Alternative Project Delivery Systems: A Recipe for Disaster for the Unsophisticated?[1]

This paper is intended to provide material to provoke discussion. I write from the prospective of an attorney who deals more frequently with the unsophisticated owner, e.g. a school district, a small (in population) county or a business with one location, and not owners experienced with construction. My experience with alternative delivery systems, even ones that might now be taken for granted such as design/build or fast track, has been that they are a recipe for disaster for the unsophisticated owner. Unfortunately, the unsophisticated owner may not hear this message.

<u>An Illustrative Project</u>:

While my opinions have developed from multiple project disputes over many years, I will draw my illustrations from the most recent disaster. A local publicly owned privately operated hospital is outdated and undersized. A remodel is eliminated as a possibility. Along comes a "developer" with a new project delivery system. Exhibit 1 is a reproduction of the presentation material (with names eliminated to protect the guilty) on the proposed benefits of the new system. The county thought that a fast, less expensive, better quality project was a great idea. The county asked for proposals. Five "teams" submitted their credentials – no price ideas and no design ideas. The "developer" who had proposed the idea in the first place won the beauty competition. It had a reputable architect, a reputable contractor and a reputable financial service as members of its team. The "developer" was a development company with no significant assets. A disgruntled team went to court on a protest claiming the procurement was illegal and the judge said "Yes, it is illegal." At that time, New Mexico did not even allow design/build as a method of public procurement. I suggest that there is a reason why public funds are spent only by prescribed methods.

However, a fast, less expensive, better quality project was still a great idea. A private not-for-profit corporation was created to hold the contracts for the new hospital, thereby eliminating the need for a

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public procurement via design, bid, build. The "developer" assisted in selling the population on the need for an increase in their taxes to build a "state of the art" hospital to meet the health care needs of the county in the "twenty first century." Contracts were negotiated more or less from scratch. No one involved in the negotiations was familiar with different delivery systems. But everyone knew that they did not want to design the hospital and then solicit bids and then contract with the successful bidder. Two contracts were signed at the same time. One contract called for the identification of the owner's program and the development of the design and construction documents. The price for this contract was 1.3 million dollars. At the same time, a contract to construct the hospital is signed for 8.5 million. These agreements were signed in September of 1997. There is a schedule of monthly payments starting September 1997 and ending November 1998 for the payment of the design and construction amounts. Exhibit 2. The architect began work identifying what the owner wanted and developed a footprint for the building. The contractor pulled a foundations permit as soon as the footprint and square footage were established and started coming out of the ground. Two months later some drawings were available and the troubles began. There were constant disputes over quality and quantity. For example, the "developer" did not want to include an operating theater that could do bronchoscopies and cystostophies (they require different air pressures). The "developer" did not think that headwalls for the medical gas were necessary while the hospital could not believe that a "state of the art" hospital would not have headwalls. Ultimately, the "developer" presented a few hundred thousand dollars' worth of change order requests and refused to proceed unless they were signed and paid. Ultimately, the not-for-profit corporation took over the project and completed it 18 months late and one million dollars over budget, not counting the pending claims.

In retrospect one might say that the owner was expecting a "state of the art" hospital that would serve the health care needs of the county in the "twenty first century" for a cost of design and construction of a little under ten million and in a no greater than 18 month time period. The "developer" was expecting to build whatever could be build for ten million dollars while preserving its entire anticipated profit amount. If you look at the third column of Exhibit 1, item 6 is the only one that came true – the taxpayers pay.

There are many lessons that can be learned, but the major lesson in my view is that the old system of design/bid/build is better understood and offers better predictability and checks and balance.

Illustrative Problems:

Single Point of Contact: At one time in our political history we thought it best to have checks and balances (legislative, administrative and judiciary). Perhaps a good idea in government is also a good idea in construction. In many of the new project delivery systems, as in my illustration, there is a single point of responsibility. Well, you may have only one party to blame, but unless you have the in-house expertise, you lack the checks and balances that were present in the old architect engineer and contractor duality.

The Performance Bond: The owner knew enough to get a performance bond, but not enough to get one that worked. The contract clause was:

> Developer shall furnish performance and payment bonds covering the faithful performance of the Contract and the payment of all obligations arising thereunder. The term of this bond shall extend twelve months after substantial completion. If such performance and payment bond is provided by the general contractor, it is acknowledged that owner is a third party beneficiary of the contract with the general contractor and shall be named as an obligee under the bond.

I suggest that this looks good, but is only a source of argument. The developer tendered a performance bond provided by the contractor naming the owner as obligee and covering the construction contract between the construction contractor and the developer. It was accepted. When the developer walked off, a bond claim was made. However, before walking off the developer sent the contractor a notice to stop work on the contract. As a result, the contractor's stopping work was arguably not a performance breach. If this hospital had been built design/bid/build, there would be a greater likelihood that a standard performance bond would have been delivered and would have offered some protection.

Schedule of Payment: I have attached as Exhibit 2 the Payment Schedule that was Exhibit A to the construction contract.[2] This schedule looked good to both parties but caused great friction when the dates and percent completion started to vary. The developer

[2] The contract was signed September 9, 1997 and the first payment made that day, as required.

insisted on payment each month of the scheduled amount and simply sent an invoice for that amount. The owner refused to pay until the percentage completion required was achieved. Standardized construction contracts generally have more predictable payment clauses.

A Partial Conclusion:

The county, the hospital operator and the not-for-profit foundation were composed of knowledgeable, articulate people wanting to obtain the best possible project for the money available. They were represented by capable attorneys. No one, however, was sufficiently knowledgeable about construction delivery systems to foresee the problems in a new project delivery system. I am reasonably certain that a design/bid/build subject to all the rules of public procurement in New Mexico would have produced the results wanted with fewer and more manageable problems.

BENEFITS OF DESIGN/BUILD/FINANCE

A. *Conventional Facilities Procurement Method*

1. **Design-Bid-Build**
2. **36 to 42 Month Process**
3. **More Expensive**
4. **Less Quality**
5. **Three Points of Contact**
   a. A/E Contract
   b. Construction Contract
   c. Financing Agency
6. **County Owns Facility**
7. **Funds Must be Appropriated Up Front**

B. *Design/Build Procurement Method*

1. **Design/Build - County Finances**
2. **24 to 36 Month Process**
3. **Preferred Quality**
4. **Less Expensive**
5. **Two Points of Contact**
   a. Design/Build Contract
   b. Financing Agency
6. **County Owns Facility**
7. **Funds Must be Appropriated Up Front**

C. *Design/Build/Finance Procurement Method*

1. **12 to 18 Month Process**
2. **Preferred Quality**
3. **Less Expensive**
4. **Single Point Contact - Design/Build/Finance Contract**
5. **County Leases Facility Until End of Amortization Schedule**
6. **County Can Identify Revenue Source - Pay As You Go Along**
7. **Private Construction - Not Subject to Govt. "Red Tape"**
8. **Maximum Not-To-Exceed Price**

Exhibit 1

Exhibit "2"
PAYMENT SCHEDULE
Part 1 & 2 Agreements

Payment Number	Date	Developer/ A&E	Construction	Project % Complete
01	September 9, 1997	$672,800.00	$0.00	7%
02	October 1, 1997	$130,400.00	$850,000.00	17%
03	November 1, 1997	$130,400.00	$1,029,000.00	28%
04	December 1, 1997	$ 39,000.00	$1,135,000.00	40%
05	January 1, 1998	$ 30,125.00	$1,200,965.00	52%
06	February 1, 1998	$ 30,125.00	$ 765,000.00	60%
07	March 1, 1998	$ 30,125.00	$ 595,000.00	67%
08	April 1, 1998	$ 30,125.00	$ 510,000.00	72%
09	May 1, 1998	$ 30,125.00	$ 425,000.00	77%
10	June 1, 1998	$ 30,125.00	$ 340,000.00	81%
11	July 1, 1998	$ 30,125.00	$ 255,000.00	84%
12	August 1, 1998	$ 30,125.00	$ 425,000.00	88%
13	September 1, 198	$ 30,125.00	$ 250,000.00	91%
14	October 1, 1998	$ 30,125.00	$ 340,000.00	95%
15	November 1, 1998	$ 30,125.00	$ 416,060.00	100%