

Construction contracts - reflections of a major irrigation project - practical contract mechanism

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Competitive tension and early contractor involvement can add significant value

We recently negotiated and documented the construction contracts for a major irrigation scheme in New Zealand. The contractor procurement process followed a reasonably traditional competitive tender and led to an early contractor involvement/project optimisation process to ensure that the scheme cost and buildability were fully optimised.

Given the particular project circumstances, two leading tenderers separately entered into project optimisation agreements with the Principal, on the basis that one of them might be invited to enter into a lump sum project for the work (over NZ\$100 million). The optimisation process was interactive and collaborative, but also contained competitive tension between the competing contractors.

The tenderers were paid a negotiated sum for their optimisation work, and whilst it was unusual to have two separate optimisation agreements running for the same project, significant project cost savings and efficiencies were identified as part of that process and gave the client the confidence to proceed with the project.

Early warning and collaborative intervention can benefit both the contractor and the principal

The project was financed with investor funding and a significant level of debt funding. Completion on due date was critical to avoid loss of production over an entire pastoral season and consequential loss of investor and financier confidence.

The risk of delay was significant as the project involved the manufacture and installation in the ground of very large pipes (of a diameter that a person can stand up in) along an alignment in excess of 100km. A number of roads and a large number of private properties needed to be crossed.

Whilst the contract provided significant liquidated damages provision for delay, a major focus of the contract negotiation was to identify and document sensible measures to monitor progress and facilitate/escalate corrective action should the achievement of any milestones become at risk.

Care was taken to identify and agree upon meaningful project milestones. The Contractor understandably wished to keep these to a minimum, whereas the Principal and its financiers required more milestones than initially proposed so as to enable them to gauge the progress of the works and hence the overall "health" of the project.

In addition to fixing milestones, and providing for reasonably frequent contractor progress reports, the parties included in the construction contract an obligation on each to provide an early warning of any issue or concern that may threaten achievement of a milestone by due date. The contract also included a critical mechanism (triggered in circumstances where the project engineer determines that the Contractor has not achieved or is unlikely to achieve a milestone by the relevant milestone date and where the Contractor is not entitled to an extension of time). That mechanism enabled the engineer to require the Contractor to submit a proposal for engineer approval for acceleration of the works to get back on programme. In default the engineer could order specific acceleration measures. The additional cost of acceleration fell to the Contractor.

Part way through the contract a major subcontractor deployed to manufacture and install the pipes unexpectedly got into financial difficulties and the delivery of the whole project became at risk. The early warning process and the graduated acceleration process enabled the Contractor and Principal to work collaboratively together over a number of weeks in response to the subcontractor's difficulties. The Contractor was able to step in and progressively take remediation steps and avoid the head contract falling into default. As part of that process the Contractor responded positively to the Principal's concerns, some intermediate milestones were adjusted, but the critical end date remained intact and delivery on time and within budget was successfully achieved.

The tailoring of contract processes to facilitate early warning and positive intervention delivered a far better result for the Contractor and the Principal than waiting for default to occur and then being drawn into the traditional adversarial contract default process.

This article was written by Stephen Whittington (partner) and Bassam Maghzal (senior associate) for the Australasian Lawyer magazine (Issue 2.6, December 2015)

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