

STUDY OF RISK IN CONSTRUCTION CONTRACTS

ER. AMIT BIJON DUTTA

Research Scholar, Department of Management, RTM Nagpur University, Nagpur, Maharashtra, India

ABSTRACT

Risk in construction is common and are enormous and hence the construction industry is subject to major risk. One of the major risks faced by construction industry is “CONTRACT RISK”. Contractual is a written document between the owner and the contractor. The contract risk can be classified as Owner/Client group and contractor cluster property and personnel, Project works, Pollution, Third parties, consequential losses, warrant obligations, Unlimited liability/damages at large, Insurance cover, Force majeure and suspension, Delay, Variation orders, Free access to worksite, intellectual property rights, Termination by Owner/Client for convenience, Owner/Client’s obligation to pay contractor.

Arbitration was established as a way to resolve contract disputes without having to enter the litigation arena. Major use of arbitration is to settle construction disputes without the need to undertake a long, exasperating and expensive legal proceeding method.

KEYWORDS: Construction, Risk, Contract, Arbitration

INTRODUCTION

Almost every construction projects carry with them enormous risks and therefore the construction industry is subject to more risk and uncertainty than most other industries. However to be totally honest, the issue of the way to effectively handle the risks which are inherent in any construction contract depends on a range of things. The handling of risk in construction contracts varies significantly. This depends on the nature and location of the work, the Owner/Client and contractor involved and the prevailing contracting climate. All of these vary with time and there also are outside influences of banks, governments and also the insurance market. In recent years, Owner/Clients and contractors have remarked that the balance and handling of risks in some contracts wasn't ideal and this document aims to push dialogue between all parties to do to improve this situation.

The owner's/client’s primary objective when planning construction is a complete an entire and serviceable facility in a well-timed manner. Every contract, project and client/contractor relationship is exclusive. Contract document does not gift a preconceived single solution or recommendation for or against contract styles such as Engineering Procurement Installation and Construction or ‘lump sum’. It aims at commenting on some of the problems that may need to be addressed in varied contracting situations.

RISK

Risk is typically poorly understood by the chief acquiring parties and contracting those outside. The impact of this can be a risky:

- To Owner/Clients, in this they embark upon or frame a development uninformed of some of the risks involved;

- To contractors, that they adopt risk that they do not understand and lose money, perhaps maybe bankrupt, so reducing the worldwide pool of contractors capable of doing work;
- To each parties, that if the risk is poorly understood and allotted, it's seemingly to be incorrectly assessed, mitigated, insured and managed, leading to poor project delivery;
- To those further down the supply chain, that if the two main players cannot agitate risks well themselves, sub-contractors are likely to manage this poorly too;
- To those outside (such as banks, national oil firms, etc.), that they can take poorly informed choices that make the risk atmosphere worse;
- To all parties, in this a lack of understanding of risk leads to inefficiency where each pays more and makes less out of the venture.

RISK MANAGEMENT

The process with which the probability of risk occurring or its impact on a project is reduced. It's carried out by following 5 steps:

- Identification of the potential source of risk in the project.
- Determination of their individual impact and choose those with a considerable impact for complete analysis.
- Measure the overall impact of great risk.
- Determine how the possibility or impact of risk can be reduced.
- Develop and place into action a set up for dominant the risks and achieving the reduction.

WHERE DO CONTROL OF RISK LIE?

One way of classifying the risk is by identifying where control of the risk lies. This may change during the life of the project. There are five classifications of risk in keeping with where control lies:

- **External: Unpredictable**

These are risks beyond the control of the individual or Owner/Client and are totally unpredictable / erratic. They come up from external influences such as third parties, act of god, etc.

- **External: Predictable but Unsure**

These risks are also on the far side the control of people or companies. They're expected, but to what extent? There's usually data to see a norm or average, but the actual impact can be on top of or below this norm. Dreadful weather is an example.

- **Internal: Technical**

The risks which arise directly from the technology of the project work, of the design, construction or operation of the facility.

- **Internal: Non-Technical**

These are among the control of people or the Owner/Client and sometimes arise from a failure of a project team to deliver the goods its expected performance.

They will lead to schedule delays, price over-runs or an intermission to an interruption.

- **Legal: Civil and Criminal**

Risks under civil law will arise from written agreement arrangements, patent rights etc. Risks under criminal law can arise under statute, e.g. the United Kingdom Health & Safety at Work Act.

CONTRACTUAL RISKS IN ALL PROBABILITY CAN INCLUDE

- Owner/Client group and contractor cluster property and personnel
- Project works (including both Owner/Client and contractor supplied items)
- Pollution
- Third parties
- Consequential losses
- Warrant obligations
- Unlimited liability/damages at large
- Insurance cover
- Force majeure and suspension
- Delay
- Variation orders
- Free access to worksite
- Intellectual property rights
- Termination by Owner/Client for convenience
- Owner/Client's obligation to pay contractor.

CONTRACTUAL RISKS

- **Owner/Client's and Contractor Property and Personnel**

The contract ought to outline the prices of loss or damage to the parties' several groups' property and personnel of whatsoever nature, irrespective of cause (including negligence).

- **Project Work's (Including Both Owner/Client- and Contractor-Supplied Items)**

The contract should outline the responsibility for loss of or harm to the project works if such loss or harm is

caused by an act or omission on the a part of the contractor cluster while the project works are in the care, custody and control of the contractor group.

- **Pollution**

The contract should outline the responsibility for the results of pollution and contamination of whatever kind emanating from the contractor groups' spread and onshore facilities, Owner/Client's facilities, the work and also the facilities of others (third parties).

- **Third Parties**

The contract should outline the legal liability for third parties' losses caused by every, including in circumstances where a contractor is required to perform work in an area of close proximity to any existing facilities.

- **Consequential Losses**

The contract need to have a clear outline defining the indemnities for every party's group's respective indirect or consequential losses howsoever caused or arising (including negligence) – whether or not foreseeable at the date of the contract.

- **Warranty Obligations**

Warranty defective performance liabilities and obligations (including post termination for default) and every one other implied liability should be expressed within the contract in terms of magnitude, time and remedy.

- **Unlimited Liability/Damages at Large**

The contract have to clearly characterize or limit the contractor group's total additive liability under the contract and at law, so as to enable him to assess his overall exposure resulting from, for instance, liability for delay, damage, rework, re-performance and/or replacement and default (whether or not such actions are carried out by a third party).

- **Insurance Cover**

Insurance policy full details, terms and conditions, limits and exclusions (and any alterations) should be available to all parties and outline the cover available or not for the project.

- **Force Majeure and Suspension**

Under circumstances when the contractor is not permitted from performing the work due to force majeure or suspension by the Owner/Client, the contract should outline whether or not the contractor has the correct to remove any vessel from site once a maximum period agreed in the contract has been exceeded.

- **Delay**

The contractor's accountability for delay/hindrance and liquidated damages should be outlined and should be the Owner/Client's sole financial remedy under both the contract and at law.

- **Variation Orders**

The contractor's obligation should be defined in the contractor, so that the obligations to be performed by the

Owner/Client instructed variation orders taking account of contractor's other existing commitments, any change to the risk profile of the workplace and a mutually agreed adjustment to price and schedule where appropriate.

- **Access to Worksite**

The contract should have a clear description of access to the work site and remedies in the event of delay or additional costs incurred as a result of restricted access to the work site by the Owner/Client or any party (other than a member of the contractor group), including intervention by an action group whether or not such intervention is outlined as force majeure.

- **Intellectual Property Rights**

Intellectual property rights (IP) in terms of the party who developed those IP before or during the project should be clearly identified.

- **Termination by Owner/Client for Convenience**

Should the Owner/Client terminate the whole or a part of the work for its convenience then the contract should outline the entitlement to payment for all work performed, materials including cancellation costs relating thereto and every one vessel and equipment costs and termination fee.

- **Owner/Client's Obligation to Pay Contractor**

Payment by the Owner/Client to the contractor is a material term of the contract and time critical.

ARBITRATION

Arbitration was established as a way to resolve contract disputes without having to enter the litigation arena. Although the mechanics used for dispute resolution are somewhat different between these two systems of justice, arbitration procedures aren't completely divorced from the judicial system. Arbitration supplements but doesn't replace the legal authority of the courts. The courts are called upon when enforcement of an arbitration clause is required. They also enforce the awards made by the arbitration board if they're not complied with voluntarily since the arbitration board has no social control authority. The primary difference of arbitration over the court system is its ability to settle construction disputes without the need to undertake a long, exasperating and expensive legal proceeding method.

THE LEGALITY AND VALIDITY OF ARBITRATION

A party to the contract may feel it's not in their best interest to arbitrate and desires to interrupt this contractual requirement. Under these circumstances they usually look for a way to attack the validity of the arbitration agreement. Cases brought before the courts to invalidate arbitration agreements include reasons such as fraudulent procurement, insolvency, or that it lacks mutuality.

CONCLUSIONS

Construction contracts founded on the principal of fixed price, low bid award are extremely competitive by their very nature. With this competition return bids having extremely tight margins of error or none at all, significantly increasing the risk to the builder. Funding to complete the project is often times as tight for the owner as the bid proposal is for the contractor.

The owner anticipates and expects to receive a complete and usable facility for the {amount, the quantity, the number} of the bid with a modest amount set aside for contract modifications. There are no winners when written agreement disputes are elevated beyond the control of the immediate parties and placed into the hands of the judicial system. Claims and disputes are counterproductive to the ultimate goal each party is making an attempt to achieve; that being timely and cost effective delivery of quality construction. Arbitration as a dispute resolution technique has reduced the requirement to use litigation to resolve contract claims. The Disputes Review Boards appear to be making significant progress toward fulfilling this need.

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