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Dispute resolution and litigation in the construction industry. Evidence on conflicts and conflict resolution in The Netherlands and Germany

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ABSTRACT

The construction industry is regarded to be a tough and competitive business characterized by short-term and opportunistic relations rather than being based on cooperative partnerships. In particular, conflicts and litigation have been claimed to proliferate in the construction industry. Upon closer inspection of the literature, it seems that the empirical basis of these claims is largely circumstantial. Using data on contractor–subcontractor relations in the construction industry in The Netherlands, we consider the extent to which litigation in construction is common. Then we compare the results to similar data sets on IT-purchasing both in The Netherlands and Germany, and to a data set with more general business-to-business transactions of larger Dutch and German firms. We find some evidence that the construction industry has higher percentages of transactions leading to either arbitration, suspension of the relation, or legal steps (1.6% versus 1.2, 0.4 and 0.6). The differences are however not as extreme as one might conclude based on superficial reading of the popular and scientific literature, and certainly not bigger than the differences between the other data sets.

1. Introduction

The construction industry has often been characterized as a harsh business. Even a brief literature review suggests that behaviour in the construction industry is characterized to be antagonistic and confrontational (Cox and Thompson, 1997; Saad et al., 2002) and relying on detailed contract specification and close performance monitoring (Kadefors, 2004). An important and typical consequence of the tough and competitive world that the construction industry apparently is, is that there seems to be a high and increasing level of conflict and disputes (Lavers, 1992; Brooker and Lavers, 1997). In addition, researchers have reported a dominant blame-culture and a strong tendency towards the use of litigation to resolve disputes.[1]

A closer look at the scientific literature reveals that there is surprisingly little representative empirical evidence to back up the harshness of the construction industry. Many publications on disputes and conflict resolution in the construction industry are largely conceptual, or make claims about the state of affairs without reference to empirical data based on specific experiences, impressions, perceptions and opinions of practitioners (cf. Bryde, 2008, and several contributions to the proceedings of the First International Construction Management Conference at UMIST/UK in 1992). In still other publications "empirical generalizations" are formulated based on case study research with only a limited number of interesting but not necessarily representative cases. Even when researchers themselves have been cautious about and warned against generalizations in the original study (e.g. Khalfan et al., 2007), subsequent researchers who present literature overviews on the subject sometimes loose the cautiousness of the original.

Let us illustrate the issue with an example. The conclusions in the influential Latham Report (1994) with respect to the widespread use of litigation in the UK construction industry have been quoted numerous times, and the report is generally used as a reference that is showing that the construction industry is a tough and troublesome business (e.g. Bresnen and Marshall, 2000; Saad et al., 2002). However, these conclusions are largely based on analyses *following several poorly performing projects*, so that representativeness is problematic. The same holds for the work of the 'Dispute Avoidance and Resolution Task Force' of the American Arbitration Association (as mentioned in Stipanowich, 1997; Colledge, 2005). Reports such as these and the general scientific literature have contributed to an image of the construction industry characterized by inefficiency and toughness, but it is not clear whether this image is correct. This image might be completely correct, but nobody bothered to really count

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[1] See, for instance, Khalfan et al. (2007), Davis et al. (1989), Fenn (1991), Fellows (1992), Latham (1994), Brooker and Lavers (1997), Saad et al. (2002), Harmon (2003), Colledge (2005), and Gibbons (2007).

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in a representative way. We do. The aim of our article is to add to the empirical evidence with respect to conflict resolution and litigation in the construction industry. Is it really as harsh as people tend to think?

In our analysis we focus on conflict resolution and litigation as our main indicators of harshness (as is customary in the literature). First we outline the literature on conflict resolution and litigation and introduce the concept of a dispute pyramid as introduced by Sarat (1984) as a useful tool to analyze dispute resolution. We then introduce the Dutch construction industry, which is also generally seen as the tough and competitive world that construction seems to be in general. Our data collection allows us to then present estimates on conflict and dispute resolution. In the subsequent section, we compare these data to similar data in the IT-sector in the Netherlands, so that we get a feel for the magnitude of a within-country sector difference. Then, we compare these IT-data with an identical data collection of IT-transactions in Germany, so that we can estimate the difference between countries, within a sector. Fourth, we compare these data to a more general set of purchasing transactions of Dutch firms. A conclusion and discussion section concludes the paper.

2. Conflict resolution and litigation in a broader business context

In the 1960s and 70s there were opposite views on litigation in business relations. At one end of the spectrum, many researchers in the United States had the impression that there was too much litigation. This was often described as "the law explosion" or "the legal explosion", signifying the growing intrusion of law in every aspect of American Society (Barton, 1974, p. 567). Similar buzz-words that were used were "hyperlexis" (Manning, 1976, p. 767) or "the litigation explosion" (for an overview, see Sarat, 1984, p. 319). At the other end of the spectrum there was a line of research sparked by a publication by Macaulay (1963). Macaulay investigated the social functioning of contract law in the business world. His research consisted of interviews with 68 businessmen and lawyers from 43 companies and 6 law firms. An important conclusion drawn from the findings of the research was that in practice, disputes were frequently settled without reference to either the contract or potential or actual legal sanctions: "Even where the parties have a detailed and carefully planned agreement [...] often they will never refer to the agreement but will negotiate a solution when the problem arises, apparently as if there had never been any original contract." (Macaulay, 1963, p. 61). Later, Macaulay's study was labeled a classic not just for the fact that it is (now almost 50 years) old, but also because it is nowadays widely recognized as one of the most influential contributions to the field of conflict resolution in the world of business. Even though most people expected that many firms run to the courts as soon as they can, closer inspection suggested they did not.

Of course there were and are potential counter-arguments to the validity of Macaulay's claim. An obvious one is that the picture painted by Macaulay is now outdated. While in the 50s and 60s of the previous century the companies, their mutual relationships and their products and prices were stable for a relatively long time, our perception of today's business arena is rather different: more and more business players are everywhere, and there is more general turbulence. These factors may in the meantime have undermined Macaulay's notion of *long-standing relationships*, as recognized by Macaulay (e.g. Galanter and Rogers, 1991; Macaulay, 1985; Galanter et al., 1991). The most important differences would appear to lie in the increased internationalization, the increased competition in business, and the increased litigiousness in the world of business. Initially, it seems obvious and consistent with what we see happening around us, that the parties in a dispute confront each other in court more often than in the past.

It is indeed a fact that over the past decades there has been a substantial increase in the number of lawsuits in the area of business contracts that are brought before the various courts, both in and outside the United States. But appearances can be deceptive. According to Galanter the "litigation explosion" hypothesis has not been based on the growth in filings in federal courts and the growth in size of the legal profession only, but also on specific accounts of monster cases (such as the AT & T and IBM antitrust cases), the vast amount of resources consumed in such litigation, and on war stories (Galanter, 1983). He concludes that we need a more "contextual reading" of the facts. The increase in lawsuits obviously needs to be viewed in the perspective of a tremendous growth in economic interactions and business activities (Sarat, 1984). What we need to consider is what is happening with the *percentage* of transactions that ultimately ends up in a lawsuit. Sarat noticed that what looks like a flood of litigation as viewed from the courthouse steps, might appear rather modest when compared against the vast magnitude of lawsuits that could have materialized but did not (Sarat, 1984).

Dunworth and Rogers (1996) likewise consider conflicts in the light of the number of potential conflicts. They took a more precise look at the growth in the number of lawsuits between companies in the 70s and 80s of the previous century, and concluded that a large part of the growth could be attributed to product liability issues. Their statistical analyses indicate that if those issues are set aside, the number of civil court cases among businesses has in fact grown less than could be expected solely on the grounds of economic growth. On top of this, the findings from later replications of these types of studies in different countries hardly seem to deviate from the picture as originally sketched by Macaulay (Blegvad, 1990; Beale and Dugdale, 1975; van Houtte et al., 1995; see also the overview by Deakin and Michie, 1997). The picture remains that it is usually quite exceptional for disputes between companies to end up in court. In the wording of Sarat: "Litigation can be thought of as the tip of the iceberg or the apex of a rather complicated process through which disputes emerge, develop, and are resolved" (Sarat, 1984, p. 331).

Following Galanter's suggestion to analyze the dispute process in more detail, Sarat uses the metaphor of a *dispute pyramid* for the steps of conflict resolution, whereby the first step is the stage of problem recognition, which occurs when one or another event or transaction is perceived to be injurious or undesirable. The second step is deciding to take up the issue with the other party (instead of just accepting the problem and moving on, a "grievance"). The third step is to decide to blame the other party for at least part of the problem, confronting an adversary rather than in the legal sense of starting a lawsuit. "Disputes" (all Sarat's terminology) can be said to exist only after the grievance has been perceived and acknowledged and after the claim has been made, but only if that claim is resisted. Sarat underlines that unless a claim is made, a dispute cannot occur (Sarat, 1984). Once a dispute has emerged, choices must be made about how it can be processed, whereby at least in theory, a wide range of alternative procedures might be employed, ranging from direct bilateral negotiations to third party mediation or arbitration, and ultimately to adjudication and litigation (Sarat and Grossman, 1975). The pyramid represents the stages through which events pass in the disputing process. One can think of each of the stages below litigation as establishing a benchmark or *baseline* against which a litigation rate can be calculated. Thus we can compare litigation to all potentially litigable grievances, claims, or disputes (Felstiner et al., 1980–1981; Sarat, 1984). Another possibility will be to view the incidence of litigation as a percentage or proportion of *potential* legal claims (cf. Miller and Sarat, 1980–1981). One way