

AVOIDING THE SAME PITFALLS

2017 Middle East Construction
Disputes Report





Introduction

Welcome to the Arcadis Construction Disputes Report 2017. Now in its 7th year, the Arcadis Contract Solutions team has undertaken its in-depth annual study which provides insight into underlying market conditions and behaviours that are driving construction disputes across the Middle East. Most importantly, the report also identifies key steps that could help to avoid or mitigate the risk of future disputes. As we know, it is always better to avoid or mitigate than to have to resolve disputes.

For the first time since launching the report, we are delighted to include insights from the perspective of a law firm active in the Middle East market. We would like to thank Clyde & Co for sharing their local insights and knowledge with us this year.

Unsurprisingly, one of the biggest issues observed in the Middle East is the impact that a sustained low oil price is having on the construction industry. Across the region, many projects and programs are facing a very different economic business case than when they were initially planned. This has led to a rise in the number of project deferrals and cancellations which in turn, has led to an increase in the volume of claims submitted and formal disputes that have materialized.

The positive news is that we are starting to see disputes in the Middle East resolved more expediently than in previous years. However, this optimism is tempered by the fact that we continue to see the same basic issues cropping up repeatedly when we analyze the most common causes of construction disputes within the region.

Many disputes that we work on could be avoided if the right level of expertise was involved in developing tighter and more rigorous contracts at the very outset of a project. Similarly, if greater discipline was applied when it came to administering the terms of the contract agreed, this would significantly reduce the number of claims submitted.

Looking forward, we must be careful that in the haste to get spades in the ground to meet fixed deadlines around 2020 (Dubai) and 2022 (Qatar), parties do not make rushed decisions when signing up to contracts on new projects. With disputes typically lagging a year or two behind project commencement, there's a risk that poor decisions taken now may only become evident closer to the delivery date when the margin for error is much slimmer. The next 12-18 months will be a crucial period for the Middle East construction industry and it's vital that proper care and attention is applied now when developing contract and procurement strategies, so that we can avoid the same pitfalls as before.

As in previous years, the study is based on an assessment of the construction disputes handled by our Contract Solutions team during 2016. While this will inevitably mean that some issues are underplayed or overlooked, the range and depth of disputes our team has advised on, means we can be confident the issues we identify are indicative of wider market trends across the region.

We hope that you enjoy this edition. If you have any feedback or insight that you wish to share, please feel free to get in touch.



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Guest foreword

Clyde & Co's experience in construction disputes over the past year mirrors the trends highlighted by the Arcadis findings. In many respects, given the size, complexity and high capital values associated with construction projects, it is not surprising that disputes are commonplace, whether "formal" in nature and advanced through arbitration or court proceedings, or "informal" site or engineer level disputes.

Taken together, Clyde & Co's MENA construction team advised on just over 100 matters in dispute during 2016. Consistent with the findings published by Arcadis, the trends behind these disputes remain remarkably consistent with what we have seen year on year, and have been driven by:

- Imperfect and often cumbersome contracts
- Over ambitious allocation of risk to one party or through the supply chain
- A lack of robust and independent contract administration
- Poor quality and overreaching claim submissions
- Pressures on available funding

The majority of disputes arising out of projects preceding the Global Financial Crisis have worked their way out of the system, and are now largely resolved. In our experience, there continues to be a steady stream of more moderately sized disputes, and perhaps a less frequent number of disputes than in recent years, driven by the smaller volume of projects brought to market. That is a trend we anticipate will continue in the short term, but we expect an increase in the volume and size of disputes over the next 2 to 3 years. This will likely be driven by:

- Increasing confidence in the regional economy, leading a greater volume of projects
- Work towards Expo 2020 accelerating
- Work towards the 2022 FIFA World Cup™ in Qatar reaching completion
- The economic vision in Saudi Arabia requiring the delivery of a greater number of infrastructure and commercial projects

Whether the root cause of disputes will change, remains to be seen. If the construction sector is to strive for fewer disputes, behaviours amongst all participants will need to evolve to "avoid the same pitfalls" that are continually recurring. There is still a lot of work to do in this respect across the region.



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Key findings from 2016

Over the last 12 months, the construction claims and dispute market has been very active across the region. Our research findings support this, with almost 60% of our team reporting an increase in the volume of work handled in 2016, whilst over 90% felt that their workload had either increased or stayed the same compared with the previous year.

There were a variety of reasons cited for this trend however the biggest factor was undoubtedly the lack of liquidity in the market, as the impact of a lower oil price continues to bite. These difficult macro-conditions have seen various programs of work cancelled, deferred, or terminated and this naturally results in a higher volume of claims and disputes.

Constraints around cash flow has also resulted in slower payment across the supply chain and, in some cases, non-payment for work carried out. In an already tight market, this has inevitably driven a much harder attitude to entitlements and obligations.

With clients spending much less overall, it's difficult for firms to absorb these losses and they become reliant on claims to help generate the cash flow they need to survive.

One other trend that came through very clearly from our Contract Solutions team in terms of what was causing disputes, was the shortage of qualified professionals with the relevant pedigree to properly administer the terms of a contract. A desire to save costs in a tough economy has seen insufficiently experienced professionals working on contract administration and claims which has resulted in a gap around the quality of technical and commercial advice provided.

In the pages that follow, we provide an overview of five of the key findings from this year's research.

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Almost 60% of our experts reported that they had handled a larger number of claims and disputes in 2016 compared with the previous 12 months.

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A dispute is where two parties differ in the assertion of a contractual right, resulting in a decision being given under the contract, which in turn becomes a formal dispute.

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1. Average value of construction disputes in the Middle East significantly lower in 2016:

The average value of construction disputes that we worked on in the Middle East last year fell by over 30%, dropping from \$82m in 2015 to \$56m in 2016. This arrested a worrying trend where the average value of a dispute in this region had increased for three consecutive years.

While this is a positive development on the surface, it must be nuanced with an appreciation that the average figure can be skewed upwards when our team supports on mega-disputes like we did in 2015. However, when you compare the 2016 figure against the weighted average from the previous six years, it's still much lower, suggesting that disputes did go down last year overall.

Dispute values in the Middle East remain higher than the global average (\$46m), although this is largely because projects in this region are typically larger and more complex than in other parts of the world. Employers and contractors face a higher level of corresponding risk which generally means that when disputes materialize, they are of a significant value.

One other factor to note is that if the overall volume of disputes went up but the average value went down, this would appear to suggest there was a greater number of smaller disputes. This reflects the move by contractors to try and pursue cash collection through claims to help protect cash flow. While in some respects it's good news that the average value is lower, it shouldn't automatically be assumed that the region is getting better at avoiding disputes.

REGION	VALUE (US\$ MILLIONS)						
	2010	2011	2012	2013	2014	2015	2016
Middle East	56.3	112.5	65	40.9	76.7	82	56
Asia	64.5	53.1	39.7	41.9	85.6	67	84
North America	64.5	10.5	9	34.3	29.6	25	21
UK	7.5	10.2	27	27.9	27	25	34
Continental Europe	33.3	35.1	25	27.5	38.3	25	19
GLOBAL AVERAGE	35.1	32.2	31.7	32.1	51	46	46

Fig 1 – Average value of construction disputes handled by the global Arcadis Contract Solutions team (2010-2016).

“ The average value of construction disputes in the Middle East decreased by over 30% in 2016 compared with the previous 12 months. ”

“ The value of a dispute is the additional entitlement to that included in the contract, for the additional work or event which is being claimed. ”

2. Disputes in the Middle East are being resolved quicker than in previous years:

In 2016, the average length of time needed to resolve a dispute in the Middle East fell by 10% to 13.7 months. This represents a big improvement compared with 2015, where the average was 15.2 months and, interestingly, is now quicker than the global average.

This trend towards swifter resolution is particularly welcome as it's exactly what the industry needs. It also reverses a trend that we've seen in recent years, whereby financial constraints have tended to drive slower decision-making in relation to projects (both before and after the point of contract formation), rather than a quick resolution.

Looking ahead, we hope that this trend towards faster decision-making will continue. Prolonged disputes are in no-one's interest and in the current market, there's an increased level of urgency to try and resolve issues as quickly as possible to keep cash flowing across the supply chain.

REGION	2010	2011	2012	2013	2014	2015	2016
Middle East	8.3	9	14.6	13.9	15.1	15.2	13.7
Asia	11.4	12.4	14.3	14	12	19.5	12.6
North America	11.4	14.4	11.9	13.7	16.2	13.5	15.6
UK	6.8	8.7	12.9	7.9	10	10.7	12
Continental Europe	10	11.7	6	6.5	18	18.5	14.1
GLOBAL AVERAGE	9.1	10.6	12.8	11.8	13.2	15.5	14.3

Fig 2 – Average length of construction disputes handled by the global Arcadis Contract Solutions team (2010-2016).

“ In 2016, the average length of time needed to resolve a dispute in the Middle East fell by 10% to 13.7 months. ”

“ The length of a dispute is the period between when it becomes formalised under the contract, and the time of settlement or conclusion of the hearing. ”

3. Basic contract understanding still at the heart of many disputes in the Middle East:

A failure to properly administer the contract remained the most common cause of disputes in the Middle East last year, closely followed by poorly drafted, incomplete and unsubstantiated claims.

This is similar to previous years and once again demonstrates the need to get the basics right from the very outset of a project. A third factor that came through in this year's report was employers / contractors / subcontractors failing to understand or comply with their contractual obligations. Although a low oil price and limited liquidity in the market may be creating the conditions for more disputes, the root causes are all avoidable if the parties to a contract are willing to work differently.

On the employer side, there needs to be a sharper focus on removing any ambiguity within the contract and ensuring there is a clearly defined scope of work. When contracts are initially being drafted, quality advice should be sought not only from good drafting lawyers but also from experienced industry advisors, even if that takes more time and costs more. Experience shows that when decisions are rushed at the tender phase or the focus is on trying to save cash, it only stores up problems for a later date. Within the Middle East, we also see insufficient levels of authority delegated to an engineer or project manager to make decisions on behalf of an employer.

Rank	Causes of dispute	2015 rank
1	A failure to properly administer the contract	1
2	Poorly drafted or incomplete and unsubstantiated claims	2
3	Employer/Contractor/Subcontractor failing to understand and/or comply with its contractual obligations	New in 2016

Fig 3 – Most common causes of construction disputes handled by the Arcadis Contract Solutions team in the Middle East in 2016.

With contractors, they need to balance the desire for a speedy claim submission (particularly at executive level, if not necessarily at the project level) with the need for a well thought through claims submission. In addition, the lack of capability to prepare a robust and credible claim that properly reflects the complexity of issues to be claimed, means that claims go nowhere and disputes drag on. Looking externally for specialist support with greater experience of managing the procedural aspects of a contract would make a big difference in terms of a swifter resolution of issues.

One other trend we noted in the Middle East region was a higher prevalence of disputes on joint venture (JV) projects. Where a dispute involved a JV, the proportion that were caused by a JV-related issue was 40% in our region compared with the global figure of 32%. This is a concern particularly given the number of contracts that are being delivered via a JV contract.

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Every year we see the same issues cropping up repeatedly. Within the industry, there's a pressing need for better training around the basics of administering the terms of a contract.

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4. Party to party negotiation still the preferred method for resolving disputes:

The three most common methods of dispute resolution used in the Middle East in 2016 were party to party negotiation, arbitration and adjudication.

This is similar to previous years and in part reflects the local culture whereby discussions tend to happen in a more direct manner and where importance is placed on personal relationships. What comes through much more forcefully in this year's report from all parties, is a desire to try and streamline the formal dispute processes, reduce the administrative burden and associated costs, and create a more transparent contracting model.

The continued deterioration (at a project level) that we observe in the contractual relationship between employers and contractors is once again raising the question on the need for a truly independent certifier on a project, and on the value that mediation could bring to the region. Mediation is still much less widely adopted compared with other parts of the world however in time it could well become more in vogue.

Rank	Dispute resolution method deployed	2015 rank
1	Party to party negotiation	1
2	Arbitration	2
3	Adjudication (contract or ad-hoc)	New in 2016

Fig 4 – Approaches most widely adopted to resolve construction disputes handled by the Arcadis Contract Solutions team in the Middle East in 2016.

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5. Public sector saw the greatest volume of disputes in 2016

Construction disputes were a facet of most market sectors in 2016 however they materialized most often on public sector and social infrastructure projects.

This was a trend that was consistent across all regions covered within the Arcadis survey. From a Middle East perspective, it's not hugely surprising as it tends to be a very active sector and more projects will naturally lead to more disputes. Furthermore, the low oil price has arguably impacted the public sector more than other parts of the market, as government budgets are heavily based on revenue that comes from exporting natural resources.

Contracts in the public sector also tend to be of a larger value and financially significant contracts typically carry a higher risk of dispute. More often than not, they also involve financially strong parties who are more likely and more capable of pursuing a dispute through formal channels.

One other trend unique to the Middle East was the number of claims and disputes that we saw within the oil & gas sector. This reflects the fact that oil & gas clients have become increasingly cautious about any risks due to the low oil price, but also the shift we're seeing in terms of the nature of the projects that are going to market. We're seeing an increased need for contractual advice on the extension of existing oil & gas fields and assets rather than green-field projects

Rank	Sector
1	Public sector / Social infrastructure
2	Property / Real estate
3	Oil & Gas

Fig 5 – Market sectors that saw the highest volume of construction disputes handled by the Arcadis Contract Solutions team in the Middle East in 2016.

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Avoiding pitfalls in 2017

As well as taking a retrospective look back to understand what was causing disputes last year, we also asked our regional team for their views on how they felt the market would evolve over the coming year. Overall, they're expecting to remain very active with almost 60% anticipating an increase in the volume of claims and disputes, whilst a further 27% expect the current high level to remain stable.

The justifications for this outlook were largely based on the fact that market conditions in 2017 look very similar to the previous 12 months. In simple terms, the region is feeling the pinch and in such an environment, cents are cherished and counted. Many contractors are struggling and are naturally looking to squeeze as much as they can from contracts. This includes pursuing any payments that they're owed through claims and formal disputes if necessary.

With that sober outlook in mind, we also asked our team what they felt were the key factors that would have the greatest impact in terms of avoiding future disputes and claims. By an overwhelming margin, our team felt that proper contract administration was the single biggest factor that would help to reduce the number of projects that end up in dispute. The next two factors also related to contract issues, with production of accurate contract documents and a more balanced approach to risk allocation coming out in second and third place respectively.

None of these recommendations are radical by nature and are largely about having the right level of experience in place, both qualified in-house professionals and external industry advisors, who take a rigorous and disciplined approach to their work.

Rank	Factor that would help avoid disputes
1	Proper contract administration
2	Accurate contract documents
3	Fair & appropriate risk balances in contracts
4	Realistic construction timeframes and no change in scope
5	Appropriate contract selection

Fig 6 – Factors that would have the biggest impact in terms of avoiding disputes in 2017

Our overall theme this year of “Avoiding the same pitfalls” seeks to underline the opportunity that we see in recognizing what has caused most disputes in the past, so that steps can be proactively taken to avoid the same issues in the future. Where disputes do arise, effective dispute resolution mechanisms must be actively deployed as quickly as possible, and implemented by knowledgeable advisors who can then help to reduce the impact a dispute has on a project.

Disputes have always been a major distraction that tie up key personnel and cash flow for significant periods of time. However, in the current Middle East economic environment, they're no longer just an inconvenience, but something that poses a significant risk that could threaten the viability of a project and the financial survival of a business. Now more than ever, we need to start learning from the past in order to avoid the same pitfalls in the future.

Thank you and we hope that you have enjoyed this year's edition.



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About Arcadis

Arcadis is the leading global Design & Consultancy firm for natural and built assets. Applying our deep market sector insights and collective design, consultancy, engineering, project and cost management services, we work in partnership with our clients to deliver exceptional and sustainable outcomes throughout the lifecycle of their natural and built assets. We are 27,000 people active in over 70 countries that generate €3.3 billion in revenues.

About Contract Solutions:

Our Contract Solutions team helps clients avoid, mitigate, and resolve disputes. The team encompasses a large pool of procurement, contract and risk management professionals. It also includes quantum, delay, engineering defects and building surveying experts.

The team provides procurement, contract and dispute avoidance and management strategies, as well as dispute resolution and expert witness services. This is delivered through a blend of technical expertise, commercial advice, sector insight, and the use of live project data, combined with a multi-disciplined and professional focus.

Contact Us

If you would like to discuss any of the points raised in this report in further detail, please get in touch:

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