

Avoidance of construction disputes through legal knowledge



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Abstract

Contract disputes cost the Australian economy a considerable amount of unnecessary expenditure. The majority of these disputes could have been avoided by having an in-depth knowledge of the contract documents and the obligations of all parties under the contract. Currently there are only a very small number of courses offered in construction law education either by way of undergraduate or post graduate construction law training. Considering the importance of construction contracts, more effort is required to educate the construction industry about contract law.

Introduction

A feature of our economic system is that we as individuals, commercial organisation or government departments, are constantly entering into complex agreements for the provision of goods or supply of services and particularly with respect to major infrastructure projects.

Microeconomic reform compels all organisations to reduce operating costs, which has led to standardisation of operating procedures and what we might describe as outsourcing or contracting out. Subsequently, both the principal and employees are being increasingly confronted with the administration of large and complex contracts which place significant responsibilities upon them and for which they are generally unprepared or unfamiliar.

Contracting is the most important and frequent of all commercial activities. Yet very little training is provided to administrators and project managers entrusted with the efficient operation of these contracts. At the same time construction professionals require a significant degree of legal knowledge necessary for the proper administration of contracts in order to avoid unnecessary disputes with the consequent disastrous effect on both parties to the contract. Unfortunately, ignorance of the law is no excuse. If you have signed a contract, the presumption is that you have read and understood it. In particular with typical construction contracts, the role of superintendant has significant legal responsibilities attached to it.

The cost of construction disputes

Currently the cost of construction disputes in non-residential construction are significant. It has been estimated that across major infrastructure projects, the average value of matters in dispute is 8.4% of the contract's price (1).

The costs of disputes are not only borne by the client, designer or contractor but through the community through additional taxes and costly delays to the commissioning of vital projects. The cost of disputes falls within two distinct categories, direct and indirect costs.

Direct costs are the costs involved with:

- obtaining legal advice
- engaging experts and consultants
- the diversion of in-house resources while staff are engaged in activities associated with the pursuit or defence of the claim
- the preparation for the arbitral or court hearing.

When a dispute proceeds to any *rights based process* such as litigation or arbitration, the overall cost can be significant. Even if you are the successful party in a litigated dispute, a party may still only recover the reasonable costs incurred in pursuing and defending a claim. With an arbitrated dispute in particular, the costs of the arbitration will be invariably subject to a taxation hearing and in seeking payment, the successful party will often require the arbitral award endorsed as a judgment of the court.

I am often reminded of the quotation of the French philosopher and writer Voltaire who stated – ‘*I have had two bad experiences with the law. The first time was when I lost a case. The second time was when I won a case.*’

Indirect costs are perhaps even more significant and detrimental than the direct costs. A recent report (2) has listed these as:

- the costs incurred by the parties as a result of delays to the project
- adverse performance of the project
- distraction and over burdening of staff on the project
- reduced morale
- erosion of trust and confidence in working relationships
- adverse impact on the reputation of the parties
- emotional impact on the people involved
- lost opportunities for future work
- destruction of business relationships
- loss of people to the industry because of wasted effort.

One can see from this list the very non-pecuniary damage to an organisation or the parties involved in a prolonged contractual dispute. There have been attempts to quantify these indirect costs to gain a fuller understanding of the impacts of a dispute.

Cost of disputes

The Australian construction industry undertakes some \$120 billion of non-residential construction work annually and the Federal Department of Infrastructure Transport Regional Development and Local Government has estimated that the industry wide value of “avoidable” non residential construction dispute is approximately 5.9 % of the contract price. It was further stated in dollar terms, the estimated total cost of resolving these “avoidable” disputes ranged from \$560 million to \$840 million per year.

When the direct costs (legal services, experts, consultants) are added to these avoidable costs then the total waste exceeds \$7 billion dollars per year.

There is also an additional cost which is the cost to the state and community generally as a result of the inflation of future project costs through higher tender prices based on previous experience with the cost of disputes. This figure can reach a significant level.

Causes of construction disputes

A number of studies have attempted to identify or categorise the causes of construction disputes (3,4). A research report (2) has expressed the key causal factors contributing to construction disputes as follows:

- Poor contract documentation that arise from the organisational system (inadequate or incomplete design information, ambiguities in contract documentation)
- Scope changes that arise from uncertainty that exists within the project management system (variations due to client, design errors, site conditions)
- Educational and behavioral adaptations of individuals within the system (poor communication, poor management, skill and experience, and personality traits).

We could summarise these again as – design, contract administration and personality issues.

The importance of the need for construction contract administrators to have legal skills and appropriate training was identified in the Western Australian Government report (5). The report notes in part that benefits of contracting out highway construction and maintenance can only be achieved where there is a proper understanding of contractual obligations together with effective dispute resolution procedures.

A well respected author, TM McDougall (6), listed 38 common causes of claims in construction projects.

For brevity, I have selected nine of the more important causes of claims:

1. ‘Inconsistencies in contract documents.
2. Unreasonable contract administration (usually relating to what the contractor sees as insufficient experience on the part of the superintendent’s representative or his site staff, leading to excessive caution or too rigid adherence to the specification).
3. Late or inconsistent decisions by the superintendent or the superintendent’s representative (particularly on extensions of time claims).
4. Variations to the works and extra works (whether the work is a variation at all, whether it is the same nature as work covered by existing items, what a reasonable direct cost rate is, what is the applicable prolongation cost).
5. Late payments by the principal.
6. Additional costs arising from requirement to accelerate.
7. Disagreement over interpretation of specification requirements.
8. Lack of formal contract agreement.
9. Effect of late approvals by the superintendent (of matters such as drawings required to be submitted for his approval prior to their being put into effect).’

Effective construction contracts

A construction contract is no different to any other commercial agreement with perhaps the exception of the role of the superintendent. Put simply a contract is:

An agreement between two or more parties to perform agreed obligations and in the event of non performance by the parties, the innocent party intends to seek a legal remedy which flows from the failure to perform.

At the same time we acknowledge that a construction contract is a complex process. It involves:

- a large number of participants in the process – approval authorities, designers, contractors, principals, architects, engineers, quantity surveyors, project managers, superintendents and unions
- economic conditions
- fluctuating workforce
- complex interaction of trades
- complexity and variation of materials
- procurement issues
- participant skills.

The contractual arrangements necessary to comply with such issues is therefore also necessarily complex. One suggestion is that a construction contract must clearly define (7):

- The scope of the work.
- The quality standards of the materials and workmanship.
- The time frame within which the work is to be constructed.
- The price which is to be paid to the contractor for carrying out the work.
- A mechanism for varying all of these parameters.

An omission from this list is an operative dispute resolution clause. While not exhaustive, the following expanded list gives some indication of the general legal issues arising in the administration of a construction contract.

- Is the scope of the work clearly defined in the contract documents?
- What documents constitute the “contract”?
- Is the quality of materials and workmanship defined in the documents?
- What happens in the event of non compliance with respect to quality and workmanship?
- Can the superintendent accept defective materials or performance not in accordance with the contract?
- Does performance have to be entire or is “substantial performance” acceptable?
- What are the rights and obligations of the parties where there has been a breach of one or more parties to the contract?

- What events give rise to termination of the contract?
- Can we vary our obligations under the contract?
- With respect to time have all obligations been performed in accordance with specified times?
- Has practical completion been reached?
- How do we determine the price to be paid for work carried out under the contract?
- Is there a dispute arising out of non-performance?
- How do we resolve the dispute?

Form of a construction contract

The form of a construction contract is essentially the same as any other commercial agreement. The essential features include the:

- date of execution
- names of the parties to the agreement
- scope of the works
- rights and obligations of the parties to the agreement
- contract sum
- time for completion of the works.

Standard construction contracts

While a construction contract may be “tailored” for each individual project a large number of “standard” contracts have been written over the years by various organisations. The main ones we will be familiar with are the SAA General Conditions of Contract – AS 2124 and AS 4000.

The advantages of these standard contracts is that they attempt to balance the risk in the project and their widespread use means that the provisions are generally well understood by all of the participants in the project.

If you examine a range of the standard contracts you will see that they essentially cover the same matters or issues. While the specific wording may differ with respect to the individual clauses, the legal issues underpinning the interpretation and application of the clauses are identical. Some of the features of Australian Standards are that they:

- have been designed to balance the risks with respect to the contract
- are widely used and enjoy a high level of recognition
- allow a level of status of the bill of quantities
- allow for the provision of a superintendent to administer the contract
- involve a lump sum price
- have the option of staged practical completion
- apply to construction in both the public and private sector.

Selecting a standard contract

The selection of the type of standard contract depends on the nature and scope of the works. By way of background, in the housing sector there are no SAA Standard General Conditions of Contract, but various organisations such as the Housing Industry of Australia and the Master Builder Associations have produced standard contracts.

In the non-housing sector there are a range of contracts used in the construction industry. These include:

- PC1-1998 Project Contract
- ABIC BW-1 2002 Basic Works Contract
- ABIC EW-1 2002 Early Works Contract
- ABIC SW-1 2002 Simple Works Contract
- NPWC3-1981 General Conditions of Contract
- AS 2124-1992 General Conditions of Contract
- AS 4000-1997 General Conditions of Contract.

The factors to be considered (7) in the selection of a standard contract include:

- the type of project (engineering, commercial, residential)
- the magnitude of the project (large, medium small)
- the complexity of the project
- whether the work is principally alterations or principally new work
- who will administer or supervise the work
- will a bill of quantities be provided, whether it will form part of the contract
- whether there will be staged practical completion
- whether payment to the contractor will be by a lump sum, a schedule of rates or cost plus.

Again you can see that this list is non exhaustive and there may be other factors to be considered.

Contract knowledge

Apart from the obvious costs arising from a lack of understanding of contract administration, it is hard to imagine any other area of “law” which has such an influence on our private or business life other than contract law. Every day we enter into agreements, either orally or in writing, which result in certain rights and obligations on the parties to the agreement. If we do not perform our obligations under the agreement then the innocent party will be entitled to a remedy that places them in the position they would be in had the other party properly performed their obligations. As you are aware these obligations, particularly with respect to a large construction contract, will be significant and unfortunately ignorance of the law is no excuse. Additionally

if we are the innocent party we want to know what our rights are with respect to the appropriate remedy and how we go about enforcing our rights.

Hopefully there will be an agreement which attempts to balance the rights and obligation of each of the parties to the agreement and each of the parties will perform all of their respective obligations under the agreement. Additionally the law will assume that the parties to the agreement have read and understood all of the terms of the agreement which set out the respective rights and obligations of the parties to the agreement. Unfortunately we all know that in practice this is far from the reality of the situation.

If there is a dispute arising from the operation of the contract then the following issues will be relevant:

- Who are the parties to the contract? (An issue of privity)
- When was the contract entered into? (An issue of limitations)
- Is there a legally enforceable agreement? (Some agreements in order to be enforceable must be in writing. Additionally some agreement will be illegal)
- Are there any issues which could give rise to a party seeking to rescind the contract? (Mistake, undue influence, unconscionable conduct, misrepresentation)
- What were the “terms” of the contract? (Express and implied)
- Has there been performance of the terms or a breach of one or more of the terms of the contract? (Does the performance have to be entire or in the circumstances is substantial performance acceptable)
- If so, what “loss” has the innocent party suffered as a consequence of the breach and what is the appropriate remedy?

Conclusion

This paper has addressed only a few elements of construction contracts and disputes. Hopefully it will inspire contract protagonists to gain further knowledge in contract law. Turning engineers or project managers into lawyers is certainly not the aim. The more knowledge we have about contracts the more that can be done to avoid contract disputes. These disputes are very frequently caused by a general lack of knowledge not by would-be lawyers.

Unfortunately despite its critical importance there has been little construction law education either by way of undergraduate or post graduate construction law training. In response to this need, two Australian universities have developed and currently offer post graduate construction law training programs – the University of Melbourne and Murdoch University in Perth. Both courses have been designed to allow persons with undergraduate qualifications in engineering, architecture or construction related disciplines

to enrol in the course. It is interesting to note that in the Murdoch course 80% of the graduates from the Post Graduate Certificate in Construction Law come from engineering backgrounds and employment with state statutory authorities.

This paper has touched on but a few of the many types of contracts that are currently being used on construction projects. New contract types are continually being introduced because of the complexity of projects and their often short delivery timeframe. It should be abundantly clear that legal disputes should be avoided and differences settled as quickly as possible to avoid escalation. Many contracts employ relationship contracting to help build rapport between the parties to free up lines of communication and generally overcome personality impediments. However while relationship contracting is an excellent way of improving the delivery of projects, it has no legal status in a contract. I am not trying to diminish the importance of relationship contracting but merely pointing out that it is not a replacement for a contract but its purpose is to facilitate a contract in a harmonious and productive manner.

All parties should have an in-depth contract knowledge so that their personal obligations and the obligations of others within the contract are known. This is the first step toward avoidance of disputes. In this way the contract can be interpreted in a more knowledgeable fashion. As a contract document cannot possibly cover every permutation of events that may occur, it is imperative that there is a strong basic knowledge base so that interpretations can be made, leading to fair and equitable decisions. At the same time, this should be occurring in a relational way. Participating in a project or contract is not just a robotic response. It requires personal interaction and interpretation based on a sound working knowledge. This sound knowledge gives the various protagonists confidence to make informed decisions and not hide behind or argue over various clauses in a contract because of lack of understanding.

Again, keep in mind the previously mentioned quotation by Voltaire as it will save you considerable time and expense – ‘I have had two bad experiences with the law. The first time was when I lost a case. The second time was when I won a case.’

Summary

The administration of a construction contract entails serious legal obligations. Unfortunately, despite the importance of the role of the superintendent or administrator, current engineering education, with some exceptions, only involves a cursory treatment of the legal issues if at all. The development and offering of programs as described above and the recognition by statutory authorities of the need for contemporary and relevant construction law education and knowledge will hopefully reduce the incidence of costly and in fact unnecessary disputes.

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