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ARE CONTRACTORS BITING BACK?

By Jonathan Olson-Welsh and Sebastian Cunningham

Construction analysis: How is the economic upturn affecting the balance of power between contractor and employer? Jonathan Olson-Welsh, partner, and Sebastian Cunningham, associate at Mayer Brown International LLP, discuss how contractors are making the most of the improving economic conditions and the growing number of projects on offer.

How is the balance of power between employer and contractor in contract negotiations changing?

Nothing stays the same. As the economic pendulum swings from downturn to upturn, bargaining power moves away from employers towards contractors. A wider variety of projects now on offer and a more positive market outlook means contractors can afford to be more selective in choosing projects and, consequently, to be more robust in contract negotiations. And, unlike two or three years ago, if a project involves a significant level of risk a contractor may simply decide not to tender.

The shift in bargaining power is repeated at subcontractor level, where the survivors of the recession are fewer, and often down-sized. The resulting shortage of certain subcontractors (joinery, for example) coupled with the high demand for their services and the similar position of suppliers of certain key materials (such as bricks) means that subcontractors and suppliers are pushing for more favourable terms. This feeds through to the main contract negotiations, where the contractor will naturally look to pass on the risk.

Large-scale energy and mining projects, however, might buck the trend. Many large-scale energy and mining projects have been put on hold or scaled back because of the recent fall in oil and commodity prices and in these sectors this could push the pendulum in the opposite direction. Watch this space.

Are negotiations becoming more protracted as a result?

While contractors and subcontractors are pushing harder in contract negotiations, which on the face of it could mean more protracted negotiations, there is also commercial pressure to agree terms as soon as possible. Employers want to reap the rewards of a rising market and contractors, aware of the work on offer, do not want to see contract negotiation getting in the way of tendering on other projects. Both parties want an agreement as soon as possible and that flushes out the key issues more quickly.

In what ways is the strengthening position of contractors being demonstrated?

In the days of the recession, contractors often took on full design risk, including responsibility for designs prepared by others. However, over the last year, contractors have become more cautious, particularly if the design has been prepared by others or in relation to the employer's basic requirements for the project. If the contractor does take full design responsibility it will probably want recourse against the other designers, either through a novation of their appointment, or through a collateral warranty or reliance letter.



Jonathan Olson-Welsh

Partner, London

E: jolson-welsh@mayerbrown.com

T: +44 20 3130 3254



Sebastian Cunningham

Associate, London

E: scunningham@mayerbrown.com

T: +44 20 3130 3519

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Limiting liability is increasingly popular with contractors to protect them from unlimited liability for defects in the works. This could be through an overall cap on liability under a contract, or by seeking to exclude liability for particular losses.

Contractors are also now more wary of the risks associated with site conditions or existing structures and are looking harder at what opportunities are given to inspect and assess the position and at what risk they are prepared to take on board.

What other is the recovery of the economy having on the procurement of construction projects?

In the downturn, contractors willing to bid for projects on a single stage design and build basis would provide a fixed-price quote, sometimes on the basis of incomplete designs produced by a separate design team. Where contractors took on the risk of errors in these designs, and errors did emerge, some contractors learnt a harsh lesson.

Many contractors now choose not to bid on a single-stage basis and employers consequently have then to use a two-stage procurement process. This requires the contractor to bid on limited information in respect of cost components like preliminaries and overheads. The final price is then negotiated at a later date when the contractor has more information and can produce a more accurate estimate.

Will work that was ‘bought’ at the bottom of the downturn return to haunt contractors?

The downturn saw reports of some contractors and subcontractors ‘chasing turnover’ in order to keep their order books full. A number of contractor and subcontractor insolvencies have occurred, particularly where contractors and subcontractors could not deliver what their contract required. Are further problems going to emerge, remembering that contractual liabilities can last for 12 years from practical completion of a project? Pass the crystal ball.

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