Study of the win – win approach in claims management related to construction contracts

Alireza Javadi Daha
The Islamic Azad University of Karaj.

ABSTRACT
The important issue concerning claims management is that the question of claims in contract agreements is an inevitable one and, hence, under present circumstances, where many faults are found in the process of signing contract agreements and in questions relating to the execution phase of contracts, the idea of their elimination does not appear to be a reasonable one. From among the problems faced in eliminating these claims, reference can be made to the present shortcomings in the general conditions of contracts and to the very noticeably slow progress made in the study and design phases of contracts. The purpose in writing this article was to offer strategies for selecting the win – win approach by parties to contracts for the whole duration of the projects from the start of the study phase to the end of the utilization period. It was necessary to conduct this research because many projects run into crises due to inappropriate management of claims laid and only result in wasting national resources.

Introduction

The Oxford Advanced Learner’s Dictionary (1997 Fifth edition) defines claim as “to demand or request sth because it is or one believes it is one’s legal right or one’s property”, and, in the Canadian Law Dictionary, claim is defined as demanding one’s right to receive property, to be compensated for losses incurred, and to be cleared of charges of dereliction of duty [4].

According to article one of publication number 4311 entitled “General Contract Conditions” and published by the Office of the Vice – president in charge of Planning and Strategic Supervision, contractors are committed to carrying out the items of the contracts with a specified quality, in a defined period of time, and at a determined cost. Therefore, a contractor can lay claims if any of the items stated in the contract is changed due to whatever reason [2].

QUALITY
↑
CLAIM
↑
TIME ⇔ COST

The important issue in claims management is that disregard for just claims, and consideration of unjust claims, will be accompanied by very disagreeable consequences for the related project. Some noteworthy statistics in this regard are as follows:

On the average, the time period taken for the completion of a project in Iran is three times that indicated in the initial contract (the Congress of Claims Management, Tehran University, the month of Azar, 2012)

Delays in carrying out the Pars – e - Jonoobi (Southern Pars) projects have led to Qatar exploiting four times more than Iran from this common gas field (the newspaper Hamshahri, June 19, 2006) [3].

According to a study conducted by the World Bank, 30 to 40 percent of all projects in every country in the world face increases in costs (EghbalShakeri and Ali Ghorbani, the Second International Conference on Project Management, Esfand [the last month in winter] of 2005).

Statistics published by the World Bank show that the problem of delays in carrying out projects exists not only in Iran but also in many other countries.

Some of the Factors That Cause Claims to Be Laid and Ways of Preventing These Factors

The following are some important issues which, on the basis of experience gained in previous projects, can be analyzed in relation to claims management:

1. Examination of the bid prices of the contractors, the necessity of their presenting cost analyses, the careful control of these cost analyses on the basis of the related instructions, and the role played by these in claims management.

Article 20 of the Law of calling for tenders, financial evaluation and determination of winners of tenders states that:
a. When carrying out financial evaluation, the bidder who has offered the most reasonable price (the most reasonable price does not mean the lowest price) will be announced as the first winner [5].

Despite the fact that the law explicitly states the bidder who offers the most reasonable price must be chosen as the winner in a tender; unfortunately, in practice, in many tenders the bidder offering the lowest price is selected as the winner. Therefore, a contractor who uses unrealistic prices in the cost analysis undertakes the carrying out of the project and, while executing the project, finds that the costs of performing the operations is more than those declared in the cost analysis. Therefore, instead of concentrating on carrying out the project, the contractor will naturally think of compensating for this difference (to be able to make a profit) and will resort to unorthodox means. Of course, it seems necessary to mention that the compensation of losses resulting from offering an unrealistic price is in no ways a valid claim and looks more like going back on one’s word; and, concerning this problem, all those in charge of projects, including project managers, must clearly distinguish the
Among the software used for the purpose of analyzing costs and that of going back on one’s word.

The Strategy for Handling Such Claims

At the time of bid opening, the fact that there are be several sheets of paper in each envelop representing the cost analysis is certainly insufficient for deciding the winner in the tender; but rather, it is necessary that the analyses performed by the related software be based on correct data (that is, data which in fact states the real prices of the items present in the internal evaluation of the project). Of course, a reasonable profit should also be included in these prices).

Among the software used for the purpose of analyzing costs, we can refer to the software TADBIR the last version of which is now available in the market under the name of TADBIR TOTAL PLUS.

2. Careful execution of phases zero and one, provision of funds, lack of haste in these stages, and the relationship of these with claims management

(On the basis of project management standard [PMBOK], projects must not start before their financial resources are determined) [3]

Due to the great goal-oriented interest of managers in the ground breaking ceremonies, and because of their disregard for the study and design phases (the consequences of which they do not take into consideration), many projects are started and put to tender (and contractors are selected), without spending the necessary time in carrying out the required study and design phases. In fact, it appears that managers consider phases zero and one as unnecessary formalities. While respecting the way of thinking of this type of managers, we know that we must learn from the results we obtained in our experiences in the past to be able to find our way in the future. If a project starts without carrying out the study and design phases, and without preparing operational maps, delays will happen at the start and during the period of carrying out the project in order to complete the documents and papers which should have been prepared in phases zero and one. These delays, in addition to prolonging the time needed to complete the project, will impose on the contractor the overhead expenses required to keep the worksite active. Unfortunately, according to the general terms of contracts, the only thing that is done under such circumstances is to merely extend the time stated in the contract for the completion of the project, and no allowances are made for compensating the financial losses incurred due to these delays. Therefore, it is evident that the contractor will lay claims which, usually, lead to nowhere. The question of lack of allocating financial resources before the start of the project can also be one of the factors for the contractor to lay claims in contract agreements because, if the employer does not honor related financial commitments, the project will stagnate and the contractor will have reservations about the future of the project, and will, in effect, get involved in details or fringes instead of focusing on the project. Concerning this issue too, the necessary mechanisms for compensating losses incurred by contractors due to delays in payments made to them have not been put in place either, except for an extension of the time stated for the completion of the project in the initial contract. It must be born in mind that in contracts signed on the basis of feedback, necessary mechanisms have been worked out regarding compensation for losses incurred due to delays in payments resulting from factors other than the shortcomings of the contractors.

The Strategy for Handling Such Claims

It is necessary to allocate realistically sufficient time for phases zero and one of the project in order to prevent claims of this kind. Furthermore, in accordance with project management standard (PMBOK), projects should not start before the necessary financial resources for the project are definitively provided.

The following schematic diagram can be used to show the relationship between different phases of a fixed project:

3. Acquiring the necessary permits from authorities related to the project and taking possession of the worksite before the start of the project and the relationship of these with claims management

In most projects, especially in road making, power lines, water and wastewater networks, etc., where the worksite is not concentrated at one place, there are authorized individuals and governmental and non-governmental organizations that can stop the project if necessary coordination has not been made and required written permits have not been obtained.

This same issue causes the realization of article 28 of the General Contract Conditions on the basis of which the employer has the duty of handing the worksite over to the contractor without consideration and without there being any interrupters or challengers; and under special circumstances, which are beyond the scope of the present article, losses incurred due to delays in the handing over of the worksite to the contractor, or suspension of work at the worksite, may entitle the contractor to receiving compensation.

When such circumstances arise, it is natural for the contractor, due to the high overhead expenses of keeping the worksite active, to claim compensation (which, of course, is a quite valid and correct claim. It is worth mentioning that the acquisition of necessary permits from related authorities can sometimes be a very complex and time consuming process and even impossible at times. Negligence in obtaining permits before the start of the executional operations of the project will certainly lead to work stoppage and to the closing of the worksite. Under such conditions, not only will the employer incur losses because of the damages that have to be paid, and due to the coming to naught of efforts made in the project (which may be followed by dire consequences), but the contractor will also run into difficulties since the main work is stopped and because, even if damages anticipated in the articles mentioned from the General Contract Conditions are paid to the contractor, the compensation received will be very small. Therefore, the contractor may be forced to make modifications in his workforce and to lose valuable members at the worksite. This will be a lose–lose situation for the parties to the contract.

Some of the organizations which, depending on the type of the project, may be in charge of issuing permits.

Among the organizations which, depending on the type of the projects, and in case necessary permits have not been obtained, can legally stop work on projects, the following (to name a few) can be mentioned: the municipality, the traffic department, the roads and transportation department, the environmental protection agency, the cultural heritage organization, and the natural resources organization. In addition to the issue of obtaining permits, the question of taking possession of the land where the worksite is located, or of obtaining the consent of the owners of the land in case it is to be used only temporarily during the period of the execution of the project, is of great importance the inattention to which may also result in work stoppage at the worksite (and in subsequent claims laid by the contractors).
The strategy for handling such claims

To prevent such claims from being laid, it is necessary to conduct required consultations with the related organizations even before the process of selecting the contractor (or during phase zero or phase one of the project), and to take possession of the land area where the worksite is located.

4. Preparation of the required and influential documents pertaining to the project including as built maps of infrastructure previously built, and its relationship to claims management

It has frequently been observed in various projects that lack of information concerning the location of infrastructure during the executional operation of the project, such as excavation operations, has brought about heavy damages. The occurrence of such problems at the worksite of a civil engineering project may, besides causing substantial financial damages, result in casualties. For example, if a loader cuts gas pipelines during the excavation operation of a project, explosions may happen resulting in the stoppage of work on the project (besides the work that has to be carried out to repair and correct the damages inflicted) and in the imposition of costs on the contractor. This also could be the grounds for claims being laid by the contractor.

The strategy for handling such claims

Preparing as built maps of infrastructure located at the worksite and in all the areas and routes leading to it through correspondence with the related organizations before the start of the executional operations of the projects is of vital importance in preventing damages happening to the infrastructure. Since some as built maps of infrastructure are confidential and governmental organizations do not readily provide them, it is necessary to think of ways to shorten the time required to obtain these maps so as the delays in the execution of the project can be avoided. Contractors must also identify the exact locations of infrastructure from as built maps and keep them in mind during the whole of the executional process of the project. It must be noted that damage inflicted on some infrastructure may even entail security problems in addition to creating financial dangers and besides endangering human lives.

6. Each party to the contract must be aware that the inevitable consequences of the infringement of the rights of the other party will be the creation of problems for the people and the extension of deprivation and poverty.

Employers and contractors, as natural or legal entities, include subsets of people whom the results of the execution of the project will directly influence; that is, the employer and the contractor have different incentives for gaining profits in carrying out the projects. The goal of the employer in the execution of the project included in his/her agenda may be to raise the general welfare level of the people, to earn revenues, etc. The contractor may also have goals such as to upgrade the ranking of the company and to receive an income. Obviously, results obtained from the execution of the project will also affect lower ranked people working for the parties to the contract. For example, if a contractor fails in a project, he will certainly not be able to pay the costs of keeping the people who work for him and, hence, will be forced to modify his workforce (which, at the macro-level, will raise the unemployment rate and will increase poverty in the related society). On the other hand, if the employer does not succeed in completing the project, he will have gained nothing in return for the money spent during the different stages of the project but the wasting of the resources of the related country (which will also result in the propagation of poverty and deprivation).

7. Inclusiveness and exclusiveness of contract agreements and avoidance of generalizations in the terms of the contract and the relationship of these to claims management

Inclusiveness and exclusiveness of the tender documents and of the agreement documents, including the agreement, the precise description of the required items, and also the clarity of the scope of the project, for the purpose of preventing different interpretations of the requirements of the project (such as the quality of the materials, the manner of making payments for the statements, the legal deductions imposed on each of the parties to the contract, etc.) can prevent claims from being laid.

8. The importance of visiting the worksite by the contractors before bidding prices and the relationship of this to claims management

In many of the projects put to tender, some contractors bid prices without visiting the site where the project is to be carried out and, in effect, bid prices without having any idea about the positive and negative risks of the project. Consequently, they either lose the tender because they have not taken the positive risks of the project into consideration and have offered a high bid price, or win the tender since they have not paid attention to the negative risks and have offered an unrealistic bid price; and when these risks materialize during the execution of the project, they will confront numerous difficulties and will lay claims in order to compensate the losses they have incurred.

The strategy for handling such claims

The most suitable strategy for preventing such claims from being laid is to make it compulsory for the contractors to visit the worksite because factors such as the weather conditions at the worksite and its distance from places where various materials needed for the project can be procured and the type of roads available, the touristic position, the topography, the height above sea level, and even the prevailing cultural and social conditions at the worksite, may directly influence the bid prices contractors will offer, and since taking the above mentioned points into consideration can contribute significantly to offering a realistic bid price.

9. Flaws in the general terms of the contract (publication number 4311 of the Office of the Vice – president in charge of Planning and Strategic Supervision) and the relationship of these to claims management

Unfortunately, ambiguities in the general terms of the contract and significant differences of these conditions from those of international standards such as those stated in the Red Feedback Book have constituted the grounds for laying numerous claims. It seems that the approach taken by the formulators of these general terms of contracts (publication number 4311) has been that contractors ought to be completely helpless and obedient, and that they should not be entitled even to the minimum rights specified in international standards. This has resulted in many false and valid claims being laid in relation to the content of the general terms of contracts. Meticulous investigation of the objections made to the general terms of contracts is beyond the scope of this article and, therefore, we will confine ourselves to mentioning only two of these terms and to comparing them with what is written in the Red FIDIC Book.

9. Article 39: Payments

On the basis of the first paragraph of article 39 of the general terms of contracts, at the end of each month the contractor prepares the statement of the work carried out from the start of the project and submits it to the supervisor engineer. The consulting engineer controls this statement with respect to its compatibility with the documents of the contract and, when
necessary, corrects the statement citing reasons, sends it to the employer not more than 10 days after receiving the statement from the supervisor engineer, and informs the contractor that he has sent the statement to the employer. The employer examines the statement controlled by the consulting engineer and makes the payment by writing a check in the name of the contractor not more than 10 days after receiving the controlled statement [2]. Objections leveled against this term are as follows:

In this article, the actual time allotted for examining the statement is not specified since it is stated in it that the consulting engineer must examine the statement within 10 days after receiving it from the supervisor engineer, and no ceiling has been set for the time required by the supervisor engineer for examining the statement [6].

Another very important point regarding this article is that the contractor will not receive any compensation for delays in timely payments of the approved statements, except that the durations of these delays will be added to the period of time set for the completion of the project. This is not a reasonable compensation because an increase in the time period for finishing the project will naturally increase the expenses the contractor has to bear, while, on the basis of article 14 – 8 of the Red Feedback Book, if the contractor is not paid the determined payment, he will be entitled to receiving the financial costs of the sum not paid at a monthly compound rate for the duration of the delay. On the basis of this same article, to the sums the payment of which have been delayed must be added an interest rate three percent higher than that of the lending rate of the central bank of the related country and the calculated amount must be added to the money due to the contractor[1].

10. Article 53: Settlement of disputes

In case a dispute arises between the parties regarding the execution or interpretation of the terms of the contract, the authority to settle the dispute will be the High Technical Council [2]. Given the fact that at present most contracts are awarded by government employers and the investigating authorities are also government employees, the impartiality of the arbitration will be in doubt, and the contractor will not be very optimistic about the way the judgment will be passed (even if the arbitrators are in fact impartial).

The strategy for handling such claims

The best way to prevent claims related to the general terms of contracts is to correct the ambiguous terms by following the principle of justice, and through employing the win-win approach that will benefit both parties. Concerning the same point, bringing the general terms of contracts nearer to international standards (including feedback) will not only solve the present difficulties faced by internal projects but also will pave the way for exporting technical engineering services abroad.

Conclusions

From the perspective of management, it can be stated that:

- Not all claims laid by contractors are necessarily exorbitant, though they may be; and an experienced project manager will possess the important skills for distinguishing valid claims from invalid ones.

- It is necessary to bear in mind that ignoring valid claims will have consequences such as a weakening of the executive arm of development projects (i.e., the contractors) and that this inattention can be the beginning of a lose-lose game. Therefore, the correct position to be taken in the question of claims management is to take as many necessary steps as possible to prevent the arising of issues that lead to disputes while heeding just claims; that is, claims must be investigated without any bias. For this purpose, and in order to maintain our professional dignity, if we conclude that one of the parties is right in his claims, we must contribute to the fulfillment of his rights no matter what our status is.

The GOLDEN SENTENCE OF THE ARTICLE: WHICHEVER PARTY OF A CONTRACT WE ARE, THE SECRET FOR OUR WIN LIES IN THE WIN FOR THE OTHER PARTY AND IF WE SOW SEEDS OTHER THAN A WIN-WIN SCENARIO, WE CAN REAP NOTHING BUT A LOSE-LOSE SITUATION.

Sources and References

1. The Red Fidic Book
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5. The Law of putting to tender
6. Majid Parchami and Mohammad Reza Adlparvar, “Basic challenges present in the contents of some of the general terms of contract agreements.”