APPLYING ADJUDICATION AS AN ALTERNATE DISPUTE RESOLUTION FOR CONSTRUCTION DISPUTES IN THE UNITED STATES

An Undergraduate Scholars Thesis

by

NICHOLAS RYAN HARRISON

Submitted to the Office of Undergraduate Research
Texas A&M University
in partial fulfillment of the requirements for the designation as

UNDERGRADUATE RESEARCH SCHOLAR

April 2011

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Director for Honors and Undergraduate Research: Sumana Datta

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ABSTRACT

Applying Adjudication as an ADR for Construction Disputes in the US. (April 2011)

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This research will look at the possibility of applying the English system of Adjudication as an alternate dispute resolution technique (ADR) in the United States Construction Industry. I focused on Construction law adjudication in the United Kingdom during my 2010 fall semester in London, and my research continued in the spring semester of 2011 when I returned to Texas A&M and began to focus my study on the American legal system. I am testing the idea that if adjudication were to be implemented into construction contracts in the United States, there would potentially be cost and time saving benefits without deducting from the justice served to the parties. I also attended a Construction Lawyer's conference in San Antonio, Texas to have a roundtable discussion with industry leaders about the possibilities and challenges of statutory adjudication. The feedback was promising for future research on the topic and the possibility of legal application. I have also submitted an abstract using this research to the 2011 Royal Institution of Chartered Surveyors legal research symposium on law and dispute resolution to be considered for publication in the International Journal of Law in the Built Environment.

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CHAPTER I

INTRODUCTION

The United States' construction industry is fraught with claims, disputes, and litigation that undermine the efficiency of the industry (Corgant, Kelleher, and Dorris, 2002). In some cases, the effect of extensive litigation, trials, and appeals can be so great that it bankrupts parties who may have worked successfully throughout to completion of a project. Adjudication is a quick process that attempts to accelerate the cash flow of a construction project by enforcing a judgment on the parties within 28 days of the dispute being filed (Kennedy, Milligan, McCluskey, and Cattanach, 2010a). This type of dispute resolution alternative might save American companies time and money, while also alleviating the sheer number of court cases in the already overcrowded legal system. For this research, the views of a number of United States contractors and legal experts will be sought to help confirm or deny that statutory adjudication would be regarded as a productive means of dispute resolution for the United States construction industry. Statutory adjudication for construction disputes functions in English and Welsh legal systems under Section 108 of the Housing Grants, Construction and Regeneration Act of 1996. The Scheme for Construction Contracts that was passed in conjunction with the act contains a model procedure for the adjudication to follow.

This thesis follows the style of the *International Journal of Law in the Built Enviromment.*

This model can be altered and even avoided completely by including the desired stipulations in the construction contract. The process of adjudication is a new and developing concept, and Section 138 to 141 of the Local Democracy, Economic Development and Construction Act 2009 that is about to come into effect will amend and add provisions to the Housing Grants Act 1996. With a review of these changes and access to up to date Adjudication Society Newsletters this research will consider the most current adjudication laws and the practicality of their enforcement.

Although adjudication is a fairly new process, it has become a part of the United Kingdom's construction industry to the effect that major construction firms have archived documents on 'Adjudication Protocol and Appendix'. This document usually contains a concise description of the law behind adjudication as well as the company's protocol from practical experience for the conduct of adjudications. Such documentation typically includes required procedures that provide protection during the project from the possibility of a dispute, and safeguards to be prepared in the event that adjudication becomes necessary. The strength of adjudication is that the decision is binding on the parties in dispute unless or until revised in arbitration or litigation. This reality has required the United Kingdom's construction industry to react accordingly and possibly more efficiently since the implementation of the procedure into law.

The following chapters will analyze the potential repercussions of applying the legal concepts of statutory adjudication in the United States. My research will also consider

the major concern expressed by subcontractors that if they referred a dispute to adjudication they might be denied future opportunities to tender for work. It is possible that weaker parties further down the contracting chain "would be deterred by the threat of commercial power from utilizing this new and powerful form of resolving disputes and allowing vital cash to flow through the subcontracting chain" (Kennedy, Milligan, McCluskey, and Cattanach, 2010a). From my current research, it appears that adjudication is considered most effective during times of downturn in workload and access to working capital, leading me to believe that it could help America significantly during this time of recession. This paper will focus on how adjudication "has been utilized during a period of recession in construction and the re-emergence of the criticality of cash flow as firms attempt to cope with increased competition and reduced margins" (Kennedy, Milligan, McCluskey, and Cattanach, 2010a).

The idea of transporting statutory adjudication as an alternate dispute resolution to a new continent is not a brand new idea; I have reviewed a paper that proposed a Duel Scheme for adjudication for the building and construction industry in Australia that would allow both parties to a construction contract to take advantage of adjudication. "The essence of the Dual Scheme is that a Supplier should be able to recover progress payments for the value (taking into account defects) of work goods or services actually supplied without deduction of amounts for cross-claims which have not yet been quantified in adjudication or in final proceedings" (Brand, Davenport, 2010). The similarities between the construction industries and legal environments of the United States and

Australia will make this analysis easier and more accurate than if the proposal was for an African or Asian nation. By focusing on security of payment, money claim versus progress claim, and other similar issues that have been addressed in this introductory scheme, I believe I can take cues from this model on how to adapt the adjudication process for a new legal environment across the United States.

My research has included investigation into The International Journal for Law in the Built Environment; specifically a paper that is based on data from the Adjudication Reporting Centre at Glasgow Caledonian University which draws its information from questionnaires received from Adjudicator Nominating Bodies (ANBs) and from samples of practicing adjudicators. ANBs function to administer training and qualifications of adjudicators who are registered with them, and then appoint the adjudicators when disputes are referred to them.

CHAPTER II

ADUJUDICATION IN THE UNITED KINGDOM

First, this paper will give a detailed overview and analysis of the process of adjudication as it currently operates under English law. Its major goal is expediting the payment process after construction disputes in order to maintain the cash flow of the effected project. Adjudication is a statutory process that is first addressed in the construction contracting phase. Unless otherwise stated in a contract, all construction projects undertaken in the United Kingdom are subject to adjudication as outlined by the terms in The Housing Grants, Construction and Regeneration Act 1996's Section 108: Right to refer disputes to adjudication. This section requires that all construction contracts enable a party to give notice of intention to adjudicate at any time, and provide a timetable with the object of securing the appointment of the adjudicator and referral of the dispute to him within 7 days of such notice. Section 108 also requires the adjudicator to reach a decision within 28 days of referral and allows the adjudicator to extend the period of 28 days by up to 14 days, with the consent of the party by whom the dispute was referred. The law protects the adjudicator from liability for anything done or omitted in the discharge of his functions as adjudicator unless the act or omission is in bad faith, and says that any employee or agent of the adjudicator is similarly protected from liability. Finally the law imposes a duty on the adjudicator to act impartially and to take the initiative in ascertaining the facts and the law and states that the decision of the

adjudicator is binding until the dispute is determined by legal proceedings, by arbitration, or by agreement (Section 108, 1996).

Other parts of the Housing Grants, Construction and Regeneration Act that address adjudication include Section 107, 109, and 117. Section 107 (5) of the Act states that if a written exchange during adjudication proceedings in which one party claims the existence of a non-written agreement is not denied by the other party in his response then constitute as between those parties an agreement in writing to the effect alleged. Section 109 and of the Act states that if effective notice of intention to withhold payment is given on a matter being referred to adjudication and it is decided that the whole or part of the amount should be paid, then the decision shall be construed as requiring payment not later than seven days from the date of the decision, or the date which apart from the notice would have been the final date for payment; whichever is the later. Section 117 is entitled "Crown application" and applies to a construction contract entered into by or on behalf of the Crown other than on behalf of Her Majesty in her private capacity. This section sets provisions that Her Majesty shall be represented, for the purposes of any adjudication or other proceedings arising out of the contract, by the Chancellor of the Duchy of Lancasteror or such person as he may appoint. It also mandates that the Duke of Cornwall shall be legally represented by any such person he may appoint.

Adjudication's impact

The power of statutory adjudication has been noticed by the professional, political and educational communities and has inspired British textbooks to include passages with a wide variety of approaches for avoiding and handling adjudication. *Engineering, Construction, and Architectural Management* even contains a document titled "Disputing the existence of a dispute as a strategy for avoiding construction adjudication" to prove its students information on what amounts to a dispute that may be referred to adjudication under the Section 108. The article contains a case study and critical analysis of 26 previous cases involving litigation on what amounts to a dispute. It is noted that The Court of Appeals has twice approved a flexible approach based on the principle that a dispute arises only after a party has been given reasonable opportunity to consider the other party's claim and has rejected it expressly or by implication (Ndekugri, and Russell, 2006). It can be noted here that increased litigation due to cases over what constitutes as a dispute applicable to adjudication could counteract the principle's original aim to reduce litigation, which would be a deterrent when considering this practice for an alternative location. The presence of adjudication has also caught the attention of organizations such as the International Center for Conflict Prevention and Resolution (CPR) who coordinated the 2nd annual "Cross Border Arbitration & Dispute Resolution Conference" in 2010. This gathering is intended for company directors and construction lawyers looking for practical guidance on how to achieve a more efficient adjudication process.

Summary

Statutory adjudication is a legal and just way to settle construction disputes in the United Kingdom without resorting to arbitration or litigation. All construction contracts must name the chosen Adjudicator or propose a formal process for the two parties to agree upon an adjudicator if it becomes necessary. The process can begin at any time after the signing of a construction contract, and from then has a maximum of 42 days before a decision will be administered. The process is a relatively new function that is still working out the logistics through application. It is unfortunate that for the short term, an act which is designed to alleviate costly and time consuming disputes which arise in the construction industry, could in itself, be the subject of cases to test the ambit and meaning of the legislation.

CHAPTER III

APPLYING ADJUDICATION IN THE UNITED STATES

When looking at the option of applying adjudication to the United States' construction industry and legal system, many issues are raised. How would it be implemented? Does it need the weight of legislation supporting it? Are construction industry players interested in the process enough to include it in their contracts? Are construction attorneys interested enough in the process to include it in their contracts?

To gain some legal and industry insight I held a roundtable discussion with a panel of attorneys, construction executives, and contract managers at the 2011 Construction Lawyers Conference in San Antonio, Texas. The majority of the panel was completely unfamiliar with the statutory adjudication for dispute resolution. However, after hearing about the process, and the immediate flow of cash, the group as a whole was intrigued by the idea as being potentially beneficial to all parties to construction and the industry as a whole. Nonetheless, the panel had several pragmatic concerns to the implementation of the process. They were worried about the burden and potential costs on the attorneys in preparing a claim, and more importantly claims responses in less than twenty eight days. This restriction; however, has a positive impact on job documentation. During my internship with a large general contractor in London I recognized good record keeping throughout projects in the event of adjudication.

The attorneys were also worried about practical application issues such as having one party wait to file all their disputes to be adjudicated until the end of a project or being given a notice of adjudication at a maliciously planned time such as the day before a major holiday. This is unfortunately a practice that UK barristers are familiar with and have coined 'Christmas bombing' because parties will file an adjudication they day Christmas to make it most difficult for the other party to be prepared for the process in only seven days. For these reasons, most of the lawyers favored adjudication being implemented as optional to avoid the timing games and manipulative strategy that are unfortunately part of almost all legal practice. When musing on this reality, the panel agreed that those that are going to game the system will try and cheat, no matter what the system.

If adjudication became a commonplace section in construction contracts in the United States as an extra dispute resolution option it could operate successfully in that capacity indefinitely, or possibly act as a stepping stone towards statutory application. Although construction contractors may be partial to applying adjudication as a statutory measure more promptly, I believe the trial period would be necessary for adjudication to win the favor of American contract lawyers. The general consensus between the attorneys and managers was that they are definitely interested in the process, and fell that it would be worth it to give Adjudication a try in the United States. A partner in a law firm and professor of construction law said that 'Arbitration has become ingrained in the industry as an alternative dispute resolution process, so there is no reason that a different process

cannot work or be applied'. When the panel discussion turned to arbitration, it was noted how the process was originally meant to be a more streamlined process with faster and cheaper decisions as backlash to the way attorneys have completely mucked up dispute resolution in the United States. This being true, implementation of adjudication may be more likely if pushed by the industry, and not attorneys.

The cross-section of people at the Construction Lawyers Conference represents the people directly involved in the dispute resolution process currently in the United States, and they were very optimistic about a process that could reduce the time it takes to settle a dispute; however, a second major issue that was brought up was the selection and credentials of the adjudicator. This topic sparked a significant debate, and the agreement was that most of the participants favored agreeing upon specific adjudicators by name and establishing them in the contract before construction begins.

Adjudication advisory panels

Another popular idea came from a commercial manager of a high speed rail project in California with forty years of legal experience who has recently worked with adjudication in South Africa. He stated that three member adjudication advisory panels are used in South Africa that are similar to a Dispute Resolution Board (DRB) and are comprised of two members that the owner and contractor each select separately, and a third member that the two parties must agree upon. The advisory board makes monthly or quarterly site visits to encourage the resolution of disputes at the job level. These

jobsite decisions are not binding on the parties; however, they may be used in court. The greatest source of hostility among the parties to a construction project is a festering unresolved dispute. It becomes increasingly more difficult as time progresses to resolve a claim, which is why a preemptive measure such as an adjudication advisory board makes the resolution of issues simpler. Whether they win or lose, the parties find it more productive to resolve issues as they arise, so they can progress the construction without carrying the baggage of unresolved claims and disputes. This reliance on the initial decision is echoed in the United Kingdom as the Chair of the Association of Independent Construction Adjudicators states that "the relatively few adjudication cases that get referred to the courts also bares witness to its success"(Kennedy, Milligan, McCluskey, Cattanach, 2010b).

Summary

Adjudication aims to eliminate the lengthy delay associated with traditional dispute resolution used in the Construction Industry. Even where both parties have legitimate arguments/claims to the funds traditional methods (litigation and arbitration) can take years to resolve disputes, often resulting in one or more of the parties closing their doors and/or succumbing to bankruptcy for lack of liquid assets, or any assets at all. What's more some entities exploit the extreme delays of traditional dispute resolution, knowing they can outlast and outspend smaller less capitalized opponents, formerly contracting partners. In the absence of swift compulsory adjudication, and despite that the respondent has the benefit of the value of goods or services, the respondent can withhold

payment and force the claimant to incur costly litigation or arbitration to recover payment. Often the legal expenses do not justify the amount involved and the claimant is left with no effective remedy. The fundamental nature of adjudication is to help a supplier be able to recover progress payments for the value of work, goods, or services actually supplied without deduction of amounts for cross-claims which have not yet been quantified in adjudication or in final proceedings. Suppliers frequently claim that the purchaser delayed the supplier and the supplier is entitled to delay costs. These delay cost claims tend to be made as overstated ambit claims at the end of a project, because arbitration and litigation effectively force the parties to leave all claims for damages until the end of the project. The right to adjudicate each delay costs claim immediately after the delay occurs could effectively and not unfairly bar the ambit claim for delay costs. After speaking with lawyers and construction professionals and hearing their opinions I feel that if adjudication were ever to be included as a statutory requirement in the United States, it would first need to prove its effectiveness and benefits during a period of optional enforcement.

CHAPTER III

CONCLUSION

Adjudication is a fast track system that was designed for calculating the amount of a progress payment due and maintaining that a purchaser is not able to raise a back charge as a reason for withholding payment of a progress payment unless liability for the Purchaser's entitlement had been admitted by the Supplier or decided in litigation, arbitration, or previous adjudication of a money claim. After first being exposed to this rather young English legal process; and thereafter researching statutory adjudication in London, I am excited about the potential this dispute resolution alternative has to speed up projects and improve the cash flow for the construction industry in the United States. The industry feedback I received when discussing the process with construction lawyers, attorneys, consultants, and contractors was optimistic with a reasonable amount of hesitation before all of the legal realities of US application are determined. Applying Adjudication to the United States would be a large psychological hurdle to overcome, both for clients, but also potentially for their attorneys who are worried about the potential increased malpractice risk for recommending this process. I still believe that adjudication is something that could easily fit into our current legal system, and would be a process that reflects a positive national drive to be quicker and more efficient in the construction industry, as well as the legal and professional communities that encompass it. The industry must not only decide to use adjudication to shake the hold that litigation has over disputes; as was the intent of mediation and arbitration, but it must also attempt

to minimize or diffuse issues before they escalate as well as keep better documentation to ensure a faster decision for when a dispute becomes a legal issue.

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