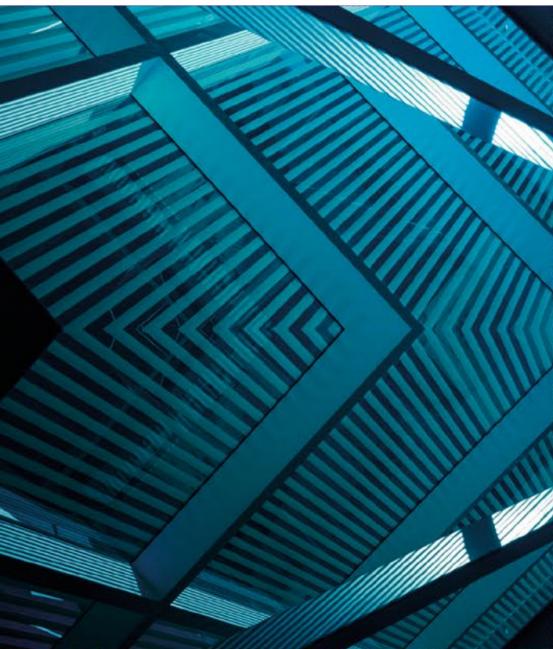


Rebuilding Confidence

CMS International Construction Study 2023





Introduction

In this era of low economic growth and high inflation, it is no surprise that the construction industry is facing a brutally challenging period. Rocketing interest rates, escalating material and labour costs, and growing pessimism are heaping pressure on the sector. Across the construction supply chain, insolvencies have been rampant in many countries.

This unforgiving climate and gloomy outlook is delaying or deferring spending and investment, but it is also creating concern, tension and discord in existing construction projects. These difficulties must be worked through by project stakeholders to stave off full-scale disputes, yet dispute resolution proceedings, such as arbitration, frequently occur across the industry.

The bleak backdrop forms the foundation of the CMS International Construction Study 2023, which draws on extensive responses collected in late 2022 from industry experts and targeted interviews with selected senior professionals. The report outlines the difficult circumstances that the sector faces, but highlights the measures that can be taken to limit or prevent the fallout.





Key Findings

CMS surveyed senior members of the construction industry from around the world, including Europe, Middle East, Africa, Asia and Latin America, and tracked data since 2020 to identify key trends.

Through additional interviews with construction sector professionals, this report further establishes the issues at play and highlights how businesses are responding to this particularly testing environment.

The findings illustrate the mounting delays and rising costs that are now the primary causes of tension and disputes in construction projects. The study shows that construction project stakeholders are increasingly looking to in-house legal teams, contract management teams and external law firms to help identify points of risk at the start of a project and to proactively monitor areas of risk through to completion.

The report highlights the appeal of settling points of conflict or dispute as they arise, spending small amounts on legal representation, rather than attempting to resolve these at the end of a project. Our research also recognises that some parties are reluctant to 'rock the boat' and jeopardise the flow of the project, which requires higher levels of sensitivity and diplomacy to address tensions.

The study demonstrates the need for construction stakeholders to improve the way they manage projects, particularly in keeping better records, managing change better and submitting notices within prescribed time limits.

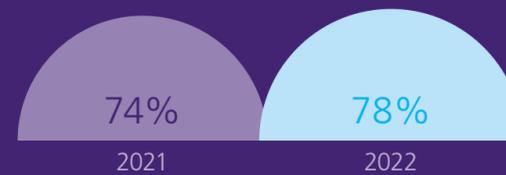
When full-scale disputes require formal processes to resolve them, our study clearly shows that arbitration is the number one preference for disputants. It also illustrates that enthusiasm for mediation has waned in recent years.



Primary Data Points



84% of respondents flagged time and cost as the most likely causes of conflict points or disputes in a construction project. This is an increase on 80% in 2021 and 76% in 2020.



Construction project stakeholders are increasingly looking to resolve issues separately during the course of a project, rather than at the end. 78% 'always' or 'often' used this approach in 2022, up from 74% in 2021.

71% of respondents indicated that keeping better records is a primary factor in improving the management of risk.

69% singled out managing change better.

65% pointed to submitting notices within prescribed time limits.

60% identified understanding the local market / region-specific factors prior to executing the project.



60% of respondents 'always' or 'often' consult the internal legal/contract management team or external counsel at the outset of the project to identify areas of risk and put in place strategies to manage these risks during project delivery. This is up from 51% in 2021 and 56% in 2020.



90% of respondents now choose to spend small amounts on legal advice during the course of a construction project to address conflict points, compared to 76% in 2021.



52% of respondents identified arbitration as their preferred method of dispute resolution, up from 47% in 2021. Only 37% singled out mediation or other forms of ADR in 2022, compared to 55% in 2021.





Interview – Fritha Wheeler-Ozanne

Fritha Wheeler-Ozanne
Senior Counsel,
Fluor Corporation

Our respondents are increasingly looking to resolve conflict points separately during the course of a project rather than leaving them to the end. Does that ring true with you?

That's definitely what we try to do. I've worked in the UK and Australia, so obviously you've got the adjudication regimes there, which are ongoing ways of resolving disputes. But I think even with our international projects, where there's no such regime, I think the contracts are getting more sophisticated provisions around DRPs (dispute resolution processes) or other interim dispute mechanisms. I think there's definitely a willingness and awareness to not wait to the end, especially on big disputes. There's definitely a keenness to get that dialogue going.

Is there still that natural tension between the business people who want to preserve commercial relationships and then the legal team that wants to address these conflict points early?

It depends. Every project is different and every client is different. So there's lots of varying factors, but I feel like the industry is trending towards being more willing to tackle interim points. I've always counselled clients from outside and now internally, that if you have a good relationship that should make these discussions easier. I think sometimes it's a case of not rocking the boat, that we've got a good relationship, we're getting things done and everyone's happy. So why would we risk having a difficult conversation? But if you leave it to the end, people then move on to different projects and it can be a lot less effective.

Has there been a cultural shift where the business people are recognising that dealing with conflict points and disputes as they arise actually preserves and secures the relationship?

I've definitely seen that there is a willingness to engage in those difficult conversations, and even do it with a framework for a dispute, rather than waiting to the very end of a project.



Interview – Fritha Wheeler-Ozanne

Given the current pressure on margins and with everything that's going on economically, our study shows that there is still a greater willingness to spend money on legal advice during the course of the project to deal with any potential conflict points. Is that something that you recognise?

From a contractor's perspective, I think we always try and actively help before disputes are left to the end of a project, even if it is in the background. I think sometimes it can be seen as an aggressive stance to have lawyers involved, but we can definitely help behind the scenes. In terms of external legal advice, there are some cases where I know that we've engaged lawyers before we're in formal dispute mode and we are getting some interim advice on particular elements.

I think it's about understanding the strategy, understanding the project and understanding the client.

When would you typically reach out to external advisers to help deal with conflict points at an early stage?

If there's a point of local law, that is important. A lot of our projects are international, so we might need international advice as to how a principle operates in a certain jurisdiction. Also, if it's not a jurisdiction or a dispute resolution mechanism that we're used to, that might be a point too. Sometimes the business would say "this is our view, we want to make sure that we're on solid ground from a negotiation perspective", or we may just want to sense check things that are quite nuanced.

Arbitration appears to be growing in popularity as the preferred form of dispute resolution, while enthusiasm for mediation has dropped. How do you see these preferences evolving?

I would say that enthusiasm for mediation has dropped a little bit from maybe where it was 10 years ago, when I think people were more excited about it. But often in mediation, you get to a point where you think this is never going to settle. And more than often than not it does. If you've got more than two parties, I think mediation really helps. Getting everyone in the same room and cutting through some of the technical issues or finding a way to navigate through different expert opinions, it's been really effective with a mediator.

Is arbitration still the preferred mode of dispute resolution?

If you're in formal dispute resolution, then arbitration would still be the preference. I think you have more control over the timetable and I think there's a certain amount of comfort from that. I think the frustration I have with arbitration is that there's a tendency to wait and make everyone do a final hearing two years down the road, when actually a court might make a motion for summary judgement. I know that people are having some success with those sort of interim hearings in arbitration, but I think it's still not as common as it should be.



The Difficult Outlook



Brexit, COVID-19, the war in Ukraine and the resulting energy crisis, have created an especially difficult environment and have led to unprecedented delays and rising material and labour costs.

These factors are threatening construction projects. AECOM's Market Forecast Q4 2022, UK and Ireland, revealed more than a 9% increase in building input costs in the year to September 2022, along with a nearly 10% rise in tender prices.

Low growth, high inflation and rising interest rates are bad news for the construction industry. This naturally impacts demand and is delaying or deferring spending and investment. Many construction projects are being paused while contract issues and other challenges are worked through. Fixed price contracts that were signed in 2019 are most likely to come under particular strain in the current climate.

Our research shows that many contractors are now looking for inflation price escalation mechanisms or fluctuation provision clauses, though understandably employers are less enthusiastic to take on more risk. A domino effect then occurs where contractors then attempt to pass on risk to sub-contractors, who in turn are more susceptible to financial distress.

Adrian Bell, Co-head of the Infrastructure, Construction and Energy (ICE) Disputes Group at CMS, comments: "Obviously, the further down the supply chain you get, the less well placed those parties are to take that risk, because they're usually much smaller companies with much more fragile balance sheets."



Identifying Risk and Resolving Issues Early

Given the difficult economic backdrop, it is natural that construction industry players are more attuned to risk and the possibility of conflict and disputes in construction projects. Our study demonstrates a growing use of internal legal, contract management or external counsel at the outset of construction projects to identify and mitigate risk. Businesses that 'always' or 'often' seek legal and contract management assistance at the start of projects has risen to 60% in 2022 from 51% in 2021.

For fixed-price contracts especially, this approach helps to sustain project viability. Consistently spending small amounts on legal advice during the course of a project is also prudent, with 88% of our respondents indicating that this is their preferred approach, compared to 76% in 2021.

Of course, operational construction projects are rarely straightforward with unexpected events being part of

the territory, particularly over the last three years. Points of conflict, tension or dispute frequently arise, but it is imperative for project stakeholders to maintain productive business relationships. It can be a delicate issue, but leaving disputes unresolved until the end of the project can be hugely counterproductive. A sizeable 81% of our respondents believe that 'always' or 'often' resolving issues separately during the course of the project is a judicious approach, as opposed to addressing them at the end of a project. The brutal current market conditions are also pushing project parties to address tensions earlier.

"We are getting more inquiries and more instructions from people during the course of the project, particularly the really large infrastructure projects that are on things like lump-sum fixed prices," says Adrian Bell, Co-head of the Infrastructure, Construction and Energy (ICE) Disputes Group. "I think it's just much more pronounced at the moment because the issues are more severe, so

I think there is really no alternative but to start dealing with them proactively during the course of the project."

While some non-legal professionals might still be wary of addressing conflict points during a project due to concerns about damaging ongoing working relationships, Fritha Wheeler-Ozanne, Senior Counsel at Fluor Corporation, warns: "I think sometimes it's a case of not rocking the boat, that we've got a good relationship, we're getting things done and everyone's happy. So why would we risk having a difficult conversation? But if you leave it to the end, people then move on to different projects and it can be a lot less effective."



Interview – Refki El-Mujtahed

Refki El-Mujtahed
Senior Legal Counsel
Besix Group

Our study shows that time and cost in construction projects have the highest risk of causing conflict points and disputes. To what extent does this match your experiences?

It's natural that extra delays and extra cost will arise. Given the models that we run in the GCC region, which are predominantly lump sum type arrangements, there's always a resistance against time and cost, because the employer wants to stick as close to their budgets as possible. And I think post-pandemic, which is a very important consideration, we are having conversations with the developer companies, because there is no benchmark against which we can realistically set or anticipate increases in cost, or anticipate delays in production, delivery or installation. It's inevitable that employers will have a more mature outlook on new projects negotiations moving forward and have to be open to a formula regarding

increases in cost. Employers also need to be more open to the fair assessment of justifiable delay that is caused either because of lack of design by the engineer and/or the architect, or just due to the sheer complexity of the engineering that's undertaken.

The study demonstrates that there are increased efforts to engage internal legal/contract management or external counsel at the start of projects to identify risk. Is this a trend that you have noticed?

In the timeframes we have with tendering, it's physically impossible for us to do the level of due diligence that's expected in order for us to get a very accurate understanding of the project. The reality is it only happens when we start on site, when we start doing the works. So yes, there is a concerted effort where contractors work hand-in-hand with their in-house counsel, our contracts team, our

technical and tendering teams. Because there are elements that are not just purely contractual, there are elements that are highly technical, and therefore needs to be considered collectively and articulated in a certain way.

Almost all our respondents recognise that there is room for improvement in how risks are managed during the course of a project. Notably, keeping better records is the factor that needs most improvement. Is this a trend that you are seeing too?

Records, records, records, is our mantra. Not just the actual records, but the method in which those records are logged and trailed. The organisation of records is just as important as having the records. When you consider a project runs for three to five years, and they are gigantic projects, then the amount of paperwork you're talking about is unfathomable. And if you don't have it



Interview – Refki El-Mujtahed

organised on a month by month rolling basis, you can forget it when you get to the end of the project and try to figure out what the records were at the beginning.

We're actually beta testing quite a lot of new technology where, for example, one of our engineers on site can take a picture of a particular scope of work that's been damaged, by say a subcontractor or something along similar lines, and it can immediately be allocated back to our project environment. So the more your environment is closed, the more efficient it is in producing the necessary reports or necessary trail of information that we require.

Our respondents are increasingly looking to resolve conflict points separately rather than all together at the end of a project. Would you agree with this preference?

From my experience in the UK, Dispute Adjudication Boards (DABs) are often set up from the beginning of the project so that they understand the parameters of the project and decisions are made in real time and are overall fair. In this respect, we need maturity on both sides, from the employer and the contractor. I still believe that those kinds of solutions are much better on huge projects than waiting till the end to resolve disputes. That's why I'm in support of DABs, because I think they create better visibility. In this day and age, when we're talking about employers that have auditing compliance, tracking the project budget on an issue-by-issue basis is a lot better than waiting to the end.

Arbitration appears to be growing in popularity as the preferred form of dispute resolution, while enthusiasm for mediation has dropped. How do you see these preferences evolving?

A lot of the contracts that I've seen recently have multi-tiered dispute resolution. So first the engineer needs to look at it, make their decision, and then senior management meets and discusses it during an amicable settlement phase. And if all else fails, then they give it to an independent third party to assess it. And if that's not accepted, then people can go off to arbitration. I have rarely seen mediation being proposed. And I don't think mediation works personally having experienced it here, because mediation requires a form of subtlety in convincing the parties to see reason. Personally, I am drawn to courts such as the Dubai International Financial Centre (DIFC)

courts. I think, it is still a good option if the employer is minded to consider such a venue, because it's faster and cheaper.



Improving Processes

Nearly all respondents to the study indicated that project stakeholders could be better at mitigating risk along with avoiding and resolving disputes.

For 71% of respondents, keeping better records is a top priority for managing risk. Many standard-form and bespoke construction contracts demand that all communications are put in writing, ensuring that clear records are kept and can be referred to in conflict or dispute scenarios.

Project stakeholders may be concerned by possible additional costs incurred by having team members on site to keep accurate records, although there is an acknowledgement that contract management and document management systems are now sufficiently advanced that it makes record keeping considerably more straightforward (see our interview with a Senior Legal Team Member of a Multinational Construction Corporation on the next page). Moreover, being on site during the COVID-19 pandemic was often impossible or difficult, creating further challenges for effective record keeping. “As margins have been

squeezed even more, people may be looking at pulling or reducing the amount of people on site who would ordinarily be compiling these records. So it’s a bit of a Catch-22. But we really emphasise the need to do that,” comments Adrian Bell, Co-head of the Infrastructure, Construction and Energy (ICE) Disputes Group.

Participants also highlighted managing change better (69%) and submitting notices within prescribed time limits (65%) as priorities to improve risk management. 60% identified understanding the local market / region-specific factors prior to executing the project as another primary concern; this is especially true when dealing with governments or government-linked entities, according to further research. Cultural empathy, an awareness of any local law requirements and an appreciation for conflict and dispute resolution is extremely valuable, according to respondents.



Interview – Senior Legal Team Member

Senior Legal Team Member
Multinational Construction Corporation in Asia

Delays and escalating costs appear to be the primary causes of tension and dispute in construction projects. Do you agree?

From a contractor's perspective, usually when we execute a construction agreement we would run a fixed-cost type EPC contract, so the more project delays of course, the more cost we have to incur. It simply leads to the increase in cost of labourers and so on. In order for the contractor to achieve the expected profitability, they must try to recover the delay-related costs from the owner. So from the owner's side, it is also a very significant issue and is not so easy to compromise on.

With the COVID-19 pandemic, Brexit, the war in Ukraine and the energy crisis, how much pressure does that put on fixed-price contracts?

Over a three-year period, we have been struggling to manage our construction schedule.

The pandemic obviously disturbed the timely implementation of the projects. As for the energy crisis, we are investing in new renewable projects, such as offshore wind projects, and due to the trend for decarbonisation, the need for equipment for the renewables sector has been higher than expected. It is a seller's market.

With those issues of cost and delay caused by the COVID-19 pandemic, how difficult has it been to resolve those problems between stakeholders in construction projects?

We tend to use the FIDIC contract, so we are able to ask the owner to simply extend the completion time, but the cost increase due to a force majeure event is not compensated by the other party. So, of course, we want to try to recover those costs through legal grounds, such as through a "change in law" clause, but often having that discussion is quite tough and difficult.

Keeping better records is a factor that our respondents feel needs to be improved. Is that something that you recognise in your business?

The technology is becoming more effective than before. Many contract management systems and document management systems are now in place. In future, it may become easier than in the current circumstances. In some teams, document management is quite well managed by the strong leadership of the project manager, but not in others due to the personality of the leaders.

Do you feel that the parties involved in construction projects need to understand local markets better?

Negotiation in a dispute is heavily dependent on not only what the contract provides, but also how it is interpreted by the stakeholders and the stakeholders in the larger projects are



Interview – Senior Legal Team Member

mainly government entities or a state-owned company. So in that sense, to understand the market standard or behaviour of the local players is difficult. So even if the contracts are beautifully drafted, if the other party doesn't comply with it, it is meaningless.

Should conflict points be resolved separately throughout the project rather than resolving them at the end of the project?

From the legal department's point of view that is partially true, but then it doesn't make sense to the business guys who always say during the implementation period that they need to maintain the relationship with the customer. So, the disputes should be resolved after completion from the business guys' point of view.



Resolving Disputes



Despite efforts to minimise risk and avoid escalating tensions, full-scale disputes do frequently occur in construction projects.

Our study shows that arbitration continues to grow in popularity as the preferred method of dispute resolution in the industry. 52% of respondents identified arbitration as their chosen form of resolving disputes, an increase on 47% in 2021.

The top arbitral institutions are credited with making arbitration more appealing again to disputants and the number of new case filings to major institutions has risen substantially over the last decade.

Seemingly, mediation is losing its attractiveness with only 37% singling out mediation or another form of ADR to resolve disputes, a significant drop from 55% in 2021. Moreover, litigation in national courts appears to have been pushed further to the margins. Only 3% have a preference for litigation in 2022, this dropping from 5% in 2021.

While the data indicates that mediation and other forms of ADR might be losing their allure, our further research suggests that mediation is still viewed as complementary to the overall dispute resolution process. Construction industry professionals appreciate the confidential nature of arbitration and the fact that disputants have some control over the appointment of arbitrators and the timetable, but it is still viewed as expensive and drawn-out. Mediation, however, gives the disputants a chance to resolve cases, before having to commit time and resources to high-cost arbitration or litigation proceedings.

Fritha Wheeler-Ozanne says that mediation often delivers a favourable resolution, even where the parties are pessimistic of achieving an agreement. She also believes it can be especially effective when there are more than two parties involved:

“Getting everyone in the same room and cutting through some of the technical issues or finding a way to navigate through different expert opinions, it’s been really effective with a mediator.”



Conclusion

In what must be one of the most challenging periods in the history of the construction industry, it is notable that attitudes to risk and dispute resolution are changing. In good times, it is understandable that businesses can absorb more risk, but where balance sheets are precarious, it especially pays to be prudent and cautious.

The pandemic, though, has also shown the industry's willingness to be pragmatic and considerate to the exceptional pressures that project counterparties and other stakeholders have faced.

With society in general developing a greater alertness and compassion towards those especially affected by the COVID-19 outbreak, these sentiments are also evident in the construction industry. A spirit of commercialism and pragmatism has filtered into the sector, although this does not mean that construction players are simply willing to stand back and not assert their rights under existing contractual arrangements. Time will also tell whether this pragmatism is here to last or whether the issues that the parties are dealing with commercially now will be the arbitrations of the future.

Nearly all respondents said the industry could still do more to manage risks, notably by keeping better records, by managing change more effectively and by submitting notices within prescribed time limits, among other factors.

At the same time, the mechanisms for resolving disputes are constantly evolving. Our report shows that mediation and other forms of ADR have a real place in the market, and that arbitration is still gaining popularity thanks to efforts to expedite arbitral proceedings and make them less expensive. Like the rest of the economy where COVID-19 has supercharged certain industries and transformed working practices, it has accelerated change within the construction industry. The sector is certainly suffering from the pandemic, the energy crisis, geopolitical tensions and other factors, but it is responding positively.



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A Year in Numbers:

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Law-Now updates

42

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5

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