

Resolving Capital Project Disputes: Adopting a business case approach

September 2014

At a glance

- Plan for project disruptions from the start, and be prepared to resolve conflicts before they end up in arbitration or litigation.
- Employ a business case approach to assess chances for success, potential liability, and pros and cons of various dispute resolution approaches.
- Know that disputes are increasingly likely in emerging markets due to the growing number of large, complex infrastructure projects.



Introduction

At a glance

- Project owners and contractors should plan for disruptions along the way and be prepared to resolve brewing disputes before they spiral out of control and end up in arbitration or litigation.
- A business case approach can help assess the chances for success and the potential liability, as well as estimate the duration, costs, and other risks of various dispute resolution options.
- One of the greatest challenges in disputes is collecting evidence to back up claims, so it's critical to keep records updated and capture information from project participants throughout the planning and construction phases.
- The mediation or conciliation process is a less costly, speedier way to resolve disputes than arbitration or litigation. But when mediation fails, arbitration is usually more popular than litigation in transnational disputes in the construction industry.
- Disputes are increasingly likely in fast-growing emerging markets where the number of large, complex infrastructure projects is expected to surge over the next decade and where there is limited experience with international business dispute resolution techniques.

Project disputes are an unfortunate fact of life in most infrastructure developments. But they need not balloon into major conflicts that result in expensive, time-consuming arbitration or litigation. The key is to spot disputes in their early stages and be prepared, through advance planning and proper controls and oversight, to resolve them as quickly as possible.

With disruptions and disputes increasingly likely to develop on large, complex capital projects in fast-growing emerging markets, it is more important than ever to be prepared to deal with them as expeditiously as possible. This report will help guide you through challenging disputes so as to reduce costs, delays, and potential reputation damage.

We explain how to try to defuse problems before they become full-blown disputes and how to assess the situation like a business case to determine the preferred approach should informal negotiations fail. We also point out some of the pitfalls to avoid, such as poor record keeping, and the pros and cons of the various dispute resolution mechanisms.

Perhaps the best, most succinct advice comes from one of PwC's capital projects partners: "Resolve claims when they're big enough to see and small enough to solve."

Planning for problems and defusing disputes

When capital projects veer off course, they need not result in a contentious, costly dispute. Ideally, problems are identified early, communications lines remain open, and projects get back on track through informal negotiations. The more effort companies put in at the outset to create proper governance and control processes, the more likely projects will remain on course.

Find out more:

Correcting the course of capital projects. <http://www.pwc.com/gx/en/capital-projects-infrastructure/pdf/pwc-correcting-the-course-of-capital-projects-v3-pdf.pdf>

But the reality is that even the best-run projects experience disruptions. “It’s about psychology to some extent,” says John Wilkinson, PwC Middle East Regional Deals Leader. “The parties approach projects on the basis that everything is going to go well, whereas empirical experience would tell you that things are always going to go wrong.”

Identifying risks early

Owners shouldn’t mistakenly believe they can avoid disputes because they have written a contract that they believe shifts all of the risks for cost overruns and delays to the contractor. Contractors will typically try to figure out how they can increase their profits within the constraints of the contract.

For instance, they will document the cases where an owner is asking them to do something different from what was originally planned, as well as any delays they experience in getting responses to requests for information. Then they will claim they were disrupted and the owner owes them money for delays and increased costs.

Owners can mitigate such risks by **establishing oversight** including:

- appointing their own staff or an independent project adviser to provide oversight;
- looking out for signs that the contractor may be trying to develop a disruption claim that could evolve later into a major dispute.

and **implementing an assurance process** including:

- designating an internal contract compliance or audit group or outside advisers to provide assurance;
- making sure that all parties comply with their respective obligations;
- identifying early potential challenges and risks and managing those issues.

“By envisaging potential problems at the start, you can be more agile and respond to challenges along the way,” says Colm Tonge, PwC South Africa Forensic Services Partner.

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More disputes expected, especially in emerging markets

Looking ahead, PwC expects more disputes—and more high-stakes conflicts—especially in developing markets, as more large-scale projects are built there.

It's likely that the number of disputes will continue to grow because the infrastructure market is expected to surge in emerging economies. PwC, in conjunction with Oxford Economics, has developed a detailed forecast of infrastructure development activity that shows the shift from developed countries to emerging markets, especially in Asia, accelerating over the next 10 years.

Disputes tend to be difficult to resolve in developing markets because they have less experience with major projects and dispute resolution. Construction disputes in Asia took the longest to resolve in 2013—14 months on average—followed closely by the Middle East at 13.9 months, according to an annual study of disputes by ARCADIS and its EC Harris built asset consultancy.¹ Asia and the Middle East also had the highest average dispute value of any region in the study—US\$41.9 million and US\$40.9 million, respectively (see Table 1).

Construction disputes in the Middle East

After the financial crisis of 2008, the number of disputes in the Middle East began to rise as developers tried harder to keep project costs under control. During the boom times before the crisis, the focus was more on getting projects completed—even if they went over budget—and then moving on to the next ones.

“Several years ago, people might have been able to say, ‘Well fine, we’ll take a hit on this one, but we’ll get another project down the line and make our money back on that one,’” says Jonathan Roe, PwC Middle East Capital Projects Director. “There’s less willingness to do that now. People are keen to settle if they can, but the clients I’ve spoken to will only settle in situations where they consider the settlement to be fair.”

Disputes in the Middle East tend to be more complex than in other regions partly because the projects often involve a host of contractors and sub-contractors. Government officials often seek the lowest price and hire a number of different parties rather than assign multiple parts of a project to a contractor or sub-contractor.

“They think they’re saving themselves money by going for the lowest price, but all they’re doing is making the project more complex and taking on more of the risks themselves,” says James Hanson, PwC Middle East Capital Projects Partner. “When they go with multiple contractors or sub-contractors, they’ve got different terms with each of them. Consequently, any dispute situation will be more complex and potentially more costly,” he adds.

Table 1: Construction project dispute values and durations in emerging markets

Region	Dispute values (US\$ millions)				Length of dispute (months)			
	2010	2011	2012	2013	2010	2011	2012	2013
Middle East	56.3	112.5	65.0	40.9	8.3	9.0	14.6	13.9
Asia	64.5	53.1	39.7	41.9	11.4	12.4	14.3	14.0
US	64.5	10.5	9.0	34.3	11.4	14.4	11.9	13.7
UK	7.5	10.2	27.0	27.9	6.8	8.7	12.9	7.9
Continental Europe	33.3	35.1	25.0	27.5	10.0	11.7	6.0	6.5
Global average	35.1	32.2	31.7	32.1	9.1	10.6	12.8	11.8

Source: ARCADIS Global Construction Disputes 2014: Getting the basics right.

¹ ARCADIS, *Global Construction Disputes 2014: Getting the basics right*.

Realising there's a serious dispute

Before owners and contractors can start to deal with a dispute, they have to know they're in one. While it should be obvious when they reach that stage, "parties are generally in dispute way before they think they are," says Daryl Walcroft, PwC US Capital Projects & Infrastructure Principal.

Sometimes what starts off as an informal negotiation gradually becomes more contentious. The tone of communication changes, going from a spirit of co-operation to keep the project moving along to a more serious discussion of why it's in trouble and who's to blame.

A project is clearly in dispute when the owner stops paying the contractor. Owners experienced in the dispute process often have a more aggressive mentality, disallowing some costs and "redlining" items they are not going to pay on the invoice. They know they're inviting a dispute, but aren't afraid of it when they know they're right.

For a UK sports stadium project, the sports league signed a maximum guaranteed price contract for £100 million and didn't pay a penny over that. The owner properly denied payment and even told the contractor that it should start adjudication procedures if it felt the owner was wrong. But the contractor never did because the contract was administered correctly and fairly.

The owner also didn't let issues accumulate into a big claim but rather hit every small issue head on as it arose. A project database was established early on to track all potential changes, be they early warnings notices, requests for information, or compensation issues. In addition, a correspondence database helped ensure prompt responses to all communications. Regular project control meetings were also held to review all outstanding issues and correspondence and clearly state the project manager's decision within the required time to all matters not resolved by mutual agreement.

"Unfortunately, many owners play the wait-and-see game," says Tony Caletka, PwC US Capital Projects & Infrastructure Principal. "They say maybe the job will be finished on time, maybe the contractor won't claim for every mistake that the owner's design team made. They play this theoretical game that the claim might go away. The fact is they get bigger, not smaller over time." Caletka's advice: "Resolve claims when they're big enough to see and small enough to solve."

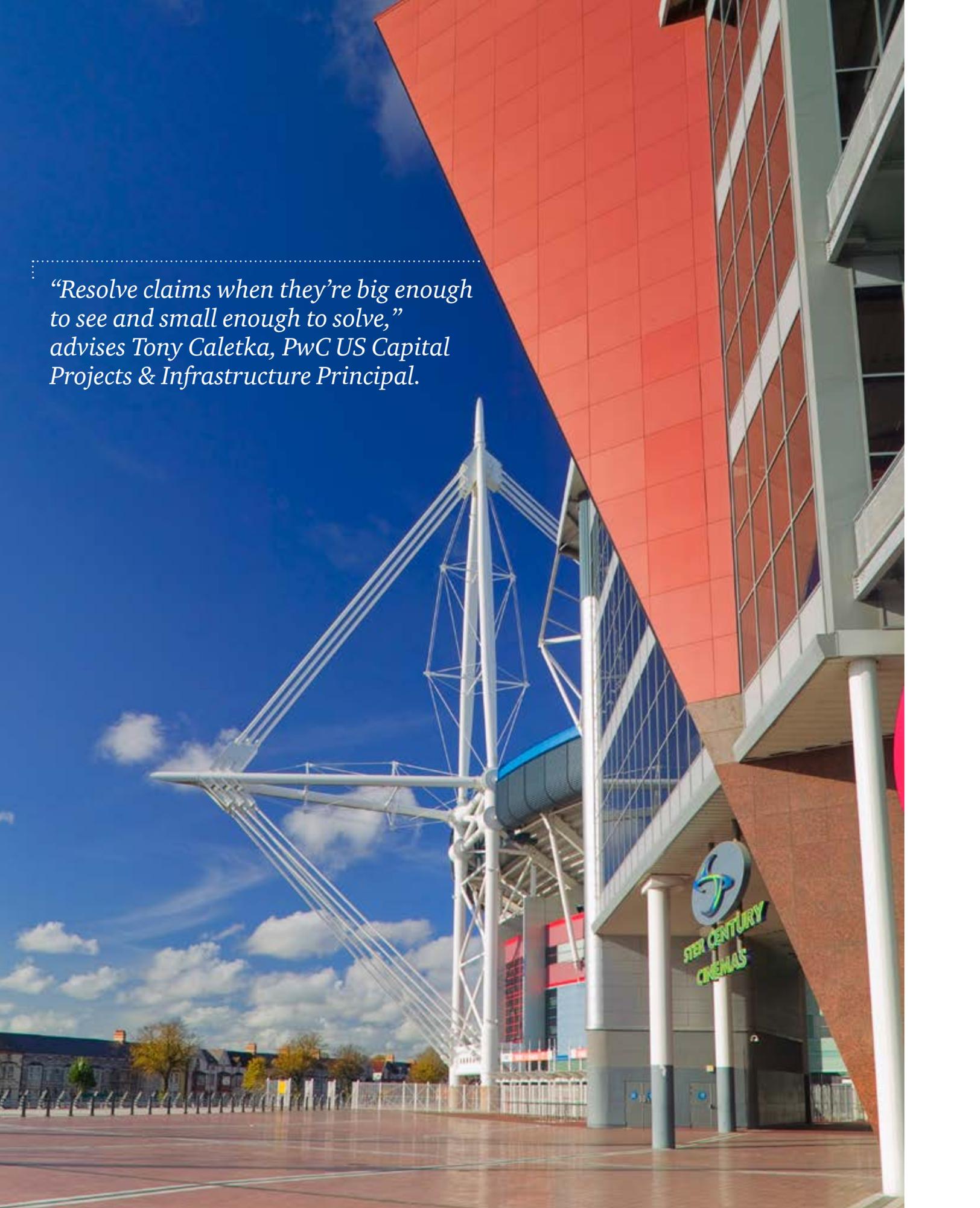
Early warning signs

There are usually early signs that a dispute is likely to erupt, which should be a signal to preemptively consult with experts and legal advisers. Some typical warning signs:

- deadlines are missed,
- the number of change orders increases,
- tensions develop at the project site creating an unhappy work environment,
- requests for information are not answered in a timely manner,
- project changes aren't dealt with promptly,
- relationships between the project owner, contractor and sub-contractor become strained,
- people start enforcing the contract to the letter.

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“Resolve claims when they’re big enough to see and small enough to solve,” advises Tony Caletka, PwC US Capital Projects & Infrastructure Principal.



Find out more:

Insights and Trends: Current Portfolio, Programme, and Project Management Practices. http://www.pwc.com/en_US/us/public-sector/assets/pwc-global-project-management-report-2012.pdf

Determining the cause of the dispute

Most disputes arise because projects go well over budget and run far behind schedule. “Poor estimates during project planning and missed deadlines” are the largest contributors to project failure, according to Insights and Trends, PwC’s 2012 global survey of project management leaders. Furthermore, fewer than half (46.5%) of survey respondents say that an effective, formal process is in place to manage changes to baseline plans.

“Disputes come out of change, where people have differences of opinion about the impact of the change on the project,” says Anthony Morgan, PwC UK Capital Projects Dispute Resolution Leader. “There can be differences in the interpretation of requirements or just a pure mistake around the interpretation.”

1. Regional differences

The ARCADIS study found that there are five main causes, but the causes of disputes vary by region (see Table 2). Errors and/or omissions in the contract proved to be the leading cause in the US in 2013, while failure to make interim awards on extensions of time and compensation was the main issue in Asia. Failure to properly administer the contract was the major reason for disputes in the Middle East. In the UK, the top cause proved to be employer/contractor/sub-contractor failing to understand and/or comply with contractual obligations, and in continental Europe, the chief cause was differing site conditions.

2. Cumulative impact

Typically, the cause of disputes is a combination of issues. The project owner may request a number of changes that add cost and time; the contractor may experience several risk events, such as flooding or a labour strike; and the contractor or sub-contractor may have performance problems.

“It’s very often a huge number of relatively minor things which have just built up and built up and divided the parties quite significantly,” says Richard Foley, head of the construction advisory and disputes group at the international law firm Pinsent Masons, who has many years of experience with project disputes in Western Europe and Asia.

The dispute gets even more complicated when it’s difficult to separate one contributing factor from another. For example, the contractor may attribute performance deficiencies to a combination of the owner’s design changes, weather and ground conditions.

When a Spanish contractor was terminated for delays and lack of performance on a highway refurbishment project in southern Trinidad, an analysis of competing delaying events was conducted. Among the issues in the dispute was variation to the stone specifications because of an insufficient supply of the needed materials on the island. The expert report separated out competing delaying events and took into account the effects of seasonal weather and related production, among other things. Ultimately, the dispute was resolved by negotiation.

Table 2: Most common dispute causes by region

2013 Rank	Cause	2012 Rank
USA		
1	Errors and/or omissions in the contract document	2
2	Failure to make interim awards on extensions of time and compensation	5
3	Differing site conditions	4
4	Incomplete design information or employer requirements (for D&B/D&C)	—
5	Failure to properly administer the contract	—
Asia		
1	Failure to make interim awards on extensions of time and compensation	2
2	Failure to properly administer the contract	5
3	A biased project manager or engineer	—
4	An unrealistic contract completion date being defined at tender stage	—
5	Employer imposed change	—
Middle East		
1	Failure to properly administer the contract	1
2	Employer imposed change	3
3	Employer/contractor/sub-contractor failing to understand and/or comply with its contractual obligations	—
4	Errors and/or omissions in the contract document	—
5	An unrealistic contract completion date being defined at tender stage	—
UK		
1	Employer/contractor/sub-contractor failing to understand and/or comply with its contractual obligations	1
2	Failure to properly administer the contract	3
3	Incomplete design information or employer requirements (for D&B/D&C)	—
4	Poorly drafted or incomplete and unsubstantiated claims	—
5	Employer imposed change	—
Continental Europe		
1	Differing site conditions	—
2	Third party or Force Majeure events	5
3	Employer/contractor/sub-contractor failing to understand and/or comply with its contractual obligations	1
4	Employer imposed change	—
5	Failure to properly administer the contract	—

Source: ARCADIS Global Construction Disputes 2014: Getting the basics right.

Find out more:

When airport projects fly off course.
http://www.pwc.com/en_GX/gx/capital-projects-infrastructure/pdf/the_new_normal_for_airport_investment_-_02_when_airport_projects_fly_off_course.pdf

Megaprojects and multiple stakeholders

Most disputes involve project owners, contractors, and sub-contractors, but megaprojects could potentially include a wider variety of stakeholders. Airports exemplify such vulnerability. “Airports are very complex structures. Unlike other infrastructure, you have a huge number of operational stakeholders,” says Michael Burns, PwC UK Airports Advisory Leader. “So that gives you a much more difficult stakeholder environment in the case of delay or failure in a project.”

When an airport expands, it affects the operations and revenues of the airlines flying into that facility, operators of the parking lots and garages, retail shops in the terminals, nearby hotels and train lines to the airport.

For example, the new airport in Berlin, Germany, has faced many construction problems that have forced it to postpone its opening several times. The delays have had major financial repercussions for such companies as Air Berlin, which intends to make the airport a major hub operation. Air Berlin sued the airport operator, seeking compensation for the financial damage caused by the repeated delays in opening the new facility.²

“If an airport is delayed, every airline will be in a position to sue,” Burns adds.

3. Political pressures

Projects can also end up in dispute because the publicly announced completion date was arbitrary due to political pressure to meet an unrealistic timeframe. A government official, for example, may promise his constituency a project on a certain date without the necessary planning and scoping of the project. In some cases, there may be urgency to reassure the electorate that the government has everything under control and will quickly resolve, say, a power or water crisis.

“Sometimes one wonders whether the original timeframes for many projects were realistic or whether it was politically expedient to make promises of delivery within fairly short timeframes, knowing that three or four years later they were going to have to face the music about the project coming in at twice the budget and twice as long a timeframe,” says Jonathan Cawood, PwC South Africa Capital Projects Leader. “We’ve seen that on a few projects in Africa, and we think maybe everybody actually knew that upfront.”

² Deutsche Welle, “Trial starts over Air Berlin damage claim against delayed BER airport”, <http://www.dw.de/trial-starts-over-air-berlin-damage-claim-against-delayed-ber-airport/a-17362076>, accessed August 29, 2014.

Disputes are increasingly likely to flare up in fast-growing emerging markets where the number of large, complex infrastructure projects is expected to surge over the next decade, according to PwC analysis.

Find out more:

Capital project and infrastructure spending. <http://www.pwc.com/gx/en/capital-projects-infrastructure/publications/cpi-outlook/index.jhtml>

Disputes and emerging economies

With infrastructure and other construction projects being built increasingly in emerging economies, it's important to be aware of differences that could come into play in a dispute.

Going in, contractors need to understand the political and regulatory environment and choose local partners well. "Finding a partner with good in-country relationships with major clients is a good step to take," says Charles Lloyd, PwC UK Capital Projects Finance Partner. "You're more likely to reach resolution if it's an Iraqi-to-Iraqi discussion or a Qatari-to-Qatari discussion than if it's a foreign contractor negotiating."

Cultural differences often come into play in the dispute process. Construction dispute experts find that in some Asian and Middle Eastern countries, there is reluctance to be confrontational and challenge others, especially the project owner.

"There's a need to suppress the bad news so you don't put egg on people's faces," says Mark Rathbone, PwC Asia-Pacific Capital Projects Leader. The problems build until there are significant cost overruns and delays that, if not resolved amicably in private, can become a messy, public dispute.

Project changes may not be viewed as a normal part of the construction process in some inexperienced, emerging markets. As a result, they may not build change control procedures into contracts, leading to disputes that can't be resolved easily.

"There also seems to be less acceptance that there will be change in the project. Then, when change is required, their expectation is that's part of the obligation of the construction

company," says Michael Burns, PwC UK Airport Advisory Leader. Consequently, it's advisable for contractors to set expectations that there will be change and put strong communication mechanisms in place.

Disputes are often more complicated if the local government owns the project. In Africa, for example, some governments don't have the same understanding of risk transfer or the private sector's level of control as international investors do. That may give rise to misunderstanding and frustration when projects go over budget and get behind schedule. In such countries as China and Vietnam, large cost overruns on government projects simply aren't discussed because of bureaucratic obstacles.

If there's a change in elected government officials, that can add further complications because a project spans two administrations. There's lack of continuity; the people who made the original decisions are no longer accountable. Such political change can lead to questioning and cancelling contracts, potentially provoking disputes.

Government involvement can also create political dynamics that affect the dispute resolution process. Challenging the government could endanger visa renewals and participation in future projects in that country.

Another risk in emerging economies is the potential for bribery and corruption. For example, there could be fraud in the certification of steel that wasn't completed to the proper standard, resulting in delays while the work is redone with the proper materials. "Bribery, corruption, and political connections can also result in people being appointed to jobs they're not ready to do," Colm Tonge, South Africa Forensic Services Partner says. "Then that becomes very expensive if it leads to delays down the track."

Assessing disputes like a business case

Disputes often end up in arbitration or litigation simply because neither side is willing to admit it was at fault. Personalities and emotions may take over, making communication strained and less productive.

The bottom line question to ask: What is the most desirable outcome of this dispute? Is it about resolving the dispute quickly to keep the project moving forward and costs down? Or is it because one has a solid case and chooses to fight no matter how long or how much it takes?

The bottom line question to ask: What is the most desirable outcome of this dispute? Is it about resolving the dispute quickly or fighting no matter how long it takes?

To take emotion and personal relationships out of the mix, owners and contractors should consider doing a business case analysis on the costs and benefits of an expeditious resolution versus more protracted arbitration or litigation. They need to take a rigorous, disciplined approach to assess the chances for success and the potential liability, and to estimate the duration, costs and other risks of various dispute resolution approaches.

The elements of risk will vary from dispute to dispute, depending on the nature and scale of the project, the contract, the specific problems and the strength of the legal team. And there are different cost and risk profiles for various forms of dispute resolution, whether mediation, arbitration, or litigation.

Considering the full monetary picture

An important consideration before going into a long dispute resolution process isn't only the potential settlement amount, but also the monetary interest that might accumulate. A good example of that issue was a project to build a women's and children's hospital in the U.S. The contractor claimed millions in extra costs because it argued that the owner and construction manager delayed it from carrying out its work. The owner disagreed and blamed the contractor for the late opening.

The dispute went into litigation and dragged on for years. Ultimately, the contractor prevailed, with the judge awarding delay damages for the entire 87 weeks in the claim and all of the 41,000 claimed hours for disruption. The contractor did even better than expected because the owner not only had to pay the settlement, but interest on it as well.

“So, there are angles to these claims that I don't think people recognise,” says Caletka, who was retained by the contractor in the hospital case to provide his scheduling expertise. “The interest on settlements is one of the factors that goes into the strategy for how you pursue and settle and which court you take the claim to.”

Protecting business reputation

The value of business reputation and relationships will also affect a party's willingness to resolve disputes quickly and amicably rather than take an aggressive approach. For example, contractors are often concerned about their reputation, both in the marketplace and with the owner involved in the dispute.

“Some companies say we have a reputation we have to uphold and if anyone tries to mess with us, we're going to litigate every time and we will never give up,” says Erik Skramstad, PwC US Forensic Services Leader. “Other clients say, ‘No, no, we don't want to litigate. Let's just resolve this in a good manner. We want to have a reputation as being reasonable.’”

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Conducting a business case analysis

Often, it takes an outside advisor, whether an expert witness, consultant, or lawyer, to be the voice of reason and encourage a business case analysis early in the dispute process. The analysis can be done relatively quickly—often in a month or so. The result is a much clearer view of the preferred way to proceed rather than an impulsive reaction to jump into expensive and time-consuming arbitration or litigation.

For example, the owner and operator of a sports stadium in the UK retained PwC in 2006 to do a detailed analysis when the Australian contractor made a claim for additional compensation because it blamed project delays on design changes by the owner.

WNSL received claims for individual changes, as well as a significant claim for “misrepresentation.” PwC carried out an “as built delay analysis,” assessing its client's liability for more than 80 changes and reviewing the impact of such factors as delays to the structural steelwork. The analysis helped WNSL reach a negotiated settlement with the developer. The stadium was finally completed in 2007.

Similar past cases that lawyers or consultants have handled can provide guidance in the business case analysis. But it's always hard to know just how difficult the opposing party will be in terms of dragging out the resolution process and driving up the costs.



Using quantitative risk analysis

The owner or contractor can also perform a quantitative risk analysis to assess dispute claims and the potential costs involved in different resolution scenarios. The cost of litigation, experts, lawyers, internal resources and business interruption would be factored in, as well as intangibles such as reputation damage.

To assess the likelihood of winning and by what order of magnitude, a quantitative risk model would take into account the contractual agreement and which side has the better documentation and strongest legal arguments for each claim. For example, there might be a 50% chance of getting

70% of a claim, and a contractor with an appetite for risk might decide to litigate. But it might settle if an offer is on the table for 50% of the claim.

Getting a rational assessment from independent advisers

A third-party independent assessment of one's position can be quite valuable because it focuses on the facts of the case to make a rational assessment of the causes of delays and cost overruns. Independent advisers can help their clients deal with such recurring issues in disputes as proving linkage between cause and effect and determining whether there were concurrent causes of delay that both the employer and contractor were responsible for.

A third-party adviser can sometimes even help the client avoid arbitration or litigation. When a new airport was being built in China, for example, it turned out that the specifications for the terminal's roof tiles were extremely tight, causing problems with the construction tolerances and requiring reworking. That resulted in a disruption claim against the owner in which the contractor retained an adviser to conduct an extensive analysis to quantify the impact of the tight tolerance on productivity and costs and presented those findings to a mediator for settlement of the claim.

When contractor claims go unchallenged

Because they have so much project experience, many contractors realise that disputes are simply part of the project life cycle and are often better at documentation than owners. They may leave a document trail for lawyers and consultants to use in a dispute and swing an arbitration panel in their favour. For example, in a monthly report, a contractor might document an event that occurred and blame the owner. If the owner fails to challenge that contention in a letter, the contractor's claim may be accepted at face value. Owners are sometimes naïve because they haven't experienced many projects and disputes.

Keeping good documentation to support claims

Information is power when it comes to disputes, which is why meticulous and extensive record keeping is so important. A complete document trail is needed to demonstrate why certain actions were taken. It can mean the difference between winning and losing. "There's only so much you can do when you've got bad documentation," Lechner says. "You can be right and you can still lose."

Throughout the planning and the construction process, owners and contractors should keep records up to date and capture information from people working on the project—especially since most people leave projects and may not be available if and when a dispute arises later.

When an international engineering contractor ran four months late in completing the retrofitting of a gas compression facility on a live North Sea gas platform, it made a claim to cover its additional costs. Fortunately, information could be retrieved from archival materials and hundreds of time sheets were entered into a database to analyse productivity and inefficiency, thus helping the parties resolve the dispute through negotiation.



It's important not only to keep records of delays but also to note the causes and impact in the document trail. That will help prove linkage of cause and effect. Owners and contractors also need to understand how accurate the data are.

Often, project schedules are designed to show the dates people want to see rather than a realistic timeline. That means they can't be relied on from an evidentiary perspective. In such cases, outside experts have to build a schedule that reflects what actually happened from other data sources, such as project reports and progress data, and interviews with the people involved in the project.

At a time when big projects can generate such a massive trove of documents, digital technology is helping with record retention and document management. For example, software can enable people to categorise documents and group them into potential claim issue files, making for faster recovery in case a dispute develops.

Perhaps surprisingly, previous documentation lapses can resurface and affect a current dispute. On a campus-style office building project, for example, the owner was pressured to settle because of a damning internal audit document from the past that the opposing party found. The audit report was highly critical of the owner's project management team and lack of controls over document flows and responses to requests for information. Even though the owner corrected all of the issues, no one ever closed out the documentation trail with a record of the corrections.

"You have to make sure that your documentation is clear, and when you identify issues, they have to be closed out," Lechner says. "You need a document showing that you proactively addressed the issues. Otherwise, you're risking documentation that will adversely affect you in a dispute even though it may not have a lot of relevance or accuracy."

Email as evidence?

These days, emails often pose a major problem because they aren't organised and classified properly. "You may have long email chains and the title may not relate to the project, so now you've got to search your systems to see when people were talking to each other, and often that's the biggest challenge—to put that factual history together," says Colin Tonge, PwC South Africa Forensic Services Partner. That issue may be exacerbated when people leave the project along the way. "It's a normal corporate practice to back up somebody's email and directories, but it's not necessarily a practice to ensure that all project-related correspondence is filed to the project," says Tonge. "So if you have a time lapse of two or three years between the person going and realising that you need everything they've got to demonstrate what happened at a point in time, that's where a lot of organisations fall down."

*"There's only so much you can do when you've got bad documentation," says Steve Lechner, PwC US Capital Projects & Infrastructure Principal.
"You can be right and you can still lose."*

Engaging in the dispute resolution process

Starting the dispute resolution process

Once the business case analysis is complete, dispute resolution planning begins. The parties will want to assemble a team of lawyers and experts. Select teams based on the experiences of the individuals and not the reputation of the companies they work for. After all, people, not companies, deliver results.

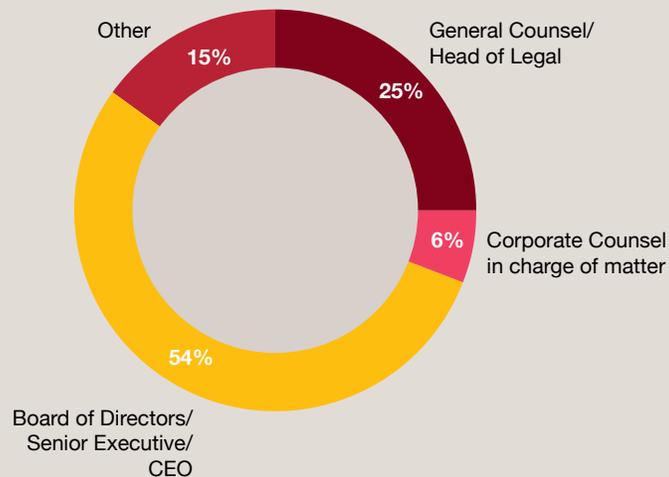
Bring in the CEOs

In some cases, involving to the CEOs of the companies in dispute can raise the discussion to a more productive level. The project teams closely involved in the day-to-day construction may have clashed, and their feelings toward one another could complicate the resolution process.

In a dispute over an energy project, Richard Foley, head of the construction advisory and disputes group at international

law firm Pinsent Masons, and an opposing counsel brought the two CEOs involved together, and each lawyer presented a summary of his arguments. “We had essentially treated the CEOs like they were the tribunal,” Foley says. “They had been contracting together for decades, and the last thing they wanted was to get into any formal dispute. We got a deal that both CEOs were comfortable with, and they’re still contracting on other projects around the world.”

CEOs and high level executives are main decision makers of litigation and arbitration proceedings



Source: PwC and Queen Mary University of London
2013 International Arbitration Survey

Weighing dispute resolution options

Owners and contractors need to consider the pros and cons of the various dispute resolution processes in light of their particular case and the jurisdiction in which it would be arbitrated or litigated. Would the dispute be handled where the project is being built or in the contractor's home country? That will help determine the preferred dispute resolution mechanism.

On one end of the spectrum is **informal negotiation** that leads to a settlement. That's the most preferred and most common course of action because the parties keep control of the process and it's usually the least expensive and fastest approach.

At the other end of the spectrum is **litigation** that leads to a binding decision. But if the parties spend a lot of time and money on legal processes, experts and so forth, then their expectations rise and they set out to recover the maximum amount possible.

In between are mediation or conciliation, dispute review or dispute adjudication boards, and arbitration.

1. Mediation and conciliation

It's frequently specified in contracts that mediation be tried before going to arbitration. In the conciliation form of mediation, the mediator or conciliator makes recommendations regarding the outcome of the process. "Conciliation can be more effective than other types of mediation in bringing the case to a close because of the opinion that is issued," Caletka says. "The weight of the conciliator is heavy because it's usually a retired judge or respected arbitrator. That person is basically saying that if he were the arbitrator or judge, this is what he would decide."

Other mediation approaches can simply be "a testing ground" in which the parties just want to know how solid the other side's case might be. "You have to approach that kind of mediation with some scepticism," adds Caletka.

Proponents of mediation or conciliation point out that the process is less costly and usually much speedier than arbitration or litigation. Moreover, mediation is often less confrontational and helps maintain business relationships. The potential downside is that time and money are lost if mediation fails and the dispute must move into arbitration or litigation.

Foley and his firm recommend to clients that they include a tiered resolution provision in their contracts. The first step might be a 30-day period where senior management must try to resolve the dispute. "If that fails, I would always advocate trying mediation or conciliation before defaulting to arbitration," Foley says.

London calling

London has emerged as one of the most popular venues for international clients to bring their disputes for a variety of reasons, including cost issues, English law, and the availability of infrastructure expertise.

Costs tend to be lower in the UK than in other parts of Europe, and unlike in some jurisdictions, the successful party will normally recover its costs, Walker says. Furthermore, he adds, "English law respects the parties' freedom of contract, and the doctrine of precedent means English law usually provides predictable outcomes." London also offers parties a wide choice of experienced arbitrators, advocates, translators and expert witnesses to help resolve disputes efficiently.

“I think it’s a pity that the dispute review boards and their like are not used more often,” says Richard Foley, head of the construction advisory and disputes group at Pinsent Masons, an international law firm. “They’re kind of keeping parties honest, but also enabling matters to be resolved as they come up.”

2. Dispute review and dispute adjudication boards

Some projects use dispute review boards, which include three members who evaluate disputes as they arise and make settlement recommendations that are not binding. There are also dispute adjudication boards, which deal with disputes as they come up and make decisions that are binding unless one of the parties issues a notice of dissatisfaction. If a notice is issued, the parties are expected to try to reach an amicable settlement, and if that fails, the dispute moves to arbitration.

Another option in the UK is HGCRA statutory adjudication, which aims to settle disputes over monetary issues in construction projects in a relatively short amount of time.

Foley believes more owners and contractors should use dispute review boards or dispute adjudication boards as soon as a problem surfaces. “I think it’s a pity that the dispute review boards and their like are not used more often,” he says. “They’re kind of keeping parties honest, but also enabling matters to be resolved as they come up.”

The boards aren’t used more often partly because they’re seen as adversarial—“drawing up battle lines,” as Foley puts it. “Whereas it should be seen as a sensible proactive step to try to resolve what is a genuine disagreement while it’s all fresh in everybody’s minds,” he says. “Then, we can all move ahead on the basis of some certainty.”

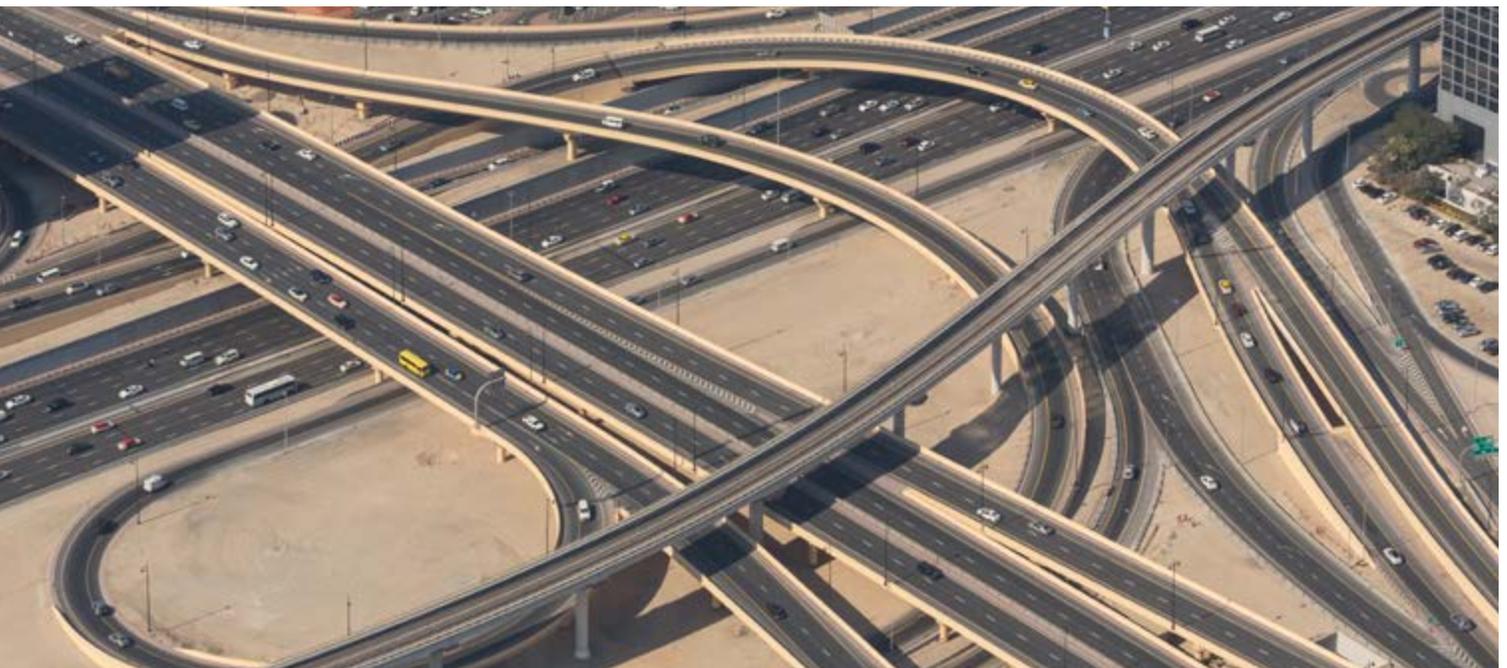
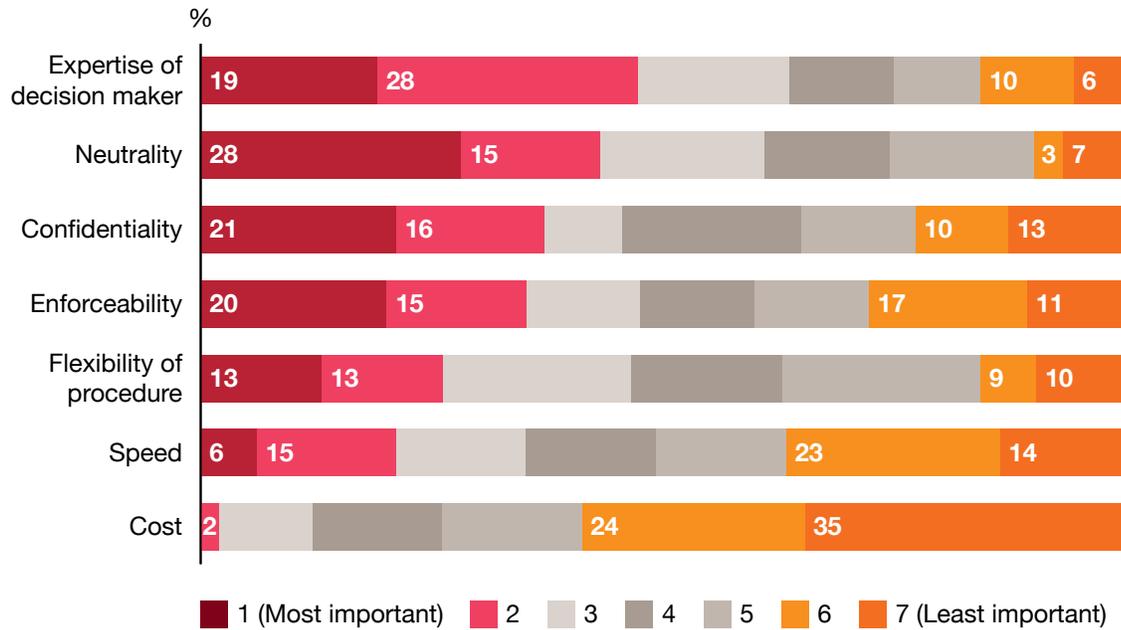


Chart 1: Most important perceived benefits of arbitration



Source: PwC and Queen Mary University of London 2013 International Arbitration Survey

3. Arbitration

In arbitration, disputes are normally heard and decided by a three-person panel. Each of the opposing parties chooses one arbitrator, and those two arbitrators select an independent third member of the panel to provide some neutrality in the case.

As Chart 1 shows, the benefits of arbitration include the ability to choose the arbitrators rather than be assigned to a judge in a court case; the ability to set one’s own timetable and rules; and the privacy it affords, compared with a public litigation process. In fact, maintaining confidentiality is perhaps the biggest attraction of arbitration for many companies.

Arbitration is a more expensive and longer process than mediation. In fact, arbitration may even last longer and be more expensive than litigation. In litigation, the parties don’t pay the judge or jury for their hours on the case. But in arbitration, they must pay the arbitration panel for their time and expenses, as well as their own lawyers, experts and others. In addition, judges don’t typically let court cases stretch on and on, whereas arbitration may continue for several years.

But arbitration is nonetheless a popular choice over litigation for transnational disputes in the construction industry, according to the 2013 International Arbitration Survey, which was conducted by the School of International Arbitration at Queen Mary University of London and sponsored by PwC.

Find out more:

Corporate choices in International Arbitration: <http://www.pwc.com/gx/en/arbitration-dispute-resolution/index.jhtml>

If a dispute ends up in arbitration, project owners or contractors need to put their money and management time fully behind the case. It's risky to start off half-heartedly in the expectation that the other party will settle.

Chart 2: Companies' preferred dispute resolution mechanisms

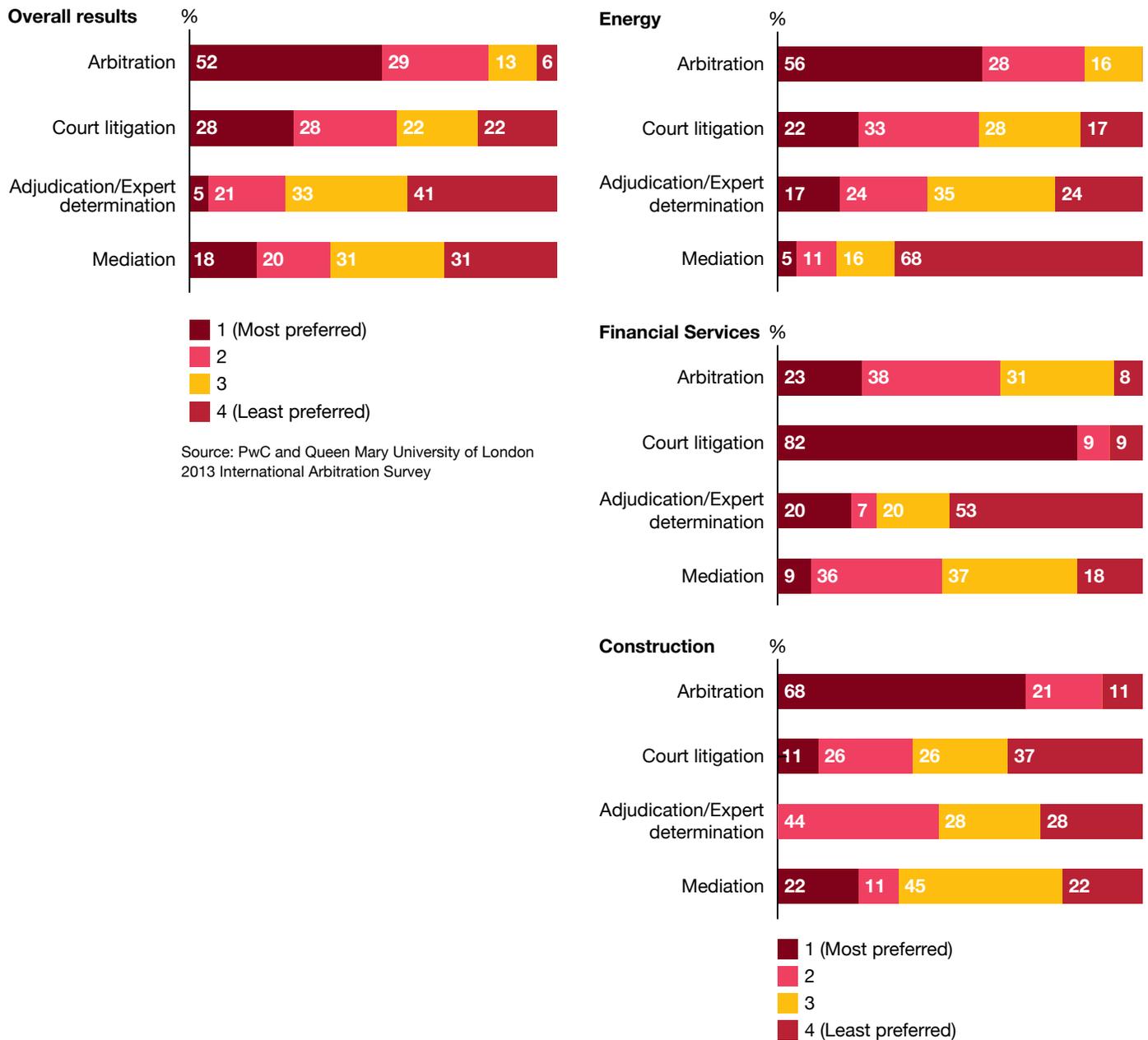
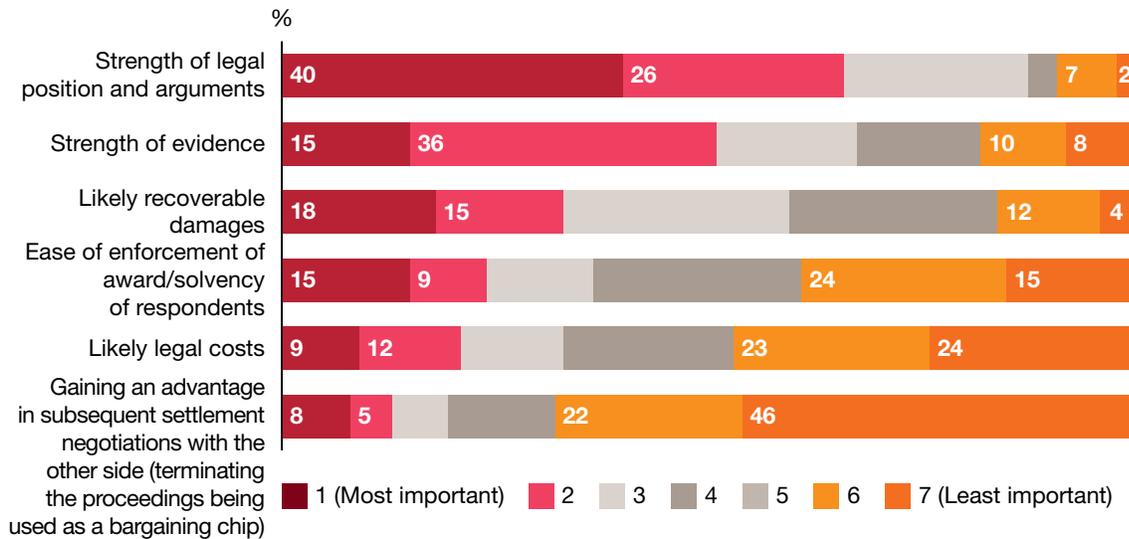


Chart 3: Most important factors in deciding whether or not to initiate arbitration proceedings



Source: PwC and Queen Mary University of London 2013 International Arbitration Survey

About two-thirds (68%) of respondents in the construction industry listed arbitration as their preferred dispute resolution mechanism, compared with 56% in the energy industry and 23% in financial services. Courtroom litigation was preferred by 82% of financial services respondents. (The other choices in the survey were mediation and adjudication/expert determination. See Chart 2).

When asked which factors are most important in deciding to pursue arbitration, respondents across all three industries cited strength of their company’s legal position and arguments as most important, followed by strength of the evidence and the value of likely recoverable damages (see Chart 3).

To prevail in arbitration, Foley also recommends “identifying the pinch points in the arbitration process when you’re most likely to get a deal and working to get yourself into the best possible position at each of those points.”

The most important pinch points usually present themselves:

- at the very beginning when the notice of arbitration is served and gets everyone’s attention;
- after both parties have made their first round of pleadings and each side can better assess the risks of going forward;
- after the evidentiary process which shows how costly the arbitration is getting and how strong the evidence on both sides is;
- a week before the scheduled start of hearings and cross examinations.

The New York Convention on the Recognition and Enforcement of Arbitral Awards

Arbitration’s popularity can also be attributed to the growing number of countries—149 as of 2013—that have agreed to the New York Convention for recognising and enforcing foreign arbitration awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards was adopted in New York in 1958 and signed by 10 countries at the time. “In my view, the principal reason why contracting parties from different nation states choose arbitration is that an arbitration award offers better prospects of enforcement than the judgment of a national court would because so many countries have adopted the New York Convention in their domestic law,” says Steven Walker QC, a senior barrister at Atkin Chambers in London.

If a dispute goes to arbitration, it's important to set a specific monetary target and develop a clear strategy that addresses the key issues necessary to succeed. Project owners or contractors also need to put their money and management time fully behind the case. It's risky to start off half-heartedly in the expectation that the other party will settle.

However, some companies do return to negotiations when arbitration drags on too long without a resolution.

That's what a developer and a construction company in the UAE decided last year. They announced plans to hold amicable discussions to try to resolve a long-running multibillion-dirham dispute over construction of leisure facilities in Dubai. Both parties agreed to withdraw their case from the Dubai International Arbitration Centre after realizing there wasn't sufficient progress in the dispute after several years of arbitration.

So, despite the popularity of arbitration, in many situations, settlement is preferable to arbitration when the terms of settlement are fair and acceptable to the disputing parties.

Legal experts usually recommend arbitration over litigation in emerging markets where there is less experience with disputes and fewer legal precedents, creating even more than the usual uncertainty.

Arbitration in emerging markets

Legal experts usually recommend arbitration over litigation in emerging markets where there is less experience with disputes and fewer legal precedents, creating even more than the usual uncertainty. There could also be a lack of impartiality with a local court, but even when that isn't a concern, it's unlikely in a less developed market that a judge with expertise in construction disputes will preside over the case. "When you're in arbitration, you are picking specialists who have dealt with these sorts of projects and issues many, many times," Foley says. "And you're getting the benefit of that experience."

Taking legal action can also raise questions about which nation's laws apply if the contractors, operators, or financing entities are based outside the country where the project is being built.

The legal system in some regions isn't conducive to some types of dispute resolution. For example, it's difficult to enforce arbitration awards in Africa. The tendency in Africa is to refer arbitration to such cities as Zurich, Paris, or London. "South Africa probably has the required professional skills and machinery to resolve disputes, but it doesn't have a user-friendly legal system to enforce arbitration awards," Tonge says. "Should a US company get into difficulty in Malawi with the government over a project, for instance, South Africa would be a logical place to come if the legal system was more supportive of international arbitration awards."

Conclusion

While the goal of any project owner or contractor should be to resolve small problems before they mushroom into major disputes, the parties also need to be realistic and enter into contracts fully aware that disputes are an unfortunate but inevitable fact of capital project life.

When disputes do develop, owners and contractors should take a business case approach to assess their positions and determine the preferred approach to resolving the conflict. A quantitative risk analysis can be a valuable way to assess the best resolution strategies. Of course, much will depend on the quality of documentation.

It's also helpful to involve people in the resolution process who aren't closely involved in the day-to-day project work and have less of an emotional stake in the outcome. They also bring a fresh view of the challenges and the uncertainties to be managed.

As more major projects are being built in emerging economies, owners and contractors should also consider cultural differences that will affect how problems are handled, as well as the legal environment for settling disputes.

But whatever the location, project owners and contractors can make dispute resolution part of the planning process upfront and establish the proper controls and oversight to manage and document issues as they occur. Not only will that reduce the chances of a major dispute developing, but it also will help them prevail should they end up in arbitration or litigation.

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