NZ PPPs – dealing with and avoiding disputes

While full-blown disputes are unusual for PPPs, there are multiple disputed issues handled informally. It's important to have good and tailored contract provisions; to have strong contract and relationship management; and to factor in what might happen years later in disputed situations when assessing the risks around entering PPP contracts. Dispute resolution provisions are a significant part of the risk assessment. Covered also at the end are procurement dispute issues. We delivered this paper at the Conferenz conference, PPPs in NZ, *in November 2012.*

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The fact that disputes rarely go to Court or arbitration doesn't mean that dispute resolution isn't a key risk issue. The risks are big, and a robust dispute resolution structure is key to driving informal resolution.

Take benchmarking down the track in relation to the operations and maintenance phase. Benchmarking in our experience is difficult, controversial, and suffers from a lack of available information, particularly in a small market such as NZ. Yet the contractor and FM provider are at large risk arising out of that exercise. Even if the formal dispute resolution is not used, it needs to be strong as a backstop in case there can't be resolution – just as the benchmarking regime needs to be carefully considered and drafted at the outset, for a situation years down the track. While the parties should take a lot of care in setting up the benchmarking regime, the disputes resolution provisions need to fit well with that regime. Likewise as to other project matters.

There are many large $ risks to consider for up to 30-odd years down the track, and the contract terms and dispute resolution process can make a real difference. During the construction phase there's likely to be issues around the change process, delays, cost over-runs, and so on.

The regimes may need to be customised to each project. That's difficult when so much crystal-ball gazing is required. All scenarios – such as law or technology change – cannot be predicted over the long term.

- ***Why is the "formal" dispute resolution so important when few use it?***

There will be multiple disputes, and some will be particularly difficult. But they tend to be ironed out before things go "formal", such as via a decision by an independent expert or arbitration. But dispute resolution expertise at the earlier and informal levels is still critical. Negotiation skills by another name. And having a robust formal dispute resolution regime to kick in if there is no resolution is very important in encouraging correct resolution of issues in the first place. For that reason, this coercive and back-stop effect of formal dispute resolution processes is far more important for the parties than is indicated by the few times it is directly used. Don't have it and expect real problems.

- ***Why don't more issues head toward the fist-fight end of dispute resolution?***

London lawyer, Peter Sheridan, provides insights on the much longer UK experience in his excellent paper, *PFI/PPP Disputes*.[1] Reasons include:

- Requirements are specified in more detail and more carefully early on for PPPs, given the nature of PPPs and the SPV's bankers' requirements for careful and detailed planning, budgeting, risk assessment, contract terms, etc.
- Profit margins of 1%-2% are typical for standard procurement, 6%-8% is normal for PPP projects. Disputes are easier to avoid where profit margins are more generous.
- With the criticality of long term relationships in PPPs, parties are more likely to take a collaborative whole of life approach.
- With over 14 years of experience in the UK, agreement forms have been tested in the real world, refined, etc.
- Usually, providers such as the FM operator and the construction company are parties to the SPV JV, plus they contract to the JV. In that situation they will tend to try and resolve issues.
- Tiered dispute resolution processes, as Peter Sheridan points out:

> One example of the refinement in the contract mechanisms which has taken place is in relation to dispute resolution, where the relevant provisions have been designed to prevent and dissuade parties to PFI/PPP projects entering immediately into litigation or arbitration.
>
> There has been a recognition that tiered dispute resolution provisions, in which typically the initial phases require senior executive negotiation, assist in providing parties with flexibility to try and resolve low value or less important problems more swiftly and with lower costs and management time than those common under more traditional forms of contract. This, in conjunction with the pressures created by the security package required by the lenders and banks, frequently acts as a stimulus to settlement or early resolution of disputes.

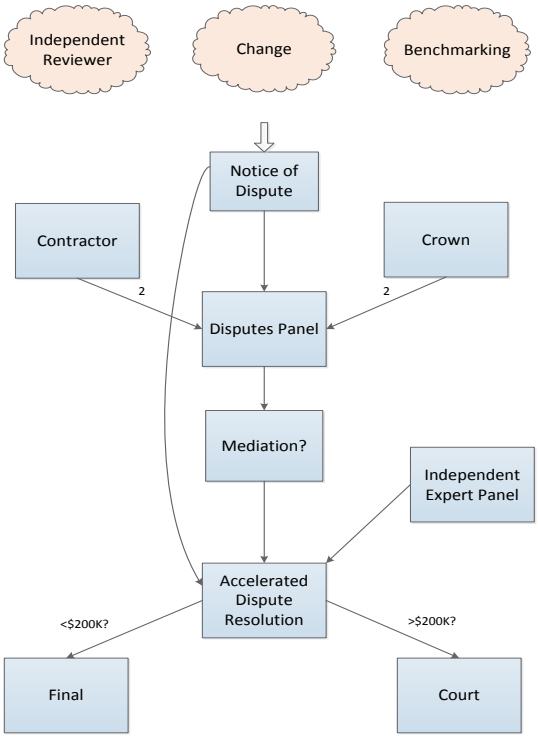
That's a good summary of how things should work, with the "formal" process there as a backstop, encouraging pragmatic resolution in that way.

- ***The flip side of that list***

That bullet-pointed list also shows that problems may arise where any of the factors in the list don't apply. A good example is where the FM provider is not a member of the SPV JV. Disputes are then more likely. So, this list will help identify the flip side: the risks if those factors don't apply.

- ***The "formal" end of the process***

The NZ National Infrastructure Unit's draft PPP contract contains – at Part 21 – a variation on the regime used in UK.[2] This is overviewed in this diagram:



This works in the following order:

1. If the parties can't sort things out informally, a notice of claim is given. Mostly, the dispute then goes for resolution by a body called the Disputes Panel. Each side nominates two people to the panel, to work to resolve issues. In keeping with the "soft" resolution approach in earlier stages, this panel can only agree resolution of the dispute if both parties' Disputes Panel members agree. They can use mediation, a brilliant option in our experience, for reasons outlined below.

2. If the Disputes Panel can't agree things, the dispute goes to an independent expert to decide the issue. The expert in each case is selected from a panel of approved engineers, accountants, and others, provided by IPENZ and ICANZ. The idea is to have subject matter experts available such as accountants for financial matters, and so on. Choice of expert is important, and the parties should make sure the right skill sets are on the panel.[3]

3. For disputes under a pre-agreed figure (we've used $200K to illustrate this), the independent expert's decision is final. Some care is needed here and it may be best to have no break-point like this. For example a $50K decision could set a $2M precedent. Parties won't go further on issues that are low value overall, so why have a break-point with the risks that entail?

4. Claims over the pre-agreed figure can go to Court. The parties should carefully consider whether to go to court (publically open) or arbitration (more private). Both have pluses and minuses.

- ***Agreement between SPV participants and their subcontractors***

The SPV participants must be particularly careful to back-to-back, where appropriate, between them, with their sub-contractors, and so on down the line. At least as between the SPV participants it may be best to have the privacy of arbitration.

For an example of a head contractor being liable to the employer for liquidated damages, arguably caused by a sub-contractor, yet those LDs could not be recovered from the sub-contract**o**r, see our article, *Back-to-backing subcontracts*.[4] The subcontract wasn't back-to-back with the head contract.

The UK standard contract recommends against – from the perspective of the Crown – allowing disputes beyond the Crown/contractor disputes to be handled with the latter, to avoid over-complication. But it advocates some flexibility on this, which makes sense, given often overlapping issues.

- ***Mediation***

We can't speak highly enough of having mediation to resolve matters, so long as the mediator has top skills and experience in this area. Mediators facilitate resolution: one of the strengths of mediation is that a mediator can get confidential information from both parties. That avoids the log-jam caused as each party states its best position, without revealing behind-the-scenes issues. Great mediators can work the magic and get through this, and can even leave the parties happier with each other than before.

This is so valuable that it would be well worth setting up a mediation facility from early on. The mediator can be called a facilitator or something else so that the role is not quite as intimidating to people: their job is to get to agreement, not to force resolution or decide things.

- ***People and pragmatic issues***

Complex projects are always dependent on the people. Everyone involved in projects has seen the A team doing the successful bid for the project, and then the B team comes in to execute. That should be a real risk factor when parties way up the risks of going into the contracts. Will the people dealing with the issues during the construction and FM phases have the skills,

experience, pragmatism, and just as importantly, the EQ, to deal with the inevitable problems while not destroying either the relationship or the cost? That talks to ensuring high quality people being involved down the track if at all possible, great training, and so on. Dispute resolution at all levels, from informal negotiation and simply having a beer with one's counterpart, to more formal processes, is an art form that is challenging to get right. But get it right and a party can do much better, and de-risk things.

The PPP literature out of the UK, Victoria, etc abounds with advice on the need for careful relationship management.[5] That's at the softer and yet critical end of dispute resolution.

- ***What to do when a dispute arises?***

Helpful maybe is the November 2012 article we've done on *Tips for getting compensation on problematic ICT projects*.[6] It's in an ICT complex project context, but many of the tips apply here too. We're doing follow up articles on drafting contracts to stop problems and using the contract to stop problems.

If there is one message that comes through from that paper and also in Peter Sheridan's article on PPPs, it's "Plan and document early for claims and do a paper trail". Plus, look for lateral solutions.

Our article also makes a point strongly made by Peter Sheridan: manage the communication flows carefully.

- ***Procurement disputes and issues***

Bidders spend millions in responding. Unsuccessful bidders may look at their rights.

Generally speaking they are not strong in NZ. See our NZ chapter in the *International Comparative Legal Guide to Public Procurement 2012*.[7] Complaints to the Auditor-General or the Ombudsman may lead to criticism of the tenderer but are not likely to win the contract.

Judicial review by the courts is usually relatively narrow, although that very much depends on the facts of the case. We do see potential in a claim based on the Mandatory Rules[8] (the procurement rules central Government must apply), based on an argument that they are legally binding. This issue is yet to be resolved by the Courts.

Any bidder in the RFP process should be very careful to follow and understand (or get first rate advice on) the rules and approach in the RFP and wider procurement rules and practice. This improves the odds, possibly markedly, plus sets a better basis for a claim if that arises.

There's a useful case study on some of the PPP procurement issues in our article, *Some interesting procurement issues for PPPs and other complex public procurement: the UFB initiative*.[9]

A particular issue lies around conflict of interest, as outlined in our article, *PPPs – handling conflicts of interest*.[10]

It is good that Government is using interactive dialogue during procurement. There is – maybe – raised probity risk,[11] but the reduction in project risk is exponentially greater and well worth taking. We've addressed this in our article, *PPPs – one to one discussions with bidders*.[12] We often find procurers overcooking or undercooking the approach to RFPs. The Mandatory Rules and other material – with care – are great for achieving best outcomes while meeting probity requirements. Nowhere is a great approach more needed than for PPP RFPs.

There are useful insights on the PPP procurement process in our article, *New Report on Australian PPPs – lessons*.[13]

Finally, in proposals etc, watch out for commitments made that are not sustainable: New Zealand has law[14] that can make proposers fully liable, in a way that terms in the contract cannot override.

1. http://www.sheridangold.co.uk/articles/pfi_ppp_disputes.pdf

2. See in particular Para 28 of HM Treasury's standard contract at http://www.hm-treasury.gov.uk/d/pfi_sopc4ch21-30_210307.pdf

3. The draft agreement has the Crown selecting the expert for a particular dispute if the parties can't agree. That is - arguably - not appropriate. The UK agreement has the expert being the next in line on the list of panel members. That's problematic too. One option is to have the relevant professional official (eg the President of IPENZ) making the decision, based on the circumstances in each case.

4. http://wigleylaw.com/assets/Uploads/Back-to-backing-sub-contracts.pdf

5. See for example the UKNAO's *Managing the relationship to secure a successful partnership in PFI projects.*

6. http://www.wigleylaw.com/assets/Uploads/Compensation-ICT-projects2.pdf

7. http://www.wigleylaw.com/assets/Uploads/PP12-New-Zealand.pdf

8. There are forthcoming amendments to the Rules but they are not intended to change the substantive aspects of the Rules.

9. http://wigleylaw.com/assets/pdfs/2010/some-interesting-procurement-issues-for-ppps-and-0.pdf

10. http://wigleylaw.com/assets/pdfs/2010/handling-conflicts-of-interest.pdf

11. As "probity" is a wide concept, our view is that reducing project risk is a probity matter.

12. http://wigleylaw.com/assets/pdfs/2010/ppps-one-to-one-discussions-with-bidders1.pdf

13. http://wigleylaw.com/assets/pdfs/2010/new-report-on-australian-ppps-lessons-for-nz.pdf

14. Fair Trading Act, although there are relevant forthcoming amendments.

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.

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