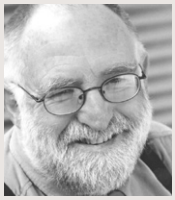


BUILDING CONTRACTS

Contracts come in many forms, with some favouring the client, others the builder. All should be taken seriously and scrutinised carefully.

By Des Molloy, Contract Technical Writer

In theory, a contract is a simple thing. It only has three parts – an offer, an acceptance and 'consideration' (payment for the work done). All three parts must be met. There are two other provisions – first, the action being contracted to must be legal, and second, the parties must have the authority to contract, be of age and not insane.

Contracts can be either written or verbal, and both are equally binding, but in practice, a verbal contract is often much harder to enforce as it relies on people's memories and interpretation at the time. It's best to avoid verbal contracts, especially when it comes to construction.

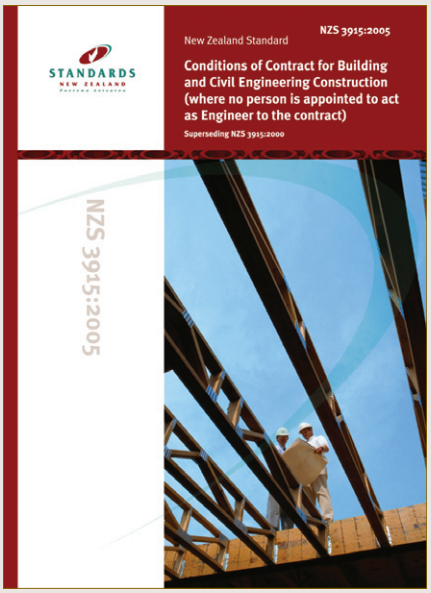
Contracts binding on both parties

What is important is that the contract is equally binding on both parties, not 'owned' by one side. Therefore, both parties must be happy with it – once signed it is bound by the 'Law of Contract in New Zealand'. This is a powerful piece of legislation that provides the rules and enables the enforcement of the contract. A building contract is further bound by the Building Act 2004, which defines many of the responsibilities and expectations of the contracting parties and includes some clauses that cannot be contracted out of. All parties should take the generation and subsequent signing of their building contract seriously, as it underpins the whole process and can make the difference between a successful (or otherwise) conclusion.

Changes must be formalised in writing

Whether using a proprietary contract form or one made for the specific project, all parties need to be aware of and happy with the content before signing. Often builders are surprised and disappointed to learn that all the conditions on their tender submission are not part of the contract, unless they are specifically included or referenced.

In building contracts, the contract is to build a specific structure for a specific price, usually within a specific time. It is bound by contract law and can only be changed with mutual agreement. So a 'variation' requested by either side must be agreed to by the other and put in writing. This should cover construction, financial and time implications. It's a two-way street and needs cooperation and agreement to prevent collisions.



One of the many contract forms available to use.

Off-the-shelf contract forms

There are several types of contract forms. The umbrella bodies looking after the interests of their builder members have their own, as do the design fraternity. Some of these are only available for use by the members while others can be purchased by any of the parties to the intended project. The New Zealand Institute of Architects (NZIA) has a set of conditions of contract for purchase. Standards New Zealand also has several suitable contract documents ranging from a contract for house building (NZS 3902: 2004) to a set of contract conditions for a large project where there is an 'engineer' administering it (NZS 3910: 2003). In between is NZS 3915: 2005, which covers building and civil engineering construction where no person is appointed to act as engineer to the contract.

These forms aim to be fair, impartial documents designed to give both sides an equitable sharing of the risky construction business. But often the client will amend the document before tender time and slant it in their favour. For instance, it's common for the 'inclement weather' clause to be removed. This gives certainty to the client but puts all the risk on the builder. Builders should price in a contingency plan to accelerate the works if bad weather delays them, or add a value to cover possible 'liquidated damages' for being late finishing. Builders have been made insolvent by hitting an unseasonable run of bad weather, thus finishing beyond the contract period and being made to suffer the consequences.

Full contracts

In a 'full contract', the builder is contracted as a main contractor with full responsibility of constructing the project and handing it over to the client as a finished item. To expedite this, the builder will have hired the subcontractors and managed the whole process including purchasing all materials and services needed whilst complying with the Building Act (and Building Code). This puts all the responsibilities clearly in one place, not only during construction but also for the subsequent performance of the building. Safety, performance and quality compliances are all handled by the main contractor, who is liable for any defects.

This is the least risky type of contract to the client and the most risky type for the main contractor, but it does give a builder the opportunity to manage the whole project and be compensated accordingly.

Managed labour-only contracts

A 'managed labour-only contract' has the builder managing the building site but he/she does →

not supply the materials or have contractual relationships with the other contractors involved in the construction. The client arranges the material supply and has individual contracts with the subtrades, who will be supervised by the builder.

This type of contract relies heavily on the competence of the client (or representative) to be successful. In this instance, the client has, in effect, become the main contractor and assumes responsibility for the quality of the end result. The on-site builder has responsibility for the on-site operations but makes no profit from the supply of materials or the subcontractors' work.

These contracts need to be carefully worded and fully understood to be successful. They will usually be tailored for the specific project and project team. They suit only a skilled client, usually from the industry itself.

Labour-only contracts

A 'labour-only contract' is just that. Like the managed contract, someone else is assuming the role and subsequent responsibility of main contractor. For a builder, this can be the least risky type of contract as there is only time to lose. Old timers often worked on an hour per square foot of standard house, knowing that, if it took longer, they must have been slacking a bit, or the person supplying materials had held them up. Either way, they could lose their free time (but never their shirts!) by having to work longer hours or weekends.

Often a client thinks that, by purchasing all the materials, they will save the margin the builder would have included in the price. This is rarely the case because the builder will have better buying power than a one-off client, even when buying a complete house-lot of materials. The builder is also more likely to get better performance from the subcontractors because of their on-going industry relationship.

As with all contracts, labour-only contracts should be scrutinised carefully because the more that isn't in the control of the builder, the more they aren't responsible for. This type of contract is often successfully used by main contractors who subcontract out the whole or parts of building work or construction to a labour-only team.

Cost reimbursement contracts

In some circumstances, a 'cost reimbursement contract' can be the fairest of all. This is where the labour rate and profit percentage on subcontractors and material supply is negotiated with the main contractor, and the entire job is paid on supplied invoices. All risk is removed from the contractor, and they should be willing to operate with reduced margins, safe in the knowledge that all their hours and expenses will be paid for. A higher-quality job can result because the need to rush is removed.

Cost reimbursement contracts should only be used where there is a high level of trust and confidence in the ability of the builder to carry out the construction competently.

The Building Act 2004 introduced 'implied warrantees' to give the homeowner defined expectations. Irrespective of which contract is used, a builder is liable for any defects in their work.