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Construction Lessons Learned No. 32 – Guaranteed Maximum Price (GMP) contracts can be challenged

Two projects, same issue, different results:

General contractor-provided labor was charged to the projects at actual wage cost but a multiplier for the labor burden – statutory taxes, medical, vacation, holiday, etc. - was a set percentage instead of the actual cost to the general contractors (GC). On one project (we'll call it the Tilt-A-Whirl Amusement Ride construction project, to protect the innocent) the stated charge for labor burdens was 40%, and on the other (we'll call this one the Tunnel-Of-Terror Water Ride construction project to protect the guilty) it was 49%. For example, if the actual amount of labor cost was $100 per hour, the 40% burden multiplier, or adder, brought the final cost of that hour of labor to $140.

Both contracts were of the form Guaranteed Maximum Price (GMP). A GMP contract means that for a particular scope of work, as defined in the ready-for-construction drawings, the GC cannot charge more (the guarantee) than say $100 million for a nice new hotel. However, a GMP contract always has a stated cost for GC overhead and profit (OH&P), usually a percentage of direct subcontractor labor, and must support all charges to the project with evidence of actual costs. Such acceptable cost support includes, but is not limited to invoices for subcontractors, equipment rentals, site trailers and the cost of the Philadelphia Eagles tickets for certain parties in interest (see upcoming Construction Lessons Learned No 64 - Insurance Claims On Substandard Concrete).

A GMP contract is not a Lump Sum contract. If the final costs are less than the GMP price of $100 million for that shiny new hotel, the developer pays only the lower cost and the difference is savings to the owner. In some cases GMP contracts include a contractor savings clause, which allows the owner and the GC to both share in the benefits of the cost savings, which has its own pitfalls (look for upcoming Lessons Learned No 18 – Contractor Savings Clauses Run Amok).

In the subject projects, DLA took the position that the intent, within the "four corners of the contract", was actual cost plus a fee and the terms of the 40% and 49% were unreasonable, excessive and must have included unintentional profit and violated the spirit of the agreement. Both GC's understandably pounded the table and pointed to the offending sentence as a valid and legitimate term and reimbursement of actual costs. DLA pounded the table back, albeit a bit harder, and said that if this was their actual cost, prove it and the rides will swirl and splash and life will go on.

The GC for the Tilt-A-Whirl project had previously admitted to an unrelated benefits calculation that resulted in a 100% recovery rate on a $1.2 million calculation "error", so he was on the ropes already and reluctantly agreed to provide their actual benefits costs. Their schedule was in the form of a spreadsheet of approximately 600 pages on a scale of 4 pages wide. The Tunnel-Of-Terror Water Ride GC also eventually relented, though would only allow a review in their offices (given the confidential nature of salaries, among reason given). At this meeting the GC would only print out the burden costs one person at a time, in 10 minute intervals, and in a type font size about 2.5mm.

Analysis of Tilt-A-Whirl GC's burden schedule revealed a 32% actual cost vs. the contractual charge to the project of 40%, while Tunnel-Of-Terror GC's cost, in a more expensive project location, was 37% vs. the contractual charge of 49%. Tunnel-Of-Terror GC "lawyered up" because of this, as well as other grievous sins which meant the poor Owner (not too far from the truth) had to in turn lawyer up. Owner's lawyer was not a table pounder and caved under the weight of the offending 49% sentence (but won on other issues, we must add). Tilt-A-Whirl GC, meanwhile, still tangled in the ropes of its earlier benefits burden transgression, and mired in other unrelated overcharges grabbed a life line, coughed and sputtered and settled while still pointing at the contract.

The moral of this tale is simple and threefold: Always pay labor at actual costs; hire good construction counsel; and just because an unfavorable contract term is discovered during an audit doesn't mean you shouldn't challenge it.