

GOING LEGAL: RATIONAL FEAR OR PHOBIA?

BY TOM PETERS, PE AND STEVEN DAVIS, PE

We once had an owner client tell us that its project managers are instructed to negotiate claims consistent with what they thought a jury would award the other party if the dispute went to trial. “After all”, the owner muttered, “owners always lose in front of a jury.”

Regardless of whether you consider this reasonable or a violation of sound project administration, the truth of the matter is that the settlement of disputes is often subjective and outside any contractual boundaries. Many owner rationalizations are predictable:

“If this dispute goes legal, lawyers will get involved and we will lose control of our project.”

“We have the right to make a business decision to make this dispute go away.”

“We are using this contractor on other projects. If we play hardball on this dispute, the effect will ripple throughout the contractor’s other projects. Then we all lose.”

“We have trouble finding good contractors in the first place. If we get a reputation for sticking it to the contractor, nobody will bid our work in the future.”

“If I can settle this dispute for fifty cents on the claim dollar, I must be getting a good deal.”

“Our team made mistakes on this project. We’d better settle this dispute now before we get embarrassed.”

“We need our project managers to concentrate on building projects, not fighting claims.”

“A jury will never see it our way. Most jurors will consider the Contractor an underdog and sympathize with their claim. Why pick this fight?”

When public owners are reluctant to go legal, it has been our experience that they routinely make global settlement offers contrary to the specific terms of the contract.

As a general premise, we believe that disputes should be settled at the lowest possible level and by those most knowledgeable of the facts. This means that project managers should be provided with the authority and latitude to affectively achieve negotiated settlements at the field level as long as the settlement is well correlated to actual issues and impacts and does not violate the terms of the contract. After all, the further a dispute moves from the team who managed the work, the less likely it is to be settled on its technical and contractual merits.

In many cases, disputes that have been escalated beyond the project team are settled by senior management solely for business reasons. Such settlements are frequently made based upon the avoidance of litigation risk rather than a direct and candid assessment of the facts. On the other hand, the owner’s blanket rejection of potentially valid claims can often exasperate the parties and ultimately increase the owner’s financial exposure.

There is also a downside in becoming too lenient in the settlement of disputes. Premature settlement strategies can end up being very expensive. In fact, the owner may ultimately pay a premium well beyond the underlying merits of the claim, in order to avoid the risk associated with the treacherous climb up the dispute resolution ladder. Further, this approach may increase risk rather than mitigate it. Why? Because the owner’s rationalizations described above rarely survive forensic scrutiny.

PinnacleOne, for example, has been retained to perform forensic audits on publicly funded work. When little to no correlation exists between the alleged issues/impacts and additional funds used for settlement, public owners are compromised. When responsibility is assigned without fact-based justification, reputations frequently suffer. Therefore, when negotiating claims, try to find the delicate balance between blanket rejection and reasoned settlement.

The trick, of course, is in knowing when to give up on negotiations and call in the legal team.

In our experience, an owner’s decision to go legal is usually a function of how well the organization tolerates risk. It is safe to say that most owners are risk averse, and rightly so. This aversion to risk is generally manifested in the construction contract. In recent years, exceptional legal minds have developed creative risk-shifting provisions that insulate the owner’s unnecessary exposure to additional project costs.

Notwithstanding the evolution of the *perfect contract*, many owners still find that their contractors routinely submit expensive and complex construction claims and that, in order to achieve negotiated settlements, these well crafted risk shifting contract provisions are constructively waived. Why? Well, there could be a lot of reasons, but consider the following condition:

Lawyers write the contracts, but Engineers administer the work.

As William Shakespeare’s Hamlet said: “...ay, there’s the rub!” While the dispute resolution arm of the construction industry would benefit from a familiar working relationship between legal counsel and project management, these two disciplines rarely meet until after the dispute has reached its boiling point. By that time, most parties to the contract have fallen in love with their arguments and only the strength of the most skilled mediator can break the hold of the combatants.

So if you are an owner, take your lawyer and your project manager out for a cup of coffee and have a frank discussion regarding your team’s objectives, perspectives and philosophies. If you can, do it prior to contract development.

There are definite risks associated with allowing your project manager to “cut a deal”. Consider the project manager’s temptation to rewrite history in order to justify the settlement. If the actual scope, cost and duration of work performed is poorly correlated to the terms of the settlement change order, the owner has assumed unnecessary and excessive risk if a forensic audit is performed.

Word of settlement travels faster than water cooler gossip. For this reason, the owner should be wary of getting a reputation as a deep pocket, as claims submissions will likely increase rather than decrease.

This practice can also confuse the public bidding process. Contractors who honestly prepare their bid based upon their assessment of the competitive and fair cost value of the work, under the assumption the contract will be adhered to and enforced, are unfairly disadvantaged by deals that are cut outside of the four corners of the contract.

The smart owner, therefore, insists that its field level managers administer the project based upon the terms and conditions specified in the contract, but with a reasonable degree of latitude. If the settlement of a claim requires that a healthy amount of *business decision* dollars be brought to the table, close-out documentation should reflect that decision.

History should not be rewritten in the name of providing a justification to sell the settlement to the next highest level within an owner's organization. Likewise, for large dollar claim settlements, industry experts and legal counsel should be consulted to help achieve a fair settlement and mitigate unnecessary risk. After all, it is often the prospect of the dispute *going legal* that can entice the contractor to the negotiation table in the first place.

Still not convinced? Still unwilling to litigate the dispute? Consider that many of the disputes that *go legal*, never spend a day

before a judge, jury or arbitrator. Rather, smart owners routinely settle the dispute for business reasons, but only after a full and open evaluation of the contractual and technical merits of the issues.

Why are analyses of the contractual and technical merits of a claim important? Because successful claim settlements occur when an owner can demonstrate to a contractor that it has objectively evaluated the issues and can effectively communicate the strength of its position along with the weaknesses of the contractor's position. Additionally, successful claim settlements frequently occur when an owner can exhibit some sort of meaningful leverage over the contractor.

The best owner leverage stems from a complete, concise demonstration of the owner's preparedness via its advance work with industry experts and legal counsel. This combination demonstrates that the owner is willing to *go legal* if a reasonable negotiated settlement is not achieved. Armed with these tools, project managers can achieve successful claims resolution and still retain control over the process.

So, if you are an owner's project manager, our advice is simple. Use the contract as your rudder. Don't fall prey to the mermaid on the rock, tempting you to "*cut a deal*". Chart your course, stay your course and above all, don't be afraid to *go legal!*

ABOUT THE AUTHORS-

Tom Peters PE is a Senior Consultant with PinnacleOne in Los Angeles, California. Mr. Peters has provided expert analysis on a wide variety of complex construction claims for hospitals, water/wastewater treatment plants, ports, tunnels, highways, five-star resorts and entertainment facilities. He has more than 26 years of experience in the industry and is a registered Civil Engineer in the State of California. He has lectured nationally and has been a featured speaker at the National CMAA, ACEI, Public Construction Superconference and the Primavera User Conferences. He has authored numerous articles on the topics of delay and acceleration and is an expert in the preparation of delay analyses and the assessment of concurrent delay events.

Steve Davis, PE has been a senior consultant with PinnacleOne for over 16 years where he has specialized in the evaluation and resolution of complex construction disputes. Mr. Davis began his career with the U.S. Army Corps of Engineers assigned to the construction management department in Los Angeles. Over his career Mr. Davis has been exposed to a wide variety of projects and disputes with significant work on transportation, water, wastewater, ports, airports, and buildings. Mr. Davis has taught courses on claims analysis and project controls. He has a B.S. in Civil Engineering from California Polytechnic State University, San Luis Obispo, and is a registered professional engineer in California.