

TRENDS IN CONSTRUCTION CONTRACT DISPUTES

J McMullan

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1. PRELIMINARY ISSUES

1.1 Procedure under the Contract

Disputes occur on major engineering Contracts on a regular basis.

The usual type of dispute is one in which the Contractor claims to be entitled to additional payment or an extension of time because of:

- delays on the part of the principal (for example, in providing the Contract drawings);
- performing work which the Contractor believes was not included in the original tender documents;
- performing work which, though including the Contract documents, is more difficult or under different circumstances to that described in the Contract documents (for example, the Contractor expected to have a clear site but arrived to find a number of other trade contractors working on the site);
- the principal requesting additional work or deleting work from the work described in the original tender documents.

In each of these and other circumstances, the Contractor will be entitled to additional payment and/or an extension of time if he is correct in his claim.

Most engineering contracts have some person in the role of a Superintendent. There is, as we discussed earlier, no need for this to occur and, there is no logical problem with the principal performing that role.

Where the Contractor is entitled, or believes he is entitled, to make a claim, that claim will usually be submitted to the Superintendent for determination.

The Superintendent will make a determination in respect of the claim, whether or not to allow the claim at all, and if so to what extent the Contract Sum should be adjusted and/or an extension of time given.

Where the Contractor disagrees with that determination, a dispute has arisen under the Contract.

The Contract will usually expressly provide a procedure for determining such disputes.

Such dispute clauses might include any or all of the following:-

- negotiations between the parties;
- negotiations between chief executives of the parties;
- mediation;

- referral to a mediation/dispute resolution (for example, the Australian Commercial Dispute Centre);
- arbitration;
- litigation.

The Contract could, of course, provide no such mechanism, in which case the parties are free to take the dispute to any forum which they believe is appropriate.

Where the Contract provides such a dispute resolution procedure, that will usually oblige the parties to comply with that procedure. In recent years, however, (we refer to this further below in relation to the topic of commercial arbitration) legislation and/or the Courts have intervened to some extent.

1.2 Pre-requisites: Negotiation/Chief Executive/Mediation/ACDC/Panel

The modern trend in dispute resolution on major engineering contracts is to attempt to remove a number of the disputes by filtering out those disputes which are able to be resolved by negotiation.

Such contracts provide, therefore, a pre-requisite upon either party taking a dispute to Court, or to arbitration, of referring that dispute to any or all of structured negotiations between:-

- the parties;
- the Chief Executives of the parties
- the parties within a structured dispute resolution mechanism such as, for example, ACDC
- reference to a panel of experts named in the Contract.

The purpose of imposing that pre-requisite procedure, which in effect, obliges the parties to go through that process but does not oblige the parties to agree on any outcome decided by that process, is to attempt to remove those disputes which are able to be resolved through negotiation.

Such processes, are by their nature, non-binding.

Accordingly, if a party, for any reason, did not wish to comply with such a process (for example, did not wish to refer the dispute to a panel) then they would merely have to go through the process but not agree with the outcome of that process.

Nevertheless, it has become the trend in modern major contracts to impose that process in the hope that it will have the effect of substantially reducing the number of disputes which proceed all the way to arbitration or litigation.

It appears, from empirical evidence (though in relation to mediation there may be even more substantive evidence) that this filter process is extremely successful in reducing the number of matters which proceed from a mere dispute to litigation.

1.3 Litigation or Arbitration

In the last 10-20 years, commercial arbitration on major engineering contracts has risen and declined.

Commercial arbitration, to which we refer further below, became in use in the 19th Century. Originally, the process of arbitration envisaged a technical expert, who may or may not hear from the parties, resolving a dispute referred to him by those two parties, as an alternative to litigation through the Courts.

In recent years, however, commercial arbitration has become a mirror image of litigation, with certain key exceptions:-

- the arbitration process is conducted in private (the proceedings are not open to the public);
- the arbitration process allows the parties to the dispute to select the person to whom they will refer the dispute.

In all other respects, at least in Australia, the commercial arbitration process has been mirroring the litigation process.

It seems fair to say that the number of actions being referred to commercial arbitration in the last five years, in Australia, have substantially declined. This may be due to a number of factors including the recession, but also perhaps, a perception as to the quality of commercial arbitrators in Australia outside the top commercial arbitrators.

Irrespective of the reasoning for this, there are a number of differences between commercial arbitration and litigation which encourage parties or not to refer matters to arbitration rather than litigation. Those differences include:

Proceedings in Court are open to the public, whereas proceedings in commercial arbitration are private, accordingly the parties who wish to preserve their commercial secrets may prefer commercial arbitration.

The commercial arbitration process permits (though, again, for different reasons this is often not made advantage of) the parties to select their arbitrator, rather than take pot luck in the Courts.

The arbitration process is slightly more expensive in that the parties are obliged to pay for the arbitrator and matters such as room hire (the Court process, once the initiating fees have been paid, are basically free).

The process of the arbitration (namely, the pre-trial steps and the time table for those pre-trial steps) are essentially a matter for the parties. In recent times, however, the Supreme Courts and lower Courts in Melbourne and Sydney, at least, have included specialist engineering lists. Accordingly, the distinction between the pre-trial steps in Court, and the timing of those pre-trial steps, has largely disappeared.

Commercial arbitration is a critical method for international contracts. Court judgments contained in a particular country are not necessarily enforceable in other countries. Commercial arbitration awards, however, are enforceable in other countries which are parties to the New York Convention 1958 (effectively, all major commercial countries are parties to that convention). Effectively, therefore, for international contracts where parties may or may not wish to enforce adjustments obtained in one country against companies whose assets reside in another country, will usually refer, in their contracts, all disputes to commercial arbitration rather than to litigation.

It was said for some time that arbitration was cheaper and more efficient than litigation. Whether this was true in the past (and this was debateable) that distinction appears to have disappeared altogether now having regard to the tenancy to use similar legal representation in arbitration as was previously occurring in litigation, and having regard to substantial increases in efficiency in the Court processes in Australia.

2 ALTERNATIVE DISPUTE RESOLUTION

2.1 Types of ADR

The resolution of disputes by alternative methods has become prolific? in the last ten years in Australia.

There are many types of ADR (perhaps an infinite variety). Some of the principal types of ADR include:-

- *mediation*

The parties choose a person to "mediate their dispute". The mediator will usually call the parties together and attempt, by persuasion, by identifying the issues, by removing common ground issues, by identifying the cost of referring the dispute to litigation in comparison to the matters in dispute between them, and by other such methods, to bring the parties to a negotiated solution to their dispute. The process is non-binding. It does not require production of evidence on oath or other such matters, however part of the process to obtain a negotiated settlement will often be to get the parties to spell out their particular case, whether in writing, or not, to assist both of the parties to identify the strengths and weaknesses of their own and the other parties case. The mediator will, in turn, sometimes express views as to the likely outcome of particular issues if resolved by a Court, again in the interest of persuading the parties to negotiate settlement.

- *conciliation*

The distinction between mediation and conciliation is blurred. In essence, mediation requires the bringing the parties together, on the basis of the merits of their dispute, towards a negotiated settlement.

"Consolidation" requires the bringing of the parties together, often on a non-merits basis, in a similar manner. Interestingly, the Institute of Arbitrators Australia has, in recent years published procedural rules for parties wishing to engage in both mediation and conciliation. "Conciliation is expressly referred to in the Commercial Arbitration Act as an alternative process for the arbitrator (outside the operation of the arbitration). In practice, however, the best arbitrators have tendered not to be involved in the Section 27 conciliation process, on the basis that, having heard matters in the conciliation process, they would effectively be prevented, later, from fairly hearing the evidence.

- *mini trial*

This process involves referring the dispute to a short form oral evidence presentation process. The advantage of this process over a Court hearing, for example, is perceived to be that the process would be substantially quicker and more efficient.

- *ACDC*

The Australian Commercial Dispute Centre is a privately run organisation which was commenced in Sydney in the 1980's. That body, referred to conveniently as "ACDC" invites parties with a dispute to submit their dispute to them. They arrange structured discussions with a, usually, high profile person as convenor.

- combination of any or all of the above.

In theory, any dispute resolution process which is an alternative to litigation could be characterised as "Alternative Dispute Resolution". In practice, commercial arbitration has come to be seen as something not included within that ambit, however this is a matter of mere definition.

2.2 Developments in ADR

Alternative dispute resolutions (ADR) has not changed much in the last few years; it has simply become more respectable.

Interestingly, despite my personal views some years ago, arbitration per se has declined substantially in Australia and mediation has gained a number of strong supporters.

In particular:-

- a) the number of arbitrations referred to the Institute of Arbitrators Australia, for example, has declined in recent years;
- b) some prominent retired judges have commenced to perform mediation on a near full-time basis;
- c) there have been a number of public advertisements for ACDC, listing organisations which have indicated that they would, where possible, refer disputes to that body for resolution rather than resort to the Courts or arbitration (this coincides with my perception that a number of large corporations which are regular performers in the construction dispute scene have something akin to a policy to avoid, where possible, litigation and arbitration); and
- d) the Supreme Court Building Cases List in Victoria has commenced, in the last 12 months, to regularly encourage the parties to refer their dispute to mediation during the pre-trial steps and those actions which are in fact referred to such mediation are being disposed of at the rate of around 50-90%.

These indicators, though random, all suggest that arbitration is decreasing and mediation is increasing in the resolution of construction claims.

In addition to the above, it is apparent that on most (perhaps all) major projects being negotiated in Australia over the last 2-3 years, the additional step of having any dispute referred to the Chief Executive and/or Managing Director of the parties as a pre-condition to taking any steps to either arbitration or litigation of any disputes is being included. This, again, it seems to me, suggests a major change in attitude in commercial parties to major contracts, namely that there is a genuine preference for a negotiated settlement rather than a strategic battle.

2.3 Project Claims Panels

We have seen on a number of projects in Australia in the last 3-5 years the inclusion of a Project Claims Panel to resolve disputes as they arise throughout the duration of the project.

In the mid to late 1980's, it was a common occurrence on major property developments which were being operated by a joint venture proprietor for there to be a project controls group. The purpose of that group was to perform the normal management functions of a principal, of this discussion) introduced by the legislation are:

1. Private Certification/Approval

The legislation introduces the possibility of a private certifier to carry out the functions of reviewing and granting building approvals. In addition, the private certifier is able to inspect buildings during construction and issue certificates of occupancy.

2. Proportionate Liability

The legislation alters the potential proportionate liability of any defendant for damages for economic loss and rectification costs arising out of defective construction of building work (but not in relation to personal injury or death). Where a person is judged, by a Court, proportionately liable, that person's total liability is restricted to his proportion of the total damages suffered.

3. 10 Year Limitation Period

The legislation introduces a fixed limitation period of 10 years, commencing on the date of the issue of the occupancy permit or, where no occupancy permit is issued, the date of first occupation of the building. This has two major advantages. First there is certainty as to the period. Second, contractors and professionals engaged on buildings have a certain end date for potential liability.

4. Compulsory Professional Indemnity Insurance

The legislation compels parties to obtain professional indemnity insurance with a number of approved insurers. In my view, this is a welcome change. It will result in all such risks being covered by insurance which, eventually, will be both adequate and uniformly worded in the policy.

These major changes, subject to the limited application of the legislation, are extremely far-reaching.

They are, potentially, of great benefit to Contractors and professionals engaged in the building industry. In addition, though some building proprietors may at first disagree, it seems to me that the elimination of uncertainty in the allocation of risk permits (in fact encourages) proprietors to identify risks, cost those risks accordingly and, where necessary, insure against those risks.

This legislation is likely, it seems to me, to substantially reduce and/or limit disputes in the building sector.

3.2 Procedural Advances in the Disposal of Court Actions

In 1984, I was in a trial in which the owner of a house was suing the architects for the cost of rectifying defective airconditioning and other services. That case had taken eight years from the date of issue of the Writ until the commencement of the trial.

This position has improved dramatically in the intervening years.

In 1995, in Sydney and Melbourne, there are specialist engineering and building cases lists in the Supreme Court. An action will usually proceed through all of the pre-trial steps, in those lists, in 6-12 months, depending on the numbers of parties. The action is then referred to a Registrar for a compulsory pre-trial conference and given a trial date if necessary. If nothing else, therefore, the time between the issue of the Writ and trial has been reduced to where it will usually be brought on inside 12 months.

Reference Out of Court

The most recent development, however, in the last few years has been the introduction of referring out technical questions to Special Referees in Sydney (approximately 4-5 years ago) and in Melbourne (within the last 12-24 months).

The process involves the Building Cases Judge agreeing to refer certain questions of a technical nature to a technically qualified Special Referee. That application is usually made by one or more of the parties, but the agreement of all parties is not a pre-requisite.

We use ADR methods better than we did several years ago. Alternative dispute resolution techniques have advanced to some degree in the past few years.

The most significant development in relation to ADR in Australia over the last few years, however, in my view, is that ADR has gone past arbitration in acceptance by the non-legal part of the engineering/construction industry.

Interestingly, despite the personal views of many, including me, the attractiveness of arbitration has declined substantially in Australia through that period, and mediation has become more attractive.

I base those conclusions on the following:-

- a) the number of arbitrations referred to the Institute of Arbitrators Australia (for example) has declined dramatically over the last few years (though this is also true, perhaps, of disputes in court);
- b) some very prominent retired judges have, in recent years, commenced to perform mediations on a regular basis;
- c) many commercial organisations have publicly (I can recall a particularly prominent series of advertisements by ACDC) and privately confirmed their distaste for prolonged litigation in favour of mediation (in one form or another);
- d) there is a trend among cases in the Victorian Supreme Court Building Cases List to mediation, and, as occurred in the County Court Building Cases List earlier, the success rate of settling such cases has been extremely high;
- e) a number of major projects in Australia have incorporated, as a first step in the dispute resolution procedure, a requirement to refer the dispute to the organisation heads of the respective disputants;
- f) a number of major USA projects have successfully adopted a disputes panel procedure on the project (I am not aware of this occurring on an Australian project yet, though this is inevitable);

- g) the use of partnering techniques is (perhaps inexplicably?) having undoubted effects in reducing disputes.

These indicators, though substantially anecdotal, all suggest that arbitration is decreasing in Australia in favour of mediation or some other form of ADR.

3.5 Partnering

In May 1990, the "No Dispute" Report was published. One of the major aims identified in "No Dispute" was to reduce adversarial relationships within the construction project and to develop equitable conditions of contracts for each industry sector.

This resulted in a move by the construction industry, in around 1990, to persuade the national government to use its purchasing powers to improve the industrial relations regime as it affected the construction industry.

In December 1991, the Construction Industry Development Association (CIDA) was launched.

In 1992 the MBA sponsored a series of promotional seminars on the topic of "Partnering" leading to the production of the document entitled "Partnering: A Strategy for Excellence" in November 1993.

Partnering is described at the start of that document as follows:-

"Partnering is about going back to the way people use to do business, and putting the handshake back into business. Partnering empowers those involved in projects with the freedom and authority to accept responsibility to do their jobs by encouraging decision making and problem solving at the lowest possible level of authority. It encourages everyone to take pride in their work and tells them it is ok to get along with each other.

Partnering provides mechanisms for co-operation between the participants to occur, so that energy-sapping disputation is removed, and productive working relations are carefully and elaborately built based on mutual respect, trust and integrity."

That quote from Charles Cowan, an American proponent of Partnering, could be accused of being a motherhood statement.

The undeniable outcome, however, of the discussions on Partnering is that certain steps have been introduced into projects which have, at least, the intent of encouraging the parties to work towards a non-adversarial relationship. The process is still in its infancy. It will be accused, from time to time, of being a motherhood process or little substance.