

## What builders can do to stay out of trouble

About twice a week these days, we get a call from a builder who tells us an all-too-familiar story. He had a few misgivings about the clients at the outset but he took on the project anyway. The clients paid the early invoices on time, and although there were some niggles along the way, they got resolved. Then when the project neared completion, the invoices took increasingly longer to get paid. Once the project was practically complete and the clients got possession, the remaining invoices didn't get paid at all. In the cases we learn about, the total unpaid amount ranges from \$10,000 to \$250,000.

Usually the builder has done his best to negotiate with the clients, but although various excuses have been made and promises given, the builder never gets to see the money. What has happened behind the scenes, is that the clients have become increasingly disenchanted with the escalating cost, whether that is because (in a fixed price project) there have been a lot of variations, or because (in a cost and margin project) the estimate has been exceeded by a wide margin. The typical strategy adopted by the clients is to wait until they have possession, and then use the remaining money to pay another builder to finish off, with any balance remaining being treated as a discount on the price.

I am not saying that the clients are necessarily dishonest. Some are, but probably the vast majority are normal human beings who are understandably stressed out by the blowout in their budget, and rightly or wrongly they attribute that to the builder. In some cases they have asked for multiple variations without any thought to the financial consequences; in others the builder has failed to alert them to the looming problem. But what the builder discovers is that the clients have absolutely no interest in doing anything about resolving the dispute, other than outlining their grievances. That is because in their minds, they have already won the dispute. They have the nearly-completed building, and they have the money.

So it is up to the builder to do something about it. Usually that involves adjudication under the Construction Contracts Act because that is the only cost-effective way to get at least some of his money back. The clients go to a lawyer, and they come back with a large counterclaim for defective workmanship, delays, and overcharging. Usually that counterclaim is intended to frighten off the builder from going any further. And because they have possession of the property, they can get a building consultant in to write a report that backs up their allegations. Many adjudicators are heavily influenced by those reports, even though they are biased in favour of the clients and the builder can't get an equivalent report because he has been denied access to the building. And so the adjudicators have no hesitation in upholding a large part of the counterclaim and denying the builder a large part of his outstanding payments.

In doing so, they fail to grasp three essential points. First, when a building consultant states in hindsight what a project should have cost, that is worthless speculation compared to the figure that the builder has proven in the real-life laboratory of the building project to be the actual cost. Secondly, the owners' list of defects is too one-sided to be reliable. Thirdly, whatever the builder has invoiced, is actual labour and materials that have gone into the building. Depriving a sole trader of \$50,000 - \$100,000 from a single project not only means a huge transfer of wealth from a small businessman to (in many cases) wealthy property owners, but it amounts to most if not all of that builder's entire annual income, and therefore threatens his ability to feed his family.

The reason I tell you this horror story is that I don't want it to happen to you, and there are things you can do to stop it happening. Here is a brief summary.

### 1. **Identify and Avoid Clients from Hell**

You can usually identify these people, because they leave a trail of destruction in their wake. The trick is to know how to uncover their history, and have the courage to turn them down.

### 2. **Complete the Contract Accurately**

You always put yourself at a disadvantage when you don't use a sophisticated building contract, or don't fill in the boxes accurately, or allow changes to be made to the contract without professional advice. One of the main mistakes is not to describe the homeowners accurately, and not to get them all to sign. If your building contract gives you the right to a mortgage over the land to secure payment of what is owing to you, then it is easier to enforce that right when all the owners have signed the contract.

### 3. **Take a Big Deposit and Hold Onto It**

The reason that the clients have the upper hand in a dispute is because you have done the work first, and hoped to get paid later. That gives them an unfair advantage which you can eliminate by holding onto a deposit that is sufficient to cover your last invoice. Alternatively, you can insist on the whole contract price being held by some independent stakeholder so that the clients have no more control over it than you do.

### 4. **Attach a Lot of Importance to Estimates**

In a cost and margin project the clients understandably want some idea of the likely cost so they can borrow the necessary money or put sufficient funds aside. The problem is that when the builder says "estimate" the clients inevitably hear "fixed price". So when the estimate is exceeded, you get into arguments about whether you took sufficient care when calculating the estimate, or whether your ability to exceed the estimate is limited by a certain percentage. There are two solutions. First, calculate the estimate on a scientific basis by reference to genuinely predicted hours per worker and their hourly rates, plus quotes or estimates from suppliers and subcontractors, plus your margin. Secondly, provide your clients on a regular basis with a comparison between the cost that you have estimated to that stage, and the actual cost to that stage, differentiating between variations and work that is within the original scope.

### 5. **The More Paperwork the Better**

In fixed price projects, a common mistake is to under-price the job by relying too much on guesswork. Instead, you should do a detailed analysis of the likely cost, and resist the temptation to undercut your competitors. You can't price a job accurately without detailed plans, so insist on them, both at the outset and during the course of the project. It is also common to be denied payment for variations because the clients successfully argue that you didn't follow the proper process, or they didn't authorise the variation, or the work wasn't actually a variation because it was within your original scope of work. You deal with that by having a very detailed scope of work at the outset, and getting the clients to sign off a written authorisation of each variation (including the likely delay) as soon as it becomes obvious to you. And in cost and margin projects, it is the labour content that is most often challenged, so maintain detailed timesheets, not just scrawled notes in your diary.

## 6. **Invoice Regularly**

Consider invoicing weekly or fortnightly, not monthly or on completion of defined stages. That way, when you find out that an invoice isn't going to get paid, you are only exposed for a small amount, not a large amount.

## 7. **Be Very Strict About Payment Defaults**

Even if there is a legitimate reason for your clients missing a payment, that is the clients' problem to solve, not yours. If it is due to a genuine dispute, insist on the disputed amount being paid into trust, and start the dispute-resolution process. If the default is unjustified, give formal notice of suspension of work immediately, and act on it. At that stage, suspension gives you very powerful leverage because what the clients want above all else is the project completed. And it ensures that your financial exposure doesn't get any worse.

## 8. **Change the Arrangements After a Default**

Bear in mind, however, that a payment default is usually a sign of things to come. If you are not carrying an adequate deposit through the project, then you will be very vulnerable once you have achieved practical completion and you still have some invoices outstanding. Under the Certified Builders contracts, you can ask for security for payment. If you can see the relationship with your clients deteriorating, think about getting out of the project by mutual agreement, on the condition that you are fully paid up to date. Often the clients will be just as pleased to see the end of you, as you will be of them, and you will have saved yourself a lot of heartache.

## 9. **Insist on the Disputed Sum Being Put Aside**

The Certified Builders contracts require the clients to put any disputed amount (of \$10,000 or more) into trust so that each party has an equal incentive to resolve the dispute. Remember that if the clients fail to do that and they still don't comply within 5 working days of receiving written notice from you, and you want to get out of the project, you can terminate the contract.

## 10. **Be Smart About Dispute Resolution**

I have major misgivings about the usefulness of debt collectors, mediation, the Small Claims Courts (Disputes Tribunals), and the regular Courts in residential building disputes. Theoretically the adjudication process under the Construction Contracts Act should give you the most cost-effective outcome, but that process currently has some limitations. Because of the naivety of some of the adjudicators, you need to choose them wisely. As it is, they are handicapped by the fact that they don't get to meet the parties and they don't do site visits. One of the things I think should be mandatory is for any allegations of defective workmanship, delays or overcharging to be resolved by one independent expert whose cost is split between the parties. The expert would have to be neutral, and would distinguish between genuine defects that the builder is obliged to fix free of charge, and mere unfinished work that the builder is entitled to complete at the clients' cost.