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## Project Management Conference

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#NZPMC19



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*Although it is blatantly obvious to everyone in the industry, no one seems to want to believe that if the contract has been concluded on the basis of draconian contractual provisions, minimum margins and generally an overriding anti-contractor approach, then what will happen is that the contractor will be on attacking position from the outset.*

*It will want to preserve its chiselled margin and it will want to ensure it does not lose money as a result of the unfair provisions. It will therefore adopt a claims mentality from the outset – probably preparing strategies for claims even before it establishes on site.*

Derek Firth, Auckland

Barrister, arbitrator, mediator and adjudicator

Source: *Buildlaw*, November 2018

# Risk Transfer – Implications

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- Increased Cost
  - Contractors gearing up to preserve chiselled margins- more staff allocated to projects
  - Principal team requires increased resource to deal with/respond
  - More disputes/litigation
- Reduced Industry Capacity
  - More staff required on both sides of project team for longer
  - Less resource availability for other projects
- Health and Safety Issues
  - Distrust + Pressure = Mental Stress
  - In construction six times more likely to die from suicide than falling from height
  - Failure to comply with legislative obligations?

# Understand the Project

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- The contractor needs to ensure so far as is possible:
  - No ambiguities or inconsistencies across the documentation
  - No buildability issues
  - Pricing risks from incomplete design documentation are minimised
- To reduce this risk, the parties should obtain:
  - Geotechnical information
  - Information on site contamination
  - Information on any sub-ground utilities up front

# Understand the Contract

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- 84% of contracts are amended
- Conditions of contract are essentially about risk allocation between the parties
- All uncertainties that cannot be eliminated should be clearly and appropriately allocated under the contract
- Unless specific alternative provisions appear, in the event of damage arising during the contract, the contractor will be obliged to complete the works and repair any damage

## So where should the risk lie?

The risk should sit with the party best equipped to deal with that risk.

# Effective Risk Management

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- The main contractual methods of allocating or addressing risk:
  - Contractual tags
  - Contingency allowance
  - Limitation of liability clauses
  - Clauses addressing extensions of time and liquidated damages
  - Shifting risk to another party – insurance and indemnity clauses
  - Bonds and retention
- Early Contractor Engagement
- Project Boards

# Contingency Allowance

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- Changes will occur during the course of any project's construction, for example:
- Important to have a proper project contingency allowance
  - The principal may change its mind;
  - Discovered gaps being plugged in the design documentation; or
  - Unforeseen matters
- If the contractor has an appropriate contingency allowance apportioned at the outset, it is more likely that extra work can then be carried out with minimal delay to the project and with reduced risk of dispute

# Liquidated Damages

Where the contractor does not complete the project on time, the principal will suffer losses associated with not being able to use the works as contemplated.

These types of losses can be difficult to quantify and prove

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Entitles the principal to be compensated for contractor-caused delays to the contractual completion date at a daily or weekly rate – with no other damages recoverable.

For example, clauses 10.5.1 to 10.5.3 of NZS 3910:2013.

Removes uncertainty to the benefit of both principal and contractor

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Contractor has certainty and a cap to its liability to the principal for delay related damages.



# Liability Clauses

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- Important to include contractual limitation of liability clauses – capping liability and/or excluding certain types of losses
- Prudent to itemise which losses are to be excluded
- Parties should bear in mind that if the clause is ambiguous, the *contra preferentem* rule may be invoked
- Contractual limitation clauses will likely be ineffective against third parties suing in tort

# Indemnity and Insurance Clauses

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- Important tool in achieving contractual allocation of risk
- A complete transfer of risk for the scope of the indemnity, provided the party giving it has the financial capacity to meet any claim:
  - The party giving the indemnity needs to have the financial wherewithal to satisfy the indemnity; and/or
  - The party has insurance that may apply if the indemnity is called on
- Common insurance types in the construction context include:
  - Professional Indemnity Insurance
  - Public Liability Insurance
  - Contract Works Insurance
  - Plant Insurance
  - Motor Vehicle Insurance
  - Errors and Omissions Insurance – this is a common issue

# Bonds and Retentions

- Method of addressing the risk that the other party will not perform their contractual obligations or perform them negligently



**Retentions:** the principal withholds a certain percentage from progress payments due under the contract (usually in the 5% to 10% range).



**Bonds:** A form of security usually issued by the bank, surety company or insurer, and often in the region of 2.5% to 10% of the contract price. Can be used in addition to, or instead of, retentions.

1. Conditional bonds require proof of breach by the contractor, e.g. by poor performance.
2. On-demand bonds do not require such proof.

# Effective Risk Management

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- Understand client past performance and attitudes
- Clearly assign accountabilities in bid team – assessing or keeping a schedule of risks
- Thorough study of:
  - Construction methodology and programme
  - Subcontractor offers and capability
  - Contract terms and conditions
- Thorough analysis of risks to all parties, opportunities and margins
- Assignment of appropriately skilled and resourced property management team
- Effective communication of all of the above at handover from bid to project team
- Constantly monitor and review all of the above through delivery
- Plan to finish – don't wait until the end!

# Ineffective Risk Management

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Adverse programme outcomes in respect of time, cost or quality can lead to:



Inefficient use and waste of resources



Time delays, which add cost



Disputes, often leading to delayed completion, both of which affect the balance sheets of principals and contractors



Compromised stakeholder outcomes, adverse reputation.

# Transfer of Risk

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- Risk is inherent in construction contracts
- Some special conditions are necessary – there have been a dozen or more relevant legislative changes since NZS 3910 was last updated
- Trend of extensive special conditions added to the contract to manage or transfer risk allocation
- Risk transfer is often subtle and not reflected in tendered prices
  - NZS 3910 has 87 pages of General Conditions at 300-350 works per page
  - How many pages of Special Conditions make a NZS 3910 contract *bespoke*?
  - Do the parties understand extensively modified contracts?
- Risk transfer can be hidden in other contractual documents, for example:
  - Specifications
  - Geotechnical reports

# Transfer of Risk – Implications

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- Increased Cost
  - Contractors gearing up to preserve chiselled margins – more staff allocated to projects
  - Principal team requires increased resources to respond
  - More disputes and/or litigation
- Reduced Industry Capacity
  - More staff required on both sides of project team for a longer term
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- Health and Safety Issues
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  - Failure to comply with legislative obligations?

# Get the Contract Right!!!

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Make sure it:

- Is best suited to deliver the project in the way the parties intended;
- Is written in clear, concise and unambiguous language;
- Is mechanically sound – consistency, all attachments included;
- Clearly defines the scope of work;
- Anticipates a variety of potential problems; and
- **Fairly allocates risk to the party who is best placed to manage the risk**



# Objectives of NEC Contracts

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- Provide flexibility
- Clarity and simplicity
- Stimulus for good project management
  - Separation of roles
  - Emphasis on continued updated programme
  - Proactive risk management meetings
  - Support new approaches to procurement which improve contract management
  - Increase use of NEC in new markets and sectors

# Pricing

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- Six main pricing options
  - Option A: Priced contract with activity schedule
  - Option B: Priced contract with bill of quantities
  - Option C: Target contract with activity schedule
  - Option D: Target contract with bill of quantities
  - Option E: Cost reimbursable contract
  - Option F: Management contract

# Early Contractor Involvement

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- Options C and E only
- Contractor engaged early to participate in the development of designs allowing construction considerations to be incorporated early
- Two stages for the contract
- Stage 1:
  - Project Manager controls cost
  - Contractor submits forecasts of its design costs for stage 1, forecasts of the project cost and also “design proposals”
- Stage 2
  - Client has absolute discretion not to proceed for any reason but limited grounds to engage another contractor
- If stage 2 doesn't proceed, stage 2 is omitted from the contract but contract is not terminated

# Risks Register

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- Project Manager responsible for issuing first register and for updating the register
- Early Warning Meetings – all involved in the project can attend (including the subcontractors) if would assist to determine actions take
- How frequent?

# Appendix One – Project Risk Register

Ref	Risk Category	The risk: what can happen and how it can happen	Qualitative Risk Analysis				Risk Evaluation		Risk Score	Risk Priority	Risk Reduction Measures & Treatment Type
			Threat or Opportunity	How likely is the event?	Consequence Rating	What are the consequences of the event?	Likelihood Rating	Consequence Rating			
Category 1: Commercial, Legal, Economic and Managerial											
T & Proc 1		Procurement									
T & Proc 1	Tender & Procurement	The project incurs schedule delays caused by difficulties with the procurement strategy sign-off	Threat	Unlikely	Medium	- Delay to commencement and completion of the project	3	40	120	High Threat	- Define strategy. Get ROI documentation out in a timely manner. Establish WSL audit process and support from management. It is noted this competitive stage may need to be by-passed in the Mt Smart case.
T & Proc 2	Tender & Procurement	The project incurs schedule delays due to extended Watercare review periods	Threat	Unlikely	Minor	- Delay to commencement and completion of project	3	10	30	Moderate Threat	- Identification of appropriate resources to provide documentation reviews. State review periods on project programme.
T & Proc 3	Tender & Procurement	Selection and implementation of incorrect/inappropriate form of procurement and contract documentation	Threat	Unlikely	Major	- High project costs due to changes / variations to the tender documents - Contractual claims - Breakdown in Watercare / project team / contractor relationship	3	70	210	Very High Threat	- Formulate a procurement strategy and assess all available forms of contract - Peer review of contract documents to ensure they contain the correct provisions and contain no errors or omissions

# FIDIC Contracts

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- Golden Principles of Contract Drafting
  - Duties, rights, obligations, roles and responsibility of all Participants and be generally as per General Conditions of Contract (GCC)
  - Particular Conditions of Contract (PCC) must be drafted clearly and unambiguously
  - PCC must not change the balance of risk/reward in GCC
  - All time periods must be of a reasonable duration
  - All disputes must be referred to a dispute board as condition precedent to arbitration

# FIDIC Aims

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## Focus on avoiding/early resolution of disputes

- Agreements re: Claims (cl. 3.7)
- Management meetings (cl. 3.8)
- Obligation to provide early warnings (cl. 8.4)
- Dispute Avoidance and Adjudication Board (cl. 21)
- Engineer and DAAB decisions – final and binding if no NOD issued with 28 days (cl. 27.5 and 21.4.4)

# Consultation Obligation

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- Engineer obliged to consult with each Party in an endeavour to reach agreement
- Detailed procedure in relation to consultation (cl. 3.7.1)
  - 42 day period (or other period as proposed by the Engineer and agreed by the Parties) (cl. 3.7.3)
  - Engineer to consult with both Parties jointly and/or separately
  - Engineer to encourage discussion between the Parties in an endeavour to reach agreement
  - Engineer to commence consultation promptly to allow adequate time to comply with the time limit
  - Unless otherwise proposed by the Engineer and agreed by both Parties, the Engineer shall provide both Parties with a record of the consultation



# Consultation Obligation Cont...

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- Consultation to reach agreement:
  - If agreement achieved within the 42 day period – Engineer gives a Notice to both Parties of the agreement which shall be signed by both Parties
  - Copy of the signed agreement to be attached to the Notice
  - If no agreement is achieved within the 42 day period (or Parties notify Engineer that agreement cannot be achieved earlier) – Engineer gives a Notice to the Parties and proceeds to determine the matter or claim

# Disputes

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## Dispute Avoidance and Adjudication Boards (cl. 21)

- Emphasis on dispute avoidance
- Prescribes how the DAAB is to proceed
- If Parties don't agree FIDIC appoints the DAAB
- Proceedings to be commenced within 42 days of issuing a NOD re: Engineer Determination or Engineer's Determination
- Ability for DAAB to provide assistance to Parties to resolve issues – non-binding

# Construction Sector Accord

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*“We as designers, clients and constructors need to establish a much stronger foundation of behavioural principles to guide our decision making. We need to reset the culture in order to lift our performance.”*

**Peter Reidy**

Chair Accord Development Group CEO  
The Fletcher Construction Company

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