NEW APPROACHES TO MANAGING CONFLICT IN CONSTRUCTION CONTRACTS

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Introduction

Construction disputes are commonplace. The multiplicity of parties and technical complexity of major construction projects makes these projects very susceptible to disagreements. The cost associated with resolving major disputes is burdensome even for the largest companies. Delay in resolving outstanding disputes causes serious cash flow problems for smaller companies and sub-trades. Acrimony fed by the adversarial system can seriously impair or permanently damage future business dealings.

The Canadian construction industry has decided to look for new approaches to dealing with conflict on the job. It has looked to the creative work being conducted in this area in Canada and it has looked internationally for examples of new approaches
(a) for preventing disputes from occurring,
(b) for managing conflicts as they occur, and
(c) for resolving conflicts which have resulted in disputes.

These new approaches are most visible in several ways: fundamental approaches to contract drafting practices and the allocation of risk under construction contracts are being re-examined; emphasis is being placed on the effectiveness of the working relationships among the parties to a construction project; private dispute resolution systems are being incorporated into construction contracts.

This paper will discuss the challenge of designing an effective conflict management system for construction contracts - utilizing creative options which can form a complete system outside the judicial system or which can form a complete system incorporating elements of non-judicial and judicial processes. A case study of the B.C. Hydro contracts will illustrate this approach.

This paper will also discuss the new dispute resolution system which the Canadian Contract Documents Committee published on June 1 as part of its revised CCDC-2 standard stipulated price construction contract.

The Design Process

It is recommended that any system which is designed to manage conflict between parties to a contract encourage the parties to try to resolve any conflict by using a method or process which provides the greatest level of satisfaction for both parties and which can be used at relatively little cost.

This approach to design will help to
1. reinforce the relationship between parties to a contract running over a long period of time,
2. manage more effectively multi-party disputes,
3. deal more effectively with technical disputes,
4. encourage creative business solutions,
5. provide more satisfactory results frorn the perspective of the parties, and
6. avoid the “ripple effect” which unresolved conflict can have on a large project.

The following list reflects some of the issues or concerns over conflict management which have been articulated by typical parties to a construction contracts. The list is only intended to be a starting point for an evaluation of specific needs to be addressed in a particular contract:
1. Disputes should be identified and resolved as early as possible.
2. The processes used should be as efficient and cost effective as possible.
3. The parties should maintain control as much as possible.
4. The processes should be conducted in private.
5. Where a third person is required to assist the parties to resolve their dispute, that person should be independent, impartial and experienced with the kinds of problems which may arise in the contract.
6. The nature of the dispute and the remedies required should strongly influence the kind of process used to resolve that dispute.
7. The processes used should be compatible with available resources.
8. The process should enhance the business relationship of the parties.

Creative Options

There are many creative new process options which have been incorporated into construction contracts, many of them very large and complex, which have been used very successfully. And it is not necessary to consider the options suggested as exclusive. One of the advantages of utilizing processes outside the judicial system is that there are few rules which govern the processes. Accordingly, the

processes can be adapted and changed to suit the circumstances. This has resulted in a proliferation of labelled processes which incorporate various elements of dispute resolution into them in a variety of ways. No one process is the right process. It will always depend on the parties and the circumstances. Here are the more commonly used options:

Conciliation: the conciliator often acts in a sort of shuttle diplomacy - talking to each party separately - diffusing animosities - identifying common ground.

Mediation: the mediator assists the parties to negotiate more effectively. The mediator establishes the order of discussions, helps the parties identify common ground, helps them to get rid of irrelevancies or unproductive discussions, defuses anger or hostility, keeps the parties focused on the issues, moves the parties from fixed positions, helps the parties to develop creative solutions, helps the parties do "reality testing" and encourages compromise. The role of the "Project Mediator" in the new CCDC-2 contract will be discussed later in the paper.

Neutral Case Evaluation: the neutral should be an expert in the legal, business or technical area in dispute. The parties or their counsel present their best case in a brief narrative form to the neutral. Documentary evidence might be tendered. The neutral renders an oral opinion, preferably immediately after the presentations, on the issues submitted to him or her. The opinion is a recommendation only and is not binding on the parties.

Fact Finding: the parties present to the neutral the information, data and even oral evidence supporting their positions. The fact-tinder will render an advisory opinion - au opinion which is not binding on the parties.

Med-Arb: the neutral conducts a mediation conference, as previously described, and if the parties are not able to settle the matter the neutral may then render a binding arbitral award.

Arbitration: the arbitrator weighs and assesses evidence presented by the parties and makes a final and binding decision. The arbitrator has the ability to call his or her own witnesses and to retain experts. The rules of evidence do not necessarily apply but evidence cannot be excluded which a court would otherwise admit. The CCDC-2 contract described later provides for mandatory arbitration so long as either of the parties to the contract elect the process within a specified and limited period of time.

Here are some of the newer options being utilized:

Partnering: is "...a method that fosters teamwork and cooperation rather than confrontation among the owner, consultants, prime and subcontractor, suppliers and other parties to a construction endeavor". The ultimate goal is to eliminate the "Us" vs. "Them" attitude in favor of a "We" mentality. For the contractor this would result in an assurance of profitability, positive incentives, pride in the ultimate product, satisfaction in participation, and the prospect of future employment. For the owner it may mean a quality product, built on time, within budget, and without accidents.

To implement partnering, parties to a construction project meet before the work starts for a Workshop. With the help of a neutral facilitator, they get to know each other better; discuss some of the likely rough spots in the project; and even settle on ways to resolve misunderstandings." This is a preventive process which begins its work long before any dispute arises.

Partnering is being used in Canada today on a limited but successful basis - particularly in Ontario and more recently in British Columbia. The Vancouver Port Authority has used the process on two of its large projects; the Greater Vancouver Regional District is using it on its large secondary sewage treatment project the Ministry of Transportation and Highways is using it on its highway maintenance contracts, the University of British Columbia has used partnering on a student housing construction project.

Step-Negotiation: in this staged negotiation process, negotiations begin between representatives of the parties, who are most knowledgeable about the problem and who try to resolve it first. If they fail, the dispute moves up the line of authority from one level to the next. The concept is not unique, but there is real value in agreeing to this process in advance to utilize it when a dispute arises. The B.C. Ministry of Transportation and Highways Major Works contract utilizes this approach to permit decentralization of authority to administer contracts across the Province while maintaining senior official accountability if a dispute occurs.

Standing Neutrals: a neutral person or body is named to be available throughout the contract to assist with the resolution of disputes. This function has been performed by a Referee, a standing mediator or arbitrator, a standing adjudicator or a disputes review board- The board or neutral

makes decisions which may be binding or non-binding - depending on how the process is set up. These persons are often familiar with the legal and technical aspects of potential disputes. The ready availability of the neutral person or body encourages the efficient disposition of disputes to avoid the ripple effect of unresolved disputes on the completion of the project. B.C. Hydro and Power Authority uses a Standing Neutral called a Referee in its standard construction contracts (see case study in this paper).

A Case Study

In the late spring of 1988, B.C. Hydro and Power Authority, the largest Crown Corporation in the Province of British Columbia launched a major review and revision of their standard form construction, supply and install and supply contracts. The dispute resolution method of the old B.C. Hydro contracts was fairly straightforward. Any disputes arising out of the contract would be referred to the Chief Engineer of B.C. Hydro. The contract provided that the decisions of the Chief Engineer were final and binding. Contractors dissatisfied with these decisions took their claims to the courts. The resulting litigation was very costly for B.C. Hydro and the contractor frorn both financial and human productivity perspectives. Final disposition of these claims often took years.

The new contracts are a significant departure from the old and provide that all disputes are to be dealt with and disposed of by private processes outside the courts. The design emphasizes that

- the parties maintain control, to the greatest extent possible, over their contract and the application of its provisions
- commonly occurring disputes be identified and resolved as quickly and efficiently as possible;
- where the parties cannot resolve a dispute by agreement, that the dispute be referred to an independent and impartial decision-maker,
- the independent decision-maker be a person who has experience and technical expertise in relevant construction issues; and
- notwithstanding the reference of unresolved disputes to an independent decision-maker, B.C. Hydro maintain full control over scheduling issues at all times.

The issue of dispute resolution was not left as a minor agenda matter to be dealt with after the substantive issues were settled. Effective dispute resolution was debated as a principal theme and addressed as an important issue in the context of each substantive provision. It was agreed that dispute resolution should be an evolutionary process - a process which moved along the dispute resolution continuum from the exercise of maximum control by the parties reaching settlement by negotiation, to a decision by Hydro's representative where consensus could not be reached, to a speedy referral to a referee for an independent review of Hydro's representative's decisions in identified, commonly occurring disputes and, finally, to a final and binding arbitration for both reviews of the referee's decisions and any other outstanding disputes between the parties which were not referable to the referee in the first instance. No appeal of the arbitral award to the courts is contemplated.

Exercise of Maximum Control

The dispute resolution process was designed to ensure, to the extent practically possible, that B.C. Hydro and the contractor resolve any disagreements themselves. It was thought that this mutual obligation and effort would enhance the ongoing contractual relationship, would lead to more acceptable solutions to both parties, would permit creative business - not necessarily legal - solutions to disputed issues and would help to reduce the overall cost of administering the contract. The parties are under a mutual obligation to attempt to negotiate a resolution to a dispute - at all times - conceivably settling a matter even where it has been referred to the referee or an arbitrator for disposition.

Negotiations appear to be the most effective when the participants deal with each other as frankly and openly as possible. The adversarial system of justice of Western counties discourages counsel from disclosing their strongest facts and arguments. The interest-based negotiation techniques being taught to B.C. Hydro officials describes such conduct as counterproductive to settlement and the contract affirms the duty to make timely full disclosure.

If new information comes available after negotiations have closed in an equitable adjustment request, Hydro's representative must reconsider his decision in light of that new information. This applies even if the contractor has asked to have Hydro's representative's original decision reviewed by the referee. In that event, the referee's review

is suspended until Hydro's representative has reconsidered his decision and the contractor requests a continuance.

Fast Track Mechanism for Common Disputes

It is impossible to discuss this issue without describing more fully the concept of "equitable adjustment" which has been adopted by B.C. Hydro in its contracts. An equitable adjustment is defined as

"...a fair and reasonable adjustment of either or both of
1. an amount required to be paid under the Contract, or
2. a time within which the Work is to be performed under the Contract
taking into account the provisions of the Contract and all of the circumstances surrounding the matter in question".

This concept was adopted to allow the contract to accommodate commonly occurring circumstances, the effects of which could not be predetermined, such as delays or work changes, and unexpected or unforeseen circumstances such as changed site conditions or emergencies.

At the same time as B.C. Hydro addressed these kinds of circumstances and the need to be able to respond with some considerable flexibility to them, it was determined that this process could be used to accommodate a fast track mechanism to resolve disputed issues at an early stage in order to reduce the financial and scheduling impact of the disputes on the construction project.

Accordingly, the contract was designed to ensure that the right to request an equitable adjustment be exercised in a timely manner -14 days after a specific or ascertainable event - and disposed of quickly. If the right is not exercised within the required time, the affected party is deemed to have waived his right. The contract does not provide a mechanism to extend the time to make such a request.
When a request is made, the applicant must also provide a summary of the supporting facts and information upon which it is made. It is anticipated that, in some cases, the applicant may not be in a position to elaborate or detail his request at the time he makes it. The contract makes allowances for this inability, but not at the expense of timely notice being given of the request. The request must be made within the specified time, but the parties may agree to extend the time within which the supporting facts and information are to be provided. This extension is likely to be considered most often in requests arising out of delays.

Procedure for Equitable Adjustment

The contract provides procedure to assist requests for equitable adjustments to be resolved efficiently. First, the contract specifies the various stages of the procedure. The first is written elaboration of the request and the written response to it. The second is the right to seek data and information verification by providing a right of access to the documentation of the other party. The third is negotiation of the request and the final is a decision by Hydro's representative if a negotiated settlement is not possible. If the contractor does not request a review of Hydro's representative's decision within a specified time, he is deemed to have accepted the decision. All these steps are required to take place within a relatively short period of time specified in the contract.

If the contractor believes that the decision made by Hydro's representative is not "fair and reasonable", he has the opportunity to have an individual called the "referee" review the decision and, if appropriate, to amend or vary the decision or substitute another in its place. The role of referee was developed to give the contractor fast access to a review of Hydro's representative's decision by an independent, technically experienced individual.

In the interests of limited cost and efficiency, the review by the referee is intended to be based on documents only -the written decision and reasons of Hydro's representative and only that documentation exchanged and considered by the parties during their negotiations. In order to obtain the greatest benefit from the available reference to a technically experienced person, the referee is given the unilateral power

1. to request additional documentation from either party - giving the other an opportunity to respond,
2. to make a site inspection - with notice to the parties of the time and place of visit, and
3. to retain an expert to provide him with any additional assistance he requires.

The referee has 30 days within which to render his written decision with reasons.

Safeguards

With a move towards a more open and negotiated approach to contract administration, there was a concern that the contract provisions would be abused or used in a manner

not intended. Clarification of intent was considered appropriate. Several responses to this concern were written into the contract

1. notwithstanding the existence of a right to request an equitable adjustment, both B.C. Hydro and the contractor have mutual obligations to make reasonable efforts to mitigate or overcome any negative effects of the circumstances giving rise to the right;

2. when an equitable adjustment is being considered, the efforts taken or not taken by an applicant to mitigate or overcome the effects of the circumstances giving rise to the right to request an equitable adjustment may be taken into account to the extent appropriate in all the circumstances;

3. the contractor cannot use the right to request an equitable adjustment as a way to redress any problems he has encountered because of his failure to tender the contract properly;

4. to discourage frivolous requests for review of the decisions of either Hydro's representative or the referee, both the referee and the arbitrator have the discretion to order the parties to pay the costs of the review requested.

The Referee

The contract contemplates that in large construction projects, it would be useful to have the referee appointed and available to handle disputes right from the award of the contract. Accordingly, with contracts valued at $5 million (Cdn) or more, the parties must appoint a referee within 30 days after the contract was awarded. For contracts valued at less than that amount, either party may request that a referee be appointed at any time - a right most likely exercised when a review is requested of a decision by Hydro's representative. The parties share equally the cost of the referee.

Seheduling Control

One of the objectives of the new contract was to ensure that B.C. Hydro maintained control over scheduling. Because of the complexity and coordination problems of large B.C. Hydro projects and because of B.C. Hydro's duty to account to the public, control over scheduling was considered absolutely vital.

Although the contract specifies that time is an issue which may be dealt with on some requests for equitable adjustment, if the contractor and Hydro's representative cannot reach agreement, the decision of Hydro's representative on time must be complied with by the contractor. The contractor has a right to request a review of that decision by the referee but, if the referee considers the decision of Hydro's representative not to be fair and reasonable in the circumstances, the contract limits the power of the referee to compensating the contractor for the additional time he ought to have been granted to complete the work.

Elements of Procedural Efficiency

The contract provides a variety of mechanisms and safeguards to ensure that issues arising out of circumstances where an equitable adjustment is available are identified and resolved at the earliest point of time practically possible. This objective helps to avoid escalation of the dispute into a situation affecting the integrity of an entire construction project, to avoid rancour between the parties souring their ongoing working relationship and to avoid "historic reconstruction of events" at the end of the project to support a claim for additional monies.

Neither party can bring a claim before an arbitrator when the contract is completed in respect of circumstances for which an equitable adjustment was available under the contract, unless that party had made a request for the equitable adjustment within the permitted time during the term of the contract and had exhausted any right to request a review by the referee.

The contract contemplates that most issues between B.C. Hydro and the contractor will be settled by direct negotiation. If these negotiations are not successful, or are not subsequently resolved by acceptance of a decision of Hydro's representative or the referee in the context of an equitable adjustment request, the contract provides that any outstanding issues are to be consolidated into a single arbitration. Unless the parties agree that an issue should be resolved earlier, the arbitration will be held on completion of the contract. If the dispute is of a local nature, the arbitration will be before a single arbitrator.

Arbitration has been chosen as the method of final resolution of any disputes under the contract. Mandatory referral of construction disputes to final and binding arbitration is another major policy shift under the new contract. The rules of procedure of the BCICAC, incorporated by reference into the contract, provide comfort to the parties who are looking for a method of reducing the typical time and cost associated with a major and complex construction disputes. The domestic rules emphasize, in

particular, early identification of disputed issues, early disclosure of evidence and expert reports and very limited discovery.

Reflection

The new standard form contracts have been in use for 4 years and the consensus of B.C. Hydro is that the conflict management system is meeting the objectives stated for its development.

Statistics reported by Hydro to March, 1993, after 3 yearn of monitoring the new contracts, disclosed 119 contracts involving $55 million of projects for civil and electrical components, transmission lines involving clearing of right-of-way and installation of towers to heavy civil work involving tunnels and rehabilitation of existing dams. These contracts have ranged in size from under $1,000 to $8 million with 14 contracts valued in excess of $1 million.

During this 3 year period, there were a total of 966 requests for equitable adjustments. Only 47 of these requests were other than requests for changes or extra work by Hydro. All these requests were resolved by negotiation.

The remaining 47 were issues arising out of delays, changed site conditions, substitutions or other potentially contentious items. All but 12 of these requests were settled through negotiations and the average time from receipt of the request to negotiated settlements was only 18 days. In the 12 cases that could not be negotiated, a decision had to be made by Hydro's representative and this took an average of 26 days from initial request to decision.

Only 2 of those decisions were not accepted by the contractor and were referred to a referee. It took an average of 113 days from the initial request to the referee's decision. In the first of these, the referee supported the decision of Hydro's representative and the contractor accepted it. In the second, the referee made a decision that Hydro did not accept and it appealed the decision to arbitration. During the preparation for the arbitration, Hydro and the contractor negotiated a settlement and the matter was finally concluded.

These time periods are remarkably short, particularly in the context of complex construction contracts. The benefits of these shortened time periods and the less confrontational process have accrued immediately to both B.C. Hydro and contractor. All indications are that these new approaches to allocation of risk and dispute resolution have been very successful.

New CCDC-2 Dispute Resolution Processes

The Canadian Construction Documents Committee recently undertook a comprehensive review of the 1982 CCDC-2 form and made substantial changes including process options to reduce the need to resort to litigation.

The dispute resolution system incorporated into GC8 involves the following steps:

1. disputes arising from the performance of the work or interpretation of the contract are referred to the consultant, who renders a decision on the matter; *[this is unchanged from the current CCDC-2 contract form]*

2. a party disputing the consultant's decision must give a notice in writing and the parties are obliged to engage in good faith negotiations for a defined period to resolve the dispute;

3. if unassisted negotiations are not successful, the Project Mediator - appointed by both parties - will assist the parties to reach agreement:

4. if the mediation process is not successful, a party can, by written notice, invoke mandatory arbitration,

5. if arbitration is not elected within the limited time period, a party can proceed to litigation or agreement can be leached to use another form of dispute resolution - including arbitration.

Consultant's Decision

When a claim, dispute or other question arises during a project which relates to the performance of the work or the interpretation of the contractual documents, the dispute is initially referred to the consultant. The consultant will provide his or her findings by written notice to the parties within a reasonable time.

If a party does not dispute the finding of the consultant, GC8.2.2 stipulates that it shall be conclusively deemed to have accepted the consultant's decision and to have expressly waived and released the other party from any claims in respect of the matter. A party wishing to dispute the consultant's decision must send a written notice to the other party and the consultant within 15 days after receipt of the decision. The notice must

contain the particulars of the matters in dispute and the relevant provisions of the contract documents. The responding party shall send a written reply within 10 days after receiving the notice of dispute which must also contain particular and any contract provisions being relied upon.

Obligation to Negotiate

GC8.2.3 requires the parties to make reasonable efforts to resolve their dispute through negotiations. This section also requires the parties to provide, without prejudice, disclosure of relevant facts, information and documents to facilitate the negotiations. If the parties have not succeeded in resolving the matter through their own efforts, 10 days after the receipt of the responding party's reply, GC8.2.4 provides that the parties shall request the Project Mediator appointed under the contract to assist them.

Project Mediator - Assisted Negotiations

The contract requires the parties to appoint a Project Mediator within 30 days after the contract is awarded or within 15 days after either party, by written notice, requests that the Project Mediator be appointed. The Project Mediator must be impartial and independent and be an experienced and skilled commercial mediator who preferably resides or conducts business in the jurisdiction of the place of work and is knowledgeable of construction industry issues. The Project Mediator will be requested to assist the parties to reach agreement on a dispute not resolved within 10 working days after they attempted to reach agreement unassisted.

The mediation will be terminated within 10 working days after the Project Mediator was requested or within such further period agreed to by the parties. This flexibility permits parties who feel that progress is being made during mediation to continue for a longer period. The limited time does not permit one party to delay final resolution by stonewalling the negotiations.

The mediation must be conducted pursuant to the CCDC Construction Mediation Rules which were developed for use with the new CCDC-2 unless the parties agree otherwise. The rules acknowledge the importance of maintaining the confidentiality of the dispute. The confidentiality characterizing the mediation conference will hopefully facilitate settlement of the problem at this early stage. Costs of the mediation will be shared

Rule 11.1 permits either party to withdraw from mediation at any time without mason.

The introduction of the mandatory mediation provision in the new CCDC-2 provides a useful function by encouraging the parties to actively review the dispute and attempt to reach an outcome which is acceptable to both parties. Furthermore, the parties fully participate in the decision-making process and do not have a decision imposed upon them by a third party without first attempting to fully participate in and agree to a mutually satisfactory outcome.

"Limited Window" Mandatory Arbitration

If the parties cannot resolve the dispute with the assistance of the mediator, GC8.2.6 provides that either party may refer the dispute to mandatory arbitration by written notice to the other party within 10 working days after the termination of mediation. Either party cannot require the other to participate in an arbitration after the 10 working days have passed. If a party does request that the dispute be arbitrated, unless the party stipulates in the written notice that the dispute must be arbitrated immediately, GC8.2.8 states that it will be held in abeyance until

1. substantial performance of the work,
2. the contract has been terminated, or
3. the contractor has abandoned the work,

whichever is earlier, and consolidated into a single arbitration pursuant to the rules.

The arbitration must be conducted in accordance with the Rules of Arbitral Procedure for CCDC-2 Construction Disputes in the jurisdiction of the place of the work.

The rules governing the arbitration of disputes are explicit and far more comprehensive than the rules governing mediation. This is a result of the need for more formalized and binding nature of arbitration, which results in a binding award being rendered by the arbitrator at the end of the proceedings. The rules were developed keeping in mind the particular needs of construction disputes.

Conclusion

With these recent examples of the successful application of creative approaches to managing construction project conflicts, the Canadian construction industry has been provided with tested tools to help to reduce the human, financial and business costs of ineffectively managed construction disputes.