

AVOIDING CONSTRUCTION DISPUTES JUST A MATTER OF PRICE?

*The reasonable man adapts himself to the world;
the unreasonable one persists in trying to adapt the world to himself.
Therefore all progress depends on the unreasonable man.*

George Bernard Shaw
Maxims for Revolutionists
(Man and Superman, 1903)

Introduction

Construction disputes invariably revolve around money, though they are presented under a number of different guises; most commonly dressed as a variation claim.

These, however, rarely represent the underlying rationale for the claims.

Most disputes have their root causes in one of the following:

- A clash of expectations, usually entrenched during the tender process, and not assisted by one party being overly opportunistic in contract negotiations, with the other being overly aggressive, or perhaps optimistic, in pricing,
- Poor allocation of risk,
- Poor communication and contract administration, and
- The parties failing to identify and deal with issues properly as they arise.

Traditional competitive contracting and procurement procedures and a preference for fixed price, fixed term contracts, do little to reduce the incidence of disputes, and once disputes have arisen, most approaches to contract administration do not do enough to promote early resolution.

In any construction or major procurement contract, the owner's core concerns will be cost of the work, the time taken to complete it and the quality of the finished product. These will be mirrored by the contractor who will also have a real interest in completing the work as promptly and as efficiently as possible, at least while its interests remain roughly aligned with those of the owner. Post award, things are inclined to change.

Tendering

It is hard to shake the expectation that major construction and procurement projects will be tendered or put through some transparent, competitive process. As much as anything else, this reflects the fact that the majority of large projects are undertaken with public money.

Central government procurement is bound by cabinet procedures and the audit office guidelines, which favour a competitive process.

For local authorities, while the requirement in s247E of the Local Government Act 1974 for all projects to be tendered has been repealed and a similar provision has not been enacted in the 2002 Act, audit office guidelines continue to require contracts to be tendered using a robust, competitive and transparent process. Individual local authorities have adopted varying approaches, but the preference remains to have a contested process.

While competitive processes bring an element of rigour to contracting, all too often the final assessment turns on price. No amount of weighting and risk alignment will convince chief executives to overlook a clear winner on price. Most contractors bargain on this, and will try to present their bids with prices that cannot be ignored; regardless of the number of qualifications and clarifications attached to their bids.

In practice tender processes will vary from a shortlisting mechanism, which enables the owner to select the best contractor to negotiate with, to a detailed process which requires all tenders to be compliant, priced and all tags to be removed and all bids to remain open until the contract is awarded. The former extreme is seen as being more efficient, but has the disadvantage of relieving the tenderers of the competitive tension before all tender qualifications have been negotiated away. This arguably rather defeats the purpose of going to tender.

The latter extreme requires the owner to ensure that all contract documentation is kept complete and up to date during the tender process, and that all tenders are amended and carried forward in parallel. This is seen as being costly and time consuming for both the owner and for tenderers, but maintains competitive tension until the commercial terms have been settled. Typically, the most common approach is somewhere between the two extremes.

Increasingly, consultants and contractors are extolling the virtues of an iterative process with shortlisted contractors, rather than a formal tender procedure with all its duplicated costs and tensions. This approach, the argument goes, captures the contractors' expertise early in the design and specification process, and avoids some of the less productive aspects of the tender process.

This, however, tells only part of the story. The issue that is glossed over in most such recommendations is the cost of tendering to the industry as a whole. A truly reliable price, established during a competitive process, requires a high level of detail in the design and a clear definition of risk. Increasingly contractors are reluctant to carry that cost. In a number of recent projects, no tenders were received which were sufficiently conforming to warrant further negotiation, leaving the project sponsor no alternative but to enter into a negotiated process with contractors, who coincidentally were not involved in the tender process.

Negotiated contracts with preferred contractors can have good results, especially where the contractor has real and recent expertise to offer which cannot be matched by external consultants. However, where the expertise resides firmly with the consultants, or it should, the contractor has little to offer over and above a price for a completed design.

Many owners pretend blissful ignorance of the cost of tendering, and try to leverage their positions as best they can by setting bidders against each other. This may result in a

good price and an initially attractive allocation of risk, for the owner. It is not hard, however, to establish a link between such price pressure and contract dispute.

Whichever approach is adopted, the single biggest factor in successful contracting is understanding and defining risk properly before prices become fixed. Whether this is done through advancing design and carrying out a thorough risk assessment prior to tender, or under an alliance, really matters little.

Post Award

During tender discussions or pre-award negotiations, most bidders will be keen to achieve or maintain their preferred status. Owners will, to varying degrees, use this to their advantage. This can give the appearance of geniality, or even *bon homie*.

The cynic would say that following award, that relationship changes, with the contractor examining risk more closely, and seeking to identify opportunities to recover concessions given away during the award process. Where the owner has been aggressive during the tender process, and may have over-leveraged its position, the contractor will attempt to redress the balance by looking for:

- Savings in materials and in subcontractor's costs,
- Improving cashflows by transferring retentions to subcontractors, extending their payment terms and making significant deductions,
- Reducing the resourcing, by re-allocating staff,
- Variations, and
- Lodging as many claims as can realistically be made under the contract, regardless of whether or not they have merit.

This arch view of the claims minded contractor may be pessimistic, but it is far from unusual.

Whatever your view, as the detailed designs develop, and unanticipated issues eventuate, the price, time for completion and performance criteria of the completed work will need to be adjusted. The contractor who priced aggressively will be unlikely not to seek to recover overheads and any margin, lost during the negotiation process, by contesting the claims process.

Regardless of whether the contract is for the construction of a building, the supply and installation of specialist equipment or for the design, construction, operation and maintenance of complex infrastructure, this basic format, with some minor adjustments, will usually be followed.

The value of the work, the complexity of the relationships, the potential for a clash of expectations and the relatively poor capitalisation of both owners and contractors in New Zealand will mean disputes of some level are to be expected at all stages in a project.

The consistent thread is also that, more time spent prior to award understanding the project, its risks and challenging design assumptions, the less likelihood there is of

dispute. Iterative processes and alliance contracts simply move this assessment back in the procurement process, till after any element of contestability in the award process has been removed. These processes have their place, where the project requires, but they are not a cure all.

Payment

The Construction Contracts Act 2002 declares, rather bravely, that its purpose is:

- (a) *to facilitate regular and timely payments between parties to a construction contract; and*
- (b) *to provide for the speedy resolution of disputes arising under a construction contract; and*
- (c) *to provide remedies for the recovery of payments under a construction contract.*

That this Act is needed speaks volumes about the New Zealand construction industry. Unfortunately, while it identifies a number of difficulties with the industry (*pay-when-paid* and *pay-if-paid* clauses, and cashflow certainty), it does not address the core issue of the relatively poor capitalisation of the construction industry as a whole.

The experience in the United Kingdom, with the Housing Grants, Construction and Regeneration Act 1996, seems to be that the adjudication process has speeded the resolution of construction disputes, but there is no reason to believe that the provisions dealing with the enforcement of the recovery of scheduled amounts offer real protection to contractors. That, with respect to the intentions of the drafters, is dealing with the symptoms, rather than addressing the root causes of construction disputes.

Certainly, lead contractors are discouraged from using their subcontractors and suppliers to ease their cashflows under the Act. The main provisions are not, however, a perfect defence against focussed and ruthless legal drafting.

The real beneficiary of unscrupulous tendering and pricing practises is frequently the owner, and there is little incentive in the Act on owners to ensure that subcontractors are protected. Sadly, the subcontractor is still the party contributing specialist skills, and is most vulnerable to pressure. Subcontractors need to work another day, and they will rarely refuse offers of work, regardless of how poorly lead contractors, or their now defunct shelf companies, may have treated them in the past.

Risk

As market conditions allow, the tender process can provide an irresistible temptation to allocate more risk than is sensible to the contractor.

It is a truism that risk should be allocated to the party best able to manage that risk. Risk can also be priced for, if not actively managed. There are problems with this approach as it may not produce value for money. In fact, it is unlikely that it will.

Where a price or contingency is attached to risk, there is no certainty that the price will meet the associated cost, should the risk eventuate. In practice the contractor will claim anyway, and if the risk is significant, the project will inevitably be put at risk, regardless of the certainty which the owner was expecting when agreeing the price to cover the risk.

In the warm and comforting world of partnering charters and alliance contracting, much is made of risk sharing. It is hard, in practice, to see how risk can be truly shared in this context.

Where a contractor has the skills or resources to deal with a risk, it is fair and logical that such risk should be allocated to the contractor, in its entirety. There is, then, a reasonable expectation that the risk will be avoided in its entirety, and if not, its effects mitigated as far as possible. Only if the allocation is unequivocal will the contractor actually address the risk completely. To share such risk simply passes part of the contingency back to the owner, and relieves the contractor of its vested interest in the outcome.

Conversely, if the risk or its effects cannot be effectively managed, then there is little point in passing it on to the contractor. To say that this is owner's risk has symmetry, but is a syllogism. If a realistic price cannot be fixed for the contractor to take on this risk, then the owner should pay the actual consequences of the risk eventuating under the claims procedure, if indeed the risk does eventuate. The owner pays either way, and it is difficult to see any benefit in shared cost; unless, of course, the contractor is prepared to make a contribution to the owner's costs in dealing with the unforeseen. This is not usually what is proposed.

Administration/Dispute

There can be little disagreement that good record keeping and proactive project management by all parties is critical to a successful project.

With the recent release of NZS 3915 by Standards New Zealand, there appears to be growing local recognition that projects can be managed smoothly with properly qualified project managers properly representing the owner's interest, without the traditional dual role for the architect/engineer. It is perhaps time also to recognise that there are better ways to manage the inevitable conflict of interest which arises with an architect/engineer as designer, project manager and disputes resolver. Professionalism is a good thing, but it has its limits.

Conclusion

In the construction industry, most disputes arise when one of the parties endeavours to redefine their position to their own advantage. This is not helped by a contracting practice which can encourage opportunism and aggressive pricing. When risks eventuate, all too frequently every one suffers, including the owner, regardless of what was contracted for.

Ultimately, there is no substitute for contracting only with parties with expertise and resources and a will to complete the project successfully. This can only really be enhanced by the parties taking the time to identify ways to manage risk prior to award and doing so in a sensible fashion which makes the most of the skills the parties bring to the project.

All this assumes, of course, that the contract accurately records the intentions of the parties. But that is another matter.

John Walton is a commercial barrister and mediator, specialising in construction and infrastructure development.