What is Wrong With Design-Build Contracting?

Jamie Peterson

Not all is well in the world of Alternative Project Delivery. In the past year, several large design-build contractors elected to limit or end their pursuit of certain types of design-build or P3 projects. When announcing these pullbacks, executives from the contractors explained that the risk allocation for these projects was out of whack, resulting in substantial losses to the companies. No large engineering and design firms have announced similar dramatic withdrawals, but they too are being more selective about their pursuits for similar reasons. From my perspective in the legal department of a large national engineering and design firm, these pullbacks are not a surprise. For too long, owners have been flowing down inequitable and unsustainable risk to the design-build teams while reaping most of the benefits of these delivery systems. A complete analysis of design-build contracting is beyond the scope of this article, but I will provide a few examples of unsustainable risk allocation that must be addressed for the long-term benefit of both design-build teams and owners.

Contractor Market Retreats

During the summer of 2019, SNC-Lavalin Group, Inc., Fluor Corporation, and Granite Construction Inc. all announced large quarterly losses resulting from mega-fixed-price alternative-delivery projects, and stated these losses were forcing them to alter their business strategies. SNC-Lavalin Group will no longer bid on lump sum turnkey construction projects and will restructure the company. The retreat was announced in a July 22, 2019 video posted on the company website, where interim CEO Ian Edwards stated that fixed-price contracts are the “root cause … of performance issues,” adding further: “I think the current model within our industry is broken.”

Granite Construction announced a large Q2 loss in August resulting from legacy fixed-price projects in its heavy-civil group, and CEO James Roberts stated “[i]t is now clear that, especially in the context of these megaprojects, the fixed-price design-build contract delivery model and public-private partnership … model resulted in an untenable imbalance in risk sharing.” Other examples exist as well. Fluor reported a large loss in Q2, and in September, announced the results of a strategic review that included plans to limit or end its pursuit of fixed-price projects across multiple market sectors. In announcing its new project criteria, Fluor stated, “[f]or lump-sum projects, the terms and conditions must have an appropriate allocation of risk between client and contractor…” Finally, Skanska quit the United States P3 market last year, electing not to pursue any work in which it would have an equity stake.

There has not been a similar exodus of large design firms from the design-build market, but they employ heightened risk-management procedures to evaluate these opportunities and are being selective in the projects they pursue. These market retreats and additional scrutiny are the inevitable result of inappropriate contract terms being
imposed on design-build teams by owners and their legal advisors.

**Principles of Equitable Risk Allocation**

A fair allocation of risks is essential to maximize the likelihood of a successful project: “a reasonable price, qualitative performance and the minimalization of disputes.” Conversely, “[i]nappropriate risk allocation may result in prolongation of construction completion times, wastage of resources, and increased likelihood of disputes.” Equitable risk allocation is by its nature subjective, but common factors cited for determining how to allocate risk include: (1) which party can best control the risk and its consequences, (2) which party can best foresee and bear the risk, and (3) which party is in the best position to manage the risk and its consequences.\(^7\) In the world of design-build contracting, equitable risk allocation frequently does not occur due to uneven bargaining power and short-sighted decisions by owners to flow down risks that arguably should not be transferred.

**Application to Design-Build**

There are many benefits to owners utilizing the design-build delivery method, including projects that are generally completed faster and at a lower cost by allowing innovative approaches through early and continual contractor involvement during design. The design-build contractor serves as a single point of contact responsible for both the design and construction of the project. The benefits to the design-build team are clear, but the risks are readily apparent. The compressed process that design-build procurement entails results in price, schedule, quantities and other key decisions being made earlier and with more unknowns. Rather than submitting a bid based on a complete set of design documents, the design-build contractor collaborates with a designer to submit a proposal—generally a firm fixed price—with the benefit of only thirty percent design drawings and frequently under a tight deadline.

The short time frame elevates the importance of the design, information, and reference documents that owners include with their solicitations. Design-build teams do not have time to verify all of the details contained in these documents before submitting their bid. Under the principles of equitable risk allocation, the resulting design-build contracts should be drafted to reflect that owners are in the best position to know the pre-existing condition of their site and the details of the conceptual design and specifications prepared prior to release of their solicitations. The design-build contracts should thus provide price and/or schedule relief for any errors in these documents. However, many design-build contracts provide the opposite and expressly prohibit reliance by the design-build team.

The same issue exists as to third-party risk, whether pertaining to utilities, regulatory agencies, or other stakeholders. Design-builders are being asked to bear the risk of issues that are out of their control and extremely difficult to quantify prior to submitting a proposal. It is inevitable that, as the design advances from thirty percent to one hundred percent, changes will be identified, and design-build risk allocation needs to be rebalanced accordingly. Much of this risk would typically remain with owners when utilizing the design-bid-build delivery system, and there is no justification in transferring it to the design-build teams for design-build projects.

Inequitable risk allocation in design-build contracts negatively impacts designers as well. First, design-builders seek to flow down these excessive risks to their design teams. Second, once the inevitable change occurs during the post-award design phase, if the design-build contractor is unable to obtain price and schedule relief due to an onerous design-build contract, the design-build contractor frequently repackages its loss as a professional negligence claim against its designer. Designers and their professional liability carriers are not a sustainable source of funding for changes on complex design-build projects that should be borne by owners.

**Conclusion**

While owners and their attorneys may be satisfied with the current risk allocation in their contracts, such short-term thinking has led us to the current situation where contractors are pulling back from the alternative-delivery project market. What is needed instead is a long-term perspective on appropriate risk allocation for the sustainable health of all parties in this market. Otherwise, owners may find a lack of qualified design-build teams responding to their solicitations in the future.

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\(^5\) https://www.whitecase.com/publications/alert/inequitable-risk-allocation%E2%80%94design-build-contracts-
\(^6\) Id.

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**Endnotes**

2. Id.
6. Id.
7. Id.
Government Construction Contracts in the Era of Buying American

David Y. Yang

While domestic preferences in federal procurements are not new, their increased emphasis is. During his campaign, then-candidate Donald Trump promised not only to keep but bring manufacturing jobs back to the United States, especially those in steel. Since then, President Trump has promoted this agenda by issuing, to date, three Executive Orders meant to strengthen domestic preferences through the Buy America and Buy American Acts, including greater emphasis on enforcement. This article addresses the potential impacts of these Executive Orders on domestic preference considerations in government contracting, including the most recent July 15, 2019, Executive Order, which may have a substantial impact on manufactured construction materials and the compliance risks that contractors should consider when bidding on government construction contracts.

The Buy America Act and the Buy American Act
The Buy America Act is the colloquial term for a collection of domestic content restrictions regarding funding provided by the U.S. Department of Transportation to state and local governments (usually through grants) by prohibiting the federal government from obligating funds “unless steel, iron and manufactured products used in such project[s] are produced in the United States.” Unless an exception (which are limited) applies, steel and iron products may only be used on a job where “all manufacturing processes, including application of a coating, for these materials . . . occur[s] in the United States.”

On the other hand, the Buy American Act generally requires contractors performing federal contracts to use “only manufactured articles, materials, and supplies that have been manufactured in the United States, substantially all from articles, materials, or supplies mined, produced, or manufactured in the United States.” The phrase “substantially all” requires contractors to use “domestic end products,” which for manufactured products means that their “cost of components mined, produced, or manufactured in the United States exceeds 50 percent of total costs.”

Alternatively, if the manufactured end product is a commercially available off-the-shelf (“COTS”) item under Federal Acquisition Regulation (“FAR”) 2.101, it too will be a domestic end product so long as it was made in the United States. An “end product” broadly includes all “articles, materials, and supplies to be acquired for public use.” The definition thus also appears to include “construction materials,” as the term broadly includes any “article, material or supply brought to the construction site.” Accordingly, for a manufactured end product to be considered a domestic construction material, at least 50% of its total cost must be attributable to a U.S. source or the construction material must be a COTS item made in the United States. These are critical considerations for construction contractors because FAR 52.225-9, Buy American – Construction Materials, a required clause in all federal construction contracts under $6,932,000, requires contractors to use “only domestic construction material in performing [the] contract.”

The Executive Orders and Their Impact
To bolster U.S. manufacturing, the Administration has now issued three Executive Orders. On April 18, 2017, the President issued an Executive Order entitled “Buy American Hire American,” which applies to both the Buy America and Buy American Acts, and requires the Commerce Department and the U.S. Trade Representative to “assess the impacts of all United States free trade agreements and the World Trade Organization Agreement on Government Procurement on the operation of Buy American Laws.” With regard to steel and iron, this Order reaffirms that for products to be considered “produced in the United States,” all manufacturing processes must be performed in the United States.

Following this mandate, on January 31, 2019, the President issued a second Executive Order entitled “Strengthening Buy American Preferences for Infrastructure Projects,” which expands on the April 18, 2017, Order. This second Executive Order instructs federal agencies, within 90 days, to develop plans and rules to encourage contractors to adhere to domestic preference requirements for iron and aluminum as well as steel, cement, and other manufactured products, which include “items and construction materials composed in whole or in part of non-ferrous metals such as aluminum; plastics and polymer-based products such as polyvinyl chloride pipe; aggregates such as concrete; glass, including optical fiber; and lumber” to the maximum extent practicable in all projects that receive indirect federal government assistance by way of loans, loan guarantees, or grants and other cooperative agreements. The Order may have significant implications for contractors because, whereas the Buy American Act has traditionally only applied to procurements issued by the federal government, this Order signals that the Buy American Act may apply to any project that receives federal assistance even if it was not solicited by the federal government. As a result, contractors may start seeing an increase in domestic preference requirements.
in state and local construction contracts funded in whole or in part with federal funds, thus introducing the compliance risks historically only associated with federal projects.

Finally, on July 15, 2019, the Administration issued a third Executive Order entitled “Maximizing Use of American-Made, Goods, Products, and Materials,” in its most recent effort to bolster domestic preference requirements, by warning industry that the “Administration shall enforce the Buy American Act to the greatest extent permitted by law,” and recommending two key changes for the FAR Council to consider, within 180 days, whether the changes should be implemented through rulemaking.

First, in order for steel and iron-manufactured products to be considered domestic construction material, and hence domestic end products, the Executive Order proposes to increase the domestic content requirement from 51% to 95% for such products to qualify. Should this be implemented through rulemaking, it could substantially reduce or even eliminate foreign content from supply chains for non-COTS steel or iron-manufactured products, thus requiring contractors to more carefully screen, review, and exercise greater diligence over suppliers as well as more carefully consider pricing and/or availability considerations.

Second, the Executive Order proposes to increase the price penalty levied against foreign end products from 6% to 20% in unrestricted procurements and from 12% to 30% in small business competitions. The price penalty is often used by civilian agencies to exempt a procurement from the Buy American Act because domestic end products are not required if their costs would be unreasonably high compared to a foreign counterpart. For example, if a domestic end product costs $10,000, but a foreign end product costs $9,000, a civilian agency in an unrestricted competition would currently apply a 6% price penalty to the foreign end product for evaluation purposes to arrive at an evaluated price of $9,540. As the evaluated price of the foreign end product, even as penalized, would still be less than that for a domestic end product, the agency could seek an exception to the statute under its unreasonable cost exception. Under the Executive Order’s proposal, however, the application of a 20% price penalty would result in an evaluated price of the foreign end product of $10,800, which would be higher than the $10,000 price for the domestic end product and, thus, the domestic end product would no longer pose an unreasonable cost. Accordingly, should the proposed penalty increases go through, they are expected to substantially constrain civilian agencies’ ability to exercise the unreasonable cost exception to the Buy American Act – a change that could further impact supply chain, pricing, and other project and business decisions for contractors.

Takeaways for Down the Road

While the Executive Orders signal greater enforcement by the Administration on Buy America and Buy American Act requirements, any actual implementation will need the FAR Council and/or federal agencies to issue rules and guidance to effectuate any changes. Nevertheless, the Executive Orders may seriously impact both contractors who traditionally have dealt with the Buy America and Buy American Acts and also those who have not. To the extent state and local procurements become more involved and additional restrictions are placed on domestic content, contractors will need to exercise greater supply-chain scrutiny when bidding and performing contracts subject to domestic construction material and other end-product requirements to ensure that certifications that they and/or their suppliers provide are accurate and complete. Notably, an incorrect certification or contract violation can raise significant business and legal risks ranging from contract pricing, administration, and compliance to exposure under the False Claims Act. Given these issues, it is important that contractors evaluate the impact and nuances that the Executive Orders may have on their projects, as well as their options to manage such risks.

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Meet Tamara Harrington — Forum’s Associate Director!

Allison Taller Reich

For years, the ABA Forum on Construction Law has run like a well-oiled machine, putting on national conferences in addition to regional conferences and programs; publishing written materials; and tackling diversity, inclusion, and other issues of importance to the construction industry and construction legal industry. As Forum leadership and Section leadership change, the organization continues seamlessly through the efforts of our much-valued Associate Director of Programming, Tamara Harrington. Tamara has been keeping the Forum moving forward for over five years, executing the programming and objectives; and she is the first Manager to remain longer than one year in ten years. Tamara is responsible for essentially every product coming out of the Forum, and is also the person behind the computer, responding to emails concerning membership questions, special rates, and discounts. All of the various national and regional meetings keep Tamara traveling quite a bit, away from her children (her 19-year-old daughter is a sophomore at Howard University, and her 13-year-old son is in eighth grade) and her French and English bulldogs: Changa and Panda. She travels between ten and twelve times per year for Forum-related events and travel—sometimes just for two days at a time, but others for a week.

Tamara is the liaison between the American Bar Association and the Forum. She attends programming calls for webinars, meetings, content, and others. Tamara said that when she initially started, she tried to attend every single call and meeting and take notes, but it was not feasible. She now reviews notes from the meetings and calls she cannot attend. Tamara says that when she initially started, she tried to attend every single call and meeting and take notes, but it was not feasible. She now reviews notes from the meetings and calls she cannot attend. Tamara tries to be cognizant of what she can do herself and when she needs to ask for help. Like most of us, Tamara is searching for the ever-elusive balance in her life, but, at the very least, she tries not to stay at the office past 8pm anymore.

Tamara recently said that lawyers’ careers move so fast that they need and want to get things done quickly, so Tamara and her staff make every effort to try to get things done quickly for them.

Prior to starting at the ABA, Tamara enjoyed a career in nonprofit education, working with disenfranchised youth and mentally challenged individuals. Allowing her faith to guide her, she mentored and planned full time after school programming for at-risk youth and wards of the state. She developed and managed programs from life skills, employment readiness, to college/vocational preparedness for child and family services, writing grants to pay for her programs. She transitioned from this work to the ABA when grants and funding ran dry.

If Tamara were not the Associate Director of Programming for the Forum, she would be consulting full time, which Tamara has done in the past. Tamara enjoys strategic development and helping organizations manage what they have and where they want to go.

Tamara would also like to travel. She has her sights set on Tobago and Australia. Tamara loves Hawaii, the energy, the people, and the water. She has been to Oahu, the Big Island, and Waikiki.

Tamara is excited about the Forum and looking forward to seeing Forum membership hit 7,000. Over the last 20 years, the Forum has grown to 6,000. The Forum’s trajectory looks good, and Tamara has her sights set on 7,000 members. One of Tamara’s favorite things about her job is getting emails and calls from new and/or unfamiliar members who have questions. Tamara can make connections for them, give them information, and really promote the Forum. She also loves to know that members are enjoying their memberships.

So, drop Tamara an email or phone call, send her a “thank you,” or make a point to chat with her at your next meeting or event. Tamara loves bowling and used to play in a league. Whenever Forum events incorporate bowling—like a recent bowling event at the Philadelphia Fall Meeting—Tamara will be there.

Allison Taller Reich, Frantz Ward, LLP, Cleveland, OH, Division 2 (Contract Documents), Division 3 (Design), Division 13 (Government Contracting)

Building For Good, Inc. (B4G) Launched at the Fall Meeting — Join, Volunteer, and Donate Today!

B4G is a national platform for pro bono construction law services currently operating in four pilot states (Massachusetts, Florida, Minnesota, and New Jersey). To submit a project for consideration, volunteer or donate, please visit http://www.building4good.org. Also, join/sponsor the Racing for Good run/walk at the Forum’s Midwinter Meeting on Friday, January 24, 2020 — https://www.building4good.org/racing4good.

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CONSTRUCTION LAW 101

Looking to build the next generation of the best construction lawyers, Under Construction publishes articles on fundamental construction law topics for our law student and young attorney members. In this edition, we publish three such articles.

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By Roddy W. Steiger and Christy M. Miliken, Stinson LLP, Denver, CO, Division 3 (Design)
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Nominating Committee Appointment and Invitation to Apply for Governing Committee and Chair-Elect Leadership Positions

DUE BY JANUARY 8, 2020

Pursuant to Section 6.1(a) of the Forum By-Laws, Forum Chair Kristine A. Kubes has appointed the following Forum Members to the Nominating Committee: Karen Denys, Drinker Biddle; Peter Hahn, Benesch, Friedlander, Coplan & Aronoff LLP; Arlan Lewis, Blueprint Construction Counsel, LLP (Chair); Deborah Mastin, Law Office of Deborah Mastin, PLLC; George Meyer, Carlton Fields; Jaimee Nardiello, Zetlin & De Chiara, LLP; Wendy Kennedy Venoit, Hinckley Allen; and Fred Wilshusen, Thomas, Feldman & Wilshusen, LLP.

Those persons wishing to be considered for either position should submit their expression of interest/self-nomination to the Chair of the Nominating Committee, Arlan Lewis, Blueprint Construction Counsel, LLP, 420 North 20th Street, Suite 2200, Birmingham, AL 35203, 205-379-1128, alev@blueprinlaw.com, by Wednesday, January 8, 2020. Expressions of interest should include a resume and a written submission that details the candidate’s activities in the Forum, the ABA and the legal profession. In addition, the Nominating Committee is interested in why the candidate wishes to serve in this role, and if the candidate has any initiatives or practices he or she may be interested in proposing if elected to the position sought.

The Nominating Committee will convene at the Midwinter Meeting to be held January 22-24, 2020. An election to fill all open positions will be held at the Business Meeting of the Forum on April 23, 2020 at the Forum’s 2020 Annual Meeting in Seattle, WA. Any questions regarding this matter should be directed to Arlan Lewis.
MESSAGE FROM CHAIR-ELECT

The Forum is all about YOU!

Arlan D. Lewis

The Forum on Construction Law focuses on “building the best construction lawyers.” Among other things, this involves demonstrating the positive value of construction lawyers to the broader construction industry. If you are reading this, you are in some way connected to the Forum as a member, associate member, or non-member (preferably a “future member”) interested in the construction industry, and the Forum is all about YOU!

The Forum remains the preeminent organization for the education and professional development of construction lawyers by doing two things: First, continuing to build upon foundational practices and activities which, over time, have proven “successful” (i.e., being of high value to its members and the industry). Secondly, Forum leadership continuously evaluates its activities and initiatives to provide innovative solutions to further increase the value of the Forum to you. Throughout my years of involvement, I have come to appreciate the willingness of Forum leadership to innovate, take risks, and take on new challenges to better serve its members. We are fortunate that Forum lawyers bring the spirit of innovation to Forum initiatives through three key elements – programs, publications, and people.

Programs

Early in my career as a construction lawyer, I identified the Forum as the best place for me to get the most relevant, cutting-edge education dedicated explicitly to construction law. From regional meetings held simultaneously in several cities and devoted to specific construction law topics, to national conferences where leading industry practitioners address front-line issues, and to the Trial Academy (the next one is set to occur March 4-7, 2020 – register early!), the Forum offers the best construction law educational programs.

If you’re not always able to personally attend regional or national meetings consistently, the Forum offers periodic webinars on substantive construction law topics and, most recently, the Construction Law Today podcast series consisting of insightful 30-minute discussions of issues of relevance to construction lawyers. Additionally, many valuable “programs” occur at the Forum division level through periodic conference calls featuring practical presentations on construction law issues of interest to its members.

Publications

In addition to the Forum’s Construction Lawyer and Under Construction periodicals, the Forum’s books have been a constant resource in my construction law practice. Recently, the Forum revised and updated its textbook Construction Law, Second Edition and published The Effective Use of Forensic Experts in Construction Litigation.

People

In the Forum, there are incredible occasions to network with other construction lawyers from all sectors of the practice – in-house counsel, law firms, government lawyers, academia, and other construction industry organizations. Such opportunities are not only good for business and professional development, but lifelong personal friendships frequently stem from Forum activities – usually from working together in the “trenches” on some Forum project or initiative. The Forum has the potential to provide you with a network of construction lawyers and friends throughout the country and internationally, who serve as valuable resources – whether as a source of business, referrals, inquiries, or expertise.

The Forum’s focus on “people” is not limited to its membership. Recently, the Forum was instrumental in launching Building for Good, Inc. (“B4G”), to provide a volunteer network of construction lawyers to serve non-profits and charities with their construction law needs. Likewise, the Forum has raised almost $100,000 for local food banks in national meeting host cities. Building the best construction lawyer is not limited to construction law.

There are so many ways for you to extract positive benefits from the Forum, no matter what your current level of involvement may be (and we’d certainly welcome your increased participation). In other words, if you’re reading this, we are interested in your ideas and your participation to improve the Forum experience. The Forum exists for the benefit of its members and the construction industry as a whole. We are here to do what we can to make the Forum the most valuable construction law resource for YOU and to help YOU be a better construction lawyer. I hope you’ll join us in this effort. I am confident that you’ll get more out of the Forum experience than you ever imagined. I certainly have!

Arlan D. Lewis, Blueprint Construction Counsel, LLP, Birmingham, AL

Learn more about the Forum’s Construction Podcast Today
For info contact: Buzz Tarlow, jtarlow@lawmt.com

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Dear Colleagues:

A new decade is upon us! As we enter 2020, we realize that we don’t do business like we used to. Hindsight shows us how the practices of design, construction, and law have changed in the last ten years. While these changes have advantages, they also present a whole host of new risks we need to manage for ourselves and our clients.

Join us in sunny Tucson, AZ for an in-depth discussion of the risks in this new era. With engaging discussion among industry leaders and insights from legal experts, the Forum’s 2020 Midwinter Meeting offers unique perspectives on the challenges facing construction professionals now and those likely to be faced in the future.

Special Features:

• Advice from experienced lawyers and industry leaders in cybersecurity and technology on the role of expanding technology in construction and design, and resultant changes in risk assessment and management
• Tech Show by our Forum Exhibitors!
• Futurist Simon J. Anderson on design/construction in the next 10 years
• ABA President Judy Perry Martinez on the 19th Amendment and ABA initiatives
• ENR’s 2019 Award of Excellence recipient Vicki O’Leary on the enormous steps she and her trade have taken to combat workplace harassment and promote inclusion
• The Hon. Christopher Staring from the Arizona Court of Appeals on ethics
• PLUS: Tours of Bio-sphere 2, dedicated to the research and understanding of global scientific issues, and learn Native history at the Presidio San Agustin del Tucson Museum

Please join us at the luxurious Tucson El Conquistador, a Hilton Resort and desert oasis, surrounded by the foothills of the Santa Catalina Mountains. See you in Tucson!

Register: ambar.org/MWM20