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CD corporate disputes

CONSTRUCTION DISPUTES

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EXPERT FORUM

CONSTRUCTION DISPUTES

PANEL EXPERTS

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CD: How would you describe the extent of disputes currently arising in the construction sector? Have you observed any significant global and regional trends in this space?

Farmer: The construction sector is vast, in that it covers many sub-sectors such as real estate, infrastructure, transport projects, energy & utilities and oil & gas. As a result, it is difficult to fully and accurately describe the extent of the disputes in the construction sector in a single article. That said, certain trends can be identified. The industry continues to report that disputes are increasing in average value and taking longer to resolve. These same industry reports identify that the biggest single cause of construction disputes continues to be a failure to properly administer the contract and I would not disagree with this conclusion. In addition, since the fall in oil prices, we have seen a significant increase in disputes in markets which are underpinned by oil revenues and we anticipate that this trend will continue for the foreseeable future.

Corbett: There has certainly been an increase in the use of adjudication across the construction sector. This, in turn, has meant a decline in the use of high court litigation because adjudication seems to be popular and is seen to be effective in helping parties to achieve a resolution to a dispute early on. I'm not saying adjudication itself has achieved the resolution, but it probably sets you on the right path and parties then end up resolving matters themselves. Trend-wise, I certainly would say there has been a decrease in high end, high court litigation, and probably to certain extent arbitration as well, but through an increase in the use of adjudications.

Lowe: The nature and extent of construction sector disputes in the UK has changed significantly in recent times. If one looks back to the 1980s, the relationships between employers and contractors were commonly short term and adversarial. Those relationships ended in dispute resolution only too frequently. Since then, the sector has learned that long term relationships supported by framework agreements and collaborative working provide better outcomes. In the UK, the advent of the Construction Act in 1998 led to a transformation of the management of disputes in the sector with a dramatic shift away from traditional resolution of disputes through arbitration or litigation, in favour of negotiated solutions facilitated through mediation and quick statutory adjudications. Justice may be argued to be rougher than it once was but it is certainly faster and cheaper.

Venegas: Undoubtedly, disputes in the construction industry have always occupied a very important spot within the wider context of general

global business disputes. Today, this is no different. As a matter of fact, it seems evident that the importance placed on disputes in the construction industry has increased over the last few years. This is an undeniable tendency in the entire world, including Latin America. A construction contract will always create the possibility of a wide spectrum of controversies, however this quite is normal since construction projects are usually long term transactions with a high number of uncertainties and complexities. This kind of contract requires highly specialised knowledge of two areas – legal and engineering. EPC contracts are very often complex, and this brings with it many challenges and issues which must be taken into consideration. The global and regional tendency that I have observed in disputes related to the construction sector have often been the same, most of them arise because of mistakes in the language contained in the contract, the low quality of the personnel involved in the management and execution of the contract, and poor documentation of the project. Furthermore, the majority of construction disputes arise in the public sector, or at least in terms of the contracts executed, between private and public parties. Each of these parties may have their own commitments and goals – generating a clash between public and private interest – which may not be compatible with each other.

Zack: A new trend in the construction industry sector, at least in the private sector, appears to be the number of claims being filed against EPC contractors by owners in the natural resource and mining sectors globally. This is especially true in the Australian LNG sector, where a number of projects have far exceeded their original cost estimate and commodity prices have slumped. Additionally, the global slump in commodity prices such as coal, iron ore, palladium, copper, zinc and aluminium, combined with a slower rate of global economic growth, has changed the planned economic outcome of many projects. Basically, the return on investment calculations that initially supported these projects are no longer achievable. As a result, numerous private owners are looking to claw back funds from the EPC contractors. This has resulted in major disputes – some running to the billions

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of US dollars – around the globe. Roles in disputes have reversed in many situations. EPC contractors, typically the claimant, are now the defendants in these disputes.

CD: What are some of the common causes of dispute within the construction industry? Could you outline the scale and values typically involved?

Lowe: The basic causes of disputes in the construction industry haven't changed. It is common for insufficient time and effort to be devoted to project planning and the old adage 'to fail to plan, is to plan to fail' is as true today as it has ever been. It is fair to say that there have been some improvements with more employers looking to the early involvement of contractors to assist with the planning phase. There is still more that can and should be done to improve certainty of scope, price and project duration and to reduce the extent to which projects are planned as they go along. Too frequently, incomplete concepts are put out to tender with inadequate engagement between employers, their professional advisers, contractors and the supply chain to achieve project certainty.

Farmer: Typically, a construction dispute will arise from issues relating to design, progress of the works and the causes of delay and disruption to the progress of the works, performance of the works, the valuation, progress and performance of additional works, the valuation and entitlement to payment for costs incurred as a result of delay or disruption to the works, or payment. The scale and value of these disputes varies from project to project. The cost of formal dispute resolution procedures will often motivate parties to settle smaller claims but, depending on the jurisdiction and the entities involved, there can be a real variety in the size and scale of disputes which are resolved by formal proceedings.

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Zack: The types of claims and disputes arising in the construction sector have not changed substantially over the years. The most frequent causes of disputes remain defective design, project delay, differing or unforeseeable site conditions, force majeure events, contract maladministration, and so on. What appears to have changed somewhat is the reported value of disputes. Surveys indicate that while the size of the typical disputes in the US has declined, the size of claims have increased in other regions around the globe. This anomaly may be the result, not of smaller claims, so much as a difference in the manner in which disputes are resolved. The American Bar Association estimates that only 2 percent of all the civil lawsuits filed in the US actually go all the way through litigation. Most are resolved through alternative dispute resolution – including dispute resolution boards, mediation and arbitration. As a result, there is no record of claims filings or outcomes. This apparently is in contrast to disputes in other regions. Thus, the data on the cost of disputes may be more readily available in other regions.

Corbett: It is difficult to talk about scale and value. I would say the common causes of disputes in construction probably are not that different now compared to what they were 20 years ago. But the construction sector is complex. It has a multitude of parties that work together, whether it is designers, subcontractors, suppliers, main contractors, employers, advisers or financiers. There is a massive team of people that are involved in a project and there are complex contractual matrixes that exist between those teams, so there is a real potential for disputes. But the common causes are around scope definition – what the client expects to receive under the contract and what the contractor or designer think has to be delivered. Other areas of dispute are typically disagreements about variations and increased work scope. Inevitably, there can also be problems arising from progress delays and payment provisions.

Venegas: There are many causes of dispute within the construction industry. From our point of view and based on previous experience, it is worth highlighting some of the most important and frequently repeated issues. One is that too many people are involved in the construction. In such cases, subcontractors find themselves in dispute with the main contractors, or the developers are in dispute with funders, banks, project sponsors, and so on. To that end, conflict often arises because work is not properly coordinated. Money is often a further cause of dispute. Conflict often arise because construction project participants are not as able to compromise and do use cash as they previously claimed they would. Legal teams can often inadequately review the terms of the construction contract, which can lead to further disputes. Unfortunately, it is not common practice

for contractors to have their attorney's contracts approval before signing them. An inability to work cooperatively can also result in companies entering into dispute. It is the responsibility of the engineering and legal staff to create a clean and clear, legal and technical document as a contract. The written language that is contained within the contract is critical. From a technical standpoint, a lack of knowledge of the construction site can also become an issue, particularly if the parties do not clearly stipulate the standard for recovering increased costs associated with encountering changed conditions – 'differing site conditions' or 'changed conditions' clauses. A lack of consideration around weather conditions – within a reasonable range – can also create difficulties for the parties.

CD: Have there been any recent high-profile construction disputes which have caught your eye? What lessons can be drawn from the outcome of notable cases?

Corbett: The lessons that can be learnt from notable cases go back to their common causes, where it is very important for parties to be clear about scope. It is also very important that dispute provisions within contracts provide for early recognition of issues. Parties then work together during the course of the contract to try and resolve those issues, so that potential delays and costs are resolved or mitigated quickly by all parties.

Venegas: From my point of view, the *CONPROCA vs. Petroleos Mexicanos* case is the most interesting high-profile construction dispute that has recently arisen worldwide. This dispute involved the discussion of recovery of some specific type of damages – loss of productivity – against a very tight legal framework – the legal regime of Petroleos Meixcanos – which establishes a strict control of the public entity budget and the payment to contractors and which does not foresee any specific standard for the payment of damages. There are many lessons that can be drawn from the outcome of notable cases. Since listing all the lessons here would be lengthy, I will limit the task to the most important lesson from my experience, which is that the best way to avoid disputes in the construction sector is to build a strong construction contract in which the legal and engineering terms are in perfect balance. In addition, contracts with the government or public entities must be treated with extreme care and with enough openness to understand the different type of goals of the two parties.

Zack: A recent high profile case in the US may be a game changer concerning a contractor's right to rely upon owner supplied information when proposing or bidding on a design-build project. In the US, bidders generally have a legal right to rely upon the information provided by owners. However, in *Fluor Intercontinental, Inc. vs. Department of State* the Civilian Board of Contract Appeals ruled that the contractor was not entitled to rely upon the integrated design drawings and specifications furnished by the owner when proposing a firm fixed price design-build contract. The board concluded that these documents were provided for the sole purpose of illustrating the owner's intent. The board upheld the owner's disclaimers that the contractor was solely responsible and liable for design sufficiency and should not depend upon the information provided by the owner as part of the contract documents. This decision allowed the owner to avoid all responsibility through its use of the design-build delivery method coupled with

contractual exculpatory language. This decision was later affirmed by the US Court of Appeals.

Farmer: A couple of recent judgments have caught my eye, the first is a TCC judgment at the back end of 2015 and the second is a recent DIFC judgment. The first judgment was in the case *Van Oord UK Ltd and another vs. Allseas UK Ltd*. In this case, Mr Justice Coulson gave great insight into his deliberations when considering the reliability, or unreliability, of factual and expert evidence. It would appear that, with regard to one of the expert witnesses involved, it was an extreme situation – the judgment notes that having left the witness box during a brief pause in proceedings, the expert failed to return. The judgment is a stark reminder for disputes lawyers, and their clients, of what to consider when appointing and working with party appointed experts and, ultimately, highlights that experts' reports must be rigorously tested prior to submission. The second judgment is *DNB Bank ASA vs Gulf Eyadah*, delivered by the DIFC Courts in Dubai. Whilst this was not a judgment relating to a construction dispute, its implications are of importance to those operating in the UAE or with UAE companies – which includes a significant number of construction companies. In short, the judgment establishes that a party may enforce a foreign judgment in the DIFC Courts and then enforce that judgment onshore via the Dubai Courts. This clearly has wide-ranging impact for those in the industry who are working in the UAE or with UAE entities but do not have dispute resolution provisions which are subject to the jurisdiction of the UAE Courts or arbitration within the UAE.

Lowe: The majority of construction sector disputes in the UK are resolved privately behind closed doors so the number of reported decisions is far fewer than was once the case. Most reported decisions turn on their own facts so one must be careful about what lessons, if any, can really be drawn from them. Two recent exceptions are *Cavendish Square Holdings BV vs. El Makdessi* and *Parking Eye Ltd vs. Beavis* in which the Supreme Court laid rest to the notion that liability for delay damages might be challenged if the rate of damages is not a genuine attempt to pre-estimate the employer's actual loss. The Court made it clear that delay damages will only be considered to be penal, and therefore unenforceable, if the damages are extravagant to the point of being unconscionable. *Bloomberg vs. LP Malling Pre-Cast Ltd*, which concerned the effect of the Civil Liability Contribution Act 1978 on clauses limiting liability in a contractor's collateral warranty. Commonly, collateral warranties which extend rights to owners and occupiers of developments who were not involved during the construction phase, limit the contractor's liability to a fixed period after project completion – usually six or 12 years. It has been generally understood by the legal profession that all rights against the contractor

are extinguished at the end of this period. Not so, found the judge in the Bloomberg case. Claims for contribution under the Act would appear to survive and it remains to be seen whether lawyers can find a contractual mechanism to overcome the effect of the decision.

CD: To what extent are the current tough economic conditions and increasing project complexities causing disputes to become more drawn-out?

Zack: During the recent recession many contractors priced work too low and with little or no contingency in order to win new projects and stay in business. This led to an increase in the number of claims when they ran out of money before they completed the work. Even worse, a tremendous amount of private construction dried up, forcing a number of contractors to bid, for the first time, public work as government agencies were the only one with money to continue building projects. While many of these contractors were competent builders, most were unaware of all the requirements that accompany a government contract. One spinoff effect of this situation is that many contractors did not understand how to file and perfect a change order or request for equitable adjustment. As a result, a large number of claims were rejected due to a lack of appropriate documentation making dispute resolution more complicated and resulting in contractors being unable to recover damages that may have otherwise been owed.

Lowe: The ever shifting economic cycle inevitably has an impact on disputes. With the advent of the recession in 2007, much of the progress which had been made in the UK toward long-term collaborative quality driven relationships was undone. There was a return to the old style lowest price wins approach with its attendant risk of an increase in disputes. Contractors, particularly those who need to be able to demonstrate year on year growth to satisfy market expectations, were subject to the temptation of trying to win work at any price in order to show a

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full order book. This left those contractors vulnerable to losses as the economy recovered and supply chain prices increased. Employer and supply chain relationships needed careful managing to mitigate the attendant increased risk of disputes. At the same time, the risk of supply chain insolvencies increases tensions within relationships and puts pressure on subcontractors to cut corners with cost and quality or, in extreme cases, to fail to complete their works.

Corbett: Tough economic conditions obviously call for all businesses to have stricter cash control. Tough economic conditions can also lead to businesses failing, and if you have a partner fail in a large construction contract, that will have ramifications for everyone – for the client, for the contractor, for the designers, for everyone. These tough economic conditions are more about cash constraints, requiring cautious investment amid the risk of failure by businesses.

Farmer: In the first instance, tough economic conditions and project complexities are two of the key drivers which are likely to lead to a dispute on any given project. So the impact of these events is more than just causing a dispute to be drawn-out; they are often causes of the dispute itself. In certain markets, particularly when dealing with government or quasi-government entities from emerging and developing markets such as the Middle East and Africa, tough economic conditions can contribute to a 'no decision' attitude. Rather than make decisions, such as agreeing to a settlement, the individuals concerned prefer to have a decision imposed on them – by a judge or arbitrator on the basis that, provided that they have pursued or defended the claim to the fullest extent possible, they cannot be individually accountable for a poor outcome. Such an approach inevitably leads to disputes being drawn-out and the more complex or expensive the project, the more likely it is that this approach will be adopted. In England & Wales the situation is somewhat different. Since 1996, parties to construction contracts have been able to resolve their disputes by way of a fast-track procedure known as construction adjudication. This process

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Marco Tulio Venegas, Von Wobeser y Sierra SC.

allows parties to a construction contract to obtain a binding decision on a dispute within 28 days.

Venegas: The current tough economic conditions indeed have caused disputes to become more drawn-out. This creates a vicious circle. If the party obliged to pay do not, the project is disturbed – and more often than not, discontinued. If this arises, the subcontractor becomes affected too. As a natural consequence of that, disputes become more drawn-out.

CD: Construction disputes typically involve a large volume of data amassed during the e-disclosure process. What strategies are available to improve speed and efficiency during this phase?

Farmer: With the rapid progression of technology over recent years, disclosure has morphed into an almost unrecognisable process. This has not gone unnoticed and both courts and arbitral tribunals are being far more pragmatic about the issue as a result. Arbitration remains a more flexible forum, however court reforms in England and Wales a few years ago abolished the 'default' of standard disclosure, and this has done much to reign in disclosure. More limited disclosure options are now available and, with regard to construction litigation, the Technology and Construction Court has introduced a comprehensive e-disclosure protocol to assist parties in agreeing an efficient and cost effective way to conduct e-disclosure. Also look out for the Shorter and Flexible Trials Schemes – known as STS and FTS – pilots now in operation in the London TCC, in which limited disclosure is a key feature. Whether in arbitration or the Courts, it is clear that the onus is being placed more and more on the parties themselves to think about which process will work best in their particular case. Accordingly, you should try to engage with the issue of disclosure at an early stage.

Venegas: Utilising electronic tools for data management processes is the key. These tools have to include key aspects of identification and organisation. Actually, nowadays there are many software programs on the market that represent a great solution. We should focus on these solutions that already exist in the market.

Zack: One strategy likely to improve speed and efficiency during the e-discovery phase of a construction dispute is to reduce the number of documents available for discovery. Some experts have recommended that proper data deletion policies be crafted and implemented. Companies that properly implement a defensible data deletion policy should reduce the cost and risks associated with information retention. A good data deletion policy includes formalised guidelines on what information can be deleted and when. Another

strategy when going into a dispute is to negotiate a Technology Assisted Review process or Predictive Coding. Technology Assisted Review is a process for prioritising or coding a collection of documents using a computerised system that harnesses human judgments of one or more subject matter experts on a smaller set of documents and then extrapolates those judgments to the remaining document collection, thus saving both time and money during the e-discovery process.

Lowe: There is no substitute for good document management. Perversely, the rise of electronic document creation and management has been accompanied by an overall deterioration in the quality of document housekeeping. It is more likely now than it has ever been that documents will prove hard to locate, having been stored in a manner or on a system which makes identification and retrieval complex, time consuming and expensive. The effort put into corporate procedures for robust document management supported by secure electronic systems, will not be wasted and will reap rewards in terms of cost and time saving when faced with dispute resolution. Too often, this is not seen as a top priority at enterprise level because of the cost and resource commitment required to establish sound systems. As a result, document management arrangements are often left to be decided at a project level; this is a mistake. There isn't a substitute for a robust enterprise level document management system.

Corbett: It is a fact that records and documentation in construction projects, and probably any commercial endeavour, are fundamental and must be adequately maintained. It is important for businesses to have a good document management system in place, as well as a disciplined approach regarding maintaining records and keeping adequate documentation.

CD: In your opinion, how important is it for companies to ensure that they have effective policies and strategies in place to manage and resolve contract issues when they arise?

Venegas: Having effective policies and strategies in place to manage and resolve contract issues when they arise could even help some enterprises avoid bankruptcy. Construction disputes, when they are not resolved in a timely manner, can quickly become very expensive.

Lowe: Dispute resolution is a sign of business failure. Frequently, the only clear winners are the lawyers with the parties on either side of a dispute each feeling dissatisfied with the outcome. It is good for business to have procedures in place which provide for circumstances which may

give rise to a dispute being identified at an early stage so that the issues may be understood and managed, with the aim of achieving early a prompt solution without recourse to dispute resolution. To succeed in this aim, close cooperation is required between commercial and legal teams with an emphasis on the practice of preventative law and 'cradle-to-grave' availability of lawyers to support project delivery with continuity of involvement from tender to final account settlement. Of course, not all projects will or should require such support. What is important is that it is available when required and applied appropriately to facilitate the resolution of project challenges before they evolve into disputes.

Corbett: Prior to a dispute, warning signs may arise during a project, and you need to be able to identify those warning signs, treat them seriously and make sure that they are addressed. The risk is that if you ignore them or fail to appreciate their significance, and allow them to fester, you end up with a large dispute that could have been resolved more easily and to everybody's satisfaction much earlier.

Farmer: Prevention is better than cure and it is clearly in every party's interest to seek to resolve an issue amicably rather than have to proceed to formal dispute resolution. The benefits are not limited to the immediate time and cost savings, both in terms of lawyers' fees and management time, but also the ability to salvage a commercial relationship before the situation escalates too far.

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Zack: Construction claims are a matter of legal right granted to contractors by the terms and conditions of the owner's contract document. Accordingly, contractors must create standardised business processes and procedures to protect and maintain these legal rights. Dispute avoidance business practices include standardised form letters for notice, an internal claims management procedure, in-house claims awareness training, well managed project documentation, practices, procedures and filing systems. Electronic dashboards can be purchased off the shelf to monitor individual

projects, tracking such metrics as owner payments and timeframes, change orders or variations, and so on. Tracking project metrics such as these will give senior management a picture of the 'health' of the project. 'Poor health' is an obvious warning sign of potential disputes. Practices such as these can be reinforced by routine high level project claim reviews. All combined, these will create an effective strategy for identifying potential disputes early, allowing for earlier resolution.

CD: What general advice would you give organisations in terms of overcoming the challenges they are likely to face during a construction sector dispute?

Corbett: If a construction dispute has arisen, hopefully you will have captured it early. If not, the important thing to do is to try and identify the key issues early on by sitting down with the relevant parties to see if an amicable and sensible resolution can be reached. Whether you decide to negotiate or go to mediation, it is always going to be better in a dispute to be sensible and to try and resolve it quickly and amicably, rather than incurring what will inevitably be large expense and extended management time. Hindsight is a wonderful thing, but it's only when you get towards the end of a dispute that you see what may have been done differently. It is prudent to jump on things quickly and be open and transparent.

Zack: In general, contractor clients should adhere closely to a number of practices concerning construction claims and potential disputes. Firstly, stay alert for, recognise and act promptly on all early warning signs of claims or disputes. Ensure that you provide prompt written notice of all situations that may, even remotely, lead to a claim or dispute. When in doubt, file notice. Follow contract procedures religiously concerning change order or variation requests, extension of time requests, and claim filings. Adherence to contract procedures will always help settle claims and avoid legal disputes. The three rules for 'winning' a construction claim are 'document, document, and document'. Absolutely nothing is as persuasive as great contemporaneous project documentation created by the people on site when the event happened. Finally, do not let claim issues linger unresolved. Construction claims are akin to fish in the refrigerator. The longer they linger, the more they smell and the worse they taste. Deal with claim issues promptly while all the details are still fresh in the minds of all project participants.

Farmer: Construction disputes are typically document heavy and this is for good reason. Construction projects generate thousands of documents and often disputes are only finally resolved several years after the event. Unfortunately, memories fade. As a result, the project records are often the primary and most reliable source of evidence in relation to a dispute. A good document

management system can greatly improve the speed at which lawyers and third parties, such as experts, can get up to speed on the detail of the project. A well maintained and properly indexed document management system can save a great deal of cost and provide you with an edge over the other party. I would also add that a document management system can only assist in retrieving documents which have been created – so make sure you record any issues in writing and get your claims and notices in within the time limit required by the contract. No one wants to face an argument that a good claim was not raised at the appropriate time and is now barred, either under the contract or at law.

Lowe: When dispute resolution is unavoidable, sound planning and the availability of the right resources is of paramount importance to a successful outcome. A few simple things can determine the difference between success and failure. Firstly, organisations should ensure that relevant documents are identified and preserved. Corporate procedures should provide for a 'hold' instruction to be imposed to prevent the destruction of relevant documents until the dispute has been resolved. Secondly, efforts should be made to identify and ensure the availability of persons who may be required to assist with the dispute, particularly, those whose evidence may be relevant. Thirdly, the early involvement of independent expert witnesses should be ensured. Allowing the company's subject specialists to take the lead in the early stages of dispute resolution is rarely the best approach, no matter how capable they may be. Fourthly, organisations should make an effort to understand their opponent and ensure that there are open channels of communication between the parties at different levels in the organisation – nothing is more likely to result in a long drawn out dispute than when the parties stop talking to each other.

Venegas: Coordination is key, as well as the knowledge of the resolution method agreed by the parties. The construction industry has made tremendous progress in developing more efficient methods of dispute prevention and resolution. Most construction contracts today contain some form of alternative dispute resolution. Actually, from the late 1990s, mandatory conciliation was incorporated in all the standards forms of building and civil engineering contract and it has become the standard way to resolve disputes. Despite the progress, there is a great deal more work to be done. CD