

Subcontractor Claim Management and Dispute Resolution Methods in the State of California versus the Province of British Columbia: A Case Study

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In the construction industry, discordance between what is expected versus what is delivered often arises. This disparity is commonly handled using informal negotiation. However, if negotiations fail, then claims and disputes often emerge. Issues involving scope of work, change orders, schedule, and payment can lead to conflicts. Companies try to employ the best alternative dispute resolution method to settle subcontractor claims and disputes without the need for litigation. Speaking with construction professionals in California and British Columbia, a difference in opinion exists as to which method is considered most effective when dealing with subcontractor claims and disputes. In California, the importance of thorough contractual writing and an airtight contract is stressed. In British Columbia, utilizing the design-assist approach and maintaining relationships with subcontractors appears to take precedence. This case study aims to uncover the most effective methods of alternative dispute resolution in California versus British Columbia. The results found that informal negotiation is the first resolution method attempted. Once claims or disputes arise, both regions tend to utilize mediation; however, British Columbia is beginning to gradually implement adjudication. In both California and British Columbia, meticulous contractual writing was the consensus for preventing future conflicts before a project began.

Key Words: Subcontractor, Claim Management, Dispute Resolution, California, British Columbia

Introduction

In the construction industry, a project is deemed “successful” if three main requirements are met: the project is completed on time, costs are managed within the specified budget, and it is built with the desired level of quality. Yet, most projects in the commercial construction field struggle to always check all three boxes. Projects are delayed, the budget is adjusted, and quality varies, mostly due to the arrival of unforeseen problems and the emergence of claims and disputes. Claim management and alternative dispute resolution (ADR) are inevitable processes implemented during every project’s life cycle. The main focus of claim management is the avoidance of claims through the diligent oversight of all contract documents, design plans, and ongoing awareness of the project’s adjusted contract price and schedule. If claims have already been submitted, ADR focuses on finding the best method for solving disputes, with constant consideration of the parties’ allocation of resources, the project’s schedule, and overall fastest method for resolving the situation. Disputes and claims are management issues, and these processes need to be effective and efficient throughout the entirety of a project’s life cycle. Given the typical complexities and variations in construction projects, it is understandable that, “the construction industry holds the unenviable reputation of being highly adversarial, which leads to a high occurrence of conflict.” (Hussin, Omran & Oui 2010). Additionally, the frequency of conflict caused by claims and disputes is considerably higher in the construction industry than in any other major sector. Given the potentially unfavorable effects of conflict escalating into a legal dispute, the foremost task for industry professionals should be focusing on the prevention and mitigation of claims. However, if either of the parties involved in the claim do not possess the skills necessary to

resolve the issue and stop it from further escalating, then “it is inevitable that destructive and expensive disputes will arise.” (Hussin, Omran & Oui 2010). It is common for even the simplest of disagreements to be misunderstood and lead to a breakdown in communication between parties.

Claims versus Disputes

The terms “claim” and “dispute” are used consistently throughout the life cycle of a project. Sometimes these terms are used interchangeably as a way of describing a conflict between owner, general contractor or construction manager, and subcontractor. However, there is a distinct difference in the meaning of the words that is important to comprehend. A “claim” refers to a demand for something due or believed to be due, usually the result of an action or given direction. On the other hand, a “dispute” cannot exist until a claim has been submitted and rejected, or when two parties differ in the assertion of a contractual right. It is important to note that throughout this case study, the main discussion point will focus on claims and disputes that arise from disagreements between a subcontractor and general contractor, or what has been installed by the subcontractor versus what was expected by the owner. Critical to this discussion is the relationship between these parties and how they interact with each other. When considering the three most common construction delivery methods: design-bid-build, construction manager at risk, and design-build, the relationship between owner, general contractor or construction manager, and subcontractor is slightly different depending on the approach, as seen in figure 1. In design-bid-build, the subcontractor deals directly with the contractor and indirectly with the owner. In construction manager at risk, the construction manager is usually brought in during the front end of the project to assist the owner. The owner will carry the direct contractual linkage with all the specialty trades in the beginning and assume the risk. Once the project begins, the construction manager will start to operate as a general contractor and take over the contracts with the specialty trades, assuming all of the risk. In design-build, the subcontractor or trade specialists are part of the design-build team and have more direct communication with the owner, albeit not contractually. Whichever delivery method is used, it is paramount to maintain open levels of communication and transparency with all parties, in order to avoid as many potential claims and disputes as possible.

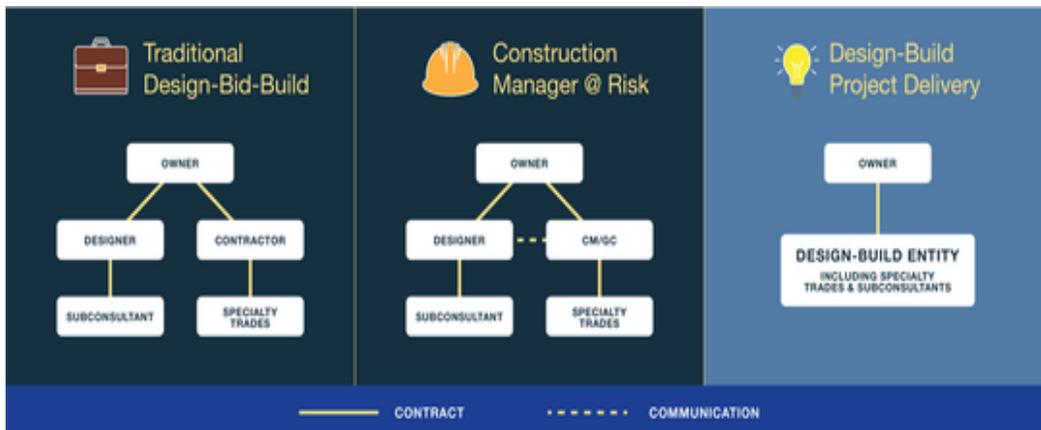


Figure 1: Breakdown of the Common Construction Delivery Method Setups
Source: DBIA-UMR

Construction Phases

The life cycle of a project is the overarching term used to describe every phase of a project, from its initial inception to the finished product. For the purpose of this case study, projects were viewed through three main phases: design, construction, and post-construction. By looking at these three phases, it is easier to determine when claims and disputes arise and what their relationship to the project's contract is. During design, the specifics of the contract are still being written and therefore this phase is "pre-contract." Construction focuses on the primary building and execution of the project once the contract is agreed upon and this phase is "during contract." Post-construction revolves around closing out the project and making sure there is no needed re-work and every requirement in the contract has been met, so this phase is "post contract." As one might expect, most of the claims and disputes that arise during a project materialize in the construction phase, since the majority of the actual building and initial operation occurs at this stage.

Claim Issues

The bulk of any building activity during a construction project is completed by subcontractors or trade specialists, and therefore these workers largely contribute to the project's success. Project claims are, "always unremitting issues that entail a lot of care in records and documentations safe-keeping." (Hussin, Omran & Oui 2010). These claims cause subcontractors to become entangled with either the general contractor or owner, whenever a disagreement over work arises. Project claims often materialize into six main issues: variations, damages, extension of time, adjusted contract price, payment, and determination over scope of work. Identifying the common claim issues that plague any project helps to prepare strategies and employ mitigation plans for any potential problems. A study conducted in 2010 found, "that *payment* was the most frequent type of claims, followed by *variations* and *extension of time*". (Hussin, Omran & Oui 2010). By understanding how most claims arise, and the best methods to deal with them, claim management has become an integral part in how contracts are written, and projects are executed.

Dispute Resolution

Dispute resolution, like claim management, plays an important role throughout a project's life cycle. As stated earlier, disputes can only emerge once a claim has been submitted and an agreement could not be found. In most cases, disputes are first dealt with via informal negotiation between the involved parties. If an agreement can be reached, then the dispute is resolved. However, if the debate continues, more formal resolution methods are employed, with the specific type depending on what is specified in the contract. The most common types of formal dispute resolution seen in the construction industry are mediation, arbitration and litigation. All three methods appear on the dispute resolution spectrum as seen in figure 2. Mediation is a nonbinding form of alternative dispute resolution (ADR), in which a mutually selected impartial third party assists in the negotiation between the two involved disputants. During mediation, the mediator has no power to impose a decision; instead, they help to facilitate an agreement between the parties. Arbitration is another form of ADR, in which a mutually selected impartial third party hears both sides of the argument and decides a binding resolution. Recently, the use of adjudication, which has been extremely successful in the United Kingdom for years, is beginning to gain traction in Canada. Adjudication is similar to arbitration, since the dispute is resolved by an adjudicator who reviews the case and makes a binding, although not final, decision. At the time the adjudicator's decision is made, the parties must abide by it; however, once the project's substantial completion is achieved, either party can dispute the decision via litigation. Litigation occurs when a dispute cannot be resolved and legal action must be taken, resulting in a

court trial. It is important to note, that while a majority of disputes are handled during the project or “in stream”, disputes can be deferred until substantial completion is reached and are dealt with at that point in time.

A new form of alternative dispute resolution that has gained popularity in recent years, is a dispute review board (DRB). A dispute review board is a committee of one or more individuals, usually three, appointed by both parties at the start of the project, before any disputes surface. Unlike mediators or arbitrators, the members of the DRB are aware of the details of the project as well as having a concrete understanding of the relationships of all parties. Typically, they will perform walk-throughs of the project to make sure they are up to date with any progress or potential deviation from the plans. Whenever a dispute does arise, the DRB will listen to both arguments and either make a decision or recommendation on how they believe the dispute should be resolved.

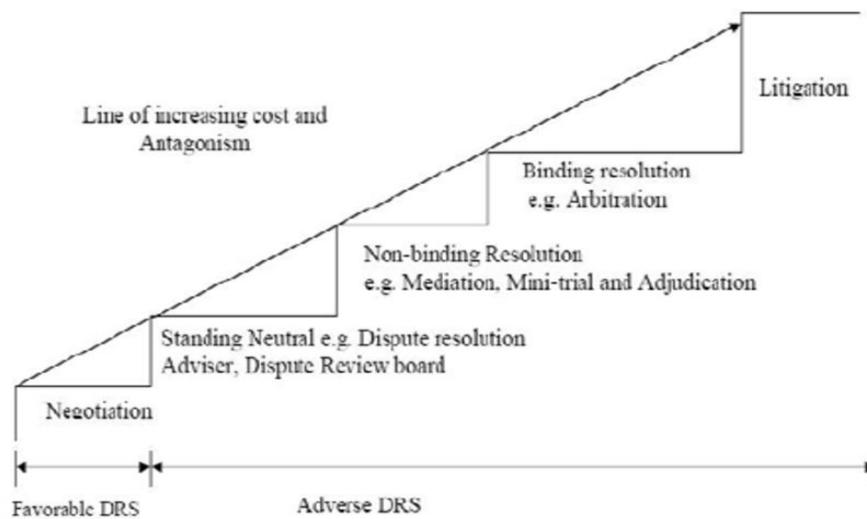


Figure 2: Dispute Resolution Spectrum
 Source: Preece, Khoshnava, Ahankooh, & Rostami 2012

Variations in Legal Systems

It is essential to understand the legal system in whichever county, state, or country the project is domiciled. This case study focuses on the State of California versus the Province of British Columbia, and how industry professionals must deal with claims and disputes accordingly. In California civil procedure, if a party has a claim against a subcontractor, and if the subcontractor chooses to cross complain, they must do so at the time of answering the initial complaint. Often, every subcontractor on a project is pulled into the dispute because California civil procedure stipulates it, or the claim against them must be waived. The Province of British Columbia follows a more English-based jurisprudence which means when a claim arises, it is dealt directly with the subcontractor involved, but more parties can be brought in as the case develops if needed. In California, anyone potentially involved must be brought in from the start, whereas in British Columbia others can be added to the claim later. This difference in legal systems has led to the stigma that the American construction industry can be overly litigious, where in fact, they are just following the correct legal procedures.

Methodology

The objectives of this case study are as follows:

- To discover which method of claim management is recommended by industry professionals.
- To discover which method of dispute resolution is recommended by industry professionals.
- To discover the best methods for preparing for and preventing future claims and disputes.
- To analyze the responses from industry professionals in California versus British Columbia.
- To analyze the responses from construction law experts in California versus British Columbia.
- To provide a recommendation for the best methods to employ for claim management, dispute resolution, and prevention.

The methodology used in this case study is predominantly qualitative. The research was gathered through interviews conducted with commercial construction professionals and construction law experts in both California and British Columbia. Each interviewee was chosen based on their expertise and experience in their field. The results from the interviews were analyzed by the researcher to identify the main similarities and differences. The information was organized into three subsections: pre-contract, during contract, and post-contract. The knowledge collected was used to suggest the best possible methods of claim management and dispute resolution, as well as provide ideas for future investigation on the topics.

Case Study

List of Professionals Interviewed	
<u>The State of California</u>	<u>The Province of British Columbia</u>
<ul style="list-style-type: none"> • Professional Contacts <ul style="list-style-type: none"> ○ Matt Padilla, <i>Austin Industries</i> ○ Chris Salmon, <i>Webcor Builders</i> • Construction Law Experts <ul style="list-style-type: none"> ○ Dan Knight, <i>Construction Attorney</i> ○ Catherine Delorey, <i>Gordon & Rees</i> 	<ul style="list-style-type: none"> • Professional Contacts <ul style="list-style-type: none"> ○ Andrew Grant, <i>PCI Developments</i> ○ Arron Colbert, <i>PCI Developments</i> ○ Doug Grant, <i>Ledcor</i> • Construction Law Experts <ul style="list-style-type: none"> ○ Stephen Coyle, <i>Norton Rose Fullbright</i>

The following information was gathered through several interviews with the professional contacts and construction law experts listed above. The goal of this case study was to pool a diverse set of information and present it as objectively as possible. Each section describes the method that has been recommended by the interviewees for each specific phase of the project. Additionally, each section lists both the opinion of the American contacts as well as their Canadian counterparts.

Pre-Contract

Throughout the interviews, a focus of discussion was the best way to prepare for potential claims and disputes while the contract was still being written. This stage will have the greatest impact on the project, as the more effort assigned to establishing contract details, the better the overall protection from claims and disputes as the project evolves. It was the opinion of all of the American interviewees, that an investment of time and effort into contract preparation was essential. The contract will serve as the guideline for how future claims and disputes are dealt with; therefore, the more clauses and specific language included in the contract, the more likely a potential issue will be covered. The contract allows the owner or general contractor to stipulate exactly what the

subcontractors scope of work, schedule, and contract price are, as well as highlight which dispute resolution method will be employed should a formal dispute arise. It is important to stress that a majority of claims and disputes on jobsites are resolved through the use of informal negotiation. If negotiations fail, it is the contract that will dictate the actions of the parties. Another point addressed during the interviews was that the subcontractor should be involved in the development of the contract, to ensure they know exactly what their responsibilities are and to make certain there is no miscommunication once the project begins. One American contact did recommend the use of a dispute review board. As mentioned earlier, a DRB must be formed before the project begins, so if the parties wish to use one, the panel of neutral individuals must be agreed upon by all parties involved before a contract is signed.

The Canadian interviewees did stress the importance of proper and well-rounded contractual language. However, across the board, they all recommended the use of the design-assist method, which brings in the subcontractors or trade specialists in advance to contribute to the drawings. By allowing the subcontractors to participate in the design process, it eliminates any future arguments or “blame game” because they are involved in the drawings’ development. Hence, when it comes time to build, most issues have been resolved. It helps to minimize changes and costs, as most problems will be caught early and dealt with before actual construction begins. This method works best if the owner identifies three preferred subcontractors or trades who they have partnered with previously, and then selects one based on past experience, contract price, or other relevant factors. The most practical use of the design-assist method resembles this structure: appoint the general contractor, bring in the chosen subcontractor or trade early in the design process, and allow them to provide their insight on the job.

During Contract

During contract focuses on finding the best solution once construction begins and a claim or dispute occurs. Every interviewee said that the most effective and efficient way to resolve any claim or dispute should be informal negotiation. This allows the parties involved to settle any disagreement without the need for the contract or third parties to be included. However, if informal negotiation fails, the most recommended method to deal with a claim or dispute was the use of alternative dispute resolution, specifically mediation. The American interviewees stated that every contract should include a mediation clause along with a contingency for attorney fees, to provoke the use of mediation. In their opinion, mediation was the best method to deal with disputes since the mediator acts as a moderator that facilitates the parties coming to a decision on their own. Mediation is viewed as the most open and honest option, since the parties are forced to evaluate their positions and come to an agreement between themselves.

The Canadian interviewees also believe that the use of mediation was the best way to solve a dispute. This method was recommended because it allows the parties to settle disputes without becoming overly contentious, since maintaining good relationships with subcontractors or trade specialties is paramount in the construction industry of British Columbia. There has also been a shift towards the use of adjudication, which lets the involved parties allow the adjudicator to make a determination on behalf of the parties based on the nature of the dispute, and while the determination is binding, it is not final.

Post-Contract

The main goal of the post-contract phase is to ensure the project is successfully completed, and all contract obligations fulfilled. Every Canadian interviewee made it clear that a healthy relationship with subcontractors and trades must be maintained during the project and afterwards. This is particularly important in the Vancouver area, since the demand for new construction is very high relative to the size of the metropolitan area. Companies with a confrontational reputation have trouble finding quality subcontractors and trades on future projects, which may hinder business opportunities. The American interviewees also brought up the importance of keeping good relationships with subcontractors, but not to the same degree. The dialogue focused more on ensuring projects achieve substantial completion and that claims or disputes are resolved before the need for litigation. For once litigation begins, the process can take years and, in most instances, continue well past the project's completion.

Conclusions and Future Research

The research in this case study uncovered interesting correlations between the construction industries of California and British Columbia. In both locations, there is a consensus that the writing of the contract before a project begins is critical for mitigating future claims or disputes. This first step has the greatest impact on a project, as the more time and effort allocated to identifying key details, the better the results. In California, the focus is on contractual writing and clauses which prepare for all foreseeable and even some non-foreseeable conflicts. In British Columbia, the preference is to bring in trades early to establish accountability and identify any potential issues. During contract is where the two regions adopt the same strategies. Everyone agrees that informal negotiation is the first method that should be employed should a claim or dispute arise. Regardless, if informal negotiation fails, employing whichever form of alternative dispute resolution that is specified in the contract is the next step. Whether mediation, arbitration, adjudication, or DRB are used, all methods involve an impartial third party to make a recommendation or decision of the conflict at hand. The greatest difference was found during the discussion of the post-contract period. The construction professionals in British Columbia were adamant about maintaining good relationships with subcontractors or trades, especially once the project is completed. A company's track record on past projects sheds light on how it operates and whether it will be collaborative on future endeavors. In California, the focus is much more on making sure the project is finished and doing everything possible to avoid dispute from escalating into litigation. This divide on the importance of relationships can be attributed to the volume of labor force in each area. California has construction activity throughout the state and, as such, competent subcontractors or trades can be found relatively easily. On the other hand, most of the commercial construction in British Columbia is centralized in Vancouver and the surrounding metropolitan area. This reinforces the importance of maintaining productive work relationships with subcontractors or trades, as collaboration with them on future projects is highly probable.

There are additional options available for future research. First, interviewing more professionals will lead to different answers on the best methods to implement. Whenever a sample size is increased, the results will become more diversified. Second, consideration should be given to reviewing the actual "boiler plate" contracts for every company interviewed. By examining these contracts, one can identify what particular clauses and methods are used most frequently. Finally, by reviewing the number of recent lawsuits each company has been engaged in, more quantitative metrics can be leveraged. This would allow the determination of which claims or disputes are most likely to be escalated to litigation and how often those trials involve the subcontractor or trade directly.

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