Kluwer Arbitration Blog

Help, I am About to be Dragged into a Construction Project!

Jorge Huerta-Goldman (TILPA – INTERNATIONAL TRADE AND INVESTMENT LAW) · Friday, August 31st, 2018

This is one of the five construction arbitration posts, providing the technical discussion from the SCAI, CAM, TILPA conference in Geneva and Mexico City. The authors include: Ms Almudena Otero De La Vega (on State enterprises) Ms Tanya Landon & Ms Azal Khan (on evidence), Dr Manuel Arrollo (on multiple procedures), Mr Serge Y. Bodart (on dispute boards and PPPs) and Dr Jorge Huerta-Goldman (on prevention to arbitration & state disputes).

In July 2018, tragically, the Chirajara bridge construction project in Colombia was demolished, following the partial collapse of the bridge at the final stage of its construction.[1)] What lessons may be learned to avoid having to resort to such extreme measures in the future? What mechanisms could be used to improve communication between the various technical teams involved in the design of the project? What about those involved in the implementation and construction of the bridge? The auditors? The supervisors? What should be the role of the government agency granting the concession (which is also a party to the construction contract)? Or the government agency authorizing the project and enforcing the relevant regulations?

In other words, how to prevent and, if necessary, settle disputes?

These issues were discussed by experts in Geneva and Mexico City (connected through videoconference), in May 2018, at a conference entitled: "Help, I am about to be dragged into a construction project!." The Swiss Chambers' Arbitration Institution (SCAI), the *Centro de Arbitraje de México (CAM)*and TILPA – Trade & Investment Lawco-organized the event, bringing together the arbitration and the construction communities in both countries.

The Goals in Construction Projects are Simple

Legitimate construction projects follow a simple logic. The client wants the construction, while the contractors are interested in their payment. It is an exchange of rights and obligations. So, breaches of contract can be classified in three main baskets:

1. **Category One: Time.**Delays in fulfilling an obligation (*g*., late delivery of goods or services, or late payments).
2. **Category Two: Money.** Requests to increase or decrease payments (*g*., a contractor requesting higher payments due to unforeseen complications).
3. **Category Three: Performance**, either complete, partial or deficient? (*g*., a contractor delivering

an electricity generation plant with inadequate production capability).

Two additional categories:

1. **Category Four: Other Claims.**Disputes can also include the annulment of the contract, and arbitrability, among many others.
2. **Category Five: Claims against a State.** This category includes both situations where a State is a party to the construction contract (covered in the contractual arbitration clause) and those where the State regulates the construction activity or the behaviour of State agencies parties to the construction contract (covered by an investment treaty, investment laws or an investment contract).

Construction Projects Can be Highly Complex

Think about a house. If the contractor builds the house entirely and the employer has all the financial resources there would be a two-party construction contract, with two main obligations: a) payment, and b) the delivery of the house. But many construction projects are far from being so simple.

For example, building a highway between two cities would require, among others: a contract between the employer (most likely the government) and the general contractor benefiting from the concession (most likely an *ad-hoc*consortium of contractors); several contracts with subcontractors; at least one contract with a financial institution; another contract with the long-term operator; and several contracts relating to maintenance.

The following illustrative list sets out a number of factors that increase the complexity of a construction project:

1. **The size of the project** (*g.*, the Hoover Dam in the US).
2. **The technology required** (*g.*, a deep-sea oil platform).
3. **The number of final users** (*g.*, the construction of a city with several housing units).
4. **The access to finance** (*g.*, access to loans in Mexico is more difficult and expensive than in Switzerland, so investors would most likely seek part of the profits).
5. **The access to insurance** (*g.*, unlike in Mexico, in Switzerland the responsibility of a contractor would most likely be covered by an insurance).
6. **The internationality of the project** (*g.*, the enforcement of the contract with respect to a foreign contractor through arbitral awards).
7. **The long-term construction projects** (*g.*, a 20-year public-private partnership agreement).
8. **The fact that construction includes both services and goods** (*g.*, "perfect tender" when delivering goods *versus*"substantial performance" in a services contract).
9. **The internal administrative law and administrationby the authorities** (*g.*, obtaining a construction permit would be easier in Mexico than in Switzerland).

These factors, among others, influence the design of the contract, the tools for administering the contract and the dispute settlement mechanisms.

The Dispute Settlement (& Prevention) Mechanisms

The tools available are vast. Some are used at an earlier stage; some are based on good practices; some are semi-permanent, as opposed to *ad-hoc*; some aim at building an agreed solution; and

others provide binding decisions by a neutral body. The following is an illustrative list:

1. **Record-keeping practices** are fundamental for each contracting party.Construction litigation is highly factual. Maintaining organized files is key to prevent and prepare for litigation. This includes communications between the parties, reports, decisions and assessments. For example, an organized file would be extremely useful to the team that designed the Chirajara bridge in Colombia.
2. **Contracts**should be clear and simple. The parties' obligations should be straightforward, such as deliverables by the contractors, and payments, including work calendars. Formal communications and notifications should be clearly identified. Templates exist such as those from the International Federation of Consulting Engineers (FIDIC). One common mistake at an earlier stage, when using templates, is to use ambiguous clauses in the special conditions to speed up the process but the danger is that at a later stage they may influence negatively the general conditions. Ambiguity is often used as a tool to finalize the contract during negotiation, but may backfire down the road.
3. **Engineers in the construction facilities** can facilitate the development of construction and spot potential problems. Indeed many contracts provide such a role for monitoring the overall development in the construction site; monitoring the performances of different sub-contractors; providing periodic reports; and notifying the parties in case of a potential problem that might evolve into a dispute.
4. **Dispute boards**, usually made up of construction experts, can address any potential issue spotted by the engineer, and issue recommendations. Semi-permanent DBs have the ability to react within a short period of time. One example is the ICC Dispute Board Rules, where arbitration clauses have been particularly designed to envisage this two-tier adjudication, as complemented by friendly arbitration rules.
5. **Expert opinion** can provide some solutions. Similar to DBs, the process focuses on technical experts. In other words, it allows the engineers and architects to find a solution before the file is sent to dispute settlement lawyers. One problem that might arise is enforceability of the recommendations. They are not arbitral awards, presenting enforceability problems. But arbitral awards on agreed terms, reflecting the agreement by the parties to solve the disputes through the expert recommendation, can improve enforceability (the New York Convention).
6. **Conciliation and mediation** can allow the parties to find a solution.DBs and expert opinions, when properly managed, will use the mediation and conciliation techniques.
7. **Commercial arbitration** is a reliable mechanism for construction.The contracting parties can take advantage of efficiencies developed by administering institutions. To cite an example, the Swiss Rulesdeveloped fast arbitration through a) expedited procedures within 6 months; b) arbitration to be decided only on evidentiary evidence; c) faster answer to the notice of arbitration—15 days; and d) faster constitution of the tribunal.
8. **Domestic Courts** can be an efficient mean to solve disputes in countries with reliable and fast State Court proceedings. But international contracts may face enforceability problems.

Construction Disputes Against States

Among others, the ***government procurement***rules regulate the genesis of government contracts for goods, services and works, providing access to foreign suppliers based on the specific commitments. Under WTO rules, the *Transports Publics Genevois* (the State company providing public transportation in the canton of Geneva) has to provide access to US bidders for construction projects larger than USD 7 million. Likewise, under the EFTA FTA with Mexico, the *Aeropuertos y Servicios Auxiliares*(the body building and managing airports in Mexico) has to provide access to

Swiss bidders for construction projects larger than USD 8 million.

When a State is a party to a contract, ***investment arbitration***is also available. Centrally, contract law works normally. But the State can direct its State entity to behave in certain way. Such action might be subject to investment arbitration. In the investment arbitration case *Samsung v. Saudi Arabia*(a pending dispute under the Korea-South Arabia BIT) the investor challenged the contract termination for a power plant construction.

Likewise, the actions or inactions (including regulating or other *jure imperii* actions) of a State towards a particular construction project can trigger State responsibility — without the need for the State to be a party to the contract. In *Lion Mexico Consolidated vs Mexico*(a NAFTA pending investment arbitration) the investor challenged Mexican authorities' cancellation of promissory notes and mortgages for real estate development claiming violations of fair and equitable treatment and expropriation.

The interaction between commercial arbitration and investment arbitration has been explored extensively (see for example the KLI book). But such link is highly relevant in the construction sector, which addresses both private contractual law and administrative law.

The goals in construction projects are usually simple, with reciprocal exchange of rights and obligations. But, the construction projects can be highly complex, depending on several factors, such as technology, size, number of parties, combination of services and goods, among several others. The complexity influences the design of the contract—or contracts—and the use of dispute mechanisms—from prevention to arbitration. Finally, investment arbitration is often available for claims against the State, both when it participates directly as a party to the construction project and indirectly as regulator.

References

?1 Allegedly, the cause of the problem was an improper design.

This entry was posted on Friday, August 31st, 2018 at 12:38 am and is filed under Commercial Arbitration, Construction arbitration, Dispute, Goverment Procurement, Investment Arbitration, Prevention, regulation, WTO
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.