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Construction Claims

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CONSTRUCTION CLAIMS

by

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PREFACE

The management of anything demands an understanding—at least a broad understanding of the whole of the subject. It is not sufficent to be informed—however fully—about only part of it. Construction industry claims are numerous, varied, sometimes simple, sometimes complex, and they almost invariably represent loss.

The purpose of this book is to describe, in outline terms, the circumstances in which construction contract claims are created; to recognise the extent to which different types and forms of contract can influence their development and settlement and to explore the various options associated with the resolution and arbitration of the disputes which can arise if claims are not settled amicably.

The book does not attempt a detailed examination of claims under this or that particular form of contract, nor does it give any complex interpretation of the law or of precedential cases. It does, however, seek to describe the multifaceted circumstances in which claims arise, to describe the huge variety of claim types and the ways in which they can become disputes. It also traces the progress of the unsettled claim to the unresolved dispute, and to capitulation, or the court, by way of ADR or arbitration.

To consider the reasons for and the origin of construction industry claims it is necessary first to examine the complex nature of construction, the influence of different types and forms of contract and the effects on claim management of the different legal jurisdictions which may be encountered. It is also necessary to remember and recognise the fact that the employer's views will always differ from those of the contractor.

Claims and disputes represent a risk of loss to both parties to any construction contract and they are themselves often the results of other risks, of error and of the unexpected. It is necessary, therefore, to consider also the wide-ranging risks which exist and how they can best be managed.

Risks are intrinsically related to insurance and any consideration of construction claims must therefore take account of those matters which can be covered by insurance claims.

There can be no doubt that it is best if construction claims can be settled amicably, on a compromise basis if necessary. If not, and if disputes develop, every effort should be made to resolve them, perhaps by alternative dispute resolution measures, without the necessity of arbitral or litigious action.

Subcontractors warrant special mention because they often face problems of main contract significance whilst having only subcontract resources and opportunities.

The last resort of arbitration is a complex procedure which can prove to be

something of a mirage for contractors: it is only suitable for claims of significant value. It can become a very expensive and time consuming process. In the international field even an approved arbitration award can necessitate litigation, depending on the local applicable law.

J.K.S.
March 1, 1999

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CHAPTER 1

INTRODUCTION

Claims appear to be inescapable components of almost all construction contracts. What is a "Construction Claim"? It is normally a request for additional payment, or for additional time in which to complete an unexpected task. A claim may be trivial, or it may be sufficient to turn profit into loss. It may be little more than a contractual formality, or it may generate such controversy between the contractor and his employer as to lead to arbitration and litigation.

WHY SHOULD THIS BE SO?

1–001 The simple answer is that, in theory, it need not be so. If a contract could be so defined that the obligations of the parties were clearly understood and agreed from the outset and did not change in any way during the execution of the work, there should be no need for either party to contemplate the possibility of claims. In practice, however, no construction contract can ever be defined and executed with such precision. The very nature of the construction industry is such that it is rarely, if ever, possible to define, initially, either the task or the basis of payment without there being good reason for doubt, good reason to expect that some changes will be required. Claims arise as a result of uncertainty of one kind or another and, in spite of all efforts to the contrary, construction contracts almost invariably contain uncertainties.

THE NATURE OF CONSTRUCTION

1–002 The word "Construction" can be taken to refer to any activity which involves fitting things together. It can embrace ship-building, aircraft construction, automobile manufacture and the manufacture of all kinds of equipment. As soon as the word "Claims" is added, however, there can be little doubt that the word "Construction" refers not to factory produced items but to those created on civil engineering and building sites; roads, bridges, dams and a huge range of structures of many kinds. It is unfortunate, though, perhaps inevitable, that very few, if any, building or civil engineering contracts are ever completed without some claims being made, for additional payment, or for additional time in which to complete the work. It is almost as though those concerned can never decide fully and completely what they intend to do, before they do the work, and that

every construction project must contain some elements of "trial and error". Claims appear, indeed, to be an integral part of civil engineering and building contracts, and arise from the many uncertainties which are an inherent part of the industry. The reason for this is to be found in the extremely complex nature of civil engineering and building construction work and the genuine difficulty of recognising fully, at the commencement of a contract, all the relevant criteria.

1–003 For an initial understanding of the nature and origin of construction claims it is helpful, perhaps, to identify the major fundamental differences that exist between the construction of manufactured items and the construction of civil engineering and building works. The basic differences are obvious, of course, but it is important to identify them because they provide the reasons for many of the unexpected problems which can arise, for the changes which are made in consequence, and the claims which can result from them.

Relationship to the Site

1–004 The first difference is that items manufactured in factories are mobile or transportable, they are not permanently anchored to, and made to be an integral part of, their place of manufacture. Every construction contract is, however, firmly part of its site and its design must, of necessity, be uniquely related to the ground conditions of that site, conditions which may not be fully defined when the work is designed. Such ground conditions can, of course, be the subject of initial ground exploration work but, in spite of the employment of increasingly sophisticated methods of site investigation, there remains a measure of uncertainty. The discovery of unexpected ground conditions, always a possibility, can result in the need for changes in design during the course of the work.

Vulnerability to Weather

1–005 The second difference is that all factory produced items (and for this purpose even an enclosed shipyard can be seen as a factory) are manufactured under cover, the production process being protected from the weather. Building and civil engineering construction work is, however, normally exposed to the weather and subject to its constraints (with the possible exception of tunnelling contracts of course!). Appropriate care is taken, therefore, to allow for weather constraints when planning project work. In spite of the increasing accuracy of weather forecasting, however, many claims are associated with delays and increased costs due to disruptions caused by unexpected changes in weather conditions during the construction process.

The Single Prototype

1–006 The third difference is that virtually all manufactured items are the result of development processes involving initial prototypes and subsequent tests, trials and improvements, in design and manufacturing methods, before production commences. In building and civil engineering work, however, every contract is a particular response to a particular need. Every project is its own prototype.

Development work in the construction industry is usually confined to the development of methods and materials. There is rarely any provision made for any development work which is specific to a particular project. Work within the currency of a contract, to test the feasibility of design or construction methods, is unusual. If any such work is considered necessary, to minimise or avoid uncertainty, in order to determine the practicability of a construction project, it must be carried out then and there, during the actual course of the work itself.

Uniqueness

1–007 These three basic differences, considered individually, account for many of the problems which arise in building and civil engineering work. Regardless of the care taken, none of them can ever be evaluated fully during the initial design and planning stages of the work. The same differences taken collectively ensure that every construction project is unique.

Quite apart from the fact that every construction project must be purpose-designed to suit its site conditions, it will also have been purpose-designed to suit the individual requirements of its client, requirements which may sometimes change, even during the course of the contract. Even though clients and designers take advantage, when they can, of earlier designs and of repetition and standardisation techniques, when such are possible, the fact remains that a construction project is never exactly the same as any earlier one and it will only be built once; never repeated. Every construction project is a prototype, which contains risks of the unexpected simply because it is "unique". This general aspect of "uniqueness", of location and purpose is, inevitably, the source of many uncertainties which can lead to claims.

1–008 To the anticipation difficulties inherent in this innovative "once-only" concept must be added the simple, inescapable, fact that at the time of commitment to a project the project itself exists only as an idea, an intention set down on paper. Not only must the client accept that "his project" is a prototype which is significantly different from anything which has previously been constructed, he must also accept the responsibility of "committing" himself to it, when it is still in that putative form and before he can examine it.

1–009 When a purchaser thinks of buying almost anything else he can examine, test and approve it, before deciding whether to accept it. In many cases, even having accepted something, he is able, if dissatisfied, to return it and get his money back. When contemplating the "purchase" of a construction project, however, a client has no such freedom; he must be prepared to promise to pay for "his" project, without first seeing it, on the basis of a complex series of stated hopes, intentions and promises, most of which depend on estimates and forecasts. It is the inadequate or misleading expression and definition of those hopes, intentions and promises which often lead to misunderstandings between the employer and his contractor and thence to construction claims. Only very rarely are the parties to the contract able, successfully, to define and explain their intentions fully and to foresee with sufficient clarity all the circumstances which will—or might—arise during design and construction; circumstances which may well necessitate unforeseen changes to those intentions during the course of the actual execution of the work.

WHAT IS A CLAIM?

1–010 The very word "Claim", in the context of construction, is not easy to define with precision in absolute terms. It must always relate to an existing contractual agreement between the two parties, the "client" or "Employer" who has ordered the work and promised to pay for it and the "Contractor" who has agreed to perform the work. Project specific definitions of the word 'Claim" must, therefore, depend on the details of the agreements made between individual employers and their contractors. Expressed in general terms, however, a claim is a request for something "extra" for which no provision had been included in the original agreement. It is normally a request for some kind of adjustment to be made to the agreement as a result of some event which has occurred, a request for additional reimbursement for unforeseen work, or for additional time in which to perform it. If the intended obligations of the parties have been agreed on the basis of a scope of work which has been defined exactly and unambiguously—and no changes are made—there should be no valid reason for a claim. A claim arises if one of the parties finds that he is required to perform some unexpected, additional, task.

Origins of Claims

1–011 The problem may arise because the contract documents which purport to define the terms of the agreement are found to be inadequate, unclear or in error. If during the currency of a contract a mistake, misunderstanding, or ambiguity is found in the contract documentation, there may be a need to make changes to parts of that documentation. This may cause arguments about the right way of dealing with the cost and programme consequences. Even if there are no "areas of doubt" inherent in the interpretation of the original agreement, however, unexpected circumstances may arise during the course of the work which necessitate changes to be made to the original scope of work or programme. Such changes, having been unforeseen, may then raise questions in respect of the payment or time to be allowed. If any uncertainties or differences of opinion arise between the client and his contractor as to the way that such modifications should be made or paid for, those uncertainties will be expressed as claims.

In the broadest interpretation of the word, therefore, any change to, or modification of, an existing contract may lead to a "Claim".

Contractual Provision for Changes

1–012 In practice, most contractual agreements between employers and contractors recognise that changes will be found to be necessary even though they cannot be visualised when the contract is let. Such agreements attempt to describe in broad terms the kind of changes which may be made within the overall scope of the contract, and stipulate the way in which they will be programmed and paid for. Such agreements refer to "Changes" or "Variations" and the word "Claim" may not even be used. If, however, something hitherto unforeseen happens which results in the need for a change which lies outside the scope provided by the agreement, it is likely to become the subject of a "Claim". This

situation provides a narrower definition of the word, namely, that it is a request for an adjustment to the terms of payment, or to the time allowed, arising from a change in the contract, for which the agreement between the parties does not make a clear, agreed provision—*or does not appear to do so.*

1–013 Ideally, construction agreements should be drawn up in such a way that they allow for the possibility of the unexpected event, provide for the probability of change and recognise fully the consequences of programme time and cost changes. It is, after all, sensible to incorporate in any agreement a degree of flexibility and an ability to cope with unexpected contingencies. This demands, however, an ability to visualise all the things that might happen, and make contingency plans for them. Even to attempt to make such plans, it is necessary to identify the many different areas of doubt and uncertainty which are implicit in the process of construction, to recognise the risks involved and the possible magnitude of their consequences. If, as a result of a risk, an event occurs for which the contract has not made adequate anticipatory provision the resulting change to the contract will probably become the subject of a claim.

Misunderstandings

1–014 The most likely reason for changes and claims by far, is the existence of unidentified misunderstandings in the agreement between the parties to the contract, as to what has actually been agreed. A misunderstanding which has been identified can be resolved, but one which has not been identified is like a loose nut on a bicycle, an accident waiting to happen. Both parties may be secure in their individual beliefs that they understand their obligations, with neither party recognising a need to doubt his belief. An innocent event during the course of the contract, however, a response to a contractors request, for example, may suddenly demonstrate a fundamental misunderstanding of the obligations defined by the words of the contract, a misunderstanding that may be due to error, omission or ambiguity of meaning. The employer may discover an oversight or design omission. The contractor can discover an underestimate or, worse, that he is deemed to have allowed in his offer for something which he had overlooked completely, or which he had thought would qualify for extra payment.

The very wording of those parts of the contract documents which seek to resolve such problems, by describing reporting procedures and the issuance of variation orders, for example, if not clear, can itself create the need for clarification and amendment. Poorly drafted clauses can amplify the very problems they seek to resolve.

1–015 Pre-contract negotiations between client and contractor are often prolonged, and are frequently concerned with such matters and with the clarification of any areas of doubt which have been identified during the tender or negotiation periods. Both parties are normally well aware that if any misunderstandings exist which have not been recognised and clarified before work starts, they will almost certainly become problems later.

In all of this the importance of clarity in the use of language cannot be over stressed. Even between parties who speak the same language, the use of that language, even in written form, can give rise to misunderstandings. If the parties

do not share a common language, in international projects, for example, there is a greatly increased risk of misunderstanding.

Unexpected Events

1–016 The design and construction planning of any project depends on the requirements of the client and on many assumptions, technical and commercial. The overall preparation of designs and forecasts for a project can take a number of years. During that time the assumptions made by the client and his designers and planners may well change and develop. During the later construction phase of the work many things can happen to upset the forecasts and estimates made during the design and planning stages. Legislation may cause the client to review his plans. Material and labour cost increases may necessitate budget economies. The geology of the site may reveal the need for design revisions. Any of the assumptions made can be found to be incorrect and can lead to changes being required. Even after work has started unexpected events can create the need for changes to be made.

Claims as the Consequences of Changes

1–017 In general, claims are the result of changes made to the original agreement, whether to the contract arrangements, the scope of work, or the proposed programme, either as a result of errors in the agreement or because some unexpected event necessitates some kind of change. The mere introduction of a change need not, of itself, result in a claim if the parties have previously recognised the possible need for changes and have made provision for dealing with them in their contractual agreement.

1–018 Changes may be instructed by the client for many reasons; perhaps following a change of mind, or because of an initial misunderstanding, a disclosed error or oversight, an unexpected event or the eventuation of a risk. Occasionally it may be the contractor who identifies a problem. Indeed, the very fact of a claim being made by a contractor, who finds himself faced with an unforeseen task, may be the means by which the need for a change is perceived. Regardless of the way in which the need for a change is recognised, however, it is often in the evaluation of the consequences that uncertainties of contract interpretation are discovered and different opinions formed between the contractor and the client. If changes are needed the sooner they are made the better, preferably before they can have a direct impact on the work which is currently "in hand" on the site. Changes made during the course of construction can be disproportionately expensive, particularly if work is delayed and if the cost of the change must embrace plant and manpower standing time. What is worse, the employer and the contractor are likely to have very different ideas about the true cost and what constitutes a fair compensation. The resulting different opinions, if not resolved, will be expressed as claims.

1–019 A comprehensive review of the possible sources of claims must, therefore, seek to recognise the uncertainties implicit in a project and the different kinds of changes which may become necessary, because *any* change is likely to result in a "claim" if the terms of the contract do not define, to the satisfaction of

both parties, the way in which the change is to be made and paid for. Many uncertainties, such as material price and labour rates increases, can be expected even if they cannot be calculated with confidence. Other uncertainties, which may or may not arise, are more difficult to assess and must be considered in the more general context of construction risks.

THE INFLUENCE OF RISK

1–020 A risk is a possibility of something happening, the exact consequences of which cannot be foreseen clearly. The risk of misunderstanding between the parties to the contract, already mentioned above, is a risk very likely to lead to claims of one sort or another. In practice such risks often exist from the very early stages of contract negotiation. Apart from the risk of misunderstanding, the more obvious source of claims is a change in the contract made following the eventuation of some risk inherent in the nature of the work itself, such as the discovery of unexpected ground conditions, or an unforeseen escalation of prices.

1–021 Many changes made to a project during the construction phase are the direct or indirect consequences of risks of one kind or another; risks of human errors in design, planning, or cost forecasts, risks of unexpected weather or ground conditions, and so on. It is logical therefore, in seeking to identify possible reasons for changes, to try to identify all the risks which have been, will be, or may be, encountered in the course of taking a project from its first "idea" stage, through all the implementation stages, to completion and to consider the different ways in which those risks might eventuate and how they can be "managed".

Risk Management

1–022 "Risk Management" may be considered as being based on the options "Acceptance", "Avoidance", "Mitigation" or "Sharing". It is the process of identification of the risks likely to be encountered, the assessment of their possible consequences and the conscious choice of courses of action which imply no risk at all, or which imply risks the consequences of which can be accepted or shared. Theoretically all risks must be either accepted or avoided and those which are accepted can then be either mitigated by adopting alleviation measures, or shared, with the contractor or an insurer, for example.

In the process of developing his project to tender stage the client and his advisers will have identified the risks which can be insured and those which must be allocated to, or shared between, the client and contractor.

Eventuation of Risk—Need for Change—Inadequate Provision—Claim

1–023 It can be said that every *risk* that is accepted in a project introduces an uncertainty which may result in the need for a *change* to be made. Every change which is made is capable of becoming a *claim* if the parties to the contract have failed in their agreement to allocate responsibility for risks or to provide equitably for changes.

Risks, whether retained by the client or "accepted" by the contractor can be of two main kinds:

1. Risks which *must* be expected to arise during the currency of the contract but which cannot be evaluated with certainty.

   Examples of such risks are those of human error, misunderstandings, unexpected ground conditions, inclement weather, and the fluctuation of market costs of materials and resources.
2. Risks which may exist, but which may *not* arise during the currency of the contract.

   Examples of these kinds of risk would be earthquakes, floods, war and the actions of third parties.

1–024 In any contract some of the risks of unpredictable events are completely beyond the control or even the influence of either of the two parties to the contract. It must be understood, nevertheless, that every such risk, whether of error or of the unexpected, is "accepted", by one or other of the parties, whether or not it has formally been recognised as a risk, and whether or not the party in question is actually aware of having accepted it. All such risks are potential problems, perhaps unforeseen ones, within the contract. The way in which provision is made by the parties for dealing with risks (by insurance, for example) can materially increase or decrease the incidence of subsequent misunderstandings and arguments. Claims arising from unforeseen risks are all too often the subject of such exchanges as:

> "I have suffered an unexpected loss. Please reimburse me."
> "This 'loss' is your risk. You should have allowed for it in your pricing."
> "I could not have been expected to allow for it. You didn't warn me at time of tender".

and so on.

1–025 The subject of risks is extremely complex and is covered more fully in Chapter 2. Suffice it to say here that every effort should be made by the parties to the contract to ensure that all risks are at least recognised in advance and identified within their agreement, with sufficient clarity to ensure that should any one of them arise the liability for it can easily be determined and the consequent responsibility for the resulting costs can be agreed. This is so obvious and so easy to state, but so very difficult to achieve in practice. Contract documents become ever more complex as a result of well-meaning efforts to define intentions more and more clearly and precisely, but the resulting complexity itself can very easily become a source of confusion instead of clarity.

The whole process of project definition must follow a sequence of stages. Each one is complex and each one contains risks, many of which may not be self-evident. The purpose of the following summary descriptions of these stages is to emphasise the many and varied decisions which must be made and the many opportunities for error and uncertainty that can stem from them.

THE CONSTRUCTION PROCESS

1–026 A construction project starts as an idea. Whether small or large in scope, complexity, or value, that idea must be tested in a theoretical sense in many ways

before it can become the subject of an actual construction contract. The site must be chosen. The design must be developed to a sufficient extent to determine technical feasibility. The probable costs of site purchase, design and construction must be estimated in order to check that the idea is financially viable. Long-term operation and maintenance costs must be estimated for the proposed working life of the project lest it become a loss-making venture instead of a profitable one. The possible source of funds—and the cost of those funds—must be established. All of this essential preliminary evaluation work must necessarily be based on estimates and predictions of many kinds by the client and his staff and, probably, by consultants and advisers in specialist fields. Regardless of the care taken, people are fallible, information is sometimes erroneous and there are risks of error in every estimate made. All such risks should, ideally, be identified even if they cannot be quantified accurately. By deciding to proceed with his project, the client accepts them all, whether he is aware of them and of their possible effects or not. Only by identifying them can he hope to try to judge their likely impact, and decide how he wishes to "manage" them, in conjunction with his contractor, during the implementation stages of the project.

1–027 Assuming that all his early predictions appear favourable the next stage in the client's planning process is to prepare for the formulation of the necessary contract documents. This necessitates a much more rigorous and detailed examination of the relevant facts and figures. The client is by this time, however, no longer concerned merely with testing the initial feasibility of his idea, but with defining that idea in such a way that it can ultimately become the specific subject of a formal contract.

On large and complex projects the client may be an individual, a company, a government department, or an amalgam of organisations and there may be a number of independent and mutually dependent contracts and contractors. The basic principles, however, remain the same in each case; "the Contract" is an agreement between two parties in which the contractor agrees to do the work and the client agrees to pay him, in accordance with the terms of the contract.

1–028 It should be recognised here, perhaps, that the word "contract" is frequently used in different ways to mean different things. It is often used in a general, all-embracing way, to describe the whole of the work and the site; it might be said, for example, that a contractor "is working on a power station contract". The words "the Contract" can also be taken to mean that collection of documents whose purpose it is to define in detail the agreement between the parties; the contract agreement, the conditions of contract, the specifications, the drawings and so on. Even more specifically, within that collection of documents, "the Contract" is the normal abbreviation of "the Conditions of Contract", the document which defines the terms and conditions of the contractual agreement between the client and his contractor.

1–029 Having satisfied himself regarding questions of initial feasibility, the client must, with his various advisers, now define his intentions, with the awareness of many, as yet, imprecise criteria, to an extent which will enable him to prepare suitable contract documents, and to choose and appoint a contractor. His actions and choices will depend on many considerations; the nature of the contract, the funding provisions, the location of the work and many other issues. The client's

assessment of the risks he faces will also influence the choices he must make regarding the form of contract and the contractor. Both are instrumental in dealing with risks and their consequences. The different ways of formulating a contract and of choosing a contractor embody their own risks of error, and these are described elsewhere. Regardless of the manner in which these choices are made, however, the result is "the Contract" between "the Client" and "the Contractor". It is to this end, namely the creation of a contract, that the client now directs his efforts. During this stage he will focus increasingly on the required content of "the Contract", in all its meanings, and the many aspects of it which must, ultimately, be agreed with "his Contractor".

Before the contract comes into being, both parties must make many preparations and both will be obliged to take many risks. The client rapidly becomes aware of the existence of most of the risks he proposes to take even though he may not be able, initially, to judge accurately their probability or likely magnitude. He will, nevertheless, seek to "manage" and minimise their consequences (to himself) as much as he can. In most contracts he will try to arrange that risks are, at least, "shared" between himself and the contractor, that the contractor will "agree" to take some of the risks, preferably those which, by virtue of his experience and skill he is better able than the client to "manage" economically. In some contracts the client sets out to ensure that the contractor takes virtually all the risks. This may be convenient for a client for whom the predictability of final cost is all-important, but it can lead to prices being higher than would otherwise be necessary. Whatever policy is adopted, however, the agreed allocation of risks must be defined adequately and unambiguously because any resulting confusion will almost certainly result in claims.

Initial Risk Recognition

1–030 The responsibility for anticipating the subject of possible claims depends initially, therefore, on risk recognition by the client and his advisers. Many of the risks ultimately taken by the contractor are risks which have been identified first of all by the client. It is in the very early stages of "idea" evaluation and feasibility checking that attempts can first be made to identify the risks which are likely to arise so that allowance can be made for them in technical and financial planning.

As has already been stated, every project starts as an "idea" and it must, as it is developed, pass through several stages of evolution before it can be transformed into a completed, working project. With all his objectives in mind, regarding the ultimate needs of the contract, the client progresses gradually through the various stages of project definition. Regardless of the nature of the project the sequence of stages leading to completion are necessarily similar and they are summarised in the following paragraphs.

Initial Assessment and Preparations

1–031 The main decision to be made at this, early, stage is whether or not the idea possesses sufficient merit to justify the expenditure of time and money which is necessary in order to investigate its feasibility in detail. In the case of a building