

# Managing Performance Risk



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# IBI Group Introduction



- Areas of practice
  - Urban Land
  - Building Facilities
  - Transportation Networks
  - Systems Technology
- About 2700 staff
- 75 offices in North America and internationally

# IBI Group Perspective



- Consultant
- Contractor
  - Software developer
  - Systems integrator
- Subcontractor
- System Manager

# My Perspective



- Transportation Systems
- 22 years
- With transit about 20 years
- Typical role
  - Planning and specifications
  - Procurement and implementation assistance

# Performance Risk Introduction



- Achieve completion after partial payments
- Encourage timely completion by original contractor
- Allow completion with different contractor for a default

# Options



- Retain leverage for completion
  - Milestone Payments
  - Withholding
- Influence timely completion
  - Liquidated Damages
  - Bonuses/Penalties
- Protect against default
  - Bond
  - Letter of Credit

# Retain Leverage for Completion

- Milestone Payments
  - Partial progress payments
  - Cash flow to reduce financing
  - Link with deliverables
  - # of payments related to project duration
  - Retain leverage for system acceptance
  - Subject of negotiation



# Retain Leverage for Completion



- Withholding
  - Retain a small percentage on all progress payments
  - Release upon system acceptance
  - Reduces need to ensure leverage with progress payments alone



# Influence Timely Completion

- Liquidated Damages
  - Pre-estimate of damages due to delayed completion
  - Enforcement involves negotiation on delay attributable to contractor
  - If accumulated amount approaches contractor profit, loss of incentive

# Influence Timely Completion

- Bonuses/Penalties
  - Can be for more arbitrary amount than liquidated damages
  - Can also lead to negotiations over contention of agency caused delays

# Protect Against Default



- Performance Bond
  - Agency collects up to value, or surety completes
  - Requires complete default
  - Contractor purchases (0.5% - 2%), may require assets as collateral
  - Value often stepped down based on progress
  - Includes Payment Bond for subs and suppliers

# Protect Against Default



- Letter of Credit
  - Non-revokable on demand payment commitment from bank (if work not completed before expiry)
  - Is a loan to contractor if invoked, working capital held as collateral
  - Often 10% or less of value
  - Costs about 1% per renewal
  - Can be stepped down based on progress

# Bonding and LOC Issues



- Costs passed on to agency
- Some vendors have constraints
- May result in less effective party as prime
- Partial software cannot be readily completed by others

# Bonding and LOC Constraints



- Parent reserving assets for acquisitions, or with cash flow trouble
- Joint venture partners not able to support in proportion
- Consulting firms with limited assets to secure bonds

# THANKS!

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