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CONSTRUCTION AND INFRASTRUCTURE LAW

Dispute Resolution

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Dispute resolution in a P3 context is different from dispute resolution in other contexts. This difference is directly related to the distinct characteristics of P3s as compared to other construction projects and commercial relationships.

The Distinct Nature of P3s

P3s typically involve the most complex construction projects – state-of-the-art hospitals and prisons; highway service centres spread across a province, state, or country; underwater tunnels connecting island airports and other infrastructure to city mainlands; light rail, subways and other public transit systems and vehicles; and high rise tribunal and court houses equipped with the latest technology. These are some of the public infrastructure projects that P3s facilitate.

The complexity in making these projects a reality arises from five key characteristics, which together make P3s distinct. First, the undertaking itself almost always requires cutting-edge design, engineering and construction capabilities given the structures to be built, the geographical breadth of the project, the locations selected for construction, or a combination of these factors. Second, the significant expense and risk involved for the private sector actor¹ assuming the undertaking almost always requires sophisticated financing arrangements and key joint venture partnerships. Such financing arrangements typically necessitate that the project be delivered on time, failing which Project Co's return on investment will decrease. Third, the

¹ Commonly and referred to here as "Project Co".

project itself and the parties' relationships often last decades as Project Co not only constructs the facility, but thereafter operates and maintains the facility for years before turning over the undertaking to the public authority. Fourth, the numerous parties that either constitute or contract with Project Co to finance, design, build, operate, and maintain a P3 over years work in close cooperation and rely on each other to perform their respective contractual responsibilities. Where parties fall short of satisfying their obligations, the project's success may be compromised and parties may face high degrees of exposure for project failures. Finally, the environment in which P3s are constructed and maintained is often highly political. Public authorities carefully select the private sector actor that will construct and operate a key piece of infrastructure for the public good. In some circumstances, the importance of the project can reach beyond the undertaking's functional purpose and become tied to a community's sense of identity.

A Distinct Approach to Dispute Resolution

The distinct nature of P3s necessitate a distinct, robust approach to dispute resolution. Unlike many other circumstances, parties in a P3 context must cooperate with each other over a long period of time. Where disputes arise, they must often be resolved quickly and with regard to protecting the parties' on-going relationship and the integrity of the project. Moreover, the potential subject matters of dispute are vast and almost always require supporting expert evidence – the failure or low performance levels of complex machinery; construction delays, deficiencies, and cost overruns; the unexpected discovery of contaminated lands; the unintended unearthing of aboriginal remains; and complex financing and accounting calculations. These are all issues that can arise and divide party interests, thereby leading to conflict.

For P3s to function and remain functional over the project's life, the dispute resolution process supporting P3s must recognize and accommodate the foregoing realities. One party simply issuing and serving a statement of claim and thereafter proceeding through the public forum of a court process over years whenever a dispute arises will rarely result in an acceptable outcome for any party in a P3 context.

P3 dispute resolution clauses within P3 project agreements accordingly feature speedy, flexible, non-public, and consent driven dispute resolution mechanisms as between the public authority and Project Co. These mechanisms are tiered such that direct communication by the parties is the first prescribed step in a series of procedures that generally include some sort of mediation or expert determination before proceeding with either arbitration or litigation. Given the varying subject matters of disputes, dispute resolution clauses sometimes require that certain disputes be resolved by a specific procedure or within a specific period of time. Regardless of what specific procedures are prescribed, dispute resolution clauses almost always include specific provision for the parties to depart from prescribed steps and proceed with an alternative dispute resolution mechanism or timing should they agree to do so.

It may go without saying that different P3 project agreements will have different dispute resolution mechanisms, requirements, and timing. The following mechanisms are dispute resolution options that often feature in P3 project agreements:

Amicable negotiations

Independent Certifier

Referee

Adjudication

Arbitration

Mediation

Litigation

These dispute mechanisms are often tiered in the order in which they appear above within a single P3 project agreement (i.e., with the exceptions that the referee and adjudication options often stand as alternatives to each other and mediation is often pursued within the context of an arbitration or litigation). While there are other available dispute mechanisms, the above-noted are among the most used in P3 project agreements and are each considered below:

Amicable Negotiations

The first prescribed dispute resolution mechanism in any P3 project agreement requires that the parties negotiate and seek resolution with each other. Such negotiations are without prejudice and often identified by dispute resolution clauses as “amicable” or that negotiations are to be conducted in “good faith”. With some P3 project agreements, it is delivery of a notice of dispute (which sets out the particulars of the dispute and the remedy sought) from one party to the other that triggers the requirement to proceed with amicable negotiations. In other P3 project agreements, a notice of dispute follows the failure of amicable negotiations and instead triggers the next step in the dispute resolution process.

Also, some P3 project agreements provide for a single phase of amicable negotiations, whereas others may require a stepped approach to such negotiations. In this latter circumstance, amicable negotiations may be prescribed first with the lowest applicable levels of management, then with designated party representatives, and finally with the parties’ respective senior executives.

With amicable negotiations, parties maintain complete control over the dispute and its resolution. This step affords the parties the maximum opportunity to cooperate, resolve the dispute quickly, limit or avoid legal costs entirely, and protect the integrity of their relationship. Sometimes, however, the nature of the dispute is too complex or the parties' positions are too entrenched to permit resolution at this early stage.

Independent Certifier

In many P3 project agreements where resolution of a dispute is not possible with amicable negotiations, certain prescribed matters (typically in respect of construction costs, schedules, deficiencies, changes, etc.) are referred to the independent certifier for determination. The independent certifier is the consultant charged with the responsibility of objectively assessing the value of construction that has been completed as the project is constructed. The independent certifier is entitled to the parties' cooperation in respect of providing information as it moves to make its determination of any disputed matter within its purview.

The independent certifier's decisions are generally subject to further consideration whether by way of independent expert review, arbitration, or litigation. However, most P3 project agreements provide that an independent certifier's decision in respect of when and whether "substantial completion"² of the project is achieved is final.

² Substantial completion is a defined term in P3 project agreements that considers the completion of a number of elements, which (in Ontario) includes satisfaction of the criteria for "substantial performance" under the *Construction Lien Act*, R.S.O. 1990, c. C.30. Many P3 project agreements provide that all disputes under the P3 project agreement, with certain limited exceptions, are stayed pending achievement of substantial completion of the project. In this way, the parties limit or prevent the ability of disputes from delaying completion of the construction phase of the undertaking.

With an independent certifier resolving a dispute, the parties have the practical benefit of an independent expert's determination at an early stage of a dispute, thereby achieving many of the same benefits that amicable resolution affords, with the exception that the parties do not maintain complete control over their dispute.

Referee

Where certain disputed matters do not fall within the purview of the independent certifier and amicable negotiations have failed to result in resolution or where a party refuses to accept the independent certifier's decision, some P3 project agreements provide that the next step in the tiered dispute resolution process is to refer the matter to a referee.

A referee is an independent expert in the subject matter of the dispute and appointed by the parties to offer a non-binding opinion in respect of how the dispute ought to be resolved. The referee's opinion is not subject to production in either arbitration or litigation, nor is the referee to be a witness or otherwise involved in such proceedings. The referee process itself is also without prejudice to the parties.

A referee, like the independent certifier, is entitled to the parties' cooperation. The referee is often given significant latitude in relation to how they wish to resolve a matter. They may choose to receive written and oral submissions, make independent inquiries, and some are empowered to appoint further professionals under certain circumstances in support of reaching a decision.

In order for the referee process to be effective, the parties must agree on a referee that they both trust. Given the non-binding nature of the referee's opinion, the referee process is only capable

of resolving the parties' disputes to the extent that the parties permit. Thus, the option of a referee can be particularly attractive where a discreet expert issue separates the parties and the degree of trust in the referee and the non-binding process is high. Legal costs at this stage are still limited or may be avoided entirely and the parties' relationship is rarely threatened. However, where parties have entrenched opposing views, a referee's support can be of limited value. In such circumstances, a dispute resolution mechanism culminating in a binding decision is often required.

Adjudication

Adjudication is similar to the referee process in that the adjudicator, who presides over the process, is an independent expert in the subject matter of the dispute and selected by the parties. Like a referee, the adjudicator is entitled to the parties' cooperation and, in the absence of specific provisions to the contrary, also enjoys significant latitude in relation to how they wish to resolve the dispute.³

However, the main difference between a referee process and adjudication is that adjudication results in a potentially final and binding decision. The decision is identified here as "potentially" final and binding as P3 project agreements often make provision for certain kinds of disputes to be elevated from adjudication to either arbitration or litigation, or both. Typically disputes that reach a certain monetary threshold or respect matters of particular significance may be pursued through arbitration or litigation either following or instead of adjudication.

³ P3 project agreements sometimes reference generally recognized model procedures and principles in respect of adjudication as applicable including the United Kingdom Construction Industry Council's *Model Adjudication Procedure*.

Adjudication offers the parties the benefit of having a final and binding decision of an independent expert in respect of certain matters with limited legal expense. While resort to adjudication indicates that the parties were unable to reach resolution on their own, the relatively early stage at which adjudication occurs and its speedy process generally limits potential damage to the parties' relationship.

Given their similarities, P3 project agreements will typically prescribe proceeding with either adjudication or a referee process, but not both, following failed amicable negotiations and, in some circumstances, a rejection of the independent certifier's decision.

Arbitration

Where the foregoing dispute resolution mechanisms fail to resolve a dispute, the next tiered step for which P3 project agreements generally provide is arbitration. Proceeding to arbitration where an arbitrator or panel of arbitrators will resolve a dispute through the exchange of evidence and most often an oral hearing is necessarily an adversarial process, but ultimately grounded by the parties' consent to that process. The parties consent to the arbitration process in prescribing the kind of arbitration that they wish to pursue – that is, P3 project agreements typically provide for how the parties are to select their arbitrator or arbitrators, the rules and legislation that are to apply to the arbitration process, the information and evidence that is to be exchanged, appeal rights (if any), and the timing or schedule of events. P3 project agreements further provide for whether disputes must be determined by arbitration to the exclusion of litigation or whether parties reserve certain or all rights to proceed with litigation in favour of arbitration.

One of the key advantages of proceeding with an arbitration process in favour of litigation is that the parties may select their arbitrator or arbitrators so that someone who understands the nature of the dispute and is trusted by both sides will administer the dispute resolution process and ultimately decide their case. Arbitrations are also private (or at least not held before the public), a circumstance which generally protects the parties' relationship to a greater extent than public litigation is capable of doing.

In addition, although court processes are increasingly becoming flexible and fashioned according to the particular dispute at hand, on balance, it remains safe to say that the parties retain a greater degree of control over the kind of process that they wish to implement and its timing through arbitration than with litigation.

It was previously considered that arbitration resulted in the saving of legal costs, but whether this remains the case is seriously in doubt. Indeed, many believe that arbitrations are ultimately more expensive than litigation given the cost of the arbitrators, the hearing rooms, and moving to resolve the dispute on often expedited schedules in comparison to the speed of litigation.

Mediation

Whether prescribed as an independent process to be pursued under a P3 project agreement, or prescribed as part of an arbitration process (or not prescribed at all), parties may come to consider mediation as a way of resolving their dispute in favour of proceeding further with the formal processes of either arbitration or litigation.

With mediation, a neutral mediator is selected by the parties to assist them in reaching a negotiated settlement of their dispute. In such a process, the parties ultimately retain control

over how their dispute will be resolved. Their discussions are without prejudice and facilitated by a mediator, who is skilled in helping the parties bridge adverse positions, assess risk, and compromise so that a settlement may be reached. As with a referee, a mediator is not to be involved in any subsequent legal processes, nor is the information exchanged by the parties solely through the mediation process included in any such subsequent processes. The parties are accordingly at liberty to engage in frank discussion with each other without fear of being held to any positions taken following the termination of the mediation should the dispute not settle.

The mediation process itself is non-binding and only works where both parties are prepared to work together in reaching a compromise. The decision to participate in mediation is often informed by the parties each assessing the cost (both legal and otherwise) of proceeding with a formal hearing, the strength and weaknesses of their positions, and the risk of losing at a hearing. Where the mediation process results in a settlement, the settlement itself becomes enforceable as a contract.

The timing of when to pursue mediation is key. If pursued too early, parties may lack the requisite information to adequately assess the strengths and weaknesses of their case, thereby resulting in a circumstance where parties are unable to bridge the gap between their positions. Conversely, if pursued too late, parties' positions become entrenched and the advantage that could otherwise exist in avoiding legal costs evaporates. Whether working through an arbitration process or litigation, the ideal moments to consider mediation are generally, 1) before proceeding with the formal dispute resolution process, 2) following the exchange of pleadings and certain key documents but before proceeding to the full exchange of materials and oral discoveries, and

3) following the discovery process but in advance of preparing for the arbitration hearing or trial, as the case may be.

Litigation

Certain P3 project agreements preclude litigation by directing that parties must arbitrate their disputes where prior dispute resolution mechanisms fail to resolve the matter. There are, however, other P3 project agreements that allow parties to select litigation in favour of arbitration, either for any dispute or in respect of certain prescribed disputes.⁴

Given the adversarial nature and public forum that litigation entails, the lack of control that parties are able to exert over the dispute resolution process as compared to those considered above, and the usually much longer periods of time required to reach resolution by way of trial as opposed to any other form of dispute resolution, litigation is generally considered the least desirable dispute resolution mechanism in respect of protecting parties' relationships.

Parties do, however, retain greater rights of appeal (which are often significantly reduced or eliminated by prescribed arbitration procedures) and have the benefit of a judge's public decision through litigation. Subject to what is noted in the section further below, the inclusion of all parties relevant to any one dispute can also sometimes be better accommodated through the counterclaims and third party claims permitted by court procedure as opposed to where certain relevant parties to a dispute may not be party to the arbitration agreement between the public authority and Project Co. Moreover, the threat of facing a public and potentially lengthy dispute

⁴ For example, the standard form P3 project agreement employed by Infrastructure Ontario permits parties to proceed to litigation in favour of arbitration where the monetary value of the dispute exceeds a certain threshold or if the dispute involves material issues of public health or safety.

can (perhaps counter intuitively) motivate parties to settle their dispute through amicable negotiations or mediation to a greater extent than would otherwise be the case.

The Contractors and Subcontractors

It is the relationship between the public authority and Project Co that has, for the most part, thus far been considered. Project Co does not, however, directly take on the universe of obligations prescribed under the P3 project agreement. By way of “drop-down” agreements, Project Co causes obligations under the P3 project agreement to be performed by the requisite contractors, who in turn may cause subcontractors to perform certain portions of their contracts with Project Co. This passing down of contractual responsibilities often continues past the subcontractor level to sub-subcontractors and so on.⁵

Issues that eventually evolve into disputes accordingly most often arise in respect of work or services that are being performed by a contractor or subcontractor. The associated loss or exposure related to any dispute also most often ultimately rests with such contractor or subcontractor. In this regard, there are “equivalent project relief” provisions in the contracts between Project Co and its contractors, often between the contractors and subcontractors, and sometimes between parties further down the contractual chain. These equivalent project relief provisions require parties “up the contractual chain” to forward disputes up to the next party in the chain and ultimately as against the public authority. These provisions at the same time permit Project Co (and other parties in the construction pyramid where applicable) to transfer

⁵ The contractual formation or “chain” of these relationships, whether in a P3 context or other construction contexts, is commonly referred to as the “construction pyramid”.

liability “down the contractual chain” to the party that bears direct responsibility for any loss or default under the P3 project agreement.

Project Co contractually limits its liability to its contractors in respect of their claims for relief to the compensation that Project Co is able to obtain from the public authority through the dispute resolution process prescribed in the P3 project agreement. In addition, Project Co often requires that any dispute as between it and its contractors that is capable of being forwarded as against the public authority is to be resolved through the dispute resolution process selected by Project Co. Thus, contractors and subcontractors can, in certain circumstances, lack significant degrees of control in respect of how and when their disputes will be resolved and what recovery will ultimately be available to them.

As such, contractors sometimes negotiate the ability to bring claims on behalf of Project Co under the P3 project agreement or secure the contractual right to join any dispute with the public authority respecting their work. In the absence of such provisions, however, contractors rely on Project Co (and often cooperate with Project Co) to pursue their disputes as against the public authority through the dispute resolution process prescribed in the P3 project agreement. Also, while Project Co limits its liability to contractors as described above, contractors remain completely liable for all losses suffered by Project Co resulting from breaches of the P3 project agreement where such breaches are caused by the contractors’ acts or omissions.

With the number of relationships in the contractual chain below that of the public authority’s with Project Co, P3 project agreements often include provisions for the stay or joinder of arbitrations and litigation between the public authority and Project Co where the facts and issues in such proceedings are the same or overlap with the facts and issues being litigated or that

constitute the subject of arbitration between a third party and either the public authority or Project Co.

Conclusion

The layers of complexity to P3s have necessitated the development of comprehensive, tiered dispute resolution schemes. These sophisticated schemes afford the public authority and Project Co opportunities to resolve disputes faster, at lower cost, and with minimal interruption to the construction process and their relationship in comparison to what would otherwise be the case. Because these dispute resolution procedures are crafted specifically for the benefit of the public authority and Project Co, however, they do not necessarily accommodate the perspectives or interests of contractors and subcontractors to the same degree. Dispute resolution provisions that afford flexibility as between the public authority and Project Co can cause delays or limitations from the perspective of contractors and subcontractors. It may go without saying that all parties engaged in P3s must accordingly carefully consider the significant risks that they are assuming and work cooperatively and with high degrees of effective communication to limit or avoid the potential for damaging disputes.

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