



## Expert's Corner Paper 2013-04

### How to Obtain Actual Cooperation in International Construction Contracts

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*Actual Cooperation between Client and Contractor is a key attribute of successful projects. However, Contracts rarely enforce directly an obligation to cooperate. How is it possible to get to this result indirectly? This paper gives unique insights into the various methods that can be used contractually to maintain the rights and obligations of the Parties while actually fostering effective Collaboration and thus, project success.*

#### What a Contract covers and what it does not

Fundamentally, construction contracts are an agreement between two parties, the Client and the Contractor, over a construction project, which allocates the duties of each party.

In any contract, the Client is essentially responsible of:

- Defining the objectives (time and quality) and requirements for the execution of the project and for the finished product (codes or standards to be followed, conceptual design, performance requirements, etc.),
- Financing the project and paying the Contractor for the work done,
- Giving access, securing the land and at the end taking over the completed project.

The Contractor is in charge of the realization, within a set of constraints (schedule, price, quality, requirements), of the object contemplated and to hand it over to the Client after completion.

Apart from those core concepts, the rest of the contract can be viewed as mere risk allocation between the two parties, where the buffer basically lies in engineering (level of definition of the project), procurement (buying of the materials and services needed) and the way the Contractor is remunerated (from the fully reimbursable services to full lump sum contracts). Other factors are derived from this risk allocation: insurances, bonds and warranties, right to vary, suspend and terminate, liquidated damages, certification, etc., which are all tools to ensure the obligations set in the contract are respected.

#### How Collaboration is not usually mentioned in Contracts but is so important to project success

However, while the contract defines the scope and responsibilities of each party, as well as the framework and tools for the project management, collaboration is not usually mentioned and is not an obligation under the

contract. Yet, collaboration, through a good management of interface and common objectives, is an additional instrument towards the attainment of project objectives in terms of quality (including safety), cost and schedule. Those three constraints, core of all projects, are mostly seen as antinomic, in particular in cases where the stakeholders may have diverging purposes. The limits of a mere contract in ensuring the project's objectives achievement is particularly blatant when looking at situations of non-cooperation: the terms and obligations set in the contract can be respected to the letter and the project nevertheless ends up a total failure and a source of disputes, as the goodwill and cooperation are a missing link between the contract and the reality of the work.

Due to the size and complexity of construction projects, as well as their internationalization, many contracts also contemplate the introduction of a third player:

- either particularly in charge of the design development or review – which is the cornerstone and very often the trigger to the success of a project – as a design consultant, an architect or the FIDIC's Engineer,
- or a 'facilitator' of the relationship and follow-up of the compliance with contract requirements, as a Contract administrator in some JCT forms, the Project Manager of the NEC3 contracts, or again the Engineer in a FIDIC form of contract.

Cooperation can then simply be defined as the willingness of the parties to effectively combine their resources for a common purpose of achieving the construction project objectives, beyond the mere letter of the contract.

#### How Contract clauses induce – or not – Cooperation

The cooperation between the parties, aiming at achievement of time and quality objectives, can be introduced several ways, which may be subjective - aspirational – or legally binding - coercive.

#### Declarative obligation of Cooperation

The concept of cooperation can simply be stated as an objective of the agreement. This is quite uniquely the case in the NEC3 form of contract. Where other forms of

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contract (JCT, FIDIC) start straightforward by an exchange of obligations, the NEC3 first clause of the contract (10.1) has sometimes been regarded as its most controversial: "The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation."<sup>1</sup> What this declaration brings in the contract terms is the attachment to good faith from the parties in entering in the agreement.

### **Induced obligation of Cooperation**

The main contract mechanisms to achieve Cooperation are legally binding tools in order to obtain the upholding of the project objectives. They are financial instruments which will affect the balance of profit for the Contractor, and therefore are meant to share the interest in reaching the project objectives, reactively or proactively.

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#### **Payment mode**

The payment mode stands at the heart of the risk-sharing strategy of a construction contract. Principally, a well-defined project with a fixed price will place the risks on the Contractor side but may close down the cooperation path, whereas a reimbursable-style contract is meant to allow better cooperation.

The main existing strategies include:

- **Lump Sum Contract** –balancing the risk and responsibilities towards the Contractor – similar to a FIDIC Silver book or JCT Design and Build, NEC3 Priced contract with activity schedule. Leaving the Contractor mostly in charge can be quite rewarding in terms of achievement of project objectives, but require the project definition to be complete enough and the contractual safeguards (warranties, Liquidated Damages, etc.) are well in place before launching the execution phase, which may delay the project start date quite consequently.
- **Re-measure Contract** –the responsibilities are the same as in a pure Lump Sum, alike a JCT SBC with quantities or FIDIC 4<sup>th</sup> (Red Book) for example, NEC3 Priced contract with bill of quantities. Basically, this leaves the Contractor in charge, but leaves more space for an incomplete design, hence the opening to re-measure, so as to cater for design developments.
- **Variation of the above forms with targets** (NEC3 Main option C and D). Those essentially are bringing in a sharing of the loss/saving made around an agreed target between the Contractor and the Client. This concept is mostly used in bespoke contracts, and notably in the NEC3. It allows an incentive to be set-up on the financial result of the project. From experience, it does in

fact create even more tension on the other objectives that are schedule and quality. In that sense, the cooperation induced in term of cost awareness should be carefully measured so as not to imbalance the care to schedule and quality.

- **Cost reimbursable Contract.** This payment mode virtually takes away the risk share of the Contractor, leaving the Client in charge of the cost part, but also allowing much more flexibility in terms of schedule (early start for example) and quality. Principally free of the cost constraint, the Contractor shall be put in a position where the care brought to those two objectives is at the heart of the contract. In terms of cost, the risk is that the Contractor indulges in more hours/work simply to inflate the contract envelope and therefore its fee – which may be consequently detrimental to schedule as well.
- **Management Contract.** This form can be seen as a variant trying to overcome the deficiency of the cost reimbursable contract, by involving the Contractor only on the management (services) part of the contract. However, this will mean that the responsibility as well is diluted, effectively placing the burden of schedule and quality control back in the hands of the Client.

#### **Constraints**

Those can be quite coercive, as for example the very common Liquidated Damages, imposing a financial burden on non-achievement of schedule or performance objectives. It goes without saying that this kind of clause stimulates more focus on the Contractor side than a contract without constraints, which would amount to a blank check. Another typical instrument used in the same way is the retention of money or introduction of a performance warranty from the Contractor, so that the Client keeps a lever against deficient performance.

#### **Incentives**

Incentives (positive or negative) are specific commercial tools often built in the particulars of a contract to ensure some kind of consistency over the project objectives and control on their identified key performance indicators. Those may commonly include:

- Penalties for changing key project staff
- Bonuses / penalties on quality targets (welding defects, scrap, etc.)
- Productivity ratios control
- Mechanical Breakdown ratios control
- Safety records targets
- Etc.

By setting intermediate everyday down-to-earth targets (and forcing them in through financial tools!),



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cooperation between the teams is instilled in the parties teams, which enables long-term results.

These types of tools are widely used in all contracts forms, having proved their usefulness as safe-keepers of a minimum control over and gearing the commercial relationship towards the contract performance and the project's objectives.

### **Instrumentalised obligation of Coordination**

In some forms of contracts, management tools are implemented which aim at empowering the cooperation within the project teams. This is yet another step, where the cooperation between parties is sought by applying common work processes aiming at safekeeping or even improving on the project objectives.

Several types of instrument can be built-up in the contract, either to improve the communication level between the parties or provide mechanisms for constructive cooperation. Those include:

- **Common risk management practices**, whereby the business risk and opportunities registers (or systems) of all parties are interfaced, so that the identification of risks and related action plans are thought of at project level instead of each entity trying to draw the cover on its own objectives. Inside the NEC3 contract form, this takes the form of an Early Warning System (clause 16)
- A parallel can be done to the practice of many contracts in terms of **Change management**, where the issuance of Change Notices (notice of an event which may give rise to a variation later on) is fairly comparable to a risk management process.
- **Comments and communications**: an important way to improve quality and timely delivery of projects is not to delay communications, which can be instructions for modifications, providing, reviewing or commenting design deliverables or project procedures, etc. Often, a rule is established between the parties, which for the sake of the project objectives must be followed. NEC3 provides as a contractual feature that a strict time-frame is to be followed (clause 13), failure of which penalties can be levied.
- **Acceleration**: as said before, contracts very often allow for penalties to be levied in case on non-compliance with completion dates. Going further, many contract forms (NEC3 and FIDIC 4<sup>th</sup> for example) include for a detailed schedule of activities to be maintained and shared with the Client, so that mitigation actions can be

ordered in case of delay. A step further lies in the ambition to submit so-called constructive acceleration programs, where the cooperation of parties can allow a more efficient execution plan resulting in time savings to be implemented.

- **Value engineering**: similarly to pure schedule acceleration, instruments can be implemented to push the parties towards optimization of the design, in order to reduce quantities, optimize the quality performance or the easiness of installation, hence possibly the schedule as well.

### **Supported obligation of Cooperation**

Ultimately, the role of parties other than the Client and the Contractor in International construction contract can serve the purpose of coordination, supporting the overall cooperation.

The Engineer in FIDIC, project manager in NEC3, Dispute Adjudication Board in FIDIC, or in bespoke contract the various forms of steering committee or sponsors set in place can all, in properly implemented projects, serve the purpose of cooperation.

In particular, the Engineer in a FIDIC contract, or an Architect or Design Consultant under other forms interfaces the critical task of detail design, allowing the requirement and objectives of the Client to seamlessly be transferred into usable data for Execution by the Contractor, either in issuing, reviewing,

clarifying or correcting ahead of time such deliverables central to any project to allow procurement, sub-contracting and construction activities to be planned and executed.

In addition to their pure technical assignment, they give an external 'cold-eyes' review on the project, its challenges and risk and are very often in a position to enhance the flow of information and agreement over common project objectives between the Client and Contractor – as well trying to reduce the emergence of misunderstanding and disputes, which are typically the source of delays and quality issues. Although not often expressed in the contract documents, this role is not to be neglected.

In order to part from the claim / dispute situation, where a contract is applied to the letter, even if detrimental to the ultimate outcome in terms of project realization; cooperation shall be sought through collaborative foresight, motivation and proactive implication towards common objectives of schedule and quality.



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**Conclusion: why it is important to foster the right level of Cooperation**

Lord Devlin, in his lecture ‘Morals and the Law of Contract’ has made the telling point that *‘If a man minded only about keeping faith, the spirit of the contract would be more important than the letter. But in the service of commerce, the letter is in many ways the more significant.’*<sup>2</sup>

In order to part from the claim / dispute situation, where a contract is applied to the letter, even if detrimental to the ultimate outcome in terms of project realization; cooperation shall be sought through collaborative foresight, motivation and proactive implication towards common objectives of schedule and quality. This can be attained or encouraged through the contracts wording, and implemented by the Parties’ management.

Ultimately, as of today, the difficulty lies, as Mr Justice Vinelott put it, in that *‘the courts have not gone beyond the implication of a duty to co-operate wherever it is reasonably necessary to enable the other party to perform his obligations under the contract. The requirement of “good faith” has not been imported into English Law’*<sup>3</sup>.

<sup>1</sup> Frances Forward, *An Architect’s Guide to NEC3*, RIBA publishing, 2011 page 14

<sup>2</sup> Brian Eggleston, *The NEC3 engineering and construction contract: a commentary*, 2nd ed., Blackwell Publishing, 2006

<sup>3</sup> London Borough of Merton v. Stanley Hugh Leach Ltd. (1985) 32 BLR 51

