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## Construction Dispute Avoidance and Profit-Sharing Construction Contracts

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### INTRODUCTION

The construction industry is by most criteria the largest in any country (Especially developing countries). Its work is highly valued but most of it is extremely complex and has to be executed in difficult conditions. It is not surprising therefore, that many disputes arise in the industry.

**Disputes** can cause problems, management time being spent on Litigation on arbitration which would be better used to advance business and avoid high legal costs.

Because of these pitfalls of dispute resolution - be it by direct negotiation, or through a neutral facilitator or adjudication or arbitration or litigation, why not consider procedures that help to avoid disputes.

Problems, arguments and claims for additional payment area on inevitable feature of every construction project. However, in most projects. The problems are resolved between the people on sight without becoming ‘disputes’.

The issue that must be considered is why some problem situations ripen into formal disputes, rather than being settled at the time.

Then it may be possible to use the appropriate management techniques and prevent problems ripening into open disputes.

## CHAPTER 1- FACTORS CONVERTING A PROBLEM INTO A DISPUTE



Experience shows that a problem becomes a dispute, rather than being solved by the people on site for the following reasons:-

1. Difficulty in resolving a technical problem, either because of conflicting expert opinions, or because someone wants to cover up a previous mistake;
2. The rigid application of one person's interpretation of a contract.
3. Personality clashes which override reasonable discussions.
4. A situation either natural or man-made which requires a correct legal interpretation and decision.

In the last situation, then a dispute may be inevitable, hence it may be necessary to resort to a formal dispute resolution mechanism. However the majority of construction disputes are caused by other reasons and disputes could have been avoided. The appropriate procedure to avoid a dispute may be a matter of contract and project management or a matter of personal attitudes and actions by the people on the construction site.

Latham in *Constructing the Team* (Latham 1994) at para 9:3 said: The best solution is to avoid disputes. If procedures relating to procurement and tendering are improved, the causes of conflict will be reduced. If a contract document is adopted which places the emphasis on team work and partnership to solve problems that is another major step.

## **1- The Construction Dispute**

To consider how construction disputes can be avoided, it is first necessary to define what is meant by a 'dispute' and review the sequence of events which results in a construction dispute.

In general usage the word 'dispute' is defined as an 'argument' or 'contest with words' (Chambers 20th Century Dictionary). However, in construction contracts the word has a more precise and formal meaning.

The ICE Conditions of Contract 6th Edition (ICE, 1991) state at Clause 66(2) that '..... a dispute shall be deemed to arise when one party serves on the Engineer a notice in writing (hereinafter called the Notice of Dispute) stating the nature of the dispute.' Before any party can serve such a notice they must first have taken any other steps and followed the appropriate procedures in accordance with the contract. The other party must also have been given the opportunity to take any appropriate action.

The FIDIC international contract (FIDIC, 1987) contains a similar procedure at Clause 67. Other standard forms of contract do not require a specific Notice of Dispute, but are based on the same principles.

In construction a 'dispute' is the formal situation, after a claim has been submitted, rejected and reconsidered. It is not just any argument or contest with words.

## **2- Contract Procedures**

Every construction contract must have some provision for the unexpected situation which may lead to a difference of opinion between the parties to the contract. Even the Latham Report acknowledged that some disputes will arise these disputes whenever possible it is essential to provide the opportunity for the parties to anticipate the problem situation and to negotiate the settlement of any claim before attitudes harden and the request and response situation develops into a dispute. This is not just a matter of written notices and procedures.

Cooperation must be encouraged, in order to achieve agreement by the people who are involved with the problem on the site.

The traditional procurement procedures and standard forms of contract are based on the requirement that the contractor must give notice when he becomes aware of a problem which could lead to a claim. The initial notice is followed by further details, which must be provided as soon as the information becomes available. The employer's representative, who may be the architect, engineer or project manager, reviews the information which is submitted, makes any decisions which are necessary in order to progress the project, and decides whether the contractor is to be given any additional time or money.

In practice, many contractors are reluctant to commit themselves until they see how the situation develops. Many consultants and employers also prefer to postpone any decisions for as long as possible. These attitudes are against the contract procedures and the principles of dispute avoidance Contracts always emphasize the need for written notices, whereas it would be preferable to encourage the culture of negotiation, rather than conflict. All contracts, including contractor's design and management contracts contain similar provisions and basic procedures. It is essential to ensure that the contractor gives the employer every opportunity to resolve the problems as quickly as possible and to mitigate the consequences of the initial problem, but this should only be a part of the requirements.

For a dispute to arise there must have been a certain sequence of events:

- Something happened – an instruction, query, unexpected natural event, or other problem;
- Someone suffered – either additional direct cost, or a delay which would cause additional cost;
- The person who suffered – or thought they had suffered-asked for compensation;

- The request for compensation was denied; the person who suffered did not accept the rejection; there is now a 'dispute'.

In order to avoid the dispute it is necessary either to avoid the initial event or to break the chain of events. This can only be done by reaching an agreed settlement of the problem at an intermediate stage.

The operation of this sequence in practice is shown by the procedures in the standard forms of contract.

The ICE 6th Edition includes a number of clauses which refer to situations which start the sequence and my entitle the contractor to additional time or money, for example:

1. Contractor encounters an unexpected physical condition and gives notice under Clause 12 (1).
2. Contractor suffers additional cost and/or delay.
3. Contractor gives notice under Clause 12(2) of intention to claim pursuant to Clause 52(4) for money and/or Clause 44(1) for an extension of time.
4. Contractor gives details as Clause 12 (3) of anticipated effects, with actions proposed and taken.
5. Engineer give instructions and consents as he thinks fit under Clause 12(4).
6. Engineer informs contractor under Clause 12(5) that situation could have been foreseen and rejects claim, or determines extent of payment and time due.
7. Contractor does not accept the situation and repeats his claim.
8. Further discussion and exchange of correspondence fails to achieve and agreed settlement.
9. Contractor gives Notice of Dispute under Clause 66(2).

**3- The Standard Form of Building Contract 1980 Edition (Joint Contracts Tribunal, 1980) known as JCT 80, has a similar sequence, starting with a 'relevant event':**

- 3.1- Progress of works is delayed by one of the relevant events as listed under Clause 25.4 and contractor gives notice under Clause 25.2.1.1.
- 3.2- Contractor suffers delay due to the relevant event and cost due to a matter listed at Clause 26.2.
- 3.3- Contractor gives particulars of the delay, as Clause 25.2.2, and loss and expense as Clause 26.1.
- 3.4- Architect ascertains and certifies any additional time or payment as Clauses 25.3.1 and 26.1.
- 3.5- Contractor does not accept the decision and repeats his claim.
- 3.6- Further discussion and exchange of correspondence fails to achieve an agreed settlement.
- 3.7- Dispute arises and is referred to arbitration in accordance with Article 5 and Clause 41.

Other contracts include similar provisions although the terminology and details of the procedure vary.

The Engineering and Construction Contract (ICE, 1995), known as the NEC, includes a Clause 60 a list of compensation events. If the contract believes that any occurrence is a compensation event then he must give notice to the project manager under Clause 61.3.

The eventual dispute is the culmination of a sequence of events and actions. The dispute will be avoided if the initial event does not arise, or by an agreement between the parties, or their representatives, at any point in the sequence.

#### **4- Avoiding the Initial Event**

The concept of the 'relevant event' as used in the JCT contracts, illustrates the way in which a particular event will start the sequence which may lead to a dispute.

The list, at Clause 25.4 of JCT 80, includes events with a variety of causes and varying liability. Events such as force majeure (Clause 25.4.1), exceptionally adverse weather

conditions (Clause 25.4.2) and the specified perils as defined at Clause 1.3 (Clause 25.4.3) are outside the control of both parties. If they happen, then they happen, and no-one can do anything to prevent the occurrence. Efforts at dispute avoidance must be directed further down the sequence.

Similarly, events such as civil commotion, strikes and the other events listed at Clause 245.4.4; delays by nominated subcontractors or nominated suppliers (Clause 25.4.7) and actions by the government (Clause 25.4.9) or local authority (Clause 25.4.11) cannot be prevented by either party.

However, it may be possible for one or both parties to anticipate these events. These problems rarely occur without any warning or some involvement by the contractor, consultant or employer.

If any of the people involved with the project sees an indication that a delay event is developing then he should raise the matter for discussion.

Even if the event cannot be avoided, the delay and cost consequences can be reduced and, which is most important, the consequences can be discussed in advance. Additional costs which have been discussed in advance are more likely to be accepted than costs which were not notified in advance.

On the other hand, events such as compliance with architect's instructions (Clause 25.4.5), delay in the receipt of architect's instructions (Clause 25.4.6) and other foreseeable problems are within the control of the parties.

The architect may, or may not, be able to control the content and timing of an instruction. He can certainly control the manner in which the instruction is communicated to the contractor. This is a matter of efficient project management. If, under Clause 25.4.6, the contractor has requested an instruction or further information then the architect can ensure that the reasons for the contractor's request are considered and discussed.

Similarly, with a failure of the employer to give ingress or egress to the site (Clause 25.4.12) or deferred possession (Clause 25.4.13), some compensation will probably be due to the contractor. However, whether the compensation is agreed, or becomes the subject of a dispute, will depend on the way in which the matter has been dealt with by the employer, the architect and the contractor.

The problems from the contractor's inability to secure labor or materials (Clause 25.4.10) must be beyond the contractor's control and not have been reasonably foreseeable at the base date. The base date is a date which is stated in the appendix to the contract.

The contractor's entitlement to compensation will depend on whether the event was foreseeable at the base date. The consequences of the problem and whether the architect's decision is accepted by the contractor will depend on how the matter was handled at the time.

Clearly some of these claim situations can be avoided by improved project management. Mistakes and omissions in the contract documents can be reduced or eliminated. Some of the problems of employer changes, lack of possession of site and unexpected natural conditions can be avoided by better planning at the design stage. However, these problems will never be entirely eliminated and the contract procedures must encourage the negotiated settlement of any problems which do arise.

## **5- Problems May Be Inevitable – Disputes Can Be Avoided**

When a problem situation occurs, one or both parties to the contract, or subcontract, will be involved in additional work. This will result in disruption to their planned work, delay to a part of the project and additional costs. The party who suffers additional costs may ask that they be reimbursed by the other party.



The other party may agree that any additional costs should be reimbursed. However it is more likely that they will not agree to everything and an argument will develop concerning:

- What actually happened?
- Who is liable and
- What is the quantum of time and money?

In order to resolve the problems and avoid a formal dispute it is Necessary for the parties, or their representatives, to analyze the problems and negotiate an agreed solution.

The traditional contract procedures put the emphasis on the need for the contractor to submit written notices. Employers are rarely required to follow the same procedures. This is presumably on the basis that any employer claims will be deducted from the contract payments and the contractor will object and claim reimbursement.

In any potential claim situation the contractor must first give written notice of the event which caused him to think that there might be a delay or additional cost.

Then he must give written notice of the likely consequences, with full details as they become available.

The employer's representative will consider the information which has been presented. Immediate written notice is important for the other party to be aware of what is happening and to take any appropriate action, but it can result in people taking fixed positions at an early stage. When people take entrenched positions and pass information to their head office or client it is far more difficult for them to modify their views when further information and evidence is provided by the other party.

Any action which results in an entrenched position must be discouraged. When a problem starts to develop into a claim the contract procedures should encourage people to listen to the other person and answer the points which have been raised. Many disputes arise because both sides are concentrating on

developing their own case, rather than trying to understand the reasons for the other person taking a particular attitude. Proper understanding requires discussion, rather than an exchange of written statements.

### **6- The 'Early Warning' Meeting**

The procedure of the 'early warning' required by Clause 16 of the NEC must be preferable to the exchange of written notice and response in the traditional contracts.

The NEC procedure includes:

- **Clause 16.1** requires the contractor and the project manager to give the other an early warning as soon as they become aware of any matter which could result in an increase in price, delay completion, or impair the performance of the works in use.

The requirement for a notice of potential increases in cost and time is similar to the provisions in other contracts. Notice of any matter which could impair the performance of the works in use is an interesting additional requirement.

- **Clause 16.2** states that either the contractor or the project manager may instruct the other to attend an early warning meeting.

In any well-organized project, under any conditions of contract, when a problem arises the contractor will invite the employer's representative to a meeting to discuss the problem. The fact that the NEC permits the contractor to instruct the employer's representative to attend a meeting demonstrates the importance which is given to this procedure.

Other people who are involved, or could help to overcome the problem, such as subcontractors or consultants, can be invited to attend. However, the contractor or project manager can veto their attendance.

• **Clause 16.3** states the people who attend the early warning meeting will cooperate in making and considering proposals on how to avoid or reduce the effect of the matter which has been notified. They then look for solutions ‘that will bring advantage to all those who will be affected’ and decide on the actions which should be taken and who, in accordance with the contract, will take these actions.

Under any construction contract the parties have their obligations.

The contractor has to complete the works and the employer’s representative issues instructions and certifies payments.

The early warning meeting does not remove these basic obligations. However, it means that the people on site will discuss the problem. They will look for the solution which will be to the best advantage, or cause the fewest problems, to all concerned. Both sides will have their views on the technical and contractual issues.

This includes the investigations which may be necessary and how any design and construction aspects should be dealt with so as to meet the employer’s requirements and minimize Disruption to the construction.

• **Clause 16.4** requires the project manager to keep a record of the proposals considered and decisions taken and to give a copy to the contractor. This is normal practice for any meeting between contractor and employer’s representative.

• **Clause 61.5** states that the project manager will decide whether the contractor gave an early warning of an event which an experienced contractor could have given.

The project manager will give notice to the contractor if he decides that the contractor failed to give an early warning, when he should have been able to anticipate the problem.

• **Clause 63.4** states that if the project manager has given notice under Clause 61:5 then he assesses any valuation as if an early earning had been given.

This clause ensures that if the contractor fails to give an early warning and, as a consequence the project manager is not enabled to take some action in mitigation, then the contractor will suffer the consequences.

In any of the 'relevant event' or claim situations which may arise during the construction of a project it is far better if the people on site have a meeting, as soon as the possibility of a problem becomes apparent, rather than just exchanging notices and correspondence.

If the potential problem and possible solutions and consequences are discussed before anyone reaches any fixed attitude then there is a far better chance of avoiding a dispute when the time comes to agree on the financial consequences.

## **7- Claims Review Meetings**

The early warning meeting will ensure that the people concerned, whether contractor and employer's representative or main contractor and subcontractor, will be aware of the potential problem and have the opportunity to take any action which would avoid or reduce its consequences. They will also be able to consider, and perhaps agree, on the best actions to be taken.

At this stage, the final agreement is not as important as understanding the point of view of the other person. The employer's representative will have the power, and the duty, to issue any necessary instructions and the contractor will be obliged to follow those instructions.

To avoid subsequent disputes it is essential that the employer's representative has considered any alternative course of action which the contract has proposed and understands the likely effects, in both time and cost, of the instructions which he has issued.

Many contracts do not require the contractor and the architect to sit down for detailed discussion, analysis of the problem, a full exchange of views and an understanding of the other person's point of view.

Some of the so-called 'improved' procedures are even less helpful if the aim is to avoid disputes. They are aimed at a fast decision by a third person, as adjudicator, without allowing time for investigation, analysis and understanding by the people on both sides of the debate. For disputes to be avoided it is essential that the early earning meeting is followed by a series of claims review meetings. For a contractor to submit notices, records and monthly requests for payment will serve no useful purpose unless the architect or engineer understands what the contractor is doing and appreciates why the contractor is spending money using men, materials and equipment in a certain way.

Many projects do have regular claims review meetings, even if they are not required by the conditions of contract, and many disputes are avoided by the agreements which are reached as a consequence of these discussions.

## **8- The Settlement Meeting**

When representatives of the main contractor and employer, or subcontractor and main contractor, sit down to try and settle a claim, they will be starting from very different positions.

The contractor will probably have submitted a very low tender in order to be awarded the contract.

The consultant will be under pressure from his client to work within a strict budget. Both sides will be trying to recover losses from other parts of the project. This will inevitably lead to arguments which are not related to the merits of this particular claim.

The construction industry has a reputation for being adversarial, aggressive and always looking for confrontation.

This reputation may sometimes be justified but frequently the reputation is used as an excuse to cover other problems. By comparison with the arguments and legal actions which arise elsewhere, the construction industry must be one of the least adversarial sectors of society.

When the notices, exchange of questions and information, early warning and claims meetings all fail to achieve an agreed settlement to the problem it is time for a final attempt at settlement before the problem becomes a dispute.

Experience shows that many apparently intractable problems, between people who have erected insurmountable barriers and created an atmosphere of total mistrust, can still be resolved by discussion and negotiation.

The meeting must be properly organized and concentrate on the problem which is to be resolved. The atmosphere of trust and cooperation will develop during a frank and honest exchanges of vies.

## **9- Reaching a Settlement**

There are some claims which are not settled on site and become formal disputes under the procedures in the contract. It is, therefore, necessary to consider why these claims are not settled and what can be done to prevent those becoming disputes. Most claims will eventually be settled by negotiation, at some point between the cause of the problem and the door of the courtroom or arbitration hearing. It should be possible to bring the settlement forward and reach the same agreement by discussion between the people on sit.

The reason why the agreement at the door of the arbitration hearing was not reached earlier may be:

- **Better legal advice.** During the arbitration both parties will have received advice from their lawyers. This advice may bring lower expectations than the advice from construction professionals to their company superiors or clients.

- **Better technical information.** Further investigations and expert reports may have revealed additional technical facts and opinions.
- **The level of proof which is required.** Consultants sometimes ask for claims to be proved to a level of 'beyond all reasonable doubt'.

Arbitrators will consider evidence from both sides and may reach their decision the basis of the 'balance of probabilities', which requires a lower level of proof.

- **Appreciation of the importance of issues.** Disputes sometimes arise because people fail to understand which issues are important to the other person. One party may be prepared to compromise on issue A, but not issue B.

The other party may have the opposite priority, but without frank discussion they will not realize that there is scope for overall compromise.

- **Realization of the costs.** It is only when they start to receive the bills that people realize that arbitration is expensive and it will be cheaper to settle.
- **The problem is removed from a personality clash.** Some disputes occur because of personality problems between the people who are negotiating on site.
- **A different decision-maker.** When someone on site has made a decision, or been obliged to correct a mistake, they will be reluctant to admit that they were wrong. When the dispute is referred to someone at a higher level, who was not directly involved with the problem, they will take a more pragmatic view.
- **The desire to dispose of the problem.** When a claim is notified during the construction period one or both parties may wish to delay matters until construction is complete. At a later date they may be more willing to compromise in order to close the files.

## **10- Overcoming the Problems – Action by Either Party**

When negotiation on a claim reaches a position of stalemate the people involved should step back and consider whether there is any action which they can take to prevent the claim becoming a dispute.

Stalemate may be reached because the people concerned are concentrating on explaining their own point of view and are not trying to understand the other person's point of view.

Many people approach a negotiation asking them 'how can I persuade him to agree that I am right'. They should be asking 'what is his point of view', 'why is it different to mine' and 'what can I do to help us to reach agreement'.

Both parties must analyze the arguments which have been put forward by the other side and see whether there is a valid point in the other person's argument then a study of that point will suggest evidence which will help to reject, or partially accept, that point and break the deadlock. Further investigation or an independent report may be necessary.

One of the problems with the traditional standard forms of contract is that they make no allowance for a combined forensic study of the problem.

The contractor is required to submit notices, provide further information and answer questions. The employer's representative considers the information which has been submitted and makes a decision. What is missing is a requirement for a joint investigation and analysis of the different views and the logic from which those views are derived.

Contractors submitting claims sometimes exaggerate, or leave the detailed presentation until they see how the figures work out at the end of the project. Consultants frequently ask for more information 'in order to prove your case'. This may be a genuine request because the information provided is not adequate. It may be because the consultant is not ready to



spend time studying the claim, or the employer wants to delay settlement for cash flow reasons.

When a claim negotiation has broken down and the claim is about to become an expensive dispute these attitudes must change. Both sides must provide specific questions and answers.

Some claims become disputes because there a number of separate items under consideration and the priorities are different for each side. An employer may be prepared to accept one claim, but is adamant that he will never accept another claim. This may be because it would establish a precedent for other projects, or for some internal reason. A consultant may feel strongly on a point of principle, particularly if the claim involves allegations against his own performance. Both sides will take the attitude that they will give way on some point, but only after the other side has made a concession on some other point. A negotiation may even have broken down because the two sides have different priorities and do not realize that there is common ground.

These problems can be resolved by a mediator or conciliator or they may be avoided by the consultant taking an impartial attitude during the negotiation.

This is, of course, the traditional role of the architect or engineer, which has become more and more difficult because of the current financial and other pressures on the industry.

### **11- The Facilitator**

There is no need to wait for a claim to become a dispute before calling for the assistance of an independent person.

The importance of an independent person to organize a partnering workshop and monitor the partnering agreement has already been considered. In projects without the formal partnering procedure there is still a role for the independent person to help to prevent problems becoming disputes.

Claims will always result in tension between the people on site. When the contractor is asking for money and perhaps making allegations that mistakes by the consultant were the cause of his problems, the consultant will not be happy.

Even when the people concerned are reasonable, logical people, there will be some tension and aggravation. Relationships will suffer and the normal routine contacts will become more difficult.

One solution is the appointment of a 'facilitator'. The task of the facilitator is to smooth the relationships, promote useful discussion and obtain agreements before the people concerned take fixed positions and generate a formal dispute. In some respects this is a task which has been carried out by the resident engineer, as part of his normal duties. However, in many situations there is considerable value in using an independent person.

The role of the facilitator has developed in New Zealand, in multiparty situations and to avoid disputes in planning approvals and other potential dispute situations. In the international construction industry, the first task of the FIDIC Dispute Adjudication Board (FIDIC Supplement 1996) is to act as a facilitator when a claim situation starts to develop.

The facilitator, who is sometimes known as the 'independent claims adviser', should be appointed at the start of the project, by agreement between the parties, before any claims arise. He will visit the site on a regular basis in order to be aware of any potential problems. He will attend any early warning meetings and follow up with discussions with both parties. He is essentially a neutral chairman, who promotes agreement to claims before the parties take entrenched positions.

## **12- Cultural Differences**

When an owner employs a local consultant and a local contractor, the people involved with the project have probably

worked together on previous projects and hope to work together on future projects. They have probably known each other for many years and may even have attended the same school. They knew each other when they negotiated their contracts and so any negotiations on additional payments should be frank and straightforward. If they have followed reasonable procedures and negotiation techniques then any problems which do arise will be difficult problems and may be insuperable without outside help.

When the people concerned are strangers to each other and are from different parts of the country, or different parts of the world, there will be additional problems. It is far more difficult to negotiate with someone from a different cultural background. This may not be a just a matter of language difficulties but of different interpretation of language; background; expectations and even body language.

Misunderstandings as a result of communications problems can destroy a negotiation which would otherwise have been successful.

In order to achieve a settlement to a difficult problem it is essential that both sides are aware of any cultural differences and make every allowance for these differences before assuming that they have failed in their efforts to reach an agreement. Above all, it is essential to maintain courtesy and consideration for the other person and their culture at all times. Attitudes and actions which would pass unnoticed by a person of similar background may be considered to be extremely insulting by someone from a different background.

For example, when visiting a country with a hot and humid climate, many Europeans or Americans will wear open-necked shirts with no jacket. However, the person who lives in that country may consider that a formal meeting demands formal dress. Many companies have lost money in a claims settlement because the employer, who will eventually sign the check, feels insulted by casual dress at a claims meeting

Cultural respects is a two way process. Most non-Christians will understand that Christians are reluctant to attend meetings on 25<sup>th</sup> December or Easter Sunday, regardless of whether these days are public holidays or working days in the country of the project. However, they will be far less sympathetic when the festive season is extended for social, rather than religious reasons. They will also expect reciprocal consideration for their own religious or traditional holidays and customers.

One custom which is almost universal is that priority should be given to the demands of family rather than business. The extent to which business meetings may start with a reference to family varies considerably throughout the world and often requires considerable tact to avoid giving offence. However the need to delay a meeting because of bereavement or family crisis is often accepted by people who are extremely tough and inflexible negotiators on all other matters.

The duties of the members within a team will also vary.

In some cultures, particularly in the United States of America, each member of the team is a specialist who will deal with his own subject. The team leader may introduce the specialist, but will leave him to state the company case on the matter for which he is the expert. In other cultures, for example delegations from some Asian countries, the team maintains a rigid hierarchy. The team leader, who is the senior person within the company hierarchy, will be the spokesman. If he requires information from a team member then he may ask to adjourn in order to obtain that information. If a specialist member knows that the team leader is not presenting the case in the best possible way he will tactfully refrain from interrupting.

Obviously a negotiation between two sides working to such radically difference procedures will be slow and may even fail, as a result of communications problems.

A typical British approach is to treat negotiations as a debate and to try and score points from the other side. This attitude can result in disaster in terms of an agreed settlement.

Everyone must be patient and look for the long terms agreement, rather than the short term advantage. The attitude at the start of a meeting is always important. Some people consider that time is critical and expect to rush in to a meeting, reach a quick decision and rush away to the next appointment.

People from the Middle East often prefer to spend time on preliminary discussion, in order to establish an atmosphere of mutual understanding and respect.

This initial assessment period will frequently result in a reduction in the overall time required for a final settlement which is better for both parties.

During a negotiation, the person from an adversarial tradition will tend to oppose anything with which they disagree and their feelings will be made very clear to the other person. In other parts of the world this behavior would be considered very discourteous.

In many Asian countries the primary aim is to reach an agreement which is acceptable to both sides and does not involve a loss of face to the other person.

This is a total contract to the typically British 'football match' attitude in which 'I am aiming to win, which means that you must lose'. The matter of language is also important.

The British are fortunate in that English is the common language for construction negotiation throughout most of the world. This frequently leads to complacency and the idea that one can work with English in the same way in any country.

In fact, the use and understanding of spoken English varies considerably.

People who have no problems with conversational English may have problems with technical and legal phraseology, so misunderstandings can arise.

Regional accents will also cause considerable problems for the non-native English speaker.

With the exception of the person who was educated in the particular region, most people will have problems in the comprehension of regional dialects, but will probably be too polite to ask for clarification. The same problem arises when a British person miss-uses English words of grammar.

People who have learnt English as a second language will often have a better appreciation of correct grammar than those whose mother tongue is English.

There may also be the problem that 'correct' English has developed differently in different parts of the world. This is not just a matter of the well-known differences between English - English and American -English but other distinctive variations have developed in many African countries and in the Indian subcontinent.

Negotiations between people from different countries and cultures require patience and a mutual exploration of attitudes in order to overcome the difficulties.

### **13- Avoiding Disputes**

The number of construction disputes can be reduced by removing the causes of the problems. This can be achieved by improved project management procedures and fewer mistakes by the people who are working on the project.

Preventing the unavoidable problems becoming claims and disputes requires careful investigation and negotiation by the people on site. This is a matter of appreciation of the other person's culture, the development of mutual respect by the people on the construction site and, above all, patience and the desire to listen to the other person.

Those people who take an aggressive attitude, fail to listen to the arguments from the other side and stick rigidly to their own preconceived ideas must change their attitude if the

industry is to save money by are diction in the number of disputes.



## **CHAPTER 2- PROFIT-SHARING CONSTRUCTION CONTRACTS**

### **I. The Concept of a Revenue-Sharing Contract**

Some form of revenue-sharing or participation agreements, especially the “usufructuary leases” (*colonia partiaria*) have been known and applied for a long time. However, this type of contract has recently started to be applied more commonly and in a wider area, due to its special features and advantages. Indeed, revenue-sharing agreements well serve the objective of increasing profit, the prevailing aim of most businesses. In addition, those agreements stipulate that the risks of commercial enterprises be shared between the parties.

Under a revenue-sharing contract, one of the parties provides the other party with an economic value that party needs for a business, investment or enterprise. The economic value may be a certain amount of money, the use of goods generating income or manpower. The characteristic feature of this contract type is that, during the conclusion of the contract, the party to whom an economic value has been promised does not promise to perform a certain specified act in exchange for the proposed economic value. His obligation is to give the party

who supplied the economic value a proportion of the gain which he will obtain by using that economic value in an economic activity. In other words, the party who provides the economic value participates in the gain.

Under a revenue-sharing agreement, in the case that the positive result does not occur, in principle the party providing the other party with an economic value does not have any right to claim. On the other hand, it is likely that, under the contract, parties agree on other terms in this regard.

In this context parties may agree on a fixed price as well as a proportion from the gain.

In this case, independent of whether or not a successful result has been achieved, a consideration agreed on under the contract is to be given to the party. If the successful result occurs, the other party shares the gain by either getting extra in addition to the minimum fixed price or an amount proportional to what is exceeded from the minimum price, depending on the terms of the contract. This situation does not affect the quality of the contract being of the revenue-sharing type. However, the terms related to revenue-sharing apply to matters exclusive of those regarding the lump sum fixed-consideration in the case where the successful consequence has been achieved. Alongside the proportion which is to be obtained from the gain, the fixed and certain price agreed on under the contract can constitute a minimum limit or a maximum limit.

The revenue does not necessarily mean a monetary gain or profit.

Material product emerging or the prevention of a loss is also considered as revenue. Thus, sharing of the material revenue, i.e. sharing of a product, or creating a right in rem over a thing can be regarded as revenue-sharing.

Where the revenue to be shared is money, (i.e. a profit), the amount thereof might be ascertained on the basis of net profit, gross profit or financial turnover.



## II. A Profit-Sharing Construction Contract:

### *A. DEFINITION:*

Under profit-sharing construction contracts, the parties, i.e. the owner and the contractor, conclude an agreement on how they will share the gain which will be obtained from the sale of independent sections which are going to be built by the contractor. The aim of entering into such an agreement is not only to perform construction (independent sections) on the owner's land, but also to make a profit by selling independent sections and sharing the gain in question. In order to achieve this result, the contractor erects a construction (builds independent sections) on the owner's land as well as selling independent sections to third parties.

As can even be observed *prima facie*, this type of construction contract differs from the construction contracts under which one party agrees to carry out construction, and the other party agrees to pay; and from the construction contracts under which the owner promises to transfer the title of certain land shares to the contractor.

Since both revenue sharing contracts, in general, and profit sharing construction contracts, in particular, are not regulated by the Code, the issues as to their legal character, type and whether their validity is subject to a specific formal requirement and rights and obligations of the parties need to be clarified.

### *B. FUNCTIONS:*

In cases where parties merely intend to make a profit from the sale of independent sections, profit-sharing construction contracts provide an effective opportunity to achieve this objective.

In large-sized projects, there is a likelihood of economic failure due to economic recession, a mistake in timing or choice of land or the fact that the project does not respond to demand.

In the case of construction jobs which have been carried out upon the offer of public enterprises and subsidiaries paying a certain sum (concluding construction contracts), it is possible that some negative situations can be faced.

These may include the payment of sums which are unnecessarily high or higher than the real cost, the delay of construction work or the quality of the construction being less than expected.

Profit-sharing construction contracts can be regarded as a method which decreases the risks borne by the owner. In this type of contract, the contractor runs the risk of failure of the project. The contractor cannot obtain any consideration by merely completing the construction. In order for the contractor to make a gain in return for the completion of construction, the generation of a project likely to achieve success and the sale of independent finished sections are necessary. Certainly, the contractor must put in a great deal of effort to reach that result. The profit-sharing construction contract also provides third parties purchasing independent sections made under this type of contract with a more efficient and reliable opportunity, compared to third parties purchasing independent sections belonging to the contractor under a construction contract concluded in return for obtaining a land share.

As a consequence of a more efficient and reliable situation for the third parties, it is possible that the sale of independent sections of the construction to third parties can occur more easily and with a higher price.

In this way, the construction may be financed more efficiently and conveniently. Indeed, in the case that independent sections are sold partially or entirely before their construction begins, an efficient financing method is thereby created for construction projects with a high cost.

*C. MINIMUM PROFIT GUARANTEE:*

Under the contract, the contractor might promise a guarantee of a minimum gain. If there is no promise of minimum gain guarantee given by the contractor, the profit which is to be made from the sale of the independent sections is to be shared between the contractor and the owner.

In the case where the contractor has promised to pay a minimum gain, no matter whether the promised minimum gain has been made from the sale of independent sections or not, the contractor has the obligation to pay the whole promised gain proportion to the owner. On the other hand, if the profit made from the sale of independent sections is higher than expected or exceeds the minimum amount promised by the contractor, the surplus will not, in principle, be kept by the contractor. On the contrary, it will be shared between the contractor and the owner in the proportion agreed on in the contract. Consequently, it can be said that the contractor bears the risk of independent sections not being sold or being sold for a lower price than expected.

However, in the case where the minimum gain promised by the contractor cannot be obtained, since no independent sections can be sold, the contractor will pay the owner's proportion on the basis of minimum gain promised by him. However, the contractor can demand the transfer of the title to the independent sections the value of which corresponds to the proportion paid to the owner by the contractor. The owner cannot demand his proportion as if all independent sections were sold, as well as retain the title to the independent sections

*D. LEGAL CHARACTER:*

*1. Dichotomy between bilateral contract and ordinary partnership:*

It may seem unclear whether the structure of the revenue-sharing contract makes it a bilateral contract or an ordinary partnership agreement.

At first sight one may think, as is the case under profit-sharing construction contracts, that it is an ordinary partnership.

It is evident that revenue-sharing contracts are not pure or typical partnership agreements, in spite of the fact that both agreements bear a similarity. Nevertheless, their similarities, differences, and the issue as to whether revenue-sharing contracts have an element of a partnership agreement are controversial.

Lately, the extent to which a revenue-sharing contract differs from a partnership contract, and the criteria for distinguishing them, are subject to dispute.

It is important to note that there is no view claiming that a revenue sharing contract is a partnership contract.

The opinions on this subject are divided into three:

- (1) The revenue sharing contract is a contract similar to a partnership contract;
- (2) It is a combination of a partnership contract and a bilateral contract
- (3) It is a bilateral contract.

The prevailing view in this matter is that revenue sharing contracts are not partnership contracts, or similar to them, but that they are bilateral (synallagmatic) contracts. The Swiss Federal Court also agrees with this view. In fact, in the framework of this classification, it has been acknowledged that revenue sharing contracts are mainly within the scope of bilateral contracts. In this context, one party is bound to provide the other party with an act which the other party needs for his economic activity, while the other party is obliged to expend the effort so as to obtain a successful result and to share the gain with the first party in case where success has been achieved. It is important to note that even though the counter act is subject to a condition, this type of contract is still described as a bilateral contract.

Whether a contract is a revenue-sharing contract or partnership contract has to be determined through an interpretation of the contract and the separate assessment of all features of each case concerned. In my opinion, it is not sensible to specify certain and restrictive criteria in this matter. On the other hand, it is clear that the view and the criteria suggested by doctrine and jurisprudence assist in making the classification in question.

**These criteria can be examined under three headings:**

**(1) The sharing of loss:** One of the criteria proposed for consideration is whether or not loss is shared.

In this regard, it is argued that in the case where the party shares not only the gain emerging as a result of the economic activity, but also the loss, the contract is considered a partnership agreement, not a revenue sharing contract. On the other hand, the Swiss Federal Court ruled that loss sharing is not a distinguishing criterion.

Nevertheless, some authors assert that loss sharing constitutes a significant indication for the existence of a partnership contract, even though this criterion alone is insufficient and not decisive.

**(2) The legal position and the involvement of the landowner:** It also indicates the existence of a partnership contract, provided that beyond a general and usual right to examine the financial records and seek for information, the landowner has the right to take a decision regarding economic activity, pursuant to the contract or practice between the parties.

**(3) Working together for a mutual aim:** Revenue-sharing contracts and partnership contracts are essentially distinguished by the existence of the will to work together for a mutual aim (*animus societatis*). The will to work together so as

to achieve a mutual aim does not exist in revenue sharing contracts.

In this regard, whether or not "will" is involved is determined by interpretation of the contract, the whole context of the case concerned, the behavior of the parties to the contract in the course of the contract, and the way the parties perform their acts under the contract( i.e. The evaluation of all conditions at the same time.)

## **2. The consideration is subject to a condition**

The basis of revenue-sharing or profit-sharing in principle amounts to a pending condition. Under the contract, sharing the revenue depends on a pending condition which is the achievement of success, e.g. obtaining again. Certainly, the validity of the contract is not subject to a condition, occurrence of which is vague. The contract came into being and was effective without depending on a condition. Therefore, technically, it cannot be considered as a "contract subject to a condition". However, the counter-act, the obligation to share the revenue with the other depends on a condition: Whether the successful consequence has been reached or not .

The party whose obligation is subject to a condition is not bound to perform any act unless the condition has taken place.

## **3. The matter as to whether the obligation is aleatory (subject to chance and coincidence):**

It is claimed that the revenue-sharing contract, which is subject to a condition, can also be qualified as an "aleatory contract" or a "contract of risk" as well.

In the event that the expected result does not occur, it is impossible for the participating party to receive any consideration from the other party.

Whether or not the result happens is independent from the parties' will, to some degree, and is also vague in the course of the formation of the contract.

It is widely acknowledged that this contract is aleatory since it is uncertain whether or not a successful consequence can be reached. The Swiss Federal Court shares the same view.

It is argued that this classification has theoretical as well as practical consequences: Under revenue-sharing contracts, the practical consequence of the acceptance that the obligation is aleatory is that, in the case where it becomes apparent that no gain can be obtained, the party who supplied the economic value (mostly the participating party) cannot claim any refund or unjust enrichment with respect to what he already fulfilled.

There may be uncertainty as to whether an adaptation of the contract, in other words, application of the frustration doctrine is possible or not in the case where the balance between the acts which are to be performed by the parties to the contract has been changed extraordinarily by *unforeseeable reasons*, after the conclusion of the contract on the grounds of that the contract is aleatory. In my opinion, revenue-sharing contracts could also be tailored even if exceptionally, depending on the features of the case concerned. It seems unlikely that a lawsuit concerning adaptation could be rejected by disregarding the will of the parties and particular features of the case concerned, only because of the fact that the contract is aleatory and the parties have given consent to all kinds of possible consequences, and have accepted the risk in advance.

## *E. DISCUSSION ON THE TYPE OF THE CONTRACT:*

### **1. In general:**

Under the Civil Law system, contracts are divided into two, nominate contracts and in nominate contracts, depending on whether they are regulated under the Code or not. Accordingly, in determining the legal character (qualification) of a contract,

one must first consider whether or not a contract is regulated in the Code. Contracts which are specified (regulated) in the Code of Obligations or in a private Code are called “nominate contracts” while contracts which are not regulated in any Code are described as “in nominate contracts.” The reason why contracts which are not laid down under a Code are called “in nominate contracts” is not that those contracts do not have a name. Certainly, they all have a name. They are described as “in nominate contracts” since their essential elements (*essentially negotiate*) are not provided for by a Code.

One of the main principles of the Law of Obligations is “freedom of contract”. As a consequence of this principle, persons can establish a contract with a content they wish within the frame of legal order, or they can amend or combine the elements of contracts regulated in the Code, or create new contract types. Freedom of contract is a broad concept.

Features include: whether or not to conclude a contract; determining the content of the contract and the form (unless otherwise regulated under the Code); being free to choose the party with whom a contract is to be concluded; designating the desired type of the contract; being free to set aside the contract by way of mutual consent, and amendment of the content of the contract.

In nominate contracts are commonly classified as follows:

- (a) Combined contracts; (b) mixed contracts; and (c) *sui generis* contracts.

**(a) Combined contracts** are formed by binding at least two types of contracts which are regulated under the Code. These contracts retain their integrity, but only their existence and validity are connected to each other.

An example of this type of contract is to lease out a mill in return for the promise the tenant will purchase raw material from the landlord. Under this contract, sale contracts and



tenancy contracts have been bound while both of them have retained their integrity. Therefore, it is argued that combined contracts should not be considered as in nominate contracts. It is suggested that their own (specific) rules apply to each of the contracts comprising the combined contract.

**(b) Mixed contracts** are formed by binding the elements of the various contract types regulated under the Code in a way which was not envisaged under the Code. Mixed contracts are also divided as follows:

(i) Mixed contracts under which obligations principally performed under different contract types are exchanged. The most common example of this type of mixed contract is a construction contract under which a construction job is performed in return for a land share.

(ii) Mixed contracts under which one of the parties has the obligation to perform more than one act which are principally fulfilled under various contract types. Examples of this type of contract are: guesthouse contracts, contracts of admittance to hospital, and lodging contracts.

(iii) Contracts under which one party transfers something to the other party partially in return for an act of the other, and partially without any consideration with the intention to donate. This type of contract constitutes mixed donation and it is controversial whether it technically can be considered a combined contract or not.

(iv) Contracts which include additional acts unfamiliar to a typical contract, as well as the principal acts which are performed under a typical contract. For example, a tenancy agreement under which the landlord is also responsible for heating the apartment being let. It is also under dispute whether these contracts can be classified as mixed contracts.

**(c) Sue generis contracts:** None of the elements composing a *sui generis* contract exist in any type of contract regulated under the Code.

## **2. Views on the type of profit-sharing construction contract:**

Determining the type of the profit-sharing construction contract is a difficult issue since there are at least four different possibilities in this matter. The contract can be considered (1) a (merely) construction contract;

(a) An ordinary partnership contract.

(b) An ordinary partnership contract which has been attached to the construction contract and a mixed contract. In our view, it is not possible and sensible to determine conclusively the type of all construction contracts which include a profit-sharing mechanism merely on the basis of the inclusion of profit-share element.

This should be seen as a matter of the interpretation of the contract and examined separately in each case. The fact that the parties to the contract have agreed on a profit share does not necessarily lead to a classification of the contract as a particular typical or atypical contract. Even though a profit share has been agreed on, the contract in question might be qualified as merely a construction contract or an ordinary partnership contract according to the consent of the parties. Thus, the legal qualification (character) of the contract should be evaluated in each case concerned. On the other hand, it seems most appropriate to qualify the profit sharing construction contract as a mixed contract in the case where the most common version available in the practice is examined.

Under the profit-sharing construction contract, the contractor is bound to make a construction, to sell the independent sections constructed, and deliver them to buyers. In turn, the landowner has the obligation to give power of representation to the contractor so as to sell the independent

sections, and to share the profit made from the sale, in a proportion agreed under contract. Under this contract, parties aim to obtain the highest profit from the sale of the independent sections.

## **CONCLUSION:**

In summary, it can be said that a profit-sharing construction contract is formed by mixing the elements of particular contracts regulated under the Code, [which are construction contract, contract of mandate, ordinary partnership contract, and guarantee contract (in the case where the contractor promised a minimum gain guarantee)] in a way which has been not envisaged by the Code.

A promise made by the contractor on the minimum gain guarantee does not affect the legal character of the contract. This promise of guarantee is not independent from the principal (main) contract. Thus, it cannot be considered an independent guarantee contract but can be regarded as an obligation of guarantee under the construction contract.



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