

Management of Contractor's Claims in Construction Projects

Lukáš Klee

Charles University in Prague

Abstract

The main objective of this work is to suggest a suitable way for efficient implementation of a Contractor's Claim Management system in construction companies in CEE countries. The Claim is a specific requirement of one contracting party for time extension for completion and/or additional payment that could be notified to the other contracting party on the basis of an event or circumstance that is foreseen in a contract clause or otherwise in connection with the contract. Claim Management (CM) is a system for monitoring and assessment of risks realization variations and their economic impact for the purpose of claim preparation and enforcement. It is a system for the early solution of problems, obstructions and complications. Claim Management starts to be crucial with the recent economic situation in construction. In case of a public procurement project, applicable law often affects change and claim procedures and causes many difficulties to all the participants of construction projects. The fact that the contractor is able to claim in conformity with the contract is a question of survival. Nowadays, it is very important to be able to implement CM in a construction company quickly and efficiently. In this work, the author seeks to discover an efficient way to implement Claim Management analyzing the relevant literature, theory and recommended types of Claim Management systems. In terms of research methods, the author chooses a qualitative method using a given set of questions to gain answers from experts within interviews, finally proposing a manual for implementation including implementation plan as the appropriate method.

Keywords: claim, claim management, construction company, project management, additional payment

Introduction

After years of growth construction companies have to face a rapid change of external environments. Their strategies must be changed respectively thanks to budget restrictions caused by the global economic crisis.

New very competitive global markets are being established. The contractors often bid without profit, risk and overhead surcharges. Sometimes they bid even

under the foreseen overall cost to win in a particular tender. It is quite common that large construction projects are not prepared well by the employer. In such circumstances Claim Management starts to be crucial. In case of a public procurement project applicable law often affects change and claim procedures and causes many difficulties to all the participants of construction projects. The fact that a contractor is able to claim in conformity with the contract is a question of survival.

Recent experience from CEE countries (for example Poland, Romania, Czech Republic etc.) shows that local construction companies have not been ready for such a tough international competition with new global rules. In many countries, formal contractual procedures haven't been used even if they were foreseen in the contract. A peaceful situation in particular markets meant the formal procedures were simply not needed. Parties were always able to find agreements.

After the need to claim was formally discovered, construction companies have been in haste to implement respective internal systems for Claim Management. Formal Claim Management is quite a strict process that is not natural for people in many countries. One often hears people say "why should I write a notice to a person sitting in an office next to me, I can simply tell him that something is wrong". Every construction professional in western world knows this premise is completely wrong. "The paperwork" is an important part of project management and claims have to be solved in formal way. This common knowledge is based on long time experience and tradition. This tradition, however, cannot be grafted in an easy way. The participants of construction projects in CEE countries have to live their own experience and create their own tradition in the new global market. A part of these processes is also an implementation of Claim Management. Many CEE countries went through significant changes after 1990. Democracy brought changes in economic systems and new laws. These changes created a lot of opportunities and threats that have not been encountered before. After 1990, the construction market increased both within Building Construction and Civil Engineering. The market share, turnover and profit of construction companies have been increasing accordingly without major disruptions. In Development and Building Construction, there was a boom and the profits were excellent. In infrastructure public procurement, the local state agencies used "measurement contracts" with "safe" unit prices, which were subject to re-measurement according to the real quantity needed for the completion of the works. The changes and variation were solved by negotiation. There was no real stress because of the sufficient funds. In fact, there was no need for a Claim Management system.

The economic crisis, EU fund termination, restriction of budget for public infrastructure projects, new competitors etc. caused a revolution in CEE construction markets.

The main objective of this work is to suggest a suitable way for efficient implementation of a Contractor's Claim Management system in construction companies in CEE countries. I will critically analyze my own experience with

implementation in CEE countries, theory and relevant literature and try to create appropriate recommendations for further implementation.

A CM Manual (Guide) will be prepared to be subject of further analyze and research to find out if it is an eligible tool for efficient CM implementation.

Research approach and methods

The literature and theory mainly in terms of Claim Management in construction will be analyzed in the paper. Focus will be aimed on the experience with Claim Management and analysis of recommended types of Claim Management systems in Guides and best practice documents.

The 'Pragmatist' Paradigm is selected for the purpose of this paper, which assumes that it is possible to work within both positive and interpretivist positions. This approach is suitable for the subject and it is also close to my personal philosophy. It is useful to pick the best from both worlds and adopt both subjective and objective viewpoints, a deductive and inductive approach. However, in terms of research methods, a purely qualitative method will be used.

In general, CM implementation is not sufficiently explored and relates to the possibilities at hand it is the qualitative research that is the more suitable method.

A given set of questions will be used during interviews. Relating to secondary research, literature and theory, FIDIC (International Federation of Consulting Engineers) Guides etc. will be of main significance.

Research sample

10 individual interviews with Construction companies employees as follows:

3 Project Managers from Construction Companies in CEE Countries

3 lawyers from Construction Companies in CEE Countries

2 individual interviews with external experts from Construction Companies in CEE Countries

2 individual interviews with Top Management of Construction companies in CEE Countries

The following research questions will be given:

- What were the main problems during the implementation of Claim Management?
- What would be efficient way for the implementation? What about a guide, a handbook, an implementation team, conference, strategic operation, training?

- How to implement Claim Management? Within particular project teams, company headquarters, with specialist such as in-house lawyers? To create a specific implementation plan based on Implementation Guidelines for change managements?
- What are the main positives and negatives of Claim Management?
- Are the employees resistant to use this system?
- What are the limits of the external environment for the use of Claim Management? What are the specifics of particular clients relating to Claim Management expectation?
- Is the proposed CM system appropriate for further implementation?

Literature (Secondary data): Intercultural Aspects

Claim Management is a rather strict system and it could cause aversion within a particular social environment. According to Nový and Schroll-Machl (2007) for example the Czechs are typical in avoiding these conflicts. They like a calm, agreeable social climate and they could perceive a formal communication as personal attacks. Claim Management stems from the British tradition. According to Fox (2004) for the Brits, formal correspondence is very natural. They do not like to talk about money they rather write it down and send a formal notice. This is in strict opposition to the Czech nature. This cultural aspect must be solved by the incorporation of Strategic analysis and Negotiation phase to the CM scheme. It is a common aspect throughout all CEE countries.

According to Nový and Schroll-Machl (2007) the next cultural aspect typical for the Czechs is called Time Polychronicity. This is manifested by low pressure on terms and time schedules. Small delays are normal, without consequences and sanctions. The Czechs often deal with the problems in the last minute. This could be a weakness in terms of the time bars for claim notices. If a claim is not notified in time, it is time barred. This problem should be solved by training.

Hofstede (2011) points out that the Czechs are quite individualistic which leads to the fact that they like to improvise. They do not follow the rules exactly and try to make everything “a little bit better” which is often counterproductive. This could be a weakness in terms of CM and it could be dealt with by training as well.

Literature (Secondary data): Lawyer involvement in CM

One of the crucial aspects for success with the further implementation is the integration of a lawyer into the project team. Research done by LEXISNEXIS (2010) describes the trend of legal departments being rather a profit center than cost center in successful companies. This has a strong connection in construction with the need of a lawyer as a team member specialized in CM.

According to LEXISNEXIS (2010) a legal department that does not consider revenue generation is not acting in the best interests of the company and its shareholders. It is a duty for in-house legal teams to recuperate any monies due to the corporation. By being proactive and more aggressive on what are, after all, only standard business arrangements with partners of a corporation, lawyers are simply doing their jobs the way they were meant to.

According to LEXISNEXIS (2010) the main objective is to proactively identify and assert claims where the company has been harmed. This benefits the company and shareholders by providing income that would not normally be available. But this will only happen when the culture of the company, from the CEO downwards, believe that wrongdoings should be proactively pursued. Once that spirit is instilled, the managers meet regularly with the legal department, and report all potential areas of concern. Those areas that look promising will be taken up by the lawyers, with or without managerial support, depending on sensitivities to relationships with the defending party. Sometimes a case will be uncovered by, or outsourced to, one of the company's external law firms to help recover the claim.

Literature (Secondary data): Claim Management Literature

Literature on CM systems such as for example Kapellmann (1997), Sykes (1999), Schwartzkopf (2000), Whitticks (2005), Jaeger and Hök (2010), Gregorc and Weiner (2009), Hewitt (2011) predict a CM formal system with description of processes, responsibilities overview, checklists and sample documents.

Kapellmann (1997) sees Claim Management as a part of management of construction contract. The use of CM in terms of particular projects depends mainly on the contract value, risks, economic situation and relationship with the client. Relate to the aspects of economic situation and relationships with clients, CM is a part of business strategy. Mainly during the recession, systematic CM becomes crucial.

Kapellmann (1997) talks about the legal management of the construction contract. In fact, he proposes four categories of legal construction contract management duties such as:

1/ Contract evaluation and Operationalization:

- Systematic determination of risk allocation with a "Legal Project Manual" that describes the operations.
- Right and duties description.
- Clarification of ambiguities.

2/ Contract Register elaboration:

- Where is what – an overview of the contract risks etc.?
- What and when has to be done.

3/ Legal Advice:

- Daily problems solving and settlement.

4/ Claim Management:

- Enforcement or defense of/against claims and/or disability compensations and/or terms changes.

In terms of Claim Management, Kapellmann (1997) stress the importance of simple checklists and sample forms. As much steps as possible must be done in advance. After a particular risk (claim) realization, the participants use the checklist and samples without the need to improvise.

The basic process description of Claim Management is not difficult to provide. For instance the flow according to Jaeger and Hök (2010) is quite simple, but fitting. For the purpose of the CM Manual used in CEE countries some further stages must be added, mainly Claim Identification, Decision making, Claim Analysis and Negotiation stage. On the other hand, the flow of Gregorc and Weiner (2009) is very detailed, but quite difficult to understand and it is not appropriate for the purpose of an efficient CM manual. The flow is too general and deals also with the change orders and other processes. In my opinion, it is not possible to implement it to the manual for CM. It would be too confusing for the users. Gregorc and Weiner (2009) mention that within a project of certain value there should be a resident Claim Manager on the project team. This specialist would be responsible for CM. This does not seem to be necessary. Every member of the project team should be incorporated into the system somehow. This is the solution that is proposed in the Manual for further implementation as well. Of course, a separate specialist could help with claims in large projects; however, for this purpose a trained in-house lawyer is the best solution. It is obvious that Gregorc and Weiner (2009) see CM as an “extra” process; contrary to Kapellmann (1997). Kapellmann says CM is a subcategory of Project management with some business strategy aspects. In fact, these strategic aspects are stressed by Gregorc and Weiner (2009) as well.

Kapellmann (1997) offers a flow that is even more general. He works with a premise that there is a “Bausoll” that means, how the project should go and there are the deviations and their solution.

Based on the flows above and my experience a scheme in attachment is proposed that would be a base for the complete CM Manual (Guide) according to the results of research. The CM Manual will have following parts:

- A) Process Description
- B) Contractor’s Claims Check-list
- C) Project Team Structure
- D) Sample Letters

Results

Interviews with the project managers, lawyers, experts and Top managers according to the Research plan were made. Discussions were made and the answers were written on a sheet.

- What were the main problems during the implementation of Claim Management?

Resistance of older project managers mentioned 6 times.

- What would be efficient way for the implementation? What about a guide, a handbook, an implementation team, conference, strategic operation, training?

A guide mentioned 9 times.

- How to implement Claim Management? Within particular project teams, company headquarters, with specialist such as in-house lawyers? To create a specific implementation plan based on Implementation Guidelines for change managements?

Particular project team with specific implementation plan mentioned 7 times.

- What are the main positives and negatives of Claim Management?

“It is time consuming” mentioned 6 times, “it is efficient” mentioned 7 times.

- Are the employees resistant to use this system?

Positive answer was given 5 times.

- What are the limits of external environment for the use of Claim Management? What are the specifics of particular clients relate to Claim Management expectation?

The limit is that the process must contain information about the claim before the notice. It is necessary to talk with the client because of Slavic nature that favors informal ways. That was mentioned 6 times.

The opinion that some local clients do not know CM was mentioned 7 times.

- Is the proposed CM manual (guide) appropriate for further implementation?

Positive answer was given 10 times.

Discussion

Almost all respondents pointed out that there will be a group of resistant people formed mainly by the older project managers. For them the CM implementation will be difficult, because how almost all mentioned, CM is quite challenging.

All participants thought that the most efficient way for the implementation is a guide (manual) with sample documents, training and a specialist (consultant).

One of the respondents said it is important to explain all impacts of lack of respect for processes that are laid down in contracts. He also said that it is worth explaining the advantages of CM principles.

Most of the research participants think that the best point where to start is to appoint a model team with a specialist closely involved (a specialized lawyer with technical knowledge or a Claim Management specialist in the team according to the extent of a particular project and according to the client specifics etc.). The participants talked about cooperation with the in-house lawyer, a pilot project with in-house lawyer CM specialist who would coordinate the CM implementation and who would assist as a consultant in close cooperation with project manager and other team members.

One of the respondents said he would appoint a leader that would have to have sufficient support from top management. The leader should have a team for implementation and coordination. The team would train firstly the top managers to be able to reflect the positives of CM and to be able support the need for CM. The team would than train the project team members. He was also speaking about necessary trust amongst the leader and eligible project teams.

Another respondent said that he is a bit worried about too many guidelines, guides, etc. that implies that guide has to be simple.

There was no doubt amongst the respondents about the need and positives of CM for Construction companies, mainly relating to the recent economic situation. It is obvious that CM is absolutely necessary in the economic recession. There was no doubt that CM will “deliver the goods” if strategically used. Some negatives were mentioned in connection with the obstacles we know, i.e. CM is time consuming and exhausting, thus not for everyone.

Lack of knowledge and fear of losing bargaining power of the Client and the Engineers, were highlighted as limits of the external environment.

What was very interesting was the point of one of the respondents who reminded of the necessary cooperation with subcontractors when submitting the claims.

What was said very often was that one needs to adjust and refine some mechanisms which could be seen as being to formalized and direct. The importance of relationships was stressed as was the fact that one needs to explain and negotiate with the clients to avoid conflicts.

The resistance to change was marked many times as a limit of the internal environment. The need for sufficient motivation and for a bonus system was mentioned as well.

Another issue was named; the necessity for top management to understand CM.

Another respondent stressed that construction companies claim but not systematically. The main problem is the insufficient coordination of information flow between the respective Project management and the superior company management.

There was no doubt amongst the participants the proposed CM model is an appropriate base for further implementation.

Conclusion

The main objective of this work has been to suggest suitable way for efficient implementation of a Contractor's Claim Management system in construction companies in CEE countries. After having critically analyzed research, my own experience with CM implementation in CEE countries, theory and relevant literature following recommendations are proposed.

It was approved during the research, mainly by the top management that the culture, internal environment and clients approach will not have a strong influence on CM implementation. The recent economic pressure causes quite a strong economic interest in CM. The resistance is more caused by individuals on Project Management positions.

It was approved that there is a strong anticipation of lawyer involvement. However, the lawyer must be a CM specialist thus education must be focused on the lawyers as well.

Furthermore, one of the most important steps is to educate the top management on CM.

A critical factor to success is to overcome the resistance of some project managers through education. These employees that are not willing to change must be eliminated of project teams. The next critical factor is that the managers and lawyers are able to negotiate and explain CM to clients that are not used to formal contract administration.

Before the research, it seemed that a manual would be a good basis for further implementation and that proved to be true. The manual is based on a powerful cooperation of project managers and lawyers that was recommended by the participants. This necessity is implied from the secondary data as well.

Implementation Plan

The main tool for the implementation will be the CM guide. Particular stages of implementation are proposed as follows:

1. The leader of the change and the agent will be appointed, the budget for CM implementation will be approved (Day 1).
2. The CM Guide becomes a part of internal normative system; the motivation bonuses for successful claiming will be laid down (Day 30).
3. The top management, project managers and lawyers will pass one seminar and one workshop in groups. This will be the very important part – the education. In this stage the top management will choose the best employees that are able to work within CM. Education will be provided by experienced internals and externals (Day 120).
4. Specialized teams will go through a thorough training with model situations etc. (Day 180).
5. First project with formal CM will be chosen (Day 180).
6. First project with formal CM starts (Day 240).

Claim Management is a system that is used in more developed countries (Germany, UK, USA etc.) as a common part of project management within construction projects. Based on the recent economic situation, the use of CM starts to be crucial in new markets as well.

Recommendations above, CM Guide and the way of implementation are in my opinion valid for all large construction companies that have not implemented a systematic CM system yet. It seems that the companies that will not be able to implement it could have serious economic problems in the future.

Reference

- FOX, K., 2004. *Watching the English: The Hidden Rules of English Behaviour*. London: Hodder. ISBN 9780340818862.
- GREGORC, W. and K. L. WEINER, 2009. *Claim Management*. Erlangen: Publicis Publishing. ISBN 9783895783357.
- HEWITT, A., 2011. *Construction Claims & Responses: Effective Writing & Presentation*. Wiley: London. ISBN 9780470654811.
- HOFSTEDE, G., 2011. Geert HofstedeTM Cultural Dimensions [online]. [cit. 20-02-2013]. Available on: <http://geert-hofstede.com/czech-republic.html>
- JAEGER, A. V. and G. S. HÖK, 2010. *FIDIC – A Guide for Practitioners*. Berlin: Springer Verlag. ISBN 9783642021008.
- KAPPELLMANN, K. D., 1997. *Juristisches Projektmanagement*. Düsseldorf: Werner Verlag. ISBN 9783804151758.
- LEXISNEXIS, 2010. *The Profitable Legal Department – How legal departments can prosper by generating revenue for their company* [online]. [cit. 20-02-2013]. Available on: <http://www.lexisnexis.com>
- NOVÝ, I. and S. SCHROLL-MACHL, 2007. *Interkulturní komunikace v řízení a podnikání česko-německá*. Praha: Management Press. ISBN 9788072611584.
- SYKES, J. K., 1999. *Construction Claims*. London: Sweet & Maxwell. ISBN 9780421604803.
- WHITTICKS, E., 2005. *Construction Contracts – How to Manage Contracts and Control Disputes in a Volatile Industry*. London: Gulf Publishing Company. ISBN 9780976511359.

Claim management zhotovitele na výstavbových projektech

Hlavním cílem této práce je navrhnout vhodný způsob pro efektivní implementaci systému Claim Managementu zhotovitele ve stavební společnosti v zemích střední a východní Evropy. Claim by se dal definovat jako specifický požadavek jedné ze smluvních stran, jež může být druhé straně oznámen na základě smlouvou pojmenované předvídatelné skutečnosti či jinak v souvislosti se smlouvou a pro jehož uplatnění smlouva předvídá určitý postup, jehož dodržením je podmíněno úspěšné domožení se požadavku. Claim Management (CM) je systém pro monitorování a hodnocení realizace rizik, změn a jejich ekonomického vlivu za účelem přípravy a vynucení claimů. Je to systém pro včasné řešení problémů a komplikací. Claim Management začíná být v současné ekonomické situaci ve stavebnictví klíčovým. V případě veřejné zakázky způsobuje rozhodné právo problémy všem účastníkům výstavbového projektu například svým vlivem na procesy řízení změn. Schopnost zhotovitele nárokovat v souladu se smlouvou může být otázkou přežití. Proto je nutné zavádět Claim Management rychle a efektivně. V tomto článku autor usiluje o nalezení účinného způsobu zavádění Claim Managementu rozbohem literatury, teorie a doporučených systémů Claim Managementu. Co se týče metod výzkumu, autor volí kvalitativní metodu použitím dotazníku za účelem získání odpovědí od expertů v rámci rozhovorů s tím, že nakonec navrhuje jako vhodné řešení použití manuálu se zaváděcím plánem.

Klíčová slova: claim, claim management, stavební společnost, řízení projektu, dodatečná platba

Kontaktní adresa:

JUDr. Lukáš Klee, LL.M., Ph.D., MBA, Katedra obchodního práva, Fakulta právnická, Universita Karlova v Praze, Metrostav a.s., U Elektry 820/2b, 198 00, Praha 9, e-mail: klee@email.cz

KLEE, L. Management of contractor's claims in construction projects. *Littera Scripta*. 2013, **6**(1), 40–50. ISSN 1805-9112.
