

# Commercial Contracts Nature and Form

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## What Is a Contract?

- A **contract** is a legally enforceable agreement between two or more parties with mutual obligations, which may or may not have elements in writing
- Contracts can also be formed orally
- The remedy at law for breach of contract is usually "damages" or monetary compensation. In equity, the remedy can be specific performance of the contract or an injunction..

## Usual Conditions Of Contract

- Scope of Work
- Price
- Time
- Quality
- Risk
- Disputes
- Owner's Responsibility
- Contractor's Responsibility

## Basic Elements Of A Binding Contract

- Offer & Acceptance
- Intention
- Capacity
- Consent
- Legality
- Possibility
- Consideration

## Central Aim Of Contract

- Is to obtain the services as agreed in the contract and achieve value for money
- Optimising the efficiency, effectiveness and economy of the service or relationship described by the contract, balancing costs against risks and actively managing the customer–provider relationship
- May also aim for continuous improvement in performance over the life of the contract

## What Is a Contract?

- The strongest contract, in terms of enforceability, has an offer, acceptance, consideration for the exchange, clearly sets out the terms of the agreement without ambiguity, and is signed by the involved parties with proper capacity to enter into the contract. There are numerous aspects related to valid contracts; in fact, an entire course in law school is often devoted to contract law.

## Construction Contracts Distinctive Features

- All Engineering Contracts of Any Size Are Made on a Standard Form of Contract
- These Forms Provide for Procedure for Variations, Payments, Extent of Contractors Liability for Defective Work, Right to Determine the Contract, Liability for Defective Work, Right to Determine the Contract, Insurance Liabilities

## The Offer

- The Builder who Submits a Tender for the Work Advertised is usually Construed as Making an Offer, and will be Bound by the Terms if it is Accepted
- The Cost Incurred by the Tenderer in Preparing his Tender will not be Recoverable



## Revocation of Offer

- An Offer may be Revoked any Time Before it Has Been Accepted, Provided the Revocation is Communicated to the Offeree

## Award

- Upon Receipt of Tenders, the Public Body is Required to AWARD THE Contract on the Basis of Two Criteria:
- Either the Lowest Priced Tender or the Most Economically Advantageous Tender
- Advantages may Include Delivery Date, Cost Effectiveness, Running Costs, Quality, Aesthetics, After Sales Service etc

## The Acceptance

- In Order for a Valid Contract to be Concluded, there must be an Unconditional Expression of Assent to the Terms of the Offer :  
The Acceptance

## Conditions of Contract

- A Legally Drafted Document
- International Practice: FIDIC
- FIDIC has Separate Docs for Item Rate, Lump-sum, Turnkey, EPC, World Bank, Multinational Lenders
- In India, Each Organization adopts own Conditions based on Past Experience, there are more than 200 versions in use, most disputes arise due to badly Drafted Conditions of Contract

## Terms Of The Contract

- Should include an agreed level of service, pricing mechanisms, incentives, contract timetable, means to measure performance, communication routes, escalation procedures, change control procedures, agreed exit strategy and agreed break options
- If the contract was poorly constructed, it will be much more difficult to make the relationship a success.

## Contract – Basic Fundamental Logic

- Definition of the parties to the contract
- Duties of the Engineer and his staff
- Description of Works
- Duties and responsibilities of the Contractor
- Duties and powers of the Employer
- Payments by the Employer
- Settlement of disputes
- Concurrent duties and responsibilities of the Contractor and of the Employer

Definitions and Interpretation	Contract Contents
The Engineer	
Contract Documents	
Commencement and Programme	
- General Obligations	
Labour	
Workmanship and Materials	
Property in Materials and Plant	
Nominated Subcontracts	
Completion	
Maintenance and Defects	
Remedies and Powers	
- War Clauses	
- Contract Price and Liquidated Damages	
Certificates	
- Terms of Payment	
- Settlement of Disputes	

## Types Of Contracts

- Item Rate
- Design & Build
- Turnkey
- EPC
- PPP

## Tender Documents

- Letter of Invitation to Tender
- Instruction to Tenderers
- Conditions of Contract- General , Particular
- Specifications
- Drawings
- Bill of Quantities
- Priority of Documents

## Responsibilities of the main parties

### FIDIC Priority of Documents

- a) The Contract Agreement (if any),
- b) The Letter of Acceptance,
- c) The Letter of Tender,
- d) The Particular Conditions,
- e) These General Conditions,
- f) The Specification,
- g) The Drawings & Schedules,
- h) Any other Documents forming part of the Contract

## Introduction to FIDIC Documents

### Guide to Particular Conditions

- Particular Conditions Of Contracts have Priority over General Conditions of Contract
- Particular Conditions Of Contracts give possibility to modify existing clauses in Contract in order to make them more suitable to actual Project Conditions
- FIDIC Guidelines to assist the Employer in preparing particular Conditions of contract
- FIDIC recommends use of qualified engineers in preparing Particular Conditions of Contract

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## Conditions of Contract FIDIC

- Red Book – Item Rate Contracts
  - Multinational Development Banks
- Green Book – Short Form
  - Design and Build
- Yellow
  - Electrical, Mechanical Works
- Orange
  - Design Build and Turnkey
- Silver
  - EPC Turnkey
- Brown
  - Design, Build, Operate
- - Dredging, Reclamation Works
- - Subcontracts



## Different Types Of Contracts Apportionment Of Financial Risks

		Design and build	Traditional with quants	Schedule of rates	Cost plus fee	
CLIENT'S RISK						design quants prices
CONTRACTOR'S RISK		design quants prices	design quants prices	design quants prices	design quants prices	

### Design and Build Contract

- An attractive option for clients, it simplifies the contractual links between the parties to the main contract as the contractor accepts the responsibility for designing and constructing.
- Benefits: single-point responsibility, prices which reflect more closely the final cost to the client, inherently more buildable designs and an overlap of design and construction phases leading to early completion

## Design and Build Contract Ganga Bridge Patna 1983



- 5.6km long PSC Bridge Design-Build Contract
- Rs 1000Cr in 2010 value
- About 20% lower than Item Rate Contract
- Contractor free to decide on spans, type of foundations, conc Grades etc

## Turnkey Contract

- 'Turnkey' allows a client to procure from a single contractor all the requirements of a scheme in the shortest possible time
- Apart from the usual design and construction responsibilities the agreement will often include land acquisition, short and long-term finance, commissioning, fitting out and recruitment and training of personnel.

## Dabhol Power Station Turnkey Contract



### Design By Third Party Consultant

- A design and build contractor may commission design from outside consultants or can employ a design team from within his own organization.
- Occasionally the client will ask the contractor to choose a design consultant from a preferred list.
- Delhi Metro Rail Corporation (DMRC) adopted this route; had given a list of pre-qualified consultants for the contractor to choose

## Design By Third Party Consultant

- Novation of consultants in design and build contracts is a recipe for friction between parties and the contractor seldom maintains full control over his consultant team
- Once the designers are fully acting in the employment of the contractor, the client finds himself without his team of advisers needed to check the tender, monitor post-tender changes,

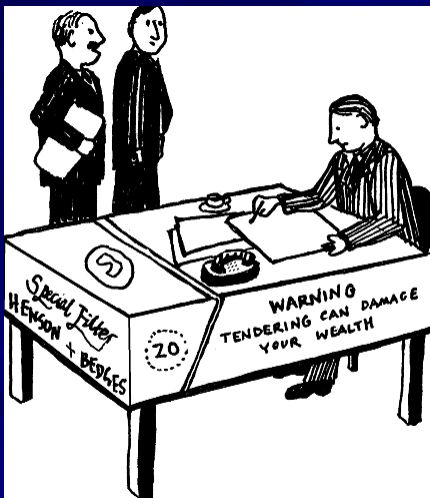
## Project Information Woes

- Missing info – not produced, or not sent to site.
- Late info– not available in time to plan the work or order the materials.
- Wrong info – errors of description, reference or dimension; out-of date info
- Insufficient detail – both for tender and construction drawings.
- Impracticable designs – difficult to construct.
- Inappropriate info – not relevant or suitable

## Project Information Woes

- Unclear info –poor drafting or ambiguity.
- Provisional info indistinguishable from firm info
- Poorly arranged info – poor and inconsistent structure, unclear titling.
- Uncoordinated info – difficult to read one document with another.
- Conflicting info – documents which disagree with each other.

## Casual Tendering



- 'Brian does his estimates on the back of a cigarette packet'



## Benchmarking

- Benchmarking aims ensuring continuing value for money, getting better performance, and improving business practices
- Organisations may seek to benchmark their own internal processes against those of others
- Measures the provider against the best in the industry, making comparisons between similar processes and/or comparing prices
- Identifies and prioritises areas for improvement

## Competition, Negotiation, Limited Tenders

- Contractors selected by competition / negotiation or by a combination of both
- Contractors who ask to be included on select lists of tenderers are usually asked to provide information about their financial and technical performance, particularly about the type of work under consideration

## **Derna, Baida Silos, Libya (1985) Negotiated Contracts**

□ 14 Storey  
elevated tower  
slip-formed in 22  
days, working  
round the clock –  
no interruptions

□ Consultant  
insisted on  
detailed method  
statement before  
starting any  
activity



## **Abuse Of Tendering Procedures**

- Large tender lists
- Short tender period
- Tender documentation
- Asking for tenders when the work is unlikely to proceed
- Qualified tenders and alternative bids
- Failure to notify results
- Late receipt of tender documents



## Visits To Consultants And Site

- The estimator must identify the work items which will be priced on site including demolitions, alterations and repairs
- A preliminary assessment made to find areas for general facilities eg site accommodation, crange, storage areas and hard standings
- If any relevant information is missing then it might be questioned at the consultant's office or during the site visit

## Method statements

- Written descriptions of how work will be carried out; deal with the use of labour, materials & plant in terms of types, gang sizes and outputs
- Employer may ask for method statement to accompany the tender, to satisfy themselves that the contractor has an understanding of the technical challenges and has considered suitable ways of overcoming them.

## Method Statements

- In satisfying the need for safe systems of work, an estimator might develop a method statement with a demolition contractor, for example, before agreeing a price to be incorporated in the tender.
- Large-scale activities needing a combination of items of plant and labour are difficult to price on a unit rate basis and cannot be started without an examination of methods and resources.

### Methods Statement: Benefit to Contractor

- it is a suitable vehicle for:
  - qualifying the tender
  - identifying dates when information is required from the client or his advisers
  - indicating when instructions are required for dealing with nominated subcontractors
  - explaining the limitations of temporary works; a contractor might have allowed for earthwork support but not sheet piling, for example

## Managing the relationship

- The relationship is championed at senior levels in both organisations; the attitudes and actions will lead the tone of the relationship
- Governance arrangements are equitable and relationships are peer-to-peer
- People should share problems, plans, concerns
- Info sharing is the key to an open relationship
- Good communications manage a relationship. Concerns over poor performance are due to miscommunication at senior management level

## Trust

### Case: 3, 4 Lanes Ganga Br Patna

- While contractual arrangement is the basis for a relationship built on common objectives, trust is a feature of the relationship between people
- Trust cannot be mandated within the contract; it has to be built and 'earned' through actions and behaviours, rather than assertions
- After completion of the first contract Ganga Br Patna 2 lanes, the Govt decided to add two more lanes on the existing foundation; based on mutual trust earned, the new contract was awarded by negotiation to the same agency

## Contract Issues

- **Contract Law**
- **Core Clauses, Strategies & Characteristics**
- **Tendering And Risk**
- **Sub Contracting**
- **Variations (Changes)**
- **Payments**
- **Insurances**
- **Time**
- **Claims & Disputes**
- **Contract Completion & Close Out**

## Offer, Counter Offer

- An offer is an expression of willingness to contract on certain terms; it shall become binding as soon as it is accepted by the person to whom the offer is addressed.
- A counter offer is a “Conditional Instruction To Proceed”; An Attempt To Negotiate Price Or Specification. Leads to “Paper War”
- Subject To Client’s Terms & Conditions (often happens between main & sub contractors).

## Reconstruction of Mandovi Br Goa Tender Decision

- Tenders invited based on FIDIC conditions; Bidders directed to quote Lump Sum without any conditions; the lowest bidder complied
- The letter of award was conditional; added some extra requirements including lead for disposal of debris; the bidder treated the letter as a counter offer and declined
- As the bid was very competitive, the Employer negotiated with the bidder, withdrew the earlier LOA and issued unconditional LOA !

## Withdrawal Of Tender Offer

- Can be anytime before acceptance UNLESS there is a condition for the offer be kept open for a period of time;
- Must be communicated to the person making an offer;
- Must reach the person before it was accepted;
- Postal rule does not apply; and
- If by fax or telex, it must be received by the person in person.



## Pamban Bridge At Rameshwaram

### Validity of Tender

- The original tender was required to be valid for X months, which the bidder complied
- Decisions could not be taken and repeated extensions of validity sought from bidders
- The lowest bidder refused to further extend the validity after the first two extensions
- On pressure from the Employer, the bidder extended the validity and at the same time revised the bid upwards; and succeeded

## Letter Of Intent

- Where immediate signing of contracts not possible; If works were done, contractor can claim 'Quantum Meruit'; (Payment for goods or services in partial fulfillment of a Contract after the contract has been breached)
- Exception, where Letter Of Intent combines with Instruction To Proceed. The latter is a conditional acceptance of a tender (e.g. subject to acceptance of client.)

## Letter Of Intent (LOI) vs Letter Of Award (LOA)

- Only LOA legally binding
- If any Contractor commits expenditure based on LOI, he does so at his own risk; he may or may not get paid
- Cases: NTPC tender for gas supply and Reliance offer
- Lime plant in Libya and offer by Gammon to the German Main Contractor BKMI

## Typical Acceptance Of Tender

- 'We are pleased to inform you that we have decided to accept your Tender dated....[or 'the offer set out in your letter dated.....'] for the construction of .....
- 'A formal contract Agreement will be prepared as soon as possible, but meanwhile your tender [or 'offer'] and this letter of acceptance will constitute a binding contract between us.'



## Is There A Contract?

- 'We are pleased to inform you that, subject to an acceptance of our main contract by the Client, the contract for the work will be placed with your company
- 'We are pleased to inform you that, subject to a satisfactory outcome to negotiations between us on certain points in your tender as above, the contract for the work will be placed with your company'.

## Time For Completion

- How long to complete?
- Site availability.
- Justifiable delay?
- Key deliverables & dates.
- Suspension of the work.
- Extensions to finish dates.
- Notices.
- Is Time the Essence of Contract?

## Is Time the Essence Of Contract? Kali Bridge at Karwar

- After two earlier contracts were terminated, the third contractor secured the job on Design & Build basis, Contract Period 4 years
- No provisions for Arbitration, Price Variation
- Inordinate delays in founding level decisions; the 4 year contract period over, without even completing the foundations
- Due to Middle East oil crisis, disproportionate price increases; the contractor declined to apply for extension of time!

## Advance Payments To The Contractor

- The employer can secure funding at cheaper rates than the contractor; or the contractor has heavy early expenditure in procuring expensive plant and materials
- Logic for initial advance and plant advance
- Advances secured by Bank guarantees
- In the case of a Dam Contract in Bihar, the Govt indefinitely delayed commencement after signing the contract, paying plant advance
- Consequent disputes

## Retention & Release Of Retention

- The employer retains a percentage of amounts due to the contractor until the works are completed and any defects period has expired; these are standard in most construction, process and plant contracts
- Half the retention is released on completion and the remainder on the issue of defects certificate.
- Ground reality in many cases- inordinate delays in release of retention

## The Site

- The 'site' is broadly the land (or area) provided by the employer which is identified in a drawing (or by description) in the contract data
- The 'working areas' are lands (or other areas) additional to the site identified by the contractor
- In many urban flyovers, the precasting yards are off-site, several kilometres away
- Issues concerning excise duty

## Time For Payment And Interest On Late Payment

- Payment on each certificate within such time as may be stated in the contract data
- Interest on late payment in the event of either late payment of a certified amount or in late payment because the project manager does not issue a certificate which he should issue
- Interest calculated for period between the due payment date and the actual payment date

## Pamban Br At Rameshwaram Interest on late Payment

- Disputes about extension of time / payment of price variation during extended period referred to arbitration; award in favour of Contractor
- Employer contested the award
- Court proceedings spanning more than 10 years resulted in the court confirming the award and directing interest payment for the delay
- Contractor received interest payment of about six times the award amount!

## Reasons For Sub-Contract System

- Better productivity & economies;
- Reduced capital outlay;
- Conservation of management resources;
- Better estimation of likely cost of work; and
- Smaller workforce to accommodate in times of recession
- Nominated Sub-Contractors;
- Domestic Sub-Contractors; and
- Designated Sub-Contractors.

## Nominated Sub-Contractors (NSC)

- Often specialist skills for particular work;
- Principal nominates & main contractor signed contract;
- A Prime Cost/Provisional Sum is included
- Builder is allowed to object but with reasons;
- Builder ensures NSC enters into a sub-contract with terms and conditions consistent with main contract;
- Proprietor has control over NSC.



## Rights Over Materials

- By implied term, once materials are fixed, they become the property of the Employer.
- Once delivered to site but not fixed, they become the property of builder even though the Employer has paid for them unless there is an expressed term to the opposite
- However, for nominated supplier, once delivered to site, they become the property of Employer unless the sub-contractor invokes a "Retention of Title" clause.

## Reasons For A Variation Clause

- Allows Employer to order changes & additional works; If no provision, Employer is restricted to agreed specification;
- Contractor not obliged to carry out the works;
- Contractor allowed to negotiate a new price for the whole contract each time a change is made;
- Disadvantage: - consultants may leave decision to latter stage.

## Procedures For Processing Variations

- A variation is considered to be warranted. The Engineer issues advice of variation requesting prices. The Contractor prices the work & advises the Engineer of the cost
- If the cost is acceptable, the Employer is advised of the variation together with the cost
- If Employer agrees, the Engineer instructs the Contractor to proceed; `Contract is varied accordingly, in both time & cost.

## Types of Insurance

- Comprehensive (contractor's all risk);
- Public Liability (risk),
- Third Party (common law); and
- Workers' Compensation - Workman's Compensation Act.



## The Pre-bid Conference

- Provide background information on the project, its nature, and the owner's expectations
- Opportunity for the bidders to discuss conflicts, inconsistencies, omissions & unclear items in the plans & specifications
- Discussion of any alternates, allowances, or unit pricing included in the bid package
- Indication that Employer is open to any cost savings proposed by the bidders

## Commencement of Work

- An official notice to proceed establishes the date of the start of construction; used to determine the "contract" time for completion
- If a notice to proceed is not indicated the official date of the start of the project should be established at the preconstruction conference

## The Preconstruction Conference

- Preconstruction conference with contractor
- Establish ground rules during construction and highlight some of the owner's requirements and procedures to establish a working relationship among the owner, Engineer and Contractor
- Introduction of all concerned in the team
- Channels of communication - mailing & e-mail addresses, telephone nos; contractor-provided job site safety & security procedures

## Preconstruction Conference

- Establish schedule for all job meetings, assign responsibility to prepare minutes of meetings
- Verify insurance certificates submitted, accepted by the Employer prior to start of work
- Procedures for submissions to the Engineer, submittal of proposed change orders, no of copies required, additional copies to others
- Review parking & storage requirements for materials stored on- and offsite
- responsibility for site safety and cleaning

## Preconstruction Conference

- Establish responsibility for temporary utilities; submission of a baseline construction schedule, procedures for updating schedule at intervals
- Contractors interface with other contracts by the owner and how to interface with them.
- Review closeout documents, incl preparation, updating, final submission of as-built drawings.
- Review the warranty, guarantee requirements, excess material to be returned prior to closeout.

## Value Engineering (VE)

- Organized effort at analyzing designed Structures, systems, equipment, material for achieving essential functions at lowest life-cycle cost consistent with performance, quality, reliability, and safety
- Contractor may offer VE suggestions with a product he deems equal/superior; he must vet the proposed change to ensure quality, performance, are equal to the specified product.

## Liquidated Damages

- They can either provide compensation for the Employer in lieu of general damages or they can limit Contractor's liability for his breach of contract
- They serve as both and are regarded in law as an exclusive and exhaustive remedy
- To be enforceable any sum specified as liquidated damages must be a genuine pre-estimate of the employer's loss or a lesser sum.

## Liquidated Damages Punjagutta Flyover Hyderabad

- There was a much publicized accident during construction; the Govt appointed enquiry committee generally absolved the contractor but recommended imposing liquidated damages of 10% of Contract Value
- The Employer with-held the amount
- Based on submissions by the contractor, it was held that liquidated damages can be levied only for default of the contractor; recovered amount refunded

## Contract Time Extension

- Meticulous correspondence
- Maintain contemporary records
- Provide addl. documents required by Engineer
- Maintain site diary, photographs, weather records, proof of any extra expenditure incurred
- As per FIDIC, contractor entitled to reimbursement of extra expenditures actually incurred due to extended construction period (due to no fault of his)

## Contract Time Extension Reimbursement of Addl. Expenses

- Panjagutta flyover Hyderabad
  - Contract period extended due to delay in handing over of certain stretches
  - Contractor claimed reimbursement of extra expenses incurred and extension of time
    - based on documentary evidence by the contractor, both were granted, though after lapse of time
  - meticulous documentation helped



## Extraordinary Increase Price of cement & Steel

- The last few years witnessed extraordinary increases in prices, disproportionate to the compensation by price variation clause
- Various Employers, Contractors in India reacted in different ways; partial compensation to abandonment of contract in extreme cases
- The American Employer and Contractors solved the issue pragmatically



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# Thank You