



Recognizing and Understanding Potential Conflicts of Interest When Negotiating a GMP Construction Contract

November 19, 2020 | Webinar will begin at 11:03am CST

Please submit any questions through the Q&A panel on ZOOM



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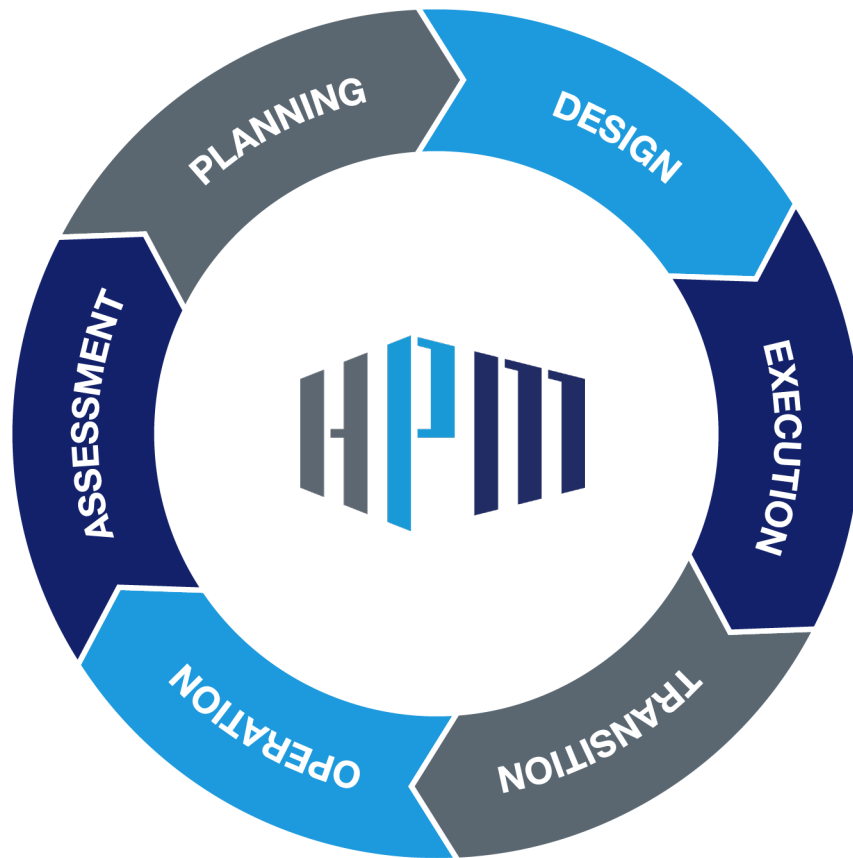
VINSON CHAPMAN

Vice President
Audit & Contract Services

About the Speaker

- BBA, Accounting, University of Texas
- MBA, Southern Methodist University
- Personally managed thousands of construction audits all over the world
- 40 years of construction and contract experience including:
 - contract negotiations and consulting
 - interim and final audits of reimbursable costs, fees, and savings allocations
 - claims analysis, management, and defense





About HPM

- Founded in 1997
- Manage more than \$750 million of in-place construction annually
- Audit approx. \$1.5 billion in construction cost annually
- Diverse international experience in education, corporate, municipal, residential, and industrial market sectors
- One of Engineering News Record's top 25 PM firms
- 150 employees throughout the US
- Offer program management, owner's representation, construction audit & contract services, preconstruction and planning services, and more



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Negotiating GMP Contract Terms when a CM May have a Conflict of Interest

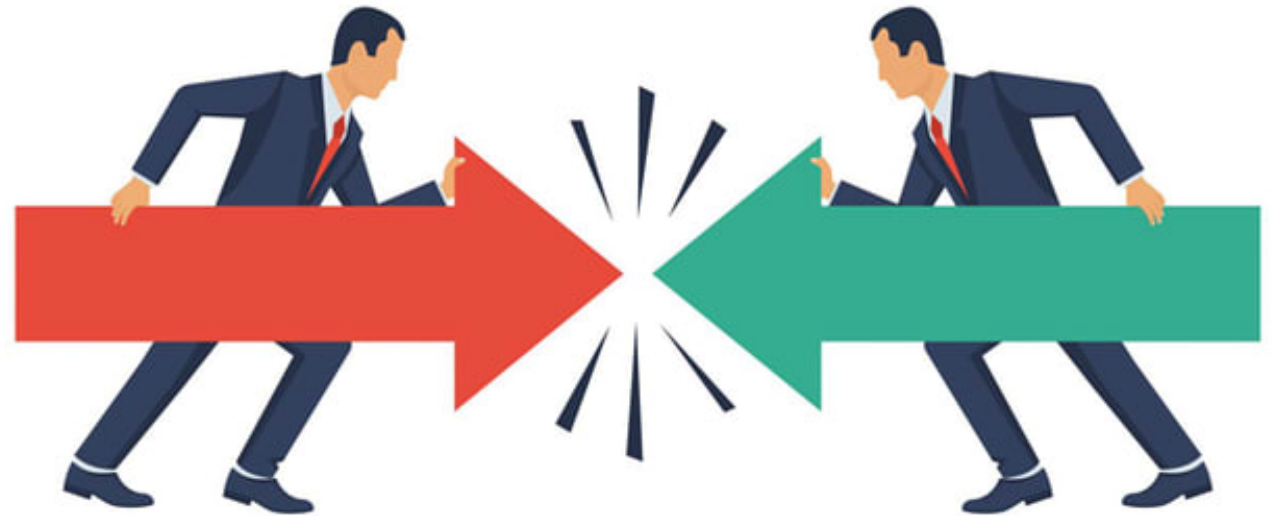
- * CCIP
- * SDI or SubGuard
- * Self Performed Work



TODAY'S DISCUSSION

- What is a conflict of interest?
- Are there inherent conflicts of interest on most GMP projects?
- Are all CM employees aware of all of the conflicts of interest?
- Can the reimbursement structure for a CCIP program create a conflict of interest?
- How can SDI or SubGuard create a possible conflict of interest?
- Deals for self performed work that may create conflicts of interest?

What is a conflict of interest?





A conflict of interest is a situation where an organization is involved with multiple financial interests where serving one interest could involve working against the other.



Is there an inherent conflict of interest in GMP contracts?

- **GMP's require a GMP**
- **Completion time is required**
- **Reimbursable costs are defined**
- **Overhead and Profit (Fee) have limitations**
- **Risk is transferred from Owner to CM**



Do all employees know about all types of CM conflicts of interest?

- **Some information is only shared with a CM's most senior management**
- **Often, relationships that might create a conflict of interest are closely guarded secrets**



What is a CCIP and why can it be a conflict of interest?

- **CCIP = Contractor Controlled Insurance Program**
- Can be W/C, GL, and Excess or GL and Excess only. Covers CM and Subs
- Reimbursement rate is almost always negotiated, with the CM having a substantial interest in selling a CCIP rate that will ultimately be greater than the cost
- Most Owners and Owners advisors have little knowledge of actual insurance cost therefore creating an opportunity to be overcharged.



What are our options?



What are our options?

- Most CCIP's are sold with the premise that the Owner will benefit in cost and coverage
- Consider requiring the CCIP reimbursement to be no more than the avoided cost (Subcontractor insurance credits plus the actual avoided cost for the CM)
- Hold open the possibility of not agreeing to a CCIP if the cost appears to be out of line
- Find out what the true cost for W/C, GL, and Excess insurance is and then negotiate from strength

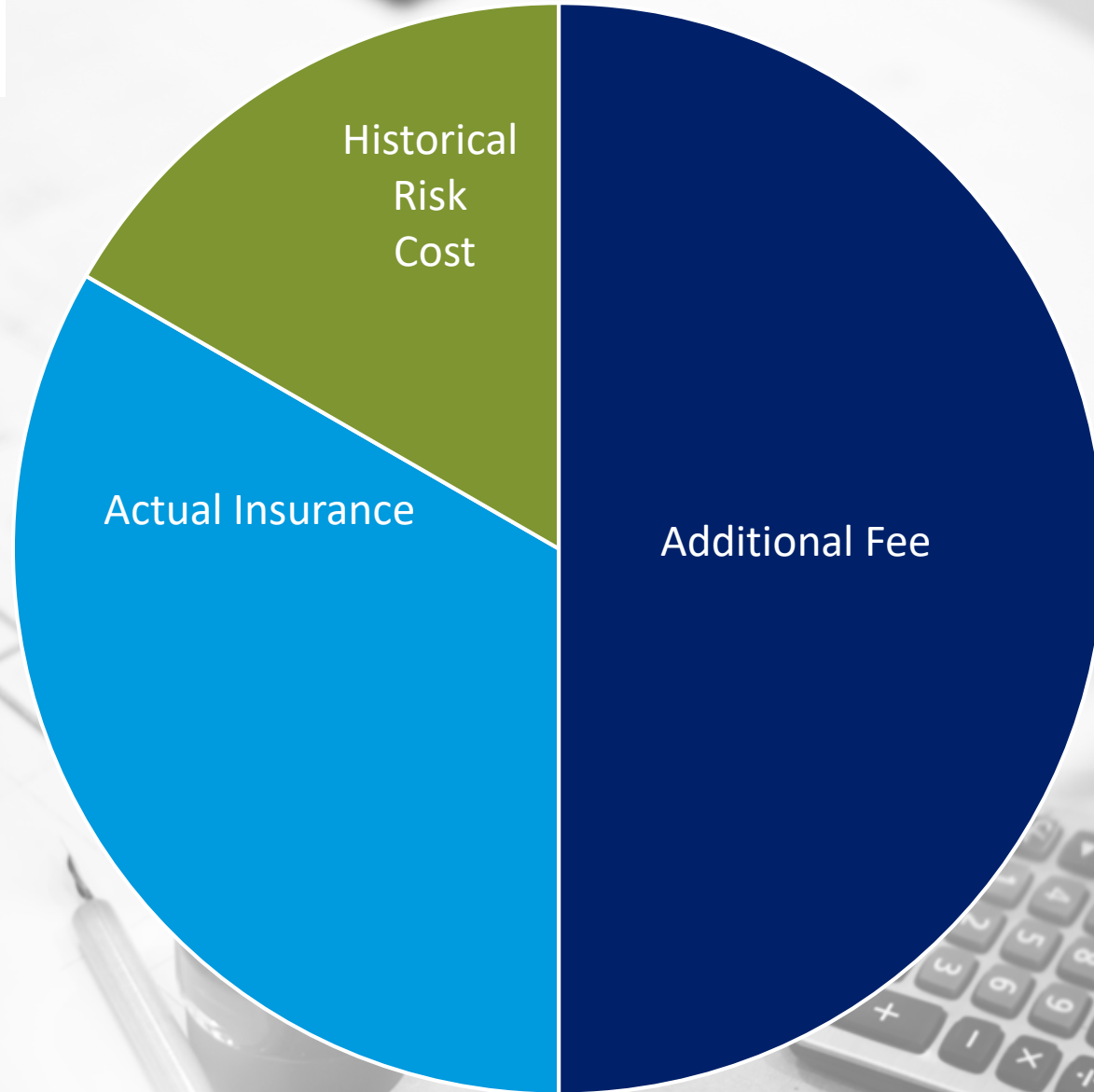


What is SDI and why can it be a conflict of interest?

- **SDI = Subcontractor Default Insurance**
- **Sold by CM as insurance but it is actually more self insurance than insurance, thereby creating a profit opportunity**
- **Sold as a cost savings over bonds but may often be much more**
- **Since sub failure risk is now with the CM, the CM may only bid to overly qualified subs *and* be reluctant to put a sub in default**



SDI @ 1.2%



What are our options?

- SDI or SubGuard is often sold as a savings over bonds and with superior coverage
- Consider requiring the SDI reimbursement to be no more than the actual cost for each Subcontractor's bond
- Hold open the possibility of not agreeing to SDI if the cost appears to be out of line
- Add contract language that requires the CM to use SDI if there is a default or makes any costs greater than the sub value, non reimbursable



If we agree to SDI, how do we ensure we get what we pay for?

[In the event that the Contractor is required to provide SubGuard, SDI, or a similar program of subcontractor default insurance, then the program and the coverage provided by the Contractor shall extend to any additional costs incurred for the Contractor to replace or supplement the forces of a subcontractor to perform the Work and their obligations under the subcontract, and such circumstances shall include, but not be limited to, any partial or full termination of the contract of a subcontractor for convenience or otherwise, unless the Owner specifically directs the Contractor in writing to terminate the contract of a subcontractor for convenience.]



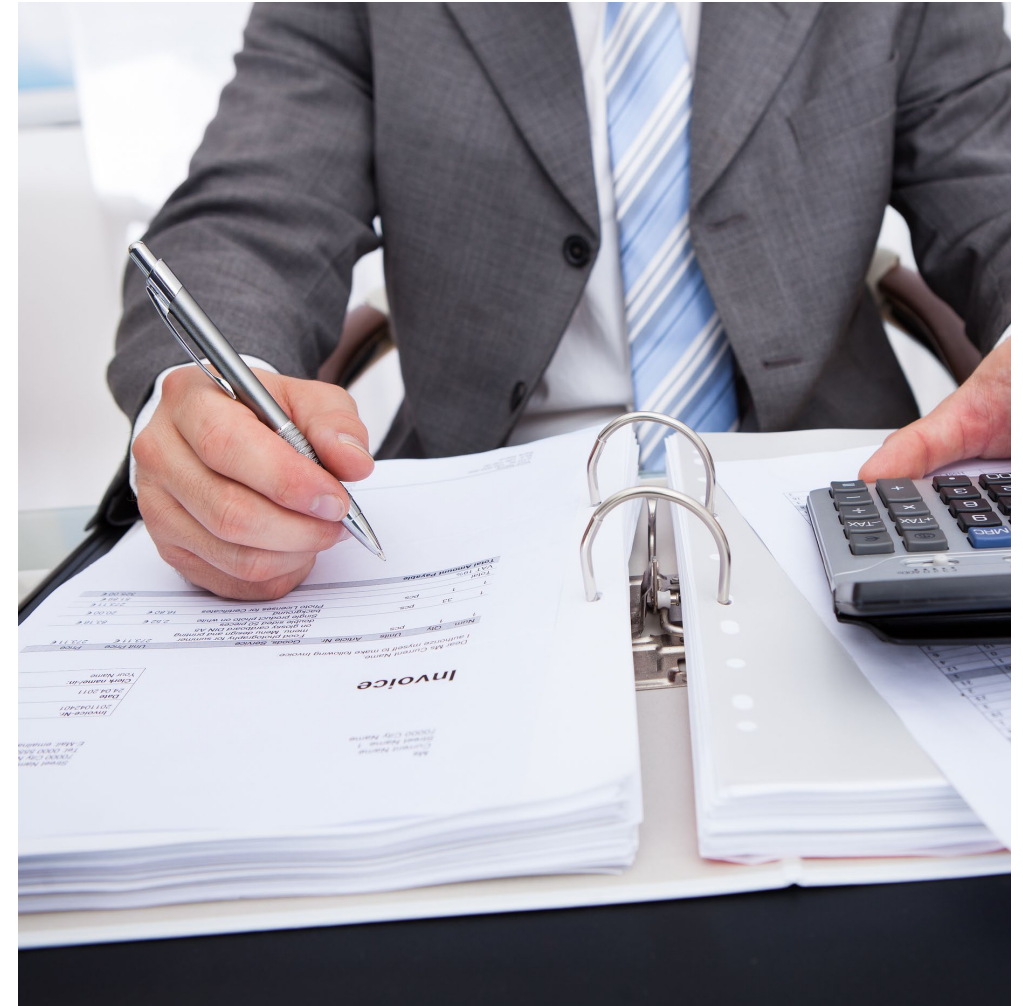
How can self performed work be a conflict of interest?

- **Self Performed Work = Work most traditionally performed by a subcontractor**
- **Sold by CM as savings in money and time**
- **Often appears to be competitively bid**
- **Sub bidders are usually qualified and solicited by the CM**
- **CM usually compares the scope and price of the bidding subs to its own bid and proposes an award to the Owner on a lump sum basis**



How can self performed work be a conflict of interest?

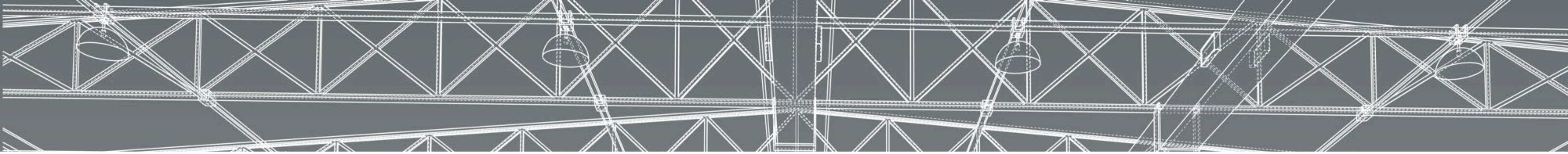
- CM can discourage bidders from bidding
- CM can decide to not divulge all the bids received. Sometimes even contracting with the low sub directly after the Owner allows the CM to self perform
- CM can incorrectly scope the bids and add cost for phantom scope not included
- CM can require subs to include scope that the CM does not have to additionally provide
- CM has an opportunity to charge some self performed scope to reimbursable cost



What are our options?

- Specify in the contract that all self performed work must be bid against no less than 3 bidders and can only be performed on a GMP basis
- Specify that no self performed work will be allowed
- Require all bids to be sent directly to the Owner and that the Owner has the ability to decide the best value option
- Clearly state that all work, whether included in a lump sum reimbursement arrangement or not, is fully auditable to ensure proper allocation of cost





Q&A from Attendees

Q: If CCIP is typically in the interest of the GC for them to turn a profit, why would the Owner agree to CCIP? Would you recommend avoiding CCIP in every scenario or is there an instance in which it would be beneficial to the Owner?

A: Even if a CCIP is profitable for a CM, it could also be less cost for the Owner as opposed to not buying a CCIP. Or it may be the same cost and the Owner may perceive the CCIP as a better value, in coverage, or in clarity of which parties insurance is primary. However, the Owner must be aware that allowing a CM to provide insurance (of any kind) also opens up the possibility that some transactions (claims and settlements) might not be divulged to the Owner and, of course, the Owner must be able to file a claim for the insurance that they have bought.

Q: For self performed work in the instance that the GC does not divulge all bids, are you saying that they may show that they are self performing for one price, then sub the work out to the lowest price (not known to the Owner), and profit the difference without the Owner knowing?

A: Yes, a CM might tell you that they have self- performed work that is actually subcontracted. Separately, for some types of Work, a CM may only be involved in self- performing 20% of the total scope and subcontract the other 80%.

Let's Talk More.



STAY CONNECTED



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