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## Conceptual approach to assessing the economic efficiency of out-of-court settlement of construction disputes

The paper is focused on the potential of conciliation mechanisms as an integral component of investment and construction projects delivering in terms of out-of-court disputes resolution, taking into account their diversity and the presence of a public element. The main goal of mediation approaches is emphasized — to reduce conflict component in both economic activity as a whole and in the construction industry. Concept approach towards cost-effectiveness evaluation of out-of-court disputes resolution is represented revealing the levels of mediation approaches development (legislative enshrinement, regulatory and consulting activity, sphere of education, the structure of contracts) and structuring the costs of litigation: litigation fee, expenses for conducting a construction expertise focusing on economic, technical, financial, value assessment and examination, expenses for the services of a representative (legal assistance) and indirect costs which are mostly related to time period. Furthermore, essential factors which have an impact on cost-effectiveness evaluation are highlighted: the amount of litigation fees, the duration of proceedings, inflationary processes, fee exemptions and refund and type of a contract. An important conclusion is made in the article that even in case of winning, court proceedings without the use of mediation technologies at the early stages (referral to conciliation rooms) is not an effective way to settle disputes. The findings and results can foster constructive partnership while delivering projects and taking preventive measures in order to reduce significantly the level of conflicts in investment and construction sphere. **Keywords:** *conciliation mechanisms, out-of-court disputes resolution, economic efficiency, mediation approaches, litigation fee*

### INTRODUCTION

The current priorities of the construction industry development are focused on the implementation of conciliation mechanisms in practice, which make it possible to eliminate contradictions and disagreements in project delivery promptly and at the lowest cost (both direct and indirect).

The above mentioned conciliation mechanisms provide mediation approaches, the main goal of which is to reduce conflict component in both economic activity as a whole and in the construction industry (given that construction disputes are among the most mediative), and, as a result, to create a framework for ensuring a favorable business climate, taking into account certain inequalities between representatives of government agencies and large construction companies, banks and representatives of small businesses. Because of this, the principle of adversarial litigation reinforces the destructive processes of construction projects practical implementation.

The basics of mediation approaches are the constructive nature of interaction among participants in economic activity, the priority of negotiation process, the voluntary nature of certain procedures, cost reduction and resource savings (compared with judicial proceedings), the availability of additional competencies of dispute resolvers, their independence and impartiality [1].

### MATERIALS AND METHODS

Concept approach towards cost-effectiveness evaluation involves revealing the levels of mediation approaches development and structuring the costs of litigation.

Structural dynamic analysis of disputes resolution methods has allowed to identify the following essential aspects:

- the greatest difficulty in resolving disputes involving a public element is the lack of conciliation mechanisms and constructive interaction [2];
- the presence of a public element significantly limits the scope of alternative dispute resolution methods, which may be non-arbitrable;
- commercial arbitration is the least preferable way of resolving disputes related to the implementation of construction projects, as it does not allow to cover all disputable points and monitor all stages of project implementation, timely relieving tension and coordinating the interests of all participants (both professional and non-professional) [3];
- project mediation with the participation of construction experts with specialized competencies may be the most promising way to resolve disputes [4];
- the relevant contract clauses should detail dispute resolution procedures and provide a clear concept of dispute resolution with a differentiated approach to managing disputes and disagreements in the project;
- it is also important to consider the option to use alternative dispute resolution after the initiation of litigation;
- in order to develop specialized ways of dispute resolution in the public element, it is necessary to develop not only out-of-court methods (mediation, extrajudicial expertise), but

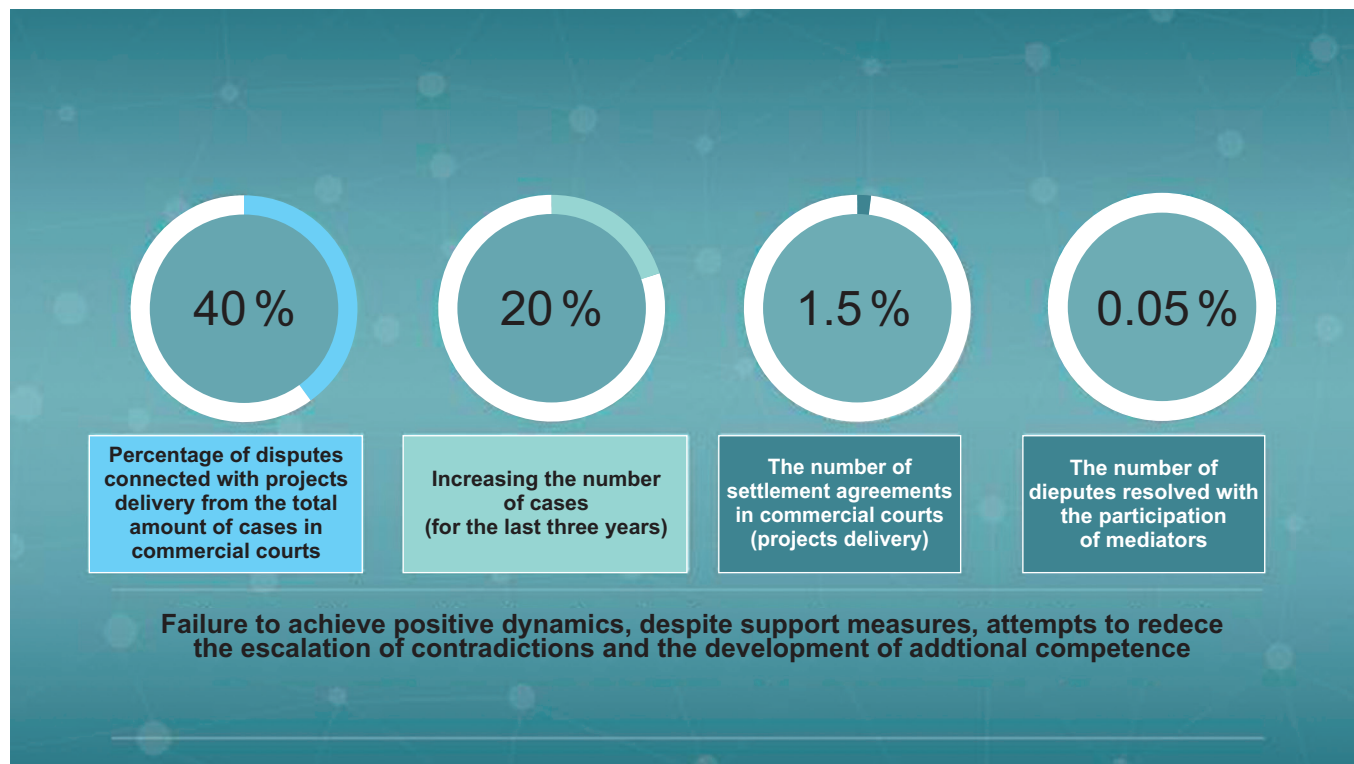


Fig. 1. Statistics characterizing the level of conflict in investment and construction (in the Russian Federation)

also conciliation procedures provided for by the procedural legislation, which can be initiated within the courts (most of them have open and functioning conciliation rooms, the parties can apply to such rooms at any stage of the process) [5].

Moreover, existing approaches to the usage of conciliation mechanisms (in terms of out-of-court dispute resolution) do not take into account the total amount of costs of disputing parties and their subject composition.

It is necessary to emphasize that in practice the amount of damage to one or more parties to a dispute is often the result of not only violations of contractual obligations arising from errors and miscalculations of parties, but also can occur for the reasons not depending on them in investment and construction activities (Fig. 1).

Mediation approaches in the sphere, in which public authorities are involved, require a number of measures that are both directive, organizational and managerial in nature [6].

Let us highlight the levels of implementation of these approaches:

1. Legislative enshrinement: the most preferable way to introduce out-of-court mediation approaches into practice is to fix the procedures in various legislative acts (having both general procedural character and sectoral affiliation). Moreover, such procedures may be mandatory, in which case the disputing parties will have no choice but to apply them. It should be emphasized that the opinions of scholars and practicing mediators are traditionally divided, not all of them are supporters of the mandatory nature of the use of alternative dispute resolution methods, as it can be of a formal nature and only delay the process (if the conflicting parties do not intend to constructively resolve the contradictions) [7].

2. Regulatory activities: establishing standards for interaction with business entities, requirements for relevant procedures,

adoption of legal acts and methodological recommendations as a guideline. Even if it constitutes "soft" regulation" of relations, nevertheless the level of conflict can be significantly reduced.

3. Consulting activities: the use of alternative dispute resolution methods involves the involvement in the processes of dispute prevention and resolution of persons with special competencies in such areas as conflict management, psychology, design and expert activities, information technology, architecture. The participation of such individuals, in turn, determines the development of consulting services market in terms of effective management of disputes and disagreements in the project [8].

4. The field of education: it is obvious that the development of additional competencies takes place at the level of educational programs that provide appropriate training areas within the framework of using alternative dispute resolution methods in relation to project management (for example, project mediation, extrajudicial examination, etc.), taking into account the intersectoral orientation.

5. Contract instruments particularly related to the implementation of projects with the participation of public authorities [9, 10]. An important conclusion can be made that public contracts, concession agreements, agreements on the procedure of monetary compensation to the owners of engineering networks often contain bonded (unfair) conditions. Such conditions may relate to excessive penalties, high amount of payments to in the absence of counterpart provision, unclear obligations of the public party, asymmetry of responsibility, overly burdensome obligations for the construction of social infrastructure, gratuitous transfer of the created objects, etc. In turn, the lack of negotiation process in a number of cases does not allow economic entities to influence the wording of contracts, so it is extremely important that the initial standard forms do not contain knowingly unreasonable conditions (Fig. 2) [11].

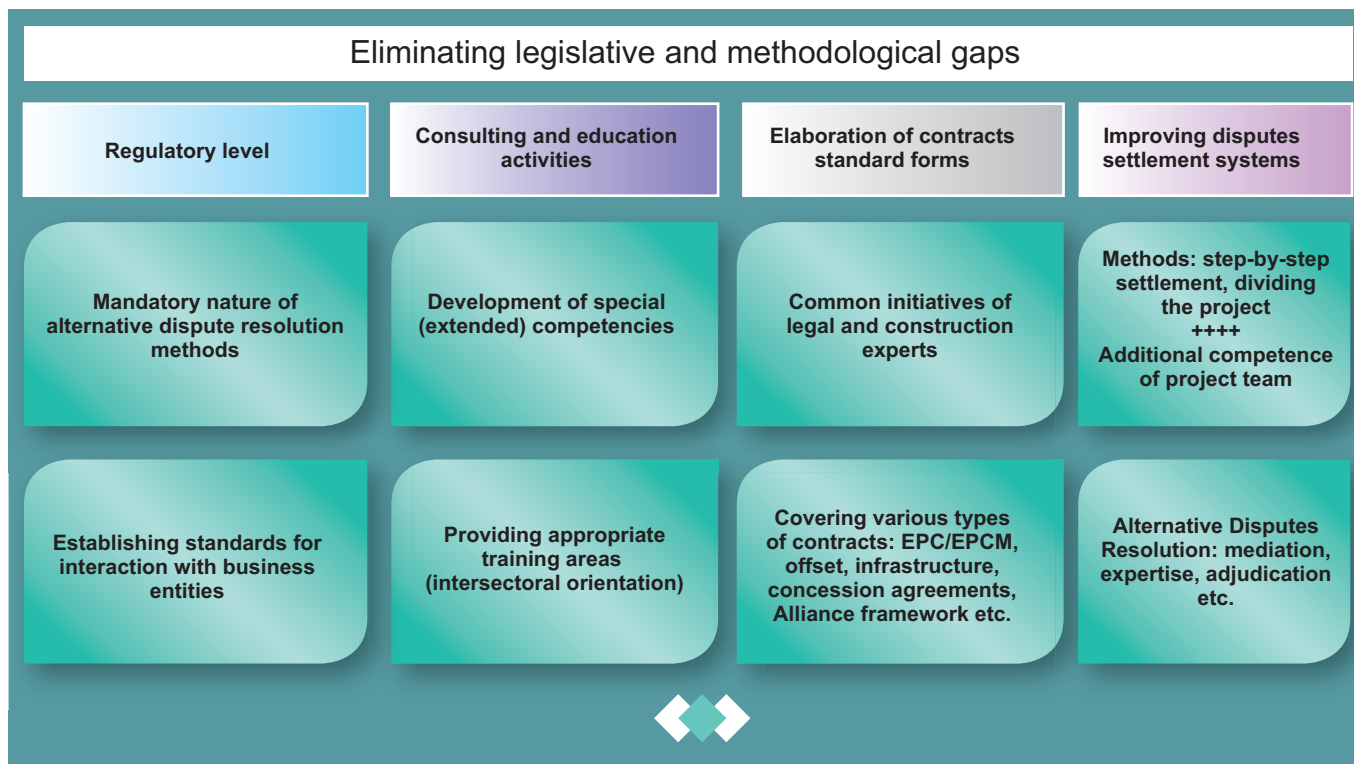


Fig. 2. Levels and directions of efficient approaches development

**RESULTS**

Adoption of measures at various levels will ensure the effectiveness of mediation approaches in the process of project delivering.

As mentioned above the cost-effectiveness evaluation involves structuring the *costs of litigation* (taking into consideration the amount of the claim, approximately — 9–10 % of this amount):

- litigation fee (which depends on the value of the claim). In accordance with the recent reform in the Russian Federation, the amount of such fees has significantly increased, it creates an important incentive for the parties to use out-of-court settlement;
- expenses for conducting a construction expertise focusing on economic, technical, financial, value assessment and examination;
- expenses for the services of a representative (legal assistance).

*Indirect costs* are mostly related to time period.

As a practical example, a case on recovery of debt under an agreement on payment of monetary compensation to the owner of engineering networks and structures (compensation for all losses caused by the elimination of gas networks on the land plot) can be considered.

These actions are necessary in the case of construction of facilities on the land plot if there is a need to take measures in relation to engineering networks and structures. The peculiarity of such disputes is the dependence of issuance of a permit for commissioning of the facility on the actions of the owner of the said networks to execute the act of liquidation. In addition, a procedural feature of similar cases is the need (in some cases) to initiate a forensic expert examination to establish the actual cost of the work performed.

Payment for work performed is based on actual costs incurred and the compensation amount specified in the contract is

provisional and cannot be used for final calculation of the cost of work.

In practice, the parties may disagree as to the interpretation of the terms of the agreement concerning the determination of the price of the work: the defendant may believe that the initially determined price is approximate and subject to adjustment in relation to the actual costs incurred in performing the work, while the plaintiff may believe that the price of the work is not subject to adjustment unless the scope of work agreed upon by the parties is changed.

If we consider the ability of such disputes to be mediated, it is clearly present, both in terms of mediation itself, which allows to agree on the value of the work performed, and out-of-court expert examination (which also belongs to alternative dispute resolution methods) in order to determine the actual scope of work performed and its value [12]. Moreover, such disputes often point to inconsistent behavior of a party to the dispute, including requests to take measures to fulfill obligations and readiness to make a final settlement.

In practice the total duration of such disputes may be about two to three years. Even in case of winning the dispute it is necessary to take into account *inflationary processes*, which for three years can amount to — 28 %.

Thus, even in the event of winning the case (although, as noted above, in such disputes the results of the forensic construction expertise are decisive), given the length of the trial, there are substantial losses due to inflationary processes.

As for mediation technologies, disagreements concerning the amount of compensation to the owner of engineering networks and structures (compensation of all losses caused by the liquidation of gas networks on the land plot) can be settled both within the framework of judicial mediation and out of court. In the first case — the plaintiff's savings would amount to 70 % of the litigation fee (in case of conclusion of a settlement agreement (conciliation

agreement) before the decision of the court of first instance, this amount is subject to refund to the plaintiff). And, in addition, time savings would have been achieved (even taking into account the expert examination) [13].

In the second case, the costs could be associated only with the negotiation process with the participation of a mediator and, if necessary, with out-of-court expertise.

Thus the analysis shows that the use of alternative dispute resolution methods is the most preferable way out of a conflict situation, and at the earliest stages. Thus, in practice there are cases of conclusion of amicable agreements after a considerable period of time (for example, almost 2 years) after filing a statement of claim and after the case has passed all the court instances. Undoubtedly, such time costs seem unreasonable in view of the above factors.

## CONCLUSION

Current development priorities require a significant revision of approaches to conflict reduction in the construction industry. The use of mediation approaches could have a significant impact on this process [14].

The conceptual approach to assessing the economic efficiency of out-of-court dispute resolution is based on the ratio of the costs of litigation and conciliatory procedures (such as project mediation and out-of-court expertise), taking into account such factors as the amount of litigation fees, the duration of proceedings, inflationary processes, fee exemptions and refund and type of a contract.

Analysis of the cost-effectiveness of dispute resolution using mediation approaches was carried out on the example of a dispute on debt recovery under the agreement on payment of monetary compensation to the owner of engineering networks and structures (compensation for all losses caused by the liquidation of gas networks on the land plot). Thus, litigation costs amounted to more than 9 % of the claim amount. In addition, indirect costs related to the time resource lead to depreciation of the claim amount for the plaintiff (due to inflationary processes). The calculation made (taking into account the average duration of the trial) showed a loss of 30 % and a long stay in the conflict. Thus, even in case of winning, court proceedings without the use of mediation technologies at the early stages (referral to conciliation rooms) is not an effective way to settle disputes.

Despite the obvious potential of mediation approaches, there is currently a clear lack of measures aimed at their development, and therefore levels of adoption are outlined: legislative enshrinement, regulatory and consulting activity, sphere of education, the structure of contracts [15].

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## Концептуальный подход к оценке экономической эффективности внесудебного разрешения строительных споров

Статья посвящена потенциалу примирительных механизмов как неотъемлемого компонента реализации инвестиционно-строительных проектов с точки зрения внесудебного разрешения споров, с учетом их разнообразия и наличия публичного элемента. Подчеркивается основная цель медиативных подходов — снижение конфликтной составляющей как в экономической деятельности в целом, так и в строительной отрасли. Представлен концептуальный подход к оценке экономической эффективности внесудебного урегулирования споров, раскрывающий уровни внедрения указанных подходов (за-

конодательное закрепление, консалтинговая деятельность, сфера образования, модификация контрактных конструкций) и структурирующий затраты на судебный процесс: судебные издержки, расходы на проведение строительной экспертизы, направленной на экономическую, техническую, финансовую, стоимостную оценку, расходы на услуги представителя (юридическую помощь) и косвенные расходы, которые в основном связаны с временными издержками. Кроме того, выделены существенные факторы, влияющие на оценку экономической эффективности: размер судебных издержек, длительность разбирательства, инфляционные процессы, освобождение от уплаты и возврат государственной пошлины, а также тип контрактной модели. В статье сделан важный вывод о том, что даже в случае выигрыша спора в суде без использования медиативных технологий на ранних стадиях (направление в комнаты примирения) судебное разбирательство не являет-

ся эффективным способом урегулирования разногласий. Полученные выводы и результаты могут способствовать развитию конструктивного партнерства при реализации проектов и принятию превентивных мер для существенного снижения уровня конфликтности в инвестиционно-строительной сфере.

**Ключевые слова:** согласительные механизмы, внесудебное разрешение споров, экономическая эффективность, медиативные подходы, затраты на судебное разбирательство

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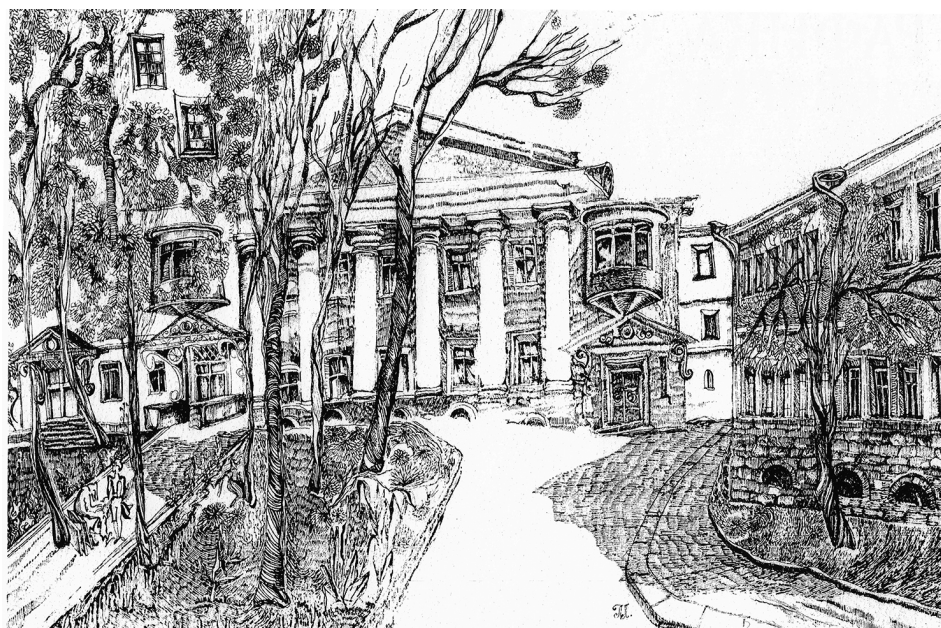
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