CONTRACTS AND CONTRACTORS

Almost inevitably, projects will make use of contractors to undertake part or all of a project.

Contractors have their loyalty to their firms and not to the promoters of the project. This means that contractors will try to maximise their own profits.

DEFINTION OF A CONTRACT

An agreement giving rise to obligations which are enforced or recognised by law. The factor which distinguishes contractual from other legal obligations is that they are based on the agreement of the contracting parties.

OR

A legally binding agreement made between two or more persons, by which rights are acquired by one or more to acts or forebearances on the part of the other or others.

A contract is a bargain between parties, where one party agrees or promises to do something (such as supply equipment) in return for a promise of the other party (i.e. to pay the price).

GENERAL PRINCIPLES OF CONTRACT

Unless a supplier and customer have entered into a binding contract, each party is still free to change his mind.

A supplier could withdraw or change his terms eg. by raising his prices.

A customer is under no obligation to accept a quotation, even though long and expensive negotiations may have preceded it, and loss borne by the supplier in preparing a tender with detailed specifications and drawings.

A letter of intent from the customer to the supplier does not normally create a contract between them.

A contract can be made on the customer's conditions of purchase, or the client's conditions of sale. The terms will be different as each views the arrangement from a different perspective

eg. Is the price quoted a fixed price?

Does it include the cost of carriage or is it ex works?

Who is responsible for any accidental damage during transit?

When does ownership pass to the customer?

OFFER AND ACCEPTANCE

Offer

An offer is a statement that the person making it is willing to contract on the terms stated. It should be distinguished from an offer to treat such as the display of goods in a shop window, where the supplier is inviting the customer to make him an offer.

Care needs to be taken to distinguish between a request for information and an offer.

An offer may be "revoked" or withdrawn at any moment prior to acceptance, unless an option agreement provides for it to be kept open for a fixed period.

Communication of offer

An offer cannot take effect until it has been received by the offeree, since he or she cannot accept something of which they are not aware.

Communication of acceptance

A contract will not be created until the acceptance is communicated to the offerer.

General rule is that some manifestation of the acceptance is communicated to the offeror.

The postal rule is an **exeption** to the general principle. If the parties are dealing through the post, the contract is made when the letter of acceptance is posted, so even if it is lost, the parties are still bound.

Acceptance

An **acceptance** will result in a contract, if it is in the same terms as the offer:

"YES" is an acceptance

"YES, provided . . . . . " is not an acceptance.

An acceptance is a final and unqualified expression of assent to all terms of an offer.

Acceptance may be communicated either orally or in writing or inferred from conduct.

Offer + Acceptance = Agreement

An extreme example. Suppose two potential parties to a contract make each other offers which "match". Suppose an individual posts an offer to sell his car to another person for £5000. Suppose also that at the same time the other person posts and offer to the first to buy his car for £5000. There is no contract in existence as two offers only have been made and until one of the individuals accepts the offer of the other there will not be a contract.

As soon as the person receiving the offer introduces a change this is a **counter offer**, not an acceptance and the counter offer can be accepted, rejected or countered by the original offerer. This leads to a game sometimes played between suppliers and customers.

INDUCEMENTS

Statements of opinion - a statement of a belief based on grounds incapable of actual proof.

Statement of intention - a promise to do something in the future and which may comprise a term in a contract.

REPRESENTATIONS are preliminary statements made during negotiations which induce the making of the contract but are not part of it.

The category a statement falls into depends on intention and is subject to objective interpretation

eg. a statement made by someone with special expertise will be viewed in a different light to the same statement made by someone without that special expertise.

Therefore it is dangerous for a supplier to make glib statements about delivery or performance of equipment.

Misrepresentation

A **misrepresentation** is a statement made by one party to another, before or at the time of contracting, about a fact, which is one of the causes inducing the contract and proves to be untrue.

Statements of opinion or intention are not misrepresentations - nor is silence - there is in general no duty of disclosure.

Exception is in insurance where the proposer must not only answer all questions truthfully but also reveal, unasked, all other material facts.

Fraudulent misrepresentation - knowingly make a false statement or without belief in its truth or recklessly careless whether it be true or false.

Innocent misrepresentation - all other misrepresentation including mistake.

PRIVITY OF CONTRACT

There may be other business involved in the performance of a contract other than its parties

eg. a contractor may purchase equipment from a manufacturer which the contractor will install:- who is responsible for failure of the equipment?

The doctrine of **privity of contract** means that only parties to a contract can sue or be sued upon it, that is only the parties to a contract may enforce the contract against each other, even if the contract was entered into with the sole intention of benefiting a third party. For example in a life assurance contract. There are cases where damages have been awarded to a party to a contract which include damages incurred by persons not party to the contract eg. to an individual who bought a package holiday for himself and his family, so that although the contract was between the holiday company and the individual the other members of his family who also incurred losses as a result of the lack of performance of the holiday company were also recompensed.

Thus as a result of this doctrine a contractor cannot shelter behind the manufacturer's guarantee.

DISCHARGE OF CONTRACTS

Contracts must be carried out strictly in accordance with the terms of the contract. Failiure to do so will entitle the innocent party to claim damages or repudiate the contract.

Frustration and Force Majeure

What happens if circumstances change unexpectedly after a contract has been made, but before it has been completed?

eg. a Government embargo on the export or import of goods to or from some country

Here the problem does not involve breach of contract as each party is keen to perform his obligations, but is unable to do so because the situation has changed.

The contract is at an end from the moment of the frustrating event.

Two main problems

1. It may be difficult to decide when the event occurred and,
2. It may be difficult to decide whether the event is so fundamental as to make the further performance impossible.

Force majeure clauses allow an extension of the contract if the job is delayed by "circumstances beyond his reasonable control" eg. Strikes.

AGENCY

A company is a legal person but nevertheless inanimate.

So two or more companies entering into a contract need an agent eg. the buyer for a customer company who is authorised to make contracts for that company.

Here the customer company is the **principal**, the buyer is the **agent** and the supplier, the **third party.**

Actual authority may be express or implied eg. the buyer may be allowed to enter into contracts of up to £100,000.

Implied authority derives from his or her position as a buyer.

Descriptions and Specifications

Goods delivered should correspond with descriptions and specifications.

Therefore the right to deliver an equivalent item needs to be stated expressly in the conditions of sale.

Quality and Fitness

It is for the customer to decide whether goods ordered are of the right quality and suitable for the purpose required.
Hence the importance of specifications.

Time

Where a time is fixed in the contract, the relationship between the parties is governed by common law. If that is not satisfied, the customer can cancel the contract and recover damages (bearing in mind *force majeure* clauses).

When the parties have not agreed a time for performance, it is implied that the contract will be carried out within reasonable time. What a reasonable time is can be a difficult question to answer.

Quotation and Estimate are not strictly defined but tend to mean:

quotation - a firm offer by the supplier to do some work at some price.

estimate - a general indication of cost.

DAMAGES AND REMEDIES

Termination/Cancellation

Where one party breaks a condition of the contract the innocent party can treat this as a breach or repudiation of the entire contract. This will discharge the contract. Cancelling the contract is seldom used, as in business, the right to terminate is a bargaining or negotiating factor.

Liquidated Damages and Penalties

In Liquidated Damages clauses both parties try to make a genuine estimate of the loss from a particular breach of contract eg. a late delivery or late performance.

This figure is then included in the contract to fix the liability of the contract breaker. If the contract is broken, the plaintiff is entitled to a stated sum as liquidated damages - no more, no less. Provided that there was originally a genuine effort at making an accurate estimate of the potential loss then the size of the actual loss is not relevant.

Penalty Clauses

In some contracts however the sums agreed by the parties are not based on a genuine estimate of the losses the parties may incur should a breach occur. These sums are usually excessive in relation to the maximum possible losses the parties may sustain in such circumstances. Such sums are termed "penalties" and are placed in the contract as a punitive measure or as a warning against breaking the terms of a contract. The courts will not award sums which are considered to be penalties and will substitute a sum representing the actual losses sustained to a party by reason of the breach.

Example.

If an inflated figure is put in by the customer say to coerce the supplier into performing on time, it is a **penalty** and is **void and irrecoverable**. The parties are left in the same position as if the clause had been omitted. ie. The innocent party can recover damages.

Contracts should:

identify the documentation on which the contract is based including targets, such as energy consumption, CO_2 emissions etc.

identify all the roles and the interface between them

require all parties to co-operate effectively with the rest of the team

Contracts should (continued):

balance risk, responsibility and reward

identify the project manager or project leader

be compatible with other projects, possibly as part of a set of contracts

leave no loopholes for misunderstanding

set out clear lists of duties and deliverables

Contracts should (continued):

define time limits for any process or stage and procedures to follow if there are any overruns

define payment conditions

define when payments become overdue and any interest charges

define when any sum can be withheld and when it will be released

Contracts should (continued):

describe the defect period process

require the parties to seek to consider properly the implication of changes

agree how to handle changes

provide for the speedy and effective resolution of disputes, including the naming of an arbitrator

Contracts should (continued):

provide a procedure in the event of the insolvency of one of the parties

define the information to be passed from the contractor to the client after project completion (eg manuals, plans, instructions, maintenance schedules, guarantees, etc.)

PROJECT CONTRACTS

Contract Writing

Standard Forms of Contract

- Save time and expense,
- Strike a fair balance of interests between parties.
- Most project contracts are on standard forms.

Public authorities, foreign governments, major companies, prefer to contract on their own terms.

Standard forms of contract

The process of offer and counter offer can lead to "the battle of the forms". Most companies adopt a standard form of contract as it is more efficient to do so than to negotiate a new contract with each customer on an individual basis.

An offer and counter offer situation can then occur when companies try to impose their own standard form of contract of another company.

FIXED PRICE CONTRACTS

Most appropriate when the project or task is well defined. Contractors can provide realistic quotations, Indeed if the project is ill defined no contractor would quote.

Contractors wish to maximise profit, on all projects. This can lead to less profitable contracts being drawn out, but this may make the contractor liable for resulting loss.

- may inhibit changes to the project as changes will involve extra payment to the contractor. Some rely on changes in the contract to make any profit at all.

- tend to extend the timescale.

- contractors need time to prepare tenders.

- contractors will try to save money at all times.

Types of fixed price contract.

1. Bill of quantities

Item	Description	Quantity	Unit	Rate/unit £	Total for the item
1	Concrete	40	m²	...	.. ...
2					
.....					
25	Brickwork	100	m²	...	.. ...
	---				
					total

- Contractor has a full knowledge of the work involved.
- Tenders can be compared.
- Contractor does not need to allow for contingencies.
- Pricing of variations is facilitated.
- Full design needs to be complete.
- Contractor's expertise cannot be included in the specification or design.

2. Lump Sum Contracts

- Speedy
- Relatively little administration,
- Contractors tend to increase price to cover contingencies.
- No rates for pricing variations.

3. Schedule of Rates.

- Usually done when design is incomplete.

	Description	Rate
1.	Excavation	....
2.	Brickwork	....
3.	.....	....
4.	.....	....

Rate could be nominal + % Profit.

- Contractor can be working when design is proceeding - time saved and contractor's expertise used.

- Cannot tell who is the cheapest contractor.

4. Package Deal or "Turnkey" contracts

- Contractor provides his own design/specification.

COST PLUS CONTRACTS

The contractor charges for the work done, and the profit is agreed as either a lump sum or as a percentage of the cost.

e.g.
1. Cost and profit (as a%)
2. Cost and fixed fee
3. Cost and target fee

Contract or knows he/she has a guaranteed profit so will work to the benefit of the client - good workmanship etc.

No incentive for contractor to minimise cost - but type 3 is sometimes used so that the contractor has a target cost and any savings are shared between client and contractor.

Contractor can start before all details of design or specification are known.

Some forms of contract attempt to attain the advantages of both fixed price and cost plus contracts include:-

1. Escalation - for lengthy contracts the cost may be linked to an index e.g. rates, material costs or labour costs.

2. Redetermination - if large contingency sums have been built into the contract.

3. Incentives - the target cost and target profit are agreed, along with a ceiling price and an adjustment formula.

Example

Fixed price incentive contract

The following have been agreed as part of a contract.

Target Cost	£200,000
Target Profit	£ 20,000
Ceiling Costs	£275,000

The Cost and Profit sharing arrangement is;

(i) If the target cost is exceeded, the customer pays 75% of the excess.

(ii) If the cost is less than the target cost, the customer receives 80% of the saving and the contractor receives 20% of the saving.

Case (a) The project has an over-run of 25%, i.e. £50,000

The Customer pays

Target cost	£ 200,000
75% of overspend	£ 37,500
Target Profit	£ 20,000
Total Cost	£ 257,500

The Contractor Receives

The Target Profit	£ 20,000
Less 25% of overspend	£ 12,500
Contractor's profit	£ 7,500

The contractor's profit margin is 7500/257,500 = 2.9%
Compared to the intended profit margin of 9.1%
(ie 20,000/220,000)

Case (b)

The project cost £20,000 less than expected.

The customer pays;

Target Cost	£200,000
Less 80% of £20,000	-£16,000
Target Profit	£20,000
Total Cost	£204,000

The Contractor receives

The Target Profit	£20,000
20% of the £20,000 saving	£ 4,000
Total Cost	£24,000

The contractor's profit margin is now 11.8%

(i.e. 24,000/204,000)

VARIATIONS IN THE CONTRACT

There may be a need for variations in the course of a contract in the course of a contract.

To maintain a close control over any changes it is desirable to have only one person with authority to vary the contract terms (e.g. the contract manager).

Form of words in a contract could be:-

"The contractor shall carry out such additional work up to 15% of the contract price, as instructed by the client at a mutually agreed price“.

Contract Documents

1. Form of Tender
2. Form of Bond
3. Form of Agreement

1. Form of tender - written offer to carry out the work.

   - signed by the contractor.

2. Form of Bond

   is a surety.

   - The contractor will get a guarantor who will pay the customer a percentage of the tender sum to suffer any losses sustained by the customer.

   - contractor pays a premium to obtain this bond.

   - the ability of a contractor to obtain a bond is some indication that he has the technical and personal knowhow.

3. Form of agreement
    1. Documents.
    2. General obligations of the contractor.
    3. Labour and Personnel.
    4. Assignment and subletting of work.

5. Execution of work - (materials, workmanship etc.) Contractor to produce programme CPM charts, and a statement of methods of work.
6. Default, delay or non-completion.
7. Payment methods and terms.
8. Settlement of disputes.
9. Special clauses - names of supplying firms etc.

TERMS OF PAYMENT

- specified in the contract.
- made according to a prescribed scheme.

Contractors want - payment with the order to cover "front end costs" e.g. tendering costs.

Clients want - progress payments e.g. when stages or milestones have been reached, but contractor will want payment at the start of activities. In some cases an arrangement for joint or independent valuation of the work is made - say monthly these are progress payments.

In some contracts there is a provision for retention money - only a proportion of the valuation is paid eg 90% - the balance is paid at the end of the contract.

Arbitration

- a process of law which has all the effect and weight of law without its formality, and is recognised by the law.

Arbitrator can be:-

1. A person who has expert knowledge in the matter in dispute.

2. Will make an expert investigation and make an expert judgment.

3. An inspection of the subject matter without wasting time listening to detailed evidence.

4. Held at a convenient time and possibly more quickly than legal proceedings.

5. Held in private.

6. It is cheap compared to legal proceedings.

Normally the arbitrator is an impartial person who is not involved in the contract.

Selecting Contractors

Selecting Contractors

Selecting a contractor is an important part of the project management process and it is well worth investing plenty of time and resources in the task.

Selecting contractors

1. By direct negotiation with a suitable contractor.

The client and advisers consider which contractors are best suited to the type of work.

Trusted contractors are invited to bid in the project by mail or direct contact.

A selection is then interviewed to determine their suitability.

- contractor can be appointed early - and expertise incorporated in the development.
- can start before design is complete.
- possibly do not get a really competitive contract.

Selecting contractors

2. By inviting tenders who wish to participate (open tendering)
   - keenest price.
   - the lowest tenderer may not know what he's talking about.

Contractors are invited through an announcement in public media.

Large number of contractors may respond – or maybe none.

Public agencies are usually required to use open tendering.

The lowest bid is awarded the job

The lowest bid contractor may fail to complete the project.

Obtain the lowest possible price.

Selecting contractors

3. By inviting tenders from a selected list of contractors who have the necessary resources and expertise.

Contractors are invited through an announcement in public media.

Only qualified contractors are allowed to bid.

The owners prepare a short list of prequalified contractors.

Limited number of contractors bid in the project compared to open tendering.

Used for important projects.

The quality of work is guaranteed through prequalification.

Government agencies and local authorities tend to select the lowest tender for a contract.

The danger is that a contractor may have little experience of the type of work, and may produce an unrealistic low price, and subsequently the contractor may look for ways to inflate the price, or skimp on quality, and this can lead to an adversarial situation.

Local authorities can sometimes under some circumstances pre-select contractors who are allowed to tender. (Item 3 in the list in the previous slide).

Contractors can apply to be on a list of approved contractors, and are then vetted.

This procedure is similar to the general selection procedure applied by some commercial organisations which include consideration of the:-

1. Reputation of the potential contractor - it may be essential for the contract to be completed on time.

2. Commercial health of the contractor - if a contractor goes out of business, an incomplete contract causes added costs and delays.

3. Ethics - a contractor may propose methods which may be unethical or against the general ideology of the client.

4. The conditions of payment.

5. The use of subcontractors - which can make the contract more difficult to control (from the client's point of view).

6. When the contractor is available to do the work, their location and resources.

In the UK and in EU there are regulations concerning choosing contractors for central and local government contracts and other public bodies

For example, Local Authority contracts are strictly regulated, mainly by the prevention of Corruption Acts 1889 to 1916,and the Local Government Act 1972, and more recent Amendments, (eg The Public Contracts Regulations 2006) together with the common law and the standing orders of the particular Local Authority and EU directives.

Some web pages with useful information.

HM Government

Guide Tendering for public sector contracts
https://www.gov.uk/tendering-for-public-sector-contracts

https://www.contractsfinder.service.gov.uk/Search

IT Tenders
http://www.ittenders.com/ (needs registration)

Welsh Government Procurement Route Planner
http://prp.wales.gov.uk/

The Official Journal of the EU publishes a list of contracts awaiting tender.

Published daily – and online.

The S series of the Journal contains invitations to tender, and other documents relating to the EU Procurement Directives

TED (Tenders Electronic Daily)
http://www.tenders.eu/ which has now become a subscription service.