

Contract Management; Integration for Best Effect

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Abstract

In this paper the author presents from the perspective of a practicing contracts lawyer some key elements necessary to help construction contract execution. The author considers that the parties' behaviour after a contract is entered into is a result of the parties' strategic approach to the contract in the first instance. Parties are more likely to execute a contract smoothly if they have a common interest as opposed to similar expectation. Aspects of this thesis are explored and some tips given for smooth contract execution.

Keywords

Construction contract management, Contract language, Contract construction, Contract integration and contract execution

1. Introduction

Why have a lawyer speak at an engineering conference? I asked myself what I can bring to the conference. How can attendees benefit by my experience? We all here hear the stories about lawyers – especially how they always win in conflict situations whether their clients win or lose. And this sentence is a good example of why contracting parties have problems with contracts and lawyers. Needing a lawyer to deconstruct a sentence or phrase in order to find meaning in a contract is a poor start to a dispute and in my experience disputes in business are a normal part of business life.

Deconstructing sentences is not what I have done all my life. For nearly twenty years I was a contractor operating my own businesses, first in metal recycling, and then in industrial gases. I have experienced deconstructing industrial manufacturing complexes to selling gases to industrial manufacturing complexes. In those times I have signed so many contracts from projects to procurement and I learned that whenever a serious dispute arose it was the lawyers who seemed to get rich. So I decided to join their ranks.

I came to university when I was nearly 40, completing a law degree and masters in management in four years. I feel confident now in my role as a Contracts Consultant and I think that if people attending this conference can learn anything by my experience then it is this:

How the parties to a contract behave is a result of how the contract is structured, and structuring a contract results from adequately understanding and capturing each party's interests.

A contract is a form of private law; it is the parties themselves that are creating the law. So what is senior management's thinking when they create the contract? How does this relate to what the Project Management think about the contract? What does the corporate lawyer think about it? My thesis is that there is a gap between senior management's understanding of how each party to the contract should

behave and how they actually behave as a result of the contract which they developed and structured. To try and get a feel for the issues therefore I am going to look first at a contract; what a contract is and isn't, what I think contract integration means in respect of an organisation's systems, and finish with a few tips on how to overcome the issues and get a better result out of your contract.

2. Defining Contracts: The Theory of Relativity

I always thought that modern contracts were really a Western invention. However I visited the Anatolian civilisation museum in Ankara and saw with my own eyes contracts recorded in cuneiform on clay tablets 4,000 years ago by Hittites! Persians, some 4,300 years ago, had written contracts covering such matters as sales and purchases, rentals, labour contracts, co-partnerships, loans and mortgages, bankruptcy, power of attorney, marriage, divorce, and adoption. The tablet pictured with cuneiform script is from Iraq and details a contract for selling a field and a house, from Shuruppak. So not only were Arabians responsible for inventing astronomy, algebra, and writing, they also invented contracts and the fine print that goes with them! Following is a contract everybody is no doubt familiar with;



Figure 1: Contract for Rent and Repair of a House, One Year Term, Thirty-fifth Year of Darius, 487 B.C. (Barton, 1904)

Iskhuya, apparently a tenant of Shamash-iddin, undertakes to repair the house in which he is living. In addition to the rent for the year he is to receive fifteen shekels in money, in two payments, at the beginning and the completion of the work. The last payment is to be made on the day of Bel. In case the repairs were not then completed, Iskhuya was to forfeit four shekels. The contract reads:

“In addition to the rent of the house of Shamash-iddin, son of Rimut, for this year, fifteen shekels of money in cash (shall go) to Iskhuya, son of Shaqa-Bel, son of the priest of Agish. Because of the payment he shall repair the weakness (of the house), he shall close up the crack of the wall. He shall pay a part of the money at the beginning, a part of the money at the completion. He shall pay it on the day of Bel, the day of wailing and weeping, In case the house is unfinished by Iskhuya after the first day of Tebet, Shamash-iddin shall receive four shekels of money in cash into his possession at the hands of Iskhuya.

(The names of three witnesses and a scribe then follow).

Dated at Shibtu, the twenty-first of Kislimu, the thirty-fifth year of Darius”.

This contract document illustrates basic contract principles which have survived millennia:

- a party making an offer,
- a party accepting the offer, and
- a consideration given for the offer.

All modern contracts must have these basic components for a contract to exist. Of course now days there are other principles necessary; intent to form legal relations, certainty, etc but they are subsequent to the fact that there are separate parties who find they have a common interest which they desire to exchange to each other for mutual benefit. It is this essential characteristic of contracts; the incorporation of both parties interests, which I would like to consider in a little more detail.

2.1 Nexus of Interests

A Contract is the foundation upon which the Parties expectations are built. It is vital to the contracting parties that they understand each other's expectations and that the contract represents a nexus of the parties' interests. Whether those expectations are understood by the contracting parties determines whether the contract runs smoothly or contentiously. But in order to understand expectations, I think it is important to differentiate between expectations and the parties' interests and if they have common interests. I think it is fair to say that a contract represents a nexus of the parties' interests; a good contract captures a meeting of the minds.

For example in the above contract the expectation is that Iskhuya is going to repair and rent a house from Shamash-iddin. Therefore it would seem they have a common interest in the house being habitable; Shamash-iddin because he wants to rent his house and Iskhuya because he wants a house to rent. However if Iskhuya knew Shamash-iddin was more interested to sell the house and for this reason he wanted it repaired, do you think it would make a difference to Iskhuya's desire to repair it, or make a difference to the quality of the repair? They might both have a common expectation; Shamash-iddin to rent the house to Iskhuya, but they would not have a common interest! Shamash-iddin and Iskhuya are going to have some conflicting viewpoints when it comes to Shamash-iddin asking Iskhuya to move out so he can sell the house after Iskhuya repairs it.

And how each would interpret the contract in case of a dispute would depend on their positions relative to each other; this is the reason why I consider Contracts similar to the Theory of Relativity. In layman's terms the Theory of Relativity means that the characteristics of an object depend on the observer's position relative to that object. (With the only constant being the speed of light) As adversaries Shamash-iddin and Iskhuya will have opposite viewpoints on the contract's meaning. For a contract to be useful as an instrument in deciding each party's obligations it would be helpful if it reflected their common interests. Many physicists have been attempting to do the same in physics; develop a Grand Unifying Theory. I am not a physics engineer so I don't really understand the underlying physics but I can understand the desire for a grand unifying theory and in Contracts I think "commonality of each party's interests" is a key element leading to a grand unifying theory, at least unifying for the contractual parties that is.

Although Shamash-iddin and Iskhuya's contract may be considered simplistic, it is nevertheless highly relevant because interests are rarely captured appropriately and incorporated into a contract. Why I am focused on this issue is that in Contracting it is a fact of life that problems will occur; it is how the problems are resolved which characterises a good contract or a bad one. Where the parties have a common interest then problem resolution will occur much more smoothly and quickly than where each party is fighting to protect their own interest. I am sure you can imagine or have experienced the problems in dealing with a contracting party who doesn't share the same interests as your-self. And where

there is a consortial partnership it only takes one party to have subverted interests for the contract to unfold in a very fractious manner.

There are a variety of influential factors underlying a lack of common interest; the relative size and power of each contracting party, the type of contract, its value, where the parties originate, to name a few. Developing and incorporating a common interest in my opinion is a subject not given due importance to, neither by the parties involved, nor the wider profession or academia. I suggest it is because each party rarely understands the other's real interests and I subscribe this fact to inadequate communication up front at the negotiation stage.

2.2 Communication Issues

What I mean by inadequate communication, especially in International contracts, is a lack of understanding by each party of the other's viewpoint. This can easily be seen in international contracting where English is the international language of choice for most contracts where the contracting parties are from different countries (Bids for 80% of the world's international contracts are now accepted and reviewed in English only) (Bragg, 2005).

I have been a Contracts consultant in 6 different countries, four of them non English speaking, yet all the contracts were in English. The company which I consult to now has contracts with international partners in 8 different countries. None of which have English as a first language yet all the contracts are in English. Consider this email:

“Please make your decision on the place of the meeting taking into account our request at least from the point of view of the overriding factor of the Consortium Agreement irrespective of the scope/extent of the agenda, but not still handling the issue out of our subject basic point put forward if your latest case is as given in the message.....”

This is nearly incomprehensible; imagine the confusion caused if such a communication was written relating to a really important element in a project. There is no short answer to language difficulties yet they inevitably arise in international construction contracting due. Cultures represented at this conference come from the West and the East. I am from the south but considered a westerner. And if you are from my country to go to the East you must go west! If you are American and want to go to the West, at least the European part of it, you go east! Where east and west is is a matter of relativity; it depends on from where you are viewing them. Ultimately however there is no difference between them as Kipling suggested 120 years ago;

“Oh, East is East and West is West, and never the twain shall meet
Till Earth and Sky stand presently at God's great Judgment Seat;
But there is neither East nor West, Border nor Breed, nor Birth,
When two strong men stand face to face, tho' they come from the ends of the earth”!

Lesson: where there are willing parties then understanding of each others' perspective can be achieved. It doesn't matter where you are from, or what your what language is – when it is important you make the effort to bridge the communications gap. I stated that there is a gap in understanding contract behaviour at the senior management level and I relate this to inadequate communications.

I consider that senior management should be leading the communications role but upfront I will state that in my experience Senior Management are failing in this action. This statement is not meant to cause offence but is meant objectively. Senior Management in all the companies and all the countries I have worked in are failing to establish good communication with their contracting parties for many reasons. This failure is then reflected within companies management divisions; Business development (*finding*

new projects), Bid Preparation (*tendering for projects*), and Project Management (*project execution*) departments. Senior management fail to integrate these departments systemically thus allowing the efficient transfer of knowledge required for effective contract execution.

This paper is perhaps not the forum to explore in depth the issues and practices required to better communicate with people from other cultures but I would strongly urge those in leadership roles to look at themselves and consider their part in communication failures. It is not possible to blame communication failure entirely on the “other” party; it is incumbent upon all senior management to actively improve communication skills. I have shown that time spent on developing up front good communication leads to parties understanding of each others interests. Lack of understanding leads to inadequate contract preparation but inadequate contract structures can still result even if there is a meeting of the minds so to speak. Structuring and writing contracts shouldn’t be left only to lawyers as I will show you next.

2.3 Contract Construction: Science or Art

The Journal of Construction Engineering and Management states that construction engineering is a science. One of my law professors stated that law is a science – I would disagree – perhaps there are methods of logic, deduction, and interpretation utilised which may purport to follow scientific methods but law, unlike construction engineering, is not an empirically based activity; a does not always follow b, so to speak! Both activities however depend on the basic communication abilities of the individuals involved and good communication also is not a science! Perhaps good communication rests on quascie principles! (Quascie: quasi scientific).

Assuming that both parties are sincere in their approach to each other then developing a contract which reflects the parties’ interests should not be left to picking out a FIDIC template and filling in the blanks. I have to state that a party can have a deliberate strategy to focus only on its own interest – in that case all the lessons still apply. The counterparty, if they make the effort, will uncover the real interest and be able to deal with it within the context of the contract! By way of illustration I can tell you about a contract I worked on in Australia. A very large German company contracted to install a new baggage handling system in an airport and subcontracted certain of the works to a local contracting company. It was well known to the locals that this sub-contracting company, itself an international company though headquartered in Australia, had an established practice of taking a contract at contract price but immediately claiming variations for works such that they could consistently obtain 15% above contract price. If the German company had understood the strategy of the Australian company they could better have structured the contract to avoid subsequent variation claims. Poorly constructed or loosely worded contracts provide fertile ground for problems to decay into conflicts. Conflicts can emerge due to contracts in which responsibilities are not defined properly (Loosemore, 1999).

Theory of Relativity applies here also; if you are contracting in the Commonwealth or America you can be sure that the legal system, based as it is on common law tradition, is quite different than in European countries. For example in common law there is no implied term for parties to act in good faith towards each other but in European courts there is (in certain circumstances!). Therefore how your contract is interpreted will depends on its context (Hughes and Maeda, 2002); the legal environment, current construction practices, business social norms; just because you think your contract has a certain meaning doesn’t make it so. Someone else is going to interpret it for you in a dispute situation and there has been little consistency in interpretation.

This has given rise to FIDIC type standardised contracts and other initiatives, including international conventions, developed to help international trade and resolve subsequent disputes. The 1958 New York Convention is the prime example with over one hundred and forty countries to date agreeing to enforce arbitration agreements decided in foreign states. International arbitration follows its own set of rules in

terms of procedure, evidence, and rule interpretation, and in fact can be considered to be outside the normal practices of the country it takes place in (Redfern *et al.*, 2004). Again the focus is on how an independent arbitral panel will interpret the contract which has been agreed to by the parties but it is possible to make it easy for arbitrators to interpret by using common sense even if you take a FIDIC contract as a starting point.

This is where senior management must take a leading role; often in the pressure to succeed in obtaining tender resources are prepared in haste and standard form contracts are utilised often heavily modified (Latham, 1994). Spend some time on this issue; don't leave it entirely to the corporate lawyer! Senior management should work through each contract clause, as I said a contract is a document that will define each party's behaviour AFTER the contract has been signed so if you don't understand the meaning of a clause or contract item then you should be asking the challenging questions up front. In other words ALWAYS read the fine print it will save you time and trouble downstream.

Remember what I said about a contract being a form of private law, when it comes to deciding in dispute situations judges will assume that the contract contains the rules each party agreed to and that the parties knew and understood them! Your role as senior management is to bring common sense to the contract. There are many instances where contract clauses are so ambiguous as to be ineffective. There is no need for long sentences in extreme legalese which requires special interpreters (lawyers) to decipher. I won't give any examples, there are many and they are so obtuse!

The point is if you don't understand a contract clause then chances are the other party may not and if the misunderstanding relates to a condition essential to the contract then in case of a breach there are going to be major issues. So be clear about the agreement, you have to be sure you have reached a meeting of the minds at the contract stage. A contract is supposed to, among other things, protect your interests but a poorly drafted contract can result in bankrupting your company. You should consider that fact before you sign a contract you have not read or do not understand!

Understanding as I use the word relates to the company's knowledge management, ie; how does the business development team's client information get transmitted adequately to the Bid preparation team or Project Management team? It is likely that if within your business structure transmission of knowledge is inefficient then the chances of achieving the required understanding are decreased. Problems of knowledge transfer can be reduced by an integrated approach to business operations.

3. Integration

On the assumption senior management establish good communication and subsequently uncover the other party's interests then this knowledge must be passed on down the value chain; if senior management don't pass on their knowledge then contract drafters will miss it and bid preparation, project managers and other line level execution staff, are going to be trying to achieve fiscal objectives while at the same time constrained by behaviour resulting from inadequate or inappropriate contract preparation. Contract Management ideally is an activity that underlies business development bid preparation and project management activities.

To properly construct a contract there must be an integrated approach to identifying, bidding for, and executing a project. The relationships between a company's Senior Management, Project Management and other departments, should be structurally related; systems must be integrated between business development, bid preparation and project execution. These three value centres should be supported by a Contract management function incorporating contract entry contract administration and contract claims processes.

On a contract I worked on in Poland there were three parties: the Owner; an American multi-national, an Irish Project Management company acting on behalf of the Owner, and the Polish branch of a Swedish International Construction company. The Owner wanted their factory operational within 9 months from first breaking the earth. The construction was started on a Letter of Intent but there was an initial delay due to the inadequate ground preparation performed by an un-associated subcontractor. Later a dispute arose centred on whether the works carried out by the Swedish construction company required to fix the initial soil preparation were 'extra' and therefore a variation. It could have been avoided by clearer boundary limit definitions within the scope but in the pressure to commence construction inadequate time was given to defining boundary limits. A properly functioning Contract Management team would be proactive in developing a clearly defined scope; a contract administration function would have picked out the technical deficiency and issued a variation notice for the Owner to agree to prior to commencing the works; a contract claims function would have no difficulty in claiming for extra works supported by the appropriate communications, variation notices, and demands.

There are many management information systems (MIS) available supposedly providing such integration including contract management software but in my experience unless senior management are specific about the type of information put into the system they are not so effective. Project Managers can give vital feedback if they are involved in contract preparation for example but usually they are handed a completed contract and told to get on with it as the above example illustrates.

I stated earlier that the behaviour of parties to a contract is a result of how that contract is structured and that the structure depends on adequately understanding the parties' interests. Profit is established at the contract negotiation stage and in today's contracting climate profit percentages are measured in single digits (Ashworth, 1999) so parties behaving in a difficult manner after signing the contract will destroy profit very quickly. In the above example the Construction Company was exposed to extra costs to rectify a problem not of their making plus liquidated damages for failure to deliver the project on time and subsequent delay and disruption damages from their own subcontractors.

I always say the best contract management strategy is to execute a contract on time and on budget. An upfront investment in time taken to establish the good communication necessary to truly understand your counterpart's interests, and then CAPTURE that information within your MIS for use by Contract management and Bid preparation departments will translate into Contract documents the Project Management team can rely on to deliver a project on time and within budget.

4. Execution: A Few Tips!

If you have taken the time to understand your counterparty, your contract, and whether the contract reflects the true intentions of the parties then you increase your chances of success. In using the personal pronoun "you" I am referring to the senior management authorised to bind the company contractually but as I have mentioned experience shows that there is often a lack of understanding by senior management and management downstream as to what the contract actually means and how its structure affects the contracting parties' subsequent behaviour.

By incorporating appropriate Contract Management functions early in the business development stage then subsequent behaviour becomes more predictable as a result of appropriate contract construction, administration, and claims management. I have a few tips that hopefully help first attempting to obtain "a meeting of the mind" which relies on uncovering your counterparty's real interests.

Nexus of Interests

Tip 1: The best results come when the bosses are involved!

The attitude of the highest level of management defines the company's and therefore the projects strategic goals – senior management's attitude defines how a contract is going to be used; as an instrument of accord or an instrument of discord. This is the same for your counter-party's strategy.

Identify your counter-party's interests then strategy; are they going to incorporate your interests as theirs, fight to hold their interests superior, or perhaps don't care. Identifying your counter-party's interests requires superior communication.

Communication Issues

Tip 2: It should come as no surprise that the Secret of Contracts is: Negotiation, Negotiation, Negotiation

There should be no surprises – this depends on obtaining knowledge in advance of entering any contract. Common interests are uncovered during negotiation so the knowledge of these interests must be passed onto whoever drafts the contract and if the contract drafter is not part of your organisation make sure your Contracts Management department knows and can check the draft to see whether it reflects those interests or not. If it doesn't, then communicate and negotiate some more until the contract is constructed appropriately.

Contract Construction

Tip 3: Don't leave it to the Lawyers - Read the Contract!

If you don't understand it, then chances are that your counterpart doesn't either so get it redrafted! The inference is that you have taken the time to read the contract; if you are the one signing the contract then you should have read it! I have no sympathy for those who don't!

Use checklist for contract construction and this checklist should incorporate clauses that capture parties' common interests. Many authors don't believe that it is possible for there to be a win-win contract (Hughes and Maeda, 2002); I disagree! For any strategy there will be an optimum outcome representing both parties' interests. It is a matter of communicating and negotiating until you can incorporate the elements necessary for success into the contract.

I consider it useful to have a clause outlining the purpose of the contract. In the event of an arising dispute, a purposive clause will assist the adjudicators to interpret any contract clauses, terms or conditions which are unclear. I also consider a good faith clause is helpful.

In common law jurisdictions there are no implied good faith terms; the jury is still out as to exactly what an express good faith term means, and in civil law countries many states have codified good faith terms. But I consider it is helpful because it gives flexibility to adjudicators in both common and civil law jurisdictions to determine in the contract's context what is appropriate behaviour taking into account the cultural differences as to what is honest and open as regards to good faith.

5. Conclusion

I have illustrated that the behaviour of parties to a contract is a result of how the contract is constructed. Congruent behaviour depends on a contract reflecting not just the parties' expectations but their common interests. Parties with a common interest are far more likely to have a successful contract but the success of capturing this interest depends on the attitude and engagement of senior management. Communication is a vital function which needs improving at senior management level.

To often there is a gap in management's understanding of how a contract affects behaviour. Knowledge of important interests uncovered at the negotiation stage is often not passed on down through the management levels. This can be overcome by integrating Contract Management into the Business development, Bid preparation and Project management departments.

Contract Construction should not be left to chance. Fidic, ICE and other template contract documents often need to be heavily modified. Two clauses useful for interpretation; a Purpose clause and a Good Faith clause, should be included.

Finally I gave three tips: Tip 1: The best results come when the bosses are involved! Tip 2: The Secret of Contracts is: Negotiation, Negotiation, Negotiation, and Tip 3: Don't leave it to the Lawyers - Read the Contract!

Contract management is an iterative process – negotiate and communicate; then negotiate and communicate; until close out!

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