

Public-Private Partnerships and the Design Firm

Recognizing that traditional public funding will not always be available, governmental agencies are using innovative public-private partnership (P3) models to incentivize their private-sector partners to deliver much needed local projects. For many engineers, P3 is already a familiar method of project delivery for infrastructure such as roads, bridges, tunnels, and transit. Architects are finding that local communities are also considering P3 for other types of building projects, including athletic facilities, museums, parking garages, courthouses, libraries, and affordable housing.

Simply stated, a P3 exists when a public entity retains a private entity to finance, design, and build a project that will deliver a benefit to the public. Often, the P3 consortium will be responsible for maintenance and operations over an extended period of time, up to 30 years. One thing is certain: private entities—and their investors and lenders—will only support P3 projects when they have confidence that the revenue stream will deliver an acceptable return on investment. The developer is then under tremendous pressure to deliver the promised financial return to investors.

Design professionals normally provide services on P3s through a design-build approach. A number of considerations exist for design professionals providing services in this manner:

Risks to Design Firms

Conflicting Cultures

Design professionals and builders have to adapt their relationships to succeed on design-build projects. Design professionals who are accustomed to serving first and foremost the needs of the owner may find it difficult to redirect that allegiance to the builder.

The High Cost to Compete

Design firms need to carefully consider the business risk of participating in a P3 competition, which is an enhanced form of design-build competition requiring significant at-risk design services. A well-crafted teaming agreement that details how proposal costs will be shared (and which may provide for a “success” fee if the team wins the competition) will help to identify and manage the up-front risks.

Delayed Payment

Even after being awarded the project, it is not unusual for the design-builder to ask that the design firms defer payment until project funding is available. The design services agreement should provide the right to collect interest, suspend services for non-payment, and terminate for cause (with all costs, overhead, and profit paid) if payment is delayed indefinitely.

Qualifications Based Selection of Design Firms Is Not Required

In lieu of a qualifications-based selection (QBS) process, owners may elect to follow a one-step process, which would result in selecting the design-builder solely on the basis of price. Design firms that have prior successful experiences working with selected construction contractors may be better positioned to negotiate reasonable fees.

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Performance-Based Contracting and Performance Guarantees

Many design firms are drawn to the idea of receiving additional incentive-fee compensation for a project that performs well according to an objective measurement. The flipside of such performance-based contracting is that an incentive may turn into a penalty when failing to meet desired performance. Contract language will be key to determining liability insurance coverage, as any express warranty or guarantee will trigger the contractual liability exclusion in the policy.

Equity Investment and Contractual Risk

The design-builder in a P3 project often takes a substantial equity position in the project as a prerequisite to being retained by the developer. Diligent review and negotiation of the professional services agreements are necessary for design firms to avoid unfair and uninsurable risk that the design-builder will attempt to “flow down” to the design team. Design firms with cash in the bank and business-savvy leadership may find ways to make an equity investment in the project, perhaps funded by its sweat equity. Consultation with both legal and insurance counsel experienced in P3 delivery is advised.

Revenue Projections

Design firms that provide estimates of future use (such as traffic forecasts) take on the added risk that their projections may not materialize. The design firm could be seen as owing a fiduciary duty to the client either through contractual language or its own words and deeds. To avoid this risk, the design contract should expressly disclaim any fiduciary duty, and any obligations to “act in the client’s best interest” should be deleted.

Extended Operation and Maintenance Period

If an operation and maintenance problem arises that could be related to the project’s design, and the developer’s revenue is cut for that reason, they may make a claim against the design firm to recover that lost revenue. Design services contracts should be written to avoid third-party beneficiaries and consequential damages, establish a reasonable limitations of claims period, and provide a limitation of liability.

Conclusion

The trend toward P3 may require a substantial amount of adaptation from design firms, but certain fundamentals will not change. Managing the financial risks of competitive pursuits, maintaining professional liability insurance, and entering into contracts that fairly allocate risk will still be critically important.

Position your firm to take advantage of P3 opportunities:

- Seek out design-build contractors as clients to gain experience and develop relationships
- Choose those design-build contractor clients with care and due diligence

Negotiate contract clauses that fairly allocate risk:

- Provide a reasonable professional standard of care applicable to all services
- Disclaim warranties, guarantees, third-party beneficiaries, and a fiduciary duty
- Include a waiver of consequential damages and limitation of liability



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