

Dispute perspectives

Delay claims: Damage quantification
in construction sector





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From the editor's desk

Dear Friends,

It is our great pleasure to introduce to you our inaugural issue of *Dispute Perspectives* – a monthly newsletter that will provide you with a focused analysis on ongoing trends and events in dispute resolution in India.

This is one among many new initiatives that we have launched to partner with associates like you in creating a vibrant forum to discuss issues related to dispute resolution in India.

Each month we will endeavour to provide one article of topical interest and snippets of information in the field of dispute resolution. In this inaugural newsletter, we have dealt with delay claims arising out of disputes in the construction sector and quantification of the damages.

We, of course, look forward to hearing from you. I believe that we should be able to assist you or at least guide you in your pursuit of finding the most efficient and effective way to resolve disputes.

Should you have any questions, concerns or suggestions for future topics, please feel free to write to us.

Warm Regards,



Vidya Rajarao
Leader, Forensic Services

Background

Over the past few years, India has been in an unparalleled phase of growth and today, she is the second largest growing economy in the world and **construction** has been the **second largest economic growth activity** after agriculture. During the Eleventh 5 Year Plan (2007-12), the Planning Commission of the Government of India had allocated USD 500 billion for the infrastructure sector.¹ Growth of infrastructure was essential to improve other aspects of the economy. For the Financial Year (FY) 2011-12, the allocation made by the Finance Ministry was USD 43 billion, an increase of 23.3% over the last fiscal year.² The contribution by the construction sector to the Gross Domestic Product was 8.1% during the last FY.³

In the current FY, real estate investments are expected to account for the maximum in the construction sector and expansion will be more in the Tier 1 and 2 cities. Although we find increased investments in the development of infrastructure, there are infinite complexities that make this industry more sensitive to disputes.

Issues with the Indian construction sector

The Indian construction sector is highly fragmented. This is partially due to the reason that though the construction projects are known for their long gestation periods, there are no long-term contractual relationships between the contractor and the owner. Further, many projects are not completed within the agreed timelines due to various reasons which may vary from changes made by the project owner to improper planning by the contractor. The delay in completing a project gives rise to disputes between the parties and the project is left unfinished till a resolution is arrived at. This would mean locking-up of substantial funds, loss to the Government/corporate and non-availability of infrastructure to the general public.

There arises the need for an expert to assist the parties in resolution of disputes as quickly as possible.

¹ Article published on Constructionupdate.com by Mr. Sandeep Sharma, Executive Director/Project Reporter in April 2011 (<http://www.constructionupdate.com/News.aspx?nid=Aqu1fWqlyOZ4Z7BX8vAFYQ==&NewsType=Construction-Sector---Opportunities-Unlimited-India-Sector> – Accessed on February 7, 2012)

² Article published on equitymaster.com on December 21, 2010 (<http://www.equitymaster.com/research-it/sector-info/construction/> – Accessed on February 7, 2012)

³ Article published on indiamart (SME News) on September 1, 2011 (<http://news.indiamart.com/story/contribution-construction-sector-gdp-remain-below-8-says-asso-cham-study-145965.html> – Accessed on February 7, 2012)

Classification of delays

To determine the quantum of delay claim in a project is based on the nature of the delay, which can be classified as below:

Type of Delay	Description	Claim for damages
Excusable	Extension of contract period is justified	Available
Non-excusable	Extension of contract period is done at the risk of the party extending the time	Not Available
Compensable	Additional compensation for costs of delay with/without additional time for contract completion	Available
Non-Compensable	No compensation for delay costs	Not Available
Critical	Delays which affect the performance and extend overall project completion time	Available
Non-Critical	Delays which neither affect the time for project completion nor warrants a compensation	Not Available
Concurrent	Where a delay occurs, setting back the completion date from what was originally agreed in the contract, due to two or more events which each delay the progress of works. One is caused by the contractor and another by the employer.	Available subject to segregation of delays caused by each party

Delay claims

The claims that may arise on account of delay include:

#01 Cost of idle labour and machinery

#02 Unabsorbed overheads

#03 Increased material prices

#04 Loss of Profits
(This is dealt with separately since it is a very important aspect of damage claim)

Valuation of delay claims

Valuation of a delay claim is the substance of dispute resolution. Some of the aspects which are considered for valuing delay claims, *inter-alia*, are:

#01 Substantial Completion: It is a significant event in the performance of contract work and is very important in evaluating delay claims. The factors that are considered for this purpose are extent of defects in the work, ease in correcting the defects.

#02 Liquidated Damages: When a party seeks to claim liquidated damages, they should calculate the same when substantial part of the contract is not completed even after the expiration of the contract period and without waiting for the completion of the project. There can be no claim for liquidated damages if it is an excusable delay, as the other party would then raise a counter claim for acceleration in cost

#03 Concurrent Delay Claims: When there are concurrent delays occurring in a contract, the party claiming for delays has to classify the concurrent delays as excusable and non-excusable delays that occurred on account of his actions and that of the other parties, in order to get the damages. Otherwise the Courts may not award damages for concurrent delays.

Methodologies for valuation

A review of available information regarding resolved international arbitration cases reflects numerous approaches to determining damages. Often international arbitrations and investment treaty disputes involve determination of damages based on Fair Market Value, particularly as tribunals become more sophisticated regarding valuation theory. The valuation methods employed to determine Fair Market Value include:

#01 economic valuation methods based on the Discounted Cash Flow (“DCF”) method;

#02 market comparables method based on the value of comparable companies or assets; and

#03 intrinsic value or asset based method.

A thorough understanding of the elements of the methodologies as well as their underlying limitations is of immense value to choose the right methodology for a dispute.

Where experts’ services are required?

Not all arbitrations need an expert. It has to be decided on a case to case basis. An expert can overcome the shortcomings of using an internal person, such as inexperience, lack of industry knowledge and independence, lack of requisite skill. Some of the critical areas where an expert’s service would be required are:

#01 Classifying delays and claims thereon

#02 Quantifying damages arising in a dispute

#03 Providing objective opinions on technical, financial and legal matters requiring specialized knowledge or expertise

#04 Probing into the counter party’s documents and facilitating a critique of the counterparty’s position

#05 Issuing expert report in arbitration

#06 Providing an educated testimony before the Arbitral Tribunal

Being pro-active

“Time is money”. When the parties to a contract are pro-active while entering into a contract itself, it can save a lot of time and money by reducing disputes or the dispute resolution time. The following points can be considered for inclusion in the contract:

- Listing down in the contract the items or scenarios under which one party can make claim on account of delay by the other party
- When the performance is in process and any delay occurs, notifying the party causing the delay, seeking reasons thereof, expected costs that would be incurred during the delayed period
- Agreeing upon the expert who would determine claims arising out of delays
- Agreeing upon the Arbitration Panel

News Snippets

#01 Difference of opinion on arbitration law

At a hearing in the third week of January 2012, on a dispute over the termination of a works-contract by the Madhya Pradesh Government, two judges of the Supreme Court differed on the application of the Arbitration and Conciliation Act. The High Court had held that the dispute should be resolved by the Central Act and not the State Act. The difference arose between the bench on whether the dispute relating to works contract should be resolved by the Madhya Pradesh State Arbitration Tribunal or under the Central Act.

(Related article was published in Business Standard on January 30, 2012 under the heading “SUPREME COURT JUDGES DIFFER ON ARBITRATION LAW”, accessed on February 8, 2012 on the following link <http://www.business-standard.com/india/news/sc-judges-differarbitration-law/463169/>)

#02 India may not be a party to international disputes between private parties

The present bilateral trade pacts allow a foreign investor to sue the Government of the host country in an international dispute. The department of industrial policy and promotion (DIPP) has in principle decided not to include such a condition when a review of this clause under the trade pacts is taken up. The reason given by the DIPP official is that the State should not get drawn into private disputes. However, the finance ministry is not in favour of DIPP's view and a finance ministry official quoted “With the growing clout of Indian companies investing in countries around the world, including the less stable countries in the African and South American regions, they need the protection of the local Governments. So, we are not in favour of reviewing this clause.” There are various views amongst the critics and advocates regarding the issue.

The DIPP official has said “When there is an international obligation, you cannot change it unilaterally. At the time of review of such pacts, which is a routine affair, we will definitely want to correct it.”

(Related article was published in livemint.com on January 29, 2012 under the heading “INDIA MAY EXCLUDE CLAUSE ON LAWSUITS FROM TRADE PACTS”, accessed on February 8, 2012 on the following link <http://www.livemint.com/2012/01/29231517/India-may-exclude-clause-on-la.html>)

#03 Controversy continues on foreign arbitral awards

The controversy over the decision in the case of Bhatia International v. Bulk Trading S.A. has again come before the Supreme Court in the case of Bharat Aluminium Co. vs. Kaiser Aluminium Technical Services Inc. A five-judge constitutional bench of the Supreme Court comprising Chief Justice S.H. Kapadia, justices D.K. Jain, Surinder Singh Nijjar, Ranjana Prakash Desai and J.S. Kehar began the hearing on January 10, 2012, of a large batch of petitions on the jurisdiction of Indian Courts over foreign arbitral awards under the Indian Arbitration and Conciliation Act, 1996.

One side is in favour of the jurisdiction of Indian Courts over foreign arbitral awards while the other side wants international arbitration to be free from domestic judicial intervention.

The decision of the Supreme Court is being awaited greatly as the apex court was previously criticised for diluting the independence of arbitral tribunals and taking away the meaning of alternate dispute resolution.

(Related article was published in livemint.com on January 10, 2012 under the heading “SUPREME COURT BEGINS HEARING ON FOREIGN ARBITRAL AWARDS”, accessed on February 8, 2012 on the following link <http://www.ongo.com/v/3028608/-1/4015BC8ACFF1B88/supreme-court-begins-hearing-on-foreign-arbitral-awards>)

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