



CONSTRUCTION LAW UPDATE No. 707

Construction management off the rails

Introduction

The District Court of South Australia recently handed down its decision in a long running dispute between a builder/architect and owner under a "cost plus" contract. The dispute has been ongoing since 1999.

Parties

Mr Carn is an experienced architect with Carn Byrne & Associates and a director of the building company, Archonstruct Pty Ltd. Carn Byrne and Archonstruct frequently work together in providing construction management services.

In February 1999, Mr and Mrs Karalis purchased a house in Stonyfell and decided to demolish it to build a new large luxury home. They entered into a short term lease on another house while the new home was to be built.

The preliminary meetings

Mr and Mrs Karalis met with Carn who produced several preliminary sketch drawings to their approval. At one of the early meetings, Mr Karalis told Carn that he had been told that the house would cost \$250,000 to build. Carn said the house "is not a \$250,000 house".

Mr Karalis again met with Carn and informed him that his brother had recently had a house built by a builder, Mr Guy, for \$500 per square metre. The preliminary design of the Karalis' house was 416 square metres plus another almost 100 square metres of verandahs, balconies and porticos, not to mention a pool. Carn told Mr Karalis he was extremely doubtful that the planned house could be built for that rate and confirmed in writing that the likely cost would be \$750 per square metre, even up to \$1,000 per square metre. Mr Karalis gave evidence that he had told Mr Carn that they had \$270,000 to spend.

Mr Kantzavelos who had recently qualified as a quantity surveyor, was a nephew of the Karalis' family and offered to help them estimate the cost of their new home. Guy and Kantzavelos met and prepared an estimate of the likely construction cost of the home at \$272,248. Mr Karalis passed this

information on to Carn but did not provide the breakdown of the various trade packages.

The meeting with Kantzavelos

At the request of Carn, Mr Karalis arranged for him to meet Kantzavelos and discuss the estimated costs and how to build the home. At the end of the long meeting, the discussion turned to construction management styles as used by Archonstruct. Mr Karalis did not want to incur the cost of an architect's fee for full services; sketch design, detail design, documentation and contract administration. Mr Karalis was anxious to avoid the cost of the contract administration, estimated at 30% of the architect's fee, or about \$9,000.

At a subsequent meeting, Mr Karalis asked Carn if he would be prepared to inspect the house once a month while it was built by Guy under a cost plus arrangement. Carn declined but said that if Archonstruct was appointed builder under a construction management contract, his time could be charged at an hourly rate for construction management and supervision.

In effect, by appointing Archonstruct as builder, Mr Karalis would be obtaining the services of a builder with the knowledge and experience of an architect but without paying the cost of contract administration. Further, by using the construction management method, savings would be achieved in the cost of the detailed design and documentation.

The contract is formed

In view of the time pressure to complete the home and the potential savings, Mr Karalis decided to engage Archonstruct to build the home.

The parties entered into an MBA/RAIA "Cost Plus" contract but Karalis did not appoint an architect as required under the contract. Mr Karalis still did not provide to Carn a copy of the detailed breakdown of estimates as prepared by Kantzavelos.

Carn provided Mr Karalis with the opportunity to consider tenders for the various trade packages including summary tender reports so that he could choose which contractors he wanted to work on the house and provided detailed reports on the cost of packages so that Mr Karalis could monitor the total

cost. Initially Mr Karalis participated in this process, but before long found it chaotic, stressful and overwhelming and asked Carn to provide one report at the end of the job.

The costs mount and the parties fall out

By December 1999, the costs incurred on the house had reached over \$356,000 and it was estimated that completion would cost a further \$109,000. There had been some invoicing errors which although resolved by Carn, caused Mr Karalis to become suspicious and demand original invoices be produced. The relationship between Carn and Mr Karalis deteriorated and in late December 1999, Archonstruct stopped working on the project. Monies remained unpaid. The parties engaged lawyers and positions became entrenched. By March 2000, Mr and Mrs Karalis took over the partly completed project and excluded Archonstruct from the site.

Proceedings are issued

Archonstruct issued proceedings claiming \$242,000 of unpaid money due under the contract. Carn Byrne claimed \$29,000 for unpaid fees for architectural services rendered.

Mr Karalis defended the claims and said the home had cost more than the \$270,000 he had told Carn that they had to spend, that no superintendent or architect had certified any payments were due, that the contract should be set aside for misleading and deceptive conduct and that the home was defective.

While the final cost of the home had been \$467,000 or about \$1,100 per square metre, even the Karalis' expert evidence contradicted the assertion that, in 1999, a home could be built for \$500 per square metre. The consistent and credible communication by Carn to Mr Karalis as to the likely cost of the home was undoubtedly decisive. While the eventual cost per square metre exceeded even the upper limit of \$1,000 suggested by Carn, evidence was led that costs were volatile in 1999.

Carn Byrne succeeded in obtaining an order that it be paid its outstanding architectural fees. The Court held that the failure by Mr and Mrs Karalis to appoint any architect implied a term into the contract that they themselves took on the role of certifier under the contract. Hence, notwithstanding the failure to certify, there was no bar to Archonstruct being paid its unpaid money under the contract, subject to the usual proof that it had incurred the expenditure. The cost of remedial work arising from the defects was offset against the outstanding amounts due. The claims for misleading and deceptive conduct were dismissed.

Conclusion

This case is a good example of a professional organisation capably prosecuting its claim and defending an apparently unmeritorious counterclaim. Regrettably, it is not uncommon for contractors to become involved in litigation in circumstances that, on the facts, do not appear to warrant a lengthy dispute. In some instances, disputes are unavoidable. Good documentation and accurate diary notes can prove invaluable in such cases.

Contractors should avoid the use of an inappropriate standard form contract. Where contractors frequently engage in a type of contractual mechanism, it is worth having amendments made to a contract to reflect the mechanism that is employed. There are fundamental differences between a "cost plus" contract and a "construction management" contract.

Reliance on inexperienced professional personnel, and particularly preferring inexperienced to experienced professional opinion is doubtful commercial sense.

Construction management agreements need to clearly define the obligations and expectations of the construction manager.

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