

# A PLANNING FRAMEWORK FOR CONDITIONS OF CONTRACT FOR USE IN PARTNERING PROJECTS

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Construction projects are characterised by their participants having conflicting and different objectives. For this reason, construction conflicts and adversarial business relationships are common. In recognising the need for a more 'co-operative' and less adversarial construction environment, Partnering approach has been proposed as a means of achieving it. Evidences can be found in Australia, UK and USA that the construction industry is beginning to recognise the benefits of Partnering, including improved working relationship, programme certainty, and reduced waste. Whilst much has been reported on the Partnering process, this paper deals with another important aspect of Partnering: the conditions of contract. With the emphasis on cooperation, trust and openness in communication, the traditional form of contract featuring strong confrontational ambit is considered inappropriate for Partnering projects. This paper describes a framework for the planning of conditions of contract for use in Partnering projects. The planning framework deals with the three key aspects namely, risks, problem resolution and performance. The principles guiding the planning for the three aspects are also discussed.

Keywords: dispute resolution, partnering, performance, planning framework, risk.

## INTRODUCTION

The construction industry is one of the main pillars of Hong Kong's economy. It accounted for 5.6% of the GDP and 40% of gross domestic fixed capital formation (CIRC, 2001). The industry employs over 87,000 site workers and the employment level for the building and construction is well over 250,000, including such professionals as contractors, engineers, consultants, surveyors and other construction-related professionals (TDC, 2001). Therefore, any major changes in the industry would not only affect the state of economy but also the Hong Kong community as a whole.

The recent spate of non-compliance construction incidents has raised public concern over the construction operations and the quality of buildings in general. The Construction Industry Review Committee's Report (2001) has made a number of recommendations on how current construction practices can be improved to foster a quality-driven construction industry. One of the recommendations is the adoption of a Partnering approach in delivering construction projects. In doing so, a less adversarial and more cooperative construction culture is expected. Such belief is consistent with the findings of earlier studies of Egan (1998) and Latham (1994). In Hong Kong, piecemeal use of Partnering had been recorded in a few Government projects prior to the MTRC's Partnering endeavor in the Tseung Kwan O Extension Project contracts in 1998 (Bayliss, 2001). Since then, Partnering approach was used in a number of projects as a new project procurement strategy. Notably, the KCRC and HKHA have

also applied the Partnering approach in the procurement of their building and construction works since the 1998. Recently, the HKHA (2000) and CIRC (2001) reports have also aroused public awareness on the potential benefits of Partnering to the construction industry.

The delivery of a Partnering project needs to be equipped with the right accessories. Success can hardly be expected if the existing one-sided conditions of contracts are used. The CIRC rightly points out that “government organizations and other major clients to consider a new form of contract that integrate the Partnering approach into the contractual relationships” (CIRC, 2001). In Australia, the New South Wales Government has developed the C21 Construction Contract to provide a solid foundation for putting Partnering in practice. The primary objectives of the C21 Construction Contract are co-operative contracting, clear definition of roles, responsibility for outcomes and focus on enabling best practice (C21, 2001). In UK, in response to the Latham and Egan reports, the ACA standard Form of Contract for Project Partnering has been launched to promote the concept of ‘co-operative contracting’. This has proven to be highly effective (CIRC, 2001). In 2001, the Engineering Construction Contract developed by the Institute of Civil Engineers has also launched a Partnering option. In view of the increasing use of partnering, the need of a planning framework for Conditions of Contract for use in Partnering projects is self-evident.

## **PARTNERING IN CONSTRUCTION**

The construction industry is highly fragmented with numerous discrete groups pursuing their own objectives and seeking to maximize their own benefits (Cherns and Bryant, 1984; Newcombe, 1996; Walker, 1996). Because of this inherent feature, conflicts between project participants are common and inevitable. Conflicts that are not managed properly, can lead to project delays, claims, and as a result, adversarial business relationships. In recognising the need for a less adversarial and more efficient construction industry, the Partnering concept has been identified and advocated as the blue print for reform (CIIA, 1996; CIRC, 2001; Egan, 1998; Latham, 1994; NEDO, 1991). Partnering has been promoted by various writers as a way of achieving a win-win business relationship in which value and communication is based on trust and openness (Bennett and Jayes, 1998; Cook and Hatcher, 1991; Hellard, 1995; Lazar, 2000). According to the studies on partnered projects (CIIA, 1996; Newman, 2000; NEDO, 1991), the perceived benefits of Partnering include: reduced exposure to litigation; lower risk of cost overruns; lower risk of delays; a better quality product; lower administrative costs; and increased opportunity successful project.

Ample studies on Partnering as a means to achieve a more co-operative contracting environment have been reported (CIRC, 2001; Kumaraswamy and Matthews, 2000; Hartnett, 1990; Latham, 1994; NEDO, 1991; Li *et al.*, 2000). These studies provide valuable background information and have been instrumental in arousing the interest of the construction profession to adopt a Partnering approach for delivery of construction projects. The interest in the Partnering approach has brought a wave of studies on the critical elements for successful Partnering (CIIA, 1996; Crane *et al.*, 1999; Li *et al.*, 2000; Kumaraswamy and Mathews, 2000). While some have conducted studies to examine the contractual aspects of Partnering (Butcher, 1997; Dorter, 1997; Heal, 1999; Mckenna and Co, 1997; Newman, 2000), others have attempted to model Partnering in a more structured and logical manner (AGCA, 1991; Gransberg *et al.*, 1999; HKHA, 2000; Li *et al.*, 2000).

Despite the extensive studies on the topic, however, little has been done on the preparation and drafting of construction contracts (Black, 1999), i.e., the style and types of contract clauses that shall be employed in order to achieve the Partnering objectives. In fact, the CIRC's report (2001) calls for the development of a new form of contract which integrates a Partnering approach into the contractual relationships.

Previous researches have attempted to examine the essential elements in successful partnering (Li *et al.*, 2000). In essence, successful partnering requires honesty, trust and proactive communication among project participants. Partnering is merely a 'lip-service' if contracting parties have no real intention to go beyond the "partnering" slogan. Partnering arrangements such as workshops and charters can be effective means to effect a cultural change; from an adversarial and blaming culture to one that is based on mutual respect and trust. However, it is believed that Partnering cannot be sustained if no practical benefits can be realized. Such view is also shared by Bayliss (2001) and Bennett and Jayes (1998). With the increasing use of Partnering contracts in the construction industry, the planning and theoretical construct for Partnering contracts would be invaluable to the industry.

## **A PROPOSED PLANNING FRAMEWORK FOR CONDITIONS OF CONTRACT FOR PARTNERING PROJECTS**

Planning of construction contracts, like any other planning function, requires a systematic approach to ensure its comprehensiveness. Construction of a project is an economic activity where the owner, in return for the construction works, promises to pay. This involves an exchange of value. In executory contract, construction being a classic example, a coordination requirement naturally arises. In the construction contract context, this coordination spans horizontally between contracting parties and involves a number of other participants not parties to the contract. The potential success of such coordination relies on the efforts spent in contract planning. The legalistic approach towards contract planning is to identify the issues, contingencies and matters that need to be dealt then followed by drafting appropriate provisions to ensure the intended effect can be materialised. A theoretical construct will help to conceptualise the planning process. Macneil (1975) for example suggested that risk and performance planning are the two fundamental planning parameters for all commercial contracts. Building on this concept and in view of the importance of dispute resolution in construction, Cheung and Lenard (1997) suggest that planning for dispute resolution is also an integral part of contract planning. These three planning parameters should be used in the proposed planning framework. In addition, the C21 Construction Contract, that has placed strong emphasis on co-operative contracting, is used in this paper to illustrate some of the suggestions of the proposed planning framework. The C21 Construction Contract is used by the Government of the State of New South Wales, Australia. It is not suggested that the C21 Construction Contract is the ideal model, but that where other appropriate conditions of contract drafted for use in partnering projects can be tested by the suggested planning framework in future studies.

## **RISK PLANNING**

Risk and uncertainty are different concepts. Risk is the exposure to the probability of economic or financial loss or gain, physical damage or injury, or delay, as a consequence of the uncertainty associated with pursuing a particular course of action. Uncertainty represents a unique situation where there is little or no empirical basis for

the information of probability distribution (Chapman & Cooper 1987). The above definition indicates that risk has at least two components; risk event and potential loss or gain. Nevertheless, it is common for risk to be considered from the negative perspective. The degree of riskiness varies with the complexity, size, and duration of the contract. Contractual provisions distribute risks between the parties who, in turn, seek compensation, usually financial, for the risks that they assume (Cheung 1997). The application of risk management provides explicit recognition of the risks which parties to a construction project are required to take. The pattern of risk distribution has a major influence on project price, and in extreme cases, the distribution of risks can result in a party withdrawing from the proposed scheme. Risk planning in construction contracts therefore is an integral part of risk management in construction project management.

According to Macneil (1975), risk is a man-made concept. It is a recognition that human beings are in a constant state of partial ignorance about the future. Risk is thus reduced whenever human being acquires more certain knowledge about the occurrence or non-occurrence of the future losses. Risk planning is therefore planning how to avoid loss in a contractual relationship. Risk planning in construction contracts has also been identified as risk allocation. In this context, ample studies (Chapman and Cooper 1987; Cheung, 1997; Erikson, 1979; Mason, 1973; Perry and Hayes, 1985; Porter, 1981) have been conducted and varies allocation principles (Abrahamson, 1984; Ashley, 1977; Casey, 1979; Lloyd, 1996; Thompson and Perry, 1995) have been suggested. Nonetheless, none of the reported studies has focused on Partnering projects.

Thompson and Perry (1995) after reviewing the allocation principles expounded by various writers provide the following summary on allocation criteria:

- Which party can best control the events that may lead to the risk occurring?
- Which party can best manage the risk if it occurs?
- Whether or not it is preferable for the client to retain an involvement in the management of the risk?
- Which party should carry the risk if it cannot be controlled?
- Whether the premium to be charged by the transferee is likely to be reasonable and acceptable?
- Whether the transferee is likely to be able to sustain the consequences if the risk occurs?
- Whether, if the risk is transferred, it leads to the possibility of risks of a different nature being transferred back to the client.

The above criteria can be conceptualised as allocating a risk to the party in accordance with the party's ability to manage, control or foresee the risk concerned. These have been well received by the construction industry. Nonetheless, for partnering projects, where emphasis is put on recognition of mutual benefits and win-win scenarios a joint risk management paradigm is needed (Rahman and Kumaraswamy, 2002). Joint risk management is fundamental in partnering endeavours as it moves away from the 'you or me' mentality. Instead it is acknowledged that certain risks in construction should and could be shared, or more precisely, be jointly managed. For example, according to a recent survey conducted in Hong Kong (Raham and Kumaraswamy, 2002) the respondents are in the view that public disorder, force majeure, third party delays,

physical impossibility, delay in resolving contractual issues, delays in resolving disputes are best managed jointly by the client and the contractor. This is seen as an empirical support to the move towards wider acceptance of the partnering approach in Hong Kong. Hence for risk planning in partnering projects, it is suggested that in addition to the well accepted allocation criteria of manageability, controllability and foreseeability, joint risk management should also be included as a planning dimension. In this regard, "which risk should best be jointly managed by the contracting parties?" should be added to the list of allocation criteria provided by Thompson and Perry (1995).

## **PROBLEMS RESOLUTION PLANNING**

One essential ingredient of Partnering is to resolve problem as soon as possible, thus avoiding the problem of them escalating and becoming dispute. In addition, a collaborative attitude is called for. Hence it is necessary to re-orient project participants in Partnering projects from a dispute resolution perspective into a problem-solving perspective. The traditional dispute resolution provisions of arbitration and litigation would not be appropriate for Partnering projects. Nonetheless, as the possibility of having dispute cannot be overruled, developing a hybrid system that enables problem solving and dispute resolution (herein called as problems resolution) is a more pragmatic approach.

It is therefore suggested that Alternative Dispute Resolution techniques should be incorporated. In addition, a problem resolution ladder involvement the senior management staff should also be considered. The involvement of senior management staff has proved to be an effective means to avoid procrastinating problems. In actual fact, many partnering projects, an issue/problem resolution ladder will be established at the first partnering workshop. This arrangement should be within the planning ambit and contract provision to accord such arrangement should be effected. This should also be set as a condition precedent before the triggering of the dispute settlement clause that involves alternative dispute resolution techniques and the other more formalised process of arbitration/litigation.

Clauses 63 and 64 of the C21 Construction Contract contain provisions analogous to the above framework. A three-tier ladder that comprises of Senior Executive, Expert Determination and Litigation for issue resolution is planned. If a party gives notice of an issue, the Senior Executives charged with this responsibility must promptly try to resolve the issue (CL 63.1). A party is not entitled to refer an issue to Expert Determination until 21 days after giving notice of an Issue (CL.63.2). A party may only refer an issue to expert determination by giving notice to the other within 28 days of entitlement. Notice has not been given within the time limited is barred from Expert Determination or any other action or proceedings (including court proceedings) (CL.63.3 and 4). Expert is to be agreed between the parties. If agreement cannot be reached within 28 days, Experts will be nominated by the person in Contract Information (CL.64.1). Letter of engagement is issued to the Expert upon agreement/nomination. (CL. 64.2). Fees and out-of-pocket expenses for the Expert must be shared equally by the principal and contractor. (CL.64.3). In answer to any issue referred to the Expert by a party, the other party can raise any defence, set off or cross claim (CL.64.5). If the Expert determines that one party must pay the other an amount exceeding the amount in Contract Information Item, then either party may commence litigation. (CL.64.6)

Unless a party has a right to commence Litigation, the Expert's determination must treat as final and binding and give effect to it. (CL.64.7)

## **PERFORMANCE PLANNING**

Partnering in many aspects is closely related to theory of relational contracting which originated in the 60's. The interest in relational contracting stemmed from the doubt over the adequacy of the classic contract law to describe and understand contractual transactions. This criticism is particularly heavy in the context of long-term contracts that typically require the contracting parties to use a co-operative manner to maintain both business and contractual relationship. In this regard, relational contracts are the norm for complex transactions to be conducted in environment of high complexity, where complete contingency arrangements are impossible. Successful completion of the transaction relies on the co-operation and the desire to effectuate the contract.

Construction contracts are used to regulate construction activities. Hence the most important goal of performance planning is smooth and efficient performance. Legalistic approach to performance favours full detailing of rights and obligations, as well as exhausting every eventuality, the so-called complete contingent contract. This approach is applicable for simple discrete transactions. However, where the environment is dynamic and full of uncertainty, effort to prepare a complete contingent contract may prove in vain. Instead a more flexible approach to allow gap fillings will be more appropriate. Construction projects are notable examples. Partnering concepts appeal to this call for flexibility. In addition, the contract must allow certain flexibility so as to enable the necessary adjustments as appropriate (Cheung, 2001; Lyons and Mehta, 1998).

The C21 Construction Contract set out the following requirement on co-operation:

### Clause 3: Co-operation

"The parties must do all they reasonably can to co-operate in all matters relating to the Contract, but their rights and responsibilities under the Contract (or otherwise) remain unchanged unless the parties agree in writing to change them."

### Clause 4: Duty not to hinder performance

"Each party must do all it reasonably can to avoid hindering the performance of the other under the Contract."

### Clause 5.1 Early Warning

"Each party must do all it reasonably can do promptly inform the other of anything of which it becomes aware which is likely to affect the timing, cost or quality of the Works, and the parties must then investigate how to avoid or minimise any adverse effect on the Works."

A caveat though is the potential opportunistic behaviours of either party to the relatively loose contractual arrangement on flexibility. Reliance on the good faith of the parties is not particularly welcome by the legal profession, at least under the common law system. This is so as the legal force of Good Faith requirement in Common Law remains uncharted (Haley and Shaw, 2001).

Another important aspect of performance planning is the use of incentives. The concepts behind Partnering are fine but cannot sustain if no benefits can be resulted or perceived. Incentive schemes have proved to be highly effective to bring about both tangible (money and time) and intangible (trust, confidence and commitment) of

Partnering efforts. Incentivisation schemes such as milestone payment, target cost and gain share/ pain share arrangements have been used successfully in Hong Kong. Value engineering options should also be allowed to make full benefit of the partnering attempts. Hence, performance planning for conditions of contract should go beyond the allocation of rights and obligations. For efficient contract performance, planning efforts should also be directed to the inclusion of incentive approaches such as milestone payment, gain share/ pain share, value engineering option and target cost.

The incentive related provisions in C21 include:

**Clause 35: Innovation**

“This clause is an incentive to the Contractor to improve its service to the Principal by innovation. Essentially, if the Principal accepts the Contractor’s proposal, the Contractor benefits by retaining immediate savings in its costs; The Principal benefits from added values to the Works, reduced operating or maintenance costs, or similar savings.”

**Clause 53: Additional Completion Amount**

“The Additional Completion Amount provides an incentive; the earlier the Contractor achieves defect-free Completion of the whole of the Works, the earlier the payment occurs.”

**PICTORIAL REPRESENTATION OF THE PROPOSED FRAMWORK**

In sum, the proposed planning framework is an integration of the planning for risk, problem resolution and performance as presented in the Figure 1.

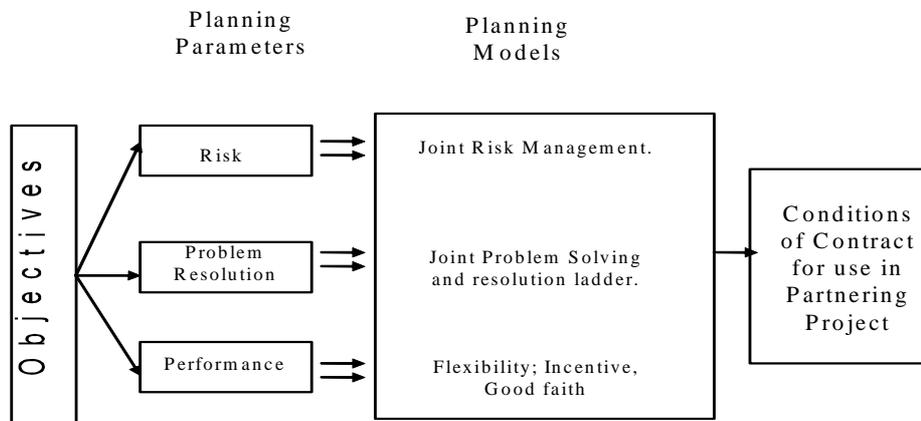


Figure 1 A Planning Framework for Conditions of Contract for Use in Partnering Projects

**CONCLUDING REMARKS**

It is evident that procuring construction projects with a Partnering approach shall become the norm. Previous researches and studies on Partnering has laid a solid foundation for the understanding and structuring of Partnering process. A successful Partnering venture must be equipped with the appropriate accessory. In this regard, the Conditions of Contract to be used should provide the governance for effectuating the Partnering objectives. A framework including risk, problems resolution and

performance as the planning parameters are proposed. Joint risk management, problems resolution ladder, appropriate allowance for flexibility, and use of incentive should be planned in all Conditions of Contract for use in Partnering projects.

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