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GL Cost Buried in Payroll Burden

As some of you are aware, many subcontractors pay their General Liability insurance as a function of payroll, not sales, but are you aware that some of the largest CM's also pay GL insurance on payroll?

We have recently audited two large projects where the Owner purchased the GL insurance (a GL only OCIP). The Owner assumed that since there was no specific line in the CM's GMP estimate for GL insurance that they did not need to get a OCIP credit from the CM. In fact, these CM's included the cost for GL and Excess Liability in their payroll burden, and therefore no OCIP credit was ever received. The credits due on both of these projects were over $200,000 each, and if not for the audit, the savings would have either been shared with the CM or gone as extra OH and P.

Be sure to review the estimate of both payroll burden and the Cost of Work, when verifying the credit due for a GL OCIP.

Contingency Buried in Subcontracts

On many negotiated GMP agreements, we see Owners allowing for a contractor controlled contingency. Sometimes this contingency will have some limitation as to what it can be used for, but sometimes not. As to allowing a contingency, we also often see smart Owners insisting that all unused contingency is returned to the Owner before any shared savings, if any, is calculated. Regardless if the owner agrees to a contingency or not, we have seen certain CM's being very aggressive in imbedding allowances and contingency in the subcontracts, at buyout, thereby making the subcontract appear larger than it really is and also lessening the appearance of buyout savings.

On a recent audit, the CM had told us that the final amounts due to the subs would be paid after the Owner had paid them. They also told us that the difference between the current subcontractor billed amounts and their contract values, was the subcontractor related cost to complete. What they did not tell us was that there was $800,000 in unreconciled subcontractor contingency buried in the subcontracts. Had an audit not been performed, or if we had not reviewed the subcontractors scope of work language thoroughly, this $800,000 may have become additional CM fee.

Manipulated Bid Packages

One of the duties required of the CM is preparing subcontractor bid packages, therefore, it is assumed that the CM will prepare these scopes of work in such a way that subcontractors can perform the work required and actually bid on the work. On a recent project, we reviewed one such bid package and found the following scope included for one sub to bid on:

Doors Frames and Hardware, Material and Labor
Site Furnishings
Metal Lockers
Overhead Doors
Exterior Maintenance Equipment
Floor Mats
Specialties
Operable Walls
Perimeter Protection

We have never seen these disparate scopes of work combined into one bid package, but, not surprisingly, the CM expressed their interest in "bidding" on this work. Also, as their luck would have it, they could only find one other sub to bid (which was very high

and located 350 miles away) and the work was awarded to the CM on a fixed price basis.

Obviously, an Owner must be very diligent in reviewing the bids and the solicitations for bid, when considering allowing the CM to perform any work on a fixed price basis. Just as important is reviewing the bid package to verify that work is normally performed by one subcontractor. In the above example, even if the Owner did not know what work is normally performed by a sub., when there are too few subs bidding, they should have asked that the CM break the bid package into smaller scopes of work and of course not allowed the CM to perform the work on a lump sum basis.

Captive Insurance Companies

Larger Contractors and subcontractors sometimes form "captive" insurance companies to shield themselves from certain insurance risks but also allow a participation in savings due to superior loss performance. Another significant captive advantage is tax deference.

Captives are most commonly associated with offshore locations, like Grand Cayman or Bermuda, where tax laws are not as punitive as other locations, but also certain states like Vermont boast a large number of captives. Some "captives" are formed and owned just by the contractor and some are jointly owned by several contractors. There are even "rent a captive" programs available where the contractor does not have to go to the expense of setting up a captive.

Captives hold another advantage for many contractors, they allow the contractor to show an owner an insurance policy, complete with rates, which in turn allows the contractor to charge the captive "cost" to the project. Since the captive rates are not guaranteed to be the final cost to the contractor, these rates usually do not represent actual final cost. Additionally, since the contractor is negotiating the rates with its own captive company, the cost of insurance, as represented by the captive rates, is suspect.

Seldom, if ever, have we had a contractor unilaterally divulge that they are dealing with a captive. Typically, the existence of a captive becomes known when you see; 1- an insurance company that is unfamiliar, 2- the insurance company address is one of the locations previously mentioned. 3- the insurance purchased is of a type not normally seen (like warranty insurance or deductable insurance).

Assuming that you have related party language in your contract, as we have advised, then requiring a full accounting of captives costs, claims, and covered contract values, should enlighten you as to the real cost to the contractor, rather than the stated captive charge.

Hierarchy of Documents

All good contracts have a hierarchy of documents. In the AIA documents, this hierarchy goes in this order:

The AIA Contract, including attached exhibits
The AIA General Conditions (A201)
Specifications
Drawings
Addenda issued prior to the contract, and modifications issued after the contract.

In the above, modifications issued after the contract, includes Change Orders and Amendments.

We often see a CM trying to insert into a CO, or Amendment, qualifying language that is intended to supersede the base contract as to reimbursable cost. In the qualifications to a CO, establishing the GMP, we sometimes see language where the CM inserts a fixed price or percentage for some element of cost that otherwise was a reimbursable item, at actual cost, in the contract, thereby creating a conflict between the base contract and the Change Order. Given the hierarchy of documents found in the standard AIA A201, it seems as if this conflict is resolved by the contract language governing over the CO language. Obviously this would not be true if the CO stated that the old language was changed and the new language should take its place. In that case there would not be any conflict, because it is clear which language the parties intended to use.

To be clear, as they say, we are not lawyers, we just play them on TV. We preach constantly to review all of the fine print in Exhibits, Change Orders, and Amendments, to make sure that conflicting language or false expectations are not present, however, we want you to not be so fast in assuming that any "gotcha" language that was inserted by your CM into a CO necessarily trumps the negotiated language of your contract.