

# WHITE PAPER ON THE AVOIDANCE AND RESOLUTION OF CONSTRUCTION DISPUTES

*Adapted from the PUNCH LIST, a publication of the American Arbitration Association.*

The construction industry is, by nature, a complex one. Plans and specifications must be converted from words and drawings to structures through the constant interaction of many parties. Each of those parties has its own priorities and concerns. The industry also is a dynamic one with frequent changes being made to accommodate actual circumstances as they evolve. In the process, inevitable differences between the parties arise concerning work scope definition, delays, obstructions, conflicting need to work in the same area and a myriad of similar problems involving coordination, scheduling and responding to changed conditions. All the while, the process of building must go forward with a minimum of disruption.

Experience demonstrates that resorting to lawsuits to settle construction disputes has many disadvantages. The four main drawbacks are (1) the cost of litigation, (2) delays in obtaining final court decisions, (3) general lack of understanding by judges and juries of the construction process, and (4) business disruptions and time consumed by key people in the organizations involved in disputes. The net result is that all too often only the lawyers, consultants and expert witnesses consistently benefit from lengthy court actions.

Approximately 25 years ago, the Construction Industry Arbitration Rules which are now prescribed in most standard construction industry contract forms as a final and binding method for resolving disputes. These rules are monitored and updated periodically by the National Construction Dispute Resolution Committee of the American Arbitration Association. Representatives on that joint industry committee include those from the Associated General Contractors of America (AGC), the Associated Specialty Contractors (ASC) and the American Subcontractors Association (ASA). The Committee also promotes use of other alternative dispute resolution methods such as mediation,

mini-trials and similar systems for faster, less expensive handling of individual disputes.

More recently, many efforts have been initiated to avoid disputes, or at least resolve those disputes which do arise quickly and informally before positions harden. A parallel aim has been to reduce the amount of lawyering involved in order to lower costs and concentrate on rational solutions rather than emphasize legal issues.

## DISPUTES PREVENTION.

AGC, ASC and ASA strongly support programs to minimize disputes through equitable allocation of risk in contracts and fostering cooperation among members of the construction team throughout the building process. There are encouraging developments that focus on the avoidance of construction disputes. For example, owners and major contracting firms report success with incentive awards for achievement of project-wide goals. They also confirm that more equitable contract terms and rational allocation of risks and rewards have prompted lower bids and more active interest in bidding their projects by responsible trade contractors. The approach not only resulted in better risk management, but there also have been fewer disputes to resolve.

One of the most promising concepts is known as partnering. The basic aim of partnering is to foster an atmosphere of cooperation instead of confrontation. The process can take many forms, but all involve a teamwork approach. Typically, this may start with a several day get together of representatives of the owner, design professionals, construction manager, general contractor and major trade contractors to work informally in a non-adversarial way to identify potential problems and develop practical solutions. The concept also may lead to the use of incentives for all of the basic project goals to be met, but with the clear understanding

that the incentives either would be paid to all contractors or none so as to provide strong motivation for cooperation among the trades throughout the job.

The partnering approach has been used with significant success by the U.S. Army Corps of Engineers on several major projects. Key elements are (1) creation of cooperative attitudes, (2) fair allocation of responsibilities, (3) representatives with decision making authority to work with facilitators to resolve disputes soon after they occur, (4) original and periodic reinforcement meetings to discuss problems positively, and (5) development of a single page project document signed by all participants that addresses accountability and how to resolve disputes quickly. The results have been projects completed on time and on budget, with value engineering savings above plan, good safety experience and no outstanding claims or litigation.

Some insurance companies are promoting dispute avoidance and quick dispute resolution by limiting the amount of money available for legal fees and related costs. They report both major dollar savings and maintenance of business relationships of construction companies on a positive basis.

Parallel efforts include a pledge system whereby firms agree as a matter of principle to make good faith efforts for settlement of disputes before considering mediation or arbitration. Name of signatories are published and given wide exposure. The system is reported to be working so well that law firms will be added as pledgers to provide a further dimension to this approach.

AGC, ASC and ASA support the principle that the vast majority of construction disputes are susceptible to settlement through the give-and-take process by decision makers of construction team members without resorting to formal third-party intervention. We further believe that

the role of lawyers should be minimized in most dispute situations inasmuch as typical construction problems generally relate to fact and customary industry practice far more than strict legalities. Formal because of the desirability of the parties settling disputes as quickly and inexpensively as practical. AGC, ASC and ASA jointly endorse the inclusion of language in contracts stating that the parties first should endeavor to settle disputes through direct discussions before considering mediation or arbitration. Such wording is included in the dispute resolution section of the latest edition of AGC Subcontract Document 600.

An array of negotiating techniques are available. Step negotiation procedures call for disputes to be passed promptly to successively higher levels of management until resolved. Experience indicates that most disputes are settled early because of a natural reluctance to bother higher management with routine problems.

**NON-BINDING ALTERNATIVE DISPUTE RESOLUTION (ADR) METHODS.** There are a number of alternative dispute resolution (ADR) methods which involve the use of a neutral but are consensual and non-binding in nature. These methods are somewhat more structured than direct discussions and negotiations between the parties. Non-binding systems have the advantages of speed and generally being within control of the parties involved. Results have been good in that a high percentage of cases are resolved without recourse to a final and binding method such as arbitration or litigation. Customarily, it is the presence of an arbitration clause in the contract that encourages the parties to engage in non-binding settlement techniques.

The traditional method of dispute resolution involving a third party, particularly on technical questions, is to use the project architect for initial decisions on disputes not involving possible fault on its part. By this method, an expert third party who is intimately familiar with the project can provide a reasoned evaluation of competing positions. Most standard industry contract documents include this role for the architect on construction jobs.

One of the most promising non-binding ADR devices is the disputes resolution panel also referred to as a dispute resolution board. This involves use of panel members who are ordinarily technical experts chosen in advance by the parties to address

disputes at the time those arise on a project. This method especially is useful for resolving problems that are technical or practical in nature. For instance, the panel for a project can address differences of opinion about scope or extra work disputes. The aim is for the panel to be able to act quickly and settle questions before confrontational attitudes harden. The very existence of the panel and the assurance that if the parties don't settle the dispute, it will be dealt with quickly and objectively by an expert, usually results in a settlement of disputes without referral to the panel at all. In those cases where the panel does act, the panel's recommendation, while legally non-binding, is almost universally accepted by the parties. If the parties don't accept the panel's recommendations, they can, nevertheless, be entered as evidence in any later arbitration or litigation.

**MEDIATION.** The most frequently used method of non-binding ADR is mediation. Mediation consists of one or more impartial parties advising and consulting with the parties to a dispute. The mediator cannot impose a settlement, but rather guides the parties toward their own settlement. The procedures ordinarily are carried out in accordance with the Construction Industry Mediation Rules of the AAA. Mediation is available to the parties by mutual agreement even though a contractor may specify arbitration as the method prescribed for dispute resolution. AGC, ASC and ASA support inclusion of contract language recommending that both parties consider mediation prior to arbitration. The advantage of including language in the contract recommending mediation is that many contractors feel it might be considered a sign of weakness, after a dispute has arisen, to be the party who first suggests mediation. However, we believe that it is inappropriate for contracts to mandate mediation, inasmuch as non-binding methods need a good faith intent by each party to use those procedures effectively. If one of the parties does not agree, both time and effort can be wasted.

Mediation is a fast process that has, approximately, an 85 percent success rate. The AAA conducts mediator training and qualifies those who merit appointment to the AAA's Construction Mediation Panel. Mediation offers a good means for resolving disputes involving public agencies unable to use arbitration because of legal or policy constraints against ADR methods that are final and binding. Mediation ordinarily requires only a day or so of time with

the mediator actively working with the parties to fashion a settlement. The process also is facilitated by addressing the issues quickly enough for memories to still be fresh and needed persons available to participate.

**MINI-TRIAL.** Another non-binding ADR method available for use as an alternative to mediation is the mini-trial. It is not a trial in the usual sense of an adversarial judicial proceeding. Instead, it is a relatively structured process whereby management representatives of the parties to a dispute usually accompanied by a neutral advisor conduct an informal hearing lasting not more than one or two days. At this hearing, the positions of the parties are presented in an atmosphere that allows for explanations, discussions and rebuttals. During this informal process, witnesses, experts and their support material are involved without need to follow traditional rules of evidence. The basic idea is to have the principals of firms see the relative strengths and weaknesses of their cases and to serve as a basis for negotiations between them for resolving the dispute, assisted if necessary by the neutral.

**OTHER METHODS.** The advisory ruling technique calls for a neutral expert to meet with the parties together and then separately to obtain information for evaluation and preparation of a non-binding conclusion that often provides a realistic basis for settlement by the parties.

Fact based mediation combines the advisory ruling and mediation methods. Here the mediator issues separate reports to the parties assessing the facts plus a dollar amount suggested as a fair settlement figure based on those facts. The parties then negotiate a settlement with the assistance of the negotiator.

**ARBITRATION.** Unlike other ADR methods, arbitration is final and binding. Decision of the arbitrators are subject to challenge on very narrow grounds such as prejudice or bad faith action on the part of an arbitrator. Arbitration is used widely in the construction industry, and the practice is encouraged by provisions in standard contract documents such as the following wording in the American Institute of Architects Document A201, General Conditions of the Contract for Construction:

***"Any controversy or claim arising out of or related to the Contract, or***

*the breach thereof, shall be settled by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator or arbitrators may be entered in any court having jurisdiction thereof, except controversies or claims relating to aesthetic effect and except as waived..."*

**ARBITRATION** may involve one or three arbitrators jointly chosen by the parties. The process normally is simpler than litigation and has the advantage of having the case heard by persons experienced in the construction industry. However, the parties may elect through agreement to make the arbitration system more like litigation through changes which may involve such court procedures as discovery, rules of evidence and legal briefs. AGC, ASC and ASA recognize the desirability of using the flexibility of the arbitration method to tailor rules to fit the needs of specific cases. However, we unnecessarily slow the resolution process and thereby add to the cost of arbitration. We also support action taken by the National Construction Dispute Resolution Committee whereby expedited procedures, including use of a single arbitrator, were extended to cases involving dispute amounts up to a ceiling of

\$50,000.

Occasionally, non-binding arbitration is elected by those interested in arriving at a third party decision that is not final and binding. Also, some prefer the so-called baseball form of arbitration where the parties present their evidence along with their separate settlement amount offers. Under this system, the arbitrator must choose one of the two amounts as being the more reasonable. The result ordinarily is binding on the parties. Its chief merit is in motivating both of the parties to bring forward rational offers.

**CONCLUSION.** The current emphasis on construction dispute avoidance appears to have resulted largely from enlightened self-interest. Increasingly, both public and private owners, as well as construction managers, and general contractors and subcontractors, have come to recognize that a level playing field approach pays dividends in the form of lower bids from responsible contractors and also fosters better teamwork.

Through the logical allocation of risks plus a quick, fair and inexpensive means for resolving the inevitable disputes that arise during the complex building process, members of the construction team can better concentrate on their primary common task of completing

quality buildings on time within cost expectations.

Accordingly, AGC, ASC and ASA support initial efforts to avoid disputes. If disputes do occur, we encourage settlement of disputes through direct negotiations. If it becomes necessary to use neutral third parties to assist in the resolution process, we recommend consideration of the use of non-binding ADR methods such as mediation because of speed and cost considerations. Finally, where parties to a dispute want final and binding resolution, we support arbitration using qualified and properly trained construction persons as arbitrators and utilizing expedited and streamlined procedures to the extent practical to achieve a final adjudication. **E**

*The American Subcontractors Association, the Associated General Contractors of America and the Associated Specialty Contractors have a variety of unique functions but at least two common goals: more efficient, timely and economical construction for the mutual benefit of owners, architect/engineers, contractors and suppliers, and equitable and ethical relations between general contractors and subcontractors. The associations' commitment to promotion of these goals has led to a working relationship on issues of common concern and interest. One of the products of this relationship is the "WHITE PAPER ON THE AVOIDANCE AND RESOLUTION OF CONSTRUCTION DISPUTES". This white paper was developed to help educate members of the construction team about the many methods available for dispute avoidance and resolution.*

