

3. NATURE AND PURPOSE OF THE CLAIMS AND DISPUTES RESEARCH PROJECT

Due to widespread concerns over the claims/disputes problem, meetings were held between public and private sector client organisations, consultants and contractors to determine appropriate action to address the problem.

It was decided to undertake a research project to establish the extent to which claims and disputes are a problem in the construction industry in other countries and the extent to which the problem is peculiarly Australian in nature. Most importantly, it was decided to research what action is being taken in other countries to address the problem; the intention being to identify changes which might be introduced into Australia to increase the efficiency of the industry and to address the problem.

The following organisations participated in the research project:

- Australian Construction Services, Department of Administrative Services
- Australian Federation of Construction Contractors
- Australian Institute of Quantity Surveyors
- Department of Main Roads, New South Wales
- Ministry of Housing and Construction, Victoria
- National Capital Development Commission, Construction Division
- Public Works Department of New South Wales

The research project involved a study tour of the following countries:

- Italy
- Switzerland
- France
- Belgium
- Germany
- Holland
- Denmark
- Sweden
- The United Kingdom
- Canada
- The United States

Not all participants in the research project went to all countries.

The Australian Federation of Construction Contractors carried out a separate study tour of Singapore, the Philippines, Hong Kong, Taiwan and Japan.

Written enquiries were made in other countries.

Enquiries were made of public and private sector clients, client associations, contractors, contractors associations, architects, engineers, quantity surveyors, professional associations, construction industry lawyers, claims consultants and the Asian Development Bank and the World Bank.

The enquiries briefly were as to the claims and disputes experience in the particular country and actions taken to address the problem. The enquiries included:

- the experience and current trends in claims and disputes;
- alternatives to the low bid tendering system;
- changes in methods of contracting to address claims and disputes in areas such as:
 - risk allocation;
 - change in or removal of the role of the architect/engineer;
 - contract documentation;
 - use/avoidance of Bills of Quantities;
 - avoidance of the Nominated Subcontract System;
 - combined construction and maintenance contracts;
 - detail and construct contracts;

- design and construct contracts;
- project management;
- construction management;
- forms of dispute resolution.

The content of this Report is based upon experience, knowledge, judgement and perceptions, supported by research in Australia and the overseas research described above.

4. THE EXPERIENCE IN OTHER COUNTRIES

General Comments

The problems of claims and disputes in the construction industry is a world-wide phenomenon. The development of a significant claims and disputes environment in the industry in Australia has lagged behind a similar development in a number of other countries.

To an extent the problem would seem to have come to be regarded in some countries as business as usual. There are other countries which claim not to have anything like the level of claims and disputation which occurs in Australia. In some instances, research project participants were sceptical of this advice and considered that an element of nationalism may have been involved.

Nowhere were there any indications given that the incidence of claims and disputes was decreasing. In the U.S.A., litigation has reached alarming proportions. In Australia, the industry must strive to prevent a similar development.

Action has been taken in several countries to address particular problems, in advance of what has occurred in Australia.

Some approaches to contracting were impressive, e.g. the French system of detail and construct described towards the end of the Report.

There is a world-wide trend to "transparency" (ensuring that actions and decisions are able to withstand public scrutiny) in the public sector and some concern, if not paranoia, which has led to the development of corruption commissions. This development has placed greater restrictions on tendering, claims settlement and dispute resolution in the public sector.

Advice was provided in several locations that many of the problems experienced in Australia arise from the traditional English system of contracting, which can lead to adversarial relationships. Whether this is so or not, there are certainly some practices in the industry which are historical and cultural, rather than based on the most efficient method of dealing with the particular issue.

Generally the sources of claims and disputes were found to be:

- lack of coordination and quality of contract documents;
- adversarial relationships;
- going to tender with inadequate documentation for a traditional lump sum fixed price contract;
- attempting to fast track construction on a traditional lump sum, fixed price contract;
- problems in contract formation;
- problems arising from late supply or errors, omissions and ambiguities in contract documentation;
- delays by the client or those for whom the client is responsible;
- variations;
- Bills of Quantities;
- Nominated Subcontracts;
- latent conditions;
- the role of the architect/engineer in contract administration;
- the role of the architect/engineer in dispute resolution;

- untimely presentation of claims;
- poor quality claims;
- poor management of claims and disputes;
- inadequacies of dispute resolution systems.

The Construction Industry Institute, located in Austin, Texas, carried out a research project in which member companies were surveyed as to "contract clauses most frequently involved in problems and disputes". It was found that the most problematic clauses fell into three categories:

"1. Work Scope Definition Clauses

- those which describe the physical work to be completed, the minimum standards of acceptability, and procedural guidelines for completing the work, along with supporting drawings and specifications.

Most problems with these clauses stemmed from omissions, ambiguities and inconsistencies.

2. Change Clauses

- those which deal with additions or deletions, and with variations or omissions in design, construction, and management efforts. These clauses provide a method for dealing with an event that was not anticipated in the original contract. Change clauses are an important element of the contract because they provide a mechanism for contract modification (either to react to unexpected events or because the owner desires changes), and for appropriate compensation adjustments. Disputes involving change clauses were found to affect negatively the project performance parameters of cost, schedule, quality, and safety. Change related disputes occurred on all types of contracts, not exclusively on the fixed price variety.

Problems most often encountered with construction change clauses involved definition and negotiation of costs, dispute resolution, and time required for approvals. A lack of well-defined procedures often compound the problem.

3. Project Control Clauses

- those which involve mechanisms to monitor and approve project performance, to confirm acceptability, and to correct unacceptable variations. Failure to reach a mutual understanding on these matters in pre-construction negotiations was a frequent source of disputes."

The comments below on the situation in particular countries are not intended to be encyclopaedic, but highlight particular points of interest.

Belgium

There is a significant incidence of claims and disputes. Problems and delays in provision of design documentation are a major cause. No use of NSC system. Quantities (although unlike our Bills of Quantities) are provided to tenderers, but they shouldn't be, as this practice leads to ridiculous claims. Resolution of disputes is predominantly through litigation, with excessive delays.

Canada

Tenderers are not provided with quantities. Use of a Contracts Advisory Board to assist in the resolution of disputes. Arbitration clauses in contracts are not common.

Denmark

In some instances, tenderers take off their own quantities. Standard contracts provide for disputes to be referred to independent experts for assessment in the first instance, prior to submission to arbitration. This system leads to a resolution of most disputes within a 6 - 12 month time frame. Contractors Federation attempts to act as an "honest broker" in giving advice on claims and in negotiations with clients.

There is a tendency towards greater use of design and construction contracts.

France

Comments were made that many of the problems experienced in Australia were as a result of our "legalistic thinking" and method of contracting, i.e. the rules of the game. The "English" approach is too precise and opens the way for loopholes to be found.

The French system of detail and construct was impressive, although only applicable to building rather than civil engineering construction. The system described ensured coordination of design and construction, by making the contractor responsible for design detailing and construction, hence removing some causes for claim and dispute. This system is described in detail in the Report. There could be some cultural and legal impediments to the ready implementation of this system in Australia.

Project and construction management is being used increasingly in the public sector. Design and construct is only used in a limited way for civil engineering projects.

There is a general tendency to use performance specifications. No use of the NSC system.

In civil work, the client's engineer makes decisions, but doesn't direct the contractor, as it is the contractor's responsibility to resolve problems. The client could give directions, but this would lead to claims.

The use of a claims committee comprising industry representatives to advise the Minister on claims and disputes in the public sector has had a 70 - 80% success rate.

With court delays of 8 - 10 years, there is very little use of litigation to resolve disputes. Most disputes are resolved through negotiation. An entitlement to interest at the rate of 15% on entitlements provides an incentive for clients to settle.

Germany

Excessive competition leads to low prices, which cause problems. German contractors are not particularly claims oriented. No use of the NSC system. Client responsible for the provision of quantities. There is no role of the architect/engineer in the contracts, the client checks the progress value of work performed. A survey has revealed that arbitration is more costly than litigation for most disputes, although there can be an advantage in arbitration in large disputes. The lawyers and arbitrators costs in arbitration are fixed by legislation to a percentage of the amount in dispute, rather than on an hourly basis.

Holland

Cost of tendering is borne by the client - this leads to the use of restricted tender lists.

No provision of quantities by the client. NSC system currently under review - attitude that contractor should be responsible for the selection of subcontractors. No use of project or construction management.

Hong Kong

The problem of claims and disputes would seem from enquiries to be as bad in Hong Kong and, if anything, probably worse than the situation in Australia. There have certainly been experiences of arbitration far worse than anything which has occurred

in Australia.

The cost of land, financing charges and extreme competition leads to the commencement of construction before design documentation is sufficiently developed to go to tender. Commercial competition leads to radical changes in concepts for buildings whilst they are under construction, e.g. from hotels to office blocks or vice versa. These factors lead to significant problems.

However, there have also been attempts, similar to those in the U.K. and U.S. to create better contractual models for the construction process, involving the contractor in the design and management process and in attempting to break down adversarial relationships.

Japan

Due to the long lead times involved in the assembly of sites, there is a low incidence of fast-tracking. The lead times available result in a high quality of documentation, which lessens claims and disputes. Most of the claims and problems Japanese contractors have relate to international work, particularly where the traditional English system is employed with the role of the architect or engineer interposed between the contractor and client.

When problems are experienced in relation to domestic construction, they are resolved by negotiation in relation to the particular contract or by adjustment to future contracts; the market is so large that there is a greater ability on the part of contractors to absorb problems than is the case in Australia. Care is taken not to damage commercial relationships.

There is no role of the architect or engineer in Japanese contracts, as exists in the English contracts, to interfere with the commercial relationships of the parties or their ability to negotiate solutions. This is not to say that there may not be an engineer, but the engineer is the client's engineer, rather than a supposed independent. Negotiations occur on a daily basis to resolve problems which occur in construction. If there is no immediate resolution, the matter is pursued by negotiation until it is resolved, even if that takes months. On occasions, a great deal of work is required to justify that a claim should be met. However, nothing is done to damage the commercial relationships. An inability on the part of the client to resolve the matter in relation to the particular contract will lead to favourable consideration in relation to future contracts, both in terms of opportunity and price.

The basic principle is a relationship of trust, good faith and cooperation. The prevailing attitude is that neither side should lose or take advantage of the other.

The focus of concern in Japan is different. Interest rates are low and time is not the first priority. Concern is for quality, then price, then time.

Tender prices tend to be very close, due to reliance on government cost price indexes. The spread of prices tends to be in the order of 10%, with the lowest two prices often within 1%. Usually, in relation to government contracts, a lower limit of say -10% of the government estimate is set below which tenders will not be considered. Tender prices contain adequate profit.

There is a tendency for the client to include significant contingencies for problems in ground conditions; the contractor is not expected to take the risk for ground conditions.

By legislation, clients and contractors are required to contract on the basis of sincerity, co-operation, good faith and equality, i.e. contracts contain this wording. In the event of dispute, the contracts contain provision for resolution by mediation or conciliation and for arbitration, in the event that these processes do not succeed.

The Japanese Ministry for Construction has a disputes set-

ting committee available for use by the construction industry, as do Municipal Authorities. Disputants may consult staff for advice in relation to disputes and avail themselves of the three tiered dispute resolution process available. Disputes may be referred to mediation, then to conciliation and finally to arbitration. Some 450 cases are currently pending in this system, which is designed to assist the industry, in the event that negotiated solutions are not possible. Resort to litigation is extremely rare.

The experience of Japanese contractors on overseas projects provides a good point of comparison. There have been instances where the contractor has been horrified at the number of architects, engineers, quantity surveyors and lawyers on the team and at the cost and complexity of the contract package. The role of the architect/engineer in contract administration is a point of concern and impediment in the commercial relationships and the resolution of problems.

Since the Japanese system is cultural, it is not readily transferable into Australia.

Singapore

The problems in Singapore seemed to be very similar to those in Australia in relation to the extent of claims and disputes, except for local cultural differences, e.g. it is not a practice to arbitrate against the government in view of the potential for adverse effect upon future potential to tender.

Sweden

The major source of dispute arises in relation to Nominated Subcontracts (60%), in relation to matters such as coordination of programmes. The next biggest problem area is in relation to disputes over prolongation costs. Arbitration is regarded as expensive and is only used in 1 - 2% of disputes.

Switzerland

The role of the designer has been separated from contract administration in large projects, to overcome conflicts of interests over variations.

The United Kingdom

Research project participants were informed that the problem in the U.K. was not as bad as the description provided of the Australian scene. However, probing indicated that all the same problems had been experienced earlier than in Australia. These problems have led to considerable use of management contracts instead of traditional contracts, the development of novel forms of contract such as the British Property Federation's system, the development of concepts for future contracts by the Institution of Civil Engineers, the simplification of Bills of Materials, reconsideration of the role of architects and engineers in contract administration and dispute resolution and the development of expedited systems for arbitration.

The experience has been that claims are commonly generated by poor documentation and design changes. The greatest problems in civil jobs occur in relation to ground conditions.

There is a current move away from the Nominated Subcontract (NSC) system. There is also a trend towards the use of pre-stated delay costs, subject to resistance from contractors.

The BPF system has been around for seven years, but hasn't taken over, despite its apparent advantages.

The detail design and construct approach to contracting has been found to work well.

There has been an increasing use of management contracting. However, this has been largely to enable early start, rather than to address claims. It has been found that there are advantages in management contracting in obtaining the contractor's input into the design process, which can lead to efficiencies and savings. Bonus/incentives are sometimes employed in relation to construction management to address the apparent problem of lack of

incentive to control costs and time.

Whether it was a valid perception or not, research project participants felt that the amount of disputed claims in the U.K. was probably on about the same level as Australia, but that this was not considered out of the ordinary and was regarded simply as business as usual. U.K. developments would seem to indicate that the U.K. is ahead of Australia in responding to the problems of claims and disputes.

The United States

In many areas of the United States of America, disputed claims have reached epidemic proportions.

According to the Associated General Contractors of America, the current claims/disputes situation in Australia parallels what was happening in the United States in the early to mid-Seventies, i.e. up to 18 years ago.

Competitive pressures on designers over the last decade or so has resulted in a diminution in the standard of design and documentation produced by architects and engineers. The result has been the development of an environment which is prone to claims and disputes.

In response to the claims and disputes environment, in the private sector, clients have moved to Design + Build contracts, Construction Management and to negotiated, rather than low bid contracts. However, AGC continues to promote its policy of open tendering, with the contract award going to the low bid tenderer.

Arbitration is bypassed by many clients as a means of resolving disputes, due to a perception that the system favours the contractor in decisions by some arbitrators to decide in favour of both parties, rather than on the basis of a strict assessment of entitlement.

In response to arbitration apparently breaking down as an efficient method of dealing with disputes, due to increases in costs, managerial impact and the time required, there have been moves to develop an expedited arbitration system involving one day proceedings for small matters and a simplified arbitration system for more complex cases. There has also been a development and use of mediation. There have also been efforts to set up a mediation panel for particular contracts along the lines of the Disputes Review Board outlined in the Report.

5. SUMMARY OF THE FINDINGS OF THE RESEARCH PROJECT

As perhaps could have been expected, there were no magic solutions. However, the research revealed that there are available a range of changes to policies, contracts and practices, which should assist to increase the efficiency of the industry and to address the problem of claims and disputes.

Recommendations under each subject heading are set out in bold type.

PROBLEM AREAS AND RECOMMENDATIONS

Selection of Contractors

Recommendations

Clients should use a system of prequalification to select competent tenderers to tender for their projects and, for clients who regularly operate across a spectrum of construction, to select tenderers for particular categories of construction.

There is no recommendation to change in Australia to a median system of selection from the system of acceptance of the lowest bid by a prequalified competent contractor.

However, bids which are apparently low, say 15% below a properly prepared estimate or the next lowest tender price, should be rejected, unless the contractor is able to establish that the price is not unrealistically low and that the work can be properly carried out at this price.

There should be developed a concept of selection on the basis of the lowest "acceptable" price, rather than selection simply on the basis of low bid. Factors which might be considered in determining the lowest "acceptable" price include:

- conformance with the tender documents;
- tender qualifications;
- technical adequacy of the offer, where this is an applicable factor;
- adequacy of the tendered price;
- technical and financial capacity of the tenderer;
- the form and adequacy of security offered;
- the tenderer's track record, including relevant experience and capacity;
- the tendered programme and its implications;
- any exposure which might be created through the tendered rates and prices, e.g. in relation to subsequent variations or liquidation of the contractor;
- claims history of the tenderer, particularly regarding unreasonable, spurious, factored or frivolous claims.

Quality Of Documentation

The comment was made repeatedly around the world, including Asia, that the greatest cause of claims and disputes in the construction industry is related to problems in contract documentation, including errors, contradiction, ambiguity and late supply of documents, which gives rise to delays and inefficiencies and hence claims.

Recommendations

Attention should be directed at ensuring that the client's objectives and requirements have been adequately defined in the brief to the designers.

Sufficient time should be permitted to ensure that design and documentation are properly carried out and that they meet the client's objectives and requirements.

Responsibility should be allocated to ensure that documentation is properly coordinated.

Consultants should be paid on a realistic level of fees for the work which they are required to undertake.

Action should be taken to coordinate the design and construction phases of complex projects, by construction industry involvement in the design process.

Consideration should be given to the development of contract packages which minimise flow on effects of problems and, where applicable, assist fast tracking.

Consideration should be given to reducing design fees in relation to cost increases during the construction period for which the design consultant is responsible.

Contingency Allowances

Construction involves unforeseeable events, problems, errors and omissions in the construction of, in effect, prototypes. Unfortunately, problems, claims and disputes are to some degree a natural consequence of construction activity, particularly if there is any element of fast-tracking in the project.

Recommendations

In budgeting and planning for projects, clients and their consultants should make reasonable contingency allowances in relation to both time and money for problems which might