

Professional Practice Corner

Incentive to Change Attitude

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In the project management arena, when one thinks of a contractor, there is a tendency to associate the term with another 'c' word: yes, claims! This has come to a point where any bid that seems unusually low is automatically perceived, and maybe rightfully so, as being claim-oriented. It is not atypical for such contracting methodology to be a business strategy for some firms. The 'bid-low and go after claims' attitude has become more of a cultural anathema than a minor irritation.

Let us analyze the repercussions that this bidding practice can have. Estimators come up with a bid and upper management slashes it at will and without rationale to ensure a win. An unrealistic low bid gets turned in by the contractor; owners cannot justify rejecting the lowest bid and are often bound to accept it. The contractor's project superintendents are then immediately put on notice by their upper management to start 'finding faults and busts' in the drawings and specifications to identify issues, and thus begins the genesis for a claim driven environment. And like a train hurtling down a hill, once it starts, it is hard to stop.

Now let's analyze the contractor's viewpoint. As we all know, construction, like any other industry is a cyclical business. In a tough economic environment, like the one we are going through currently, it is exceedingly difficult for contractors to hang on to the people and resources they may have amassed and enjoyed through the good times. Forced to control costs, cutbacks are imminent. A perfect opportunity to get rid of inefficiency, one might say. But cutbacks will affect even the efficient parts of the company. It's like amputating an infected arm while the fingers still work.

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To prevent this, the contractor is forced to find a way to keep the engine running. This is where the contractor's hand is forced to begin bidding low, so that the efficient parts of the engine can keep running along with some of the inefficient ones. They are thinking: Bid low to win the work so that the engine doesn't stall. But the problem arises when the "bid low" turns into "bid too low." Then, after the work is won and the dust has settled, reality sets in. How do we make money? How long can we go on running a business that will lose money? Well, let's find an easy way to make up the lost money. How about the 'c' word? Claims! That's the tool that gets resorted to most often.

Now let's analyze the owner's perspective. In the best interest of the bottom-line, the owner selected the lowest bid. For that, the owner gets exposed to being slammed with claims. Mounting management fees, claim settlement costs and legal bills are what you get in return for looking after the best interests of the shareholders and taxpayers? As unfair as this seems, owners need to look internally and revisit the vehicle used for project delivery.

While several alternative delivery methods have been tried in the past with successful results, such as design-build and construction management at-risk (CM at-risk), some of these delivery methods require massive changes in the contracting standards established within an organization. While this can happen over a long term basis, the change comes with a lot of upfront cost.

For example, for a state agency such as a Department of Transportation (DOT) or for a county toll road authority or a city department such as public works, lots of effort would need to be expended by expert contract managers and legal counsel of these government institutions, to change the way they have been doing things. While I am not advocating stagnancy and systems do need to continually change to adapt to more optimal standards, the reality is that switching a system that is used to issuing low-bid contracts for the past several decades to one that employs complicated delivery techniques such as design-build or CM at-risk cannot happen overnight.

But there is a certain technique that can be employed, almost immediately by such agencies, with tremendous results. It's nothing new. It's been around but under-utilized. It's the incentive/disincentive plan. While the disincentives are used almost regularly and are present in many contracts in the form of liquidated damages, it's the incentives that make the difference, and that are hardly ever used.

Let us use Texas Department of Transportation's recently completed, \$2.7 billion award winning Katy Freeway Reconstruction Program in Houston as an example. This program involved reconstruction and widening of approximately 24 miles of the I-10 freeway and related interchanges with complicated utility relocations, massive right-of-way takings exercising eminent domain in several instances, and multiple contracts, consultants and contractors.

This very complex program was completed in record time. Apart from careful planning, proactive management and dedicated project personnel, the tool that worked best to achieve timeliness and achieved coordination amongst different contracts and contractors, by nearly eliminating claims and resulting delays, was the incentive/disincentive program.

Approximately **\$51 million** was spent in multiple incentives on **\$1.59 billion** worth of construction contracts through establishment of a variety of milestones. This amounts to over 3% in bonuses. In a tough economic environment, this can be the difference between survival and bankruptcy. This can serve as a huge incentive for the contractors to start working with a positive mindset. Depending on how the bonuses are structured, this is a win-win situation.

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This is the critical point. The incentives have to be structured correctly for the scheme to work. There has to be a hard finish line, set in stone and immovable. Allowing the incentivized finish line to be fluid and movable is worse than not having one because it could potentially be moved out, via a frivolous time extension claim, and then the owner would still be liable to pay the incentives for finishing the program later. Therefore, the incentives need to be structured so that the date is hard and absolute, and any movement of the schedule beyond this hard date begins to decrease the incentive.

The other very critical condition that should be included in the incentive program is that the hard finish date that is set in the contract will not be changed irrespective of what causes the delays that are encountered, be it weather, acts of God, owner driven changes, consultant errors and omissions and so on.

While, on the face of it, this sounds very unfair to the contractor, this is where the problem lies to begin with. Any and every excuse is used to move the end date out via claims as contractors wish to collect delay related expenses. Unless this basic problem is acknowledged and dealt with head-on, it will be hard to tackle the problem described in the opening paragraphs of this article. After all, the contractor is being paid an incentive to finish early. Nobody expects the early completion to be achieved at no cost.

Introduction of this kind of incentive will force the contractor to think outside the box and think positively, to actually solve the problem rather than resort to the easy way out, that is, claim for additional time, dump the entire responsibility on the owner and continue with business as usual. On the other hand, in case the owner or its parties are at fault, they should not take a back seat approach in resolving the problem at a lackadaisical pace, hoping that the contractor will solve it for them.

What was clearly visible on the Katy Freeway Reconstruction Program was the change in attitude of the contractor. Houston was hit with two severe hurricane seasons through the lifespan of the construction. Traditionally, this would have been an automatic delay to the end date by weeks, resulting in large overall delays to the program. But because the incentivized end date was held firm by contract, the contractor found ways to accomplish the goal, by working additional shifts, enhancing crew sizes and employing supplementary equipment.

Another example is working around design problems. It's unrealistic and impossible to expect a program of this size to not have some design conflicts. However, the contractors found ways to keep working in other areas while design problems were being reviewed and resolved in the problem areas. This is a result of an attitude shift by the contractors, which in turn was a consequence of bearing in mind the loss of incentives.

As a final example, the Harris County Toll Road Authority was to employ its own crews and contractors to build out a wide stretch of tollway about 13 miles long down the center of the freeway. Customarily, there would be wide resistance, if not a claim, from the contractors to allow a new project to be built right in the middle of their construction zones. However, again, keeping the end goal in mind, the contractors cooperated and accommodated these new and unforeseen developments so as to not jeopardize the completion of the program and the attached incentives.

To summarize, there was a definite shift in the attitude of the contractor in wanting to complete the work, a shift away from making excuses for delays. On the Katy Freeway, the contractors won because there was a tangible reward for timely performance and the owner won because claim management costs were minimized and the end product was delivered ahead of schedule.

In conclusion, the introduction of the incentives into contracting philosophy needs to be seriously considered and should be as regular a feature of contracts as is the disincentive or liquidated damages concept. It is a proven concept. How they are structured and how much incentive is offered depend on the project and risks associated with the local conditions. But one thing is for sure: Incentives work! **CM**

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