

Getting it right from the ground up

A survey on construction disputes:
The causes and how to avoid them

Russell
McAugh



Introduction and scope

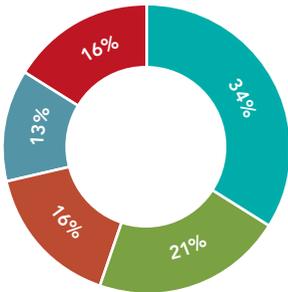
Earlier this year, Russell McVeagh surveyed members of the construction industry to delve further into the key risks that are driving construction disputes in New Zealand today.

With over 70 per cent of survey respondents predicting an increase in the number of disputes in the next two years, it is timely to reflect on the key lessons for avoiding them.

Respondents, including Principals, Engineers, Contractors, and Project Managers ranging from substantial, to medium-sized entities, shared their views on the key trends for New Zealand’s construction industry. Most respondents are engaged in projects with values of over NZ\$10 million.

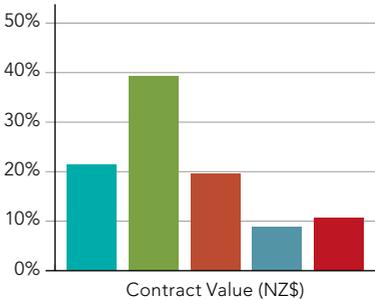
We would like to thank all who participated whose views have enabled us to form these unique insights into the sector.

Roles of survey respondents



- Principal/Employer
- Main contractor
- Project manager
- Engineer to the contract
- Other (specialist adviser/consultant)

Contract value of survey respondents (NZ\$)



- Up to \$10m
- \$10m to \$50m
- \$50m to \$100m
- \$100m to \$200m
- Over \$200m

Summary of results

Mitigating risks in construction contracts is a key concern for all respondents in the sector.



Contracting

The number one factor identified as contributing to disputes is a lack of understanding of contract obligations within the industry, with bespoke contract amendments reportedly not always read and understood by all parties.



Delay

Both Principals and Contractors identified Principal/Employer variation as the leading cause of delays. However, they didn't agree on what the other leading causes were. Principals blamed the slow pace of construction and the consent process, while Contractors blamed the quality of design.



Disputes

A clear majority (over 60%) of respondents believe disputes in the construction sector have been on the increase for the last two years. While some causes of a rise in disputes appear to be structural to the industry – others, particularly around relationships, risk allocation and contractual terms are within the parties' control.



Solutions

Suggested ways of decreasing the risk of disputes fall into two broad categories: improving the construction contract and improving industry conditions. Principals may wish to focus on the need to remedy the skills shortage through training programmes and immigration, while Contractors are calling for more standardisation of contracts and rethinking risk allocation.

NZS 3910 IS MOST COMMON, WITH SOME DIVERSITY

- NZS 3910 a clear favourite: over 80% use it
- Limited use of NZIA/ NEC/ FIDIC standard forms and bespoke contracts

Over **80%** of respondents base their contracts on **NZS 3910**

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VARIATION, DESIGN QUALITY, SHORTAGES AND INSOLVENCY

- Respondents felt that Principal/Employer variation is the leading cause of delay
- Principals and Contractors did not share the same views on the other causes of delay

Top causes of delay viewed differently by **Contractors** v **Principals**

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ON THE INCREASE; DRIVEN BY POOR CONTRACT UNDERSTANDING, ESPECIALLY AROUND RISK ALLOCATION

- Lack of understanding of contract is by far the biggest perceived cause of disputes (over 60%)
- Over 70% of all respondents expect disputes to increase in the next two years
- Contractors are more pessimistic – 91% expect disputes to rise in the next two years

Over **70%** of respondents expect disputes to rise over the next **two years**

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PREPARATION, STANDARDISATION, RELATIONSHIPS

Pre-contract

- More sophisticated assessment of project risk
- Fairer allocation of contractual risk
- Greater standardisation of contracts

During contract

- Focus on relationship and project outcome
- "Empowered" project committees to resolve disputes

External

- Meeting the skills shortage: immigration and training

100% of respondents favoured negotiation between parties over more formal **dispute resolutions**

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Trends in contracting

NZS 3910 (Conditions of contract for building and civil engineering construction) is by far the most popular standard form contract in use.

Other New Zealand Standard (NZS) contracts including, for example, NZS 3916, (Conditions of contract for building and civil engineering – Design and construct) are also common.

Around **20%** of respondents “often” base their contracts on other forms, including:

- **FIDIC Yellow Book** (International Federation of Consulting Engineers);
- **NZIA** (New Zealand Institute of Architects); and
- **NEC 3** (New Engineering Contract).

And **25%** “often” use bespoke contract forms.

Q: What features from the other standard forms could NZS 3910 import?

NEC 3

- | | |
|---|--|
| • Clear and definite process for assessing the impact of compensation events | • Suite of pricing options |
| • Clear statement of risks retained by Principal | • Definition of “reasonable foreseeability” |
| • Providing for key dates to be achieved, in addition to practical completion | • Definition of “exceptional weather” |
| | • Include all compensation events (equivalent to variations under 3910) in a single clause |

FIDIC Yellow Book

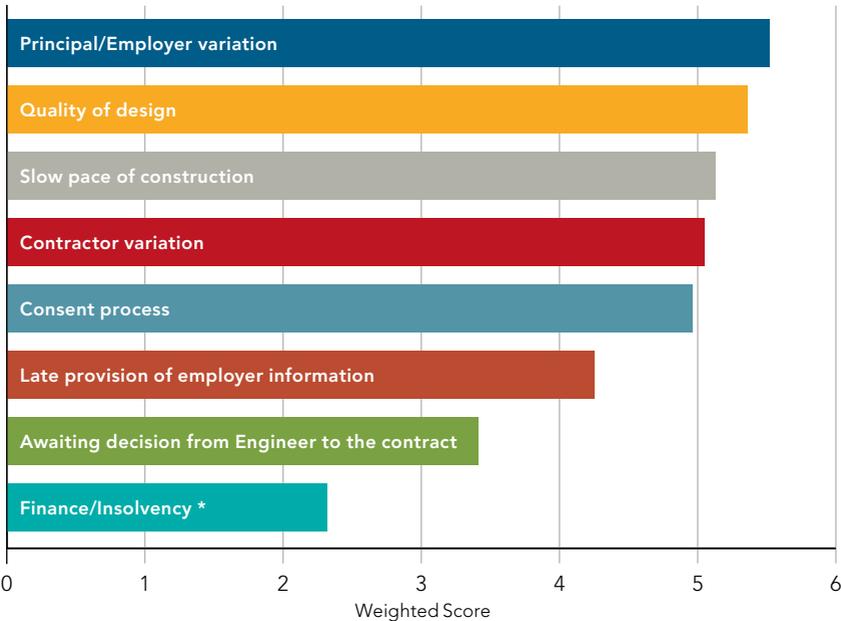
- | | |
|---|--|
| • More comprehensive in many aspects than 3910 | • Use of dispute avoidance/ adjudication board |
| • Clear and definite process for claiming additional payment or extension of time | • Testing on/after completion |



Causes of delay

Principal/Employer variation, followed closely by deficiencies in the quality of design, is considered the main cause of delay by respondents.

Q: Ranked causes of delay during the construction phase of the project



Looking at the data in further detail, both Principals and Contractors ranked Principal/Employer variation as the leading cause of delays. Principals also blamed the slow pace of construction and the consent process (58% and 52% respectively). While Contractors also blamed the quality of design.

*Insolvency on the rise?

While Finance/Insolvency ranked lowest as a perceived cause of delay, since the survey was conducted, Russell McVeagh has seen a marked increase in insolvency-related construction disputes. We expect this trend to continue over the coming months.



Disputes

Trends

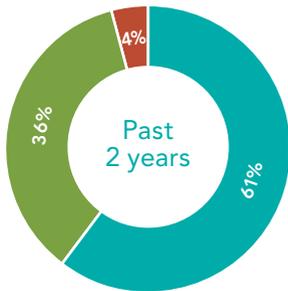
Disputes are on the rise. A clear majority (**61%**) of respondents believe that disputes in the construction sector have generally increased over the past two years.

The outlook for disputes is even more negative, with **71%** of respondents believing that the number of disputes will increase in the next two years.

Contractors are more pessimistic than Principals. Responses from Principals on past and potential disputes were stable (with **63%** noting disputes had been and will be on the rise). Of Contractors, **75%** observed that disputes had been on the rise in the previous two years and **92%** believe disputes will get worse in the next two years.

CONSTRUCTION DISPUTES: PAST AND FUTURE OUTLOOK OF RESPONDENTS

Q: Disputes in the past two years have:



Q: Disputes in the next two years will:



● Increased/Increase ● Been stable/Stabilise ● Decreased/Decrease

A larger number of Principals (**26%**) responded that they had not been involved in any disputes in the last two years compared to just **8%** of Contractors.

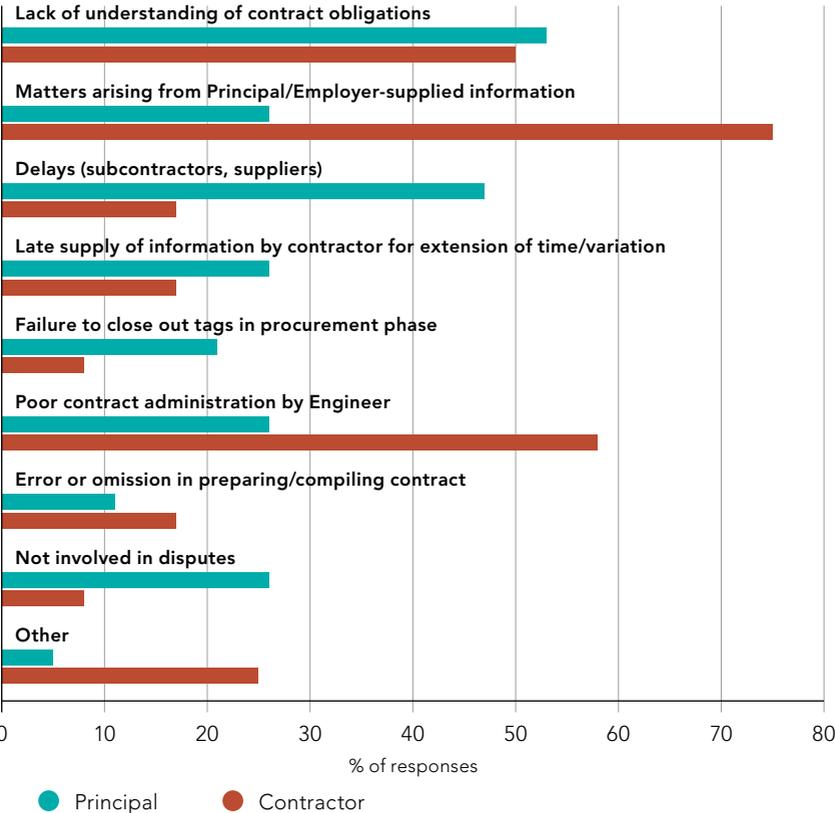
Causes

Both Principals and Contractors identified a lack of understanding of contract obligations as a key cause of disputes, with bespoke contract amendments reportedly not always read and understood by the parties.

Principals and Contractors also had different perspectives on the causes of disputes. Respondents were asked to indicate the three main causes of disputes. Principals and Contractors answered as follows:

CAUSES OF DISPUTES: CONTRACTOR VS PRINCIPAL

Q: The three main causes of disputes in construction projects respondents have experienced in the past two years



Causes of disputes – close up

Many respondents – particularly Contractors – focused on the issue of risk allocation under the contract. Typical comments included:

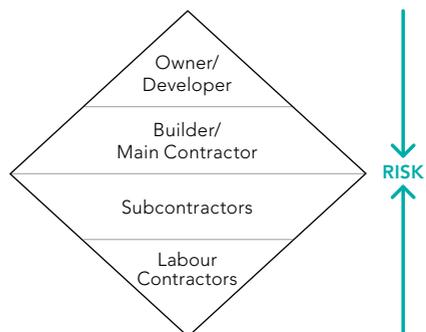
- *“Principals increasingly transfer what should be considered as the ‘Principal’s Risk’ to the Contractor. This can only lead to further disputes.”* (CONTRACTOR)
- *“There is potential for the risk share balance between Contractor and Principal to swing toward the Principal.”* (ENGINEER TO THE CONTRACT)
- *“Inappropriate risk allocation, backed by unfair contract conditions is resulting in poor financial outcomes for those delivering projects, resulting in more aggressive claims to try to recover their position.”* (PROJECT MANAGER)

Others – particularly Principals – focused on labour and materials shortages, higher costs, and lower margins. Typical comments included:

- *“Lack of resource and skills in the market leading to underperformance and disputes.”* (PRINCIPAL)
- *“Costs and margins are tight. Builders are stretched because of inexperienced teams exposing them to litigation.”* (PROJECT MANAGER)
- *“As Contractors keep undercutting each other, this will put pressure on them to recover revenue which will lead to disputes.”* (PRINCIPAL)

DISTRIBUTION OF RISK IN CONSTRUCTION PROJECTS

The themes emerging from respondents’ comments reflect the concentration of construction-related risks in the centre of the contractual chain. The pressures which result are ultimately felt by all parties, and it is unsurprising to see the concerns raised in this regard.

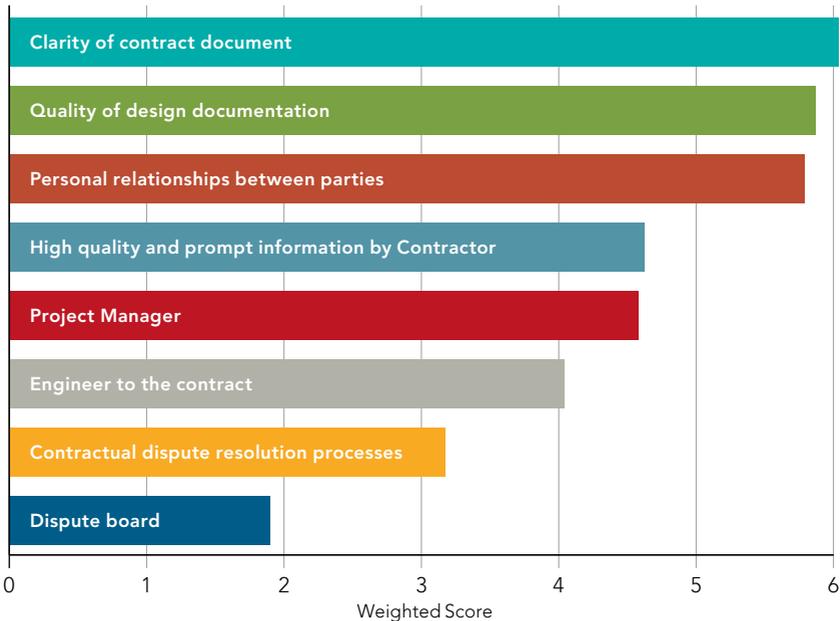




Solutions – avoiding disputes

Principals focus on the need to remedy the skills shortage through training programmes and immigration. Contractors, who focus on poor risk allocation in contracts, call for more standardisation of contracts with a fairer risk allocation. All respondents favoured negotiation between the parties over more formal dispute resolution.

Q: Ranked factors based on their importance in avoiding disputes



Suggested ways of decreasing the risk of disputes fall into two broad categories: improving the construction contract and improving industry conditions.

Improving the construction contract

Q: What should Industry and/or Government be doing to mitigate the risks affecting the construction industry?

- *“Government should centralise more procurement and provide greater guidance and procurement resource to local Councils and Territorial Authorities, so that contract forms (including special conditions) are standardised across NZ for the same types of work and each Council doesn’t reinvent the wheel with its own bespoke heavily tailored forms.”* (CONTRACTOR)
- *“Stop changing contracts to make them so onerous.”* (CONTRACTOR)
- *“Review contract documentation. Keep it sensible and appropriate to margins.”* (PRINCIPAL)
- *“Encourage standardised contracts so the focus can be on the production of quality documentation and construction.”* (ENGINEER TO THE CONTRACT)
- *“Focus on capability of project managers and design teams. Keep contract conditions simple and focus on top quality design.”* (PROJECT MANAGER)

Avoiding disputes – close up

Respondents’ suggestions for avoiding disputes included:

- *“Actively using collaborative working process and use of 3D design – all parties clearer on deliverables.”* (PRINCIPAL)
- *“Form of contract and fair risk allocation between the parties.”* (CONTRACTOR)
- *“Project team culture, adequate budgets, realistic programmes, fair Quantity Surveyor, simple contracts.”* (PROJECT MANAGER)

Improving industry conditions

Principals tended to be more concerned with broader structural issues:

- *“Ensuring support of training apprenticeships schemes and providing certainty to industry via funding commitment.”* (PRINCIPAL)
- *“Targeted immigration.”* (PRINCIPAL)
- *“The Government needs to focus on making consent process simpler and streamlined and achieve stated time periods.”* (CONTRACTOR)

Dispute resolution – close up

The adjudication process remains by far and away the most popular process for resolving disputes coming through the Building Disputes Tribunal (BDT). That said, BDT has seen a significant increase in contracting parties adopting its Arbitration Rules since the launch of its 2018 revised suite of Arbitration Rules (including three sets of expedited processes).

After a fairly consistent couple of years, BDT has also seen a significant increase in applications for dispute resolution services across the board, with numbers for 2018 currently forecast to exceed 2017 applications by over 25%.

Source: Building Disputes Tribunal

Conclusion

The market perception of disputes being on the rise reflects our experience at Russell McVeagh.

While some causes of this are structural to the industry (eg skills shortages), others, particularly around relationships, risk allocation and contractual terms are more within the parties' control and may repay a focus at the outset of any project.

Again, we would like to thank all survey respondents whose views have allowed us to form these unique insights into the sector.

Contact one of our experts

Please get in touch if you would like to discuss how the report's findings may be relevant and helpful to you and your organisation.

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