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Cost Effective Resolution of Construction Disputes

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Abstract

Litigation and arbitration of construction disputes have become increasingly expensive, time consuming and unappealing. Adjudication, expert determination and dispute boards (evaluative ADR) are increasingly being used to resolve disputes in a more timely and cost-effective manner than litigation or arbitration, In contrast to the compromise outcome typically negotiated by the parties in a mediation or conciliation, these evaluative methods of ADR result in a reasoned determination in accordance with the contract and the law, prepared by a third party independent neutral. Each of the alternatives has its advantages and disadvantages, canvassed in this paper. Statutory adjudication for certain types of disputes is mandated in a number of jurisdictions around the world, and although the resulting determination is only provisionally binding, in the great majority of cases it becomes de facto finally binding. Disputing parties can implement expert determination in either a binding or non-binding form, tailored to suit the circumstances of a particular dispute. Dispute boards come in two versions – an ad hoc dispute board set up to adjudicate a specific dispute, and a standing dispute board implemented at the start of a project that is not only able to adjudicate disputes if they arise, but is in a unique position to assist the parties to avoid disputes. The paper discusses the formal requirements for each of these evaluative methods of ADR, and makes some suggestions as to the types of disputes they are most suited to.

Learning

- an understanding of the different features of adjudication, expert determination and dispute boards
- procedural requirements for implementing these forms of ADR
- advantages of evaluative methods of ADR over litigation or arbitration
- the types of disputes most suited to evaluative methods of ADR
- how a standing dispute board can assist parties to avoid disputes

Introduction

Corporate counsel are well aware of the cost and time involved in litigation or arbitration of commercial disputes. For some types of disputes, there is no realistic alternative, such as where a binding court precedent is required to assist in the resolution of a large number of similar disputes.

Many disputes are settled on a commercial basis by the disputing parties themselves, or with the assistance of an independent third party facilitator such as a mediator. The commercial settlement of a dispute in this way may be driven more by the desire to preserve relationships, or the relative bargaining positions of the parties, rather than their legal or contractual rights.

There are various methods of alternative dispute resolution (**ADR**) that are intermediate between the commercial "non-legal" methods such as mediation, and the full blown (and time-consuming and expensive) formal "legal" methods of arbitration and litigation. This

paper reviews three "evaluative" methods: adjudication, expert determination, and dispute boards, all widely used in construction disputes. These evaluative ADR methods are equally applicable to other forms of commercial disputes. Each of these ADR methods seeks to provide the parties with a determination of their rights according to the contract and the law, prepared by an independent and impartial third party with relevant legal and technical skills, and based on the facts.

This paper looks at the features of three widely used evaluative methods of ADR, their advantages over litigation or arbitration, and the types of disputes they are suited to. The important role of dispute boards in dispute avoidance is also discussed.

Adjudication

Adjudication can be defined as "*a method of dispute resolution in which an independent adjudicator resolves the dispute by providing a provisionally binding determination of the parties' contractual rights following an impartial assessment of the parties' submissions and other evidence*".[1] In principle at least, parties can agree on adjudication of any contractual dispute and enter into a contract to implement the agreed procedure (**contractual adjudication**).

A number of common law jurisdictions have implemented adjudication in a statutory form for construction disputes, as a speedy and economical alternative to litigation for provisional resolution of disputes (**statutory adjudication**). The United Kingdom was the first jurisdiction to implement adjudication in statutory form in the *Housing Grants, Construction and Regeneration Act* 1996 (**HGRCA**). Parties to a construction contract (as defined in the Act) are given a unilateral right to refer a dispute arising under the contract to adjudication. The contracting parties can define their own adjudication process, provided that it satisfies the mandatory provisions of the Act. Although the outcome of such an adjudication is provisional, and the dispute can be finally determined by arbitration or litigation, in a large majority of cases, the parties are prepared to accept the outcome as final. This has led to a substantial reduction of cases heard by the Technology and Construction Court, and adjudication has become the principal method of dispute resolution in construction contracts in England.[2]

Statutory adjudication for certain types of construction disputes has been enacted in a number of other common law jurisdictions: New Zealand, Australia, Singapore, Malaysia and Ireland. These jurisdictions have taken a narrower approach to the scope of statutory adjudication, and have confined it to disputes over payment, in an endeavour to maintain contractor's and subcontractor's cash flow, "the lifeblood of construction". The differences between these Acts, and their advantages and disadvantages are beyond the scope of this paper. However, they are all based on an adjudicator assessing the factual and legal submissions of the parties, and providing a provisional determination of the parties' legal rights in respect of the dispute referred to him or her within a very limited timeframe. The adjudicator's decision is not a final determination of the parties' legal rights; their right to litigation or arbitration is preserved. However, notwithstanding the "rough and ready" nature of the time constrained adjudicator's assessment, for many parties it apparently provides an acceptable outcome.

The mandatory statutory adjudication regime in a particular jurisdiction may therefore significantly limit the parties' options in respect of devising their own contractual adjudication regime, if their construction contract comes within the ambit of the relevant Act. Whilst a party's resort to statutory adjudication is optional, it is also a right that

[1] Philip Loots & Donald Charrett, Practical Guide to Engineering and Construction Contracts (2009) 362.
[2] Cyril Chern, The Law of Construction Disputes (2010) 343.

cannot be contracted out of. Accordingly, any alternative contractual adjudication that was in conflict with the relevant statutory adjudication Act would not be enforceable, if a party chose to file a statutory adjudication claim.

The advantages of contractual adjudication include the short timeframe and limited costs involved in obtaining an independent neutral's evaluation of the parties' contractual rights. The parties have control over the process, including selection of the adjudicator. Such a provisionally binding resolution of a dispute, even if ultimately disputed, enables the parties to deal with issues in a timely fashion when the evidence and memories are fresh.

The disadvantages mainly stem from the limited time and scope of the process. The short time period allowed for may be insufficient for a complex legal and factual dispute that requires careful consideration of a large number of documents and other evidence.

Expert determination

Expert determination can be defined as "*a method of dispute resolution in which an independent impartial Expert is engaged by the disputing parties to determine those disputed questions of fact and/or law in the reference defined by the parties*".[3]

Expert determination is purely a creature of contract, the procedural rules and enforceability being those defined in the relevant contract. Thus, parties can agree to a finally binding expert determination from which there is no appeal, a provisionally binding expert determination that only becomes final if neither party issues a notice of dissatisfaction within a defined period of time, or a non-binding expert determination. A non-binding expert determination provides the parties with a reasoned assessment of the facts and the law in dispute, prepared by an independent and impartial expert; such a determination may provide the parties with an appropriate basis for reaching a negotiated resolution of their dispute.

The parties need to be careful in preparing the procedural rules for conducting a binding expert determination, to ensure that their agreement is not void for uncertainty, or for ousting the jurisdiction of the court. However, there is ample caselaw to demonstrate that the courts will uphold a properly drawn up expert determination agreement, and keep the parties to their bargain of resolving their dispute by expert determination.

The advantages of expert determination stem from the independence and skills of the expert. A non-binding determination provides the parties with a "reality check" on the dispute, and may dissuade them from proceeding to expensive litigation or arbitration. A binding determination resolves the defined issues in contention by means of an assessment of the relevant facts and law by an independent third-party neutral. The expert can rely on her/his personal expertise on the issues in dispute, and is not confined to the evidence submitted by the parties. The time and cost of an expert determination are usually substantially less than for the more formal procedures of arbitration or litigation.

The major disadvantage of non-binding expert determination is that it may not conclude the dispute between the parties if they are unable to subsequently negotiate a settlement. Binding expert determination suffers from the disadvantage that there may be no avenue to appeal a determination that is plainly wrong because it is based on errors of fact or a misapprehension of the law (a disadvantages it shares with arbitration). As an expert normally acts inquisitorially and does not hear evidence, a determination may not be based on all the available evidence.

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[3] Philip Loots & Donald Charrett, Practical Guide to Engineering and Construction Contracts (2009) 368.

Dispute boards

A dispute board can be defined as "*a panel of one or three suitably qualified and experienced independent persons appointed under the contract to be available to confer with the parties to assist in the avoidance of disputes or if necessary to provide a determination on a dispute referred to it*".[4] This is the definition of a "standing" dispute board, typically appointed at the commencement of a contract, becoming familiar with the contract and the project, and meeting regularly with the parties to facilitate resolution of issues before they mature into formal disputes. Such a dispute board is able to provide a reasoned decision on a formal dispute in a limited time and at low cost because it is already "up to speed" with the issues.

By contrast, an "ad hoc" dispute board is only established after a dispute has arisen, and acts essentially as an adjudicator or expert to provide a reasoned decision of the dispute referred to it. Since an ad hoc dispute board is only appointed to determine the specific dispute, it cannot assist the parties to avoid disputes in the way that a standing dispute board can. There is little to distinguish an ad hoc dispute board from contractual adjudication; the use of the term dispute board in this paper will be confined to a standing dispute board.

There are several variants of dispute boards. A Dispute Resolution Board (**DRB**) provides a non-binding decision on a dispute referred to it; the DRB decision will only be binding if the parties agree that they will adopt it, This is the preferred dispute board model in the United States, A Dispute Adjudication Board (**DAB**) provides a provisionally binding decision on a dispute referred to it; if neither party issues a notice of dissatisfaction within a defined time, the decision becomes final and binding. If either party issues a notice of dissatisfaction, the decision is binding unless and until it is later overturned by agreement or arbitration or litigation. This is the dispute board model adopted by the Fédération International des Ingénieurs-Conseils (**FIDIC**) in its widely used construction contracts (commonly referred to as the "**rainbow suite**").[5]

In their dispute resolution role, dispute boards have features in common with adjudication and expert determination, and the respective advantages and disadvantages discussed above also apply to dispute boards.

In assessing the full role of a standing dispute board, the major disadvantage is the cost. Whilst the cost of a dispute board is typically a small percentage of the overall contract cost, in absolute terms the cost of three senior and experienced people with the appropriate expertise along with their associated travel costs may appear to be substantial. In this writer's view, these costs can be well justified as "insurance", given the track record of projects with dispute boards having very few disputes.

The features of evaluative methods of ADR

The evaluative methods of ADR outlined above have a number of common features. Leaving aside statutory adjudication, each of these three methods is defined by the terms of the relevant contract. They all involve one or more independent and impartial third party "neutrals" to produce a reasoned decision on a dispute, based on an assessment of the relevant facts in light of the contract and the applicable law. The parties are free to

[4] Philip Loots & Donald Charrett, Practical Guide to Engineering and Construction Contracts (2009) 367.

[5] FIDIC Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer (First Edition 1999) (**Red Book**); FIDIC Conditions of Contract for Construction MDB Harmonised Edition for Building and Engineering Works Designed by the Employer (MDB Harmonised Edition 2010) (**Pink Book**); FIDIC Conditions of Contract for Plant and Design-Build for Electrical and Mechanical Plant and for Building and Engineering Works, designed by the Contractor (First Edition 1999) (**Yellow Book**); FIDIC Conditions of Contract for EPC/Turnkey Projects (First Edition 1999) (**Silver Book**).

select the neutral based on her/his expertise in the relevant technical area and the law, and the parties are free to define the procedural rules that the neutral is required to follow.

Every dispute is different, and it is arguable that the "best" method of dispute resolution for a specific dispute should ideally be selected as appropriate to the features of that dispute, after it has arisen.[6] However, that utopian view assumes that parties in dispute will agree on the procedure for resolving their dispute at a time when they may be disinclined to agree to anything. The usual situation is that, at the time that they enter into the contract, the parties agree to the form of ADR to be adopted in the event of a dispute, even though the nature of any dispute is unknown at that stage. The application of ADR, its enforceability under the contract, and the procedural rules to be adopted are therefore frequently included in the original contract.

Implementation of one of the evaluative methods of ADR typically requires the following three documents:

- An agreement by the contracting parties to adopt a specific form of ADR in the event of, or on the occurrence of, a dispute, and the contractual consequences of the decision of the independent neutral (**ADR Clause**);
- **Procedural rules** for conduct of the ADR method (which will typically be incorporated in the parties' agreement, at least by reference); and
- A **tripartite agreement** between the contracting parties and the independent ADR neutral that incorporates the procedural rules.

Unless the parties have agreed to the identity of the independent neutral, their agreement to adopt a specific evaluative method of ADR will usually need to provide for the method of appointment of the independent neutral in the event that they cannot agree. The selection of the most appropriate neutral to adjudicate a particular dispute is perhaps the parties' most important decision. In addition to independence and impartiality, the neutral may require specific technical skills to fully understand the issues in dispute, and will also usually require sufficient "legal" expertise to construe and apply the relevant terms of the contract (and the tripartite agreement).

Many institutions perform the role of a nominating authority for the independent neutral, in the event that the parties cannot agree. For example, in the UK the Royal Institute of British Architects and the Royal Institution of Chartered Surveyors are nominating authorities for adjudicators under the HGRCA, in Australia the Resolution Institute will nominate an expert, and internationally FIDIC will nominate dispute board members from the President's list of approved adjudicators.

Standard forms of procedural rules for evaluative methods of ADR are available from many sources. In England and Wales the Secretary of State has made regulations that are the default rules if a construction contract does not satisfy the adjudication requirements of s108(1) – (4) of the HGRCA.[7] In Australia the Resolution Institute has published Expert Determination Rules.[8] FIDIC includes the procedural rules for dispute boards in its rainbow suite of contracts. Procedural rules for dispute boards are also published by the Institution of Civil Engineers,[9] the Chartered Institute of Arbitrators,[10] and the

[6] Dr Donald Charrett, 'The "Best" Method of Resolution of Construction Disputes: Elusive or Illusory?' (2013) 30(1) *International Construcion Law Review* 88, 99.
[7] The Scheme for Construction Contracts (England and Wales) Regulations 1998.
[8] http://www.iama.org.au/resources/expert-determination-rules.
[9] ICE Dispute Resolution Board Procedure (1st ed, 2005).
[10] The Chartered Institute of Arbitrators Dispute Board Rules (2105).

Dispute Resolution Board Foundation.[11] The ICE dispute board rules are published in two alternatives – one complying with the adjudication requirements of the HGRCA in the UK, and an alternative for international projects.

The International Chamber of Commerce (**ICC**) publishes a document that contains all of the three procedural requirements for implementation of a dispute board – an ADR clause, procedural rules and a tripartite agreement.[12] The ICC rules are unique in that they provide for three different types of dispute board – a DAB, a DRB, and a combined dispute board (**CDB**) that is primarily a DRB, but can be a DAB if the parties choose.

The parties are always free to prepare their own bespoke version of an evaluative method of ADR appropriate to their specific dispute, accompanied by the appropriate ADR clause, procedural rules and the tripartite agreement. Such bespoke agreements need careful drafting to ensure that they are workable, comprehensive and enforceable. Standard agreement such as those identified above may provide useful guidance in the preparation of bespoke agreements.

Advantages of evaluative methods of ADR over litigation or arbitration

The advantages of evaluative methods of ADR over litigation and arbitration can be summed up in two words – speed and cost.

The applicable procedural rules may have explicit times within which the neutral's decision must be delivered, e.g. an adjudication under the HGRCA must be completed within twenty-eight days after the date of the referral notice (subject to limited extension by agreement), and a dispute board decision under one of the FIDIC rainbow suite contracts must be delivered within eighty-four days of the date of the notice of dispute.

In the case of a bespoke agreement for an evaluative form of ADR, the parties will generally be concerned to obtain a decision in the shortest reasonable time, and will engage the neutral accordingly.

The ability to obtain a decision on resolution of a dispute in a short period of time is itself important. On many long-running projects such as construction projects, resolving disputes as they occur materially assists in maintaining working relationships between the parties. It is far preferable to deferring all disputes to the end of the project to be resolved in what may be a large arbitration or litigation when memories have faded and key witnesses may not be available.

Speedy resolution of a dispute also has the collateral benefit that it materially assists in minimising the costs. It is trite to observe that the more formal the procedures are to be complied with, the more time will be required to comply with them, and this will inevitably incur significant cost.

Most procedural rules for evaluative forms of ADR provide the neutral with the power to determine in detail the procedures to be used, subject to any specified requirements in the procedural rules. The following is typical of this type of provision: "*The Expert shall adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay and expense, so as to provide an expeditious cost-effective and fair means of determining the Dispute*."[13]

This power enables the neutral to consider the real needs of what is required to determine the specific dispute, considering such things as the availability and extent of existing

[11] Practices and Procedures Dispute Review Boards Dispute Resolution Boards Dispute Adjudication Boards (2007).
[12] Dispute Board Rules (2015).
[13] The Institute of Arbitrators & Mediators Australia, Expert Determination Rules (2001) Rule 5.3.

documentation, the necessity for further lay evidence, expert reports, the form of legal submissions, whether the dispute can be decided on the documents alone or whether a hearing is necessary. This flexibility to tailor the procedures to the needs of the specific dispute is in contrast to the formal procedures of litigation and (to a lesser extent) arbitration, both of which are subject to the constraints of the applicable legislation.

The neutral's key role in determining the expeditious and cost-effective procedures to be adopted emphasises the importance of selecting the appropriate individual as neutral – he/she needs to be fully conversant with the range of appropriate techniques for parties to present their evidence and submissions in the most efficient ways that afford them the required degree of procedural fairness.

The types of disputes most suited to evaluative methods of ADR

Because adjudication is normally carried out within a very limited timeframe, it is particularly suitable for disputes in which the disputed issues are confined in scope. Complex disputes involving many separate issues, large volumes of documentation or complex legal issues may not be appropriate for adjudication. The parties must be prepared to accept that the adjudicator's determination may be "rough and ready" because of the limited time available, and that the determination will be provisionally binding and must be complied with.

Expert determination is particularly suitable in disputes in which there are complex technical issues, the questions of law are straightforward, and both parties have confidence in the expert's skill and ability to determine the issues fairly and justly. The parties will usually have control over the timing, and can ensure that the expert has sufficient time to consider the issues properly. It can be very suitable for the final determination of relatively low value disputes that would not justify the expense of litigation or arbitration.

A DAB required to give a decision on a formal dispute essentially undertakes a role akin to adjudication or expert determination, and the remarks above about the types of disputes suitable for these methods of ADR are apposite, A standing dispute board required to make a determination of a formal dispute enters that role already prepared with detailed knowledge of the contract, the project, the parties and the issues. It is therefore able to address the issues in a complex dispute within a short time period, as it is already "up to speed".

How a dispute board assists parties avoid disputes

Whilst the ability of a dispute board to provide a reasoned decision for a complex dispute within a limited period of time is important, its role in assisting parties to avoid disputes may be even more important. The experience of dispute boards around the world has been that many of them have not been required to give a decision on a single formal dispute, as the parties, aided by the dispute board, have been able to avoid disputes. Recent dispute boards appointed for government infrastructure projects in New South Wales are called "Dispute Avoidance Boards", as the avoidance of disputes is seen as their primary role.

Many authors have written on the reasons why dispute boards have been effective in assisting contracting parties to avoid disputes. In this writer's view, the primary reason is that the implementation and operation of a dispute board on a project requires the parties to effectively communicate with each other and the dispute board on a regular basis. There is a useful discipline in regular dispute board meetings, attended not only by those personnel at the "coalface" of the project, but also by senior executives of the contracting parties who have management oversight of the contract. Routine dispute board meetings are typically held "without prejudice", to encourage free and frank discussion of issues in

a forum that does not impact on legal or contractual rights. Senior management hear issues from the "other side", which may be at odds with information provided by their own personnel. The parties will generally prepare for a dispute board meeting, on the basis that they do not wish to appear unrehearsed by the dispute board.

The following is a succinct statement by a very experienced dispute board member of how a dispute board assists the parties to avoid disputes:

> *"Its very existence (its "long shadow") minimises the outbreak of disputes and fosters cooperation between the parties, often providing the impetus for amicable settlements. The damaging "duel of the egos " is avoided. Claims and defences are more carefully prepared and more credible as there is a natural desire not to appear foolish before the Dispute Board, or be seen as unhelpful or exaggerating. The parties thus undertake their reality check before embarking on the referral. Fewer spurious claims are advanced and fewer meritorious claims are rejected. Dealing is more open and the procedural posturing, so common in arbitration or litigation, is rarely evident.*
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> *Parties are less inclined to send acrimonious correspondence that can damage relationships. They are aware, possibly subconsciously, of the Dispute Board's reaction to such exchanges. The parties approaches are thus tempered by their perception of the Dispute Board's view of their behaviour. Attitudes remain positive, not adversarial."*[14]

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Prior to becoming a lawyer, he worked as an engineer for over 30 years, including 12 years as a director of a consulting engineering firm. Dr Charrett's engineering experience included computer applications, structural design, managing engineering projects, acting as an expert witness, and management roles in contract negotiation and administration, insurance, international joint ventures and corporate restructuring. From 2012 - 2014 he was non-executive chairman of the Australian consulting engineering company AMOG.

Dr Charrett has published widely on legal and engineering subjects, and has presented conference papers, workshops and training courses in Australia and internationally. His legal publications include articles on expert evidence, FIDIC contracts, dispute boards, dispute avoidance, contract risk, forensic engineering, contractual lessons from past projects, design and construct contracts, quantum meruit, solidary liability, professional indemnity insurance and reinsurance. He is joint author of Practical Guide to Engineering and Construction Contracts.

In 2014 Dr Charrett established Loots&Charrett Pty Ltd with Philip Loots to conduct training courses on the application and use of contracts in the inception, design, construction and operation of projects.

Melbourne TEC Chambers is a "virtual" chambers of Australian barristers specialising in technology, engineering and construction disputes.

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[14] Cyril Chern, The Law of Construction Disputes (2010) 370.