

Notes from the Editor**Issue No. 43, May 15, 2003**

I just got back from New Orleans where I spoke at the annual conference organized by the Control and Information System Integrators Association (CSIA); an organization founded in 1994 with member-firms providing industrial automation and control systems worldwide. [www.controlsys.org]. The subject of my presentation titled "Costly Contract Disputes Can Be Prevented" included both a historical perspective and an overview of management approaches to challenge the proclivity of engineering-construction conflicts escalating into intractable disputes.

In addition to the core contingent of U.S. based firms, conference attendees came from as far away as Australia, Kuwait and India to share their knowledge and learn better ways to evaluate and continuously improve their businesses. Based on a show of hands a significant minority in the audience had direct experience with mediation, arbitration or litigation to settle stalled claims, etc. When I asked if anyone would willingly go back into arbitration or court, not one hand was raised.

I have long argued that mediation should not be compared with these other processes, because mediation is in a field of its own. It's privacy, flexibility and non-adjudicative methodology direct that it's focus be forward looking and not rooted in the past. It's core competency is an ability to define

the issues in dispute and then proceed to explore the inherent business interests of each party to arrive at a settlement understanding that each participating decisionmaker can support. Based on the response to my session I am heartened to report that the construction industry continues to seek out effective ways to avoid costly disputes and claims.

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This month's feature article is written by an Aussie whose background reads similar to my own. **George Strohfeldt** is a Chartered Professional Engineer - based in Brisbane Australia, with 30 years of international construction and mining experience. As a consultant and Director of Contract Control International, Pty Ltd, he provides commercial and contractual advice to Owners, Contractors and Engineers, often related to contract disputes. He is also an active mediator and arbitrator with Fellow membership in the Institute of Arbitrators and Mediators, Australia and the Institution of Engineers, Australia.

George's article was originally published in its entirety in the Institute of Arbitrators and Mediators, Australia Journal "The Arbitrator and Mediator". He can be contacted at cci@gil.com.au.

Joe Grynbaum, P.E.

**Managing Disputes with Contractors and Maintaining Performance - Part 1 of 2
by George Strohfeldt****Introduction**

Like it or not, disputes seem to be part of the human experience. In the context of a contract, disputes can have a negative effect on both parties' anticipated outcomes, but more importantly can sometimes affect the business relationship itself.

History has seen many methods of dispute resolution evolve. For instance, King Solomon made a third party determination in a dispute between two women claiming to be the mother of an infant (some would argue he acted as a conciliator). With the passing of time society has established procedures whereby parties can have their disputes determined by neutral third parties. In relatively recent times the court system has

assumed the role of making binding third party determinations. The Courts resolve disputes by the strict application of their interpretation of the law to the facts that are presented to them. Whilst the court system is publicly funded, the cost of participating in this system is usually funded by the litigants.

Whilst litigation has always been viewed with some disfavor, it is probably true to say the level of dissatisfaction has risen sharply in the last 10 to 20 years. This dissatisfaction relates to time delay, frustration and excessive cost (usually made up of legal, expert and management costs). Also, because of the adversarial approach employed by the Courts, there is the potential for damage to the long-term business relationships between parties. Thus, some organizations view litigation as only a means of last resort. How then can one avoid the risky and costly process of litigation? The simple answer is by avoiding disputes; however those actively involved in contracts will tell you this is not an easy matter. The facts are that disputes can and will occur.

Arbitration as a process is arguably thousands of years old. In relatively recent times Governments have moved to support this privately funded means of dispute resolution by statute. Even more recently, there has been a move towards alternative dispute resolution (or ADR) procedures. ADR can be a private affair (i.e. Organized privately by the parties) or as an adjunct to the court system, (e.g.. Court-annexed mediation or case appraisal). Disputes can arise over many issues during the course of a contract and can have a marked effect on contractor performance. When they occur, the degree to which they are managed or mismanaged will almost certainly have a bearing on how, when and if they are resolved, the associated cost "fall out", the effect on the performance of the Contract and the business relationship between the parties.

What is a dispute? - It is common to differentiate between an "issue and a "dispute", as follows:

1. An "issue" is simply a difference in opinion or disagreement between the parties to a contract.

2. A "dispute" on the other hand is an issue that has been formally notified under the Contract, e.g. by way of a notice of dispute.

A distinction between issues and disputes is sometimes also made in respect of the applicable dispute resolution procedure, e.g.:

1. "Issues" are said to arise when the parties have not taken defined positions. Such issues could be referred to, for example, expert appraisal.
2. "Disputes" are said to arise when the parties have taken defined positions. Such disputes might, for example, be referred to arbitration.

In respect to managing a dispute (or issue) the above distinctions are (arguably) often academic. If the parties to a contract have invested time and expense in having a matter referred to an independent third party for a decision, they are unlikely to not have taken a position on the matter. However one analyses it, the parties are (arguably) in dispute in regard to the matter.

What issues can lead to disputes? - Disputes can arise from many issues and can differ from one type of contract to another. The author's experience of numerous contracts from different industries indicates that the same themes (with variations in flavor and terminology) tend to re-occur.

The following are typical of the causes of a dispute for capital works projects that are contracted out:

1. Bidding Phase

- Bid document conformity
- Alternative designs / approaches
- Ambiguity in bidding documentation
- Changes in workscope
- Misunderstandings in the post-bid negotiations
- Bidder selection criteria

- A challenge in regard to the selected Bidder

2. Project Phase

- Disagreement over measurements of quantities
- Disagreement over progress of the works
- Change costs
- Untimely changes
- Late payments
- Under payments
- Changes to workscope
- Costs related to acceleration of the works
- Out-of-sequence works
- Project delays/disruptions
- Suspension of all or parts of the works
- Abnormal inclement weather
- Industrial disputation
- Lack of provided facilities / services
- Changes imposed upon the Contractor's work methods or program
- Lack of performance against program or other benchmarks
- Directions or instructions of the Superintendent
- Late issue / approval of drawings or other contract documentation
- Inadequate information in drawings or other contract documentation
- Errors, ambiguities and/or inconsistencies in the contract documentation

- Changes in site condition (either misrepresented or unanticipated)
- Default of subcontractors
- Defective workmanship and/or materials
- Changes imposed by statutory authorities
- Late approvals by statutory and Government authorities

3. Post-Project Phase

- Release of security or retention moneys
- Defects in the works
- Settlement of outstanding claims

How disputes can affect contractor performance - How a dispute affects a contractor's performance will depend on the nature of the matter in dispute, the attitude and position of the parties, and how the dispute is handled by the parties. In some cases an issue or dispute will have no bearing on a contractor's performance (e.g.. a minor dispute over the sum payable for a change). In other cases it can have a marked effect, leading to suspension of work or a "show cause" notice seeking information why the Contract should not be terminated. It is worth noting that the contractor's performance can itself be the source of a dispute.

Sometimes a minor dispute, if not attended to early, can develop into a major dispute between the parties, characterized by bloody-minded attitudes and positional (i.e. ego-on-the-line) stances on the part of both parties. If allowed to escalate, such disputes can have a marked effect on contractor performance as a result of demotivation of the Contractor's workforce, resulting in delay in completion of the project, escalation of costs and damage to the ongoing business relationship. If, for example, the Superintendent decides on an issue in favor of the Principal, and the Contractor feels strongly that it has been "hard done by", it is not uncommon to see an attitude of "if I can't win,

neither will you". Such an attitude usually results in losses to both parties, i.e. a "lose-lose" result.

If issues or disputes are not attended to (presumably in the hope they will go away) or if they are improperly managed, the situation can soon spiral out of control and the matter will likely proceed through the various steps of the stipulated dispute resolution process. In such a case, the resultant legal and other costs can soon overtake the costs associated with the original matter in dispute, thus making resolution of the dispute more difficult.

If such disputes arise while the contract work is still on foot, the effect on contract performance can be devastating. In such cases it is imperative that all issues or disputes be identified early and properly and pro-actively managed.

As a point of interest, the author was recently involved with such a matter that (with the benefit of hindsight) could have been better managed. This matter related to a latent ground condition, which could have been settled about five years earlier for the sum of \$80,000. Instead the matter continued to absorb valuable management time and accumulate legal and other costs over another four years. A total of about \$1.5M was spent on this matter by way of legal, arbitration and other costs prior to it settling about one year ago. This sum excludes administrative and other consequential costs. Had the matter continued to proceed up the contractual claim to another arbitration, it is estimated the parties' costs could have escalated to over \$4M.

Goals and Tactics - Dispute management involves setting realistic and achievable goals. To do this, one needs to develop a strategy and put in place tactics to achieve this strategy.

For example, one must decide whether it is best to attempt negotiations first, or alternatively proceed straight into an ADR procedure such as mediation. Where a party is mercurial or fails to respond, it

may be necessary to issue a notice of dispute so as to introduce formality and "trolley tracks" to assist one to manage the dispute resolution process. A notice of dispute can also prove useful in keeping peoples' minds focused on the dispute, the serious nature of the process, the reality of each side's position and securing an outcome. Mediation can sometimes prove to be a waste of time for one party, especially if the other party chooses to abuse the process by using the mediation to deliberately stall the other party for commercial or other reasons. Principals are usually the guilty party in this respect as they usually hold the money.

Generally the aim will be for a negotiated commercial settlement. Such negotiations are sometimes held against the backdrop of an impending third party determination or other processes (these are sometimes referred to in the contracting industry as parallel negotiations).

Provided one has a working knowledge of the various dispute resolution procedures, by analyzing your sides' and the other sides' position and interests, one can usually develop an appropriate strategy. The most productive way of analyzing the other sides' position and interests is by "putting yourself in their shoes". It is noted that this step is equally important to analyzing the reality, reasonableness and viability of your own approach to the matter. If there is insufficient skills in house to call upon to assist the project manager in this regard, he/she should outsource the assistance needed.

Dispute resolution should be approached on the same basis as any other strategic management, viz. "we are here", "we want to go there" (this needs to be a realistic goal) and "this is how we get there" (i.e. the strategy and tactics). The strategy needs to be based on sound commercial logic and knowledge of "how the game is played".

[To be concluded next month]