

# Different contract forms

Ulf Eriksson, 2009-01-12

## Introduction

When you are about to purchase a major project or refurbishment measures, there are number of things that you must take into consideration.

Depending on how much influence that you will have on the project, you must select which form of contract that you will use. You also have to decide on your organization, and how the projection will go forward.

Below is an overview of the most common forms of contract that is used in Sweden.

## Organization

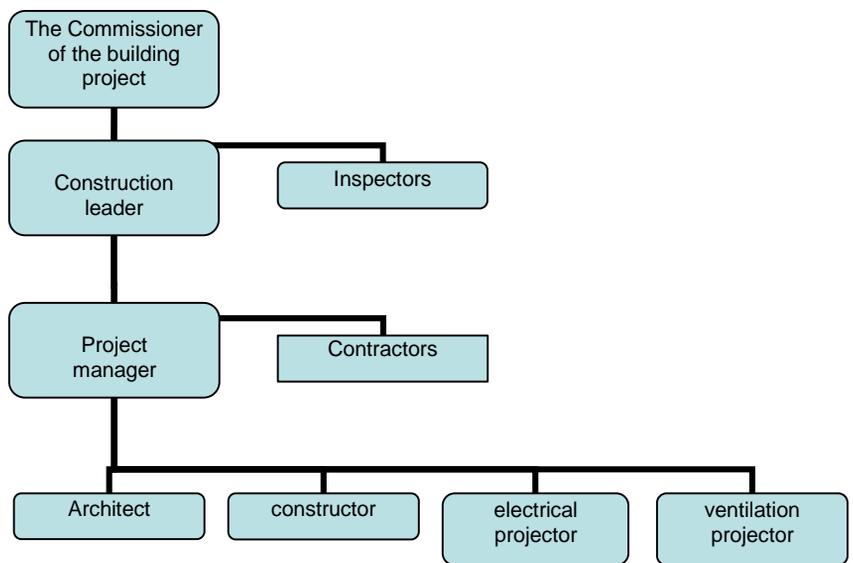
The commissioner of the building project usually uses someone from his own organization, or a consultant, to be responsible for coordinating the construction project. This function is usually called construction leader. In bigger projects both the purchaser and the contractor have project managers or construction leaders in their own organization.

For the technical and financial control during the construction period, the purchaser needs resources in the form of inspectors, surveyors and project managers. These controllers are usually included in the team of the construction leader.

The control is usually distributed to the client and the contractor. A large part of the quality assurance is done by the contractor himself, through their own checking lists and the use of quality management systems.

## Projection

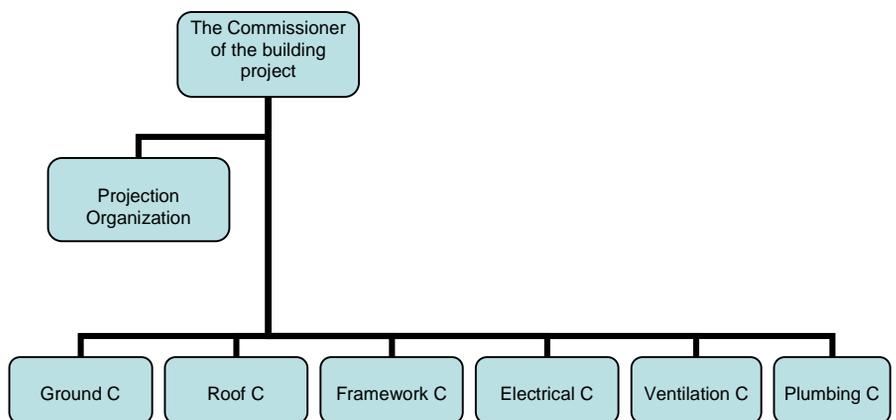
Projection can be organized in many different ways, either that you have agreements with each of the projectors, or an agreement with the entire projection team. Normally, in both cases, a design leader who is responsible for coordination will be appointed. Sometimes the construction leader has this role, sometimes the current architect for the project has the role.



*The above figure illustrates the projection organization with construction leader, inspectors and projectors.*

## Sub-divided Construction Contract

Characteristic of this type of contract is that the traditional construction contract is sub-divided into smaller contracts. The commissioner of the building project also has contracts directly with both the projectors and each of the contractors.



*The above figure illustrates a sub-divided construction contract where the future proprietor is responsible for every single contract and all the projectors.*

## Analysis of the contract form

### *Economy*

The contract form provides the developer a good opportunity to find the best offer for each party of the contract by allowing many tenders in each branch. Costs for coordination and administration can however reduce the profits.

### *Time scale of the project*

The contract form allows a progressive projection during the construction period which allows opportunity for a quick start

up of the construction. Not all documentation needs to be ready when the earthwork and the foundation work starts.

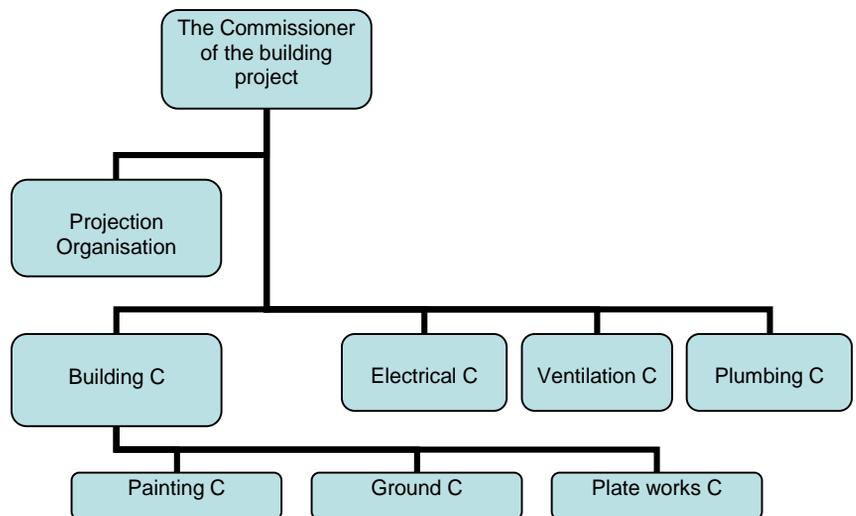
### ***Risk /Responsibility***

The commissioner of the building project is responsible for the projection and is also responsible for errors in the documentation that cause the contractor to incur additional costs. They do however; have the possibility to take such requirements further with the projector who is responsible.

The highly fragmented contract form requires major coordination effort by the developer. Incorrect execution or delays caused by a contractor can lead to contractors demanding compensation against the developer for damages incurred. Since there are many interfaces between the different areas of responsibility, there is a major risk that problems will arise.

## **Split Construction Contract**

Unlike the sub-divided contract, here all the normal building work is collected in a single contract. The commissioner of the building project therefore has contracts directly with both the projectors and all the various side-contractors. Generally the construction contractor is called the Principal contractor, which means that he is responsible for certain facilities such as scaffolding, barracks and other workplace facilities. The Construction/Principal contractor may also be responsible for coordination between contractors.



***This illustrates a split construction contract where the commissioner of the building project is responsible for every single contract and planners. The building works are gathered to the construction contractor, who is also the principal contractor.***

## Analysis of the contract form

### *Sub-contractors*

The construction contractor may have sub-contractors, but this means that the construction contractor is responsible for them as well as for their own jobs.

### *Economy*

This form has the same advantages and disadvantages as the sub-divided construction contract, to a lesser extent however.

### *Time scale of the project*

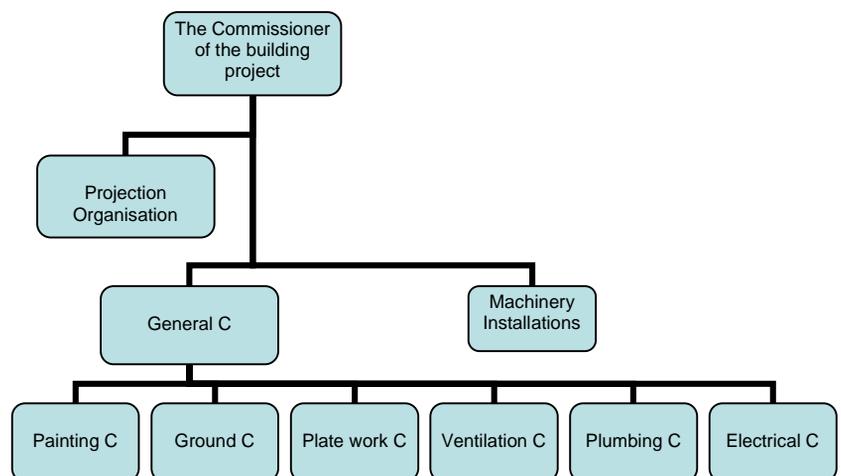
It does not have quite the same advantages as with the sub-divided construction contract because it requires that the documentation for the sub-contractors is ready before the construction starts.

### *Risk /Responsibility*

The same advantages and disadvantages as at the sub-divided construction contract. Coordination responsibility, however, is considerably smaller for the customer and the contract borders are easier to define.

## General Construction Contract

In the General contract, the commissioner of the building project only has one agreement concerning the work in the construction area. However, some side-contractors in a specialised line of business may wish to contract for things such as machine/plant installations. All other contractors are sub-contractors to the General contractor. He is also responsible for all of the facilities such as scaffolding and barracks in the workplace.



*The above figure illustrates a general contract where the developer has an agreement with only one contractor.*

## **Analysis of the contract form**

### ***Economy***

During procurement in the form of a general contract, the bidders are used to basing their bids on a limited number of offers from potential prospective sub-contractors. The contractor who wins the contract has the opportunity to go out with more quotes in an effort to press the earlier specified price. Any potential profits will not then be available to the customer because the general contractor will receive everything.

The administrations costs for the commissioner of the building project are less in the general contract than in a split construction contract, since they are no longer responsible for the coordination.

### ***Time scale of the project***

Regarding the starting time and the time scale of the project, there is no significant difference between a split construction contract and a general contract. Possibly the start could be a little bit earlier.

### ***Risk /Responsibility***

In relation to a split construction contract, the responsibilities are smaller in a General contract because the developer has contracts with only one party at the building site. However, the developer is still responsible for the projection toward the general contractor.

## **Coordinated General Contract**

In order to take advantage of the benefits of a general contract in combination with the benefits of a split construction contracts, it is quite common for the commissioner of the building project to invite tenders as a split construction contract and then during the procurement of the construction contracts, allow the construction contractor to overtake the procurement of all the other contracts. This is known as a coordinated general contract. Side-contractors will then be sub-contracted to the construction contractor.

Appropriately the prospective general contractor will be purchased first. Then the other contractors will be contracted in consultation with him. In this way, the general contractor is given the opportunity to affect the contracts so that they suit the forthcoming work. In this way the risk of confusion, misunderstanding and disputes is minimized.

## **Analysis of the contract form**

### ***Economy***

The contract form gives the commissioner of the building

project a good opportunity to influence and gain control of the costs for each contract, whilst avoiding the coordination responsibility of the construction site.

When planning the procurement of a coordinated general contract, this must be informed to the prospective sub-contractors, so that everything is noticed.

### ***Time scale of the project***

Regarding the start and the time of the project there is no significant difference between a split construction contract and a coordinated general contract. Possibly the start could be a little bit earlier.

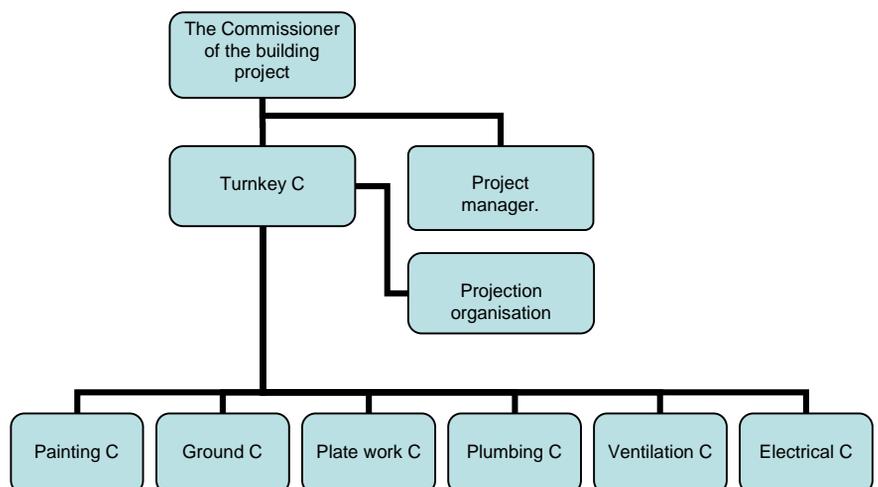
### ***Risk /Responsibility***

The contract documentation in a coordinated general contract are exposed to higher standards than in a general contract, therefore great importance should be given to describing the contracts at the tender stage.

If the general contractor is awarded first and other procurement is done in consultation with him, you usually avoid problems which arise as a result of the contract documents.

## **Turnkey Contract**

At a turnkey contract the commissioner of the building project only has one contract that covers both projection and execution of the contract. The turnkey contractor is responsible to ensure that the building should be constructed according to current standards and to the functional requirements that are compiled in the specifications.



### ***Organization in a turnkey contract.***

A project manager is usually appointed to communicate the commission's wishes and follow up the project during the period of construction.

The projection that each of the bidders performs does not imply that it will be more expensive in the long run.

## **Analysis of the contract form**

### ***Economy***

The reason why it can be cheaper for the contractor to pre project is that the documentation does not need to be legally binding and comprehensive as in a detailed contract.

It is enough with documentation that satisfies the legitimate requirements and the needs of the place of works.

The risk is that the customer may have a building with high operating and maintenance costs because bidders may look for the cheapest solution for each functional requirement. The requirements of the tender documentation must be made so that it takes into account the operation and the maintenance costs.

### ***Time scale of the project***

From a time perspective, the turn-key contract has about the same advantages as the sub-divided construction contract. A quick start of the construction is possible because the projection can be done in parallel with the construction.

The projection is simpler than in other forms of contract.

### ***Risk /Responsibility***

A turnkey contract is the simplest form with regard to liability. The commissioner of the building project has an agreement with only one party.

The demand in the inquiry must be clear with regard to functions and expected operating and maintenance costs, in order to prevent sub-standard quality and that the building will end up being expensive to own.

Turnkey contracts can lead to a restriction of competition. Only companies that have sufficient economic resources to manage the projection can compete for the overall work.

Turnkey contracts should therefore not always be selected for all projects.

## **Negotiating Contract**

In a negotiating contract the fundamental idea is that the contractor comes in at an early stage of the project. Only then can they affect the design through their knowledge of production and costs.

You can say that the turnkey contract in its most extended form is in fact a negotiating contract; the main difference is that you usually only have one contractor for the commission.

As the conditions of the contract take shape, the economics in the agreement between the client and the contractor will be established. The agreement can then be reached in the form of a turnkey contract.

This type of contract requires a high level of trust between the parties.

## **Functional Contract**

This is a relatively new type of contract form. This means that it is not just the lowest price you compete on; for example it could be the best future function expressed in annual costs.

In traditional contracts where the developer takes over the operation and maintenance responsibility, it could be difficult to achieve a fair assessment of different contractor's bids, with reference to the annual costs that a building will experience. One solution might be to let one contractor be responsible for the management and the maintenance costs for all or part of the lifetime of the building. This is known as a functional contract.

Another application of functional contracts may be the design of roads, bridges, and tunnels for a certain amount of traffic.

The functional contract in construction work is mostly used in Sweden for the procurement of operational/running and maintenance contracts on existing buildings.