

CONSTRUCTION RISKS AND THE BUSY SASKATCHEWAN MARKET

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I. INTRODUCTION

The risk matrix of the construction industry has always involved a fair amount of money and considerable complexity.

II. IS THE MARKET HOT; SO WHAT?

A. STATISTICS

- (a) Until 2002, owners and consultants were accustomed to being the king of the economic hill; take it as they see it or move out of their way.
- (b) Between 1986 and 2002 North American construction services capacity experienced a steady decline involving financial failures and consolidation of contractors; by 2002, consultants had cut their fees in half, while contractors had squeezed their margins to between 2 and 5%
- (c) Now, the contractors, trades, and suppliers have taken the top of the hill; since 2006, the available skill trades continue to remain at a 1999 level, while the available knowledgeable site supervisors and contract administrators has dropped by 16% since 2000; yet, in the Saskatchewan market project values (construction services and materials only; not land) since 2006 have jumped as follows:
 - i. Industrial 40%
 - ii. Commercial 49%
 - iii. Institutional 70%
- (d) As a result, since 2006:
 - i. Consultant fees have returned to pre-1990 levels
 - ii. Contractors' margins have tripled
 - iii. Salaries are up 34% and employment terms are more family-friendly
 - iv. Contractors are highballing the costs of risky, novel projects
 - v. Skilled trades are reluctant to go to remote job sites
 - vi. Bidders are shying from forecasting long term future pricing and delivery of specialized equipment made out of steel

- vii. The competitive bid process no longer assures a cost effective schedule and price
- viii. Owners are considering pre-ordering fuel, cement, steel, and specialized large metal machines to secure pricing and delivery even before the design process is complete.

B. CONCEPT STAGE QUESTIONS AND WISDOMS

So, in a nutshell, these dynamics are **requiring owners to, at the very concept stage** of their project, carefully answer questions like the following:

- (a) Can the owner save design costs of up to 5% to 7% of the eventual project budget by defining its cosmetic and functional purposes so as to be satisfied with a simple, standard box rather than an innovative Taj Mahal?
- (b) Does the owner have sufficient cash flow and flex time to tolerate a project schedule of **“it gets done when it gets done,”** or must the owner accept a 50% premium for a stipulated lump sum price and a completion date secured by “legal” penalty clauses?
- (c) Does the owner’s project team have the requisite knowledge and available time to become intimately involved in the design and construction of the project, or must it transfer the risks of poor design, faulty workmanship, and delayed performance to the consultants, contractor, trades, sureties, and insurers?

When I was a neophyte construction lawyer in 1986, these questions weren’t usually dealt with because tradition was the norm. **Today, owners (even governments, though they seem to be the most reluctant) require the answers** So, what wisdoms can I impart?

- (e) Don’t try to sell them on a one-off unique contract, because it will only unsettle the traditionalists involved in the project and diminish the requisite trust to achieve the needed harmony among all of the players associated with the project to obtain quality completion on time and on budget.
- (f) Every project always requires some tweaking of the contract language; but, begin with the industry’s standard document forms (R.A.I.C.; A.P.E. & GS.; CCDC; CCA) and always achieve the tweaking by clear Supplementary Conditions; because, traditionally the stakeholders only read the Supplementary Conditions and otherwise, put the contracts in their drawer and behave traditionally until a dispute arises.

- (g) If an innovative design is required and the owner has the financial capacity to take up the risk of cost escalations, consider a Document 6 with either a CCA 5 or a CCDC 3 governance model.
- (h) While, if the owner wants an innovative design but requires an early guaranteed price, then consider a Document 6 and CCA 5, which can later be converted to either a CCDC 2 or a CCDC 18.
- (i) On the other hand, if the owner's job is pretty standard with no frills and the owner can take the risks of an extended construction schedule and escalating construction costs, consider the cost effectiveness of a CCA 5 supported by either a CCA 17 or a CCDC 3.
- (j) Finally, if it's a standard job but the owner wants to fast track completion, consider a CCDC 14 or the soon to be released CCDC 5 B.

III. ENGAGING DESIGN SERVICES

A. EARLY INVESTMENT IN QUESTIONS AND ANSWERS

Very early on, the owner needs to make a smart decision; does the project need an architect, an engineer, a construction manager, a specialized trade contractor, or some combination of the four? The E & O insurance market has a product for all of these situations, but the more designers a project requires, the higher the project's costs and the longer the schedule. Thus, an owner's early investment in coming to terms with the following will, in the long run, definitely be cost effective:

- (a) What are the functional requirements for the project?
- (b) What are the required cosmetics for the project?
- (c) What are the geologic and zoning limitations of the project site?
- (d) To what extent must the prospective users and maintenance people be involved in the design process?
- (e) What are the budget and cash flow limitations of the owner?
- (f) What are the local market political constraints on the owner?
- (g) What schedule extremes can the owner manage?
- (h) Must special equipment prices and supply be verified?

With answers to these questions, here are my judgments:

- (i) **Innovative Taj Mahal:** Owner will need an architect for cosmetics and coordination of design, a construction manager for constructability, and engineers for innovative technology.
- (j) **Utilitarian but Innovative:** May be able to get away without an architect if you have a construction manager strong on constructability and the requisite specialized engineers for the innovative functions.
- (k) **Standard Functionality With Special Cosmetics:** Start with an architect and go from there.
- (l) **Plain Jane Standard Functionality:** Consider Design-build supported by required professionally sealed as-built drawings on completion.

B. PREPARATIONS FOR NEGOTIATION

Once the owner has identified the type of project and its design requirements, it should be ready to negotiate the following terms:

- (a) Who will be the members of the design team? Consultants have the people skills to accommodate a crowd, but they will be looking for a decisive authoritative available individual to make the decisions on behalf of the owner.
- (b) When must the design phase be completed? All Saskatchewan design firms are struggling to recruit and thus are struggling to keep up.
- (c) Is the owner expecting to elevate the standard of professional care for the design above “fellow practitioner;” most consultants are risk averse and, because they can’t get insurance for this elevation, will bargain hard concerning limitation of liability terms.
- (d) Does the owner expect a very reliable costs forecast? The Supreme Court of Canada has opined that a variance greater than 12% is careless, but consultants can’t get insurance for this risk.
- (e) Limitation of Liability Clause! Consultants are risk averse and are also concerned about long tail claims as well as liability of sub consultants to the owner and will seek to limit the coverage available when the claim is made.

- (f) What will be the consultant's duties? Consultants shy from being responsible for the methods of construction, but will want to administer the construction contract so that they can spot design problems while they're still a molehill and haven't grown to the mountain stage.
- (g) Who retains the Intellectual Property? Consultants covet their intellectual property rights to their "Instruments of Service," and this includes sub consultants as well as specialty subcontractors for whom the prime consultant will be concerned.
- (h) Termination Clause! Here, consultants usually low ball their costs and expectations during the concept and early design stages, thus they will want to back it up with a termination clause, which entitles them to a severance fee to fully recompense these costs.
- (i) Dispute Resolution! Almost all E & O insurance policies mandate arbitration for dispute resolution between the insurer and the consultant, thus architects prefer arbitration of architect-client disputes so that efforts can be made to have all issues handled in a single process.

IV. CONTRACTING CONSTRUCTION SERVICES

A. STANDARD DOCUMENTS ARE BEST

My experiences have persuaded me to become an unapologetic big proponent of the CCDC contracts for use as the base for your construction contract governance model. That is because they meet my requisites:

- (a) The stakeholders in the industry understand and trust these terms.
- (b) The interdependence between the various contract levels on any project has been optimally harmonized, thus reducing surprises and the cost of dispute resolution.
- (c) But for attending to timely written change orders, the traditional practices on the job site are usually consistent with the CCDC terms.
- (d) Though each CCDC form has its own purpose, wherever possible, they all use the same language.

- (e) Dispute resolution is cost effective because a substantial reservoir of jurisprudence construing these common terms has been developed and annotated.
- (f) The always dangerous gap between contract terms and available insurance products is narrowed because the new CCDC terms adopt the always upgraded CCDC 41.

Thus, if an owner wants to maximize the appeal of its project to contractors while minimizing the costs and delays of disputes, I recommend that you stick with the standard documents and revise them only with clear Supplementary Conditions.

B. CHOICES TO BE MADE

Briefly, the choice of documents comes down to the following and each has its own advantages and disadvantages.

1. CCDC 2 Stipulated Price and CCDC 18 Unit Price

(a) Advantages:

- i. Owner gets a fixed price for specific work.
- ii. Owner has no responsibilities for weather, constructability, or supply problems.
- iii. Owner has no contract liability to either the trades or the suppliers.
- iv. Owner can rely on contractor's insurance and bonding but must pay some of the cost.
- v. Owner's instalment payments are only for completed/delivered work at agreed contract value.
- vi. Owners and consultants are able to continue to be involved during construction.

(b) Disadvantages:

- vii. Owner has invested in construction drawings and specifications before having a certain price.

- viii. Owner pays extra for the risks transferred to the contractor.
- ix. Owner pays for design changes during construction.
- x. Owner can't fast track the design and construction phases.

2. CCDC 3 Cost Plus

- (a) Advantages and disadvantages similar to CCDC 2
- (b) But, owner can reduce the contractor's risk premium costs for escalating prospective construction costs and design changes during construction.

3. CCA 5 Construction Management

(a) Advantages

- i. Owner gets the benefits of an expert on constructability and costing during the concept and design phases.
- ii. Owner may be able to minimize the costs of "professional services."
- iii. Owners' employee with valuable building skills and/or who will be responsible to operate the project once completed, can be involved in all phases of the project.

(b) Disadvantages

- i. The construction manager is another cook and thus the elevated risks of mistrust and miscommunication.
- ii. Construction managers cost money.
- iii. Construction managers seldom have the owner's authority to make binding decisions on behalf of the owner; thus, delay is created because the line of communication between the owner and the consultant or contractor is extended.
- iv. Construction managers are becoming scarce in the Saskatchewan market.

4. CCDC 14 Design Build

(a) Advantages

- i. During the whole project, the owner need deal with only one party, the builder.
- ii. Project can be fast tracked by overlapping the design and construction phases.
- iii. Owner freed from ongoing involvement during the construction process.
- iv. Builder provides all insurance and contract security.
- v. Contractor assures design and construction warranties
- vi. Usually, the life of a construction project is reduced by approximately 30%

(b) Disadvantages

- i. Very early, owner must fix its Requirements
- ii. Owner must commit to the project before the design and cost details are fixed.
- iii. There is a potential for lack of construction quality control, but this can be checkmated by requiring professionally sealed as-built drawings.
- iv. There will likely be no substantial savings on the eventual project costs.

C. FINDING A BUILDER

So, now that the owner has determined the contract terms, the next step is to find an available skilled, efficient contractor. Clearly, contractors prefer fair negotiations rather than competitive bidding (some contractors will no longer participate in competitive bidding) because:

- (a) It costs them \$4,000 to \$8,000 to prepare a bid when they have only roughly a 20% chance of recovering this investment by winning the award.
- (b) The bid process treats all builders equal in spite of the fact that they are not; thus there is little opportunity for a bidder to show its strengths and suggest cost and schedule savings.
- (c) All bids are for the spec'd work, but the bidder takes the risk that the consultant's design is constructible

D. NEGOTIATING WITH A BUILDER

It is my judgement that the following are the requisites for successful negotiations resulting in quality work at a reasonable price and schedule.

- (a) The RFP, which can be distributed electronically through the construction association's websites, should announce:
 - i. The owner's functional reasons why it is not an Invitation to Bid.
 - ii. Announce an assurance that there will be a second stage of negotiations
 - iii. Provide performance based description of the owner's required work and schedule, but also encourage cost effective modifications.
 - iv. Include all available site access and geologic information.
 - v. Assure that the owner will treat all proposals as confidential.
- (b) When the proposals are received, treat the proposals as totally confidential; don't bid-shop the contractors, trades and suppliers and, don't reject the contractor's proposal without second stage negotiations.
- (c) Even after a proposal has been rejected, don't bid-shop its pricing and work changes among the remaining contractors.

These rules seem to be the prerequisite for sufficiently polishing the needed trustworthy image of the owner and consultant to optimize contractors' interest in the project.

E. THE COMPETITIVE BID PROCESS

Otherwise, where the owner has public policy reasons, or the integrity of the proposed design is not suited to accommodating significant constructability savings, then the owner is likely into the legal labyrinth of the competitive bid process where judges have been quick to second guess what owners and their consultants have decided.

- (a) A clear clause in the Invitation to Bid will approbate bid-shopping, but the owner should expect few bidders and initial high pricing.

- (b) Further, a clear clause in the Invitation to Bid limiting the time for and mandating arbitration for bid process disputes is legally possible.
- (c) A disclaimer clause proscribing any and all claims arising out of the Bid process **may be effective, but unless the owner/consultant have a good reputation for fairness, the owner should expect fewer bidders.**

F. THE RISK SENSITIVE CLAUSES

Finally, a few comments on the more risk sensitive clauses of the standard CCDC terms, which may be modified by supplemental conditions.

- (a) CCDC expects to, before Easter 2009, publish a new Construction Manager (as agent) form CCDC 5 A together with a guide
- (b) And, before the end of 2009, CCDC hopes to publish a new Construction Manager at risk form, CCDC 5 B, but here in Saskatchewan, contractors have recently developed a culture of disinterest in bidding such a contract.
- (c) Warranty Clauses – The one year period together with assigning on the manufacturer’s extended warranty is traditional and contractors are willing to take the risk that their suppliers and trades will come through with no cost support; otherwise, performance bonding is usually not available while contractors try to manage their risk by regularly stripping the net worth out of their operating company.
- (d) Indemnity Clauses – This clause is no more secure than the ability of the indemnifier to pay, thus give close attention to the contractor’s insurance and its continuing net worth. Generally, contractors do not have replacement coverage value in their liability policy.
- (e) Waiver of Claims – The usual term excludes the warranty and indemnity terms, but otherwise limits the owner’s claim to “substantial defects” discovered within the time bars of our *Limitations Act*. Here, the owner’s only security are the terms of the GCL policies of the contractor and the trades.

- (f) Disclaimer Clause – The usual term is that the owner disclaims any responsibility for method of work, while the contractor disclaims any responsibility for undiscovered design faults. These terms are so universal that “it goes without saying.” But, that doesn’t mean that judges won’t try to weasel around them.

V. BONDS AND INSURANCE

- (a) At the moment, the battles seem to arise where an owner decides to permit the project to go forward without All Risk property coverage, or where property damage to the project is not discovered until after both the performance bonds and the property coverage have expired, while the damage to the project is the insured contractor’s defective work.
- (b) Also, a reminder that beginning with the CCDC 2 – 2008 form, CCDC will henceforth be publishing contracts which adopt CCDC 41, a regularly updated compendium of the current insurance terms.

VI. CONCLUSION

I hope I haven’t made you a construction lawyer. Rather, I hope I’ve signalled some red flags and encouraged you to phone!