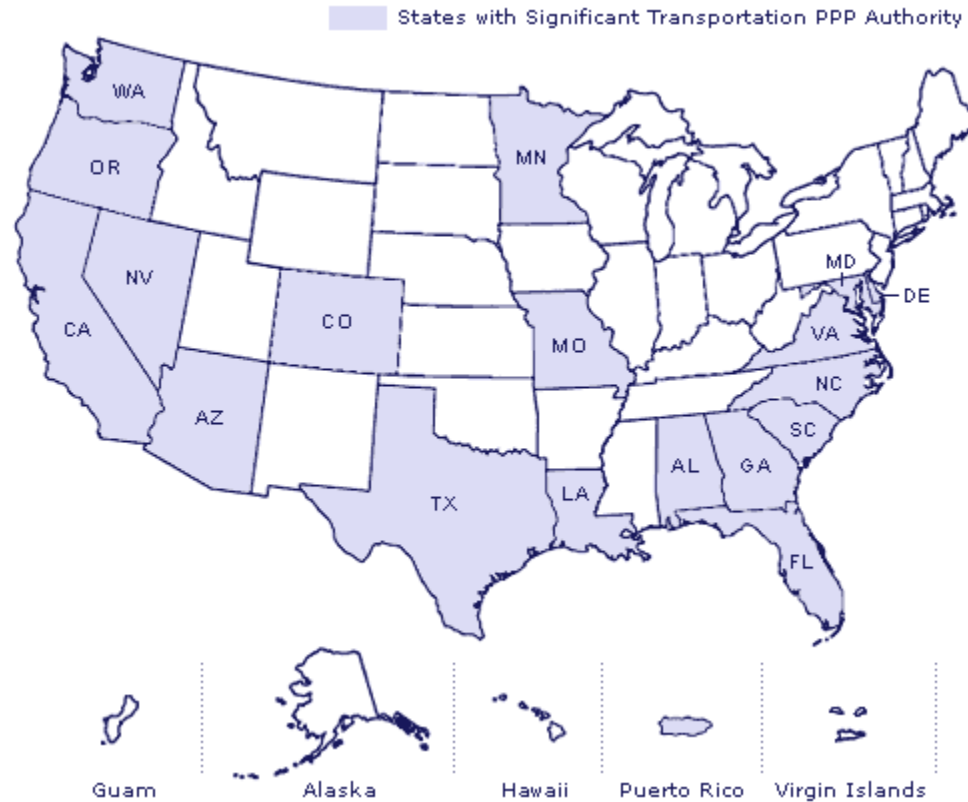
Selecting the Right Delivery System

- Major change in use of innovative project delivery through legislative changes
 - Design-Build
 - At-Risk Construction Management
 - Public-Private Partnerships
 - Solicited proposals
 - Unsolicited proposals
- Using lessons from private sector
 - Bundling of services to obtain single point of responsibility
 - Qualifications-based selection
- Public owners struggle with how to do the “right thing” – or even knowing what the “right thing” is

States with Transportation D/B Authority



States with Significant Transportation PPP authority



Changes in Project Delivery Strategies:

Public Sector Owners

- Major change in use of innovative project delivery through legislative changes
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Transparency and Public Thirst for Information

- Fear by contractors of what information will be disclosed to public and competitors
- Pragmatics of dealing with FOIA
 - Broad rights as a matter of law to withhold information
 - Limited rights to withhold as a matter of politics and policy
- Challenges of negotiating on the front page of the newspaper

Implementing an Effective Selection Process

- Many agencies have yet to develop standard PPP contracts or RFP templates
- Agencies have difficulty in assessing their key differentiators
 - First phase shortlist vs. second phase detail
 - Inexperience in assessing financial components of the deal
 - Inability to value proposals if agency decides to use agency funds
- Use of stipends is varied
- Statutory authority may be prescriptive, but incomplete
- Conflict of interest policies are still in flux

Managing Funding Partners/ Stakeholders

- Every major project will have several interested agencies
- Challenges in determining how the capital funding partner will be influenced by the partner who will live with the project
 - Aesthetics
 - O&M
 - User-friendliness, needs and wants
- Some permit agencies are stretched beyond capacity and capabilities
- Some agencies are struggling to evaluate project “metrics” under new delivery system approaches
- Challenges in getting multiple stakeholders to speak with one voice (who is the boss?)

Estimates vs. Final Contract Pricing

- Owner is heavily reliant on contractor's estimates vs. comfort of competitive bids
- Practical challenges in gaining access to and understanding contractor's financial information
 - JV partners hold secrets from each other
 - Risk, contingency and fee numbers are not necessarily clear
 - Fear of liability for defective cost and pricing data
- Challenges when design is performed by developer vs. agency's designer
 - Ability to move forward with the project without the design-builder can be illusory
 - GMP approach for facility projects under CMAR approach has some strong benefits

Estimates vs. Final Contract Pricing

(cont'd)

- Key Issues:
 - Ability to reasonably price scope that will be designed and constructed several years from execution of DB contract
 - Ability to ultimately agree upon a price

Subcontractor Pricing and Involvement

- Subcontractor involvement can be a major political issue
 - GMP approaches
 - Use of competitive processes at subcontractor level
 - Determining which subcontractors will be subject to competition
- Handling risks of design that will be developed late in process
 - Undefined scope
 - “Vapor” projects from subcontractor perspective
 - Use of allowances
 - Procurement vs. performance risk
- Escalation and inflation assumptions

Implementing a Bonding Program

- Contractor and bonding communities are struggling to deal with:
 - Long-term “guarantees” of performance
 - Large bond amounts for values that include design, construction and financing
 - Bond statutes that require 100% performance and payment bonds
- Variety of approaches being taken to address pragmatics:
 - Reducing bond amounts to maximum of \$250-500 million
 - Ensuring that the surety can be involved in the default process
 - Reducing bond amounts at substantial completion
 - Shifting classic “warranty” items outside of bond coverage
 - Overall contract liability limits in dollars and time



Funding Uncertainty and Delays

- Major challenges if the funding sources are uncertain at time the process starts
 - Agency needs to be realistic in assessing capital sources
 - Developer needs to have both patience and potentially available capital to nurture project
- Approaches that have been used to mitigate this risk include:
 - Not putting head in sand regarding capital constraints
 - Astute lobbying
 - Limited release of work to keep project moving
 - Substantial pre-planning to ensure that the project is perceived as being well-conceived
- Creation of a “Plan B” and “Plan C”

Quick Perspective on Risk and Contract Terms and Conditions

- Risk balance is “out of whack”
- The financial markets to better understand construction risk
- Letting the “engineers be engineers” has major ramifications
- Letting the “lawyers be advocates” has major limitations
- The need for each party to really understand the other’s position

Typical Risks Identified in 10K Filings: The E&C Contractor's Perspective on Risk

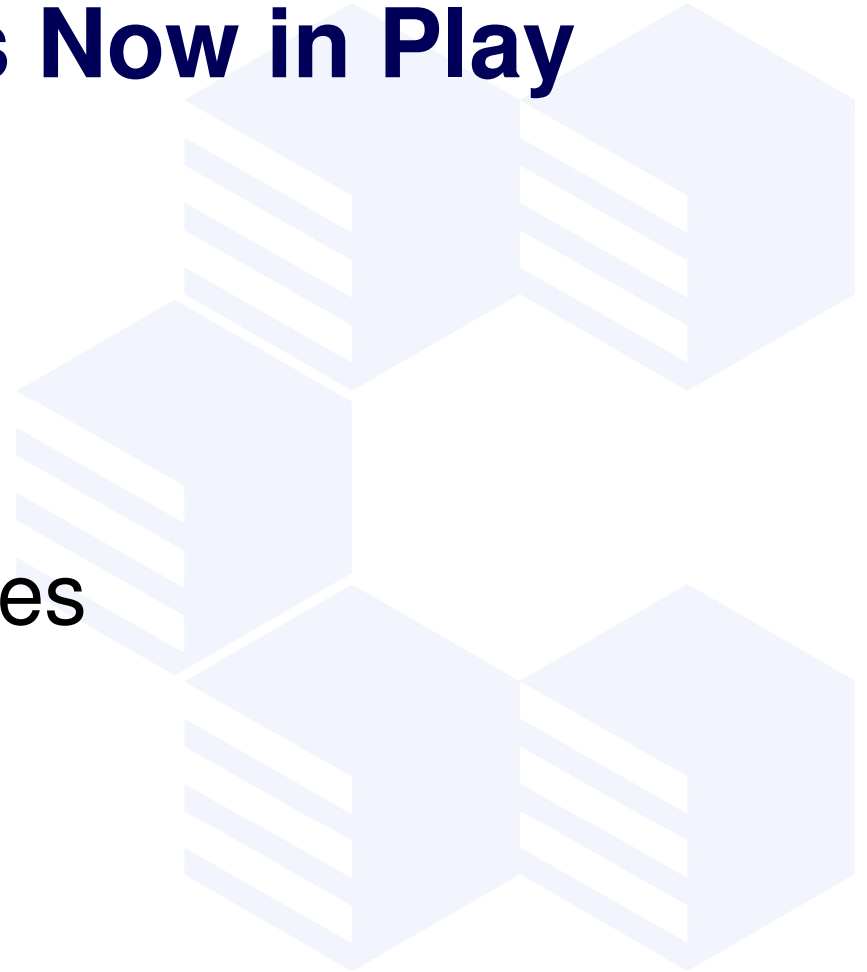
- Revenue, cash flow and earnings may fluctuate
- New work and liquidity may be adversely affected by bonding capacity
- Intense competition
- Failure to accurately estimate costs or perform on fixed price contracts
- Commodity and labor pricing
- Foreign exchange risks
- FCPA
- Exposure to E&O, product liability and warranty claims
- Litigation and claims that could impact earnings and financial conditions
- Potential inability to fully realize the revenue value of backlog
- Political and economic conditions

The Deadly Dozen: Major Contract Terms Now in Play

1. Scope of Work
2. Site Conditions
3. Owner Rights of Approval
4. Payment and Guarantees
5. Dealing with Other Project Contractors
6. Changes

The Deadly Dozen: Major Contract Terms Now in Play

7. Project Controls
8. Time Extensions
9. Force Majeure
10. Delay-Related Damages
11. Limitations of Liability
12. Warranty



Unique Public Sector Contracting Issues

- Escrow Bid Documents
- Sovereign immunity
- Appropriations and cash flow curves
- Terminations for convenience
- Changes within the structure of the contractor/developer both during and after the selection process
- How much control do I really want/need to have?

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