

# A CHANGE IN MINDSET IS ESSENTIAL TO ADDRESS PROBLEMS IN THE CONSTRUCTION INDUSTRY

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## PART A - SOME PROBLEMS

Every prospective project owner and developer is now severely disadvantaged by the absence of a large pool of financially strong contractors. This situation has been self-inflicted by themselves and their predecessors.

It is often said that risk allocation is inappropriate, and this is best illustrated with examples. It is totally irresponsible for an employer to require a contractor to take all the risk in relation to ground conditions. Let the present claim for over AUD 1 billion against NSW Transport be a lesson to everyone, whether you are building an underground railway or a house, or something in between. That claim is for damages for deceptive and misleading conduct in relation to underground issues. It seems to be an example of the consequences of an owner trying to be too clever.

It is totally irresponsible of an employer to hold over the head of the contractor the right to give some work to others in the future; and it is totally irresponsible to retain the right to make significant programming adjustments yet deny a variation to the contractor. These are simple examples of numerous situations where contractors are being regularly asked to take risks which they are not equipped to either manage or price.

Another common example is thrusting onto the contractor the risk of future design issues when the owner retains control of design.

There is an obsession with accepting the lowest price regardless of good reasons, often, not to.

There is an obsession about requiring tendering for every project when that is not always appropriate.

In Fletcher's heyday, that company was well known within the construction industry for two strategies. First, it went through a period of many years when it negotiated as many contracts as it could and avoided tendering wherever it could. This significantly reduced its risk, but it also ensured that the employer ended up with a financially strong and very reliable contractor. Secondly, it had a reputation in the industry for looking after its subcontractors. They are the lifeblood of any major contractor.

It was not the fault of Fletcher that the opportunity to obtain negotiated work significantly fell away. It was probably due to the short sightedness (and inexperience) of those at the procurement end who could not stand the thought of missing out on an alternative contractor being a fraction cheaper.

Some of these issues are not only about owners and their consultants, but also their bankers, and their consultants. They do not seem to understand that it is better to pay a slightly higher price and have the security of a financially sound contractor with a reputation for consistent quality workmanship. Some seem to think that shaving a few dollars off another contractor's margin to enable it to secure the job will provide the best outcome. This could not be more short-sighted and wrong.

Unfortunately, consultants advising owners who wish to impose draconian contract conditions and shave the margins to the bare

bone would rather assist them to implement these very unwise tactics than see the owner shift to another consultant who will quickly accommodate their foolish requirements.

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 an attacking position from the outset. It will want to preserve its chiseled 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.

## PART B - SOME SOLUTIONS

The first, and likely to be the most effective solution will be a change in mindset. Owners and their consultants will be likely to achieve the best results if they stand back from inappropriate procurement tactics and take a broader view of getting the right contractor for the appropriate job at a fair price and based on fair conditions. A mindset of saving a few dollars and imposing harsh conditions because they think that is how it should be done, will continue to not work.

Ironically, many very experienced employers and very experienced consultants have no difficulty with this and adopt good approaches. The problem lies with a very large number of less experienced people coming into a busy



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market and wanting to prove themselves.

Another solution which can often require an enormous level of will-power is to complete the design before tenders are called or a contractor is asked to price the work. We are riddled with projects where owners are always trying to "beat the gun". Neither they nor their advisors want to see the wisdom in having design finality before an effective price is determined. The alternative will always bring future difficulties.

The fallacy with an obsession for always requiring tendering can be simply illustrated. Consider a project such as a hotel or a block of apartments which is likely to cost in the region of say \$80m. That is not the amount which will avoid being tested in a negotiated contract. This is because usually about 80% of it is competitively bid anyway through the tendering for subcontract work. Only about 20% of that price is what is really being negotiated, being the margins and some builder's work.

Good quantity surveyors will have a very accurate knowledge of the going rate for the various margins (on-site and off-site overheads and profit) and they will know if a contractor is underpricing or over pricing those parts of the price. What on earth is there to be gained by shaving a little off one or more of those margins and ending up with a contractor which is not as financially sound or does not have as good a track record as a contractor which is trying to retain normal market margins. Absolutely nothing, so why do owners consistently try to do it?

Obviously, if one decides to proceed with a negotiated contract it is essential to require agreement by a date which still leaves time to tender if agreement can't be reached.

All consultants (lawyers, architects, engineers, project managers and quantity surveyors) should stand up to their clients and explain to them why short cuts, harsh clauses and penny-pinching are counterproductive in many ways.

### ABOUT THE AUTHOR

Derek Firth is an Auckland Barrister practicing as an arbitrator, mediator and adjudicator. He is a Fellow of AMINZ and a Fellow of the Chartered Institute, UK. Derek has had a number of party and Court appointments under the ICC Rules and is one of the leading dispute resolution practitioners in New Zealand, particularly in construction, property and commercial disputes.



Derek is the New Zealand Alternate Director of the ICC International Court of Arbitration (Paris) and has been appointed as Member of the New Zealand Order of Merit (MNZM).

He is Chairman of the Dilworth Trust Board, a Trustee of the Melanesian Trust Board; Chairman of BioDiesel Oils NZ Limited and a director of a number of companies in the InterTech Group in Australia.

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