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Negotiating Claims and Change Orders

by Al Morgan, P. Eng.
Revay and Associates Limited, Vancouver

Al Morgan

INTRODUCTION

There is almost no aspect of construction that does not directly depend upon the negotiating skills of the construction professional, whether it is the engineer, architect, owner, contractor or subcontractor. The subject of negotiating, as a non-technical but basic survival skill, is one that presents a dilemma between the natural competitive bargaining process and understanding how to negotiate successfully.

Despite the prominence of negotiating as an everyday affair in the construction industry, there are common problems that continue to reappear between the parties engaged in negotiating change orders and claims. These problems are indicative of the fact that not all negotiations are alike but, more commonly, that the problems emerge from two sources; 1) either a lack of knowledge of negotiating techniques or 2) due to a general lack of experience in the construction business. There are numerous books and courses on the subject of negotiating but these have not specifically addressed the business dynamics found in the construction industry nor the idiosyncrasies associated with claims and change orders. In an article written in the Journal of Management in Engineering in 1992, Michael Lee Smith identifies ten common problems which prevail in planning and executing the negotiating process. These include:

- Starting with a win-lose approach
- Inability to change negotiation style
- Making concessions for the sake of client relationship
- Bargaining instead of negotiating
- Establishing objectives as a fixed point instead of a range
- Not choosing a fixed point wisely
- Failing to establish priorities
- Not planning for possible concessions
- Attempting to negotiate with unclear authority
- Failing to take notes or debrief

All too often, such problems rarely merit consideration from most construction professionals since the only measure of success in negotiating a construction claim or change order is the monetary payment actually received or the amount of money actually saved. This attitude prevails in the construction industry and unfortunately, the degree of success or failure in negotiating agreements is probably accidental and not due to a measurable understanding of the most effective characteristics of negotiating techniques. Understanding the process, styles and characteristics is a combination of both theoretical and practical knowledge. While it is not intended to provide an exhaustive analysis of the subject of negotiations, some of the most common aspects pertaining to the topic of negotiating change orders and claims are presented in the following discussion.

APPROACHES TO NEGOTIATIONS

There is no one procedure that is appropriate in all negotiations. The methods or approaches taken by the respective parties are acquired by real life experience. Negotiating behavior is reactive to rewards achieved in the past and therefore, it is inherently a conditioned process. We learn through trial and error and typically, in the construction community, the attitude is a combination of reason and emotion – you win some and you loose some. To a lessor extent, it also represents conscious decisions made by the parties in reasonably balancing the probable payoffs of a negotiated settlement against the time and expense of litigation.

General dispute resolution theory states that the parties to a contract dispute select one of two major negotiation procedures; either positional-based bargaining or interest-based bargaining. Positional bargaining is characterized by the following:[1]

- The stakes for winning are high
- The resources (time, money, etc) are perceived to be limited
- A win for one side means a loss for the other side
- Interests of the parties are not interdependent or are contradictory
- Future relationships have a lower priority than immediate substantive gains
- All major parties have enough power to damage the others if an impasse in the negotiations occurs

Negotiating for change orders and claims is characteristically positional bargaining. The parties present settlement options that meet their individual interests and portray these as solutions for the issues in question. Typically the initial position taken by the initiating party in positional bargaining represents its maximum expectation.

Where attention is directed at the strategic interests of the parties, rather than the specific merit of the matter under dispute, the process becomes an interest-based negotiation. The philosophy of such negotiations is that "it isn't what people want, but why they want it". For the contractor it is usually of no matter which pocket the money is paid from as long as it's paid; for the owner, however, the reasons for payment may be more important. In the latter case there are more often political repercussions or social consequences attached to the reasons for payment.

Arriving at a solution involving opposing situations or bargaining positions most often requires compromise and flexibility. This does not mean that negotiations are not without confrontation and disagreements. It depends on the style. Some people like to approach confrontation in a low key manner where disagreements are discussed reasonably and with a minimum amount of unpleasantness. On the other hand, some individuals favour a confrontational style that creates discomfort, fear and/or annoyance and generates an agitated scenario between the parties.

In general, current negotiation philosophies tend to focus on the "win-win" approach or a model that promotes the negotiation of interests rather than positions. The "win-lose" approach is apparently not in vogue within the general population; however, it remains the model that predominates within the construction industry. This sets apart negotiations surrounding most construction claim and change orders from those involving most other aspects of life that usually include social, political or personal issues.

[1] Moore, Christopher.W., *The Mediation Process – Practical Strategies for Resolving Conflict*, Jossey-Bass Publishers, San Francisco, 1986

We are proud to offer in this mailing a reprint of an article published in the July 2002 edition of *Toronto Construction News* on Stephen G. Revay, President of Revay and Associates Limited. This article describes his role as the dean of "dispute resolution" for the construction industry and should be of interest to our readers.

Conflict is inherent in executing construction projects and the settlement of either disputed change orders or claims is generally resolved by face to face negotiations between the parties. While mutual agreement is the desired outcome, for most situations the "win-win" platitude, while desirable, is one that should be treated as a self-inflicted illusion. At the end of many negotiating sessions there is resentment, hard feelings, disillusionment and dissatisfaction. All too often emotion and objective fact get confused and personal reactions are bared because of the failure to reach a satisfactory settlement. Negotiating for relationships, while desirable, is often not the most appropriate outcome for construction situations where the motivating force is driven by economic survival and business needs. The consequences of negotiation for relationships in a social or political situation are lifelong whereas, the consequences of negotiating a business decision involving change orders or claims do not extend beyond the life cycle of the project.

COMMUNICATION

As in life, negotiations between parties involved in the construction industry depend on communications. The intent and format of the communication are the key instruments that motivate discussion and, when negotiating change orders and claims, the communications among the parties present one of three possibilities, depending on whether the parties have similar or opposite objectives. The first possibility can be viewed as an attempt by one side simply to frustrate the other side while the other side attempts to reach common ground. The second possibility is one where there are similar objectives and both sides immediately move toward common ground. The third view is one where no objective negotiations can be agreed upon and no common ground is developed by either side. Depending on which of the three objectives is being considered, pursuing your best alternative to a negotiated agreement is an option that must be considered if the interests lay outside the practical boundaries of compromise.

Common lines of communication, whether they involve contractor/owner, contractor/subcontractor or contractor/engineer, require parties interested in communicating. Typically the parties engaged in construction negotiations are communicating from a bunker mentality where each side is convinced that it has a winning argument and that it can elucidate a perfectly defensible understanding of its position. Attempts to preempt the development of such polarized and intransigent positions have been fostered by introducing the concept of partnering[2] into the management of construction projects. Although the concept may promote more open communication, past experience on numerous projects indicates that partnering alone is generally insufficient as a negotiating mechanism when dealing with issues of change orders and construction claims.

Unless ultimate litigation or arbitration dominates the strategy, the opportunity to negotiate always exists. Negotiating from a very hard and strong position may be possible but first it is necessary to position yourself to allow the other side to buy into the process. If the other side from the outset does not wish to entertain any overture of communication, then the most important part of the negotiations may not be the issues, but a tactful method of beginning the negotiating process.

NEGOTIATING STYLES

In preparing for negotiations there are several approaches or styles that have been identified and the selection of a particular style, whether deliberate or involuntary, is a critical variable in negotiating. Each of the parties will undoubtedly apply its own psychological profile and develop a strategy assessment that it feels can best give advantage or prepare itself to provide a proper response. For the average untrained negotiator, this profile is not scientific and judgements on behaviorism depend on the experience of the negotiator. Individuals participating in negotiating claims and change orders are not unique and in most cases the negotiating personality will emerge as one of five general styles[3]:

1) competitors,
2) problem solvers,
3) compromisers,
4) accommodators, and
5) conflict avoiders.

The identification of a general style is only a guide and does not mask the other side nor does it guarantee that the approach will not change. Each response may change relative to another aspect of the claim or individual item of negotiation.

While professional negotiators learn about and generally understand the personality dimensions of the general population at large, the average construction negotiations do not start with a prerequisite course or workshop in the Myers-Briggs personality classification system. Past experience is important and negotiating styles are characteristically limited to observing behavior and determining the level of assertiveness employed by the other side. However, because negotiating is an acquired skill, it can be improved with study and practice and wider knowledge of personality and behavior improves the chances for successful negotiations.

Often style is substituted by procrastination and the communication process is deliberately obscured and muddied to cover poor preparation and can be interpreted as a deliberate ploy to delay communication to a later date. This is part of the body of thinking that believe gamesmanship and posturing are critical parts of negotiating. In reality it is axiomatic that gamesmanship is no substitute for preparation, and ill conceived, poorly researched, poorly presented and poorly argued positions do not contribute to resolution of the negotiation process. Using this approach will lessen the credibility of the negotiator or, worse, it may poison the relationship between the parties so that the dispute escalates to another level or pushes the parties into litigation.

The most successful, yet unheralded, approach to negotiating construction change orders and claims is to play it straight, be alert and prudent and listen carefully. This style does not lend itself to decisions made by intuitive feeling or inner judgmental instincts drawn from observations of body language, hand writing analysis or reading the daily horoscope. Most engineers, accountants and project architects are analysers[4] and when negotiating with them it is useful to understand that they seek accuracy and precision and like facts and figures to study. They make decisions based on facts, not emotions.

On occasion, the negotiator may follow a confrontational or aggressive style. This is typically a style of the authoritarian who does not wish to proceed through a form of cooperative communication and will use all means to stultify negotiations. A variation of the confrontational style is a form called passive aggressive where the negotiator refrains from continuing personal argument and withdraws into solitary communication where his first position is the final position. Regardless of which style prevails during the negotiation process, it is probable that there will be some airing of differences and confronting the adversary will be part of the dynamic.

BLUE COLLAR vs WHITE COLLAR NEGOTIATIONS

For many projects, negotiating at the field level is an everyday occurrence that can ultimately become the key factor in the contractor's future financial success or failure. Negotiations performed by the foreman or superintendent tend to be based on achieving an outcome and moving on to solving the next issue. Blue-collar negotiators generally work with more knowledge of details and the participants are looking for solutions. They are not seeking problems or anticipating unforeseen impacts or difficulties that may arise in the future from other contractual, budget or schedule problems.

In blue-collar negotiations the participants generally tend to tell the story in a simple, appealing way. They do not tend to quote chapter and verse from the contract nor do they tend to use overly legalistic terms. They tend to explain the issues without beating the facts to death. To the young and inexperienced engineer or architect, it is almost a right of initiation into the construction business to discover that the silver-tongued tradesman who is so good at his work can also be a skilled and crafty negotiator.

Most change orders go through phases of negotiation before being approved. Failure to agree or settle change orders at the blue-collar stage raises the negotiations to the white-collar level where tactics may change. All too often the white collar negotiator does not understand the detail problems and the immediate response is to select positional negotiations where a saw-off or bargaining process can be instituted. Contractors who do not have good documentation or good cost reports can easily fall prey to positional negotiating as their immediate need is to maintain a cash flow. These situations can introduce gross errors in judgement and

[2] Owens, Stephen D. and Webster, Jr., Francis M., *Negotiating Skills for Project Managers, chapter 21 of Field Guide to Project Management,* Van Nostrand Reinhold, 1998

[3] Shell, G. Richard, *Bargaining for Advantage – Negotiation Strategies for Reasonable People,* Penguin, New York, 1999

[4] Pinnell, Steven S., *How to get paid for construction changes,* McGraw-Hill, 1998

often the contractor eventually discovers that it has underestimated its actual cost by many times the amount it hastily negotiated.

Also to their own peril, contractors will quickly submit a poorly prepared claim at the request of the owner who either promises a quick settlement or intimates that there exists a critical date after which negotiations or a settlement will be much more difficult. Quite often, in this situation, the owner has a final figure in mind and it is not concerned about the reality of negotiating differences nor in the process of advancing discussion. Even more damaging to the contractor is the fact that the owner will use the poorly prepared document against the contractor in future negotiations that inevitably arise after the project is complete and after the contractor finds itself in a worse financial crisis.

When white-collar negations are left to the end of the project it reveals a failure by senior management to understand the importance of managing the financial needs of a project at the detail levels. Under the guise of management responsibility the blue-collar, and its initial white-collar negotiating stage, are weakened by senior management who perceive themselves as the only problem solvers.

FACT NEGOTIATING OR NEGOTIATING WITH OBJECTIVE CRITERIA

Negotiating is a process where fact finding is absolutely critical to arriving at a possible outcome. Breakdowns in the negotiating process are often caused because the participants do not know how to advance the discussion forward into another level of fact finding. Because conflict exists, the parties must recognize that this does not bring negotiations to a halt. At some point an impasse in negotiations offers an opportunity for the parties to re-examine their situation and to seek an alternative route to reach agreement.

Traditionally, in negotiations involving changes and claims, there are distinct communication tasks at different stages of the negotiations. At the outset, one of the parties begins the negotiations by presenting its case in an effort to justify the basis of its submission and explain its demands for additional compensation or contractual restitution. In a majority of cases, the initial negotiation is followed by an exchange of correspondence and meetings where the parties discuss and clarify the specifics of the submission and explore areas of overlap or compromise. Before an agreement is reached, the negotiations proceed through a final stage of trading and exchanges where concessions and compromises are integrated to produce a settlement. Each negotiation is unique in so far as the facts are concerned and a structured one-of-a-kind approach can pose some difficulties. It is the substance of the negotiations that is of primary interest and even a less experienced negotiator can be more effective if he is more fully prepared to use facts to gain opportunities and/or to find zones of possible agreement.

Most people are adamant that they do not wish to go the arbitration/litigation route to settle disputes. When this happens, however, it is recognized there are several stages in the arbitration/litigation procedure which are opportunities to induce negotiations. First there is the threat of an arbitration/lawsuit, then the commencement of an arbitration/lawsuit, after which there is the preparation for arbitration/trial, and finally it is possible to negotiate a settlement during the course of the arbitration/trial. In today's construction contracts, the inclusion of onerous risk transfer clauses lessens the opportunity for successful negotiation between the parties and increases the dependency on communication by means of arbitration/litigation and the use of legal assistance. The fact that negotiations are intended to advance the settlement of differences before the completion of the arbitration or litigation process is a self revealing fact that preparing for negotiations should be treated much the same as preparing for litigation. You can never be too prepared and you can never have too many facts. There is a common adage which states that it is more important to be prepared than to be right and it is preparation for negotiations that lessens the chance of litigation.

PREPARING FOR NEGOTIATIONS

How each party prepares its behavior and develops its objectives toward negotiation begins with various levels of information and knowledge about their own issues and similarly in the solutions that they are seeking. Generally there are a number of common basic considerations that immediately come to mind when developing an opening for the negotiating process itself. These should include:

1) where and how to begin (agenda),
2) major and minor issues,
3) revealing your maximum and minimum positions,
4) anticipating the opponents maximum position,
5) assumptions,
6) strategy, and
7) tactics.

It is basic theory that as negotiations continue, concessions alternate from side to side. In the exchange of information and presentation of facts, the dynamics of the discussions will change from offensive to defensive positions. Each side should thoroughly understand its own shortcomings and failures and recognize that each issue has a value to the other side. Even the best of negotiators find themselves on the defensive, at times, and they should be fully prepared to deal with the discomfort that this situation can involve. In the extreme case there are times when one of the parties is forced to have salutary negotiation based on cutting its losses rather than making any gains.[5]

The number of people who should participate in negotiations depends on whether it is bargaining for change orders or claims. For change orders, a single individual such as the contract manager or site supervisor foreman undertakes the majority of the process for the contractor and the engineer/architect for the owner. For claims, the number of negotiators depends on the issues and the quantum being negotiated but it is still not uncommon for the contractor to have only one negotiator. If there is a team approach, the lead negotiator would carry the communication and hold the position as the primary decision maker. The second member should include the person most knowledgeable about the actual circumstances or facts of the issues under dispute. Two people may be sufficient for each team but a third individual, who has detailed knowledge of costs, schedules or legal issues may be involved. Too many individuals at the negotiating table will simply postpone discussions to some stage when only one individual from each side eventually meet and resolve the issues being negotiated.

Written communication is critical to the negotiating process. Most construction contracts include provisions that make written notice of change or claim a specific requirement and both owners and contractors should recognize that negotiations begin at this point. When written notice is not an explicit requirement, written correspondence should be viewed as an important way of reserving rights that help to ensure that communication exists on crucial matters of negotiation. Written correspondence is where the parties try and explain their position and demands and it is a key part of the process of preparing for face to face negotiations.

Aside from the legal imperative that may force the time of discussion onto the parties, most of the internal time pressures are artificial deadlines. All too often the intrusive injection of internal time pressure becomes the overriding aspect of negotiations and this creates an environment where the negotiator exercises poor judgment for the sake of expediency. Whether it is your accountant, the bank or procurement decisions, any extraneous factors that do not represent real interests should not be brought into the negotiating process. Time is an advantage if used properly and with knowledge but can be a disadvantage when the strategy of the other party is to frustrate.

MEETINGS

At some point face to face meetings are called for. It is interesting that some parties are eager and willing to engage in discussion with little or no preparation while other parties do not like to attend personal discussions unless reasonably well prepared.

Meetings provide an opportunity to state positions and to make evaluations on the response exhibited by the other party. It also allows an opportunity to revisit the merits of the case and to gauge the major areas of agreement or disagreement between the parties. Open discussion about the methodology used in any analysis in itself should be recognized as a negotiating area because costs and schedules can be areas of uncertainty.

Asking questions is a major component of meetings and face to face discussions provide the forum where the parties can review the data, compare quantities, calculate delay and verify costs. Such tangible topics of discussion can generally provide an area of objective evaluation in which both sides can engage in civilized dialogue.

Meetings also allow the proponents to present an explanation of how their respective positions were derived. More than any other aspect of negotiating, it is a cardinal rule to listen actively and pay attention to what is being

[5] Gotbaum, Victor, *Negotiating in the Real World – Getting the Deal You Want,* Simon & Schuster, New York, 1999

said and what is not being said. There is no such thing as a stupid question. Information is the most important thing that you can derive, the more you learn the smarter you get.

While listening is critical to the negotiating process, this aspect is severely hindered because of the failure to make notes during the discussions. Time and again when discussions are held during caucus or between negotiating sessions, the information existing in written form reveals major flaws or contradictions to the verbalization that follows when participants express what is remembered. Ultimately the party going into discussions with no preparation weakens its position because it generates a second tier of correspondence where the emphasis is now on clarifying the basis of the submission instead of advancing the negotiating process.

NEGOTIATIONS AS A BUSINESS SKILL

For a contractor, negotiation is an essential business skill that involves continuous episodes of managing monetary loss or gain while maintaining continuous ongoing relationships with parties committed to legal obligations.

Some projects exhibit problems from the start and characteristically the contractor initiates a plethora of claims and change orders. Inevitably the volume of unpaid change orders, along with the increased cost of performing the contract work, creates a situation which often draws the parties into negotiating an early adjustment to the contract price. Generally, the owner has an advantage to settle on an interim payment as the contractor knows nothing of future anticipated changes yet to come nor in the compounding effect that these changes will have on its contract work. Contractors should recognize that negotiating interim agreements usually favours the owner and that "fair play" is not a consideration for some owners who are only interested in lowering the price they have to pay for the work. Such a Machiavellian attitude is not limited to negotiation between owners and contractors as it is just as common between contractor and subcontractor. It is not to say that all early settlements are to be avoided but, that they must be carefully executed to lead to satisfactory agreements.

While it is imperative to properly analyse change orders and claims on their merit, it is a fact of business that the contractor must also consider other aspects rather than the merits of the case. The first consideration is in recognizing who is holding the money and how much money is being held. Despite any arguments as to the ethics of the situation, some owners will deliberately withhold retention money as long as possible because they recognize the leverage it holds in completing close-out contract negotiations. The importance of negotiating skills is especially critical to contractors and subcontractors, as they exist on the lower rung of the monetary food chain, are frequently shown little professional respect and must continuously fight for their money. Unfortunately, they are generally also more challenged in doing a good job and tend to ignore the fact that negotiating is a vital ingredient in the ongoing success of their business.

In addition to the merits of the case, the other consideration given much weight and impetus to negotiate, is the need to recognize the burden imposed on the parties to maintain an ongoing business relationship while dealing with the time and cost of continuing the settlement process by arbitration or litigation. Due to contractual, statutory or procedural requirements, it may be necessary to parallel litigation or arbitration with negotiations; however, it is imperative that the opposing parties recognize that they should not allow the alternative legal processes to usurp the negotiation option.

A stalemate or breakdown in the negotiating process can often be resolved by third party intervention. Assisted negotiations by using third party intervention, such as a mediator or facilitator, is not a substitute for negotiations although binding arbitration, as a alternate dispute method, represent one form of assisted negotiations. The mediator is there to keep negotiations moving along so that the parties come to an agreement on their own. When fact finding is a one sided affair or where the adversaries are antagonistic and overtly unwilling to consider solutions presented by the other party, the simple suggestion of introducing a mediator will sometimes break the impasse in negotiations. If the mediation process continues between the parties, there is also the benefit conferred by the disclosure of factual matters which often aids in settling the differences before proceeding into litigation and the discovery process.

The premise of conduct in the negotiating process should be the principles of fairness and prudence and that laws or rules do not, as a general rule, govern the process[6]. In negotiating changes and claims both sides, presumably, try to get the best deal and proceed within the general understanding that no one has committed fraud. While it may be fraudulent to knowingly make a misrepresentation of a material fact, demands and bottom lines are not material to a deal as either party can walk away and seek a better alternative.

NEGOTIATING – FINDING THE PROBLEM AND WORKING OUT A SOLUTION

The process of negotiation is not a physical science which can be repeated as a scientific experiment. However, research has shown that successful negotiating skills can be acquired by learning the most important behaviors that increase the chance of continued success. Although there is no clear authority who reins supreme in providing current theory and understanding of basic negotiating principles, there seems to be general agreement within the business community to build upon the foundations laid out by Fisher and Ury in their book "Getting to Yes"[7]. These negotiating principles are as follows:

1. Separate the people from the problem
2. Focus on interests, not positions
3. Invent options for mutual gain
4. Insist on using objective criteria

Fisher and Ury identify the main problem in the negotiating process as the practice of bargaining over positions and further, they postulate solutions which they believe to be effective in social, political and other areas of general commercial endeavour. This, however, runs contrary to the negotiating philosophy most evident in the construction industry and it may be one reason for the high incidence of litigation. Whether the industry can solve the legal problems by applying more principled negotiation strategies, as an alternative to positional negotiations, remains an open question. This philosophy, however, may not be acceptable to many in the construction industry. Whether the result is win-win or win-lose, the success in negotiating, regardless of theoretical differences, is in the front-end effort and not in the back-end gambling. It is an axiom that a poor settlement during negotiation is better than a good lawsuit.

[6] Note: Different jurisdictions have different laws governing this issue. In the USA, attention should be drawn to the False Claims Act pertaining to Federal Government contracts.

[7] Fisher, Roger and Ury, William, *Getting to YES,* Penguin, New York, 1991.

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