Building

The Building Industry – Has It Lost The Plot?

- Hank C Laan, HCL Associates Pty Ltd.

Hank C Laan has had more 35 years experience in the engineering and building construction industries. During this time he has held senior executive positions in both the private and public sector including senior consultant project manager for a $650 million (1980) petroleum industry project in South Australia and inaugural Chief Executive and Director of the NSW Government Darling Harbour Authority.

Since 1985 Hank Laan has operated a consultancy practice specialising in the research, analysis, documentation and resolution of commercial disputes in the construction industry.

In this article Hank Laan argues that the building industry in NSW has "lost the plot" and makes some interesting recommendations how it might get back on track.

Given the findings of the 1992 Gyles Royal Commission into Productivity in the Building Industry in NSW, there is little doubt that the industry had to change. Now some seven years later it is relevant to pose the question have the changes that have been introduced improved the industry, or has it "*lost the plot*"?

There is little doubt that post Gyles, the militant unions have lost most, if not all, of their power to disrupt projects in the orchestrated manner that was such a feature of work during the 1980's when strikes or walkouts during concrete pours were not uncommon and project managers and clients alike lived in daily fear of the unions' guerilla tactics.

The Royal Commission also exposed certain illegal practices that were orchestrated (or at least aided and abetted) by organisations representing major contractors. The net result of that exposure is that one of the organisations that played an active role in promoting the contractors' best interests has ceased to exist whilst the other appears to have been emasculated (by real or perceived Government intervention) to the extent that few of the major contractors now look to it to represent them on issues of vital interest to the contractors' side of the industry.

There is little doubt that the demise of contractor organisations as an effective voice for contractors has led to a fragmentation of the contractors' part of the industry. As a result, instead of acting from a position of relative strength, individual contractors are being pitted against the might of the public sector and well organised client/ private sector developer organisations who are all determined to change the industry to suit their own best interests. The pendulum has swung with a vengeance!

The public sector, the single largest client of the industry, gave early notice of its intention to use its purchasing power to bring about change. Few would argue that the public sector is indeed well placed to bring about change, however, with the ability to make change comes a duty to act responsibly and that surely means taking a broader view and pursuing change that benefits the whole of the industry not just the industry's clients.

Private sector client organisations obviously have a somewhat different focus and may be forgiven for concentrating solely on their members' best interests, however, it should be obvious that in the long term their best interests will also be better served by taking the broader view.

As a young project engineer, I well remember my then project manager mentor's recipe for a successful project, he said, "*do whatever you reasonably can to make sure that everybody can make a quid*". That recipe is as relevant today as it was in the early 60's, however, it seems that very few, if any people now subscribe to it.

A senior public sector representative speaking at a recent Building Science Forum seminar, made the observation that clients want a guaranteed outcome. That is, they want to know what a project is going to cost up front and to get no surprises at the end. The same representative, when discussing contract conditions, made the point that the Government is not into "*consensus documentation*", it is the client and as such it is entitled to dictate terms. On their face, both those remarks would appear to be eminently reasonable, after all it is the client who is paying the money, therefore, it should be entitled to "*call the shots*". However, it is not unreasonable to suggest that a client's demands, should be based on realistic expectations that can be met by the industry rather than a client's ultimate "*wish list*".

Typical examples of "*wish list*" changes are Quality Assurance and Partnering. It is now widely accepted that neither of these initiatives have met the expectations held of them by those who saw them as a panacea for all sorts

of real or imagined problems of the industry. What appears to have been overlooked by those with the power to effect change is that everyone in the industry draws from the same skills pool. Client organisations, be they public or private sector, do not have a mortgage on superior skills, education or knowledge and are just as prone to making mistakes as contractors. Same goes for consultants. Hence, any attempt to introduce change should take due account of the impact of the proposed change on the whole of the industry, including the party that is driving the call for change and its ability to make an effective contribution to the change.

Quality assurance has undoubtedly achieved improvements in the way that the industry does business. However, taken as a whole, it is possibly one of the most expensive white elephants of the industry in recent times. Those who so stridently insisted upon its introduction have often themselves failed to meet the objectives of quality assurance. Then, instead of correcting the problem at source these organisations attempted to cover that situation by designing contract conditions that pass the risk of an incomplete or erroneous design onto the contractor who is supposed to check it during the tender period, identify all errors or omissions and then accept the risk. Convenient but not very equitable or realistic and one of the main reasons for QA being discredited in the eyes of many parts of the industry. Also a typical case of "*do as I say*" not "*as I do*" and a surefire recipe to discredit an otherwise laudable initiative.

The desire for a guaranteed outcome is not restricted to client organisations. Contractors likewise seek this Holy Grail. The real question, however, is balancing the equation to enable everyone to make a dollar and to do that, to enhance the possibility of a guaranteed outcome for all parties, requires a different approach from that which is being followed at this time.

In simple terms, the potential for achieving a guaranteed outcome for all parties is very much affected by the degree of uncertainty surrounding what it is that is to be delivered or reducing uncertainty in the description of what is required to be delivered improves the probability of a guaranteed outcome.

Unfortunately, the trend over recent years has been that more and more contracts minimise certainty whilst passing the risk of uncertainty onto contractors, leaving contractors with very little opportunity to obtain redress for matters that clearly have their roots in some act or omission on the part of the client or the client's representatives. As a result it is reasonable to state that for the majority of major building projects in progress at this time the contractor or builder is expected to carry the can for their clients' or their clients' consultants mistakes, misjudgments, sloppy workmanship and the like. It follows that contractors and builders will try to pass this on to their suppliers and subcontractors and thereby compound the inequity of this trend.

Senior representatives from major clients, particularly those from the public sector, are on record as agreeing that this is what is being done but that in the pursuit of the mythical "*certainty of outcome*", they are expecting the contractor to price the job accordingly and take the risk. With respect to those client representatives, that represents a hopelessly naïve point of view and demonstrates that the clients have not been able to get their own house in order and have had no option but to look to contractors to make up for their own deficiencies. Is this really the way to go or is it merely transferring the problem to the party that is least able to deal with it, either at time of tender or subsequently.

By direct contrast to NSW's "*we are the client so we get what we want attitude*" the Victorian Government via the Minister for Planning and Local Government Direction No 2 is seeking to embrace a more enlightened attitude including:

- that contracts should allocate risks to the party best able to manage the risk; and
- that standard terms of conditions should be used in public construction with special conditions kept to a minimum.

Whilst not the answer to all of the industry's problems, the Victorian initiative would go a long way toward creating a more equitable position for all parties.

Another "*fact of life*" of the industry is that builders and their subcontractors generally price the drawings. Very few, if any, have the time or even the necessary specialist personnel to do a complete crosscheck between drawings, specifications and the other documents that comprise a contract. Hence, if there are significant inconsistencies between the drawings and the other contract documents then it is almost inevitable that a builder, when tendering for a contract, will not have identified those inconsistencies and made appropriate allowance for them.

It is not stretching matters too far to suggest that persons or organisations charged with the responsibility for preparing documentation when faced with cost overruns in their work, might opt to cut corners, instead leaving the Builder to make good any errors or deficiencies. If the Builder accepts that risk, then the matter of the documentation containing errors or deficiencies is never raised again and the party who prepared the poor documentation gets off scott free. No accountability, no responsibility!

How does a builder assess the cost of that risk? What criteria can he use? Add 10% or 20% to the price or hope for the best? The first will mean not getting the job, the second potential disaster!

Has the industry in New South Wales lost the plot? If the aim is to have a viable industry where everyone can make a dollar, where risk is shared equitably, where expectations are realistic and achievable, where a party that has the capacity to bring about change does so with equity and fairness, then, yes, the current situation is that we have lost the plot, big time!

So how does the industry get back on track? How does it achieve that certainty of outcome that everyone, both client and contractor would like to have? The answer has previously been identified via earlier industry reports such as "No Dispute" the 1990 predecessor to the Royal Commission. The recommendations of "No Dispute", were generally acknowledged by the Royal Commission, hence it is relevant to restate excerpts in respect of both the allocation of risk and contract documentation.

With regard to "*risk*", No Dispute adopted the basic principles of allocating obligations and/or risks as

expounded by the international construction lawyer Max Abrahamson. Part of these principles include a statement that reflects the principle being adopted by the Victorian Government that is:

" a party to a contract should bear a risk where;

- *'The risk is within the party's control.'"*

No Dispute, in dealing with the "*quality of documents*", also made the following recommendations.

- "*Attention should be directed at ensuring that the client's objectives and requirements have been adequately defined in the brief to the designers.*"
- "*Sufficient time should be permitted to ensure that design and documentation are properly carried out and that they meet the client's requirements.*"
- "*Responsibility should be allocated to ensure that documentation is properly co-ordinated.*"
- "*Consultants should be paid on a realistic level of fees for the work which they are required to undertake.*"
- "*Actions should be taken to co-ordinate the design and construction phases of complex projects by construction industry involvement in the design process.*"
- "*Consideration should be given to reducing design fees in relation to cost increases during the construction period for which the design consultant is responsible.*"

Sad to say, almost none of the above recommendations appear to be reflected in a large percentage of the contract documentation issued for tender since No Dispute was first published. What is clearly evident is that the client side of the industry has seized on the fragmentation of the industry (post Gyles) to selectively implement those recommendations of both No Dispute and the Gyles Royal Commission that suit the client's needs. The result is the current trend which, rather than improving the whole of the industry, will ultimately cause contractors to refuse to work for particular clients. The industry is already seeing examples of that and more are likely to follow.

It has been suggested that the only real way to achieve the result that client organisations appear to be looking is for margins to be significantly increased thereby providing a "*buffer for builders*". In support of that suggestion, research into the incidence of commercial disputes in the building industry both by the author and Government instrumentalities shows that contracts tendered during recessions in the industry are more likely to be the subject of disputes than those tendered in more buoyant times. The author's research into building projects over the period from 1985 to date conclusively shows that commercial disputes generally only arise when the contractor is losing money on a project. That is, notwithstanding, that a contractor might have an entitlement for additional monies under a contract, if that contractor or builder is in fact making a reasonable margin, then in a majority of cases the builder or contractor will not pursue any claim for additional monies preferring instead to maintain the goodwill of its client and look to future business. All of this supports the view that increased margins would help to solve the current problem. However, as projects are generally bid on a competitive basis then short of collusion between tenderers, it is highly unlikely that the industry will suddenly increase margins "*across the board*" and thereby solve the problem. It is just not going to happen under a competitive tendering, lowest tender type of industry.

One possible way to lift margins and one that could readily be instituted by the industry's largest employer, the New South Wales public sector, would be to adopt some innovative way of analysing tenderers prices. By way of example, rejecting the highest and lowest tenderers then averaging the remainder and accepting the tender from the party that is closest to the average would have the effect of raising margins. Given that a client adopting this selection process will clearly be paying a higher price than is initially available from the lowest tenderer it is reasonable to suggest that this selection process is unlikely to find great favour with private sector clients and highly unlikely to be adopted by Government organisations charged with the responsibility of spending public moneys to high standards of public accountability.

Another option might be for clients to clearly identify the areas of risk that they require the contractor to accept and then require tenderers to nominate moneys allowed against each of those risks. Any cost arising out of the risks actually being encountered might then be dealt with in a variety of ways, including some form of costs sharing, e.g. where up to the amount nominated, the contractor be entitled to be paid for a significant percentage of cost arising out of the risk. Conversely, if the actual cost exceeds the amount nominated by the contractor, then the contractor bears the greater part of the costs. A typical example might be 70:30 in favour of the contractor for cost up to the nominated amount and 30:70 for cost in excess of the nominated amount.

The introduction of such an initiative would clearly identify what clients are paying for contractors to take the risk. This in itself would be a significant benefit to both parties. It would also operate to mitigate at least part of the financial burden that the contractor would otherwise be required to bear.

Of course, the introduction of such an initiative would only work if it was accompanied by an administrative system that considers costs entitlements on their merit and not subject to all sorts of restrictive contract conditions designed to prevent the contractor from being paid.

A common complaint of the industry is the high cost of tendering and the fact that since the Gyles Royal Commission the industry has lost the benefit of bills of quantities being issued as part of the tender package. It has been suggested that tenderers jointly employing a firm of quantity surveyors to prepare a Bill of Quantities could be construed as collusive practice, which to a legal layperson such as the author, smacks of overkill in the extreme. However, it should be possible for client organisations to engage the services of a firm of quantity surveyors to prepare a Bill of Quantities to the standard

generally desired by the industry and then levy a fee on all parties tendering to cover the cost of the preparation of the BOQ. A client organisation adopting this initiative would of course want to distance itself from having any responsibility for the accuracy of the Bill and in that regard it would seem appropriate for the tender documents to include the terms of engagement and specification issued to the firm of quantity surveyors thus enabling prospective tenderers to clearly determine the quality of information being provided to them. A further refinement might be for the quantity surveying contract being novated to the successful tender with provisions that would allow the successful tenderer some recourse to the quantity surveyor for any errors that result in the tenderer incurring significant or the additional costs. Such a system, if implemented, would reduce the cost of tendering as well as increasing the accuracy of Bills of Quantities. A further benefit would be to increase the likelihood of at least part of the errors and omissions in the design being identified by the firm of quantity surveyors and thereby maintaining a "*level playing field*" where all tenderers are pricing the work on the basis of identical information.

Much has been said about different forms of project delivery systems, e.g. design and construct ("D&C"), design, novate and construct ("DNC"), design documentation and construct ("DD&C"), project management and construction only contracts.

Again, the main source of the information regarding the different forms of contract are publications distributed by the public sector. The publications are voluminous and appear to cover every possible situation or eventuality, however, a significant number of major contracts have failed to meet the expectations of their authors. There are many reasons for this, including the fact that, in the case of public sector projects, political imperatives often have projects being tendered before documentation has been completed to the stage required to support the particular project delivery system. A typical example of this is the DD&C type of contract which appears to have attracted more than its fair share of problems over recent years. One of the problems with DD&C appears to be that cost planning is utilised by client organisations prior to calling tenderers. However, once a contract has been let, then regardless of the incomplete or erroneous nature of the documentation, the contractor is denied the opportunity itself to cost plan to maintain the contract price. Instead, clients will often insist on the "*best of everything*" on the basis that the contractor accepted the risk.

It is the author's view that a DD&C form of project delivery system, modified to incorporate cost planning as part of the contractor's way of dealing with increased cost could resolve some of the problems being experienced with this form of project delivery system.

Notwithstanding all of the foregoing comments, the real key to improving the industry and securing a guaranteed outcome for all parties lies in improving the documentation for a project. To illustrate just how far the industry has gone away from properly documenting projects, we only need to look at a report prepared by the Research and Policy Division of the Gyles Royal Commission into productivity in the building industry. That report entitled "*Towards Implementation of Existing Reform Proposals*" cited extracts from a joint submission of the Royal Australian Institute of Architects and ACA (Association of Consulting Architects). The submission noted that design consultants are often engaged on such unrealistically low fees as to make it commercially impossible for them to provide the resources necessary to meet their obligations to produce quality design documentation. Herewith, perhaps, lies the nub of the problem. Consultants preparing documentation to a price rather than a standard of quality/completeness. Under this scenario, the ultimate client has gained nothing!

Allowing consultants to dictate the standard of documentation they will deliver for their price is fraught with danger. Whatever happened to specifying the level and accuracy of detail required to be delivered by the consultants and then ensuring that regardless of the price offered, the consultants be required to perform to that standard.

That information clearly needs to be made known to all parties who will use the documentation right up front.

Another positive means of identifying the risk that builders are being asked to accept would be for the clients to require their consultants to specify the level of detail that has been provided by them on the drawings, and most importantly, what has been left out for completion by others with specific, not generic, descriptions of the omissions. It is surely not beyond the capability of the various professions to develop detailed check lists of typical design details for various types of buildings and to utilise these to indicate what has or has not been detailed. This could fill the dual purpose of clients being better placed to check the completeness of documentation being provided by their consultants and guide the builder as to the risk that he is being asked to assume.

Finally, with regard to errors or non disclosed omissions in documentation provided by consultants, what is wrong with holding the consultants themselves responsible for such errors? Surely it is not beyond the skills of the legal profession to come up with a means of establishing a contractual linkage between the client's consultants and the builder such as would empower the builder to claim against the consultants for errors or non disclosed omissions in their design. The adoption of such an initiative would benefit clients in that there would be a higher probability of a guaranteed outcome, it would benefit consultants in that their input to individual projects would inevitably be increased resulting in increased fees and it would benefit the builder and subcontractors by "*sign posting*" the level of risk that they are required to accept as well as providing a means of recovering cost incurred as a result of errors or non disclosed omissions in the design. Under this arrangement everyone bears responsibility for the part that they play in a project. ❑

Editoral Note:

In Building Australia magazine, February 1999 at p12, Janet Holmes a Court speaks of "*the abysmal state of design documentation plaguing the industry*". Mrs Holmes a Court's comments about "*the poor quality or late delivery of design documentation*" provide timely support for Hank Laan's comments.

- J.T.