



Why Construction Disputes Occur and How to Promote Early and Amicable Settlements

Michael Harris

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1. INTRODUCTION

Most construction projects, irrespective of size, type, and location, are subject to claims and disputes of numerous kinds. Claims are not parochial by nature. They are not peculiar to specific legal systems, languages, or cultures, or exclusive to certain materials or processes. Construction is full of risks involving all stakeholders in a project. How and when these risks are identified and managed will facilitate overall success and will determine if each member of the team serves the mutual interest of all and the project itself. Not all risks can be foreseen, and often it is the unforeseen impacts that create increased distress and conflict amongst the parties due to lack of understanding, insufficient planning, and inadequate claims and disputes process management ability that results in an adversarial situation which can escalate exponentially without resolution, particularly where large sums of money are involved and neither party is willing to move from its stated position, notwithstanding the basis of merit.

The most effective way to deal with construction claims is through a common doctrine of prevention and/or early recognition and efficient change management utilizing solid contract documents that identify and allocate the construction risks between the parties in concise and defined language, understood and utilized by everyone. Unfortunately, such idealistic circumstances rarely, if ever, occur. However, even where such conditions do not exist, given the appropriate actions and application of contract administration processes by the parties involved, it should be possible to promote a set of circumstances that will help facilitate, if not early resolution, a general settlement at a later date.

Construction claims can manifest themselves in numerous ways as combinations of key contributory factors as diversified as interpretation of contract documents, legal systems, cultural perspectives, statutory regulations, inter-party communications, and even personalities. Disputes can arise at any time and any stage of the construction process from concept through bidding, engineering, procurement, and construction and even post-completion after the project has been handed over. Construction disputes are universal but much can be done to manage the consequences of such core issues as delay and disruption, particularly given that in today's world it has never been easier to "manage the risks of change and to prevent what, in the past, was thought to be the inevitable knock-on effect on completion."¹

It is sometimes said that the collective noun for the parties to a construction contract should be called an "argument". It is unfortunate that such a comment all too often rings true. As soon as the parties have signed a contract, whether between the main contractor and owner, contractor and subcontractor, owner and supplier/vendor or design consultancy, or any other combination thereof, the complexity and often burdensome processes involved with individual party interpretation and application of contract language, drawings, specifications, statutory regulations, etc., begins and

¹ Delay and Disruption in Construction Contracts, Keith Pickavance, Third Edition, 2005, Introduction and Terminology, p. 1.

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continues until the end of the project. It is this self-interested interplay between the various contractual relationships, thousands of supposedly coordinated construction documents, overreliance upon misunderstood or misinterpreted legal precedents and systems, and a combination of numerous other applicable factors, coupled with the commitment of the monetary risks and financial stakes involved, that provides a breeding ground for lack of trust and the rapid creation of an adversarial atmosphere between parties, often from the beginning of the project.

Notwithstanding the plethora of contributory factors that can and do create disputes on construction projects, there is, however, one factor that stands out with regard to its ability to provide both a negative framework in the development of disputes and a positive foundation in helping resolve them, and that element is communication. Webster's Dictionary defines "communication" in part as follows:

... the act or process of using words, sounds, signs, or behaviors to express or exchange information or to express your ideas, thoughts, feelings, etc., to someone else; a message that is given to someone: a letter, telephone call, etc.; communication: the ways of sending information to people by using technology.

All too often, the lack of exchange of information and/or comments and concerns, or not communicating contemporaneously, or at all at any stage of the project, simply provides the basis for a dispute to crystallize and grow from what can seemingly be a benign and innocuous beginning into a complex, expensive and, on its face, irredeemable issue of contention with a life of its own.

Communication as one of the core drivers of and key reasons as to why construction claims develop is not, however, exclusive to the interface between the various contract parties involved in a construction project. It also relates directly to the individuals within a single party. For example, where the Contractor's project team does not communicate well with its own upper management, this can lead to misunderstandings about, inter alia: 1) the real status of the project both in time and cost as opposed to the internally reported level, 2) the veracity and basis of merit of any changes and potential claims, and 3) commitment of management to support the onset of the adversarial process based on the wrong or poorly defined premise.

A primary difference between situations that avoid disputes on a project and those that do not is that disputes are avoided when the participating organizations and the project team working together have the ability to develop an open communication strategy regarding issues of concern to a participant and are

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*committed to resolving issues in a proactive, cooperative, and timely manner as they arise.*²

Where good and detailed communication exists at all stages of a particular issue and throughout the project, and from all parties involved, it provides a solid foundation upon which to facilitate an early solution of a specific isolated problem or a documented basis for resolution at a later time of much larger encompassing disputes. All parties involved are part of the communication process from the beginning. When good communication exists, the parties have a more realistic and better understanding of the risks and implications of the various contributory parts and facts of the dispute as presented, and it is clearly easier to reach an agreement based on timely and detailed information, even if it is questionable, than where the information is lacking or does not exist at all.

Timely and positive communication fosters the potential avoidance of disputes and claims, allowing the parties at least to attempt to resolve specific matters before they develop into more complex and larger adversarial issues. There is, of course, no guarantee that even when excellent communication has taken place that resolution and settlement will occur without additional due diligence and assistance by third party regulators. However, given the nature of the dispute process, whether it be negotiation, mediation, arbitration, litigation, or any other ADR approach, the presence of a bulk of contemporaneous communication and materials can only help to bring parties closer together and provide more definition for a fair and reasoned judgment and award.

Numerous articles have been written that describe in great detail the plethora of causes of why claims occur. Accordingly the intent of this article is not to follow a list of contributory mechanical issues but to provide an outline of some of the lesser discussed reasons why claims and disputes occur during the construction process and to demonstrate that, by following a simple approach to the effective management of such issues, the opportunity to avoid claims, foster early resolution of changes and/or promote settlement of disputes can be greatly increased. The concepts involved are not complex and relate to common sense basic principles of project and construction management, which, unfortunately, are all too often found lacking even on major projects and amongst sophisticated global construction stakeholders.

² Guide to Leading Practice for Dispute Avoidance and Resolution, CRC Construction Innovation, November 2009, Managing Disputes, p. 28.

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2. THE RFP / BID STAGE

The process of preparing the construction contract, whatever the size, may be divided into three simply defined parts:

1. The decision of the type of contract and the terms and conditions under which the work will be carried out
2. The selection of the contractor
3. The establishment of the contract price or how the price will be determined

2.1 CONTRACT

If a standard contract form is not used, owners often develop their own ad-hoc form. In this latter regard, owners can expressly attempt to redefine and reallocate all of the construction risks in their favor, often placing undue burden on the contractor. The ad-hoc form can be poorly drafted and, therefore, create a myriad of problems related to lack of terms definition, misinterpretation and misunderstandings and lack of legal guideline precedence. Furthermore, the over-apportionment or lack of definition of risk can cause a contractor to increase its price to a point of being noncompetitive, or failure by the contractor to recognize such risks at the bid stage can create disputes during the execution of the contract when the contractor attempts to recover its unanticipated risks as they transpire through the contractual change mechanisms.

It is essential, particularly where ad-hoc contract forms are used, that experienced legal input is utilized to redline the contract for clarification, definition and negotiation purposes. Redlining contract forms is a common practice that helps both parties to better understand the operational parameters of the terms and conditions. If a contractor does not clearly perceive the meaning of a term or allocation of a risk, it is again vital that this be raised and expressly clarified at the pre-bid and pre-contract stages, otherwise it will almost certainly result in later conflict and disagreement.

The contract provides the legal basis of the obligations, rights, and entitlements of the parties, so it is crucial that both sides, where possible achieve common ground on how the contract reads and is to be implemented. The only way to do this effectively is to raise questions through the pre-bid Q&A or redline process and seek at least clarification, if not joint agreement regarding comprehension of specific clauses. Not to do so is a guaranteed recipe for a dispute to occur. Contractors either fail to do their due diligence with the pre-bid contract review or make unilateral assumptions about interpretations, both of which can prove to be costly.

One area where this approach cannot be applied is with Federal contracts under FAR (Federal Acquisition Rules). The Federal government does not allow any changes to the contract form, and any participating contractor is expected to be entirely familiar with and understand the basis of the contract terms and conditions. This places a very specific emphasis on the contractor to be

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thoroughly versed with all aspects of FAR, as no excuses to the contrary are acceptable at a government and/or supporting law level.

2.2 *CONTRACT DOCUMENTS*

If the RFP and/or contract documents (contract, drawings, specifications), are not properly prepared and coordinated, and/or if they contain errors, particularly of magnitude, this creates ample latitude for both parties to facilitate disputes during project execution. From the owner's side, the position is usually one of denial, placing the emphasis upon the contractor to resolve such document conflicts from an "assumed all risk" umbrella, particularly under a lump sum fixed price contract. The contractor adopts a contrary position of "defective specifications and drawings" which on its face has considerable case law and legal support, but this does not necessarily provide a timely solution to the discrepancy, which can result in an expansion of the dispute at a time when it needs to be resolved expeditiously for the benefit of the project. There is no shortcut regarding an owner expending time and money upfront to provide a properly coordinated and prepared set of RFP and contract documents. However, the rush to achieve a commencement deadline coupled with the quick and simple ability to electronically "cut and paste" from other projects can result in serious documentation errors.

Clearly, the requirement is upon achieving a fully coordinated and correct set of contract documents which benefits everyone involved in the project. However, there is no such thing as a perfect set of contract documents, as mistakes and errors of some form will always be present. The key is to minimize both the presence and effect of such issues through prudent and detailed reviews by the participating parties, as well as ensuring that the contract provides express procedures to be followed when errors are discovered, where the liability resides, and who is responsible for the appropriate redeeming actions. Many ad-hoc contract forms fail in this latter regard.

Contractors are sometimes afraid at the pre-bid stage to highlight document errors or discrepancies on the premise that it will somehow disqualify their tender or work against them in some way. However, such an approach places the contractor at risk of having assumed responsibility for the issue during construction if prior notice is not given during the bid stage.

It is not unusual for Contractors to be placed under considerable pressure to review and issue their bid pursuant to a short tender period. If the contractor is not allowed sufficient time to properly review the RFP documents and facilitate a competitive price, two negative outcomes are likely to occur. One is that the contractor's price will be high to make sure that any risks that could not be fully ascertained during the bid process are covered by some level of built in contingency. Secondly, the price may be too low for failure to recognize potential cost impacts associated with such risks. In both cases, the end result is likely to end up in a dispute when the risk arises. If the contractor's price was high, the contractor may still attempt to claim for additional costs of the risk when it occurs irrespective of any internal contingency allowed for in its bid, unless the

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contingency itself is expressly identified in the bid. If the contractor's price was low, the contractor will fight to recover costs not allowed for in its contract price.

The assumption of risk is part of any construction contract. It is paramount, however, for the contract to be executed successfully that all foreseeable risks are identified within the contract documents, allocated to a specific party and management/action processes are identified. Similarly, for any unforeseen risk, the contract documents must also expressly identify the processes to be followed in order to manage such risks. If this is not done fully and correctly, the end result will be a plethora of claims and disputes, with both parties fighting over contract language and risk interpretation. The contract must be expressly specific about the mechanisms to be followed by all parties when changes and risk events arise. Standard contract forms through committee development over many years provide solid frameworks; however, ad-hoc contracts by their very nature as one-off forms may not. If the contract is in any way lacking in this regard, the onus is upon the contractor to question such discrepancies during the pre-bid Q&A stage, requesting answers about interpretation of specific contract clauses, if not thoroughly understood, and/or lack of definition of risks and change management processes to facilitate potential conflict reduction.

A key purpose of drafting solid contract language is to avoid claims and disputes. Notwithstanding, whatever and however the contract defines the recognition and management of risk, it must provide mechanisms which allow the progress and continuing operation of the project, even if an issue is in dispute, to avoid costly delays if immediate resolution cannot be achieved.

2.3 QUESTION AND ANSWERS (Q&A)

Most contractors fail to make sufficient use of the pre-bid Q&A opportunities prior to finalizing the tender price. Contractors however must never be afraid to use this stage of the process to raise any questions and concerns about the RFP, including but not limited to: 1) the interpretation, understanding, and operation of the contract itself, 2) risk and change mechanisms, 3) clarification of errors and discrepancies, and 4) any other issue that will help facilitate a competitive package. Furthermore, when a question is raised and a definitive answer is received, it provides an express framework for a specific issue that should help avoid the onset of a dispute if and/or when the matter arises during the project. At the very least, it provides a written record of the interface and potential agreement between the parties which is difficult to refute at a later date.

The author has witnessed many examples of where a sophisticated major contractor on a large, complex project, during the pre-bid stage, has failed to raise a single question regarding the RFP package, or solicit any additional information that would help with its tender preparation and potentially avoid claims and disputes during construction execution. If and when a claim does occur, a key part of reviewing both liability and entitlement is to look back at the contractor's basis of bid and particularly the Q&A sequence prior to the bid and contract execution. If the contractor

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raises a question after contract award that could and should have been raised during the pre-bid Q&A stage, the potential for the presumption of risk being placed on the contractor is high.

Clearly, not all issues can be raised, questioned or even recognized during the project bid stage; however, when more clarifications are sought by the contractor during this period, fewer issues of dispute will result at a later time. A contractor may be disqualified if he attaches a list of pre-qualifications with its bid; however, no contractor can be disqualified for seeking clarification and asking questions during the pre-bid period.

2.4 THE BID

The lowest bid does not necessarily mean either a qualifying or solid basis of bid. If a contractor is desperate for work or simply decides to buy the contract for whatever reason, this is likely to facilitate a low bid that may not support the full execution of the project without recourse to claims for additional money and/or time. In the private sector, there are generally no specific rules or laws that require an owner to question the lowest bid with the exception of a number of legal precedents regarding the correction of bid errors. In the government sector, however, under FAR, where there is a considerable price difference (usually 20% plus) between the lowest and second lowest bids, the government is under an express obligation to notify the lowest bidder of the disparity (without providing cost or quantum details), and requesting the lowest bidder to reaffirm or amend its bid. If the government does not do this during the bid and contract negotiation stages and awards the contract to the lowest bidder who then discovers the disparity post award, there is legal precedence for the contractor to challenge the basis of its bid price and attempt to recover additional monies that it may or would have included if it had been advised of a bid level price disparity. Even if the contractor is not aware of the detail of the differences, it clearly understands that a 15% or 20% difference or more exists pursuant to the government's notice in this regard.

Where there are clear levels of pricing difference between bids, the owner should take appropriate steps to assess why such disparities exist and what action to take, if any, to verify the basis of the differences. For example, two or three bids that are close together may indicate a solid and reasonable contract price; however, a bid that does not conform to the group datum average, particularly if it is lower may indicate a potential problem with the bid. Significantly low bids raise the question: Can the contractor actually execute the contract for the price quoted without recourse to a series of change requests and/or claims?

It is not always easy for owners to analyze or question such bid differences, particularly as raising a question about a basis of bid may well cause the low price to change upwards when the contractor is faced with either amending or reaffirming its bid. However by simply asking the question of the contractor in this regard, the owner is potentially avoiding or reducing the onset of future claims facilitated through a low basis of bid or, at the very least, providing a much stronger foundation to rebut later associated change requests.

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An owner is always drawn towards the lowest bid price for the obvious financial reasons; however, if they fail to undertake any bid relationship due diligence, they are likely to discover themselves embroiled in a series of potentially avoidable disputes during project execution related to the contractor's bid price. The fact that a bid is questioned and/or reaffirmed during the pre-award stage is no guarantee that claims related to bid price will be avoided; however, it is always better to raise concerns and questions before and not have them surface after the contract is awarded. It is not an easy decision for an owner to question a low bid to the point of rejection, but the cost of accepting such a bid can result in major disputes and the potential exposure to considerably more cost and expenditure in fighting and resolving the matter compared to an increased bid based on pre-contract discussions and negotiations.

Of high potential for bid abuse in terms of a contractor buying a project is with regard to government IDIQ (Indefinite Delivery, Indefinite Quantity) contracts. Under such an open operational framework, contractors will often low bid the first contract with the intent of getting a "foot through the door" and establishing a relationship with the owner or government entity in order to facilitate a chain of future contracts based on more realistic and profitable bid levels. However, the first low bid contract depending upon the bid/execution price disparity may still result in the contractor fighting to recover lost monies, damaging contractor and client relationships for future work (the very opposite of what the contractor was attempting to achieve), and may even cause the contractor to overbid future contracts in an attempt to recover the initial low bid losses.

2.5 *BID QUALIFICATION*

Where the RFP stipulates that a contractor is not allowed to pre-qualify its bid, this can result in either the assumption of risk in the bid for specific issues and items that the contractor may not be prepared for and, hence, will fight to recover at a later date, as and if such risks occur, or the bid price itself will be pushed upwards to cover such factors, sometimes to the extent of making the contractor less or even non-competitive.

Government contracts usually do not allow contractors to pre-qualify bids. This can place the contractor from the onset of the award in a dispute mode questioning issues under the umbrella of "presumptive risk" based on the unqualified bid process, and is certainly a major contributory factor as to why so many federal contracts end up in some kind of dispute forum. This is not so with the private sector. The very basis of a pre-qualification potentially clarifies areas of contract risk that need to be resolved and allocated prior to the contract award. Where both parties jointly review a specific item or series of pre-qualified risk factors prior to the contract award, the potential for a conflict arising from such matters during project execution is greatly reduced through express clarification and agreement.

Where pre-qualification of a bid is not allowed, and even under federal contracts, there is nothing to stop a contractor during the pre-bid Q&A stage seeking clarification of any issue or item

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accordingly. In fact, it is essential that the contractor follows this approach for the obvious reasons of contract clarity, basis of bid, and the potential avoidance of claims.

2.6 PROJECT BUDGET

Where an owner has not completed its due diligence with regard to contract budget preparation matching the basis of the project design and execution and when the budget is tight or no contingency is allocated, this creates the increased potential for disputes and claims as the owner has little or no flexibility with regard to approving required changes as the project develops.

It is essential that any construction project should have some level of contingency allocated to the budget process as projects are rarely, if ever, executed without some level of change occurring. If the owner cannot accommodate changes, the project will invariably suffer. Owners will want to facilitate changes for the benefit of the project because no set of contract documents are perfect with regard to fully covering the project requirements and contractors will want to be paid for implementing such changes. Any kind of dichotomy between the two will result in claims and disputes.

The emphasis is upon the owner to solicit the appropriate funding before the project commences. While this may appear to be obvious, it is not always the case. Furthermore, if a project undertakes changes to the extent that the budget and/or contingency is used up, this creates a situation where the owner has no ability to accommodate further changes or settle contractor change requests and claims which will then create the onset of a dispute.

While owners have an obligation to facilitate appropriate funding to fully support project execution, a similar emphasis is placed on the contractor in terms of its bid preparation covering both foreseeable and sometimes unforeseeable risks, depending upon the risk allocation expressly described in the contract documents, through accurate cost analysis and the application of a contingency sum either internally allocated or externally and expressly declared.

Contractor allocated contingencies are often the subject of dispute as to who benefits from its appropriation. For an externally declared sum identified within the contractor's bid, the owner will attempt to use the contingency for owner initiated changes, thus accommodating the costs within the original bid price, while the contractor will want to expend such monies to cover the occurrence of risks that are within its contractual scope.

The process of managing contingency sums can create disputes between the parties. An internal and undeclared sum by the contractor as part of its bid is easier to manage but can result in problems regarding how much to allocate compared to the risks that may occur and in terms of facilitating a competitive bid.

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An owner requirement for a contingency or provisional sum in the RFP and bid may or may not provide a better definition of its use and allocation but in the absence of a clear and unequivocal contract stipulation in this regard, the process is open to potential dispute as to whom the money belongs.

Conflicts regarding use of contingency can be limited if all parties involved in the project agreement understand the purpose of the contingency and how it will relate to their respective roles during the course of the project execution.

2.7 *COMMUNICATION*

The RFP and Bid stage of a construction project is full of potential pitfalls and risks that can result in a series of claims and disputes during the actual execution of the project. However, all of the above issues and processes have one clear and undisputed overriding common factor involved that helps to avoid and/or resolve the onset of disputes. That factor is consistent, express, and open communication between the parties at every stage of the project.

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3. PROJECT EXECUTION

This can for sake of brevity and clarity be split into the three separate disciplines related to EPC work:

1. Engineering and Design
2. Procurement
3. Construction

The above processes interface in different ways depending upon the type of contract utilized, i.e., lump sum turnkey as opposed to the more traditional design/bid/build. However, the fundamental issues found at the core of potential disputes resulting from the baseline disciplines are not dissimilar.

For the most part, the majority of conflicts and disputes arise during the construction stage of the project. This is where previously unknown design, bid, procurement issues usually manifest themselves as part of the execution process, where both time and cost factors assimilate themselves in a critical matrix that can cause the project to become embroiled in a series of claims and disputes, which if unresolved can severely and negatively impact all parties involved and the project itself.

There are a plethora of reasons and combinations of causes as to why claims and disputes occur during the project execution phase, and there are numerous articles that describe such factors in detail. The following sections highlight some of the key, fundamental, underlying, repetitive, and sometimes misunderstood foundations of why conflicts occur during the project implementation stage, based on the author's extensive experience on major global EPC projects.

3.1 EPC FORMAT

Where an EPC contractor has sufficient contractual leeway to provide a design that satisfies the owner's RFP and/or performance specifications and its own basis of bid in terms of design and construction expertise coupled with a competitive tender price, and where some design assumptions may not have been declared during the bid process, there is always considerable risk that both parties have moved into a construction agreement whereby the expectations and requirements of the owner and contractor are at odds with each other.

Disputes can occur because of undeclared and misunderstood differences between the parties as the project moves from contract award into the design and detailed development stage. If the project is of a particular type, for example, a Power Station or Water Treatment Plant, where the contractor was selected based on its specific and perhaps extensive experience of similar projects, the contractor is likely to favor specific factors in the design and procurement process that allow it to be competitive, providing they are not in conflict with the basis of the RFP and any pre-contract

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negotiations and declarations. However, any assumptions and allowances the contractor has made in its bid do not always translate directly into owner expectations and needs.

A contractor will use standards, materials, and equipment that it considers will meet the RFP and the contract requirements. This allows the contractor to be competitive and provides a foundation for a planned, realistic, and understood framework for construction based on previous and similar experience. As the contractor submits the design through the various stages of the owner approval process, conflicts can occur and manifest themselves in two distinct ways:

1. Both parties end up in a series of disputes as the design develops which if unresolved in a timely and positive manner create project delays and foster mistrust and poor inter-party relationship problems thereafter. This occurs where the contractor's submittals are in conflict with the owner's expectations, notwithstanding the basis of bid and any pre-contract interface. More often than not, the owner will not want to pay for any changes to the design as the owner deems them to be included in the tender price and believes it has the right to request or instruct changes on a "no cost" basis because "that was what they wanted in the first instance" even though the RFP may not have been specific or even declaratory in this regard.
2. Contractors accept minor owner requests and small changes during the design development and approval stages without fully understanding the potential time and/or cost ramifications that can result at a later time. This accords to the much noted construction principle of "death by a thousand cuts". Contractors, particularly at the beginning of the project, will go out of their way to avoid upsetting the owner in this regard. It is all too easy for a contractor during the numerous approval and review stages to accede to minor drawing and specification changes and developments, only to discover that it has utterly failed to comprehend the impact to the procurement and construction process. Depending upon the magnitude of the cost impact, the contractor in all likelihood will end up disputing the additional costs.

3.2 EPC CONFLICT OF REQUIREMENTS

If an owner fails to fully understand the basis of how the project has been bid under a turnkey EPC umbrella, for example, compared to their own desires and needs, claims and disputes will occur. If the RFP and contract documents do not fully reflect what the owner wants and/or expects, or give the contractor sufficient leeway to make certain allowances in its bid, the project is likely to suffer as any differences surface during the project development.

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It is absolutely essential that open and continuous communication between the parties exists at all times. While not every contingent risk or change can be covered, the concept of avoiding future conflicts and disputes through an express interface process at each and every stage of the EPC process, particularly during the preparation and coordination of the design package is fundamental to supporting the reduction of potential claims during construction.

3.3 EPC COORDINATION

Any significant lack of coordination between the parties at any stage of the project, even within each individual participating party's own organization, will result in disparities that foster change and create disputes.

In the rush to submit a successful bid, contractors can fail to pay the required attention to the contract start and completion dates specified in the RFP. If the contractor fails to analyze the realistic achievement of the contract period for the particular type, size, and format of project to be built, no matter how well specified and detailed the design, the project is likely to fail because of unrealistic time constraints being imposed against the risk of liquidated damages for a late finish. This is further exemplified if the contractor's detailed schedule lacks sufficient and careful coordination of items such as key procurement milestones against construction needs. The risks associated with key procurement items should be built into the main construction schedule as core activities, and this is particularly vital if equipment or plant is being provided by the owner. While this may appear to be obvious, the author has witnessed many instances of such occurrences creating major project delays that could and should have been avoided with the application of a simple "common sense" approach and general due diligence by both parties.

A factor that is often missed by contractors is the risk involved with the procurement and delivery of a key construction item or piece of equipment compared to the overall risk of a resulting delay to overall project completion. For example, if a key item is procured from a supplier and it is crucial to the project schedule, the contractor will correctly impose liquidated damages in the purchase order with the vendor to cover the contingency of delay. However, where the process may break down is the level of damages potentially levied against the vendor under the PO agreement compared to the contractor's exposure of LD's under the main contract. Where a major equipment vendor may well accept say for example \$3,000 per day in LD's for being late with its delivery, the contractor may be facing \$25,000 per day under the main contract. It is unlikely that the vendor would accept LD's to match the main contractor's exposure, thus the contractor is placed at considerable risk in this regard. One way to attempt to avoid such an occurrence is for the contractor to manage the vendor supply on a critical day by day basis, perhaps having a contingency plan in place in the event a delay occurs. Another means of mitigation is to provide third party insurance to cover any such contractual gaps. No matter what occurs, communication with both the vendor and the owner is vital to facilitate a possible "work around" and alternatives.

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If the owner is part of the process through open communication, the opportunity to avoid LD's and end up in a dispute can be marginalized.

3.4 *COMPLIANT NOTICE*

Failure to recognize an impact issue and provide timely notice pursuant to the contract can prove fatal with regard to entitlement and the right to recover losses. Contractors must be aware of and apply the contract notice clauses otherwise they run the risk of losing any entitlement to claim for additional cost and/or time, even if the basis of the claim has merit. This is probably the singularly most crucial but repetitive factor as to why contractor's claims can fail. Numerous articles have been written about the use and application of contractual notice compliance and the intent of mentioning this as an issue is to simply highlight the fact that contract notice expressly relates to the key and fundamental component of contractual communication between the associated parties.

3.5 *PERSONALITIES*

Effective communication between the contracting parties and its potential for breakdown, abuse, and failure can be observed in a common trait and occurrence that is not covered by any express or implied clause of a construction contract. The concept is one of personality and the potential for clashes to occur that are allowed to negatively impact the project itself.

Because of the risks, high stakes, and the overall investment of resources and finances involved in a construction project, the potential exists for individuals in a position of management power to quickly adopt an approach of individual and/or company preservation, ignoring the basis of the contract agreement and its fair and reasoned administration and application. Once this occurs, it is often not recognized until it is too late to avoid conflict, and even then it is sometimes ignored where one or both of the parties have committed themselves to a particular position irrespective of what a reasonable interpretation of the contract may or may not be.

Such instances can occur at any stage of the EPC process; however, they are probably most prevalent on site where conditions in terms of time and cost are at their most critical. Senior management oversight and site reporting provide the potential to control and resolve such matters before they spiral out of control. However, for this approach to work, it involves timely, regular, effective, and honest reporting and communication.

If caught early enough, the intervention of other uninvolved parties can provide an amicable resolution to such problems. Without such interface, a situation can quickly be created that fosters a non-cooperative atmosphere, negatively affecting everyone involved, and impact the success of the project. This can happen with personalities between the contracting parties as well as internally within any one party. Simple, constant, and open communication can only help and not hinder, a concept that is all too often found lacking.

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4. POST PROJECT COMPLETION

4.1 BALANCE OF POWER

Once the project is complete, the balance of power and leverage between the contracting parties changes and is moved from the contractor to the owner. During construction, the contractor has the potential for applying some level of leverage to facilitate and agree on changes as the project is still ongoing and depending upon the circumstances involved, the possibility of achieving completion without a series of ongoing and protracted disputes can sometimes help promote flexibility towards the possibility of settlement. As soon as the owner has taken possession of the project, the ability to foster an agreement using the project itself as a basis of discussion is dramatically decreased, if not eradicated. The contractor has very little left of substance to bargain with other than to be faced with the onset of expensive dispute resolution procedures to recover the monies to which it believes it is entitled.

Any claim or dispute that can be settled early and particularly while construction is ongoing is likely to be a better all-around solution for both parties than allowing the matter to continue post completion, even if one or both parties compromise with regard to the nature and level of any such settlement.

4.2 PROJECT LOSSES

Where the contractor is faced with financial losses and the owner is faced with the possibility of paying additional and unbudgeted costs, the potential for the continuance of a dispute is increased considerably. Neither party wants to concede its position, particularly where the monetary gap is substantial. This is where control of the disputed issues moves from site management to corporate, and the aspect of shareholder responsibility and profit and loss can override a rational settlement approach.

Where potential losses are substantial, it is sometimes difficult for a party to recognize its true exposure from one based on hopeful and wishful thinking. If company management is not fully aware of its true or reasoned exposure, it can often be misled by the project team in terms of level of expectancy and recovery and adopt an intransigent position based on incorrect information instead of reasonable negotiation. Where company management has been involved in the project on a regular basis during execution, the prospect of such an occurrence is greatly reduced. Management often takes a cursory review of a project to satisfy whatever oversight procedures it deems are acceptable, perhaps one project of many, and relies upon the site team to provide and dictate the basis of the developing dispute. If the site team, for example, has made unreported mistakes that have contributed to the potential or actual losses or failed to grasp and better understand their specific entitlement and rights, such a situation does not usually foster a later and open admission of their errors to upper management.

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Claims or unresolved contract changes should never be booked or allocated as company assets or revenue. Contractors desperate to support their bottom-line losses continue to implement such procedures in order to bolster the company books pursuant to an audit or satisfy bank loan oversight. This process is dangerous in several respects, not least of which means that if a settlement is achieved but the final figure is less than allowed for on the books, a loss is still recorded and the contractor takes a financial hit. The very process of booking claims as revenue promotes unreasonable claim figures to improve the company financials as much as possible and this also reduces the contractor's ability to negotiate a reasoned settlement as anything other than a full recovery pursuant to the booked asset is a direct loss, even if the claim figure had little or no merit in the first instance.

4.3 *LAWYERS / EXPERTS*

Companies sometimes involve lawyers, often specialized construction practices, too early in the resolution process. As soon as one side involves a law firm in the claim process, the opposing side is effectively forced to commit to the same. This then further commits the parties to increased expenditure and risk of recovery in order to continue with the dispute process which in turn creates additional pressure both in terms of financial obligations and timing. While law firms provide a valuable service, the question is at what stage of the dispute should parties bring in legal counsel? If a law firm or expert is doing its job correctly, it should provide its client with an early assessment and analysis of success to enable a rational decision regarding dispute resolution. Notwithstanding, the introduction of legal teams can sometimes over complicate issues and create the proverbial drawing of "lines in the sand" and battle cries from both sides.

Failure to understand the settlement processes described expressly in the contract as well as the general dispute resolution procedures available to parties in conflict clearly works against both sides. This can be further exasperated by a general lack of appreciation and understanding of the nature of the claims involved, the true nature of entitlement and reasoned recovery, the "blinding" effect of financial losses irrespective of fault, and general failure to have a game plan towards settlement. All of these factors involve the concept of project communication at all levels and timing in order to achieve the desired result of a reasoned and equitable solution that each party can understand, accept, and move forward with. Unfortunately, this concept is found lacking in many construction players, large and small, sophisticated or otherwise.

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5. THE SETTLEMENT PROCESS

The following is a list of some of the key concepts and actions by and between the parties to a construction contract that promote the increased potential for the settlement of disputes as and when they occur. The list and commentary is by no means exhaustive but provides a framework which, if implemented, will help build a reasoned pathway to project success and achievement of amicable completion.

5.1 COMMUNICATION

Open communication at all stages of the project. As described hereto, perhaps the primary reason for the onset of disputes and lack of early resolution of claims is the failure to communicate issues and problems until it is too late and a dispute arises. The prospect of an open communicative forum is not always conducive to the construction process; however, even under the most extreme of circumstances, such an approach, no matter how disparate can help provide potential grounds for resolution, if not at party to party level, by an independent third party. It can also increase acceptance regarding the expectancy of success or failure. Open communication promotes negotiation, which is first and foremost the primary approach to early settlement.

5.2 THE CONTRACT

Pursuant to the issue of communication, the contract is the primary document that must be followed to preserve the rights and entitlements of both parties to the agreement. If the contract mechanisms are not managed and operated throughout the project in a timely and efficient manner in accordance with the express terms and conditions, this is a recipe for failure and conversely where the contract is correctly followed, preservation of rights and the opportunity to achieve success in a dispute is increased. Contract compliance promotes conformity of “notice” which is a vital element to any change or claim process and further fosters the production of accurate and detailed documentation in support of a party’s position. This in turn facilitates a factual and contemporaneous framework to a claim as opposed to a retrospective and less credible approach.

5.3 CONTRACT COMPLIANCE

Communication on a constant and reasoned basis between the parties cannot be overstressed in terms of the ability to provide a foundation for negotiation and agreement, no matter what the basis of the dispute. There will always be disagreements and the seemingly intransigent taking of sides; however, the party that has followed the contract and provided fully supporting and timely documentation will always be in a better position to succeed in a dispute forum. Contract disputes in arbitration or litigation are based on the “balance of probability” and weight of evidence.

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5.4 DISPUTE BOARDS

Where possible, include for a dispute board or adjudication process in the contract agreement. This provides an ongoing and contemporaneous mechanism by which a dispute or claim that occurs during the execution of the contract can be quickly resolved before it gets out of hand. This allows both parties to move forward with the issue resolved, at least on a temporary and relatively immediate basis to the benefit of the project in avoiding major delays during execution. If one party disagrees with the Board or Adjudicator's decision, it can always dispute it at the end of the project. However, such a decision by a qualified jointly appointed expert during the heat of the project often provides clarification and crystallization to a party regarding the future chance of success of overturning the decision in another and later dispute forum. Such an approach is not without risk for either party but it does help the ultimate goal of allowing the project to complete sooner rather than later in an improved atmosphere where the potential for mistrust, conflict, and the escalation of a dispute are at least in the short term put to one side.

5.5 STEPPED NEGOTIATIONS

Contracts sometimes call for senior executives from each side to get together in a stepped attempt to reach a solution when a dispute arises. This can prove effective if the personnel involved have not had a heavy or regular and active involvement in the project as this allows them to act more independently and openly during any discussions and negotiations. However, the timing and timeline of such an intervention where possible should be contemporaneous to avoid protracted discussions or one side simply dragging out the process through lack of interest of settlement for whatever reason of which there are many. If at all possible, both parties in dispute should attempt to establish communication links at management levels to maintain a general interface and the continuance of baseline discussions.

5.6 LESS CAN BE MORE

If an offer of settlement is made, particularly during construction execution, the contractor should give very careful consideration before accepting or rejecting the deal. Depending upon the circumstances, it is sometimes better to accept less money and/or time during the execution of the contract than hold out and fight for more at a much later date. Cash flow can be both the contractor's nemesis and king. A carefully rationalized acceptance of an early settlement may be of extreme benefit compared to nothing at all and the prospect of further risk and expenditure going after more. Both parties will benefit from a fair and reasoned approach in this regard.

5.7 REALISTIC EXPECTATIONS

Both parties must be realistic in their expectations of settlement success and exposure to risk. This however is easily said but harder to facilitate for many reasons as described above. One method that can help a party in dispute to reach a reasoned and clarified position is to utilize an expert

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consultant and/or law firm to help review the basis of the dispute and produce an independent report. Often for a reasonable investment in terms of consulting and legal fees, the party is provided with a better understanding of its rights and entitlement in terms of cost and time. It may not want to hear what it is told but its position will be further crystallized in terms of a decision about how and/or if to go forward with the dispute. An exhaustive analysis at the outset is not usually needed and a simple high level overview of a claim by an expert coupled with an outline legal review, if needed, can provide enough foundation to plan the next move. Any such outside expert report can then form the basis of further and more detailed analysis and reports if needed. The party can then negotiate from a position with some level of confidence, and avoid the pitfall of reliance upon its own staff that often has a vested interest in maximizing any form of recovery, irrespective of merit.

5.8 *LEGAL / EXPERT ADVICE*

Where legal and expert teams can provide further support to a party in dispute is with regard to helping them better understand the resolution processes involved, whether for arbitration or litigation, and the general level of expectation for success or failure. This also helps in the preparation of a budget for the dispute which must be planned on a realistic and rational basis against the value of the risk or claim.

5.9 *COMMITMENT TO THE PROCESS*

When a dispute arises and a decision is made to pursue claim preparation or defense, then the party in question must commit to the process. Where disputes reach the level of full blown arbitration or litigation, any kind of half-hearted approach and overall lack of commitment is destined to fail. Furthermore, no dispute resolution process, no matter how strong the evidence, no matter how positive the entitlement, no matter the level of confidence in the merit, is guaranteed success. The process is flawed in this regard; however, the chance of success can certainly be improved by adopting many of the project concepts and rationales described hereto. A party in dispute must always be prepared to lose, suffer the resulting consequences, and live with them.

5.10 *DANGEROUS PRACTICE OF INFLATING CLAIMS*

A party must never inflate its claim over and above any rationalized and provable level of cost and time with the intent of settling for less during negotiations and effectively attempting to recover its baseline figure. For example, a contractor inflates its claim by 50 percent and then hopes to settle for half the amount, thereby achieving its planned recovery goal. This almost never succeeds and is a dangerous concept. What the contractor will find out is that the inflated portion of the claim will often bring into question and damage the positive and entitled portion of the claim, reducing the prospect of a fair settlement or any settlement at all.

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5.11 MEDIATION AND MORE

Wherever possible during the dispute process, it makes sense for both parties as early as possible to attempt to negotiate. Where negotiations continue to fail, mediation is the next step. Mediation is relatively cheap compared to most alternatives and can be facilitated quickly if the parties agree to do so. What a successful mediation will do, even if both parties do not actually settle as a result of the mediation, is crystallize each side's position with regard to entitlement and risk. A party may have believed it had a strong position only to be told by the mediator that this is not the case. Such a comment from a qualified construction mediator should rapidly bring a party back to a reasonable level of reality and expectation which can only help towards facilitating a settlement. At the very least it will help to bridge the size of gap between the parties that existed prior to mediation.

5.12 POST-DISPUTE AUDIT

Any party involved in a dispute of any kind, at any stage or level, should, post resolution, hold an internal analysis and review to try and make sure that the reasons why the problem arose in the first instance are not repeated for future projects. While this makes absolute sense, it is not something that most construction contract stakeholders apply or undertake. A post completion project audit can only be positive for the future avoidance of claims. Contractors and owners should not, but do, make repetitive and costly mistakes time after time, effectively starting from scratch in each case, failing to communicate to the next project team and general management. The provision of simple procedures based on the premise of effective and timely communications can help claims and disputes to be managed and improve the chances of a successful resolution.

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6. SUMMARY

The evolution of dispute resolution in construction contracts has been significant in the last 20 plus years with the development and inclusion on a global basis of ADR clauses in standard forms of contract as well as ad-hoc owner forms. There is considerable variance in the cost of each approach with Negotiation being the most cost effective and reliable form, then in order of rising expenditure and risk is Conciliation or Mediation, followed by Dispute Board or Adjudication, followed by Arbitration, and finally the most expensive and time consuming of all, Litigation. Whatever the dispute mechanisms are as expressly defined in the contract, the parties should always be encouraged to adopt a staged approach at the onset of a dispute, i.e., maximize efforts to negotiate, and where possible stepped negotiations from lower to upper management based on an agreed timeline. Once the dispute moves from a failed negotiation to the next level in the chain, costs begin to increase, financial commitment and risk increases, and the prospect of the parties “digging in” begins to assume a different and more ominous perspective.

The maxim “prevention is better than cure” will always be the case in construction contracts and the concept of maintaining constant interparty communications as described hereto supports both ends of the spectrum in that it can promote early resolution through negotiation as well as provide detailed and documentary evidence through whatever cure process is utilized as the dispute progresses. The foundation of effective communication relates to “clarity of understanding” and involves both transmission and feedback, which can be verbal but, wherever possible, confirmed in writing to benefit the dispute process itself. If communications between the parties are successfully applied and managed from both sides, the chances of facilitating an early and amicable settlement as and when a claim or dispute arises are greatly increased. Clearly, there are no guarantees in this regard but the very nature of a regulated and well implemented communication process coupled with the regimented contract forum provides a supportive framework for potential interparty agreement at every stage of the project, from conception through to handover and post completion interface.

There is no substitute for the requirement of following the contract, providing correct and timely notice and producing factual and timely documentation at each and every stage of the construction process. All of these are contractual actions but they are also part of a critical communication framework that is an absolute requirement if a project is going to be successful. When a party in dispute conforms to this approach, it provides them with a more informed, supportive and confident foundation upon which to plan for resolution and commit to the dispute process, whatever it may be. Accordingly, with a more informed and better understanding of the issues and the potential for success or failure based on the above premises, a party can be flexible and constantly strategize and re-strategize at various levels as the process develops and fluctuates towards resolution. Whether the result of the dispute is success or failure, a party that has utilized a well communicated and contract compliant administration, sought appropriate advice from experts, and adopted realistic expectations of the risks based on the facts will be in an

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appropriate position to attempt reasoned settlement at each and every stage and accept the outcome without recourse.

Early settlement is never guaranteed. Indeed, any kind of settlement when a dispute arises is never guaranteed. What can be guaranteed, however, is that by applying simple contract administration procedures, maintaining joint communication lines at all levels at all times, and promoting constant interface between the contracting parties, the project overall will benefit and the probability of being able to achieve some kind of settlement through negotiation without recourse to more expensive, at risk, and time consuming ADR procedures is greatly improved. There are no “rocket science” principles involved in fostering construction dispute settlements. More often than not, all that is needed is a common sense communicative approach that allows both parties to negotiate openly and realistically under an umbrella of fairness, reasonableness, and equity, in other words adopting the basis and common intent of the contract itself.

About the Author



Michael Harris is a Senior Principal with Long International and has over 35 years of construction project and claims management experience. His comprehensive consulting and management background includes risk evaluation and managing and resolving complex claims and contract disputes on major construction projects throughout the U.S. and globally for a wide range of industries, including the power, water, petrochemical, industrial, commercial, healthcare, and general building sectors.

Mr. Harris has extensive expertise in key construction disciplines including project design, project management, construction management, contract management, risk and claims analysis, on-site risk management, claims resolution, claims avoidance management, cost management, and expert witness report preparation and testimony.

As well as his extensive project execution background, he also has considerable experience in various types of dispute resolution forums such as arbitration, litigation, and mediation proceedings in North America, Europe, the Middle East, and the Far East. Mr. Harris has also been appointed as a mediator and arbitrator on various international projects. He has been responsible for the management of numerous major projects, both from a construction and dispute perspective, ranging in size from US\$100,000 to over US\$500 million.

A strong and rounded project execution background in many countries, together with expansive experience in dispute resolution processes, has allowed Mr. Harris to be thoroughly versed in the management of construction risks and claims for any type of project or problem in any location/country. He is skilled at contract analysis, claims strategy and preparation, claims defense, and the negotiation of settlements. For the 10 years prior to joining Long International in 2009, Mr. Harris has held positions as Executive Vice President and Corporate Director of Claims with two Fortune 500 construction companies. In these roles, he has had responsibility for the management, strategy development, implementation, and resolution of numerous construction disputes and contract claims for major projects on four continents.

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