Introduction

Negotiations take place every day in almost every aspect of our lives. We negotiate with our spouses over the color of the new couch, with our children over how many brussel sprouts they will agree to eat, or with a colleague over where to have lunch. The list goes on and on, and in most cases we never think about the process of negotiation.

The purpose of Mutual Gains Negotiations Training is to encourage preparation for negotiations beforehand, with the goal of producing agreements that can increase the benefit to all parties involved.

Introduction

Although Mutual Gains Negotiations is not a rigid process, for training purposes, we will be looking at four steps that may serve as guidelines for productive negotiations:

- Prepare
- Create Value
- Distribute Value, and
- Follow-up

The following lessons will break down these steps and introduce several concepts and terms that are utilized in Mutual Gains.

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Step 1: Prepare

Although many negotiations are similar, none are identical. Every negotiation deserves preparation, no matter how similar to the one before.

The preparation step should be done by each party involved, and should occur before any negotiating actually takes place.

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Step 1: Prepare

Determine Your Purpose and Define Your Team

The preparation step **IS NOT** asking yourself:

- What do I hope to get out of this negotiation? We will address this later.

Preparation does involve answering the question:

- What is my role in the negotiation, and who will assist me in the process?

Step 1: Prepare

Determine Your Purpose and Define Your Team

When the role or authority of team members is unclear or unknown, it is possible that negotiations can become stagnant or unsuccessful.

As a team or individual representing one side of a negotiation, each member must understand:

- Who will gather what information?
- Who will participate in the negotiations?
- Who has the authority in the negotiations?

Step 1: Prepare

Determine Your Purpose and Define Your Team

Who will gather what information?

Depending on your organization's structure, it is possible that various individuals or offices will have access to necessary information needed during negotiations.

For example, if you are a consultant, your Human Resources office may need to compile the salary information, while the work effort estimate may need to be established by the Project Manager or Senior Engineer.

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Step 1: Prepare

Determine Your Purpose and Define Your Team

Who will participate in the negotiations?

Not everyone involved with the team's research will have an active role during the negotiation. To avoid confusion and frustration for all parties, establish who will need to attend the negotiation, and who may simply need to be available as a resource for questions.

Step 1: Prepare

Determine Your Purpose and Define Your Team

Who has the authority in the negotiations?

At the onset, establish who will have the "final decision" in each area of the negotiation. This will reduce the chance of having to table an issue or the need to revisit topics. When the authority is clear, participants are more comfortable with the final product.

Step 1: Prepare

Estimate Your BATNA and Theirs

BATNA

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Next

Step 1: Prepare

Estimate Your BATNA and Theirs

What Is Your BATNA?

A **BATNA** is your **B**est **A**lternative to a **N**egotiated **A**greement.

Your BATNA is the best you can do without coming to an agreement. In other words, your BATNA is not what you prefer to accept, but is the option available if you do not accept any offer.

Step 1: Prepare

Estimate Your BATNA and Theirs

In any negotiation, it is important to protect yourself.

Saying yes for the sake of "closing a deal" is not a sound business decision. You must recognize that sometimes it just isn't in your best interest to complete a negotiated agreement.

"Agree to disagree."

Step 1: Prepare

Estimate Your BATNA and Theirs

Remember when working to estimate your BATNA, this is not a negative thing.

Your BATNA should be what you would prefer to do if an agreement cannot be reached.

Step 1: Prepare

Estimate Your BATNA and Theirs

Many times parties leave a negotiation unsatisfied because they failed to establish their BATNA prior to negotiating. As a negotiator, it is crucial that you know your BATNA to ensure a "mutual gain negotiation" can take place. If you have a legitimate BATNA, and the offer on the table is not better, accept your BATNA and walk away. In Mutual Gains Negotiation Classroom Training we will spend more time on creating and improving your BATNA.

Note: Often the negotiator does not have the authority to establish the BATNA and walk away. In this case it is very important that the roles and authority of the negotiators are outlined in the first step of your preparation.

Step 1: Prepare

Estimate Your BATNA and Theirs

When estimating the BATNA of your counterpart it is important that you put yourself in their shoes and think objectively. Many times, when this type of "role reversal" takes place, objectivity is not present. You must try to put yourself in their shoes.

It is realized that you will not be able to accurately estimate their BATNA because you do not have all the necessary information at your disposal. However, you should be able to make a reasonable guess.

Step 1: Prepare

Try To Improve Your BATNA

Take a long look at your BATNA. Remember, **your BATNA is your Best Alternative to a Negotiated Agreement**; it is not what you prefer to accept, but is the option available if you do not accept any offer.

Step 1: Prepare

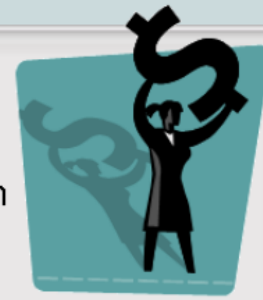
Try To Improve Your BATNA

You may decide to call a meeting to review, receive comments, or brainstorm ways to improve your BATNA. Reconsider the following:

- If we don't sign this agreement, will we be better off financially?
- How long will it take us to come to an agreement with another party that would be mutually beneficial?
- Is my BATNA based on facts?
- Remember, that in most cases, there is a time value to money.

Step 1: Prepare

Define Your Interests



Defining your interests is really quite simple, yet overlooked in many negotiations.

Take time to evaluate and define your party's interest in the agreement. When you have well-defined interests, you can negotiate based on your interest alone, and not on opinion or position.

A common misconception is that price and profitability are the only interests for both parties. Therefore price and profitability receive all the attention and focus during negotiations. Consider whether there are other items of importance to the negotiation such as quality, schedule, relationship, public perception, etc. The interest list could be quite extensive.

Step 1: Prepare

Try To Estimate Their Interests

In all negotiations, it is in your best interest to know the other party's interests.

In fact, it is also in your best interest for the other party to know your interests. Take time to estimate what the other party's interests are in this negotiation. **Remember, there are usually many more interests to consider other than price and profitability.**

Step 1: Prepare

Prepare Options That Could Benefit Both Parties

Often during negotiations, options remain that are never considered; therefore, leaving missed opportunities for all parties.

Try to “get outside the box” and consider options that may not have yet been thought of. Time spent on this step will depend on your level of commitment to creating options.

Step 2: Create Value

Creating value involves interaction between the parties that are in negotiation.

It is very important that special attention be given to this step, and concerted effort made toward creating value.

Step 2: Create Value

To encourage open discussion and to protect all parties, it is recommended that this step be reserved as a "brainstorming session" that is separate from a negotiating session.

Step 2: Create Value

Since, in the transportation industry, parties are accustomed to meeting solely for the purpose of negotiating or reaching an agreement, it is suggested that an independent session be established specifically for brainstorming or "creating value."

Setting time aside to "create value" as a separate function from "deciding on an agreement" would be worthwhile in any negotiation.

Step 2: Create Value

Whether realized, individuals often create value in many "everyday" negotiations. For example, when shopping for a vehicle you might say:

"I like the style of this compact car, but I really need a vehicle that will accommodate seven passengers."

"Yes, the 08's are very sharp, but are there rebates on the 07's?"

Step 2: Create Value

Open discussion may also be an opportune time to establish guidelines for your negotiation and to ensure that each party understands and is in agreement.

Important guidelines should include:

- Ensuring criticism is avoided
- Establishing a time frame for the negotiation
- Setting an agenda (what you hope to accomplish and when)
- Establishing the course of action when an impasse is reached
  - Table the issue?
  - Seek mediation?

Step 2: Create Value

Talk About the Interests of Both Parties

Don't be afraid to express your interests; it is necessary in achieving your desires.

In Mutual Gains Negotiations, **ALWAYS** reveal your interests, but **NEVER** reveal your BATNA. An item that is of high interest to one party may be insignificant to the other party, therefore, it could possibly be obtained by the interested party during the negotiation.

Step 2: Create Value

Come Up With Suggestions Without Committing to the Product

During the "brainstorming session" all parties should have the freedom to say "What if we..."

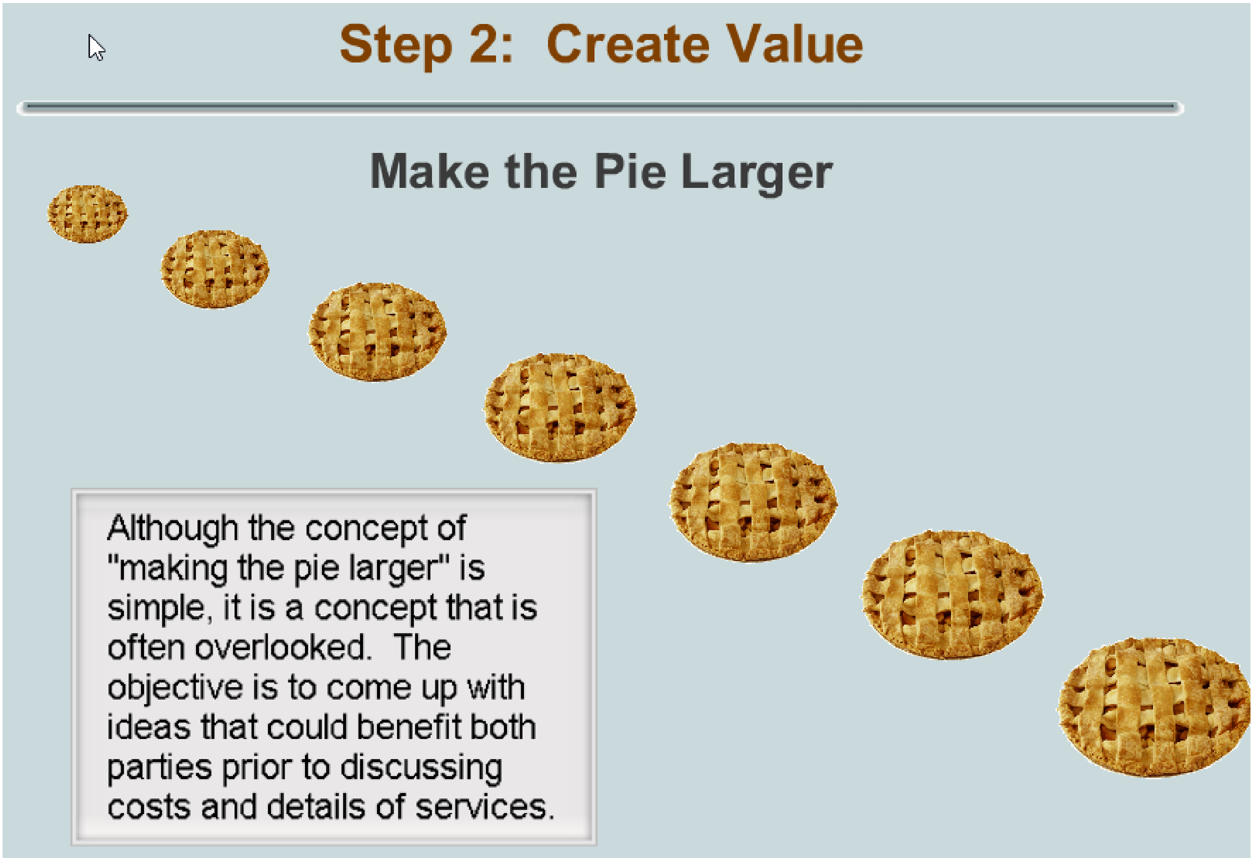
This statement may open doors and avenues to the negotiation that have not yet been considered.

Step 2: Create Value

Come Up With Suggestions Without Committing to the Product

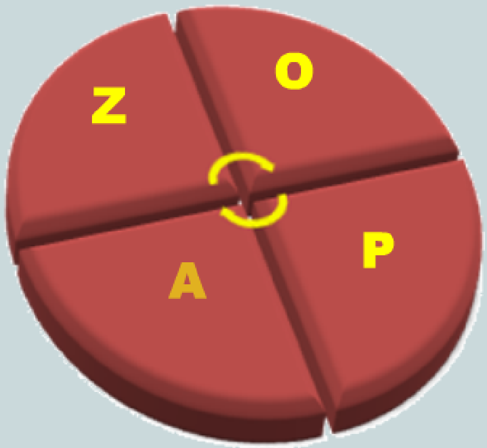
You may try proposing several ideas at once. This will imply that you are open to options. This brainstorming session is for the purpose of creating new ideas about your agreement without having to commit to these new ideas.

Be Creative!


Step 2: Create Value
Make the Pie Larger
Although the concept of "making the pie larger" is simple, it is a concept that is often overlooked. The objective is to come up with ideas that could benefit both parties prior to discussing costs and details of services.

Step 2: Create Value

Make the Pie Larger



ZOPA

The "pie" could also be referred to as the **Zone of Possible Agreement**, or ZOPA.

The ZOPA is the area that is better than either party's BATNA while being within the practical constraints of reality.

Often parties will settle for something just a little better than their BATNA without entertaining the idea of getting something more.

Step 2: Create Value

Make the Pie Larger

ZOPA

Let's imagine that a small town recreation department is in need of outsourcing the management and facilitation of the concession stand at their local Little League baseball field.

The department would like someone to keep the stand open throughout the summer and provide quality service and products to the public. It would also like to receive a certain portion of the proceeds to improve the park facility, take care of other needs (such as hiring someone to work at the park entrances to ensure no contraband is brought into the park), and to collect admission fees.

Step 2: Create Value

Make the Pie Larger

ZOPA

The department advertised the contract in a manner that would allow maximum flexibility and has selected Fan-Cession, Inc., a company it believes possesses the experience to provide good services.

As the parties prepare to negotiate the agreement, Fan-Cession recognizes some of the other needs of the park, and offers to also provide gate personnel if a fair price can be reached.

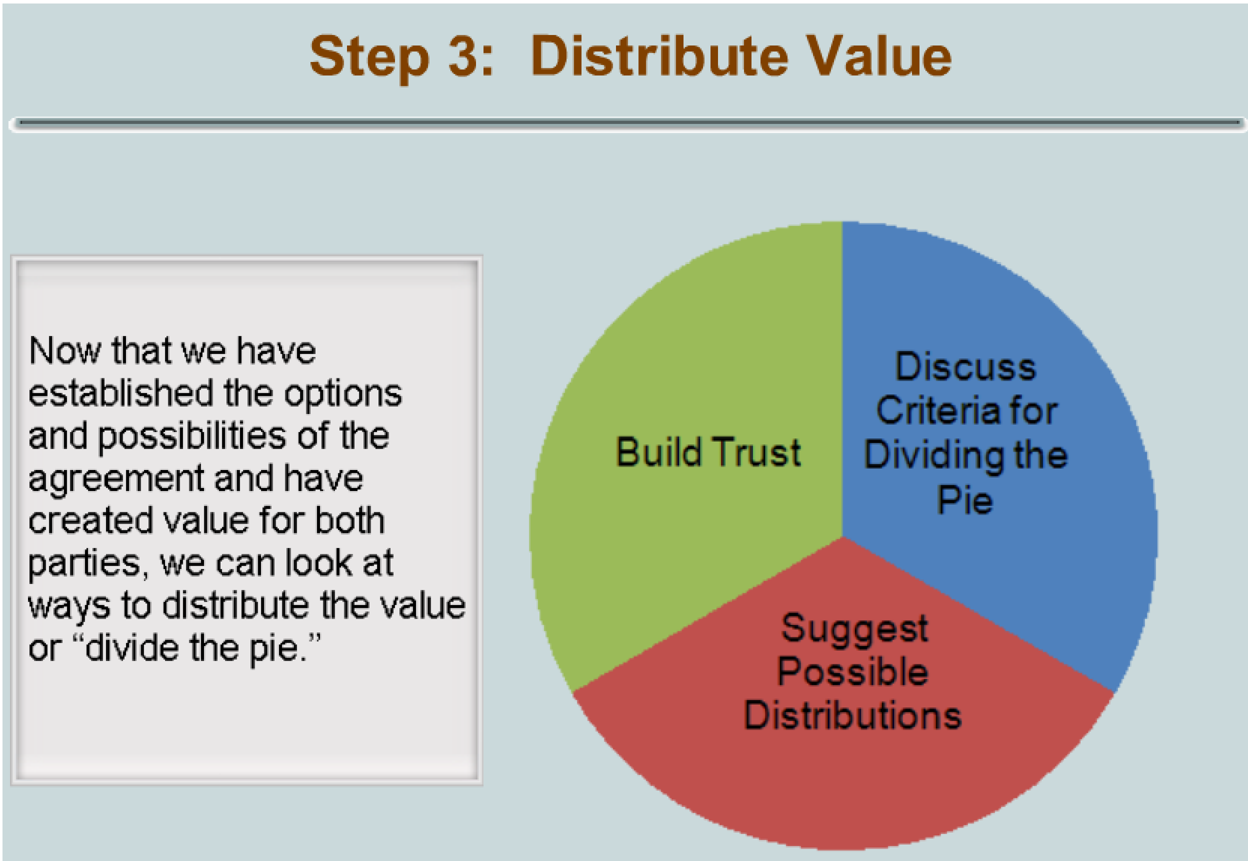
After this offer, the recreation department notes that there is also a need for maintenance during and after “high traffic” events and it would like to entertain the possibility that Fan-Cession will provide these services as well.

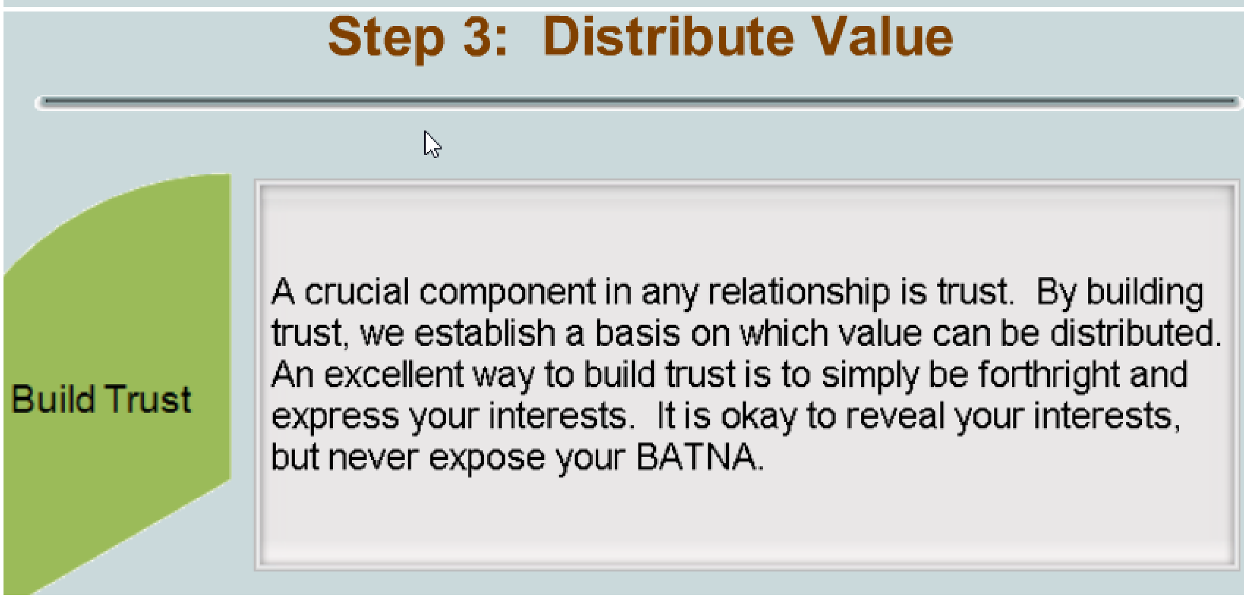
Step 2: Create Value

Make the Pie Larger

ZOPA

In this example, both Fan-Cession and the recreation department created ways to make the pie larger for both parties.

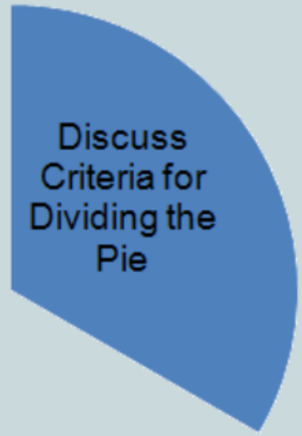

Step 3: Distribute Value
Now that we have established the options and possibilities of the agreement and have created value for both parties, we can look at ways to distribute the value or "divide the pie."
Build Trust
Discuss Criteria for Dividing the Pie
Suggest Possible Distributions


Step 3: Distribute Value
Build Trust
A crucial component in any relationship is trust. By building trust, we establish a basis on which value can be distributed. An excellent way to build trust is to simply be forthright and express your interests. It is okay to reveal your interests, but never expose your BATNA.

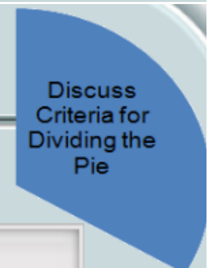
Step 3: Distribute Value

When discussing how the pie will be divided, it is important to stress the desire to create joint gain.

Often in negotiations, both parties leave too much of the pie on the table. During the Creating Value discussion, the “pie” was referred as the ZOPA (Zone of Possible Agreement). If both parties have objectively contributed toward broadening the ZOPA, there will be items available that will benefit each party without putting an undue burden on the other.



Step 3: Distribute Value



Again, consider the example of the city recreation department and the concession vendor.

What if the possibility of a long-term contract were available? Would Fan-Cession be more likely to take a lower price in exchange for the possibility of providing continued services?

This is another example of broadening the ZOPA and dividing the pie in a manner that could be beneficial for both parties.

Step 3: Distribute Value

Discuss Criteria for Dividing the Pie

While discussing how the pie will be divided, it is important to establish ground rules:

THE RECREATION DEPARTMENT: “First, I would like to discuss what needs to be accomplished, getting a concession vendor in place, and then I will be happy to entertain other options that will benefit both parties.”

FAN-CESSION, INC: “I think that is a great idea. Since the length of this contract will have an impact on our personnel, let's discuss the time frame next.”

Step 3: Distribute Value

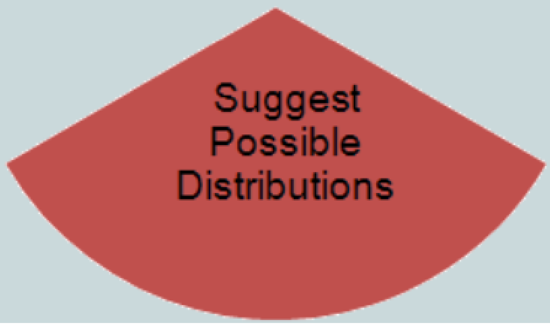
Discuss Criteria for Dividing the Pie

In discussing ZOPA, we have created an agenda to follow for the negotiations.

It is important to note, however, that the objective of mutual gains is to view the agreement as a whole and recognize the impact it will have on both parties. It is important to develop solutions for issues while still leaving them open for discussion.

Step 3: Distribute Value

Everyone prefers choices; this is why car manufacturers make various colors and models. When negotiating an agreement, establish different choices or methods to distribute the value and make them available for discussion.



Step 3: Distribute Value

Suggest Possible Distributions

As someone representing your organization, try to establish at least three possible options:

> Option 1: One that would be beneficial to you while fair to your counterpart.
>
> Option 2: One that would accomplish what you would like, but would "throw a bone" to the other party.
>
> Option 3: One that is better than both your BATNA and their's (perhaps a last option).

Once each party has prepared these options, consider ways they can be combined to reach a consensus and move forward with an agreement.

Step 4: Follow Up

Make Sure Commitments Can Be Easily Reached

Now that an agreement has been reached, it is truly in the best interest of all parties to ensure that it is a success.

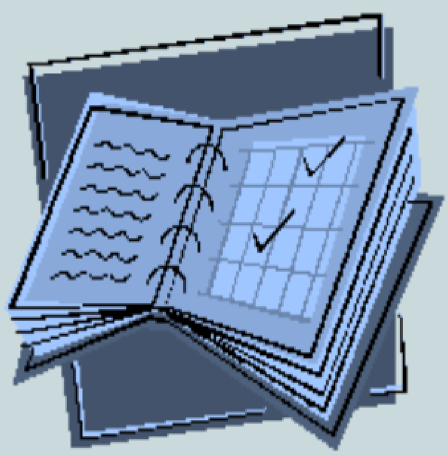
To do so, each party should strive to ensure that the commitments and goals of the agreement are met in full and on schedule. It's not enough to create solutions that are good only on paper; everyone must work to achieve the purpose of that agreement.

Step 4: Follow Up

Establish Periodic Reviews of the Agreement

The best planning and forethought does not always guarantee success. Even the best negotiated and crafted agreements can run into difficulties along the way.

To reduce the chance of unexpected failures, periodic reviews of your agreement should be scheduled to ensure everything is going as planned.



Step 4: Follow Up

Establish Periodic Reviews of the Agreement

Create a list of questions that should be reviewed periodically:

- Is everything on schedule?
- How are we doing on our commitments?
- Does the budget look okay?

These are just a few questions that can be asked by both parties of any agreement. Prepare a list of questions that should be asked about the agreement and set a reasonable schedule to review those items.

Step 4: Follow Up

Improve the Relationships

It's a simple fact; better relationships equal better outcomes.

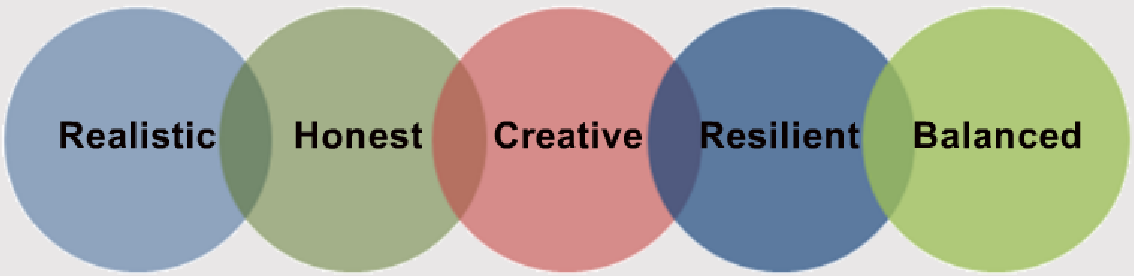
Think about a basketball team. In order to be successful, the team members must have a good on-court relationship with one another. If one team member is always taking the ball and refusing to pass, or another team member will not set a pick to allow his teammate to get an open shot, then the team will not be successful.

Step 4: Follow Up

Improve the Relationships

If you want your current agreement to be successful, and if you have hopes of pursuing other successful agreements, you must work on the relationships of all parties.

What are some common terms to describe successful relationships?



If both parties strive to attain these relationship goals, the agreements they craft together will benefit and improve over time.

FDOT Negotiation Handbook

To assist Department staff and Consultant partners with negotiations of professional services consultant contracts, the Florida Department of Transportation, Procurement Office, maintains a Negotiation Handbook.

In this lesson we will review the Handbook for the purpose of improving your understanding of FDOT Consultant contract negotiations.

FDOT Negotiation Handbook

Florida law requires state agencies to acquire Professional Services by competitive negotiation. The process mandated by Florida Statutes (287.055, 337.107 and 337.1075), Florida Administrative Code (Rule14-75), and departmental procedure (No. 375-030-002, Acquisition of Professional Services) requires a competitive selection of the consultants based on qualifications, followed by a competitive negotiation process to establish a fee for the desired services.

Select to open URL and bookmark Florida Statute 287.055

Select to open URL and bookmark Florida Statute 337.107

Select to open URL and bookmark Florida Statute 337.1075

Select to open URL and bookmark Administrative Rule 14-75

Select to open URL and bookmark FDOT Procedure No. 375-030-002

FDOT Negotiation Handbook

The objective of the total Consultant acquisition process is the selection of a well-qualified firm at a fee that is fair, competitive and reasonable to both the state agency and the Consultant.

FDOT Negotiation Handbook

Negotiations should be conducted in good faith, recognizing that compromise may be required to achieve an equitable contract.

The Department's negotiators must recognize the legitimate interest of the Consultant industry in recovering their costs and making a reasonable profit when performing work for the Department.

Conversely, the consultants must recognize the legitimate interest of the Department in receiving quality work at a fair, competitive and reasonable cost to accomplish the work program while maximizing the use of taxpayers' dollars.

A contract that is beneficial to both parties is the desired outcome of a successful negotiation.

FDOT Negotiation Handbook

The negotiation portion of the Consultant acquisition process consists of establishing agreement between the Department and the Consultant on the following major points:

1. Scope of services to be performed

2. Work effort required (both quantity and level of personnel required)

3. Cost of services
    a. Wage rates (or billing rates for some services)
    b. Overhead rate
    c. Direct expense rate
    d. FCCM rate
    e. Operating margin
    f. Subconsultant costs

4. Method of compensation

Although these items are listed separately, it is important to note that the negotiation process should be viewed as a whole, and it is believed that greater value may be generated by looking at all components together.

FDOT Negotiation Handbook

The Negotiation Handbook addresses each of these components.

Although the purpose of the Handbook is to serve as a guideline, it is important that the process be followed to ensure fair, equitable negotiations among all Consultant and Department staff.

FDOT Negotiation Handbook

Fee Proposals

Florida Statutes specifically require the Department to conduct a detailed analysis of costs for contracts acquired under the Consultants Competitive Negotiation Act (F.S. 287.055).

The fee proposal must provide sufficient information to allow this. It is the obligation of the Professional Services Office to review the proposal and bring any errors, omissions, or deficiencies to the attention of the Consultant immediately.

It should also be understood that the acceptance of the documentation does not guarantee agreement to the proposed fee.

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

The fee paid to a consultant firm is determined using the standard contract cost elements of:

- Direct labor costs (direct payroll, substantiated by payroll registers)
- Direct expense percentage (audited rate)
- Overhead (audited indirect labor rate)
- Facilities Capital Cost of Money (audited rate), and
- Operating margin

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

Overhead is defined as follows:

The Department reimburses a consultant's indirect costs of contract operations using an overhead rate, often referred to as a combined overhead rate.

The "combined" rate is the total of the "Fringe Benefit" costs and the "General Overhead" costs in relation to the direct labor base.

Fringe benefits are non-salary costs associated with employees and employment taxes and are always treated as indirect costs by the Department.

General overhead includes all other indirect costs, including Indirect Labor.

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

Direct Expense percentage is defined as follows:

All professional services contracts negotiated since October 1, 2003 have included reimbursement of direct expenses by application of a **direct expense rate** based on the audit listing of direct costs in relation to the direct labor base. The direct expense rate shall be applied to the direct salary costs.

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

Operating Margin is defined as follows:

Operating margin is intended to compensate the Consultant for those normal business expenses which are excluded from allowable overhead by Federal Regulation (e.g., interest, advertising, bad debts, unrecovered direct costs, etc.) as well as provide the Consultant with a reasonable profit. The range is 12% to 42%, applied to the direct salary costs. Four major criteria are considered when determining operating margin: complexity of project, risk, schedule, and cost control efforts.

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

Facilities Capital Cost of Money (FCCM) is defined as follows:

The FCCM rate reimburses the cost of maintaining the facilities necessary to perform professional services for the Department, instead of investing the capital in other opportunities. There is a single FCCM rate for the firm as a whole, based on total direct labor (Home + Field).

FCCM is determined from the "average net book value" of the consultant's capital assets and rates covering six-month periods established and published by the U.S. Office of Management and Budget.

FCCM rates are applied to the direct salary costs.

FDOT Negotiation Handbook

Calculating the Fee Paid to a Consultant

The fee calculation for a contract is as follows:

Direct Labor (DL) is the raw unburdened labor = Staff Hours x direct labor rate

Overhead (OH) = Audited Overhead Percentage

Operating Margin (OM) = Operating Margin Percentage

Direct Expense (DE) = Audited Direct Expense Percentage

Facilities Capital Cost of Money = FCCM

Total fee = DL + [(OH + OM + DE + FCCM) x DL]

FDOT Negotiation Handbook

Fee Proposals

In an effort to achieve uniformity in cost proposals, the Department has established the Automated Fee Proposal (AFP).

The AFP allows the Consultant to provide the department the necessary information for negotiations in a standard format that can easily be updated and maintained for the purpose of future audits.

The AFP combined with minimal supporting documentation provides sufficient information to support the cost of the Profession Services Agreement.

FDOT Negotiation Handbook

Fee Proposals

Information, training, manuals, and updates to the Automated Fee Proposal may be downloaded from the Department's Procurement Office web site at:

http://www.dot.state.fl.us/procurement/forms/formmenu.shtm

Select to open URL and bookmark Automated Fee Proposal

FDOT Negotiation Handbook

Scope of Services

The scope of services is one of the major factors affecting the fee for Consultant services since it defines the nature and volume of work to be performed.

A well written scope of services establishes the tasks to be performed, materials to be delivered, meetings to be attended, schedule to be met, equipment that will be used, standards that will be followed, and responsibilities of both the Consultant and the Department.

The scope of services should be carefully reviewed and agreed upon to assure a mutual understanding of the product and create value for both parties.

FDOT Negotiation Handbook

Scope of Services

Typical items within the scope of services requiring negotiation are:

- Tasks, subtasks
- Deliverables
- Standards, policies, and guidelines to be followed
- Number of and types of meetings, presentations, etc., to be attended or provided
- Schedule for project services
- Division of responsibilities and relationship between Consultant and Department

FDOT Negotiation Handbook

Work Effort

The objective of this process is to ensure that the proposed staff hours are reasonable for the specific project. It is also critical to determine if a reasonable distribution of work among various levels of staff is proposed to ensure the most economical staffing commensurate with the complexity of the project.

FDOT Negotiation Handbook

Work Effort

Upon receipt by the Department of the Consultant's staff hour estimate, the Department's estimate shall be provided to the Consultant.

The Consultant's staff hour estimate should be compared with the Department's and the differences evaluated. Discussions will be conducted with the Consultant to resolve differences between the Department and Consultant staff hour estimates.

As with the entire negotiations process, a record should be kept of the key points discussed and the resulting resolution.

FDOT Negotiation Handbook

Work Effort

Some items relating to work effort include, but are not limited to:

- Staff hours, overtime, survey crew days, etc.
- Levels of personnel required
- Distribution of work among levels of personnel
- Subconsultants (quantity of work effort, personnel)
- Delineation of work to be provided by Consultant, the Department or others

FDOT Negotiation Handbook

Cost of Services

There are many items included in the cost of services, some are negotiable while others are fixed in nature due to federal audit guidelines. Some items that need to be taken into consideration for cost of services are:

- Wage or billing rates
- Overhead percentages
- Direct expense percentage
- Subconsultant costs

FDOT Negotiation Handbook

Cost of Services

To assist with the negotiation of these items, the Department collects data of all proposed and negotiated wage rates for standard job classifications, as well as average audited Overhead, Direct Expense, and FCCM.

Average wage rates are published on the Department's Procurement web site, and are updated nightly. Average audited Overhead, Direct Expense, and FCCM rates are updated annually, and are available in the Negotiation Handbook.

Select to open URL and bookmark FDOT Negotiations Web Page

FDOT Negotiation Handbook

Operating Margin

The operating margin paid in a Consultant contract does ***NOT*** represent net profit to the Consultant.

Consultants have normal business expenses that are excluded from allowable overhead by Federal Regulations (e.g., interest, advertising, bad debts, unrecovered direct costs, etc.). These legitimate costs cannot be recovered on FDOT contracts except through operating margin.

Operating margin compensates the Consultant with a reasonable fee.

FDOT Negotiation Handbook

Operating Margin

Operating margin in FDOT contracts is generally calculated as a percentage of direct salaries.

The percentage is negotiated within a range of 12 to 42 percent. The resulting dollar amount is the "fixed fee" portion of a cost plus fixed fee type contract or becomes part of the total fixed price in a lump sum agreement.

The negotiation of operating margin as a fixed fee provides an incentive for the Consultant to efficiently complete the contract requirements. Completing the contract with less than the estimated costs (excluding the fixed fee) benefits both the Department (lower overall contract cost) and the Consultant (higher profit margin).

FHWA will not participate in cost plus percentage of fee for operating margin unless the Consultant's operating margin is established as a fixed fee.

FDOT Negotiation Handbook

Operating Margin

For non-federally funded contracts, operating margin may be compensated on the basis of "cost plus percentage of cost". Cost plus percentage of cost is defined as the use of a fixed percentage operating margin, applied to direct salary costs.

FDOT Negotiation Handbook

Recent Changes to Operating Margin Guidelines

Effective January 1, 2009, the Department's Operating Margin Guidelines used to negotiate contract operating margin will be updated. The changes are the recommendations of the FDOT/FICE Negotiations Sub Task Team, and have been fully reviewed and approved by the FDOT/FICE Negotiations Task Team, the FDOT/FICE Liaison Committee, and the FDOT Executive Board.

FDOT Negotiation Handbook

Recent Changes to Operating Margin Guidelines

The intent of the changes to the Guidelines was to make operating margin more sensitive to individual firms and the project requirements, and avoid developing a hard and fast formula.

FDOT Negotiation Handbook

Recent Changes to Operating Margin Guidelines

What were the changes?

- The definitions of the four criteria considered in negotiating operating margin were expanded.
- The suggested standards for each of the criteria were revised, adding a Medium Standard.
- The list of typical project types associated with each of the criteria was expanded.
- The spread of the ranges for each criterion was modified, giving more emphasis to the cost control efforts.

FDOT Negotiation Handbook

Recent Changes to Operating Margin Guidelines

The new Operating Margin Guidelines are addressed in this CBT, on the next slides to follow.

FDOT Negotiation Handbook

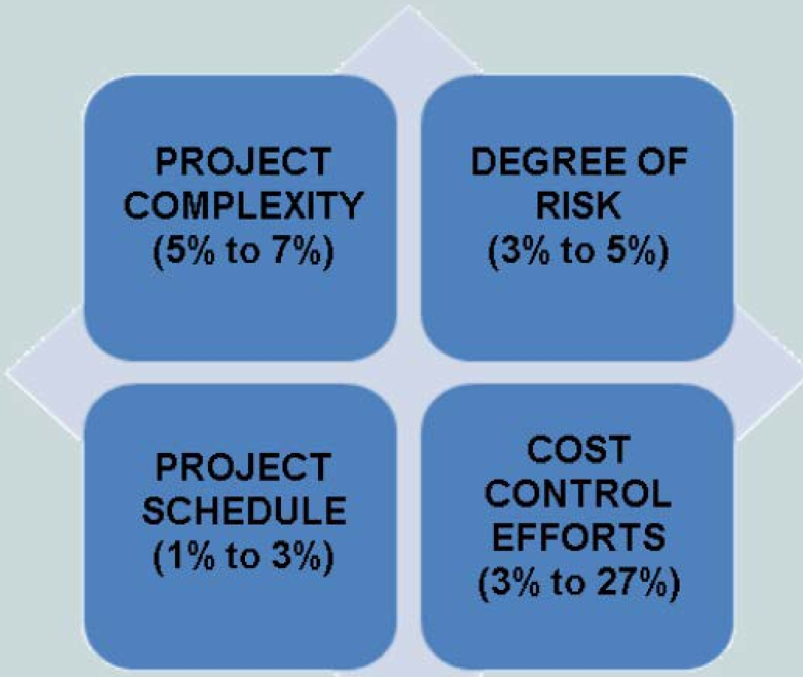
Operating Margin

Operating Margin is negotiated based on the criteria of:

- Complexity of the project
- Degree of financial risk assumed by the Consultant
- Project schedule, and
- Consultant cost controls demonstrated by the Consultant's proposed staffing and overhead, direct expense rate, and salary rates compared to industry averages

FDOT Negotiation Handbook

The following ranges are to be used as a guide in negotiating the Operating Margin for each contract.



Operating Margin

Project Complexity (5% to 7%) - The degree of difficulty and level of coordination associated with the project. Are there unique aspects to the project?

Degree of Risk (3% to 5%) - Risk associated with specific financial exposure on technical requirements of scope, not risk on Professional Liability or Errors & Omissions. Should be recovering PLI and E&O through overhead.

Project Schedule (1% to 3%) - The degree to which critical deadlines have to be achieved by the Consultant.

Cost Control Efforts (3% to 27%) - The degree to which the Consultant controls its costs for wage rates, overhead, expenses and FCCM.

Operating Margin Guidelines

Complexity of Project: Percent Range 5% - 7%

Criteria	Suggested Standards	Typical Project Type
Complexity of Project: The degree of difficulty associated with the project. Are there unique aspects to the project? Degree of coordination with others outside FDOT should be considered. This includes other agencies, municipalities, etc., Multiple Districts, multimodal projects.	**Low** - Simple Straight forward projects. Small and specific scope of services, very minor issues/improvements	Bridge Inspection: bridge inspection except scour: All; CEI: 3R Rural, Painting, CEI signalization, simple and straight forward projects; Design: Simple 3R-Rural; 3R Urban ride only; Geotechnical: standard; PD&E: Small simple projects with specific scopes; Planning: Data/traffic Counts; Survey: Resurfacing 3R rural/urban; Traffic Operations: turn-lane projects (design)
	Medium - Projects with some specialized areas requiring some specialized skills. Moderate improvements on a project	Bridge Inspection: generally not applicable; CEI: CEI resurfacing with some improvements; Design: 3R Urban with some improvements, intersection improvements with safety, Category 1 bridges; PD&E: widening with limited issues and bridge replacement with limited impacts; Railroads: All; Survey: survey in water areas; Traffic Operations: traffic operations studies and signal design projects
	High - Complex multi-disciplined projects requiring specialized skills with significant management issues. Major improvements on a project	Bridge Inspection: bridge scour; CEI: CEI for multisections in a corridor, MOT Issues, specialized skills, ITS, construction on new alignments, and signal system timing, development and implementation; Design: new alignments, major widening, major reconstruction; railroad bridge design; Segmental/Class 2 bridges, Movable Bridges, PD&E: PD&E with Feasibility study, multiple disciplines, significant issues; Planning: large planning (multimodal); Survey: pilings and bridges; Traffic Operations: ITS

Operating Margin Guidelines

Degree of Risk: Percent Range 3% - 5%

Criteria	Suggested Standards	Typical Project Type
Degree of Risk: The amount of financial risk assumed by the consultant in relation to the project.	**Low** - Contracts with well defined and specific scopes, minimal probability of cost overruns and low financial risk exposure. Scope clarification meeting held, if applicable	Bridge Inspection: bridge inspections; CEI: CEI subconsultants providing support personnel, ITS, maximum limiting amount contracts; Design: Simple 3R Rural, 3R urban ride only; Geotechnical: All; PD&E: accurate and specific scope & pre-negotiation meetings; Planning: Most Planning; Survey: all, including SUE; Traffic Operations: traffic operations studies; traffic counts
	Medium - Projects with potential for additional coordination efforts with outside agencies/parties; coordination with several Districts, multiple municipalities, etc	Bridge Inspection: bridge scour; CEI: Standard CEI; Design: design for new alignments, major reconstruction, and widening; PD&E: experimental design and broad scopes; Planning: some planning; Railroads: All; Traffic Operations: traffic signal projects, ITS design
	High - lump sum contracts with possibility of overrunning costs; experimental design; projects involving significant financial risk, hazardous materials, potential for significant unknown issues.	CEI: high visibility, lump sum contracts, multiple projects; Design: projects with multiple bridges; PD&E: multiple alternatives, multiple agency approval required; Planning: large multimodal projects (airports, seaports, railroads, transit)

Operating Margin Guidelines

Project Schedule: Percent Range 1% - 3%

Criteria	Suggested Standards	Typical Project Type
Project Schedule	**Low** - no critical short term deadlines or requirements for large staffing concentrations, unfunded projects to go on the shelf	Bridge Inspection: Bridge Inspection; Bridge Scour; CEI: ITS; stand alone resurfacing; ride only, support services; Design: all 3R projects, standard schedule; PD&E: no design phase scheduled in Work Program; Planning: All; Railroads: All; Traffic Operations: ITS; Survey: all 3R projects
	Medium - Standard schedule	Bridge Inspection: generally not applicable; CEI: push button construction; Design: standard design; bridges, large corridors; Traffic Operations: traffic counts; Survey: increased number of crews needed
	High - High visibility projects with short durations and aggressive schedules requiring large commitment of staff. Fast track projects with high profile and quick implementation schedule	Bridge Inspection: generally not applicable; CEI: multiprojects, construction bonus, CEI Urban (day & night), high visibility; short duration, utility reallocation by others; Design: Mobility/ Economic Stimulus; PD&E: design phase funded in the work program, bridge replacements

Operating Margin Guidelines		
Cost Control Efforts: Percent Range 3% - 27%		
Criteria	Suggested Standards	Typical Project Type
Cost Control Efforts: The degree to which the Consultant controls its costs for wage rates (by region), overhead, expenses and FCCM.	**Low (3% - 6%)** - Lower or minimal cost control efforts	The cost control is not generally dependent upon the type of project. Factors to be considered in negotiating this criteria: burdened salary rates (by region) by classification, specialized services requiring specialized staff, reasonableness of the proposed distribution of staffing for the project, reimbursed or excluded premium overtime, and other project specific items
	Medium (7% to 15%) - Moderate cost control efforts	
	High (16% - 27%) - Substantial cost control efforts	

Total: 12% - 42%

This is intended only as a guideline - not a fixed formula.

FDOT Negotiation Handbook

Operating Margin

Please note that the operating margin guidelines are only to serve as a guide, ***NOT A FIXED FORMULA***, for negotiating operating margin.

There is a large variation in operating margins within the range to account for the wide spectrum of project complexity, project degree of risk, project schedule, and cost control efforts by various Consultants that conduct business with FDOT. There will be significant variation in operating margin from contract to contract.

Negotiators ***SHALL NOT*** use a standard operating margin for all contracts.

FDOT Negotiation Handbook

Operating Margin

Since Cost Control Efforts account for such a large portion of the Operating Margin Percentage, additional guidelines have been given for evaluating cost control efforts. Again, fixed formulas ***SHOULD NOT*** be used to calculate the percentage to be applied.

FDOT Negotiation Handbook

Operating Margin

Factors to be considered in negotiating the cost control efforts percentage shall include:

- Burdened salary rates by classification (overhead, expense percentage and FCCM only)
- Specific services requiring specialized staff
- Reasonableness of the proposed distribution of staffing for the project
- Burdened salaries by geographic region
- For CEI contracts, if the firm has Overhead or Direct Expense percentages that include Premium Overtime (reimbursed) or firms where the Premium Overtime is reimbursed directly on the contract (excluded), and
- Other items specific to the contract being negotiated.

FDOT Negotiation Handbook

Operating Margin

It should also be noted that it is possible for Negotiators to negotiate operating margins outside of the range for special circumstances on a contract.

For example, if overhead rates, direct expense rates or salaries are significantly above (or below) the normal range, operating margins below (or above) the ranges may be negotiated.

Other factors that impact the cost/benefit to the Department and/or Consultant may also be considered.

FDOT Negotiation Handbook

Other Important Negotiation Guidelines

Department's Policy on Field Office Expense Reimbursement for CEI and Right of Way Acquisition Contracts

The Department will reimburse the costs of rent and utilities for field offices as a direct project cost. Field office rent and utilities should be excluded from the consultant's direct expense multiplier.

FDOT Negotiation Handbook

Other Important Negotiation Guidelines

Department's Policy on Field Office Expense Reimbursement for CEI and Right of Way Acquisition Contracts

Reimbursed field office costs: Field office rent, utilities, field office set-up and mobilization costs only, when authorized and when properly supported by invoices, receipts, or other acceptable evidence of payment.

Utility costs may include electricity, water, natural gas, sewer, internet connection (e.g., non-mobile DSL or cable lines; not T-1 lines), trash pick-up, and hook-up fees associated with the aforementioned utilities.

FDOT Negotiation Handbook

Other Important Negotiation Guidelines

Department's Policy on Field Office Expense Reimbursement for CEI and Right of Way Acquisition Contracts

Field office set-up and mobilization charges involved with transporting the trailer to the job site may also be reimbursed.

Charges for furniture, supplies, and equipment (including fax, copier, computer, phone, and monthly phone charges) are included in the direct expense percentage and are not compensated as an itemized expense directly on the contract.

Method of Compensation

Negotiation of the Method of Compensation is often overlooked due to the emphasis on individual costs.

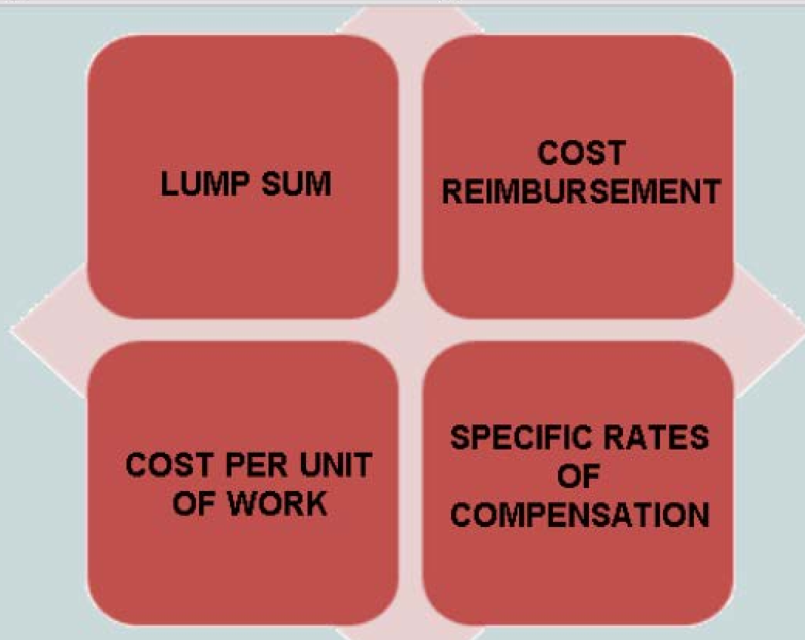
Discussions should be conducted with the selected Consultant regarding the Method of Compensation. To some extent, the selection of whether the compensation element is to be lump sum or cost plus is a negotiable item.

Under Departmental procedures, lump sum compensation elements may be used where the scope of services is well defined and the level of effort can be reasonably predicted. In addition, consideration must be given to requirements imposed by the FHWA for federally funded projects.

FDOT Negotiation Handbook

Method of Compensation

The following standard methods of compensation will be used:



FDOT Negotiation Handbook

Method of Compensation

LUMP SUM

A firm fixed price not subject to adjustment due to the actual cost experience of the Consultant in the performance of the contract. This places the maximum risk on the Consultant and provides motivation for efficient cost management to maximize profits. It also minimizes the Department's time in contract administration.

It is the recommended Method of Compensation when the scope of services is well defined and the level of effort can be reasonably predicted.

Federal Aid Policy Guidelines prohibit the use of lump sum contracts for CEI work unless the "extent, scope, complexity, character and duration of the work" have been established.

FDOT Negotiation Handbook

Method of Compensation

COST REIMBURSEMENT

The Consultant is reimbursed the actual costs incurred in the performance of the contract. A "maximum limiting amount" is normally established to cap the amount the Department will pay for the services.

This method is used when the services are so vague or complex that the level of effort or expenditure cannot be estimated with reasonable accuracy. This provides minimal incentive to the Consultant to control costs and is time consuming to administer.

FHWA only participates in cost reimbursement contracts in which the Consultant's operating margin is a lump sum or "fixed fee."

FDOT Negotiation Handbook

Cost Reimbursement

For non-federally funded contracts, the Department has the option of reimbursing on the basis of “cost plus percentage of cost” for maximum limiting amount contracts. Cost plus percentage of cost is defined as the use of a fixed percentage operating margin, applied to direct salary costs.

FDOT Negotiation Handbook

Method of Compensation

COST PER UNIT OF WORK

A negotiated unit rate for a repetitive task or deliverable product is established and paid for each unit produced. The unit rate is not subject to adjustment. A maximum limiting amount is normally established based on the estimated number of units required.

This method is frequently used for geotechnical services, lab tests, soil explorations, traffic counts, bridge inspections, etc.

FDOT Negotiation Handbook

Method of Compensation

SPECIFIC RATES OF COMPENSATION

Billing rates are established for units of time, usually per hour. These rates normally include wages, overhead, estimated expenses and operating margin but can also be average hourly raw salary rates established for the contract. A maximum limiting amount is normally established.

This method is frequently used for surveying, legal services and expert witness contracts.

FDOT Negotiation Handbook

Information Resource

The Negotiation Handbook contains a considerable amount of information to assist both FDOT and Consultant staff with contract negotiations.

FDOT Negotiation Handbook

Conclusion

The Negotiation Handbook is a reference tool established, and maintained for the purpose of providing assistance to Department staff and Consultant partners in reaching agreement on professional service contracts. It may be downloaded for your use from the Procurement Office web site.

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