

Building contracts: from rivalry to cooperation



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The relationships between developers and building companies in the Czech Republic, and possibly also in some other countries, are far from ideal. And since the “our customer is our master” approach is still in place here, in spite of the influence of the larger or smaller dominance of demand over supply on the construction market, building contracts are still interlarded with expressions such as “penalty,” “sanction,” “retaining fee,” “liability for damage,” “complaints” etc. Of course, this spirit reflects standard customer protection, but the scope of sanctions and the sophistication of the provisions aimed against the contractor, sometimes not far from draconian, testify to a deficit of mutual trust and will for actual efficient cooperation. And it has to be added that the above-mentioned brutality is justified by the not-so-rare efforts of contractors to maximize their profits to the detriment of customers. No doubt the current contracts are in line with the actual situation and experience of both parties. “In the past customers were very cautious; the pressure on prices was minimal, and customers could therefore protect their interests through retaining fees and penalties best of all,” said Igor Klajmon, of the development firm Quinlan Private Golub, at one of Stavební fórum’s discussion meetings.

Different approach in different conditions

“It’s time to treat risks,” Klajmon comments on a major parameter of the present economy, whose various aspects affect builders as well as building customers. Higher project risks, where developers cannot already count on the more-or-less automatic utilization through sales or rentals, a credit vacuum and the consequent enormous pressure on reducing costs are calling for changes in building contracts as well. The list of reasons and motives to switch to a different quality level of contractual relationships in construction also includes the inability of contractors to weather the “after delivery” payment system, because of which they require continuous financing for their operations.

According to Martin Drvoštěp, of the law office Allen&Overy, the most frequent approach in the Czech Republic so far is that, in the old way, the mutual rights and obligations of the parties to the contracts and the recovery procedures are specified one by one. However, the companies commissioning construction work, especially foreign ones, wish to establish contracts in the Czech Republic that would provide for the participation of all parties in the most efficient contract implementation possible.

This type of contract has been known for long, dating back to the 1980s. Quite typically, it appeared in the highly risky mining sector first, where the outlooks of large investments are often uncertain. “We call them third-generation contracts. First-generation and second-generation contracts typically feature an almost

hostile relationship between the parties, and third-generation contracts principally change their mutual relationships. The customer and the contractor become team-mates, with common objectives and procedures and, last but not least, teams,” explains Ivan Telecký, lawyer of Allen&Overy, which operates in this area. According to him, 3G contracts have two principal forms - partnership and alliance - and numerous variations thereof, but the basis is always the same. “Third-generation contracts bring a transition from pressure to motivation,” Telecký defines the essence.

No magic

It is not too hard to make sure that suspicious contractors become real partners. Alliances constitute a higher and more beneficial form of close cooperation. Their basic element is motivation of the parties to share in the success of the project, consisting usually in the sharing of cost savings; while the sharing of the customer’s extraordinary unscheduled incomes may be a certain “bonus”. This can typically involve a share in the revenues of a new plant that starts operating earlier thanks to earlier project completion. Of course, the other side of this sharing scheme is an adequate risk distribution.

From an organizational point of view, alliances can have the form of a joint venture (for strategic partnerships), or the well-established special purpose vehicle (for one specific project). An alliance board is usually set up to solve disputes and problems; the companies also create joint teams comprising employees of both parties. Some projects involve the so-called open books system with open and mutually accessible accounting books.

The specific content and progress of cooperation is, to a large degree, determined by key project indicators stipulated in the contract. These indicators apply to financial issues (profit and loss distribution, budget, costs) as well as deadlines, the definition of main risks (a reliable warning system has to be set up for this purpose), but also for example reputation indicators or, in other words, the project’s public relations level.

“There are sample lists of key indicators, but they have to be used flexibly, since each project is different. At any rate, their clear and accurate definition is a principal success factor,” Drvoštěp summarizes, pointing at developed countries where, a bit surprisingly, they use “hard” financial indicators less and focus on “reputation” indicators more. Some of such indicators could be the frequency of media attacks against the project and the number of occupational injuries during construction: “This reflects the interest they pay to corporate social responsibility in the West, unlike here.”

The different situation here and in other countries is also well-signalled by other aspects of 3G contracts. The goal may not be (and sometimes cannot be) only cost minimization; the range of goals is much broader in specific cases and generally. “It may sound strange, but a standard goal for alliances is the factor of entertainment or fun during work,” says Drvoštěp, almost with hesitation. However, this is not strange at all - the competitiveness and work efficiency of teams and enterprises with employees for whom work is not merely an obligation, but also “fun”, are enormous. The question is how this “goal” could resonate with domestic managements. Human resource managers in the developed world more or less agree that people without motivation - employees who want to be employed, yet do not want to work - are their biggest worry. From this point of view, 3G clauses on friendly and creative workplace atmosphere are not an oddity, even though they could seem so. Quite to the contrary - the overview of obstacles to the execution of 3G contracts, mentioned by Drvoštěp - personal and system conflicts, lack of competency, lack of interest and ignorance - seems to describe our domestic context very accurately.

What to do?

Regardless of the practical obstacles in the form of uncertain feelings and attitudes of the parties and the concerns of the presently highly cautious banks, another problem will arise with the implementation of 3G contracts within our legal system. The sample contracts used abroad for many years cannot be applied in

the Czech Republic in their original form because of the differences in the legal systems and in many specific concepts (e.g. in liability for damage), but also material factors and differing practice, e.g. the absolutely different position of the project's architect, who is automatically a party to the contract in Anglo-Saxon countries. However, the lawyers in Allen&Overy have already prepared a sample contract. "Just like in other such cases, it is a contract for work. But it's a semi-processed document that has to be always tailored to each specific project," says Martin Drvoštěp. He adds, however, that the specific contract will always reflect the attitudes and thinking of the corporate management: "Contracts have to copy the actual relationships, otherwise such a sample is just a blank piece of paper."

Establishment of a new form of customer-supplier relationships in construction is definitely in the interest of all parties involved. We know of cases even in the Czech Republic when "hostile" contracts, which are very rigid and do not allow any major change of contractual conditions, resulted in hundreds of millions of crowns in losses for builders, for example in case of the highly risky tunnel projects. On the other hand, according to serious studies, 3G contracts bring, along with fun during work, cost savings of 15% on the average, sometimes even more. For instance British Petrol profited from its enhanced relationships with Bovis, moving from simple project management contracts to alliance, with 45% cost savings in the field of construction and operation of filling stations.

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