Public or Private Construction Contract: The Contractor's Dilemma Resolved [1, 2]

Jordy Efanga

ABSTRACT

The World is still recovering from a crisis that no one really anticipated. In the United States, numerous banks, companies and contractors went bankrupt. At that time, contractors working for the Federal government, more precisely those executing contracts for it, were quite protected from the effects of the crisis compared to the ones operating in the commercial construction project sector. However, as the economy is recovering, a problem may arise. In a situation in which a contractor can choose between the two alternatives suggested by the paper title, its choice may be influenced by many factors. For instance, a contractor's decision to bid for one alternative or the other and the resulting contractual obligations due to the choice can affect its profitability. It may increase the probability that the amount the contractor devoted to the project goes up. After analyzing the dynamics of this topic, the paper suggests that private construction contracts provide the best framework to protect the contractor against carrying unwanted increase in the contract price. Also among the industry's best practices in relation to private construction contracts, the FIDIC framework provides the best guarantee.

Keywords: Performance bonds, Payment bonds, Contract, Construction, Claims, Procurement, Cost

INTRODUCTION

It is commonly accepted that the main goal of every single private company or organization is to make profit. In that purpose, companies are constantly looking for market opportunities and contracts to cover their initial investment. Some companies work closely with government and bid contracts in which they engage to deliver goods and/or services. The private sector often struggles when the economy is in recession. It is not always the case for the government which

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primarily get its income by taxing the citizens and companies operating on its territory. Therefore, its cash flows remain quite steady. There are firms that try to grab some public contracts when the economy is not performing well and tend to go back to private sector when things get better.

Getting involved with a government is not as simple as working with a private company. Because given the fact that the government pays the bill with taxpayer's money, it must be very careful and needs to justify clearly where the money goes, what is it used for. As a result, there are more control and, most of the time, less revenue for the companies contracting with the State. In the field of project management, dealing with Cost is very important, as the final cost of a project must not exceed the budget allocated to it. However, once a project has started, many factors can lead to a cost increase. Many contractors find themselves bankrupt because those contractors chained contracts on which it is hard to make a margin. One reason for it, is that those contractors had to face a contract cost increase. Most of the time, this could not have been avoided because the contractor had to respect the contractual obligations.

Choosing carefully the type of contract to execute is essential for a contractor survival. In this paper, the aim is to analyze clauses in contracts that may increase the financial cost of a project compared to the estimated cost from the contractor's perspective, when it decides to bid with whether a Public or Private contract (a comparison of the bidding processes will be performed). Change orders are excluded because usually the owner carries the extra cost involved. Based on this analysis, the contract that will minimize the probability of a project's cost increase will be highlighted.

OBJECTIVE STATEMENT

To summarize, in this paper, we will try to show:

I. How bidding for a public construction contract differs from bidding for standard construction contracts
II. Which contract the contractor should choose to avoid its contract price increase

METHODOLOGY

1. Problem definition

Let us suppose that a contractor has the choice between two similar lump sum contracts for a building construction project, one that it must bid with the government (understand here the U.S Federal State) and the other one for which the contractor bids with a company or private entity. Each building mentioned in both contracts has approximately the same specifications, and fairly the same project cost than the other. The Government uses the Federal Acquisition Regulation (FAR) construction contract and the private company contract can be based on AIA or FIDIC or EJCDC.

2. Feasible alternatives:

The contractor has the choice between three alternatives:

I. The contractor may decide to bid the government's contract. (1)
II. The contractor may decide to bid the private company's contract. (2)
III. The contractor may decide not to bid a contract with any of the mentioned above. (3)

3. Development of the outcome for each alternative

- The contractor decides to bid the government's contract

If the contractor wants to bid for the contract with the government, it must go through a competitive bidding process. The contractor must then demonstrate its ability to execute properly the contract and meet the owner's requirements. It will have to demonstrate not only its capacity to deliver what the government expects, but also which is in the best position to execute it compared to other bidders (which one provides the best price). Indeed, when the government makes a bid, bidders are supposed to be placed on an equal footing for competition. This competitive bidding process prevents from unethical or illegal actions that might be undertaken by public officials and/or collusion amongst contractors.

- The contractor decides to bid the private company's contract

In the case that the contractor chooses to tender for the private company's project, the contractor does not necessarily need to face competition (based mainly on price). Because private companies tend to award construction contracts to one or more selected contractors. Less competitors involve, all things being equal, more chance to win the bid. However, private companies often use negotiated contracts and prefer to work with contractors that they know (meaning that they had worked together in the past) and/or they trust (meaning that the contractor has a good reputation with the project owner).

- The contractor decides not to bid a contract with the Federal State nor the company

The contractor also may make the choice to not bid for any type of contract mentioned above. It is the contractor's right to not engage in any activity if it considers that those contracts are not profitable and/or present too much risks.

4. Selection of a criterion

Criterion that the contractor will choose the option that minimizes the risk of carrying an increase of the contract's price. (assuming the contractor can successfully win any contract that he bids for).

Paradoxically, the last option (3) is less likely to happen. Even if the best way to avoid a risk is to avoid the activity that might causes this risk, it is important to keep in mind that the main goal of every single contractor is to make profit. In that purpose, contractor needs to bid contract and expect to make a comfortable margin. Even if a significant margin cannot be

made, the contractor increases the probability that it might bid another contract with the same owner.

Let's now compare the first (1) and second option (2).

The 3 clauses will be analyzed in the different contracts. Claims, Procurement, Performance and Payment Bonds.

According to the Global Construction Disputes Report 2017, poorly drafted or incomplete/unsubstantiated claims are the second most common causes of disputes. Claims usually arise for financial matters, when the contractor considers entitled to get a financial compensation or Contract time from the project owner. The contractor does not always realize that it has a very precise time frame for claiming. The consequence is that the contractor finds himself losing an amount of money that he may legitimately deserve, carrying a price increase that he should not assume. Some contracts are more flexible in terms of time frame for claiming than others. The more it is flexible, the better it is.

Good procurement is one the key to reduce considerably the cost of a project for a contractor. Choosing good suppliers, with reasonable prices may help to win a bid because it gives a comparative advantage over competitors. It also decreases the whole project cost. Having the contractual obligation to change its supplier (different from the ones we are used to work with) can lead to an increase of the project cost for the contractor.

A performance bond is "a type of contract surety bond which guarantees that a principal will fulfill their contractual obligations". A payment bond is "a type of contract surety bond which guarantees that a contractor or subcontractor will pay their subcontractors, material suppliers or laborers for the work and materials provided." The contractor must deliver those bonds that it gets form an insurance company. It may happen, for some type of contract that the amount of performance and payment bond rises because of a contract price increase due to whatever (an increase in the price of supplied materials for instance). The contractor must spend more money to adapt the amount of his bonds to the new contract price.

To determine which contract is the best if the contractor wants to minimize the risk of rise in cost on its project (public or private contract), Pairwise comparisons will be demonstrated below.

(MADM – DOMINANCE Comparison between Government Contract vs. Comparable Documents)

DOMINANCE (USING PAIRWISE COMPARISON)			
Selection Attributes	FAR vs FIDIC	FAR vs AIA	FAR vs EJCDC
Performance Bond	Worst	Unknown	Worst
Payment Bonds	Worst	Unknown	Worst
Claims	Worst	Worst	Worst
Procurement/Supply	Worst	Worst	Worst
Dominance	NO	NO	NO

Figure 1: Multi Attribute Decision Making Tools – CaR[3]

Analysis/Observation:

- We can eliminate Option (1) because Option (1) < Option (2).
- The contractor should choose the second type of contract and bid for the private company.

Now the question that needs to arise is which of the private contract is the most optimal for the contractor.

MADM Dominance Comparison between Global Standard Comparable Documents

DOMINANCE (USING PAIRWISE COMPARISON)			
Selection Attributes	FIDIC vs AIA	FIDIC vs EJCDC	EJCDC vs AIA
Performance Bond	Unknown	Better	Unknown
Payment Bonds	Unknown	Better	Unknown
Claims	Better	Equal	Better
Procurement/Supply	Better	Worst	Better
Dominance	YES	LIKELY	YES

Figure 2: Multi Attribute Decision Making Tools – CaR[4]

The MADM above does not really allow us to take an unbiased decision. A deeper analysis needs to be demonstrated.

FINDINGS

[3] See CaR Guild: Planning Planet. http://www.planningplanet.com/guild/gpccar/managing-change-the-owners-perspective
[4] See CaR Guild: Planning Planet. http://www.planningplanet.com/guild/gpccar/managing-change-the-owners-perspective

5. Analysis and selection of the alternatives

COMPARISON USING RELATIVE WEIGHTING TECHNIQUE

Performance Bonds	
Relatively low	1
Unknown	0,5
Relatively high	0

Payment Bonds	
Relatively low	1
Unknown	0,5
Relatively high	0

Claims	
Sufficient time to submit	1
No sufficient time to submit	0

Procurement	
Free	1
Constraining	0

Attribute	FIDIC	AIA	EJCDC
Performance bonds	1	0,5	0,75
Payment bonds	1	0,5	0,75
Claims	0,93	0,23	1
Procurement/Supply	0,5	0,25	0,75
TOTALS	3,43	1,48	3,25

Figure 3: Multi Attribute Decision Making Tools – CaR [5]

Analysis/Observation:

- Ranking: **FIDIC > EJCDC > AIA**.
- FIDIC is approximately 6% better than EJCDC and 131% better than AIA in reducing unwanted increase in the project price.

6. Selection of the preferred alternative

Everything mentioned above allows us to conclude that the preferred alternative is the option (2). The contractor should thus bid the private company's contract. Then, it should be based on FIDIC document (optimal). EJCDC can also be an acceptable alternative.

- Option 2 is bidding for the private company contract
- FIDIC stands to remain the most preferred document for adoption of clauses
- EJCDC may be considered as the second alternative

[5] See CaR Guild: Planning Planet. http://www.planningplanet.com/guild/gpccar/managing-change-the-owners-perspective

7. Performance monitoring and post-evaluation of results

Whenever a contractor has the choice between 2 similar projects (approximately same cost, time and technical specifications), if it wishes to avoid carrying unexpected cost:

- the contractor should bid, everything being equal the private company's contract rather than the government's contract.
- A contract based on FIDIC would be optimal in this condition.

Conclusion

To conclude, bidding a contract for the government differs considerably from bidding for a private company. In this case, it is understood that the bidding process is longer for a government contract and the probability to win the bid is much lower. Moreover, a binding contract signed with the federal State is less interesting from a contractor's financial perspective than a binding contract signed with a company. Whereas, in the case of a private company, the contract puts less tensions on the contractor finance and the probability to win the contract is much stronger. After considering some clauses (Performance and payment bonds, Claims and Procurement) contained in the standard contracts and comparing them one against the other, it came to light and understanding that the FIDIC General Contracting Guidelines clauses highly support the contractor's interests. Thereby, FIDIC seems to be the ideal type of contract that fits the purpose, meaning avoiding unwanted contract price increase fluctuations for a contractor.

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Appendices

The summarized clause analysis of the FAR Contract along with Comparable Documents FIDIC, AIA, EJCDC are mentioned below.

Claims

FAR	FIDIC	AIA	EJCDC
52.233-1 Claim means a written demand by one the contracting parties, seeking the payment of money in the sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to this contract. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim under 41 U.S.C chapter 71.	2.5 The contractor can make a claim if it considers itself entitled to any extension of the Time for Completion and/or additional payment, under any Clause of these Conditions or otherwise in connection with the Contract. The contractor has 28 days to give notice of a claim after he become aware of the event or circumstance.	15.1 and 15.1.2 Claims by either the Owner or Contractor must be initiated by a written notice within 7 days after occurrence of the event giving rise to Claim or within 7 days after the claimant first recognizes the condition giving rise to claim. Claim is a demand or assertion by one the parties seeking payment of money or other relief with respect to terms of the Contract.	12.01 The contractor makes a claim when it is seeking an increase in Contract Times or Contract Price, or both. The party submitting a claim shall deliver it directly to the other party (but in no event later than 30 days) after the start of the event giving rise thereto.

Procurement

FAR	FIDIC	AIA	EJCDC
52.225-21 The contractor has to buy American products unless the cost of domestic construction material would be unreasonable (if the cost of such material will increase the cost of the contract by more than 25 percent or would be 6 percent lower than in US.	15 The contractor must follow the rules of the Institution that which finances the Project otherwise that might be a reason for termination of contract by Employer.	11.1.1 The contractor shall from and maintain in a company or companies lawfully authorized to do business in this jurisdiction in which located and needs to contract an insurance for those purchases	7.06D Contractor shall submit to owner the industry of the proposed Supplier (unless Owner has already deemed such proposed Supplier acceptance during the bidding process). Such proposed Supplier shall be deemed acceptable to Owner unless Owner raises a substantive, reasonable objection within five days.

Performance and Payments Bonds

FAR	FIDIC	AIA	EJCDC
28102.2 Only for contracts higher than 150.000$ for performance bonds, and for contracts which price is between 35.000$ and 150.000$. The penal amount of bonds is 100% of original contract price + 100% of an increase in the contract.	4.2 The contractor shall obtain a Performance Security for proper performance, in the amount stated in the contract.	11.4 This paragraph has been deleted from AIA document. An issue may arise on whether performance bonds and payments bonds must be furnished.	6.01 Contractor should furnish a performance bond and a payment bond, each in an amount at least equal to the Contract Price.

About the Author

Jordy Efanga

Lille, France

Jordy Efanga is currently a Masters Candidate at SKEMA Business School, Lille Campus, based in France for the academic year 2017-2019. He hails from the Republic of Congo. He has previously completed his Masters in Globalization and the World Economy from the University of Lille, 2016-2017. Previously, he has also completed his bachelor's degree from University of Lille in Strategic Management 2012 – 2016. He may be contacted at jordy.efanga@skema.edu