

The construction sector: Will anything change?

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The start of another year and I wonder what this new decade holds for the construction sector. I am heartened by the actions that the Government and private industry are taking to address (what has been described as) a dysfunctional sector. In particular, I am referring to the Government's work in trying to transform the sector through the Transformation Plan developed by the Construction Sector Accord (Accord) and the support that the New Zealand Infrastructure Commission (Infrastructure Commission) will provide to public sector agencies in procuring and delivering major infrastructure projects.

However, I wonder, as others have, whether anything will change at all. I don't commit this thought to paper lightly. Everyone in the sector wants to point to a success story and wants to boast about 'on time' and 'on budget' projects.

The challenges that the sector faces are immense requiring a concerted effort by all sector participants over a long and sustained period of time. It will require all industry participants to mature in their approach and gain each other's trust to move away from an adversarial to a collaborative relationship. The change will not happen overnight. The Transformation Plan has outlined some steps the sector will need to take to achieve this level of maturity.

Last year, the Infrastructure Transactions Unit (ITU) (which now forms part of the Infrastructure Commission) commissioned an independent review of the use of the New Zealand Standard (NZS) Conditions of Contract for Building and Civil Engineering Construction in local and central government (public sector) initiated infrastructure projects, including the use of special conditions of contract. The findings of the review were delivered in a report (An examination of issues associated with the use of NZS Conditions of Contract) of August 2019 (Report) the purpose of which was to assist the ITU in its role to lift the performance of New Zealand's public and private sectors in procuring and delivering major infrastructure projects.

The Report's principal finding was that there is a 'culture of mistrust' between the public and private sectors which manifests itself in the approach to procurement, contracting (including unfair transfer of risk), and the construction methods used. Ultimately, this lack of trust is the overarching reason that construction sector parties add extensive special conditions. No one involved in the sector will be surprised by this finding.

The main reason for the lack of trust between the public and private sectors was summarised in the Report as follows:

"The industry does not trust that the public sector has the skills and experience to appropriately procure and deliver major infrastructure projects. Industry does not believe that the public sector always follows its procurement rules and does not trust it to carry out a fair and transparent procurement process. The public sector is concerned about non-delivery and cost blowouts. This has led to modified contracts that place unreasonable levels of risk on the contractor contributing to unsustainability."

Essentially contractors (private sector) consider the developers of projects (public sector) have an unspoken focus on lowest price and transferring risk to the contractor. Further, there is a view that public sector procurement processes tend to be undertaken before they are sufficiently developed (forcing the contractor to make assumptions) and impose unrealistic timeframes for the tender process (and the project). To win tenders, contractors may, as a result, try to deal with this by submitting bids that over-promise on price and time and include significant tags to ensure that they are not taking on risk they have not priced for. On the other hand, developers don't trust contractors to finish jobs to the required standard, on time and on budget (quality, price and time certainty). As a result, developers try to deal with this by changing standard contract terms. The consequence of this culture of mistrust is serious. It is leading to an unsustainable industry that has low productivity and which does not deliver on project outcomes. Consequently, value is not being delivered to the New Zealand public.

The Report sets out other related issues at play. Some of these issues appear symptomatic of the lack of trust between the contracting parties:

- There is an aggressive approach to transferring risk to the contractor that is discounted or not priced for when assessing tenders which arises from a lowest price culture
- Unrealistic time bars are being used to prevent the granting of variations or extension of time claims which arises from the need for cost and time certainty for the public sector
- Many modifications are being made to standard construction contracts; which presumably are being made to reflect the preceding two issues.

The Report further identifies that:

- There are no caps on contractors' liability including in the NZS standard form contract
- The independence of the Engineer to the Contract is being compromised by acting as the client's consultant; which may result in the Engineer's decisions being (or at the very least, appearing) skewed in favour of the client
- There is a perception that there is a lack of knowledge and experience in delivering infrastructure projects in the public sector.

The way industry participants have been dealing with project risks provides an excellent illustration of how the culture of mistrust is perpetuated by industry participants. The Report identifies:

- Previous experience with poor contractor behaviour towards client retained risk has meant that public sector participants no longer trust that contractors will act in the project's best interests and has driven the public sector to transfer such risks in future projects to contractors in order for the contractor to take interest in mitigating or managing such risks
- Conversely, a practice by the public sector of transferring risk to contractors by stealth has meant that contractors no longer trust that they won't be held accountable for a risk over which they have no control (and are also not being paid for). For example, where the public sector requires contractors to take on design risk in construct only contracts as a result of making buildability or efficiency suggestions. It is reasonable to ask a contractor to stand behind a solution it proposes. However, contractors have not wanted to take on that risk and this has meant that contractors have stopped proposing any ideas for fear of being seen as accepting that risk.

The above practices are counterproductive behaviours that impact on productivity. It is legitimate for the public sector to transfer risk that the contractor has control of and is better able to manage. However, it is an issue if the risk is not being priced for or it is already being managed by a third party who has been paid to do so. The cumulative effect of this contracting environment is increased risk and exposure to contractors.

The Report outlines a number of prudent opportunities for improvement by the public sector in relation to risk transfer:

- "Issue guidance in relation to risk transfer, its purpose and management, and the potential impacts if risk is inappropriately transferred. This guidance could require risk transfer to be fully assessed and signed off at an executive level
- The public sector should assess the level of risk transferred to individual contractors across all public sector projects that they are undertaking
- Follow-up with public sector engaged legal advisors in relation to expectations of fair risk transfer when drafting special conditions of contract."

If implemented, the opportunities for improvement outlined in the Report will transform public sector procurement. In particular, if there is an understanding of the value of risk transfer and acceptance that it must be budgeted for and priced, this will likely change current attitudes about who should bear some project costs and, hopefully, win back some of the private sector's lost trust.

The Government has already taken steps to address these issues and implement the Report's improvement opportunities by issuing a revision of its Construction Procurement Guidelines in September 2019 (Guidelines). The new Guidelines promote better procurement practices and include guidance on risk management and associated resources. The Accord has built on this progress in the Transformation Plan programme of work which includes as an action step the ongoing review of the Guidelines which are to be adopted by both the public and private sector members of the Accord. These Accord members will also work with central and local government agencies to ensure their contracts:

- Are transparent on risk and where it sits
- Limit the number of special conditions
- Hold all consultants to account for their work including designers, project managers and quantity surveyors
- Ensure any Engineer to the Contract is fully independent
- Include provisions for efficient and fair dispute resolution.

The Transformation Plan also provides for the Accord's steering group (and then the Transformation Plan's leadership group) to design and implement a programme to inspire and foster behaviour change in the sector. The programme will include actions to develop strong leadership, create a personal commitment to change and a shared accountability for success that will ultimately help lift sector performance.

I agree that there needs to be a change in the behaviour of construction sector participants in order to regain each other's trust. In my view this is the Report's most important finding; that the sector must ensure that **all** participants are prepared to operate in a fair, reasonable and sustainable manner towards all parties. This is what a mature construction sector would do. The Report outlines what a mature construction sector would look like for clients, consultants and contractors and there are many benefits. The challenge is creating and maintaining the leadership to implement change that focuses on the traits and activities identified in the Report as demonstrating a mature construction sector, measuring any change in the sector and bedding it down so that participants don't resort to old habits when there are difficult trading conditions.

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