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AGREEING TO DISAGREE: Contract Clauses and Proactive Strategies for Resolving Disputes

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INTRODUCTION

We cannot solve our problems with the same level of thinking we used when we created them.²

The promise of Alternative Dispute Resolution (“ADR”) is that it offers creative and practical ways to think differently about resolving disputes. This paper advocates a creative and practical approach for avoiding disputes in the first place, and further advocates for having effective mechanisms in place to solve disputes, through alternatives to an adversarial approach, when they can’t be avoided. What follows has been written:

- to illustrate dispute avoidance techniques;
- to illustrate the fundamentals of ADR and to illustrate what aspects of ADR are relevant to the construction industry;
- to illustrate the types of construction disputes best resolved by ADR; and
- to illustrate the effective existing practices in setting proactive strategies and for the use of ADR contract clauses.

The traditional adversarial approach to conflict resolution does little to repair and preserve damaged relationships between the parties.³ It has been said that rights-based talk and rights-based solutions (described in the literature as zero-sum or win/lose outcomes) do little to fix the underlying problem: “if you fix the problem and not the blame, then no one gets the blame”. This resonates in construction disputes as owners, consultants and contractors have to deal with each other not just during the entire life of the contract, but potentially on future projects as well.

² Attributed to Albert Einstein.

³ Trial can be a considerable ordeal. In *Foundation Co. v. United Grain Growers Ltd.*, (1995), 25 C.L.R. (2d) 1 (BCSC) the parties endured a marathon 99 days of examination for discovery and 132 days of trial spending approximately \$5 million in legal fees to distribute \$1.6 million plus interest worth of construction claims among themselves.

ADR runs the gamut of negotiation, partnering, mediation, conciliation, expert determination, mini trial, and arbitration.⁴ The idea that ADR is about imagination and creativity helps bring a new perspective to resolving construction disputes. An approach to dispute resolution that is exploratory and sharing (rather than adversarial) makes sense, particularly where the objective is preserving an ongoing relationship.

Contract templates drafted by the Canadian Construction Documents Committee (CCDC)⁵ have provisions for mandatory mediation and arbitration. Are these systems regarded by the participants as producing a fair process and durable outcomes? What is the interplay between power relationships and dispute system design? Will ADR create more delay and force nuisance settlements as rights are ignored in construction disputes? On the other hand, will ADR achieve the promise of less costly, more timely and more durable outcomes in construction disputes?

The evolution of ADR in construction began with arbitration. Arbitration, however, has lost a certain degree of flexibility in its process that was one of its greatest advantages over litigation and is not now really regarded by clients as an alternative. Its variant forms were mainly intended to provide faster and commercially oriented outcomes, usually through the use of recognized experts as the arbiters.⁶ A quick decision may not be as critical in certain circumstances where the dispute (and its settlement cost) can be deferred until later. However, the benefit of the early resolution of disputes prevents the breakdown of an ongoing relationship.

⁴ Informal and formal practices to resolve disputes include negotiation, mediation and arbitration, the use of dispute resolution boards (formal dispute resolution tribunals), Geotechnical Design Summary Reports (baseline geotechnical studies), Escrow Bid Documents (where bid documents are sealed to later prove contractor's extra claims are legitimate). See for example, Paul Sandori "Alternative Dispute Resolution" (1993), 18 C.L.R. (2d) 231.

⁵ For example, CCDC 2 (1994) and CCDC 2008.

⁶ Kerry Short "What Alternatives are there to Litigation for Construction Dispute Resolution?", (1988) 8 C.L.R. 213 writes a brief early Canadian article on alternative approaches to litigation. He astutely points out the evidentiary value of a mediation/arbitration (alternative process) as a step prior to litigation makes subsequent court challenge an "uphill battle".

In this paper, I analyze how ADR processes work in construction disputes and how dispute process design aimed at early intervention can achieve savings of time and money⁷ by way of speedy and informal settlement of disputes, tailored resolutions, increased satisfaction and the restoration of common values. I further suggest that to ensure a business relationship benefits from ADR processes contracts should be proactively and effectively tailored towards the use of such mechanisms.

HOW CONSTRUCTION DISPUTES ARISE

The construction industry has unique management problems. Construction of a new structure is a project based operation. Each project tends to be one-off. Each participant (architect, engineer, contractor, supplier) is interdependent, although linked in ways specific to each project.⁸

Since construction disputes are caused by many different factors, there may be a concern whether dispute resolution processes have the ability to deal with them. How do you deal with the bully, the staller, the deep pocket, the empty pocket — various parties with different power dynamics — in construction disputes.⁹ The ten principal causes of construction disputes have been identified as:

1. unrealistic shifting of risk under the contract;
2. unrealistic expectations, particularly under financed owners;
3. ambiguous or incomplete contract documents;
4. unrealistically low bids;
5. poor communication between project managers;

⁷ The current insistence on legal rights may have extinguished the leap of faith necessary for durable solutions. When we disclose interests and values, aren't we acting in a way contrary to self-interest? One answer may be that the paradigm of rational self interest is too narrow and excludes a fundamental notion of "good faith" that informs human behaviour.

⁸ Ron Hellard, *Project Partnering: Principle and Practice* (London: Thomas Telford, 1995).

⁹ For every one way to speed up a case, there are ten ways to slow it down. "If someone wants to stonewall, its far easier to stonewall in arbitration than it is in a lawsuit, and its not too hard [to stonewall] in a lawsuit sometimes . . ." Robert Jenkins, construction litigator, in a panel discussion in 1991 reported in "Construction Litigation: Tips from the Experts" (1994), 4 C.L.R. 294 at p.299. The consensus view of the panellists was that ADR in a multi-party/multi-issue dispute may well not be the best route. Case managed litigation was their preferred option.

6. inadequate management;
7. failure to deal promptly with change;
8. lack of team spirit or collegiality among participants;
9. an adversarial or litigious mind set;
10. failure to assume responsibility for dispute resolution at the source.¹⁰

Surveys have shown that disputants in construction disputes rank the saving of money as the most important reason to use ADR, although the saving of time and producing a better outcome are also important.¹¹ This is true of partnering too. Savings of time and cost by preventing disputes will likely be the principal reason for clients to choose partnering.¹² Part of the reason for this is the immense factual investigation required and its attendant cost.

Another feature of construction contracts thought to affect the number and seriousness of disputes is the separation of design and building functions. Construction projects have other dispute promoting factors. Contractual documents are often standardized forms that aren't tailored to the specific project, creating interpretive gaps. The inherent unpredictability and complexity of modern construction projects creates unforeseen risks.¹³ Unfair risk shifting may well be the most avoidable source of many disputes.

¹⁰ Darrick Mix, "ADR in the Construction Industry: Continuing the Development of a More Efficient Dispute Resolution Mechanism", (1997) 12 *Ohio State J. on Dis. Res.* 463 at p.463, and Gail Forsythe, "The Revised CCDC 2: Negotiation and Mediation of Construction Disputes", (1995), 18 C.L.R. 240, at p.252, note 26. Both authors cite a survey of attendees at the U.S. Construction Industry Institute Annual Conference, (1991). The survey is also reported in "Preventing and resolving Construction Disputes", 9 *Alternatives to High Cost Litigation* 182 at p.185.

¹¹ Deloitte & Touche Litigation Services 1993 Survey of General and Outside Counsel, cited in Forsythe, *supra*, at p.254 notes 44 and 45. In British Columbia, cost and delay have been described as the "twin evils of cost and delay". Bonita Thompson, "There Must Be a Better Way", (1989), 32 C.L.R. 74, at p.77. In the Deloitte & Touche survey it was reported that fewer than 50% of general contractor's counsel recommended ADR tending to show opposition to alternative procedures such as partnering, which leaves out attorneys. Rob McManamy, *Industry Pounds Away at Disputes*. ENR, July 11, 1994, at p. 24.

¹² Although partnering also tends to lead to safer projects with fewer days lost to job site injuries and accidents, and improved communication makes value engineering more likely.

¹³ Plottel, *supra*, at p.48. Plottel also says "that no contractor will overlook a dispute that will mean his bankruptcy" Conversely, owners and contractors will act rationally and not pay when it "pay[s] not to pay". This defers the early resolution of disputes. Mix, *supra*, at p. 463.

The nature of construction contracts also creates potential conflicts of interest. For example, the contractor may be incentivized to maximize profits by minimizing project performance, contrary to the interest of the owner to maximize performance at the least cost.¹⁴ Alternative project delivery methods can be used to address any such concern. The project design consultant is called upon to administer the contract and their own design in a fair and unbiased manner, but may be biased towards the owner. Effective construction contracts try to manage the allocation of risk among the parties, minimizing the risk of disputes.¹⁵ Effective partnering can address competing interests by attempting to align the contractor's, the owner's and the consultant's interests into common project goals.

THE KEY TO ADR

In my view, all successful ADR mechanisms must be transformative in some way.¹⁶ The objective is to ensure real communication and understanding. I suggest that this means the disclosure of true interests and values.¹⁷ Real communication and understanding, at the very least, reduce problems of *selective perception* — the problem of people forming and holding quickly reached judgments, then filtering out contradictory information.

Some aspects of ADR may seem counter-intuitive: for example, *process* (and therefore dispute process design) is more important than *substance*. Since ADR aims to achieve consensus, those responsible for the decision participate in it, and are responsible for the follow up. While not

¹⁴ “The tendency for both owners and contractors to assume an adversarial posture with each other is based on the inherent conflict between owner’s costs and contractors’ profits. This is essentially a zero-sum game in which one party’s gain is the other party’s loss”. Erik Larson, “Partnering on Construction Projects: A Study of the Relationship Between Partnering Activities and Project Success” (1977) 44 *IEEE Transactions on Engineering Management* (No. 2) 188 at p. 188.

¹⁵ Allen, *supra* at p. 22.

¹⁶ It is a truism that when parties come together in an ADR process they have often taken the difficult first step of having been able to agree on something. The fundamental insights of Fisher and Ury in *Getting to Yes* assist in transforming conflict: (a) separate the people from the problem (b) look behind the position to the interests of the parties (c) examine ways those interests can be addressed (d) create options for mutual gain.

¹⁷ For example, partnering is said to be based on effective communication, advance planning and co-operation among the participants to a construction project. It involves a “shift in attitude”. Gail Forsythe “Partnering: Effectively working together to Minimize and Resolve On Site Disputes” (1993), 18 C.L.R. (2d) 142 at p.143.

everyone may agree with the result, at least no one opposes. The effect of power reversal adds to the sustainability of any compromise. The winner is responsible for the loser, promoting a shared commitment to fix the problem, not the blame.

Another counter-intuitive aspect of ADR is to manage the power relationships between the parties. Usually, power relationships between parties to the dispute are viewed as fixed.¹⁸ It has been suggested that by viewing power instead as fluid (a changing dynamic between disputing parties), any perceived power inequality can be affected and changed. By choosing one dispute resolution process rather than another, by controlling information flow, and by identifying the parties' underlying interests, counsel and the third party intervener can move the conflict towards resolution.

Even though an attempt at ADR is required in all civil cases in Ontario and in other provinces, and in most CCDC contracts (when they are actually signed), I believe it will not gain wide-spread acceptance unless it saves parties both time and money. While traditional rights based litigation will continue to fail to deliver a solution that repairs ongoing relationships — it will be the promise *and delivery* of savings of cost and time, and the perception of the better administration of justice that will increase the use of ADR.

¹⁸ Power is real and complex. In process design, fiddling with the power dynamic through varying degrees of intervention (i.e. parties alone, parties with counsel, third party negotiator, third party mediator, third party arbitrator, judicial decision maker) can create opportunities for resolution. This in turn raises ethical and strategic questions if some of the design is not done by the parties, but instead by the intervener. If the parties are to participate in the process, and the process is to be transparent to the parties, what degree of disclosure is required of the third party intervener as to what he or she is really doing, or should be doing? Further, mediation and arbitration are chosen often precisely because they are private and confidential. In theory, disclosure and publicity are the touchstones of the court process culminating in the fulsome, written and publicly expressed reasons for decision at the trial by the trier of fact (at least when the trier of fact is a judge). It is interesting that juries are not compelled by fairness or natural justice to give reasons. A whole host of studies suggest we would be shocked to learn what really persuades and motivates juries. Here is a related thought: maybe disclosure, but not publicity, helps resolve disputes. Is a private process better than a public process in some cases? Why?

PARTNERING AS A DISPUTE AVOIDANCE TECHNIQUE

Participants in a construction project define and limit their rights and obligations with each other using traditional contract notions of risk allocation.¹⁹ The general rules of contract formation apply together with usual rules of contract interpretation. The idea of “partnering” is a procedural overlay to the contract that has dispute prevention as its goal. This concept arose because players in the construction industry were becoming increasingly frustrated with the cost and delay associated with other means of dealing with disputes, the defensive attitudes, and the lack of cooperation that results.

Partnering can be regarded as an innovation or a new name for traditional principles of cooperation and trust. Partnering can be single project or multi project partnering. From a lawyer’s perspective reduced to its practical essence, partnering means that the contract parties get together at the beginning of a job, identify common interests and agree on procedures to expedite resolution of problems that are likely to arise.²⁰

The usual procedural elements of partnering involve a preconstruction workshop, a problem-solving escalation plan, a partnering charter or mission statement, and continuous evaluation of whether the goals and objectives are being met. The idea of the pre-construction workshop is to introduce parties to each other, and to identify their expectations and mutual objectives. The problem-solving escalation plan is an agreed procedure where conflicts will be escalated stepwise to pre-designated higher representatives of each party. The partnering charter or mission statement is supposed to be a non-binding document committing each party to the goals and procedures of partnering for the project. Author and practicing construction litigator Justin Sweet has described the process component as follows:

Partnering is more of a pre-contract and performance process than a contract for a building project.

A legal partnership is a legal entity in which people join together and share profits and losses. But I

¹⁹ “As far as the law of contracts in general is concerned, building contracts as such do not possess any esoteric characteristics which distinguish them from other forms of contracts, and they merely represent one particular species of the genus of contracts as a whole.” Immanuel Goldsmith and Thomas Heintzman, *Goldsmith on Canadian Building Contracts*, 4th ed. (Toronto: Carswell, 1988).

²⁰ Douglas Oles “Partnering on Construction Projects,” *The National Construction Law Round Table 1996*, (Aylmer, Quebec: Canadian Bar Association, 1996) at p. 3.

am talking about not the noun of a partnership but the general verb built, ungrammatically from the noun. The process seeks to reduce or even eliminate the adversarial mood created in the traditional method of contract. Such a mood can be harmful to the cooperation needed to have a successful construction project. Partnering is an attempt to get key personnel together to realize that, while they are not partners in a technical sense, they are partners in the sense that each one is relying to a degree upon the other for economic success.²¹

Some years ago, it was said that the Canadian construction industry has not embraced partnering as fully as it ought to because of concerns that it will change legal obligations. Lawyer and partnering facilitator Gail Forsythe states:

Members of the Canadian construction industry may have misconceptions about partnering due to a lack of familiarity with the concept. For example, Partnering does not change the legal obligations under the contract nor does it involve a rewriting of the contract. Partnering does not involve a sharing of risk or profit. Partnering is merely an attitude based upon good faith; it is not the legal relationship that I know as a “partnership”.²²

Project neutrals, referees and dispute review boards can be hired as autonomous observers appointed by the parties to provide expeditious and on-site consideration of a dispute. This can help prevent the problem from escalating, and takes the dispute out of the hands of those on the job who may be too close to the problem. The cost of hiring neutrals is usually a fraction of the cost of full-scale litigation or arbitration. The neutral has the opportunity to actually observe the construction problems when they occur, which saves having to reconstruct events after the fact.

²¹ *Sweet on Construction Law*, p.99-100. Justin Sweet’s book is a good overview of construction law, written in an alternative style. It self-consciously omits footnotes. In his chapter on Dispute Resolution, Sweet makes the point that “perhaps too much energy” is devoted to thinking about dispute resolution, and not enough about dispute prevention. How are disputes to be avoided? How can we help parties resolve them? If a third party must be brought in, who do we bring in and what process do you use? Sweet, *supra*, at p.441.

²² Forsythe, *supra*, at p. 144 I believe partnering *does* have legal significance in that it brings with it implied duties of good faith and fair dealing which, in my view, may be part of contract analysis as it is developing in Canada anyway. However, I also agree with Forsythe that partnering does not and should not be interpreted as importing the traditional rights and obligations of “partnership.”

Partnering represents a change in attitude to “foster a nurturing environment that promotes risk sharing.”²³ There is an agreement in principle to share the risks involved in completing the project, and to establish and to promote a non-adversarial environment.

DOCTRINE OF GOOD FAITH AND FAIR DEALING

The origin of modern contract law both in the United States and Canada is the English law of contract.²⁴ An important feature of classical contract theory is the development of a general body of contract law that overshadows the various branches of specific contracts. Classical contract law embodies a number of features (the absence of pre-contractual duties) that offer considerable advantages to the powerful and knowledgeable while posing substantial right to the ignorant and the unwary.²⁵ The doctrine of good faith provides an important tool for the control of contractual terms and their application. English judges seem reluctant to import notions of good faith into negotiation.²⁶ Lord Steyn has suggested that while business people have no problem with the concept of good faith or fair dealing he suggests that there is not much difference between objective requirements of good faith, and the reasonable expectations of the parties.²⁷

²³ Sandori, *supra*, at p. 238

²⁴ Jack Beatson and Daniel Friedman, “Introduction: from ‘Classical’ to Modern Contract Law in Good Faith and Fault in Contract Law (Oxford: Clarendon Press, 1995) at p. 3.

²⁵ Beatson and Friedman, *supra*, at p. 11.

²⁶ RT. Hon. Lord Steyn, “Contract Law: Fulfilling the Reasonable Expectations of Honest Men” (1997), 113 *Law Quarterly Review* 433 at p. 438. “The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations” per Lord Ackner in *Walford v. Miles* [1992] 1 All E.R. 453 at p. 460. More than that, traditional contract analysis fails to capture the grey area. Traditional rules of contract formation and the desire of certainty over flexibility leave “no room for the norms and remedies that gradually increase in intensity as the relationship between the parties grow”. See also Cassels, *supra* at p. 76.

²⁷ The impetus to consider whether good faith ought to be brought more squarely into English law is the coming European economic union. Principles of European law (civil codes) require that parties must negotiate in good faith, conclude contracts in good faith, and carry out contracts in good faith. In exercising rights and performing duties each party must act in accordance with good faith and fair dealing. Further, the parties cannot contract out of this duty in civil law systems. Lord Steyn, *supra* at p. 438, citing *Principles of European Contract Law, Part I: Performance, Non-performance and Remedies*, prepared by the Commission on European Contract Law, ed., Landon and Bobeal (1995), art. 1. 106 at p. 53.

The expression “good faith” makes frequent appearances in contract law.²⁸ However, good faith can be used in different contexts with different meanings.²⁹ Good faith is a concept capable of both enlarging and restricting contractual obligations.

One of the problems with good faith is that it is a vague concept. It may be easier to articulate what good faith *is not* than what it *is*, which may provide little guidance to parties seeking to arrange their affairs. Prof. Brownsword³⁰ favours equating good faith with honesty and fair dealing judged by the standard of ordinary people in their practical experience. Importing good faith is going beyond preventing active deception. It may be contrary to good faith not to disclose important information. There is a legitimate criticism that substituting a standard of fair dealing may upset the supremacy of contractual intention. Only such terms as can be confidently attributed to the parties’ unstated intentions are usually implied.

Discussions of good faith and fair dealing are emerging in the case law and still await resolution by the Supreme Court of Canada.³¹ In the United States, the Uniform Commercial Code is explicitly based on the concept of good faith for contracts subject to it.³² There are both objective

²⁸ S.M. Waddams, “Good Faith, Unconscionability and Reasonable Expectations”, *supra*, at p.55.

²⁹ Waddams, *supra*, at p. 56. One example of good faith is the primary level of duty agents owe their principals. This is a not a concept of good faith that ought to be imported into partnering. Another point about good faith is that good faith performance and good faith enforcement of contracts can be distinguished. The idea of good faith performance is that contractual rights can’t be exercised, in some circumstances for motives of self-interest. See also David Friedman “Good Faith and Remedies for Breach of Contract” in Beatson and Friedman, eds., *Good Faith and Fault in Contract* (Oxford: Clarendon Press, 1995) at p. 400.

³⁰ *Good Faith in Contract: Concept and Context*. R. Brownsword et al., eds., Dartmouth Pub. Co. (1999). [O]nce we have to transpose the issue from the classical context of the discrete (spot) contract and short-term adversarial dealing to the context of longer term dealing with a willingness to invest in the future, it is a great deal more plausible to imply terms that involve some act of co-operation or sharing of risk — and, what is more, to do this from the basis that such implications are necessary if we are to be faithful to the parties’ expressed intentions and expectations. Brownsword, *supra*, at p.124.

³¹ Don Clark, “Some Recent Developments in the Canadian Law of Contracts” (1993) 14 *Advocates’ Q.* 435.

³² The Uniform Commercial Code (UCC), first published in 1952, is a uniform act that have been promulgated in conjunction with efforts to harmonize the law of sales and other commercial transactions amongst the United States of America. The UCC, in one or other of its several revisions, has been enacted in all of the 50 states. UCC Section 1-203 says: “every contract or duty within this Act imposes an obligation of good faith for its performance or enforcement”. Section 2-103 says: “good faith” means “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade”.

and subjective standards of good faith.³³ The possibility of contracting out of the duty of good faith remains open.³⁴ This would certainly be saying something meaningful to the party opposite (i.e. indicating that you do *not* wish to be fettered by duties of fairness and good faith in disclosure of information and performance of contractual obligations). Partnering must include notions of “full and frank dialogue”.³⁵ The American Law Institute’s Restatement of Contracts Second provides at s. 205:

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.³⁶

In the Canadian construction contracts, there has not been such a broad and explicit articulation of principle.³⁷ In *Kubota Canada Ltd. v. Merchant Private Ltd.*,³⁸ the court expressly

³³ Ross Landsberg and Peter Megens, “Applications of Good Faith in Contracting” (1996) *International Const. L. Rev.* 180 at 181.

³⁴ Although some U.S. authorities suggest good faith is not a contractual term that can be bargained out of. Chaisson, *supra*, at p. C16, and Chivers, *supra*. Further, O’Byrne, *supra*, argues (with reference to the Alberta *Opron* case) that all contracts subject to a standard of good faith that can be modified by the parties’ agreement. O’Byrne, *supra*, at p.94.

³⁵ Richard Turner, “Avoidance and Resolution of Construction Disputes — Prior to and During the Construction Process” (1997) July *International Const. L. Rev.* 384. Richard Turner a practicing lawyer in London and Dubai suggests that there should be a seamless integration of contract documents (first draft by the lawyer) with the plans and specifications (first draft by the design professionals) such that there will be “one consistent unambiguous document . . . free from the conflicts and gaps which so often lead construction projects to end up in disputes”. He sees what he calls the “continuing dialogue arrangements” which dialogue includes input from the lawyer and design professional as described in the “buzz word partnering”. Turner proposes that the contract expressly provide for the resolution of disputes during construction through a step approach (“tier approach”) with mediation or conciliation first followed by a binding dispute resolution method (expert, dispute review board). Arbitration or litigation would only follow after construction is completed.

³⁶ The Restatements of the Law are treatises on U.S. legal topics published by the American Law Institute as scholarly refinements of black-letter law. Although the Restatement of Contracts is still an influential academic work, the UCC has replaced the Restatement in regard to the sale of goods. “An explicit good faith and fair dealing requirement has been part of sales transactions for years, requiring ‘honesty in fact and the observance of reasonable standards of fair dealing in trade’. The Restatement goes further by requiring good faith and fair dealing in the performance of every contract.” Belobaba, *infra*, at p. 74 and n. 7.

articulated a general duty of good faith in contract in respect of contract performance and enforcement. In *Kubota* the court would not permit Tuckahoe to rely on *Kubota's* mistake and technical failure to give notice under a purchase option under which Kubota to mistakenly paid certain sums to Tuckahoe. Madam Justice Molloy broadly commented that the position taken by Tuckahoe did not accord with the principle of good faith dealings in contractual relations increasingly recognized by Canadian courts.³⁹

³⁷ Although notions of good faith and fair dealing inform the equitable doctrines of inequality of bargaining power, unconscionability and other equitable doctrines that justify the non-performance of contracts. General statements about good faith can be found in *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 2 SCR 574 where a plurality of the Supreme Court of Canada said the institution of bargaining in good faith is one that is worthy of legal protection where such protection accords with the expectations of the parties. Don Clark argues that the Supreme Court of Canada in *Houle v. Canadian National Bank* [1990] 3 S.C.R. 222 has found a duty of good faith in the exercise of contractual discretion between parties within an existing contractual relationship. Clark argues the court has affirmed a principle of good faith in both the civil law and common law traditions, Clark, *supra*, at p.436, Cassels, *supra*, p. 57 and p. 71.

³⁸ [1997] O.J. No. 2028.

³⁹ “The good faith requirement in contractual performance has long been recognized in certain species of contract [in Ontario]. For example, in *LeMesurier v. Andrus* (1986), 12 O.A.C. 299, 54 O.R. (2d) 1 (C.A.) . . . The approach may be merely an example of the development of an independent doctrine of good faith in contract law at least in the performance of contracts, one explicitly set forth in the American Uniform Commercial Code and in the American Restatement and exhibited, although perhaps in disguised form, in many English and Canadian cases — - see the lecture of Professor Belobaba, Special Lectures of the Law Society of Upper Canada (1985), [Belobaba, *supra*] . . . The *LeMesurier v. Andrus* decision has been extensively applied in cases involving contracts for the sale of land . . . Essentially, the courts have imposed upon parties a duty to act in good faith when invoking escape clauses in such contracts. There is no particular reason that this good faith requirement should only be imposed in contracts for the sale of land. If it is rooted in common law and equitable principles of fairness, and I believe it is, it should have equal application to all contracts . . .

“In *Opron Construction Co. v. Alberta* (1994), 151 A.R. 241 (Q.B.), Feehan J. found that the defendant in a construction contract had breached an implied covenant of good faith. In that decision, Justice Feehan traced the development of the principle as applied in a number of Supreme Court of Canada cases. In some of the earlier of these decisions the Court interpreted art. 1024 of the Quebec Civil Code as including the principle that each party to an agreement “owes good faith to the other, both in the manner of stating the agreement and in its performance”. Subsequently, the Court extended that principle to impose a duty to bargain in good faith arising at common law in a situation where this was in keeping with business morality and within the expectations of the parties: see *International Corona Resources Ltd. v. LAC Minerals Ltd.* (1989), 101 N.R. 239; 36 O.A.C. 57; 61 D.L.R. (4th) 14 (S.C.C.). Feehan J. applied these decisions as well as the Nova Scotia Supreme Court decision in *Gateway Realty Ltd. v. Arton Holdings Ltd.*, (1991) 106 N.S.R. (2d) 180; 288 A.P.R. 180 (T.D.) and the Ontario *LeMesurier* case in reaching the conclusion that there is a common law duty to perform a contract in good faith.

Adopting good faith and fair dealing doctrine is not so much to rewrite the general principles of contract law as a recognition that adversarial dealing is not the “only game in town”. For example, good faith in negotiations could mean an inquiry into the reasons for breaking off negotiations. There is an important difference between walking away from negotiations for any reason, and walking away for a reason that keeps faith with the integrity of the negotiating situation. The distinctive function of contract law is to secure the reasonable expectation that exchanges will be mutually beneficial.⁴⁰ Good faith and fair dealing in contract performance does not substitute for the parties’ bargain — it fills in the gaps. The parties can choose to engage in detailed planning, or substitute good faith at the margin.⁴¹

The implied duties of good faith and fair dealing could be invoked in Canada to rule out bad faith and non-cooperative conduct in certain circumstances such as:

[N]egotiating without serious intent to contract, abusing the privilege to break off negotiations, entering a transaction without intending to perform or in reckless disregard of prospective inability to perform, nondisclosure of known defects [in the subject of a sale], abusing superior bargaining power, evading the spirit of a transaction, lack of diligence, willfully rendering only substantial performance, and abusing the power to specify terms or to determine compliance . . . interfering with or failing to cooperate in the other party’s performance, pretending to dispute or arbitrarily disputing, adopting overreaching or “weaseling” interpretations or constructions of contract language, taking advantage of the other party’s weakness to get a favorable readjustment or settlement of a dispute,

“The good faith standard is by no means foreign to our system of law. Numerous statutes incorporate a good faith requirement and the concept is a familiar one in the areas of public administrative law, constitutional law and labour relations. Professor Belobaba makes a compelling case for using judicial language and norms which are understandable and relevant to the real world. “The explicit adoption of a good faith and fair dealing doctrine would go a long way to making contract law relevant to the community it serves. If nothing else, the economic rationale for such a doctrine is alone persuasive: a good faith doctrine would minimize transaction costs by acting as a gap filler and would thus relieve contracting parties of the need to make 100-page agreements for each and every transaction.”

⁴⁰ Brownsword, *supra*, at p.137.

⁴¹ The doctrine of fair dealing limits the exercise of discretion in invoking privilege clauses when rejecting low bid tenders and “bid shopping”. See *Ken Toby Ltd. v. British Columbia Buildings* (1997) 34 C.L.R. 81 (B.C.S.C) in British Columbia and *George Wimpey v. Hamilton Wentworth* (1997) 34 C.L.R. 123 (Ont. Ct. Gen Div.) in Ontario, with *MJB Enterprises Ltd. v. Defence Construction Canada* [1997] S.C.C.A. no. 245 still to be heard on these issues by the Supreme Court of Canada.

abusing the right to adequate assurances of performance, refusing for ulterior reasons to accept the other party's slightly defective performance, willfully failing to mitigate the other party's damages, and abusing a privilege to terminate contractual relations.⁴²

What may be striking about a judicial inclination to monitor the exercise of contractual rights for conformity to perceived standards of fairness or reasonableness, is the extent to which that may compromise certainty in favour of flexibility.

The explicit recognition of a good faith and fair dealing doctrine will enhance conceptual and doctrinal clarity. In a partnering context, it acknowledges what the parties are doing expressly anyway. It will add a healthy measure of doctrinal integrity to reasons for judgment and it will further the important realization that contract law and doctrine can on occasion align itself with the vocabulary and values of the people it serves. By making a good faith doctrine explicit the need for doctrinal manipulation is minimized and the needs of a real world community with heavy relational elements is better served.⁴³ Good faith and fair dealing bridges the gap between partnering theory and partnering practice, where there are no express contractual provisions spelling out exactly who is to do what.⁴⁴ An obligation of good faith and fair dealing could require disclosure of material

⁴² For example in the United States, see Corey R. Chivers, "Contracting Around the Good Faith Covenant to Avoid Lender Liability" (1991) *Colum. Bus. L. Rev.* 359, citing Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968), 54 *Va.L.Rev.* 195 and Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith" (1980), 94 *Harv. L. Rev.* 404, at p.365 and fn 21. Substantively, the implied duty of good faith in the United States has been invoked to rule out a wide variety of forms of bad faith. See also in Canada, Elizabeth Hewitt, "Implied Terms: Reading Between the Lines" in *New and Overlooked Issues in Contract Law*, (Toronto: CBA(O) Insight, 1998) with reference to the exercise of discretion (in a commercial franchise and other contract termination contexts in a fair and reasonable manner with the advice that lawyers ought to counsel their clients to act "reasonable and fairly" in contract performance.

⁴³ Belobaba, *supra*, at p.88.

⁴⁴ Landsberg and Megens, *supra*, at p.187. They suggest good faith obligations are most likely to arise on infrastructure projects. ". . . An express or implied obligation in the contract, or in relationships established as an adjunct to the major contracts, but which may not themselves be contractually binding on the parties (e.g. partnering charter) to assist in dealing with contractual performance, or to address unforeseen difficulties. . . ." In my view, changed or different soils conditions, issues ("concealed or unknown conditions" in the language of CCDC 2 (1994)) or inadequate disclosure of soils information may be the greatest source of such arguments for implied terms of good faith and fair dealing.

information inconsistent with or contradictory to the information provided in the contract or the plans and specifications.⁴⁵

An approach to dispute resolution that is exploratory and sharing, as opposed to adversarial, makes sense where the objective is preserving an ongoing relationship.⁴⁶ A partnering process design that affects the linkages among rights, interests and powers produces more durable outcomes in the construction industry. A durable outcome is one that satisfies the parties and is respected by them. It is likely a more satisfactory outcome because the parties real interests have been satisfied.

THE ROLE OF THE ADVOCATE

Traditional advocacy roles can be inconsistent with some of the objectives of ADR. When lawyers convince themselves what they are saying is unquestionably true, they may create advocacy distortion. The dilemma is that effective advocacy advances a case to the point where it is ripe for resolution — and then perversely blinds counsel and the client to pursue the solution that is so near their grasp.⁴⁷ Real communication is the disclosure and advocacy of interests and values, not rights.

Engaging in mediation sometimes involves an element of vulnerability and letting go. The parties must foster an approach towards conflict which emphasizes shared effort over competing effort.⁴⁸

Goals that are not common to the parties need to be discussed, so that ways to manage conflict can be developed. Managing ongoing relationship involves automatically elevating disputes for resolution if they persist for a given period of time. Results may also be tied to the participants'

⁴⁵ See, for example, *Opron Construction Co. v. Alberta* (1994), 151 A.R.241 (Q.B.) “Alberta Environment owed an obligation of good faith and fair dealing to the plaintiff to disclose that it possessed material geotechnical information which was inconsistent with or which contradicted the information which had been provided to the plaintiff in the tender documents”. O’Byrne, *supra*, at p.82.

⁴⁶ Some argue more broadly ADR is part of a fundamental transformation of how we view law. The willingness of lawyers to embrace dynamic change may become the hallmark of the practice of law into the 21st century. Rod Macdonald, “Images of Law, Imagining Lawyering”, August 23, 1997, draft paper delivered to the students of the part time LL.M. programme in ADR, Osgoode Hall, York University.

⁴⁷ Is this “particular late-twentieth century cultural artifact we happen to know as law” blinding us to other social visions and values? (see Arthurs, *infra*, p.45) Was this Shakespeare’s insight, metaphorically speaking, when he said “First, lets kill all the lawyers”? *Henry The Sixth, Part 2*, Act IV scene II.

⁴⁸ This point is made generally for mediating commercial disputes. Genevieve Chornencki, “Mediating Commercial Disputes: Exchanging ‘Power Over’ for ‘Power With’”, in *Rethinking Disputes*, Toronto: Emond Montgomery, (1997), J. MacFarlane, ed, at p.168.

levels of sophistication and commitment. Lawyers who are sensitive to this type of relationship can enhance the potential for successful partnering by assisting communication and helping to negotiate contracts from the perspective of *risk sharing* rather than *risk shifting*.

THE ROLE OF THE DESIGN PROFESSIONAL

Technical specifications and plans are at the heart of any construction contract. The preparation of the specifications along with coordinated plans are the single most important documents generated by the design professionals.⁴⁹ These documents represent the culmination of planning and design efforts. The best dispute avoidance technique is quality. Some specifications include catch-all phrases that require the contractor to perform work that may be implied as incidental, or required in compliance with the authorities having jurisdiction. Identifying externally imposed requirements can assist in mutually satisfactory outcomes.

The role of the design professional (defined under the CCDC 2 2008 as the “Consultant”) is to provide those services or undertake responsibilities defined and enumerated in the model Owner Consultant Agreement. Usually this will involve administration of the contract and providing one or more project representatives on site at the place of work. Such services may include:

1. performing on site observations as to the progress and the quality of the work;
2. certifying payment;
3. reviewing time records and quantities of materials;

⁴⁹ There are many events that may entitle a contractor to change in price or extension in time for performance. A project under time constraints can lead to design that has not been thoroughly reviewed which later lead to disputes. Construction is not the time to coordinate drawings. No design is ever perfect and addenda will be necessary to pick up oversights, just as change orders will be necessary to correct problems discovered in the field. In evaluating a change the most important procedural requirement of a construction contract is usually the notice provision. In most instances the notice requirements must be followed or the contractor may waive its right to the claim. The notice provision is based on the principle that if the owner knew the contractor was going to claim that certain work was beyond the scope of the contract, the owner and the consultant would then have the opportunity to take action to avoid such a claim or, at a minimum, to monitor the magnitude of the work of the claim. A consultant may have to avoid a conflict of interest where the allegation is that the plans and specifications are unclear. Given the fact that the consultant usually works for the owner, the consultant may be naturally reluctant to explain to its owner/client why the project will cost more money or take more time than anticipated, because the plans and specifications are said to be defective. Richard Allen, *Dispute Avoidance and Resolution for Consulting Engineers* (New York: ASCE Press, 1997) at pp. 54-55.

4. monitoring the construction schedule;
5. interpreting contract documents;
6. maintaining a log of site activities and minutes of all site meetings.⁵⁰

The services may be limited, and should be so specified in writing if any one or more of the above responsibilities are to be excluded. No arbitrary time limits have been established to respond to claims disputes or other problems. It is good practice for a design professional to advise both the owner and contractor on anticipated time frames to respond when making an interpretation or finding. A good practice is to fix a schedule, preferably jointly with the contractor, for the receipt of detailed drawings and instructions for the timely completion and performance of the work. A schedule for the release of supplemental instructions is also important in the event of a delay and impact claim. Changes in the work which would otherwise postpone the completion date or delay holdback release should be handled by separate contracts or purchase orders.

In the context of his role under the contract, the Consultant still has an important and particular role in dispute resolution. Part 8 (Dispute Resolution) of the General Conditions of the CCDC 2 contract recognizes the need to find alternatives to the costly, slow and adversarial litigation process. It incorporates the ADR concepts of negotiation, mediation and arbitration in a manner consistent with, and in order to promote, the speedy, inexpensive and voluntary resolution of construction disputes. This Part 8 General Condition on Dispute Resolution must be read in conjunction with the Rules for Mediation and Arbitration of CCDC Construction Disputes (Document 40) incorporated by reference into the contract. The basic steps are:

1. Claims, disputes and other matters in question are initially referred to the Consultant in writing for finding and interpretation;
2. Where such claims, disputes and other matters in question are not resolved in the first instance, then staged negotiation is imposed where the parties must attempt to reach a

⁵⁰ “A Guide to the Use of CCDC2 1994 stipulated price contract”, (Ottawa: Canadian Construction Documents Committee, 1994).

settlement within a fixed time frame on their own or with the assistance of a neutral third party mediator;

3. If mediation fails, then the parties have the right to seek binding arbitration in accordance with the law of the place of work by serving written notice within certain specified time frames;
4. If neither party elects arbitration within the specified time frame, either is free to pursue litigation or to further agree on another ADR process.

All disputes must initially be referred to the Consultant for a finding or determination even if they contain allegations of errors or omissions by the Consultant. The recommended practice is that the Project Mediator be decided upon and so appointed within 30 days of the Contract award, and the CCDC 2 contract contemplates this. Failing such an appointment, either party may appoint the Project Mediator on 15 days notice. If there is a dispute as to the Consultant's initial finding, notice must be sent within 15 days of the receipt of such finding, failing which the finding is deemed to be accepted.

This timed response helps focus the parties on the importance of resolving disputes quickly and encourages early and good faith disclosure. If mediation proceeds the parties can always agree to extend the time limits if progress is being made. Litigation can be excluded by an arbitration clause (see 8.2.6), and the parties can agree that if the matter is not referred to arbitration within a reasonable specified period of time for an express waiver and release of rights.

TAILORING CONTRACTS TOWARDS ADR

Despite the recognition afforded to DR in the CCDC 2 contract, a review of the use of mediation and arbitration clauses more generally is warranted. The degree to which any contract can be tailored to ensure effective use of ADR is an important consideration at the time of contract formation. Keep in mind that after a dispute has arisen, the involved parties may have lost the trust in each other that is necessary to reach an agreement about an ADR process.⁵¹ Further, parties may

⁵¹ J. Kenneth McEwan and Ludmila B. Herbst, *Commercial Arbitration in Canada A Guide to Domestic and International Arbitrations* (Aurora: The Cartwright Group Ltd., 2004+) at 2-3.

shy away from proposing ADR after a dispute has arisen for fear that it will appear they are admitting weakness in their case or resources.⁵² Accordingly, any certainty that can be given to the process at the outset of contract formation will be useful in shaping the effectiveness of the ADR process and will ensure that neither party “loses face or admits weakness by complying with the contractual provision.”⁵³

a) Mediation Clauses

The following passage encapsulates the usefulness of mediation:

Even if unsuccessful, mediation at an early stage can bring clarity to a dispute by identifying and defining which issues or matters do or do not require decisions to be made. Sometimes a mediation or negotiation can overcome or reduce communication problems between the parties and even reduce tension and improve (or at least prevent further deterioration) of relationships between the parties.⁵⁴

This is no doubt why the CCDC 2 contemplates the use of mediation and it highlights the importance of at least considering the prospect of mediation at the time of contract formation, particularly within the construction industry where the maintenance of a business relationship may be desired.

The specific wording of a mediation clause may be of less consequence than that of an arbitration clause because the mediation may be simply an early step in the DR process. Proper drafting of such clauses is still important, however, as it can assist in setting the proper tone for DR and helps set out the expectations of the parties.⁵⁵

⁵² Wendy Earle, *Drafting ADR and Arbitration Clauses for Commercial Disputes* (Toronto: Thomson Reuters Canada Ltd, 2001+) at 3-5

⁵³ *Ibid*

⁵⁴ *Ibid.*

⁵⁵ For precedent mediation clauses see Richard H. McLaren and John P. Sandersson’s *Innovative Dispute Resolution: The Alternative* (Toronto: Thomson Reuters Canada Ltd., 1994+) at 4-32.8.9; see also Appendix A in Earle, *supra*.

Case law on the enforceability of mediation clauses reveals that there has been very little in the way of consideration of this issue by the courts in Canada.⁵⁶ Enforceability most likely becomes an issue in situations where mediation acts as a precursor to other forms of DR. For example, if parties are required to negotiate or mediate for a particular period before pursuing arbitration, as is the case with the CCDC 2, what exactly must be done to satisfy that requirement? Courts outside of Canada have considered these types of provisions but with varied results⁵⁷ suggesting there is no definitive answer yet and that each case will have to be evaluated in its own factual circumstances.

b) Arbitration Clauses

Though it more strongly resembles litigation than mediation, it has been suggested that arbitration has significant defined advantages over litigation including the following: it is more expedient, it is cheaper, it will achieve a binding result earlier with less procedural hurdles or stalling and upon completing a properly drafted award will provide minimal rights of appeal thus most likely producing a final result.⁵⁸

While the true extent of the benefits of arbitration over litigation may be debated, in a construction context the usefulness of arbitration is encapsulated in the following simple example.⁵⁹

This dispute involved an insurance company, a general contractor and a large building under construction that was extensively damaged by unknown individuals. It was of extreme importance that this building be completed quickly. Accordingly, while the parties had originally planned to appoint appraisers, which would have significantly stalled the project, they instead agreed to proceed straight to arbitration. The arbitration proceeding took place soon after the dispute arose and lasted four hours, after which the parties were able to refocus and turn their attention to the construction of the building.

⁵⁶ The majority of case law dealing with enforcement in the context of mediations deals with enforcement of settlements reached at mediation rather than enforcement of the mediation clause itself.

⁵⁷ For an overview of the results see the discussion in *Earle, supra* at 3-10 where it is suggested that in England courts will enforce mediation clauses only where the process is a determinative one, in contrast to Australia where the courts are more willing to enforce such clauses more generally.

⁵⁸ *McLaren, supra* at 5-2.

⁵⁹ Taken from *McLaren, supra* at 5-8.

In light of the potential usefulness of arbitration, due consideration must be given to the construction of an arbitration clause within a contract. It has been suggested that often too little attention is given to this element.⁶⁰ Unless the required care in drafting the arbitration clause is used “it might as well be omitted from the parties’ agreement as the advantages of arbitration can in large part only be enjoyed where the terms of the clause are certain and exact.”⁶¹ It would be impossible to outline all of the intricacies of drafting an arbitration clause or a larger arbitration agreement here,⁶² however, some insight regarding the timing of arbitration is worth noting at this time, given that a large focus of this paper has been on proactive strategies to avoid costly litigation.

Clauses which specifically require parties to participate in arbitration as a condition precedent to any litigation have generally been upheld by the court in the past.⁶³ More recent decisions suggest, however, that this type of explicit language making the arbitration a condition precedent is no longer required in light of statutory developments in this area. The decision of the Alberta Court of Appeal in *Babcock & Wilcox Canada Ltd. v. Agrium Inc.*⁶⁴ is instructive in this regard and is particularly relevant for purposes here in that it deals with a construction contract.

In the *Babcock* decision the contract contained a clause stating that any dispute or difference between the parties “shall be submitted to arbitration” and any award “shall be final.”⁶⁵ A statement of claim was filed by Babcock and Wilcox Canada Ltd. and Agrium moved to have the action stayed. In granting the stay the Court relied on the provisions of the *Arbitration Act*⁶⁶, which mandate that the court must stay a proceeding where the parties have agreed that the matter in

⁶⁰ See McEwan, *supra* at 2-20 where the author suggests this could be for a number of reasons: “This is perhaps due to the fact that as a commercial relationship is being structured, the possibility of subsequent disputes that may erode that relationship is not at the forefront of the parties’ concerns. Limited experience with arbitration may also account for the fact that often little time is spent on drafting the arbitration clause; the high cost of contracting (both monetary and tactical) may also be considerations.”

⁶¹ *Ibid.*

⁶² For a good overview of considerations that may come into play in drafting an arbitration clause see McEwan, *supra* at 2-20 through 2-24 and for a review of how common clause terms have been interpreted in Canada see 2-26 of same. For various precedent arbitration clauses see Appendix A in Earle, *supra*.

⁶³ McLaren, *supra* at 5-7.

⁶⁴ [2005] A.W.L.D. 1133, [*Babcock*].

⁶⁵ *Ibid.* at para. 1.

⁶⁶ R.S.A. 2000, c. A-43, s. 7

dispute be submitted to arbitration.⁶⁷ The Court found that through this type of provision the legislature had effectively made arbitration a condition precedent to litigation where parties had agreed to have their disputes submitted to arbitration, even where no express language to that effect was contained.⁶⁸

In light of *Babcock*, by using language in the arbitration clause that clearly expresses the intention to resolve disputes through arbitration, a court action is essentially prohibited in all but limited circumstances. It can be noted that where there is uncertainty regarding the wording of the clause, and the intention behind it with respect to whether arbitration was agreed to or not, it has been held that the court will favour the use of arbitration.⁶⁹ To resort to the courts to determine whether arbitration was in fact intended, however, diminishes the value of inserting an arbitration clause in the first place. Accordingly, careful consideration of the scope and wording of the clause at the time of contract formation is recommended.

CONCLUSION

The ADR methodologies discussed here represent mature approach to construction contracts. A leap of faith may be required to make ADR work: specifically, a willingness to act fairly and in good faith, and expecting others to act in the same way. Foresight regarding construction and insertion of an ADR clause will also be required. Nevertheless, the benefits are clear: the parties will identify areas in advance that may lead to disputes, and design a process (such as a dispute escalation ladder or straight mediation or arbitration) to resolve the problem in an amicable and productive fashion.

⁶⁷ Similar provisions can be found in arbitration legislation across the country. See British Columbia *Commercial Arbitration Act*, R.S.B.C. 1996, c. 55, s.15(1); Manitoba *Arbitration Act*, C.C.S.M., c. A120, s. 7(1); New Foundland & Labrador *Arbitration Act*, R.S.N. 1990, c. A-14, s. 4(1); Northwest Territories *Arbitration Act*, R.S.N.W.T. 1988, c. A-5, s. 10(1); Nova Scotia *Arbitration Act*, R.S.N.S. 1989, c.19, s. 7; Ontario *Arbitration Act*, 1991, S.O. 1991, c. 17, s. 7(1); Prince Edward Island *Arbitration Act*, R.S.P.E.I. 1988, c. A-16, s. 6; Saskatchewan *Arbitration Act, 1992*, S.S. 1992, c. A-24.1, s. 8(1); Yukon *Arbitration Act*, R.S.Y. 2002, c.8, s. 9.

⁶⁸ *Babcock* at para. 12.

⁶⁹ *Onex Corp. v. Ball Corp.*, (1994) 12 B.L.R. (2d) 151 at para.24.

By disclosing interests and values to each other in early stage negotiations, the parties may be acting in a way that is contrary to the traditional focus of contracts on self-interest. Perhaps the traditional paradigm is too narrow, since it excludes a norm of good faith and fair dealing. As cooperative partnering and ADR processes gain favour, clients will demand counsel who can assist in the design and implementation of creative solutions — counsel who can negotiate effectively, and who can prepare construction contracts and agreements that address not just rights, but also interests and values. Lawyers having these skills will be better equipped to help their clients avoid and achieve durable resolutions to any disputes that might arise.