

Dispute Resolution in Complex Construction Contracts

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Abstract

In this paper, characteristics of dispute resolution mechanism of complex construction contracts which is mainly commercial arbitration are investigated. Some of the rules applicable to and the legal characteristics of complex construction contracts are examined. Some case studies are also given under related topics.

Keywords: *complex construction contract, arbitration, dispute*

1 Introduction

The global development in the construction world has caused application of new type of contracts which may be named as complex. Complexity in these contracts also is one of the cause of the development itself. Most of these contracts are international and include parties of different jurisdictions.

During the course of any construction most likely is to appear some disputes between the parties, i.e client, contractor, subcontractor and consultant/engineer. Generally accepted method of dispute resolution in such cases is arbitration.

Complexity of a contract makes the arbitration itself also complex. Therefore contractors must be careful in due course of the management of a construction.

In the following sections some basic aspects of dispute resolution mechanism, namely arbitration, are outlined and keypoints which should be taken into account in construction management are underlined.

2 What Makes a Construction Contract Complex?

Some characteristics existing in a construction contract allows us to distinguish it as a complex construction contract. These characteristics include:

- Number of parties involved and their interdependence
- Number of nationalities involved and their jurisdictions
- Total volume and duration of work
- Probability of disturbance of contract
- Sensitivity for disturbance of contract

Main actors in a complex construction contract are client, contractors, subcontractors, consultants. Contractors usually are in the form of entities known as Joint Ventures or Consortiums which are formed by more than one companies of same or different nationalities. Similar characteristics are also applicable for subcontractors. Not all of the parties are dependent on each other by a single contract. On the contrary there may exist many contracts relating the parties each other each of which may be having different dispute resolution mechanisms.

Complex construction contracts usually last more than one year. This long term, on the other hand, creates other problems such as planning the activities of parties which are dependent on the performance of each other.

A complex construction contract most probably will be disturbed by the changes in factual circumstances, and also most probably will be delayed for many reasons. It is a fact that time schedules and cost estimations will have to be revised over the contract time. It is impossible to anticipate all contingencies at the time of the contract.

Delays and disturbances in the time schedules of the project will put into question the further cooperation of many parties and will lead to additional costs for the contractors. The ability of one party to perform in substantial measure is based on the performance of the other. The contacts between the parties in the course of collaboration requires a certain degree of mutual trust and at the same time leads to additional sensitivity of parties whose interests only partially comply with each other. For example the conflict between the employer's interest in having a project on time and the contractor's desire to consume additional time required because of changed conditions or changed volume of work is the main reason of a time related dispute (Joachim G. Frick, 2001).

3 Characteristics of Disputes

In an ongoing project there may occur many disputes between the related parties. But, if the construction contract is a complex one, some of the disputes have some special characteristics which can only be seen in complex contracts. Those are the disputes arise i) from applicability of arbitration clause, ii) from applicable law, iii) from the parties to be involved in dispute.

3.1 Applicability of Arbitration Clause

Generally, arbitration clause of a contract is treated as if it is a separate agreement. Therefore its boundaries must be defined clearly. Two of the very special type of disputes which may arise between the parties of the contract due to the applicability of arbitration clause are: i) the applicability of the arbitration clause on the addendums of the contract, ii) the applicability of the arbitration clause on additional works.

Due to the sensitivity of complex construction contracts against the disturbances many addendums to the original contract are most likely to happen in the due course of the project. By signing addendums parties can change both scope and parties involved to any contract. But the applicability of arbitration clause of the main contract to new defined work or the party in the addendum is many times challenged in arbitrations. Challenging party may claim that the arbitration clause is not valid for the signed addendum.

If an addendum to a contract adds a new party to a contract or adds new works to be executed, then the applicability of the arbitration clause of the contract to both new party and to new works can be argued. In an arbitration between **A Turkish Contractor versus A Russian Entity(2004)**, it took 3 years for the claimant to prove that the arbitration clause of the contract is also applicable to the third party which signed the related protocol. Therefore in order to avoid such disputes it is the best way to include a settlement of dispute clause in all protocols or addendums.

In a dispute between **A Turkish Contractor versus A Korean Contractor(2007)**, supreme court decided that if a dispute arises in the works which were executed additional to the works defined in the contract and if they are not included in the original scope, arbitration clause of the contract is no more applicable depending on the nature of the works executed additionally. In order to avoid such kind of disputes, the wording of the arbitration clause must indicate also the additional works or contract variations.

3.2 Applicable Law

In arbitration proceedings the law to be applied usually is chosen by the parties within the related contract. If the parties have not chosen the applicable rules, the arbitral tribunal should determine such rules by:

- application of conflict rules of the seat of arbitration,
- application of general principle of conflict laws,
- cumulative application of the choice of law systems of the countries having a relation with the dispute,
- application of the rules of the country whose court would have had jurisdiction had there not been any agreement to arbitrate,

- application of the conflict rules of the state in which the award will be executed,
- application of conflict rules of domicile or nationality of both parties,
- no conflict rules, direct application of appropriate national rules.

Each of methods described above normally leads to a specific set of national rules (Joachim G. Frick, 2001).

In some cases, because of the nature of the complex contracts, two set of national rules come on the scene. A well known case happens when a contractor and its subcontractor arbitrates under a subcontract fo which applicable law is different than the applicable law of the main contract which also at the same time may under arbitration between contractor and client.

Usually international contractors select subcontractors from their home countries while they are performing contracts abroad. Such selection causes selection of different applicable law than main contract which causes conflicts during an arbitration between contractor and subcontractor.

In a case between **A Turkish Contractor and A Russian Entity(2001)**, at the end of the arbitration which was held under Russian Law, the contractor was penalized due to the incomplete items after acceptance. When the contractor turned to its subcontractor which was responsible for that section of the work and started arbitration against subcontractor it was not possible to collect the same amount because of the difference of the applicable law of subcontract agreement which was Turkish Law.

Disputes on the performance bonds are also very typical examples of complex contracts. Performance bonds usually are issued under different rules than the related contract. If nothing explicitly written on the performance bond, then it is subject to the law of the country issued. Actually banks never agree to issue a bond under law of a different country. So, if a dispute appears on the performance bond regardless of the applicable law of the contract the dispute shall be resolved under the law of the country it is issued.

In a case between **A Turkish Contractor and A Russian Entity(2001)**, performance bond was issued in Turkey whereas on the bond it was written that the bond is subject to Swiss Law. The arbitration between contractor and the client was subject to Russian Law. When the client called in the bond the contractor succeeded to get an injunction in order to protect its bond in a local court in Turkey because any dispute on performance bonds is to be resolved in issuing country according to the Swiss Law.

3.3 Parties to be Involved

A complex contract by its nature involves many parties bound by each other with separate contracts. Such a structure is very sensitive against disturbances. For example any delay in the scope of a party may cause damages on other parties which are not proportional to the scope of works of the first delayed party. Complex contracts are often connected with other contracts and embedded in a network of contractors, subcontractors and suppliers. The connections between multiple claimants or defendants can be different in nature. They may have signed the same contract, or they may belong to same group of companies, or they may simply be involved in the same project although there are no direct contractual links between them.

In such situations, if there are various proceedings, the finding of fact made by one tribunal will not bind the other, or the two tribunals will arrive at different conclusions on the same disputes. There will be also timing problems, since a claim against one defendant can not easily be pursued, while a claim against a second defendant is still pending. The main problem of a multiparty arbitration is the appointment of arbitrators.

Various proposals have been made to resolve this problem. One proposal says that all arbitrators should be appointed by the arbitral institution. Second proposal says all parties have the obligation to appoint one single arbitrator in absence of an express agreement. A third proposal suggests each of the multiple parties has the right to appoint an arbitrator. Fourth proposal would give a single party the right to appoint the arbitrator(s) (Joachim G. Frick, 2001).

Another typical case for complex contracts appears if a consortium or joint venture member of a contractor wants to arbitrate with another member and the client at the same time. A joint action of a client with a member of the contractor may cause damage to any other member of contractor. In such a case a conflict of applicable arbitration clause and a conflict of applicable rule appears because almost in all complex contracts the dispute resolution mechanism between the members of the contractor and dispute resolution mechanism between contractor and client are different.

Authorization is also another typical problem which may appear in complex contracts. If a member of a contractor decides to arbitrate with a client, he should get the authorization of the other members. What happens if there exists a conflict of interest for such an arbitration between the members of the contractor? In such a case, one of the other members may not be willing to give authorization to the member who wants to arbitrate with the client. Parties must be careful not to be in such a case while they are entering into a contract.

A similar case happened in a consortium of five companies having different nationalities as a contractor in a contract against a client which was a Turkish Entity. One of the members decided to go to arbitration with the client, but another member did not give authorization, considering his future relationship with the client. According to the consortium agreement, authorization was necessary. The problem was solved only by giving a guarantee letter to the other member for all damages of all possible consequences.

Although contractors do not have contracts with consultants/engineers, there may exist certain circumstances under which contractors may want to bring an action for the recovery of damages against consultants/engineers. A failure on the part of an engineer or consultant to exercise reasonable skill when issuing payment certificates or performing other functions under the contract could prove expensive for the contractor. Does this leave the contractor with a right to recover his losses from the negligent consultant? The matter was considered in the case of **Arenson versus Arenson(1977)** when the judge said: "... The Architect owed a duty to his client to use reasonable care in issuing his certificates. He also, however, owed a similar duty of care to the contractor arising out of proximity; see **Hedley Byrne & Co Ltd-v-Heller & Partners Ltd(1964)**, **Sutcliffe-v-Thackrah(1974)**" (James R. Knowles, 2000).

4 Conclusion

Dispute resolution mechanisms need care during the drafting phase of the contracts. Parties entering into a contract must define clearly all tools within the contract in order to avoid the problems mentioned in this paper. But these precautions will not be sufficient. During the management of the project, the managers should consider the probable consequences of the above-mentioned problems while taking decisions.

References

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