



How to Contain Construction Disputes

Imagine if, when a dispute involving defective design or defective construction first arose, it could be dealt with in a safe environment so that the defects could be remedied and the possible impacts of them limited, reduced or avoided?

There is no reason why this cannot occur. All that is necessary is an environment where relevant experts (internal or external) are free to focus on remedying the defects.

Background

In the author's experience, complex commercial construction and engineering projects often suffer defects and, at least occasionally, these defects will, if not addressed quickly, result in serious financial consequences for the owner/user of the building, plant or equipment. The defects might also require significant analysis and engineering, with input from all parties, before a cost-effective remedy can be found and a partial or total rebuild is avoided. Sometimes the most cost-effective remedy might involve the owner being left with something different from that which was originally promised but which will be more than adequate for the owner's purposes.

Consider the following scenario. An owner of a mineral reserve engages an engineering, procurement, and construction ("EPC") contractor to design, procure, and construct a processing plant for many hundreds of millions of dollars. The owner provides the contractor with a run of mine ore specification along with the specification required for the product. The contractor, in the EPC contract, promises that the plant, as built, will have a minimum output of product that will meet the product specification.

After a number of years of design and construction, the plant is commissioned and it is discovered that the plant will not produce the quantity of "in specification" product required. The owner alleges that the plant is defective, and the contractor alleges that the run of mine ore contains elements that were not mentioned in the run of mine ore specification in the contract. A dispute ensues. The superintendent refuses to grant commissioning, the contractor disputes this refusal and refuses to accept responsibility, and the owner refuses to take the plant and operate it. While the plant sits idle, many millions of dollars are being lost due to lost production. The contract contains a limitation of liability clause, but there is no limit in respect of a failure to achieve commissioning.

If the dispute is allowed to continue, without the plant being fixed, the commercial problem will increase in size.

What Are the Options?

The options available to the parties include the following:

1. Continue with the standoff;
2. One or both parties seek to terminate and then seek to recover damages;
3. One or both parties refer the matter to dispute resolution under the contract;
4. One or both parties give up some or all of their rights (e.g., the owner accepts the defect or the contractor takes steps to remedy the defect);
5. One or both parties take steps to rectify the defect while reserving their rights (e.g., the contractor rectifies the defect but argues that it is entitled to a variation and extension of time for doing so).

None of these options is likely to see the parties working together to arrive at a cost-effective way to rectify the defect.

The ideal option would be for the parties to combine their experience and expertise and analyze the problem, consider all possible methods of rectification and agree on the most cost-effective method of rectification, while also reserving their legal rights.

How can this option be pursued?

How Do We Create a Safe Environment?

In order for the parties to work together in the manner set out above, it is necessary for the parties to come together and work as a team, and for the result of their work to affect the parties' rights as little as possible.

Creating Teamwork. According to Katzenbach and Smith, "A team is a small number of people with complementary skills who are committed to a common purpose, performance

goals, and approach for which they hold themselves mutually accountable."¹

Therefore, if teamwork is to be achieved, it will be necessary to bring together, from the various parties (and possibly from beyond the parties), individuals with complementary skills that are relevant to the rectification of the defect. It will also be necessary to ensure that they have, and are committed to, a common purpose (e.g., to work in good faith together to work out the problem and arrive at a rectification of the defect), performance goals (e.g., a timeline to arrive at rectification of the defect), and approach (e.g., sharing ideas and information). Finally, it is important that they hold themselves mutually accountable to the purpose, goals, and approach. This can best be achieved by ensuring that all of the parties contribute equally in terms of resources and that all work is carried out in an environment free of blame and risk. This environment can be created if the environment in which they work is without prejudice, is confidential, and will not result in any rights being lost due to participation in the process.

A Without-Prejudice Environment. The parties can agree that their interactions will be without prejudice and that all documents created in the process will be privileged from production, and not require to be produced, in any proceedings.

This will allow the parties to communicate openly and without needing to be concerned about admissions made and documents created being used against them later in proceedings.

Some parties might want to go further and also cloak with privilege documents used in the process. The risk of this approach is that documents that would otherwise not have attracted privilege and would have been required to be produced in proceedings might no longer be required to be produced. If this approach is going to be adopted, it is recommended that the parties discuss and agree upon the documents or categories of documents that are going to be so protected, in order to guard against any party being unintentionally prejudiced by being unable to call for production of documents that were created before entering into the without-prejudice process.

1 Katzenbach, J. R. & Smith, D.K. 1993, *The Wisdom of Teams: Creating the High-Performance Organization*, Harvard Business School Press, Boston, Massachusetts.

Confidential. It is easy to make all communications confidential, but thought needs to be given to what will be excluded from any obligation of confidentiality. For example, communications might include information that was in existence prior to commencement of the process and that would not otherwise have been confidential (and might have been required to be disclosed in any proceedings). Unless there is some good reason for preventing preexisting information from being used or disclosed for other purposes (including being used in subsequent proceedings), it might be appropriate to exclude it from the obligation of confidentiality.

Likewise, if the information is going to be required to rectify the defect, it may be necessary to disclose it to contractors and others involved in carrying out the rectification work. It will therefore be necessary to exclude communication of information to the extent it is necessary to carry out that work.

In addition to dealing with confidentiality, it might be appropriate to include a restraint on the use of all or some of the information. For example, it might be appropriate to restrict the use of information created during the process to use for the purpose of rectifying the defect.

Preserving the Parties' Rights. Teamwork and open and honest communication, and therefore good problem solving, are unlikely to occur if the parties are concerned about losing their rights, or worse still, prejudicing their positions.

A number of rights need to be protected.

First, there are the rights that might be affected by the effluxion of time. These can be protected by the parties agreeing that time stands still in respect of these rights while the process is ongoing. Time bars which affect the prosecution of rights in the future may need to be dealt with by these stand still arrangements. Care needs to be taken in the drafting to ensure that rights that have already been lost due to the passage of time are not enlivened by mistake.

Second, there are the rights that might be affected by the exchange of information (e.g., the making of admissions). These can be protected by the mechanisms discussed above (privilege, confidentiality, and restraints on use of information).

Third, there are the rights that might be affected by the finding of a cost-effective method of rectification. These are best left to be considered once a cost-effective solution has been found.

What Should Go into the Agreement?

The process should be governed by an agreement between the parties to the original contract who will be involved in the process. It would also be wise to include any other parties who will be involved in the process (for the purpose of dealing with privilege, confidentiality, and restraints on use of information).

The agreement should include provisions that deal with:

- The contribution to be made by each party (and the payment of expenses);
- Acting and communicating in good faith;
- The standstill arrangements;
- Confidentiality;
- Use of information; and
- Privilege.

Does It Work?

The author recently used the process on a major project. It resulted in the defect being satisfactorily rectified and the losses suffered by the owner being reduced to about one fifth of what they otherwise would have been.

Conclusion

When disputes on major projects involving defective design or defective construction first arise consideration should be given to dealing with the defect in a safe problem-solving oriented environment, so that the defect can be rectified and the impacts of it avoided or at least limited or reduced. This can be done by creating an environment that allows the parties (and possibly others) to work together and combine their experience and expertise and analyze the problem, consider all possible methods of rectification, and agree on the most cost-effective solution, while also reserving their legal rights.

Such an approach can work and makes sense.

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