

Split, turn key, general and partnering contracts.

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Contract forms

Contract Forms

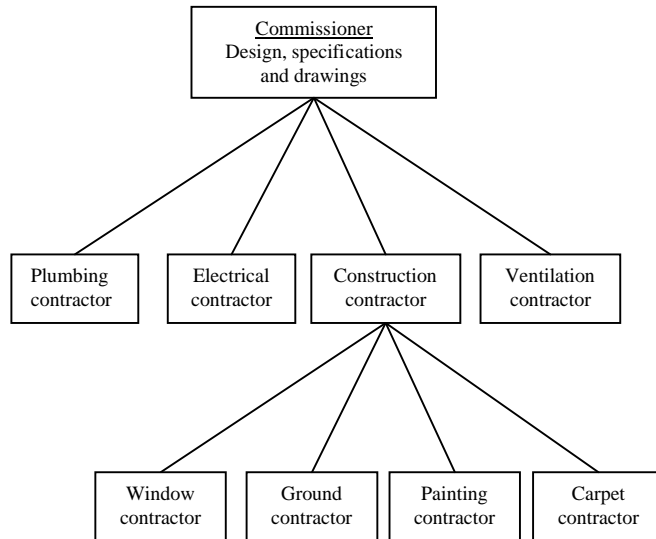
When a building or facility is to be built, in general it requires the interaction of a large number of different professions. These are mostly represented by different companies. For this interaction to be made and organized, a number of different agreements have to be completed. The pattern of the various agreements may look different, depending on which company is "in charge" and what the different parts perform. To easily describe the most common agreement patterns, the construction industry has developed some simple terms, and the most common agreement patterns are called contract forms. These are split construction contract, general construction contract and turnkey contract. In addition, there are some other contract forms in between.

Split construction contract

The split construction contract is characterized by several contractors having contracts with the client but not with each other.

In split construction contracts, the commissioner of the building project hires developer planners, consultants, who may be instructed to prepare documents for the project after a more or less detailed program. The consultants form a working group, who jointly works out a proposal. The outcome of the consultants work is expressed mainly in descriptions and drawings.

In split construction contracts the commissioner takes on a heavy responsibility to coordinate and manage the business on site. In return, they have through the various agreements, a direct impact on the various contractors. However, sometimes the commissioner of the building project appoints one of the contractors to coordinate the sub contractors. This contractor is generally called the principal contractor. The principal contractor is often entrusted with the responsibility for site establishment such as scaffolding, electricity, cabins, etc. In general, it is the building contractor who receives this assignment.



Picture 1. Contract pattern in a split contract.

General construction contract

The general construction contract is an attempt to relieve the commissioner of the building project from the problems of coordination and fragmentation of the responsibility that exists in split contracts. General contracting is different from split contracting, since the commissioner only have an agreement with one contractor, the so-called general contractor. The general contractor then makes agreements with the sub contractors.

General construction contracts occur in two forms. One is simply called general contract and means that the commissioner has an agreement with one part, the general contractor, and has no influence on the selection of sub contractors.

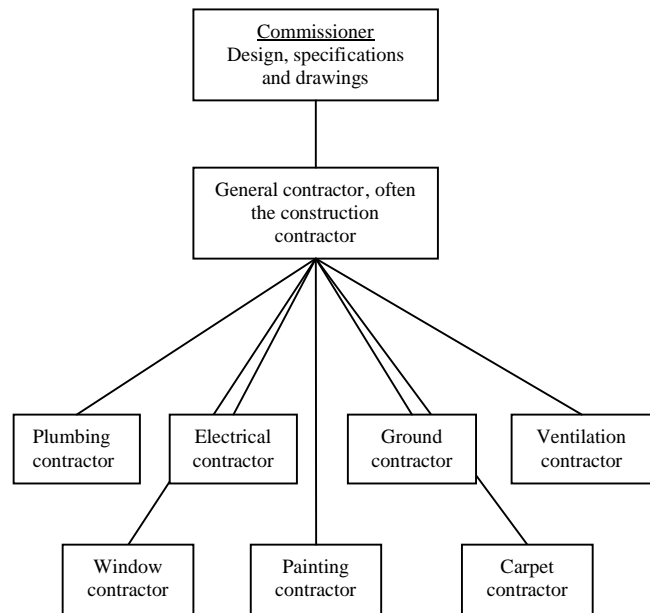


Figure 2. Contract pattern in a general contract.

The coordinated general contract is the second form of general contract and means that the commissioner requests bids from, and possibly makes agreements, with several different contractors. Then the commissioner transfers the majority of the contracts to one of the contractors, usually the building contractor. The building contractor is then sole responsible to the commissioner regarding all the other contractors commitments.

When performing a general contracting, normally the contractor state in their tender, in the form of percentage or fixed amount , the compensation they require to assume responsibility and risk, and also for administration of other contractors work. This is called general contractor fee.

The coordinated general contract comes in two variants, one with a liability of the commissioner, the other with the liability of the general contractor. The first variant means that the commissioner, even though he has transferred, for example the agreements on installation contracts and no longer is the customer, still pays directly to the contractors for their work. The general contractor certifies the contractors' invoices.

The coordinated general contract is a complex network of different agreements and contains a lot of pitfalls. General contract means that the commissioner is relieved of some coordination problems and that they will not become involved in disputes relating to compensation due to lack of coordination between the various contractors on site. Still there remains a lot of problems regarding the interfaces. As in the split contract, tender documents have been produced by several consultants, whose work must be coordinated. Therefore, disputes may occur between the commissioner and the consultants, if for instance the contractor makes claims due to error in the documentation, e.g. inconsistencies between different documents.

Performance Contracts (Utförandeentreprenader)

A common name for the split construction contract and the various forms of general construction contracts is performance contract. The definition of a performance contract is; "a contract or a part of a contract where the customer is responsible for the design and the contractor is responsible for the execution".

Turn key contract

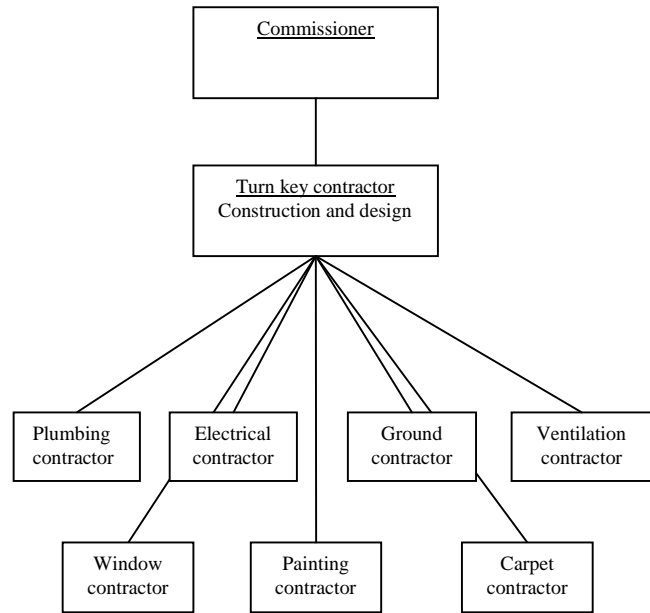
Turn key projects means that the commissioner makes an agreement with a single contractor and instructs them to do both the projection and the construction of the building.

Turn key projects can be designed in many different ways. The contractor can be involved at different times in the design process. In one case, perhaps the developer appoints the contractor in connection with the decision to build. In other cases, the developer may have appointed consultants to do a "half finished" design and then the contractor's influence on the design is restricted to detail solutions and the choice of some materials.

Sometimes, the only difference between a turn key contract and a general contract is that the specification consists of main drawings and a brief technical description instead of traditional, more detailed documents.

Sometimes the term early procurement is used, in the case when the commissioner has made an agreement with the general contractor, and gives him the opportunity to comment on, but not perform, the design of the drawings and technical descriptions.

In the "ideal" turn key contract, the developer has supplied basic specifications, not very detailed, in which the developer expresses its demands such as functional requirements, and not in the form of specific, precise technical solutions.



Picture 3. Contract pattern in a turn key contract.

Compensation Arrangements

There are numerous ways to determine the price for a contract. The most common variants have been given specific names, on whose meaning the construction industry is reasonably consistent.

Fixed price - with or without index

A fixed price means that the parties have agreed on a lump-sum compensation for all contract works. Unless the scope of the contract work is changed, though this in practice always happens, the price does not change.

It is generally inappropriate to use the term "fixed price" without adding the words "with index" or "without index", because otherwise misunderstandings could easily arise.

A specified fixed price, with or without index, usually does not include VAT, so it is standard practice that all price quotations are exclusive of VAT, except when the customer is a consumer, i.e. an individual who orders something for private use.

Quantity Contracts / Price per unit contracts

A contract form frequently used in ground works is sometimes called a quantity contract. This means that the commissioner specifies a certain amount for a number of different work operations, such as soil excavation and rock excavation. The volumes are presented in a specification which is provided to the tenderer, who puts prices on the different operations and summarizes the amounts. Thus, the tender is the sum of a

number of sub items, which consist of prices per unit. In these cases, a measurement of the work is done when it is performed, and the final compensation is determined after the measurement. The specified quantities are based on calculations that in some respect can be uncertain. In these cases we talk about adjustable quantities or quantity contracts.

Price per unit (A-pris)

Agreement on the application of “price per unit”, means that the parties have agreed to apply a fixed price per unit for future performance, and the scope of the performance can be quite unclear when the parties agrees on the contract.

A very large supplementary work can disturb the contractor’s planning and cause additional costs, which are only partially covered by the prices per unit. A deduction from the scope of the contract works may mean that the contractor does not receive fair compensation for their fixed costs or for expenses they already had received, and which therefore can not be undone.

In order to create a reasonable "safety net" for the contractor, there are limits on the validity of agreed prices per unit. The limits are of both quantitative and qualitative nature.

To avoid having to apply an agreed price per unit as a result of altered amounts, the contractor must, so to speak, break through two barriers. At first, they must show that the change of the amount is more than 25 percent of the actual price per unit volume. In the second, they must show that the changed amount, priced with price per unit, has a value that exceeds 0.5 percent of the contract sum.

It is very unlikely that the customer is the one who wants to change an agreed price per unit; it is almost always the contractor.

A price per unit can also be renegotiated if the conditions have changed, not necessary the amount.

For example:

The specification for a building states that the walls are supposed to be built with plaster and wood. In the contract there is a price per unit for drilling a 50 mm hole through the wall. Now the commissioner has changed the conditions, so that the walls instead are built in concrete. The specified price per unit is then not applicable and the parties will be referred to seek to negotiate a new price per unit.

What does a price per unit include?

A price per unit can have different extents. The most common is that it covers the compensation of all costs associated with the work, including material, labor costs, interest rates, central administration and profit.

Time and material contract (Löpande räkning)

The opposite of a fixed price is when the contractor gets payment for their own actual costs, in other words the customer pays what is subsequently found to have been the cost for the contractor to perform the construction. This compensation form is called “time and material contract”.

The actual costs for labor, material, subcontractors etc. are specified, and upon that the contractor adds a fee, as a specified percentage, covering central administration, interest, profit and risk. This fee is called contractor fee.

The pure time and material contract form means that the contractor gets payments for their own expenses and above that the contractor fee, intended to cover the interest and the central administration and profit.

This type of contract tends to be regarded with skepticism by the developers, since it contains inappropriate incentive for the contractor. Of course, the more expensive the construction becomes, the more money the contractor makes, since profits are a percentage mark-up on the prime costs.

However, this compensation form has its justification, for example, when a job is so urgent that cost means less than the speed, which may be the case after a fire or when it comes to repairing water damage in an apartment.

One advantage with a time and material contract is that it allows a very early start of the construction, which can lead to interest gains for the developer, especially in times of rapid inflation. Another advantage is that the contractor is not exposed to the temptation of cheating in quality to make money in the context of a fixed price.

Another advantage is that the contractor can be very flexible, because they get paid for all of their costs. It is possible to build without specifications and drawings, for cases where the developer can not provide this.

Sometimes, the parties agree that the contractor for their invoices shall include copies of the bills they have received, or other supporting documents to prove that they had a cost.

Time and material contract with a ceiling price

It is also possible to combine a fixed price contract with the time and material contract. This is achieved when the parties agree on that the compensation is to be paid according to the time and material principle, but also that the compensation should not exceed a certain amount, the so-called ceiling price. The idea is that the customer shall feel special protection, since they only need to pay what the building really costs, but still do not have to fear that a certain amount will be exceeded.

However, it is an unusual compensation form, possibly due to the fact that it can be considered a bit unfair - the contractor has little to win and much to lose. From the customer's point of view there is also a risk, they risk ending up in discussions about raising the ceiling price due to changes and additions

Time and material contract with a fixed fee

Commissioners tend to be reluctant to use the compensation form time and material contract, since it is considered that the costs easily become high. And why is it so? Well, the customer bears the costs, and the contractor spends the money.

Another view is that the more the building costs, the more profit to the contractor. This depends on the fact that the contractor's fee also includes the contractor's profit. Furthermore, since the contractor's fee is calculated as a percentage markup on other costs, the contractor's profit becomes higher when the costs become higher.

The time and material compensation form requires that the customer has great confidence in the contractor and their staff. Although even if such a trust exists, the customer may consider that the compensation form is nevertheless an inappropriate temptation for the contractor.

In some cases you can eliminate this temptation by having the contractor's fee as a fixed amount instead of a percentage markup. Still, you have the disadvantage that the customer pays for the costs, while the contractor creates the costs, but you have at least eliminated the problem that the contractor can increase its profits by increasing costs.

Incentive Agreement

Another contract form is the incentive agreement, which is a mix between the fixed price contract and the time and material contract. The basics in this contract form are related to the time and material contract.

The parties agree on a total estimated cost for the project. If the actual costs exceed the calculated costs for the project, the parties share the loss. On the other hand, if the actual costs for the project are less than calculated, the parties share the profit.

How much each party will have of the profit or loss is determined by an agreement in each individual case. Often, the contractor's share is 20 percent and the customer's is 80 percent.

The contract forms create a sliding scale

In figure 4 you can see that the different contract forms create a sliding scale, from “very fixed price” to “very loose price”, that is, from fixed price without index to time and material contract with a percentage mark-up

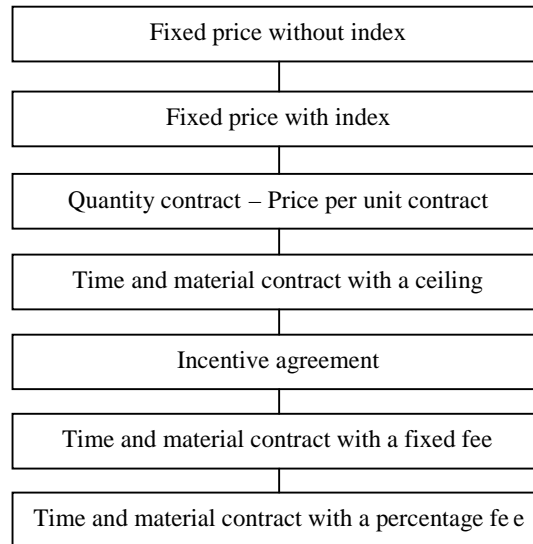


Figure 4. Compensation forms

Partnering

Introduction

Within the construction industry there are often disputes. It is no exaggeration to say that the construction industry is the industrial sector where disputes most frequently occur. However, it is not surprising, since a construction project is exposed to a multitude of risks of different kinds. Each project is unique and there are almost always changes and additional work that alters the scope of the project. A very large amount of conditions, which often are difficult or impossible to control, may affect the economics of a project. The construction is performed on a construction site that is under continuous change. The ground conditions are often uncertain and the weather conditions have a major influence on quality, time and costs. On the construction site there are a lot of people going back and forth in different errands, and often at a relatively small area. It is difficult to clarify the boundaries between various contractors and consultants work, and it is difficult to coordinate them in an effective manner.

New materials, untested designs and technical solutions are often used. Different systems will be connected and tested together.

The activities may be annoying to the surroundings, the risk of injuries to person and material is great. The work is often carried out under time constraints and with not fully completed drawings and documents.

Depending on the economic climate, prices can be more or less pressured, which can lead to lower quality, more argumentation regarding additional work, etc. Bankruptcies can occur ; it may be unclear when the ownership passes over to the customer. In short: Everything can happen.

In today's construction process there are often conflicts between the parties in the project. The commissioner must examine and verify everything that the contractor delivers. The customer has the attitude that I am paying, I specify the demands and it is you who delivers. The contractor on the other hand, sees the customer as the person providing the money and seeks to maximize compensation by finding as many additional jobs as possible. The commissioner and the contractor understand each other as two separate parties, and not as two parties that jointly try to make the project to be as good as possible. When problems arise, you do not share the problems, instead you focus on finding reasons to let the other party take the risk and costs.

Partnering as a solution to the problems?

In England during the 1990s, there was a growing interest in different types of partnering arrangements. Among the reasons mentioned was the fact that the construction industry was characterized by conflicts and contradictions, which led to poor implementation of the projects, low profit margins and bad morale.

What is partnering?

A variety of definitions have been proposed. One feature is that you are looking to work in consensus in order to be able to focus on a common goal, to reach success in the project to all parties' benefit, to work for quality, good climate of cooperation and avoidance of disputes.

In short, partnering can be described as a partnership by which the parties work together to complete the project efficiently, with high quality and without any major disputes. A partnering cooperation can occur at all levels of a project, but most common is that it involves the commissioner, the contractor, and also often the consultants and subcontractors.

Important elements in a partnering arrangement

A partnering cooperation must be based on the fact that the parties have confidence and respect for each other. They should see the project's best at all time, and not primarily ensure their own interests. The cooperation shall take place in a group that contains the key persons, and the intention is to create a "we-feeling", instead of the contrary position that often prevails in the construction process. In order to achieve this cooperation, a very open communication between the parties is essential, instead of blaming each other; you try to find solutions to the problems that arise during the project. It is important to identify risks and to determine how they should be handled. Some risks may be borne by the project, while other risks are borne by the individual parties. Throughout the cooperation the parties shall seek improvements in the cooperation and in the performance of the project. If there is a risk of problems, the other participants have to be warned as soon as possible, and if problems or disagreements still occur, they shall be resolved at the lowest possible level. If this is not possible, the problem may be lifted to a higher level, and only as a last resort remains a court process.

Workshops

The objective of partnering is not achieved by itself. In particular, since the persons who become involved in partnering projects themselves are accustomed to the more traditional contract forms.

An appropriate introduction to a partnering is to bring together all the key people in the project for several days so that they can talk about the principles, brain-storm and come up with how to best work together to achieve the common goal. You also have to teach the participants the new point of view, and the principles that must apply for the project to achieve success.

Partnering Charter

A partnering agreement often has some form of separate document, where the fundamental principles are determined. This document is not a legal paper, but instead describes the soft values as the basis for the cooperation.

A partnering charter can consist of:

- The work shall be carried out on time, within budget and with desired quality.
- The starting point for the design shall be defined, to also meet future requirements.
- Any negative impact on the future operation and maintenance should be minimized.
- Systems are to be created for creating knowledge regarding future operation, maintenance and improvements.
- A good cooperation will enable the parties to have cooperation in future projects.

Each party must in advance analyze their intentions for cooperation. What is driving the party to try partnering cooperation? What will the company benefit from the cooperation? What risks and concerns are there? What are, on the other hand, the biggest expectations for the cooperation? What specific knowledge and skills is the company bringing into the project? What does each of the participating parties need to perform to be completely satisfied with the cooperation?

Profit and loss sharing

Characteristic of partnering agreements is that the parties share the risks for the profit and loss. There must be incentives for both parties in the project. Regarding the price, it is common to have a target cost and that the parties share the gain or loss when the final cost differs from the target cost. It happens that the contract is divided into a fixed price and a variable price, and the part that has a variable price is connected to a target price. Some smaller percentage deviations may not be taken into account, but certain limits are set. In a construction contract, the fixed part may be costs for management, office staff, surveyor's assistants, central costs and profit, while the variable part consists of materials, labor costs, costs for facilities not included in the fixed part and subcontractors with verified net costs.

The variable target cost may be adjusted based on various factors such as:

- Changes in laws and regulations
- Changes in the scope of the project, defined in a particular way
- Significant changes to the future use of the project
- The adding or deducting of technical systems
- Ordered changes in quality or other functions, over a certain level, errors in the document provided by the commissioner
- Index

It is common that the commissioner and the contractor equally shares gains and losses, but nothing prevents that you have a different sharing.

Risk sharing

Generally speaking, the commissioner and the contractor share the profits and losses in relation to the price that they agreed upon, whether it basically is a fixed price or some form of budget price with a target cost. For the cooperation to be effective, one must also review the regulations regarding the responsibility for e.g. delays and damages. Normally there is no reason to limit the responsibility regarding errors in the construction; however, the liability can be limited in various situations. According to Swedish regulations there is a limitation of liability related to insurance compensation, or 15% of the contract sum if there is no insurance. Furthermore, there is an additional limitation, saying that liability does not exist for damage due to interruption or interference in industrial production or in significant commercial activities relating to the letting of premises. In standard agreements, it is common to limit the liability of damages, so that liability for so called indirect damages is excluded, for instance standstills or lack of profit.

How to, in detail, regulate the responsibility, is often decided in workshops, where the parties discuss the factors that seem to lead to success in comparison with those that may impede success or make the cooperation difficult.

Grading System

A common feature in partnering agreements is the grading of the participants, and this grading is then supposed to affect the size of the compensation. You have certain key factors, Key Performance Indicators, KPI, and rate the performance on a scale, for example 1-5, where three is average. High score gives more compensation and lower score less compensation.

These key factors can be:

- Number of errors
- The quality of the product from an overall approach
- Contract duration
- The costs of the project
- The nature and extent of injuries and accidents
- Number of disputes
- The nature and extent of proposals for cost savings
- The efficiency of communications between the parties

Decisions regarding the factors in the grading system are made by the project team. The demands on the participants in terms of transparency and self-criticism are great. This is not always easy, but it emphasizes the importance that a cooperation of this nature is preceded by careful consideration and brainstorming in form of an initial workshop, but also later during the project, new follow-up workshops to correct and improve the cooperation, and thus the project.

Sources:

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