

Managing project risk to secure profit

The way to secure target profit on a job is to negotiate a good deal at the outset and thereafter adhere to the contract, performing (only) as contractually required.

By Ryan Whelan

It's simple to state in the abstract but, as we all know, a constant battle in practice.

Here in the Middle East, the pursuit of profit can be particularly difficult. Competition is fierce, scope for negotiating is low and contracts can—consequently—be onerous to the point of being (practically) impossible to comply with. But that's not the only difficulty. Once on a job, client expectations and/or decisions are often unreasonable, with employers sometimes using cash-flow as a bargaining chip to secure additional work to which they are not contractually entitled (there being no protectionary legislation in the region to secure payment as is common in other jurisdictions). There are no easy answers. To succeed in securing target profit, contractors need to “box clever”.

Planning for success is key. Risk and profit are two sides of the same coin. Identifying and pricing risk at the outset is essential to securing profit. Post award, managing the contract is vital. Teams on the ground can focus too much on “getting the job done”, carrying out work at the request of the employer in order to be “helpful”. That's an understandable but risk creating (and so potentially costly) mindset: there is getting the job done and getting the job done at any price.

Project teams should always step back, consider and take advice on the terms of the contract. Beware of informal practices, whether they arise at the employer's suggestion or otherwise. Also, take care with project correspondence. Emails and other informal project correspondence often completely contradict the formal project correspondence, leading to substantial disputes.

Similarly, one of the most common problems encountered by contractors seeking payment relates to notice provisions, which are often loaded in favour of the employer. It is important to make every effort to comply with notice provisions and ensure (for example) the submission of extension of time and/or variation requests in accordance with the contract. Not to do so is an unnecessary risk.

Even teams who have heard the battle cry and are actively in dispute mode sometimes fail to maximise their own chance of vindication (and so recovery of costs/profit). The classic example is record keeping. Many contractors fail to record contemporaneously the relevant staffing, time and equipment against what they consider, for example, to be a variation. There is undoubtedly an up-front cost associated with improved record keeping. Nevertheless, the real cost of record keeping is only realised when it is not done.

A contractor's loss in such circumstances may be substantial given that defective or non-existent records typically reduce the amount recoverable and so, in turn, profit achieved - or, in the worst case, increase the loss to be borne.

If you want to maximise profit, you cannot afford to lose sight of possibility that claims may arise in the course of the project. Perhaps counter-intuitively, preparing for the possibility of a claim before an issue arises often means that a claim is avoided all together. Below are seven best practice suggestions for avoiding problems at the contracting and project execution stages.

First, as ever, remember that prevention is better than cure. Bad bargains are rarely, if ever, turned into profitable jobs through post-contractual negotiation or at arbitration/litigation. Contract on terms that you can live with and share pre-contract intelligence with the project team. Construction contracts are typically loaded in favour of the employer and so there is an element of inevitability to shouldering onerous terms.

While an overly onerous contract can (on occasion) be somewhat offset by the application of civil law concepts, such as good faith, the application of these concepts should not be relied upon. Make sure that you can discharge your obligations and manage the project risks. If a contract is unusually onerous or complex or a dispute looks likely to occur early on in the project, consider bringing in project counsel to assist with interpreting and complying with the contract. The cost of such a service can often be dwarfed by the potential gain if implemented/the potential exposure if not.

Second, sharing knowledge and expertise is key. Arrange workshops to explain, discuss and hand over the contract to the project team. Ensure that knowledge captured at the outset is passed on and that the key terms of the contract are known and understood. Consider circulating contract commentaries and/or risk matrices.

Third, communicate properly with third parties. Ensure project correspondence is clear and considered. Try to avoid becoming embroiled in the type of intemperate, expletive laden exchanges that we've all seen on difficult construction jobs. Such correspondence might be cathartic but it also has the potential to be damaging.

Fourth, pro-actively manage schedule risk and be alive to terms in the contract that are likely to make an extension difficult to obtain e.g. float, mitigation, strict notice requirements, the requirement of 'actual delay' etc. Identify these provisions, factor them into your risk analysis and perform accordingly.

Fifth, do not fall into the trap of departing from the contract "for the good of the job" e.g. by following informal arrangements such as not bothering with the notice provisions or submitting variation claims in the proper form. Diligent contract management is to be prudent, not difficult.

Sixth, create and maintain records (and so evidence). Think ahead. Ensure your time management system is followed and sufficiently particularised to allow workstreams to be identified. Pro-actively manage financial claims (e.g. prolongation and disruption) and ensure that experts, if required, will be able to identify the causal link between what you are doing and what you say caused the need for that work/project spend.

And seventh, if there are problems, try and identify the impact of each problem separately wherever possible. Avoid thinking in terms of global claims. As Keith Pickavance notes in his leading textbook in the field of delay and disruption, there are only two circumstances in which a global analysis is suitable to establish delay: "*one where the contractor comprises no more than two men and a dog and the dog can write better than the two men. The second is when the contractor simply does not have a case...*".

If, unfortunately, the project looks likely to fall into dispute, continue to think strategically and pro-actively in order to maximise your chance of a positive arbitration or court decision. As a first step, take advice and secure relevant documentation and records (a case being only as good as the evidence offered in support of the pleadings).

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