

Procurement Standards Oversight Committee

PROBLEM STATEMENT

1. **Title/Subject:** Risk Management

Agreement terms and conditions that affect the risk of the supplier and the risk of the purchasing agency are difficult for the parties to evaluate, particularly regarding the value (or cost) of rare events. Therefore, standard terms and conditions affecting risk will significantly expedite agreement and will avoid inadvertently unfair or uneconomical provisions.

2. **Scope:** Standard terms and conditions to allocate risk between purchasing agency and supplier, and to otherwise manage risk, should be developed in light of the economical allocation of the entire range of contract risk including:

- Third party risk – A third party is damaged (e.g. in auto accident)
- Performance – Contractor fails to achieve specifications (quality or completion)
- Supportability – Agency incurs additional cost to use and maintain the product delivered
- Schedule – weather delays, underestimates, external delays
- Cost - e.g. unexpected labor rate increases or productivity losses or increased units (e.g., spoiled materials or soil for fill)
- Technical or design – design envisioned by contractor or agency does not fulfill user's need or deal with conditions
- Programmatic risk – Agency requirements change

Standard contract terms and conditions for the principal situations encountered in transit agency contracting, together with clear guidance regarding the situations in which the clauses should be used and indicators where they may not apply may include clauses addressing:

- Contractor Insurance requirements (property damage and third party risk)
- Performance, Payment and Warranty Bond requirements (performance and after-delivery supportability risk)
- Indemnification Limits of liability (property damage and third party risk)
- Force majeure exceptions in delivery time and other performance clauses (schedule and performance risk)

3. **Benefits and impacts to the transit industry, including cost savings that would contribute to a return on investment:** The benefits of standard risk management terms will accrue in three phases: the agreement process, pricing or the cost of goods and services, and the cost of losses or damages.

- *Agreement Process:* The use of standard terms and conditions in documents issued by the purchasing agency should largely eliminate cost incurred in requesting deviations from agency documents, discussing and negotiating changes, and occasional impasse over risk terms and conditions; for example, a relatively few lines in indemnification provisions have been the subject of extended negotiations in many contracts, particularly professional service

contracts, and yet few of these contracts occur in unusual circumstances that would warrant unusual risk allocation provisions

- *Pricing*: The use of standard terms and conditions should result in a more economical allocation of risk between the parties, and in the rapid appreciation by suppliers accustomed to these terms and conditions regarding the extent of the risk imposed on them by the standard terms and conditions. This will result in more economical risk mitigation by both suppliers and purchasing agencies, and in lower costs of the goods and services supplied to the industry. For example, some purchasing agencies have required performance bonds for off-the-shelf goods or supplies, even though the bond adds very little to the agency's right to re-procure in the event of default; the full cost of the performance bond is normally added to the price of the procurement, thereby increasing the cost of the goods supplied to the industry. Similarly, standard insurance terms can avoid the purchase by the agency and the supplier of duplicative or uneconomical insurance coverage.
- *Cost of Losses or Damages*: Standard terms and conditions can also reduce the cost incurred by suppliers and purchasing agencies in the event of risk materializing in the form of losses or damage. For example, if a catastrophic accident in a rail structure project results in loss of life and significant property damage, adequate insurance coverage for work on or near railroad facilities can protect both the construction firm and the agency against major financial consequences.

4. **Potential parties that might be impacted by the standard:**

- a. All transit properties
- b. All contractors that supply the transit industry, including manufacturers, equipment and supply firms, construction and service firms, professional service firms, including particular impacts on small and disadvantaged businesses
- c. Insurance industry participants (brokers and underwriters)
- d. Performance bonding firms

5. **Known research or information that might contribute to the standard development:**

Existing Best Practices documents from FTA (BPPM) and APTA.. National performance bond and insurance underwriting associations can offer an informed point of view.