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CONSTRUCTION DISPUTES – SELECTION PHASE

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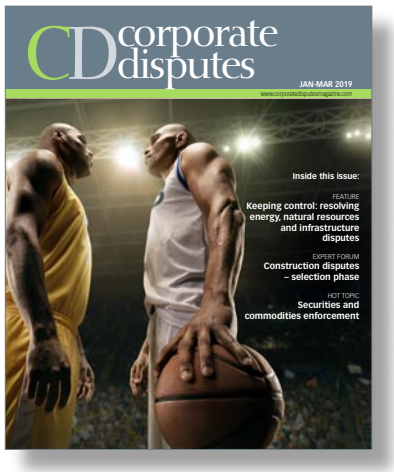

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EXPERT FORUM

CONSTRUCTION DISPUTES – SELECTION PHASE

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Tom Peel specialises in both the contentious and non-contentious fields of construction and engineering law. He advises on projects ranging from commercial, residential and industrial developments to high value energy and waste schemes, procurement of bespoke plant and equipment as well as infrastructure and land remediation projects. On the contentious side, Mr Peel has extensive experience of all forms of dispute resolution proceedings, including mediation, adjudication, arbitration and court.

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Jules Harbage specialises in non-contentious and contentious construction and engineering work. He is skilled in drafting and negotiating building and engineering contracts (particularly the JCT, NEC, IChemE and FIDIC forms), professional appointments, bonds, collateral warranties and related documents for a wide range of projects in both the private and public sectors. Mr Harbage also has extensive experience in all forms of dispute resolution, particularly adjudication.

Lowe: How would you describe the level of construction disputes over the last 12-18 months or so? What overriding trends are defining this space?

Hanson: We are seeing a steady level of disputes, showing no signs of slowing down in the short term. Disputes are active across a variety of sectors, notably airports. One theme that is common to nearly all the disputes we are seeing is the transactional and adversarial nature of the contracts and the disproportionate risk allocation within them. It is less common to see disputes on projects that are set up and delivered collaboratively. A trend we are beginning to see is an increase in the number of parties seeking advice, and making an investment, at the beginning of projects. The acknowledgement that projects are often inadequately planned before being tendered is focusing efforts on mitigating the risk of disputes further down the line.

Lachheb: From our perspective, we have seen a constant level of dispute-related enquiries over the last 12-18 months. We can reasonably infer that the number of disputes in construction projects is not declining. The dynamics of this space varies from one region to another. In Europe and Africa, for example, the level of investment in the infrastructure sector is projected to grow significantly. Given the strong correlation between these two areas, we should observe a rise in the number of disputes over the coming years. We should also see an increased use of better contracting mechanisms to resolve disputes, such as dispute adjudication and review boards.

Peel: I would say that we are seeing more disputes at present. The fallout from the Grenfell disaster has been a significant contributor, with a number of properties, clients, designers and contractors affected. The construction market has been overheating for the last few years, which always leads to increased disputes. Everyone from developers, consultants, contractors and their supply chain take on too much work. Mistakes are made. New parties come into the market who are not set up to deal with the work they take on. Parties unfamiliar with each other start to work together. Quantity becomes more important than quality. All this leads to disputes, whether it is financial or defect related.

Harbage: The level of disputes has significantly increased. In particular, we are seeing disputes relating to delays and cost. An overriding trend is that building projects are inherently complex and involve significant risks of problems emerging that cause substantial delays to the programme. Programmes are often agreed at the outset with a very demanding critical path, with very little float, if any, to accommodate slippage in

productivity. Another trend is that the importance of recordkeeping seems to have been recognised and implemented on a number of projects, particularly larger ones. Contemporaneous records are valuable evidence to support or defend a case, so this is a welcome development.

Lowe: In your opinion, is sufficient attention focused during the early stages of project development on mitigating the risk of disputes arising later on?

Harbage: My perception is that people still very much prioritise the business critical output of the project: what they want and when. I think it is often assumed there will not be a dispute, or to focus on dispute avoidance is seen as a distraction or 'contracting to fail'. Many of the disputes we see concern contract interpretation, where the wording has perhaps been rushed. Furthermore, there are many cases where the courts have to grapple with significant discrepancies between the documents comprising the contract because they have been put together quickly, without checking for inconsistencies. In an ideal world, mitigating the risk of disputes would be a priority on every project, because dealing with a dispute later can be very time consuming and costly.

Peel: Construction involves risk and so disputes are often unavoidable, particularly when the majority of parties involved through the chain are seeking to make a profit. It is not fair to generalise here, as I would say the majority do consider risk but commercial factors usually drive the key decisions. The difficulty is that cost or programme requirements will nearly always take precedence, and it only takes one party to have unrealistic expectations, or to make a mistake, and a dispute becomes inevitable.

Lachheb: From the perspective of an owner, in the earlier phases of a project, the priorities are more to establish the business case and develop the definition of a concept that fits it best in order to obtain project sanction. It is only at the very end of the process, prior to or during tendering, that we start to observe, for the most advanced organisations, some efforts towards mitigating the risks of claim crystallisation or disputes during execution. It is rarely seen as a specific and separate process in most of these organisations, and is rather embedded in the various existing processes at play – design, contracting strategy set-up and implementation. It would certainly benefit from a more effective coordination by a dedicated function within the project. The current lack of focus on these matters can be explained by the fact that it is not yet perceived as a major risk likely to affect the project economics and therefore project sanction. A second reason is that it is essentially a multidisciplinary activity involving a number of skills

and competencies – technical, legal, operational, commercial and so on – which are hard to find, mobilise and coordinate within a limited period of time and under budgetary constraints.

Hanson: One would think that the continued prevalence of disputes in the industry would provide an incentive to increase upfront planning of projects but, notwithstanding some exemplar projects, I do not believe it has. It appears to continue to be a challenge to shift from short-term, goal-driven behaviours to collaborative ones, with a focus on upfront investment. Projects tendered with unclear, variable or incomplete requirements and scope definition are a particular example. Rather than tendering fixed-priced contracts for undefined scope, by acknowledging the incomplete nature of what you are asking to be delivered, alternative approaches can be pursued that will ultimately deliver greater value.

Lowe: What do you consider to be the strengths and weaknesses of current approaches to the procurement of construction projects, in terms of ensuring projects will be on time, on budget, meet quality standards, provide value for money and, therefore, be less likely to result in disputes?

Lachheb: From an owner's perspective, the traditional approach to procuring projects is insufficient to guarantee the kind of objectives that minimise disputes. In terms of strengths, the current approach provides a certain degree of comfort for owners, as it is easily auditable and sequential in nature. In essence, an unsophisticated process provides an illusion of efficacy. There are numerous shortcomings. One is that assigning key performance indicators (KPIs) in order to measure whether the process delivers its outcomes efficiently can only be assessed at the completion of a project, which occurs several years down the line. In addition, the process is adversarial in nature, with each party working towards its own interests which are opposite – limiting project budget versus maximising project margins – which results in unbalanced schemes. Furthermore, risk elements are not

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Khalid Lachheb, Accuracy

properly handled and the process does not promote a long-term relationship. All these factors tend to produce unbalanced schemes and unrealistic schedules or budgets.

Hanson: I believe that the only strength of current approaches is their familiarity in the market. The industry is used to the commercial, organisational and operational frameworks, as well as the opportunistic behaviours, that support these approaches. I would say that the success of these approaches is highly questionable and I do not believe that they are particularly well suited to complex major projects. Current procurement approaches typically result in relationships that ultimately do not deliver value – by any measure – to the client. I think the key weakness of these approaches is their inability to promote collaborative problem solving and risk sharing between client, designer, contractor and operations teams during the project life cycle. Ultimately, this leads to projects delivered late, over budget and with lower than expected benefits.

Peel: We do see parties using frameworks and two stage tendering more and more. This does generally allow the contractor and design team more time to work through issues, which should lead to programme and quality being achieved. The contractor and its supply chain should also get their price right, meaning the need to 'generate' claims up or down the chain reduces. It is debatable whether a two stage tender would always deliver value for money beyond a single stage tender. Two stage can also leave the client at the mercy of a contractor that knows that it is in a strong negotiating position when the client's only other option would be to go back to market with no guarantee of a lower price, and loss of programme. However, there is no perfect way to procure. Market conditions drive the process and as more and more contractors refuse to partake in single stage tenders, clients will seek to negotiate with their preferred contractors.

"Current procurement approaches typically result in relationships that ultimately do not deliver value – by any measure – to the client."

Matthew Hanson, Accuracy

Harbage: A strength of the NEC suite of contracts is that it includes devices or mechanisms specifically aimed at managing risk. Parties are encouraged to

allocate resource to proactively deal with issues as they arise, and therefore reduce the likelihood of disputes arising or escalating. Any procurement that uses a risk register from the outset and encourages the parties to identify risk as soon as it emerges – through early warning notices, risk reduction meetings and so on – is likely to benefit a project. The weakness of this approach is that there is an administrative burden, and therefore cost, in dealing with the plethora of paperwork that the NEC contract can generate. Furthermore, if the parties fail to adhere to the procedures, then there can be significant uncertainty as to the resulting rights and obligations of the parties.

Lowe: What might be done differently during the procurement phase of construction projects to secure better value for employers, a better return for contractors and also make it less likely that the parties will find themselves in dispute?

Peel: I could say that there is overuse of design and build when traditional procurement may be more appropriate, or too much single stage tender rather than two stage. However, we have to recognise that it is the developer that creates the project and cost will generally be the difference between it going ahead or not. If there was a perfect way to procure a site, everyone would use it. In my view, the one common factor that can be better controlled is making sure the right individuals are on the project, and, as far as possible, they stay on the project. The importance of relationships, open dialogue and constant communication from client, contractor, fund and subcontractors cannot be overstated. I also believe that modular construction will continue to become more and more prevalent. As the industry becomes more familiar with the necessary processes, and techniques and methodology continue to advance, this should lead to better control of price, quality and programme, and so fewer disputes.

Harbage: Ideally, more time will be allocated to the procurement phase, so that the employer and contractor can be much better informed as to project risks. For example, contractors can have time to carry out surveys and various tender clarifications can be fully considered and answered. The more informed the parties, the more likely the contract price is transparent and realistic, which is good for both parties. For employers, they are not paying a premium for a risk that never materialises, or dissuading contractors from bidding for work if unknowns are considered too risky. For contractors, minimising exposure to costly liquidated and ascertained damages (LADs) for delay, or unforeseen ground conditions, among others, will mean a higher proportion of projects return a sustainable profit.

Hanson: I believe the answer lies in creating a contractual environment that prioritises technical and commercial collaboration and cooperation between client, contractor and designer. Building information modelling can act as a foundation for this and would lead to projects that deliver benefits to all parties, reducing the likelihood of disputes. I am a huge advocate of early contractor involvement and the benefits that this can provide in reducing buildability and health and safety risks on site. From experience, I think the principles of integrated project delivery (IPD) have also produced favourable outcomes on projects. IPD concepts of collective risk management and commercial alignment of all parties through profit pooling, contingency sharing and appropriate incentivisation often end up generating less adversarial behaviours.

Lachheb: The construction industry will benefit from applying the solutions of adjacent industries, such as manufacturing and automotive, which have already delivered increased value. Both owners and contractors will benefit from increased cooperation and transparency during the procurement phase. When objectives and interests are shared, parties are keen to build more balanced arrangements, pay attention to the other party's interests, and act in a more integrated manner to address risks and find solutions. Currently, it seems hard to depart from the usual approach, as it is still perceived to deliver satisfactory outcomes – in the absence of any

objective indicator. Some initiatives are observed in the sector, such as long-term partnerships – selecting a single contractor for all capital projects, for example. We still need to see the extent to which such schemes deliver better value, as cultural barriers may remain.

Lowe: In your experience, how effective at preventing and managing construction disputes are partnering and alliancing arrangements?

Hanson: I think partnering and alliancing arrangements can be effective in developing cooperative relationships to produce 'win-win' scenarios, especially for one-off transactions such as major projects. On their own, they are not enough to prevent disputes and need to be part of a wider, more collaborative framework for delivering projects. I have seen such arrangements break down where business relationships were formed to fill a capability gap rather than to create a symbiotic arrangement between two strategically and operationally aligned parties. In any case, if contracts do not support behaviours envisaged by such arrangements, then they are just as

likely to lead to disputes. From my experience, success also depends on the operating system and culture of each party. Arrangements that have adopted lean principles collectively, such as commitment based planning, for example, tend to be more productive and successful.

Lachheb: Partnering and alliancing arrangements appear to be an interesting solution in theory. Most of the shortcomings of the current procurement approaches could find a response through alliancing and partnering arrangements. If such arrangements are working effectively, disputes are more likely to be prevented. There are, however, many practical obstacles to overcome. One example would be an owner seeking to retain a single contractor for all its capital projects. There would be then be significant cultural and organisational changes to implement within the two organisations before such an arrangement could work effectively. Consequently, theoretical solutions still need to be worked through before organisations can adopt them broadly in practice.

Harbage: Formal arrangements have not necessarily prevented disputes, particularly if there is a significant claim arising from delay or a defect, of a size which neither party believes can be absorbed purely for the promotion of the long-term relationship. It can also depend on the particular sector or market. If there is little competition, and therefore a dearth of alternative providers, then it is often this lack of a plan B which helps manage disputes efficiently, rather than a formal partnering or alliance agreement. There are several standard form contracts available that embrace partnering or alliancing, with useful mechanisms for pain/gain share associated with target cost, key performance indicators and steering group meetings. However they are still relatively rarely used in our experience.

Peel: Much depends on the individuals involved. I have seen developers work successfully for years with an undocumented framework of contractors and consultants. Major issues have arisen and been resolved because the individuals involved recognise the long-term value of working together. Equally, I have seen written frameworks and partnering style contracts end in dispute. In particular, the inevitable healthy long list of key performance indicators and targets that come with partnering and alliancing arrangements are prime fodder for lawyers when things start to unravel. Ultimately, if someone has made a mistake or something unforeseen occurs, someone has to take it on the chin. The contract cannot prevent disputes occurring. However, it can require the parties to deal with them efficiently. Partnering and alliancing contracts will typically seek to manage disputes, for instance by creating dispute boards to deal quickly with issues arising during delivery. This is definitely a positive development, particularly on larger projects.

Lowe: To what extent do you consider that conventional structures for delivering construction projects which comprise the employer, professional advisers and project manager, a main contractor, subcontractors and suppliers, contribute to the substantial number of disputes which the industry experiences?

Harbage: Many construction disputes involve complex arguments as to causation, particularly if culpability for a defect is a mix of design, workmanship, interface issues or operator error. A potential solution to this, which is becoming more prevalent, is project insurance, where all the parties are effectively joint insured, and the insurance pays out for a loss irrespective of blame. The downside is the additional cost – the premium is usually paid for by the employer – and the excess on any claim can be quite high, particularly for any business interruption endorsement. However, it can be particularly beneficial in high value energy projects where losses could exceed the amount of liability insurance maintained by most of the parties engaged in the project.

Peel: From the client's perspective, I do not see having a team of skilled advisers – including the contractor – as being a negative. In particular, it is essential in my view to separate design from cost, and also to have strong independent project management. As soon as these roles are merged, the risk of conflict heightens, to the detriment of the client. From the contractor's point of view, a larger supply chain clearly makes coordination more complicated. It also makes more likely a weak link in the chain. However, I do not see what options the contractor has here other than to utilise a tried and trusted supply chain – when someone new comes in, there is always a risk. Equally, relationships break down and people move on. The conventional structure, particularly from contractor downwards, clearly contributes to disputes. However, I am not sure how it could be done differently and in a way to

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Tom Peel,
Walker Morris LLP

avoid disputes. Money will always solve the problem, but this is usually in limited supply on a construction project.

Lachheb: I observe the following principle in practice: the more interfaces you create within a project, the more exposed to claims and disputes the project becomes. A multilayered and interfaced project will necessarily lead to greater or unmanaged risks. The principles of cooperation and transparency need to diffuse within this conventional structure. Practically, areas of cooperation should form naturally: contractor with suppliers and subcontractors, and owners with engineers or architects.

Hanson: I think the conventional structures for delivering projects reinforce the longstanding issues that the construction industry has faced for decades. They fragment the value chain, establish and maintain contractual silos that parties are not incentivised to work across, and disproportionately distribute risk. This delivery model is a primary contributor to the number of disputes the industry experiences, which has generated and reinforced self-preservative behaviours. Concerning risk, I think the greatest particular paradigm shift we can experience as an industry is to move away from 'the party that can best manage the risk, owns the risk'. It would improve our approach and success of delivering projects immeasurably if we were to accept the obvious: the 'project' owns the risk and it should be managed as such, meaning collectively by all parties.

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>
> *Jules Harbage, Walker Morris LLP*

Lowe: Looking ahead, what is the outlook for disputes in the construction sector? What key developments do you anticipate over the coming months?

Lachheb: The construction industry is a very conservative sector. The scale of time to shift from the current culture could be years. In order to accelerate the change and provide responses to the current challenges, this industry is in real need of

a catalyst. I see this catalyst in the development of digital and artificial intelligence-backed tools, which are likely to create an environment of increased cooperation and transparency between project players.

Hanson: It is impossible to predict, but we have seen a steady pipeline of disputes. We certainly have not seen anything to suggest that current trends will not prevail given the continued use of familiar commercial and contractual structures. Given what has happened to Carillion, and the continued financial distress of construction firms generally, it will be interesting to see how insurance companies respond over the coming year or so.

Harbage: Construction activity is currently very busy on live sites, with other projects due to start soon. We are not experiencing any material slowdown associated with fears of recession and Brexit, and we are seeing a number of speculative commercial developments at the moment. Although it has been reported in the media that some companies are postponing plans to invest in expansion and growth, which could influence construction activity, we are not seeing this trend at the moment. As a consequence, it seems inevitable that, across the industry, disputes will arise out of these forthcoming projects. As such, disputes are likely to remain at a high level over the coming months and years. One key development may be a greater use of the expedited arbitration provisions under the International Chamber of Commerce arbitration rules. These came into force in 2017 and automatically apply to any dispute under $2m. The expedited procedure provides for a decision within six months, and therefore provides a much quicker and more cost-effective resolution for parties using arbitration as their main dispute resolution process, which is common for international contracts.

Peel: I cannot see any reason why the level of disputes will reduce any time soon. In particular, any slowdown in the market, whether caused by Brexit or otherwise, will inevitably lead to increased use of dispute resolution clauses. We also need to see what will come out of the Hackitt review. Long term, I do believe that advances in design modelling and modular construction will see a radical change to procurement in the construction market. A large number of uncertainties will be removed from the current processes, giving better control of cost, quality and programme. This, in turn will hopefully reduce disputes. However, I am cynical about the prospects of reducing disputes in the traditional sector. Market forces, together with economic, commercial and political pressures are too powerful and prevent the radical changes that would be necessary to procurement processes. CD