

PUERTO RICO'S CONSTRUCTION INDUSTRY:  
Its importance, problems, and the causes of its present crisis

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The construction industry is of such vital importance that most other industrial activities simply fade in comparison. In every country in the world, the construction environment normally comprises more than half of the total national capital investment and represents as much as 10% of GNP. It is generally considered to be the world's largest industrial employer, generating approximately 111 million jobs, which represents 28% of all industrial employment and 7% of total employment. Construction is a primal constituent of the world's economic engine. What's more, this sector is responsible for the continuous improvement of mankind's physical, economic, and social conditions.

Puerto Rico's construction sector is not devoid of these roles. Yet the truth is that it is falling behind in its duties and responsibilities: it's an industry in crisis. A detailed presentation and discussion of the causes, remedies, and risk control associated with this crisis would be unrealistic in a one-page article. Therefore, this article will limit its scope to a mere presentation of the authors' point of view on the primary challenges and measures required to redirect this industry onto a path of sustainable development where it can fulfill the present needs of our society without compromising future generations.

The construction industry in Puerto Rico generates over \$7 billion a year in direct economic activity. In this industry large amounts of money can be earned or lost in a short period of time. The capital and employment devoted to the industry is considerable. According to the Puerto Rico Planning Board and the Association of General Contractors, P.R. Chapter, as of December 2005, the local construction industry was generating 67,100 direct jobs and a total of \$6.5 billion to the economy. The industry represents approximately 15% of the gross national product (average in the last ten years has been 13.7%, totaling \$37.1 billion). Although these numbers are still significant, after the year 2000, the industry has continuously decelerated. It has lost an estimated value of approximately \$700 million from 2000 to 2006. In the last three years, the industry has lost some 20,000 jobs. Puerto Rico has lost many of its main and largest contractors, prestigious firms like Triangle Engineering, Rodríguez & Del Valle, and others. The insurance industry has significantly reduced its capacity to generate construction bonds and foreign bonding companies have totally or partially withdrawn their presence from the island due to the grave problems affecting our construction sector. Available financing for private projects is scarce, and the image and profile of the industry are at their lowest.

After having devoted more than thirty years to servicing the construction industry, intensely analyzing and litigating its problems, our law firm has been able to identify and outline the following factors as the main problems and causes for the crisis affecting the industry:

1. Schematic and anachronistic legislation regulating the industry. The legislation remains as drafted by Napoleon over two centuries ago. Legislation to facilitate the formation of consortiums—

with pre-established and clear distribution of responsibility, distribution of profits, and administration of the relation intra and extra consortium—is essential.

2. Absence of a Code of Ethics for the industry and its resulting influence on the behavior of professionals. There is ample disregard for professional conduct and a lack of adequate identification of abusive and/or criminally punishable conduct, such as larceny under trust, false representation to deprive others of their wealth and/or rights, misrepresentation of substantial completion, abuse of trust or power, etc. Isolated professional bodies have outlined some ethical rules in their governing programs, but these are insufficient and are not legally binding to the industry as a whole.

3. Lack of clear guidance and limits in the scope of discretion of some of the professionals involved in the process, leading to serious conflicts of interest. For example: is the inspector's opinion about compliance subjectively or objectively guided? Which are those guidelines? The same is applicable to the designer and the project owner when the designer must decide issues arising from his own design errors and/or omissions; when the inspector, paid by the project owner, must decide issues for or against the person that pays his fees. The public interest is at stake when, under contract, someone is appointed to be a judge or arbitrator in his own cause.

4. Absence of a regulatory body that certifies excellence in the field and provides guidance to the industry players and related industries such as banking and bonding. This body should have capacity to express, review, and suggest the levels of professionalism, ethical conduct, and level of excellence that constitute the goals and standards of the industry. This should preferably be a private, well respected, self regulating entity.

5. Lack or limited comprehension of contractual mechanisms that identify, control, and distribute risk. Many contractors and project managers are not familiar with essential concepts, such as substantial completion, arbitration process, subrogation rights of the surety, critical path, congruence between the financing and construction contract, management of the contractual time and time extensions, the extent of the default clauses, cure notices, waiver of liability for future negligence, and prerogatives of the inspector, among others.

6. Absence of efficient mechanisms before the courts, arbitration institutions, or otherwise that facilitate the resolution process. The lack of certainty and delay causes large capitals and numerous labor jobs to be needlessly and uselessly lost. The abuse of the arbitration provisions—for example, the inclusion of an arbitration clause that is tantamount to a waiver of all contractual provisions, which is irrational.

7. Lack of predictability about the result of one or another course of conduct. The decisions by courts and arbitrators are extremely erratic. Such uncertainty spills over to the surety and banking industry which are not willing to risk extending credit in contracts to contractors and situations that are or may be controversial.

8. Use of unilateral contracts, such as the AIA model, that disguise the purpose of making one party immune and unjustly wealthy while the other party is held hostage to the caprice of the other.

Model contracts such as the AIA's should not be abused, not even adopted without proper advice. Multimillion dollar projects deserve a tailored contract, and public project contracts are not the exception.

9. Utilization of arbitration to multiply litigation and making redress so costly that it is preferable to take the loss and move on, provoking unjust enrichment. There's widespread ignorance about what arbitration entails and its consequences. Arbitration is more frequently used to shield from demands than to resolve controversies.

10. Lack of a summary proceedings that permits the efficient liquidation of contracts. Too many contractors have and maintain their working capital tied up in uncollected retainers and accounts receivables from contracts that were concluded long ago. This increases their operating costs, risks the company's survival, and limits their bonding and working capacity.

11. Financing of thinly capitalized projects where the bank considers as capital the moneys owed by the developer to the designer and the retainer to be owed to the contractor.

12. Lack of certainty as to when are the sureties liable and for what. There's lack of clear guidance about what the surety may or may not do when a claim situation is confronted. Abusive use of the surety's indemnity rights is common.

13. Absence of a unified procedure to obtain the governmental construction permits. When the endorsements of the agencies is finally obtained it may be changed in the middle of the construction process. This is the case of agencies such as the Puerto Rico Power Authority or the Puerto Rico Water and Sewer Authority who frequently change the connection point for a project thereby causing extreme delays and damages to all parties.

14. Absence of a rigid structure of payments, resulting in frequently belated payments to those supplying to and/or performing the projects, particularly by governmental agencies. Puerto Rico needs a prompt payment act like the federal government's. Private industry cannot sustain financing the government and should not finance the government unless the finance charges are factored in and are duly authorized as part of the contract.

15. Limited access to direct action by the professionals who are unjustly deprived of their contractual rights against those causing the damage. Such limited access tends to provoke an unjust and illegal transfer of risk, cost and liability from one party to the other. This is more frequent from designer and owner to contractor, but it is not infrequent the other way around.

16. Absence of a master plan for the development of infrastructure for Puerto Rico. There are no established set of priorities, such as aesthetics, distances between working, living, recreational, agricultural, distribution and transportation areas. Other jurisdictions have consulted the population to establish those priorities since this is not a matter for one or another political party to decide.

17. Absence of highly skilled, motivated labor, supported by adequate economic and tax incentives.

18. Absence of a well defined plan on developing symbiotic relations with other countries in the Caribbean.

Other serious problems exist in the industry. We have limited this article to identifying the most serious, frequent, and damaging ones. Spain and England are only two of several jurisdictions that have addressed these problems in diverse fashions. Both jurisdictions have acknowledged the serious need to attain an efficient and reliable dispute resolution mechanism. For example, England has adopted a procedure labeled *adjudication*, while Spain has adopted a serious, reliable arbitration process which has to be entered after the dispute arises, can be signed only through public deed, and the award must conform to law.

How will our private and governmental institutions, as well as our professional bodies, address, administer, and control the risks and damages that result from the prevailing problems in the construction industry? How can predictability and certainty be injected into the construction sector to induce, among others, greater investment, more employment, and the creation and preservation of local capital? In short, the answers to these questions and appropriate solutions to the severe problems that have led the construction industry into a state of crisis is a matter that pertains to each and every member of the industry and society in general.