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Is the CM's Total Fee Earned When Terminated after Preconstruction?

This question came up the other day and the answer may surprise you. While the AIA121 /CMc contract is not completely definitive, one interpretation of the basic language is that the CM may be entitled to the full fee if the contract is terminated after the preconstruction services but prior to any actual construction. While articles 2.2 and 2.3 clearly indicate that there is contemplated to be a Pre-construction Phase and a Construction Services Phase, it is not indicated clearly that these are separate contracts, and if the Owner desired to terminate the CM after the preconstruction phase, such termination would not allow the CM to collect (the AIA A201 Article 14.4.3) "reasonable overhead and profit on the Work *not executed*". Such work not executed could be interpreted to be the Construction Phase work.

We would strongly recommend that you review these provisions in your basic contracts and see if the above concern has already been addressed. If it has not, we would recommend that a provision be added that allowed the Owner to terminate the CM's contract after the Pre-Construction Phase with an "agreed to" final compensation.

Auditing the Contractors Sub Bids Prior to Agreeing to a GMP with a Shared Savings

Many of you are negotiating contracts with a shared savings clause. Often we have seen Owners overlooking a couple of key protection points in these contracts. First, is there a limitation on the total amount of savings subject to sharing? This limitation can be expressed as either a percentage of the Cost of the Work or as a fixed dollar amount, and doing so

may avoid a windfall bonus payment to the GC. Second, has there been a thorough review of the Contractors estimate including reviewing the subcontractor bids? We had a recent project where the CM manufactured \$400,000 in savings on a \$3,500,000 project by just padding each sub bid. The Owner believed that agreeing to the GMP, after all of the sub bids were in, protected them against an artificially high estimate. In this case, having the bids ensured that the CM knew how much buyout savings they would have and locked in the savings sharing bonus.

Have you agreed to Bonuses for CM Employees?

Over a long flight, we had the opportunity to read a current newspaper article concerning a survey of US companies' expectations for the upcoming year end and 2009, as to employee compensation increases, bonuses, and health care benefits. These surveyed companies indicated that expected pay raises would be lower to 3.5%, 62% expected bonuses to be the same or lower, and 25% said that they were increasing the employees contribution for health care.

We know many of you have locked in labor rates for salaried employees that included bonuses, yearly increases, and company contributions based on past history and that renegotiating these deals for projects that have already begun may be very difficult. For others, your contracts may indicate a reimbursement of actual labor costs and benefits, including bonuses to be paid with your prior approval. We also know that one of the concerns when entering into a GMP or Cost Plus contract is the lack of contractor incentive to save the Owner money. This same concern exists when a CM knows that employee bonuses are going to be reimbursed by the Owner. The GC is possibly inclined to build up good will with its employees at the Owners expense.

We have already seen very large CM's laying off employees and starting hiring freezes in certain markets. We expect that trend to continue, including all of the cost factors indicated in the survey results above. We recommend that you have a conversation with your CM about its reimbursement expectations for labor cost increases, including bonuses, in the coming year. If your CM acts like it is business as usual and that there has been no negative economic effect on them, you may want to clearly explain what your company's economics are like and what your expectations are.

A Little Detail Never Hurts

If we had to rate the ways that you can be overcharged on a GMP contract, not getting sufficient detail in the pay application process has to be near the top. One place where a CM will almost always try to get by with little or no detail is with its labor costs. Commonly we have seen all salaried labor lumped into one account with no employee names, employee hours, and no actual cost per employee. We had the fortune to review a project recently where the CM made a \$400,000 "mistake" in its salaried labor billings in one month. You have already guessed if this mistake was in the CM's favor so there is no need to discuss that, but one key ingredient that allowed the CM to be successful (for a while) was that very little detail for labor costs was provided by the CM to the Owner. A CM should be able to provide the detailed support for every charge every month. At a minimum, this support should include employees names (so we can tell who is being billed to the project), the employee hours by work week (so we can tell if Sam is billing us when he was on vacation last month), and gross labor cost by work week (so we can tell if Sally's bonus is being charged to us).

You can't have our Job Cost Reports

The situation is as follows; you begin a project with one of the largest CM's in the nation, you start getting pay applications with all of the billed amounts supported by copies of invoices, everyone is playing nice together, and then you ask the CM to give you a copy of their job cost report. "We cannot give you that", is the CM's answer, "it is proprietary".

Let's examine this perplexing situation. First, what is a job cost report and why did you ask for a job cost report to start with? A Job Cost report is a report common to almost all GC's (by almost all we mean 99.99%), where job costs accrued and incurred are

kept separate from those costs incurred on other projects. These incurred costs are entered into the job cost by a variety of means, with accounts payable, payroll, and journal vouchers the most common. As costs are entered through each of these systems the CM's overall accounting system is monitoring the inputs to verify amounts, invoice numbers, employee names, etc. and also look for duplications and input errors of various kinds. Having a job cost report to review does not eliminate overcharges but gives some safeguards on certain errors such as invoice duplications, voided invoices and false payees. In fact a recent subcontract audit found \$500,000 in duplicated invoices billed on a \$7,000,000 subcontract where the subcontractor said that they had no job cost system. They did and the duplicated billed invoices were not in the job cost report twice, so, getting a job cost report would have shown that job cost and cost billed were different.

Next question is; are these types of reports actually proprietary and why would a CM not want you to see it? We think we answered the latter question above, but the basic answer is that there is something in the report that the CM does not want you to see. Credit invoices never included in the billings is one common reason for hiding a cost report. Cost billed that is different than cost accumulated in the cost report is another. So is a report that 99.99% of all CM's have, proprietary? Typically CM contracts do not define such a term (which legend says was invented by a CM to keep an Owner from seeing actual cost) but regardless, a CM should be required to keep full and detailed accounts and exercise controls as may be necessary for proper financial management under the contract and the accounting and control systems shall be satisfactory to the Owner. The last phrasing comes from the AIA standard contract. Giving the Owner access to the billed invoices does not ensure the proper accounting and control systems required by the contract. Only the CM's own job cost system does that and is therefore required if an Owner wants to avoid a host of incorrect charges.

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