

Dispute Management in Contracts

A recent study conducted by the Cooperative Research Centre for Construction Innovation (CRC) into dispute avoidance and resolution in the construction industry¹ has found that without cultural change being led from the top it is unlikely that there will be a reduction in disputes arising from construction projects. This finding is likely to be consistent across all industry sectors.

Why does it matter?

Disputes cost money. The CRC's project team estimated an industry wide weighted average value of avoidable costs that end up in dispute of about 5.9% of contract price. The costs are direct (legal services, arbitration, consultants and in house resources) and indirect. Some of the indirect costs include:

- Delays to the project
- Adverse performance of the project
- Reduced morale
- Erosion of confidence and trust in working relationships²
- Adverse reputational impact
- Emotional impact on people involved and the loss of people to the industry because of wasted effort, disillusionment and frustration
- Lost opportunities for future work due to the destruction of business relationships.

What can be done?

The CRC research has shown that strategic decisions substantially determine the project environment or culture and the manner in which the project team is conditioned to behave. They are at the heart of whether a collaborative approach to the project is possible. The causes of disputes are often the downstream consequences of decisions made by a project sponsor during project initiation. While everyone engaged on a project has a role to play, the ability of the project team to play that role is largely determined by the commercial framework of risk allocation and contract conditions imposed by project sponsors.

The CRC research indicates that risk averse contracts which attempt to transfer risk of matters within the control or influence of the party transferring the risk are entirely counter productive and lead directly and indirectly to project inefficiency, delays, costs, quality issues and disputes; and that that it is preferable that clients remain engaged with risk management throughout the life of the project³. However, even on the best structured projects, disputes or differences will arise and need to be effectively managed⁴ to avoid unnecessary harm to all parties.

Underlying Principles of effective dispute resolution

Regardless of the issue resolution process adopted for a particular project, the underlying principles of effective issue resolution can be reduced to 5 key points:

¹ See **Guide to Leading Practice for Dispute Avoidance and Resolution** download from:
<http://www.mosaicprojects.com.au/Resources.html#Construction>

² For more on this see **The Value of Trust**:
http://www.mosaicprojects.com.au/WhitePapers/WP1030_The_Value_of_Trust.pdf

³ See **The Meaning of Risk in an Uncertain World**:
http://www.mosaicprojects.com.au/Resources_Papers_040.html

⁴ For more on personal conflict management see:
http://www.mosaicprojects.com.au/WhitePapers/WP1041_Managing_Conflict.pdf

1. Ensuring that the contract embodies a process to resolve issues at the lowest appropriate level
2. if necessary, escalation of issues to a more senior level and if need be, to the most senior level
3. employing every endeavour to resolve issues by negotiation⁵ without involvement of lawyers
4. using skilled facilitators to assist in resolving issues⁵, and
5. if formal dispute resolution is inevitable, selecting the most appropriate method to achieve an early, cheap and non-project disruptive solution.

All of these matters must be considered at the time of entry into the contract, not when a dispute arises. Ideally the contract will include a requirement for the parties to a dispute to negotiate in *good faith* before resorting to Arbitration of the courts. This requirement now has a firm legal definition.

Agreements to negotiate in good faith.

Many contracts require, as a part of their dispute resolution clause, the parties to *negotiate in good faith* before having the right to take other legal action. The NSW Court of Appeal⁶ has determined that this type of agreement is ‘certain and enforceable’ and has outlined some of the factors that would indicate a lack of *good faith* in any negotiation⁷:

- Not attending a mediation (or negotiation)
- Sending someone without the authority to settle, to negotiate
- Constantly altering demands
- Failing to state the requirements for a resolution
- Pretending to negotiate having previously decided not to settle to force the issue into an expensive trial or Arbitration (having recognised the claim is good and hoping the costs of the dispute would deter the claimant)
- Threatening a future breach of contract to force a lower settlement
- Failing to pay monies owed on a ‘*known to be spurious*’ pretext.

Negotiating in *good faith* does not require a party to abandon or disregard its own interests. What is required is an honest and genuine attempt to resolve the differences by discussion and, if thought to be reasonable and appropriate, by compromise. Failing to negotiate in *good faith* are grounds for staying other actions until after the negotiations have occurred and may give rise to damages for breach of contract.

Dispute Prevention Techniques

The best dispute management skill is the ability to stay out of disputes; not as an avoidance technique; but rather, as specific prevention strategy. Three key areas to manage are:

Clear specifications

Writing a specification that will be interpreted the same way by different people (within a single organization and between parties), is a skill that takes years to acquire. In a dispute, it does not matter what was meant, only what is in the contract.

⁵ For more on negotiation see ***Negotiating and Mediating***:
http://www.mosaicprojects.com.au/WhitePapers/WP1024_Negotiating.pdf

⁶ United Group Rail Services Ltd v Rail Corporation New South Wales [2009] NSWCA 177

⁷ At this time it is unclear if this decision extends beyond the administration of dispute settlement clauses within a contract to other aspects of negotiations.

A recent Australian study has shown that nearly 60% of organisations had a major contract renegotiation, on average, two years from signing. Most disputes arose out of ambiguous specifications regarding scope (55%), price (42%), and key performance indicators (27%).

An independent specification review should find and correct material ambiguities. Unfortunately, most organizations do not conduct such reviews and find out later, after the contract has been put into operation, that the specification should have been much, much clearer.

Clear communication protocols

Internal policies and procedures regarding communication, approvals, signoffs and the like, have no bearing in a dispute unless incorporated into the contract and made an obligation of the parties. Consider the number of people who might have a discussion, some form of correspondence, or even just contact with anyone in the other party – there will be quite a few people acting with presumed authority and inadvertently committing your organization or conducting estoppel (variation by conduct). Have clear internal processes, authorities, forms and the like, incorporate them into the contract and make them binding on both parties.

Proactive issue management

It is not unusual, in a contract of reasonable size and complexity, to have up to 300 unresolved issues at any given time; they can quickly grow into disputes if the environment is right. Before declaring something a dispute, consider managing it as an 'issue', at least to begin with.

Defining a problem an 'issue' rather than a 'dispute' has a big impact. You can apply normal project management techniques to issue management. Have a mechanism for anyone to raise an issue (even if just an email account), track and assign all issues, and have regular issue resolution meetings (weekly is the norm). Lastly specify the issue escalation process as too many contracts do not specify an inter - party escalation process prior to getting external parties involved such as arbitrators.
