

WHITE PAPER ON TRANSIT PROCUREMENT RISKS

**APTA Procurement Standards Committee
Contract Risk Allocation Working Group**

Draft as of March 11, 2007

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White Paper on Transit Procurement Risks

I. Introduction

This paper is the work product of the Contract Risk Allocation working group of the APTA Procurement Standards Committee. It is intended to provide an overview of procurement risks in the transit industry. It identifies the stakeholders in procurements; specific risks and risk factors that arise in the transit context; variables that affect the degree of risk; and how risk can be assessed, managed, and mitigated. As outlined in this paper, the subject of procurement risk is very broad. As such, this paper is intended to provide an overview of the risk allocation issues related to the procurement process. The working group stands ready to provide input on specific topics to the extent requested by the Procurement Standards Oversight Committee.

The risk issues addressed in this paper relate primarily to the pre-award planning, contract preparation, and award phases of the procurement process. This is consistent with the guidance provided by the Oversight Committee in the Problem Statement issued for the working group, which focuses the group's attention on the assessment of contract terms and conditions that allocate risk, and on the provision of guidance as to when such terms and conditions should or should not be used.

Procurements vary greatly in size and complexity. The focus of this paper is directed toward major procurements but the principles it addresses are applicable to procurements of all sizes and complexities.

II. What is the Purpose of Procurement?

For a transit agency, the purpose of procurement is to obtain a quality product or service at a fair and reasonable price that will support the broader objectives of the agency. The procurement methods and processes used should facilitate information flow between the agency and sellers to permit:

- a realistic assessment and mitigation of risks;
- an accurate determination of price; and
- a timely and clear process.

The procurement process should result in:

- an open and fair selection of the product, service, or contractor;
- clear and appropriate terms and conditions;
- prices that are reasonable;
- the agency "getting value for its money;"
- satisfaction of each party's interests

In general, the primary objective of a business supplying an agency is to make a fair profit on the sale of its products or services. Other business objectives may include increasing sales by selling more existing products or services, by selling new or innovative products or services, or by identifying new customers for its products and services. Commercial investment in research and development creates new products and services that can help the transit industry operate more efficiently and effectively. An effective procurement process provides an opportunity for the attainment of the objectives of both the agency and the business, and for the procurement of transportation-related products and services in a cost-effective manner.

III. Stakeholders

An early, critical step in any procurement initiative is to identify the stakeholders related to the procurement. In a procurement process, the stakeholders include any person, group, or institution that will affect or be affected by the initiative.

For a major public transportation-related procurement, key stakeholders are the transit agency, the contractor/supplier, and the public users. As most of these initiatives involve public funding and regulatory oversight, additional stakeholders will generally include a variety of federal, state, and local agencies, property owners, third-party developers, utilities, and taxpayers. Others might include labor unions, suppliers' partners, insurers, sureties, and special interest groups. All of these people and groups are stakeholders with varied—and sometimes conflicting—interests in the procurement.

Once stakeholders have been identified, further examination is required to identify the specific interest that each stakeholder has in the project. To identify interests, one should consider issues such as the project's benefits to the stakeholder; the changes and efforts that the project might require of the stakeholder; and the project activities that might cause damage to or conflict for the stakeholder. An understanding of stakeholder interests, coupled with regular communication with each stakeholder, increases the probability that each stakeholder's interests will be met to the extent feasible, promotes the identification of better project methods and solutions, and creates a greater level of commitment among stakeholders. Ensuring that all stakeholders have their voices heard in the process can facilitate the setting of project priorities and the implementing of a successful project.

IV. Elements of a Successful Procurement

There is a direct correlation between an agency's procurement practices and the number of contractors willing or able to do business with the agency. Good procurement practices are designed to maximize the probability that both parties meet their objectives and that neither party is inappropriately burdened by risks that may jeopardize the overall procurement or that may cause undue harm to one of the contracting parties. Agencies should allow sufficient time to plan the procurement process to ensure that all issues are adequately addressed as early as possible in the process. Elements of a good procurement process include:

A. Prepare a Detailed Acquisition Plan

A sound procurement process should begin with the development of an Acquisition Plan. During the planning process, the major elements of the procurement should be identified, coordinated, and integrated in advance of any procurement action. In general, the plan should:

- Address the objectives of the procurement;
- Identify the type of contract to be awarded;
- State the method of procurement to be used, such as negotiation or low bid;
- Define the criteria upon which an award will be made;
- Identify the appropriate stakeholders and include them in the development of the procurement plan;
- Include a statement of needs identifying the goods or services that are required;
- For major procurements, include an independent review of the scope of service and/or specifications;
- Review past procurement history or previous experience with similar products;
- Identify budget and funding sources and include independent cost estimates;
- Provide for a means to ensure adequate competition for the goods and services required;
- Discuss trade-offs and their impact on cost, performance, and schedule;
- Identify the risk factors and classify them as high risk, low risk, and shared risk; and
- Evaluate the optimum contracting and pricing approach for the procurement.

B. Communicate with Potential Contractors Before Issuing the Solicitation

Many agencies issue solicitations and then hold pre-bid or pre-proposal conferences only a short time before the bid or proposal is due. Too often these conferences provide little or no opportunity for potential contractors to offer ideas and innovations that may improve the utility of the product or service, or lower the cost to the agency. A better approach is for agencies to institute a procedure that allows for the draft statement of work or specification to be circulated to potential bidders or offerors prior to issuance of the solicitation. Input from potential contractors can improve the quality and clarity of the scope document, and can decrease the procurement risks for both the agency and the contractor. By facilitating an understanding of the agency's needs and the price drivers for the vendors, this pre-solicitation communication process may yield a lower price and better value for the agency.

C. Use a Risk Analysis Process to Allocate Contract Risk

Agencies should include risk analysis as part their procurement process. The analysis should consider risks associated with, for example, failure of the product or service to perform as specified, force majeure events, price volatility, environmental issues, and the unique risks presented when the contract calls for a new or innovative design. Agencies should be open to inquiries and suggestions pertaining to risk allocation during pre-bid processes and be willing to make adjustments that will protect the agency and the contractor from unnecessary risks. Transit agencies can request that the contractor help identify critical risk elements and offer proposed contract terms and conditions to address those risk elements.

As a general rule, risk should be allocated to obtain the maximum value for the lowest cost. Those who are charged with the responsibility of allocating risk in the procurement process should be cognizant of the many factors that can contribute to risk. Risk allocation is the process by which the potential risks are assigned to the agency, vendor or insurance provider.

Because public sector officials have a duty to protect the public's interests and their actions are closely scrutinized, it may seem safer for an agency manager to shift as much contract risk as possible to private sector contractors. What appears to be a good decision in a current procurement, however, could ultimately have a detrimental effect on the agency. This is especially true when the risk that is shifted is one that the contractor has no means of controlling. When the shifted risk results in a major loss, the results can include expensive contract disputes and the loss of contractors or subcontractors. Particularly in industries that have few competitors to begin with, overly-aggressive contract risk-shifting is almost certain to lead to higher prices, either as a result of contractors going out-of-business, contractors refusing to bid at all, or by contractors adding significant contingency factors to their prices in order to protect themselves from the added risk of contracting with that particular agency.

Use of a risk analysis process can result in many benefits, including:

- increased and more accurate competition;
- reduced costs;
- improved partnerships between public agency and private contractor;
- reduced litigation;
- fewer defaults and walk-aways by contractors; and
- reduced business failures

D. Carefully Define the Product or Service Desired

A proposed procurement's scope of work or product specification should, and generally does, receive significant attention during the procurement process. Although these descriptive sections receive much attention in their development, they can also be the source of confusion and misinformation as to what the agency is "paying for" and may cause contractors to submit poorly-constructed bids.

The scope should be developed carefully and receive several reviews by agency staff and, when appropriate, outside experts. These reviews should be made by both the agency personnel responsible for the procurement and by the personnel who will use the product or service. A bus specification, for example, should be reviewed by multiple departments with inputs from passengers and drivers on selected elements. The review should include departments with an indirect interest in the product or service, such as safety and security. In addition, the draft specification should be reviewed by vendors, allowing them to submit ideas, requests for clarification, and to identify risk issues presented by the proposed specification.

E. Consider the Cost Implications of Boilerplate Terms and Conditions

An agency's standard terms and conditions (T&Cs), and even non-standard T&Cs, are frequently viewed by contractors—and by some procurement officials—as “take-it-or-leave-it” boilerplate. In fact, T&Cs are seldom “unchangeable” and should be given as much consideration for a specific procurement as the procurement methodology or the specifications. T&Cs can contain high cost drivers. For example, onerous indemnification clauses and clauses shifting all environmental risk to the contractor can result in contingency pricing or a reduction in competition. Standard insurance requirements can also add unnecessary costs to a procurement. The level of insurance or bonding required should be consistent with the overall risk allocation, levels of risk, and probabilities of risk for the procurement at issue. Because agencies may not fully appreciate the effect of boilerplate T&Cs on vendor bids or proposals, agencies should be receptive to vendor expressions of concern about such T&Cs, and should evaluate the extent to which the agency actually needs the term or terms at issue.

V. Procurement and Project Risks

Risks represent the possibility of suffering losses or achieving gains; and the uncertainties associated with any given action. In the transit industry, risks are the positive or negative possibilities related to transit project and procurement actions. Different stakeholders may hold conflicting views of transit project risks. For example, a homeowners' association opposed to a light rail transit project may have negative risk associated with completion of the project because of possible inverse condemnation or changes to the nature of the neighborhood. On the other hand, the proposed project contractor has a positive project risk because of expected profits. Stakeholders may each have multiple risks, and each stakeholder can be expected to seek to minimize the risks of harm and to maximize the opportunities for gain.

Project developers for private real estate or infrastructure projects are subject to the typical property and casualty (P&C) risks. The ultimate determination of a private project's success or failure may well turn on a selected financial measure, such as return on investment, or total long-run net profit. The ultimate success of a public project is rarely judged according to such narrow financial measures and, in due course, the public served by the project may never reach a consensus on the success or failure of the venture. Transit project risks fall into the broad project stages of planning, performance, and operations. Each stage presents its own unique types and degrees of risk.

A. Planning Risks

Public transit projects, like other public projects, occupy an exposed position and have many stakeholders and competing interests. Some stakeholders seek to delay or cancel the project altogether, others wish to modify the project, and still others want to advance the project without interruption. Broad participation in project planning often means that stakeholders such as homeowners, residents, local government officials, funding partners (federal and state regulators), environmental groups, and industry groups will be present and active. Even within a transit property, planners may disagree between themselves regarding specific project elements such as an alignment, grade separation, or even the color of a platform. The planners may disagree with the construction manager over value engineering changes and with the operations staff over the anticipated vehicle maintenance schedule. Transit executives should anticipate that even the best planned and managed

transit infrastructure projects will be complicated by competing goals and objectives. Such political risk is inherent in public transit project planning and development.

Aside from political risks, transportation project planners need to consider how to integrate the new project into the existing transportation infrastructure, particularly systems such as train control, traffic signaling, communications, vehicles, and other rapidly changing technological elements. Frequently, existing infrastructure will need to be upgraded concurrent with the new project to facilitate interoperability. Interoperability is also complicated by the lack of industry standards, general requirements for low-bid procurements, and the relative scarcity of qualified providers of transportation goods and services. While none of these issues need be fatal to a particular project, transportation procurements should consider future system expansion, system upgrading, the ability to purchase new vehicles, and other technological elements when contracting.

B. Performance Risks

Among the easiest risks to mitigate are P&C risks related to the design and construction of transit projects. Most of these P&C risks are known and insurable, and the insurance costs can be easily incorporated into a project budget. Insurance professionals and brokers can be of great assistance in providing advice and access to specific financial products to increase certainty and reduce the risk of P&C losses. Insurable risks include damage to the property under construction, and the risks of catastrophic losses due to flood, earthquake, and hurricanes. Insurable risks also include loss or damage by the contractor or transit agency to third parties during construction. Professional liability insurance generally protects the transit agency from design negligence by its architects and engineers. Project performance and payment bonds protect the transit agency, suppliers, and subcontractors from contractor default. Statutory workers' compensation coverage protects the contractor and the transit agency from liability for injuries to project workers. More esoteric coverage can also protect the parties against environmental perils.

While insurance can protect against the financial consequences of P&C losses, political risk usually follows in the wake of such events. Loss of life at an unsafe jobsite can shut down a project, even if insurance protects the contractor and transit agency from the financial consequences of the deaths. Hence, risk control measures are always appropriate, even under circumstances where financial risks have been transferred to another party, because not all risks are transferable—particularly political ones.

Uninsurable risks include changes in prices for commodities, like steel or concrete, and exchange rate risks that arise when the project involves the purchase of foreign products. Although not insurable, many of these risks can be mitigated by hedging. Hedging limits the pricing risks of commodities and currencies through the purchase of contracts guaranteeing future prices. Hedging, like insurance, imposes a risk premium. Most public transit properties have yet to adopt hedging because of relatively high risk premiums and modest currency/commodity pricing risks. If extreme price volatility becomes commonplace, hedging may be viewed more favorably as a risk reduction strategy.

Other uninsurable performance-related risks include project delays, scope changes during performance, indemnification exposure, and the loss of funding. Such risks can impose relatively large personal, professional, and public costs. Effective mitigation of such risks can require the employment of high quality project management personnel or the hiring of lobbying or marketing talent.

C. Operations Risks

Post-performance risks frequently relate to realized errors in planning, design, and construction; funding changes; and unanticipated operational problems. The near-term operations risks arising from planning, design, and construction errors may well be covered by financial guarantees such as warranties and insurance policies covering products and completed operations,

and professional liability policies covering latent design flaws. The operational risks relating to project funding are harder to predict or control. In the transportation context, capital funding for new projects may be easier to obtain than lasting commitments to fund ongoing revenue operations and capital-intensive system improvements. When they arise, operational funding shortages can obviously pose a serious risk to transit operations.

With an increasing pace of technological change, obsolescence of key transit system components on a new project should be assumed. Obsolescence frequently does not affect major civil infrastructure improvements such as bridges or tunnels, which may last 50 years or longer with appropriate preventative maintenance. Other project components such as rail vehicles, while not as long-lived as the major civil structures, frequently last 20 to 30 years. Over the course of the depreciation periods of these assets, major overhauls will be necessary and should be taken into consideration during project planning. Computer systems and software are much shorter lived, with obsolescence sometimes resulting in less than 5 years.

VI. Factors that Influence Risk or Risk Tolerance

The level of risk that a person or entity is willing to accept is dependent upon many variables. One set of variables relates to the magnitude of the potential loss or gain presented by the risk and the likelihood that it will in fact occur. A second set of variables relates to the attributes of the person or entity, the attributes of the procurement, and the degree of risk mitigation planning by the person or entity.

A. What is the risk?

The best case for a transit procurement is the maximization of the gains by all project stakeholders. This would involve, for example, the agency receiving a very high quality product or service at a very low price, and the contractor making a high profit on the transaction. The downside risks are, however, often the more important drivers in transit procurements.

In the spectrum of risk consequences, death is the extreme for individuals, and bankruptcy is the extreme for entities. Transit systems employ rail cars, buses, trolleys, heavy construction and maintenance equipment, and high voltage and power systems, mostly in close contact with passengers, the public and transit employees, often in densely populated areas. The potential life-safety risks presented by the products and services being procured need to be identified and addressed during and after the procurement. Major construction projects pose a serious risk of death or serious injury during contract performance.

The risk of bankruptcy is the extreme risk for entities. Because most transit agencies are publicly funded and generally not likely to face bankruptcy, the risk of going bankrupt is primarily an issue confronting contractors and subcontractors providing goods and services to agencies. Contractors should—and generally do—take steps to protect themselves from this risk by, among other things, securing appropriate insurance and by seeking to limit their exposure to inappropriate contract risks. Bankruptcy of a contractor can also have serious consequences for the success of a procurement. To protect themselves from this risk, agencies generally require contractors to post performance and payment bonds. These bonds enable the agency to complete the project if the contractor is financially unable to do so.

B. Variables affecting risk

A wide array of variables affect the nature and degree of risk presented by a procurement. The major variables fall into four groups: (1) the nature of the procuring agency and its personnel; (2) the nature of the procurement and the contracting method; (3) the clarity of the contract, including its risk-allocation provisions; and (4) the character, or reputation, of the contracting parties. Outlined below are some of the more significant of those variables.

1. The procuring agency and its personnel

i. Agency size

The size and resources of the agency may affect the success of a procurement. Large agencies tend to have more resources to devote to the various phases of the procurement process. In addition, a small agency may not require a sufficiently large quantity of a good or service to attract the large, more efficient vendors. Further, even if the vendors offer a price or quote, such a price may well be appreciably higher than one offered to a much larger agency. To some degree, it is a matter of supply and demand. Larger suppliers are more apt to work with larger agencies thus driving down per-unit costs. Additionally, the smaller agency may not be able to spread the risk or costs over a variety or succession of purchases.

ii. Expertise of procurement team

As the level of complexity of the procurement increases, so too must the quality and expertise of the procurement team increase to efficiently and effectively initiate and manage the procurement. Although the individual members of the procurement team may never fully appreciate the technical complexities of the supplies or services being purchased, the team, collectively, should have a firm grasp of the impact of the procurement on the agency. An appropriate procurement team should consist of individuals knowledgeable in contract issues, technical issues, financial issues, and operational issues. At times, outside consultants may be needed to offer expertise not available from within the organization.

iii. Agency infrastructure (age of system; state of repair)

As an agency's infrastructure ages, repair costs escalate, as does the probability of an unanticipated incident or failure that may impact a planned procurement. In addition to these unexpected events, a procurement which adds to, rehabilitates, or modifies an existing transit system requires that particular attention be paid to issues of compatibility, integration, and interoperability of the new product or system with the old.

2. Nature of the procurement and the contracting method

i. Maturity of the item (e.g. technology) being procured

Technology developed in years past may offer a lower degree of risk simply due to the fact that "it exists," and "is operational"—meaning that it is mature. Unfortunately, although existing technology may be functional, it may also be approaching obsolescence. New technology, such as software in the development stage, carries with it a high degree of risk that it will not be timely completed and implemented. The same might be true with technology that has just recently been implemented—there are always "bugs," sometimes quite large in size and duration.

ii. Type of contract

The selection of the type of contract affects risk and its allocation. For example, when the contract will be awarded on a lump sum, or fixed price basis, the potential contractor bears most of the procurement risk. A cost-reimbursement contract, in contrast, tends to place the highest risk on the agency and is generally appropriate where the scope cannot be clearly defined and priced; these contracts are typically negotiated, which permits more flexibility in allocating risk effectively. Other contract types include incentive contracts, level-of-effort contracts, and variable quantity contracts. The type of contract selected can have major implications for the risks to the agency and the contractor.

iii. Procurement Method

Agencies typically procure goods and services using either the negotiation method or the low bid method. Use of the negotiation method of procurement is generally preferred for the purchasing of non-standardized products or services, such as rail cars, buses, engineering services, and contract service operations. Negotiated procurements can also be effective for construction projects, particularly those involving design-build or design-build-operate. The preference for the negotiation method in these contexts results largely from the flexibility inherent in the method to allow award to the offeror whose product or service would provide the best value. Agencies should avoid selecting professional services on price alone. On the other hand, low bid procurements are typically preferred for the purchase of standardized products and services. Once the agency has defined the product that it wishes to procure, contracting on a low bid basis typically takes less time and fewer agency resources than contracting by negotiation. In many instances the procurement method may be determined by federal, state or local laws and regulations.

iv. Contract Duration (fixed duration or option years)

Multi-year contracts may be more efficient because they can eliminate costs of re-procurement; increase efficiencies associated with continuity of parties; lessen or eliminate learning curve costs; and bring other cost efficiencies to the contractor and agency. Long-term or multiyear contracts offer the risk of a protracted, adversarial relationship, and limit the opportunities for other firms to obtain contract awards. Multi-year contracts can be useful for procurements in which there is a reasonable chance that the work or product at issue will not be needed over the long term. For example, if an agency executes a five-year contract and later determines that it no longer needs the supplies or services, the agency would probably need to avail itself of the *Termination-for-Convenience* provision of its contract. If, however, the contract was for a period of one year with four one-year options, then the agency could simply decide to not exercise the remaining options, which is a far easier and less costly solution. On the other hand, single-year contracts or other contracts of very limited duration raise the risk of increased costs. In general, longer-term contracts offer the potential for reduced costs and greater efficiency, but present a risk of greater costs should they need to be terminated.

v. Schedule constraints

The procurement schedule, as well as the actual delivery of goods or services, may be driven by a schedule mandated by the operational aspects of the system, or by external factors. Consequently, at times, the normal procurement cycle must be shortened in order for the appropriate goods or services to be obtained within the limited timeframe. However, excessive compression of the procurement schedule may result in increased risk as a result of too little time to properly plan the solicitation, develop the solicitation documents, less than thorough proposals, and increased contract prices due to the vendor's lack of preparation time, or an overly accelerated performance schedule.

vi. Complexity of the procurement

The size of the procurement may or may not correlate to the degree of risk presented by that procurement. Size, in and of itself, does not create complexity. Many procurements small in dollar amount, duration, or quantity can be highly complex from a technical or financial perspective. A procurement small in dollar amount may be associated with very sophisticated consulting or design. Factors that tend to make a procurement more complex include: (1) that the product or service being procured is highly complex from a technical perspective; (2) the contract is for more than one year; (3) the project has multiple funding sources; (4) the procurement involves the development of complex systems that impact operations; (5) the product or service requires interfacing or integration with other systems; and (6) there are a large number of stakeholders with varied interests. Failure to appreciate the intricacies associated with large and complex procurements may enhance the risk of failure.

vii. Safety concerns related to the procurement (system/product failure)

When examining a potential product or service, an examination should be made as to the direct and indirect consequences of failure. Examples include the risk inherent in the failure of system operating software, the failure of an operating component in a rail system, and the failure to timely repair infrastructure. Particularly when safety considerations are present, assuring the safe operation of a procured product or service is paramount.

3. Clarity and terms of the contract

i. Quality of the procurement documents

Overall procurement risk can be reduced by improving the quality and clarity of the procurement documents. The procurement documents should be drafted to allow both parties to understand the underlying need, the scope of work, the solicitation process, and the resulting contract requirements. An incomplete or unclear statement of work, or unclear contract terms allocating risks can lead to misinterpretation, changes, delays, and disputes. Time spent developing a specification and providing a quality document with clear terms will benefit both parties and go a long way toward producing a successful and beneficial contract.

Especially in low bid contracts, unclear specifications present significant risks to vendors. While the need to submit a competitive bid is always present, vendors need to protect themselves against the unknown requirements presented in the bid documents, which often means that the vendor will have to factor in cost allowance—or contingency—to cover the unknown factors. This results in unnecessarily increased costs for the agency—an outcome that can be avoided with better specifications.

ii. Schedule provisions

Most procurement documents set precise dates for such items as submittals, progress milestones, first article inspections, factory testing, and final delivery. The quality and clear definition of the schedule requirements will reduce or eliminate elements of risk to the benefit of both parties. Schedules can trigger other risk elements associated with other agency departments or third parties. Schedule clarity is essential for an effective procurement process.

iii. Pricing and payment terms

The need for clarity is particularly acute when dealing with pricing, both in how the pricing is identified within the procurement document and how the contract calls for payments to be made. The pricing structure detailed by the procurement document can greatly affect the bidder's financial risks and the overall pricing of the project. An agency should carefully analyze the price and payment structure to ensure that it has considered adequate sharing of risk for the most beneficial procurement. Clearly identified price and payment terms will assist an agency in obtaining the best procurement services and risk allocation for a given project.

iv. Authority-furnished property clause

When the procurement process entails authority-furnished equipment, several risk factors come into play that need careful consideration and analysis. Failure to spell out clearly in the solicitation the property to be provided and the terms under which it will be provided creates significant risk of ambiguities and conflict during contract performance. This risk must be weighed against the product, cost, and schedule benefit that usually occurs when authority-furnished equipment is provided. Making sure that the property is clearly described and outlined within the procurement document will lessen the risk of surprise (and perceived or actual contract changes) when it comes to receipt and use of the property or goods. See Recommended Practice for Owner-Furnished Property.

v. Changes clause

There is significant risk to both parties during contract administration due to potential changes and the process involved to incorporate changes into the contract. Most contracts anticipate changes and accommodate the through change order provisions or other clauses in the contract T&Cs. The changes clause typically allows the agency to make changes to the contract as long as those changes are within the contract's general scope, and describes how changes should be priced. A clear and reasonable changes clause reduces the risk of the agency not receiving what it actually needs.

vi. Termination clauses

Agencies should pay special attention to clauses that define the conditions under which the agency may terminate the contract either with or without cause. These contract terms are typically referred to as the *Termination for Default* clause, and the *Termination for Convenience* clause.

vii. Insurance requirements

The types and amount of insurance appropriate for any given procurement require an assessment of the risks each procurement presents. Excessive or unnecessary insurance requirements can cost agencies substantial sums and provide little or no benefit to the agency. Inadequate insurance requirements can present an excessive risk to the agency because of the potential that a loss will exceed the limits of coverage. Insurance professionals should be consulted in connection with major procurements to evaluate the need for insurance and to assist in making a financially sound decision regarding the types and levels of coverage to require. See White Paper on Professional Liability Insurance Coverage Issues.

viii. Indemnification provisions

Indemnification clauses are powerful risk-shifting tools. Often, these clauses are used in conjunction with insurance provisions to shift to the contractor the risks and costs related to project-related claims for personal injury or property damage. Insurance secured by the contractor protects the contractor from unexpected costs relating these types of occurrences. Indemnification clauses are frequently used to shift the risk of uninsurable economic losses to the contractor. Shifting the risk of uninsurable loss to the contractor often makes sense when the risk shifted is one which the contractor is in the best position to control. In contrast, shifting the risk of loss to a contractor for events or occurrences over which the contractor has little or no control creates a high level of risk for contractors. Contractors who do not protect themselves by adding contingencies in their bids or proposals can be put out of business if the risk event occurs and significant loss results. When such indemnification clauses are used, agencies can expect to pay more because of price increases to account for the risk, or because fewer contractors submit bids or proposals on such procurements.

ix. Disputes clause

Like most contracts, transit procurement contracts should have a clear disputes provision that establishes a fair and efficient procedure for the resolution of disputes arising under the contract. The dispute procedures should be tailored to the nature of the procurement, and should seek to facilitate resolution of disputes promptly and at the lowest level possible. A wide array of dispute resolution options exist. For major procurements, consideration should be given to the use of a phased procedure. Potential steps in the process can include required negotiations at the project management level; the use of a disputes review board for long-term construction contracts; non-binding mediation; and final resolution of the dispute by either arbitration or judicial proceeding. The disputes clause should provide a clear mechanism for resolving disputes as they arise, and avoid the temptation to defer dispute resolution to the end of the contract.

4. Character, or Reputation, of the Contracting Parties

The character, or reputation, of both the agency and the contractor can have a significant impact on the nature and magnitude of the risks presented by procurement and the willingness of the parties to tolerate those risks. Most procurements involve some level of trust, along with an analysis of the risk/reward benefit offered to both parties. An agency which uses unusually harsh T&Cs, does not pay promptly, or which tends to be unreasonable during the contract administration phase, may receive few or no bids. Similarly, a contractor or vendor with a history of unacceptable quality, a history of claims, or other unfavorable characteristics may cause an agency to reject its bid, which may lead to protests and disputes which will, at best, cost the authority money and delay the project, and may result in costly litigation.

Prior to issuing a solicitation, an agency should identify and address any special concerns pertaining to vendor reputation, character and trust. Use of a prequalification process or the inclusion of past references and project histories may assist an agency's analysis of a vendor's abilities, credibility, and general character. When attractive prices or regulatory requirements force an agency to accept a contractor with a bad reputation, the agency should consider supplementing its own staff to deal with whatever problems may arise. Likewise, when business conditions or interests cause a contractor to need to contract with an agency that has a less-than-stellar reputation, the contractor should supplement its own staff to deal with the problems that are expected to arise in light of the agency's reputation.

VII. Contract Administration Risk Management

Even the most thoughtful and well-constructed procurement documents cannot ensure a successful procurement. Both contracting parties must continue to assess and manage risk through the contract administration phase of the procurement. Both parties need well trained and experienced contract administrators. Each party should strive to treat the other with respect and should work cooperatively to resolve disagreements. Disputes should be resolved promptly to minimize the risk of damage to the parties' working relationship. Agencies should provide effective yet reasonable project oversight, should employ a sufficient number of competent inspectors, and should pay contractors promptly. Risks will present themselves throughout the contract administration phase, and project success will depend in large part on how effectively the contracting parties mitigate and manage those risks.

VIII. Conclusion

The purpose of this paper has been to provide an overview of the transit procurement stakeholders, risk types, variables affecting risk, and potential avoidance, allocation, and minimization options. The Contract Risk Allocation working group is prepared to address specific issues to the extent the Oversight Committee considers it beneficial.