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CONSTRUCTION LAW—2011 UPDATE
PAPER 2.1

Designing a Suitable Dispute Resolution Process for Major Construction Projects

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DESIGNING A SUITABLE DISPUTE RESOLUTION PROCESS FOR MAJOR CONSTRUCTION PROJECTS

Major construction projects, especially those involving long-term relationships, present special challenges to those charged with designing and implementing a suitable dispute resolution regime. These challenges include:

- Some disputes will relate to technical or scientific matters, some will involve legal rights and obligations, some will involve disagreements on business matters and some will be mixed.
- Disputes may involve small sums or very large sums.
- Resolution of legal disputes on the merits is important, particularly when large sums of money are involved.
- In many cases, whether involving large or small amounts, speed of decision-making will be important to keep the project or business going.
- Disputes will often involve more than two parties.
- Disputes may arise on the same facts under multiple agreements.
- Disputes may involve the application of statutory remedies over which courts may have exclusive jurisdiction.
- There may be a chain of contractual relationships that could result in third-party claims.
- Disputes may arise in more than one geographic jurisdiction.
- Time demands on operational personnel (to give evidence or prepare or defend claims) must be managed.
- Maintaining a constructive business/working relationship is important.

I. Steps in the Design Process

The design process should begin with a "visioning process"—a collaborative effort between the operational, executive and legal personnel within the sponsoring corporation, in which they look ahead to identify as best they can the range of disputes that might arise and the specific demands these will entail. Then the responsibility shifts to legal advisors to create the regime and identify the steps needed to implement it.

There is a tool-box of available concepts that may be used to address relevant issues or concerns. But there is seldom a "one-size-fits-all" solution. Ultimately, a healthy measure of creativity is needed to create a regime that will effectively manage disputes arising in the context of a specific project or long term relationship.

The DRP should be designed before any contracts to implement the project or undertaking are completed. The DRP, or the applicable elements of it, can then be included in the contracts as they are executed. In a long term project involving numerous participants and separate agreements, it is possible to require that every participant agree to be bound by a project protocol for dispute resolution that addresses all of the potential concerns listed above. At the very least, if it is simply not feasible to fully design and document the DRP before any contracts are made, those contracts should leave the sponsoring organization with sufficient flexibility to implement a comprehensive DRP at a later stage.

A DRP also should be straightforward enough that it can be understood by and, at least in the preliminary stages of a dispute, applied by operational personnel, yet comprehensive enough to treat each claim appropriately.

II. Identifying Categories of Potential Disputes

A well-drafted DRP will often establish different procedural pathways for different kinds of disputes. It is essential to identify at the outset what categories of dispute may arise over the life of the project or the course of the relationship and to ensure that the DRP allows these disputes to be resolved in the most appropriate manner.

A. Disagreements About Matters of Business Judgment

Long term contracts often intentionally leave some important business matters for future discussion and decision, as future circumstances are simply too difficult to predict. Business people like to retain the flexibility to change their plans to reflect changes in circumstance. This happens most often in relationships that are akin to partnerships or joint-ventures, where decisions are by a management committee or some similar body. Sometimes, a corporate vehicle is used to implement this type of arrangement, with the result that the legal relationship between the parties is that of shareholders in a company.

In all such cases careful thought must be given as to whether the structure may allow deadlocks to arise where the parties simply cannot agree on a matter of business judgment. If so, and if there is no prescribed deadlock-breaking mechanism, there is a risk that the undertaking may fail for want of agreement. Disputes or differences about what is the best business decision may not give rise to any legal rights or obligations. If a corporate vehicle is used, an applicable statute may provide a remedy, but oppression or winding-up proceedings are unlikely to preserve either the undertaking or the relationship.

Business people often prefer to count on common sense and good business judgment prevailing in the end, and prefer to avoid having deadlocks or disputes about business judgment subjected to any contractual DRP. Where that is not the case, with creative drafting, identifying objectively ascertainable criteria or standards that are to be applied where there is a business dispute or deadlock, sometimes disagreements about business points can be transformed into legal disputes. Then, care must be taken to ensure that the contractual process and remedies are properly meshed with any applicable

statutory remedies or processes. Generally, the parties will want to ensure that every effort is made to reach agreement on matters of this sort before the decision is put into the hands of a third party for adjudication. These kinds of dispute often are best handled through a "tiered" process, involving negotiation and mediation before arbitration or litigation.

B. Disagreements About Matters of Opinion Involving Expertise

Even where the contractual relationship does not involve joint decision-making, specific matters may be left for future agreement. Often prices or rents or other elements of monetary consideration are to be adjusted periodically by agreement. There are sometimes complicated accounting processes called for under the agreement, and disputes can arise about the results of these. In construction projects there may be myriad detailed decisions to be made on a daily basis about how particular situations or site-conditions should be addressed.

As with disputes about matters of business judgment, with careful drafting disagreements about matters of opinion involving expertise also can be transformed into legal disputes, but that may not be the most desirable alternative. Often, disputes of this nature are best resolved by placing the matter in the hands of a qualified independent expert for decision, with the parties agreeing to be bound by and to carry out that decision. Sometimes they lend themselves to being resolved by "baseball" or "final offer" proceedings.

C. Disagreements About Legal Rights and Obligations

Disagreements about legal rights and obligations generally should be resolved according to law, by a form of adjudicative process. That process generally should afford each party an opportunity to present its case, after which an independent decision-maker decides the dispute on its merits. This is, of course, the situation for which either litigation or arbitration provide a procedural solution. Which of these alternatives is preferable deserves fresh thought in the context of each new project or relationship. It is fair to say that generally arbitration is the more flexible of these two alternatives, and is often preferred for that reason alone, but there will still be instances where the litigation option, at least for some kinds of relief, should remain open.

The parties can expressly agree that some criteria other than the usual legal rights and remedies—criteria such as "fairness" or "commercial reasonableness" or "*ex aequo et bono*"—will be applied. Such agreements are rare, however, as they are fraught with uncertainty.

III. The Fork in the Road Provision

Once the potential types of disputes have been identified, suitable pathways for their resolution must be laid down. When the DRP is to provide different procedural pathways for different types of disputes, as is usually the case for major projects, a threshold challenge is to define the relevant categories with sufficient clarity and precision that there is no room for dispute about which procedural pathway applies. The fork in the road provision also has to be flexible enough to deal with "mixed" disputes and, ideally, disputes that may change their character due to amendment or otherwise.

Some DRP's attempt to stream disputes into different processes depending solely on the amount involved. Although the idea is a good one, the implementation can be perilous. For example: the amount involved may be over-stated for tactical reasons; single claims may be broken down into impractical pieces or very distinct claims may be unnaturally consolidated to stay under or get over the threshold for a particular procedure; a respondent may resist being taken down an undesirable path by attacking the credibility of the amount claimed; the claim may be amended mid-process in a way that could take it into a different stream, etc.

One good way of categorizing disputes is by referring back to the specific contractual provisions under which they arise; for example, "disputes arising under article 12.2, 14.3(a) etc." This approach is difficult to use in multi-contract, multi-party settings, especially if some of the relevant agreements do not yet exist when the DRP is drafted. Care must also be taken to set out what is to be done where more than one provision of the contract is relevant.

Even where the categories are well defined, it may be appropriate to provide for a speedy, summary final determination of disputes that may arise at the "fork in the road" about which path to take from that point, or to agree on a "default" pathway if there is any dispute about the applicable process.

IV. Expert Determination

One category of dispute which often is capable of discrete definition are disputes concerning technical or scientific matters, or other matters involving expertise, that the parties have identified at the time the relationship is established; for example, disputes concerning quantification of profits or losses, or the value of property, or the physical composition, functionality or attributes of an object, substance or work product. To make the relationship work the parties know that from time to time they will have to agree on such matters, and if they are unable to agree they want someone with suitable expertise to decide for them.

"Expert determination" is the label generally attached to the process most suited to resolving these kinds of disputes or disagreements. But that phrase is not universally recognized as a term of art, in the same sense as "arbitration" or "mediation" or "conciliation." Thus, when establishing the pathway that leads to expert determination it is not enough, nor is it necessary, to simply use that label—one has to describe with clarity the steps and characteristics of the intended process.

Expert determination is conceptually different from arbitration. Arbitrators generally adjudicate the rights and obligations of parties, based on a record of evidence. Procedural fairness generally requires that an arbitrator, no matter how expert in the subject matter of the dispute, must not decide the dispute based on personal expertise or experience that the parties have not had an opportunity to test or challenge. Except in those rare cases where arbitrators are empowered to decide *ex aequo et bono*, arbitrators decide by applying the applicable law. Experts, on the other hand, are appointed by the parties for the precise purpose of applying their own expertise and deciding the matter in dispute according to their own views, and the resolution of the dispute does not turn on legal rights. For a true expertise process, it is only the opinion of the expert that matters. The parties agree that they will act in accordance with the expert's determination. There is no requirement for procedural fairness. There is no award or other adjudication from which to appeal.

A major source of difficulty when drafting complex DRP's is that parties often want to encumber the expert determination process with the procedural trappings of an adjudication. The parties want to present documents, information, the opinions of other experts, submissions or even evidence to the expert, before a decision is made. There is grave danger in going too far in that direction, for the more the process is designed to resemble an adjudication between two competing positions, the greater the risk that a court may find that in substance the process is an arbitration. And when the process is so characterized, that may bring into play arbitration legislation, unexpected standards of conduct and procedural requirements, rights of appeal and other unintended consequences.

The International Chamber of Commerce has done a useful service to drafters of complex DRP's by publishing "Rules for Expertise." Those rules set out a procedural framework for the appointment of experts and the conduct of ICC administered "expertise proceedings," ranging from expressions of non-binding opinion to binding determinations. Even those rules, however, must be viewed in the light of any law that may be applicable to the particular process, as the rules require the expert to give the parties the opportunity to be heard, and, if the result is said to be binding, the process could be characterized in some jurisdictions as an arbitration.

V. Project Referees and Dispute Boards

Often, to keep a construction project moving forward, the parties will need access to speedy, informed decision-making. At the same time, they want to ensure that, especially as regards important legal rights, their ultimate rights are not irrevocably prejudiced by a decision that emphasized speed and practicality over thoroughness and correctness.

To balance these concerns one common mechanism is the use of a Project Referee. Sometimes they are referred to as "Adjudicators," but for the reasons alluded to above, unintended legal implications may flow from a process that is regarded as adjudicative. In some jurisdictions, including the United Kingdom, there are statutes that provide a legal framework for this kind of process. In most places, however, there is no legislative framework for non-arbitral processes of this sort.

Project Referees should be appointed and named in the DRP. A process for alternates or replacements should be set out, ideally naming pre-agreed individuals who are willing to serve, and giving one party the power to make the selection. This is necessary because, if the Referee is not an arbitrator, arbitration statutes that allow for court appointment of arbitrators in the event of disagreement will not apply. As with experts, sometimes an arbitral or professional institution will be willing to appoint a Project Referee in the case of disagreement, but before naming such an institution the drafter should get written confirmation from the relevant institution of its agreement to act.

A decision must be made about whether, in any circumstances, the decision of a Project Referee is to be binding. Often the answer is "yes" with respect to some kinds of disputes but "no" with respect to others. Again, this raises the drafting challenge to define these situations in a way that will not create uncertainty or disagreement.

It is common for the DRP to provide that a decision of a Referee is "binding" unless one of the parties takes a step (typically delivering a written notice within a specified time) to move to another step in the dispute resolution process. Careful thought has to be given to the legal basis for a "binding" decision. If the process is not an "arbitration" within the meaning of applicable arbitration law, and if there is no other statute to give them binding effect, neither party can look to those laws to enforce the decision. In such cases, the "binding" effect of the decision is purely a matter of contract. Recognizing this, a prudent drafter may be well-advised to include in the DRP, or elsewhere in the contract, an express covenant by the parties to conduct themselves to give effect to the Project Referee's decision. The failure to perform that covenant would then become a breach of a legal obligation. Tools such as liquidated damages might be considered to add teeth to the commitment. But the ultimate remedy would be to pursue the claim for breach of contract in the same manner as other such claims. Again, the right to do so should be specified.

Usually, to further their business objectives, the parties will wish a Project Referee's decisions to be binding, at least in the first instance. If they relate to business decisions or matters of opinion (the Project Referee may be, in effect, an "expert"), they will not want them to be subject to any reconsideration. If, however, they relate to legal rights and obligations, they will wish to have an opportunity to have the dispute resolved according to law after a more through consideration of evidence. When that is the case, DRP's may state that such disputes may, within a stipulated period of time, be referred to arbitration, but, unless and until the arbitrator determines otherwise, by way of interim or final award, the Referee's decision is binding and must be put into effect. This allows the project to move forward, while preserving ultimate legal remedies.

An issue the drafter must consider and address is what remedies, if any, there will be to recover costs or damages associated with carrying out a Project Referee's decision that is later reversed or modified by an arbitrator; this is a question of risk allocation, and the answer will vary from one agreement to the next. Sometimes the issue is "ducked" by giving the arbitration tribunal a broad discretion to allocate such losses as it deems appropriate in all the circumstances.

One tool that is sometimes used to lower the likelihood of further proceedings being taken after a Project Referee's determination is to set out in the DRP factors or criteria the parties agree the Referee should take into account when making a decision; for example, "the parties agree that it is essential that the project be concluded by January 1, 2010" etc. Especially if such criteria are provided it is important to make it clear whether those criteria are to be applied in any later arbitration. Generally, the DRP must state whether the arbitrators are to decide whether the Project Referee's decision was correct or not (in essence, an appellate process), or whether the arbitrators should simply decide afresh the underlying dispute; normally *de novo* arbitration proceedings are more appropriate, with the Project Referee's determination simply being a background fact.

Dispute Boards are a variation of the Project Referee approach. They consist of panels of decision-makers established at the beginning of a contract

The ICC has published Dispute Board Rules, which illuminate and address some of the issues discussed above. The ICC rules identify three alternative types of Dispute Boards: (a) a Dispute Review Board, which issues "recommendation" that become contractually binding if not challenged within a specified time but which are non-binding if a party elects to take the dispute to arbitration; (b) a Dispute Adjudication Board which, as its name suggests, issues decisions which are contractually binding unless and until the dispute is referred to arbitration and the tribunal otherwise orders; and (c) a Combined Dispute Board which may issue either recommendations or decisions. The difficult question of whether any of these might be regarded by some applicable law as "arbitration" proceedings cannot, of course, be resolved by the ICC or anything stated in the rules.

VI. Multi-Party and Multiple Contract Relationships and Project Protocols

The entire DRP instantly becomes more complex if there are more than two parties, or groups of parties, involved in the relationship or if there is more than one contract. Most projects entail extended chains of contractual relationships between owners, consultants, financiers, contractors, sub-contractors, suppliers, customers and others. At inception the participants have a common interest in the success of the project and its timely execution. Often there is more than one contract between the same parties. In the ordinary course, each contractual relationship will have its own DRP. A single incident or set of facts and circumstances can give rise to claims under multiple agreements and based on myriad permutations of bi-lateral and multi-lateral relationships. The time and cost of determining rights and liabilities and allocating and reallocating financial responsibility can jeopardize the project and the financial well-being of its participants.

These circumstances are often said to shift the balance of effectiveness in dispute resolution away from arbitration and toward litigation. Through third, fourth and fifth party proceedings, counterclaims and set-offs, adding parties and consolidating actions, courts do have the capacity to manage multi-lateral, multi-party disputes. Conventional arbitration, which is essentially a bi-lateral process for the resolution of disputes arising from a single relationship cannot achieve what litigation can achieve. What is required is a multi-lateral agreement to arbitrate, with procedural rules that are flexible enough to do what courts can do, while still delivering the potential benefits of commercial arbitration. These arrangements sometimes are called "project protocols", but the concept can be applied to any multi-lateral long term relationship. They represent the supreme DRP drafting challenge, but can deliver huge benefits to participants.

The design of a project protocol should be undertaken by the major project sponsors. One of the first decisions to be made is how far to reach, in terms of encompassing other potential players and relationships and binding them to the DRP. Sometimes key participants in a project will *not* want to involve participants who play a minor role or who are several steps away from them in the contractual chain, and usually they will not want "remote" parties to be able to embroil them in disputes. However, they may want remote parties to commit to them to resolve any disputes with others in a particular way. One benefit of a contractually implemented DRP is that the same rules do not have to apply to everyone or in all cases.

Elements of a project protocol could include:

- a stand-alone protocol document that is then incorporated by reference into other contracts;
- a provision that each party subscribing to the protocol agrees with each other subscribing party to resolve all disputes between or among subscribing parties relating to the project or undertaking pursuant to the protocol (possibly with specified exceptions);
- a section defining any categories into which disputes are to be divided for the purposes of receiving different treatment under the protocol (for example, disputes that will be finally determined by expert determination, by Project Referee or Dispute Board; disputes that will be subject to preliminary determination by a Project Referee or Dispute Board, but possibly subject to further arbitration proceedings; disputes that will go straight to arbitration);
- appointing named experts, Project Referees or Dispute Board members, and alternates or substitutes, or establishing a mechanism for their appointment;
- the processes and time limits that will apply to each type of dispute;
- a mechanism to resolve any disputes about which category of dispute applies;
- provisions for how notice is to be given and who it must be given to for each category of dispute;
- detailed procedural rules for each process, or references to institutional rules such as those of the ICC;
- for some categories of dispute, criteria that the decision-maker is to take into account in making a decision;
- provisions for consolidation of disputes arising from the same material facts, for adding parties and for third-party claims;
- covenants to carry out and give effect to any decisions, with remedies for breach of that covenant;
- covenants to continue performance while the dispute remains unresolved.

VII. Tiered Regimes and Other Ideas

For many business people, the first priorities for any process to resolve disputes arising over the life of a long-term relationship are, as far as is feasible, to preserve an effective working relationship and to prevent disputes from interfering with business success. Often, it is not the fact of a dispute, or of contentious proceedings, that results in a breakdown of business relations; rather, it is the way in which the dispute is sought to be resolved that creates undesired tension.

The most common way of addressing this need is to mandate negotiation or a form of assisted negotiation as a precursor to any formal adjudication. There are potential pitfalls to such "tiered regimes"—disputes about whether the mandated steps have been taken to fulfill a necessary pre-condition to arbitration, disputes about whether "good faith" obligations have been met, concerns about being unable to move for immediate enforceable emergency relief, concerns about information exchanged or concessions made during efforts to resolve matters later being used as a weapon in an arbitration, concerns about delaying tactics—but many of these can be overcome by good drafting and often business people are willing to live with any residual risks.

There are, however, other approaches that can be considered. Mini-trials and other processes that allow relatively disinterested senior executives to break logjams developed at the operational level can be considered. Even in formal, adversarial proceedings that will lead to a binding adjudication of

rights, rules can be adopted to de-personalize the proceedings—limited oral discovery, unsworn evidence, expert witness conferencing and unreasoned awards may have a place. It may be possible to provide a mechanism for interim resolutions, while deferring the resolution of contentious proceedings on their merits until a later stage, when accumulated complaints and cross-complaints can all be considered together and the underlying common business objectives have been achieved.

VIII. Conclusions

The creation of a dispute resolution process for a major construction project is not a task to be taken lightly. However, it is task which, if done with care and vision, can save vast amounts of money and time and make a direct contribution to the success of the undertaking. There are many procedural permutations and combinations from which to choose, and there are institutions, like the ICC, ready to assist with some of them.