Alternative Dispute Resolution Construction Adjudication Primer

The International and Domestic Adjudication of Construction Disputes

Fifth Edition 2006

Edited by

Corbett Haselgrove-Spurin

NATIONWIDE ACADEMY OF DISPUTE RESOLUTION

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Construction Adjudication Practice

5th Edition 2006

The International and Domestic Adjudication of Construction Disputes under English Law

Edited by

Corbett Haselgrove-Spurin

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Construction Adjudication Practice

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He has been active in the ADR field since 1978. He has been a trial attorney, a state judge, a law professor and has served in thousands of cases as mediator and arbitrator. Judge Faulkner is widely published and speaks regularly before local, state and national and international groups. He has taught mediation and arbitration in England and Malaysia for neutrals to serve in Europe, China and South East Asia. He is a member of a panel of worldwide, international arbitrators, and is one of the prominent dispute review board panel chairman in the Dallas/Fort Worth metroplex area.

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PREFACE

By Mark Entwistle

Construction contracts have traditionally been formulated to reflect the legal rights and obligations of the parties. Their primary intention has been to regulate the relationship between the parties, with the objective of securing the due performance by each party. Where a party failed to perform as demanded by the contract, the agreement between them would typically provide remedies which would compensate the aggrieved party. Whilst this rights-based approach ensured that a strong framework of remedies existed, mirroring in contract terms the approach of the common law, it did little to persuade the parties to work together to secure the successful outcome of the project.

Building and engineering construction are endeavours fraught with risk. This essentially arises as a result of both the complex and the unpredictable nature of the work carried out and the circumstances in which it is carried out. Whilst it would be true to say that many of the risks inherent in construction can either be eliminated or reduced, the unpredictable nature of the circumstances of construction work means that many of the risks have to be borne by the parties involved.

The legal relationship arising from contracts also has, as one of its fundamental purposes, the allocation of risk between the two parties involved, and every construction contract and sub-contract ensures that risks either remain with the party promoting the contract terms or are passed to the other party to the contract. A fundamental cause of construction conflict and financial claims made by one party against the other arises from either a failure to appreciate the nature of the risks being borne or a failure to effectively manage those risks.

It is as true of construction conflict as it is of all other aspects of professional, commercial and private life that prevention is better than cure. Most of those involved in the pursuit of resolution of construction conflicts will testify to the amount of time, energy and cost, which is expended in that endeavour. It is a sobering thought to reflect that in the last 20 or 30 years the pursuit and defence of contractual claims has taken on almost epidemic proportions and represents one consistent growth area in the construction industry, becoming as it is now, a virtual industry within an industry.

That being the case, there is a growing demand evident around the world for a mechanism of dispute resolution which is quick relatively inexpensive, and which delivers a result in a manner which enables parties to preserve their working relationship by allowing disputes to be ruled upon by an independent third party as the project progresses.

The traditional processes of litigation and arbitration have tended to take considerable time to reach judgement or award, very often after the completion of the project. In addition, the costs involved can be considerable, sometimes even exceeding the sum in dispute. It is with these factors in mind that Adjudication has been developed and is in use in a number of legal jurisdictions. The success of the process will undoubtedly expand its use around the world and it is foreseeable that it will not be very long before adjudication becomes the foremost dispute resolution mechanism for commercial contracts.

Objectives of the course.

By the end of this course participants should have acquired a substantial knowledge of the construction adjudication process. This course is designed for experienced construction professionals and aims to provide sufficient academic background to the process to enable them to engage in construction dispute settlement and the statutory adjudication process in England and Wales.

However, in order to practice, a period of time should be spent undergoing pupilage to acquire practical knowledge and experience of the process. Furthermore, this is such a fast growing and evolving area of practice that it is essential that knowledge of the process is continually updated. The Scheme is due to be revised in the very near future and about four significant cases appear each month at the present time. There is a major ongoing process of revision of construction contracts and new industry protocols and in house schemes appear at regular intervals at the present time.

This course provides the intellectual tools for addressing this area of practice but due to the changing nature of the industry and its documentation, cannot be taken as a definitive statement of law and or practice.

Background to the introduction of Construction Adjudication in the United Kingdom.

1) Intro to Industry

The UK Construction Industry is arguably the largest industry in the UK. Certainly it is the largest if you include all the associated industries such building material suppliers. The UK Construction Industry employs 1.9 million people and is worth £65 billion a year, which equates to approximately 8% of the UK's Gross National Product.

Given the size of the industry it is reasonable to suggest that the performance of the Construction Industry can and indeed does have a real impact on the overall performance of the UK economy generally.

Now whilst I don't have specific data on the impact of the Construction industry on economies worldwide, it is inevitable that they will have an impact. Even if a particular country's construction industry contribute less than 8% of the Gross National Product, as in the UK, they will nonetheless have a direct impact on an economy. Commerce relies upon construction to provide roads and rail links for communication, new offices or upgrading existing, factories, workshops and the power stations, which provide the energy, which all industries need to function. The construction industry workforce is also reliant upon shops, hospitals, schools and housing. The list goes on and on. If the construction industry does not function effectively and is inefficient, the entire economy becomes inefficient. Everyone pays for that inefficiency. The client will pay more for his building, which will almost certainly be late resulting in further losses. The contractor, being inefficient will make less profit, this will probably follow down the line to sub-contractors. Even consultants will be affected. If a job is run inefficiently the consultants will be required to spend more time on the project dealing with the problems.

2) Adversarial Nature

The UK Construction Industry, and in fact the industry worldwide has long held a reputation for being conflicts ridden and has been described as large, fragmented and adversarial. The industry is a fertile seed-bed for disputes.

Whilst working overseas I came into contact with construction professionals from many different countries, yet almost without exception our experiences were similar in that disputes are rife within the industry.

Reasons for this dispute culture could be attributed to a variety of factors such as the extreme diversity of the industry, to the fact that Construction covers such a wide range of end products and because it employs a large variety of different professions. New projects will normally differ in one way or another from previous projects. This individuality of projects and the inevitable resultant learning curve involved will place pressures on the whole project. It is also common that at the inception of what is already a unique project, a team of people is brought together who have never worked with each other before, to manage and construct it. Is it so surprising that problems occur?

Construction contracts have developed on the basis of conflict. Most standard forms of contract provide for the requesting of extensions of time, loss and expense claims and also liquidated and ascertained damages. It would perhaps not be wrong to suggest that the construction industry had reached the stage whereby the submission of a claim for loss and expense was regarded as the norm rather than the exception. Of course all that really achieved was to devalue the position of genuine claims in the eyes of the main contractor or employer.

Whilst the adversarial atmosphere affected both clients and main contractors, it was the sub-contractors who were affected the most. The impact of this adversarial atmosphere put additional if not unfair pressure on the sub-contractors. Main contractors traditionally were of a sounder financial background than sub-contractors. Main contractor's could engage in the playing of financial games as part of the construction process. Sub-contractors did not have the financial grounding to survive. The majority of sub-contractors, when faced with a delay in cash-flow, were susceptible to company failure.

Whilst undoubtedly some sub-contractors submitted, shall we say, somewhat spurious claims geared towards solving errors in tenders, many claims were genuine entitlements caused by factors outside the control of the sub-contractor. Now I do not expect anyone to shed a tear for the potentially greedy sub-contractor, who having made an error, seeks to recover the financial consequences of that error from the main contractor, but what of the genuine claim?

Pre-HGCRA 1996 what were the options available to a sub-contractor if he had a genuine grievance against the main contractor. We focus more on the sub-contractor simply because he was normally the weaker party in a contract. In fact this weakness should be considered. When negotiating contract terms and conditions it is likely that a sub-contractor would be in a far weaker bargaining position than the other parties to a contract. This might have been simply because of their financially weaker background or more likely because of the increased competition, which most sub-contractors find themselves facing. Without doubt a main contractor would normally be able to exert reasonable commercial pressure on the sub-contractor to dictate at least slightly more advantageous terms in their favour.

So what were the options available to parties to a construction contract when problems occurred? Pre HGCRA 1996 there were generally only two options available, or in fact more accurately only one option available, depending as to whether the parties had pre-determined arbitration or litigation. Arbitration, as I'm sure you are well aware is a voluntary process. If the parties agree in advance that any disputes that might arise will be referred to arbitration, then those disputes will be referred to arbitration unless both parties subsequently agree that they no longer wish to resolve disputes via arbitration. It is generally acknowledged that parties in dispute will not agree what day of the week it is, let alone agree on matters as important as whether to abide by an agreement to arbitrate disputes. Therefore if an agreement incorporated provisions to arbitrate it was quite likely that the method of employed to resolve disputes would therefore be arbitration.

Now I deliberately mentioned the word ***"generally"*** when talking about the options available to resolve construction disputes. Certain standard forms did provide for alternative methods of dispute resolution. The JCT sub-contracts facilitated a form of adjudication for the resolving of disputes. However adjudication was only available to the parties in respect of resolving issues of set-off or contra-charges. Whilst helpful in a limited way disputes normally encompassed wider issues than that of set-off or contra-charges and as such the adjudication provisions were seldom used.

Arbitration and litigation placed enormous strains on the cash flow of sub-contractors. Neither process was quick. The average arbitration took in excess of 15 months to conclude from start to finish. The average litigation, based on a sample of 205, took 34 months. Not only did these processes take a long time to reach a conclusion they also tended to be expensive. Cases involving sums of between £12,500 and £25,000, the parties costs averaged at 96% of the claim value. The 96% was after taxation, meaning that the actual cost of litigation before taxation could be in the region of 130% of the value in dispute.

It is no wonder that both litigation and arbitration were steps, which were not taken lightly. The resources and finance required to pursue either option were significant, particularly for the average sub-contractor or small main contractor in an already competitive market place. A further consideration for UK construction companies prior to 1996 was that arbitration was not a settled process. All to often the courts intervened and it was not until the inception of the Arbitration Act 1996 that the UK Arbitration process was brought back on track.

3) Latham Report

Sir Michael Latham, a former Conservative MP and ex-director of the UK House-builder's Federation, was commissioned by H.M. Government to lead a year-long, enquiry with the purpose of ending "the culture of conflict and inefficiency that dogs Britain's biggest industry".

The report, entitled Constructing The Team, *Final Report of the Government / Industry Review of Procurement and Contractual Arrangements In The UK Construction Industry* [HMSO, London, 1994 (hereinafter "the Report")], was initially greeted with "almost universal praise" [7]. In addition to reviewing the state of the UK construction industry, Sir Michael makes 30 recommendations for improving the industry.

Among the recommendations were:

- creation of a standard form of contract based upon the New Engineering Contract;
- establishment of a building clients' lobbying organisation (called 'NewCo' by Sir Michael [8]);
- clarification of building liability responsibilities;
- implementation of 10-year building defects insurance similar to the insurance utilised in many parts of Europe;
- implementation of productivity improvements leading to a 30 per cent reduction in real construction costs (Sir Michael points out that construction costs about 30 per cent more in the UK than in the US [9]);
- requirement of trust funds to ensure companies get paid;
- broader utilisation of so-called "alternative dispute resolution methods".

Generally Latham emphasises the importance of the team in construction projects. Latham's considered that it was necessary that disputes were resolved quickly and fairly. Lingering disputes were likely to have a negative effect on the team effort. Recommendation number 26 of the 30 recommendations included in his report stated that adjudication should be the normal method by which disputes, which arose during a construction project should be resolved.

As you can see on page 16 of chapter 1 in your workbook Latham made three principal stipulations,

(i) there should be no restrictions on the issues capable of being referred to adjudication;

(ii) the adjudicators award should be immediately enforceable;

(iii) appeals against the adjudicators award should be permitted but generally only after the implementation of the decision and further more only after practical completion of the project.

A further important recommendation of Latham was that of payment. Latham recommended that a trust fund be set up as a way of protecting the payments of both contractors and sub contractors, particularly in the event of insolvency of a party further up the chain.

Despite much scepticism by observers as to the likelihood of any of the recommendations promoted by Latham being incorporated into legislation, the HGCRA96 came into force on the 1 May 1998. This legislation introduced dramatic changes both in respect of payment and also the resolution of disputes in the UK construction industry.

Now the HGCRA 1996 actually completed its passage and became an Act in 1996. However the Act was also reliant on the Scheme for Construction Contracts before it could function. The Scheme for Construction Contracts or the Scheme as I shall refer to it basically acted as a default for the Act. The Act might require that a construction contract includes certain provisions, however if the contract did not, the parties to a construction contract would then be bound by the provisions of the Scheme. In effect the Scheme provided the detail necessary to implement the requirements of the Act.

By Nick Turner

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The International and Domestic Adjudication of Construction Disputes

Fifth Edition 2006, Edited by, Corbett Haselgrove-Spurin

This is the fourth major revision of a text initially developed by Professor Tony Bingham and Mark Entwistle in 1996 to train personnel drawn from the construction industry in adjudication practice to meet the needs of the proposed legislation, implementing the recommendations of the Latham Report. The primary aim of the first edition, which has not changed in any way, is to provide a work book with background information on and the sources of law, both under the common law and statute, in relation to construction adjudication as practiced in pursuance of the Housing Grants Construction and Regeneration Act 1996, in the UK.

The success of the construction adjudication process in the UK has exceeded all expectations. With this success has come many challenges to the process and the courts have provided over two hundred cases clarifying the application of the process in respect of specific situations and regarding the many facets of the industry which are impacted upon by the legislation.

No one really appreciated or understood exactly what construction adjudication was when it was first introduced. We do now. It is in some ways much as expected but in other respects it has proved to be a far more judicial process than anticipated, partly because its success means that it has a major and mostly final impact on the legal rights and duties of the people working in the construction industry. This new law and understanding is set out in the text.

Furthermore, the success of the process has not gone unnoticed globally. The adjudication process is now an integral part of the FIDIC Green Form contract and New South Wales, Australia and New Zealand have adopted legislation providing for the use of construction adjudication. Other states are likely to follow. Global aspects of construction adjudication practice are introduced in the book.

The Editor, a contributing author, Corbett Haselgrove-Spurin is a Construction Adjudicator, Arbitrator, Educator, Mediator, Scheme Leader, LLM Commercial Dispute Resolution, Senior lecturer, Commercial & Construction Law at Glamorgan University. He is a Construction Law Consultant and Director Nationwide Academy of Dispute Resolution UK Ltd and Middle East Co Ltd.

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