Construction Dispute Resolution: A Changing Landscape

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A construction project even if it is a repetition of the same design in a new location is largely considered to be prototypical in nature. As a prototype, the constructed structure is never tested for its performance. Hence, differences in opinion as to its execution or performance are common causes of different views in the construction industry. Many of these differences eventually developed into full-blown disputes requiring the intervention of neutrals.

For decades, arbitration and litigation are the two commonly used forms of construction dispute resolution. The choice of these two methods of resolving construction disputes stems from the fact that the decisions of the arbitrator or a judge, though appealable in higher court, could not be re-litigated by a dissatisfied litigant in another forum. The application of the legal doctrine of *res judicata*[1] shuts a litigant from starting a court action or arbitration on the same issues, thereby putting a finality to the dispute.

Today, with the increase in globalised commercial activities, the untold advantage of arbitration (apart from being able to choose the preferred tribunal in arbitration) is the availability under the New York Convention 1958 of an avenue to enforce arbitrators' awards in more than 140 signatory countries.

Parallel to this development, the dispute resolution fraternity has proposed an increasing use of other intermediate dispute resolution process to save cost and time, before attempting arbitration or litigation. In many international contracts and some standard form contracts, multi-step dispute resolution clause has been routinely included in the contract. This form of multi-step dispute resolution clause is commonly known as 'forced escalation clause'. Here, the disputants who are unable or refuse to settle their disputes are forced to move to the next level of a more formal, more adjudicative and more expensive form of resolution method.

MULTI-STEP DISPUTE RESOLUTION CLAUSE

In many common law jurisdictions, a typical multi-step Alternative Dispute Resolution (ADR) clause includes the initial negotiation, followed in order by mediation or conciliation, expert determination or adjudication before the parties are forced to resolve their disputes in arbitration or litigation. The dispute resolution processes become more adversarial and adjudicative as it progresses up the ADR chain.

Earlier, there were some doubts whether an agreement to negotiate is enforceable until a decision in *Watford v Miles*[2] where the House of Lords held that an agreement to negotiate is not enforceable in law. However, in Australia, Justice Giles[3] took a narrower stand in holding that an agreement to submit any dispute to a conciliator before arbitration was enforceable if the parties agree to conciliate an already identified issue prior to issuance of the notice of dispute.

In this case, Giles J said the clause on conciliation is enforceable because a previous letter had identified the issues to be resolved in the conciliation process. The moot point is, will the Australian court rule as it did if the parties have not had prior agreement on the issues to be conciliated? It is submitted that the Australian court would probably have followed the House of Lords' decision in *Watford v Miles* and rule the clause unenforceable for uncertainty.

Whilst a multi-step dispute resolution clause may be unenforceable for uncertainty due to poor drafting, such intermediate dispute resolution process has proven to be an effective cost saving device in the hands of experienced professionals. Mediator Philip Naughton, QC, for example, facilitated a resolution of a multi-million pounds claim dubbed "mega-mediation" in just two days as opposed to the planned six weeks trial involving multiple parties, layers of insurers, three solicitors firm and a dispute running into four years. In another case involving the collapse of the canopy in Aberdeen, Hong Kong, the 10-years-long running civil litigation was resolved in five and a half months of mediation.

Quite clearly, intermediate dispute resolution process has served to expedite the dispute resolution process and minimise cost notwithstanding the difficulties of lack of clarity of the end of one tier and the beginning of another, usually brought about by poor drafting of the multi-step dispute resolution clause. Today, many standard form contracts including FIDIC, JCT 98, ICE 6th Edition and our PAM 2006 have adopted some form of multi-step dispute resolution process.

ADJUDICATION

In 1972, Lord Denning made a historic decision for the construction industry when he stated that:

> *"There must be cash flow in the building trade. It is the very lifeblood of the enterprise".*

His sympathy for the contractor/sub-contractor is evident in this statement:

> *"He is out of pocket; probably has an overdraft at the bank. He cannot go on unless he is paid for what he does. The main contractor is in the like position. He has to pay his men and buy his material. He has to have cash from the employer, otherwise he will not be able to carry on. So once the Architect gives his certificate, they must be honoured all down the line[4]".*

[1] *Bulletin Editor's note: Latin, meaning that no further adjudication of an issue or dispute is possible as it has already been authoritatively and definitively settled by another adjudication.*

[2] *[1992]1 All ER 453*

[3] *Hooper Baille Associated Ltd v Natcon Group Pty Ltd (1992) 28 NSWLR 194*

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Lord Denning quite clearly wants the contractor/subcontractor's interim payment certificates to be paid without set off from the employer/contractor. His rationale for wanting interim payment certificates to be honoured without allowing the employer the right of a set off is encapsulated in his previous statement.

Shortly after Lord Denning's landmark decision, the Federal Court[5] in *Bandar Raya Developments Bhd v Woon Hoe Kan & Sons Sdn Bhd* echoed Lord Denning's view where Ong Hock Sim FJ decided that, *"a debt due under an interim payment certificate [is] a debt of a class which ought not be allowed to be made the subject of set-off or counterclaim'.*

Lord Denning's brave decision did not find favour with the House of Lords, it was quickly overruled in *Gilbert-Ash*[6] in 1974. However, in Malaysia, we have had to wait another 20 years before the Federal Court in *Pembenaan Leow Tuck Chui v Dr Leela's Medical Centre Sdn Bhd*[7] overruled its own decision of 1974. Edgar Joseph Jr said:

> *[W]ith all due respect to Lord Denning, for the reasons stated in the House of Lords' case of Gilbert–Ash, we are unable to agree with him that an interim certificate or indeed any certificate issued by an architect or engineer pursuant to provisions of the RIBA and other known forms of building contracts and subcontracts are to be virtually treated as cash, like bill of exchange. In our view, therefore, there is no special rule of construction operating in the building contract cases, such as was advocated by Lord Denning by way of obiter dictum in Dawnays case, which lays down that contracts with provision for payment of certificates negative the ordinary common law right to set off enunciated in Mondel v Steel (1841) 8 M &W 871 at p872.*

This decision of the Federal Court has unwittingly encouraged unscrupulous employers or contractors to use the right to set off as an excuse to reduce or negate the interim payment certificate amount due to a contractor/subcontractor thus plunging some contractor/subcontractor into cash flow crisis. Such unreasonable practice has, therefore, become the source of numerous disputes in construction industry.

To solve the cash flow problem in the construction industry, England, in 1996, led the revolution of the dispute resolution landscape. The Housing Grant and Construction Regeneration Act 1996 (HGCRA) was introduced pursuant to Sir Michael Latham's report "Constructing the Team" which studied exhaustively the malaises afflicting the UK construction industry. HGCRA introduced the mandatory statutory adjudication as an intermediate dispute resolution process to redress growing contractor/subcontractors' complaints of debilitating cash flow caused by employer/contractor's unjust withholding of interim payments.

The qualified success of adjudication in UK has served to encourage others to study the feasibility of introducing such legislature in their jurisdiction. In fact, several countries, i.e. New South Wales in Australia in 1999, New Zealand in 2002 and Singapore in 2004, quickly adopted statutory adjudication in varied forms. Adjudication has since been touted by the construction industry as the most "appropriate" mechanism for the contractors/subcontractors to redress their problems of cash flow precipitated by an unreasonable withholding of payments by the employer/contractor.

After adjudication was introduced in the UK some 15 years ago, Malaysia is once again at a crossroad, mulling over the enactment of some form of adjudication mechanism. At this juncture, the proposal has generated many, sometimes heated, discussions as to the pros and cons of the introduction of adjudication and the form it should take. Until a consensus is reached, I am sure the proponents and the opponents of adjudication will continue to debate the merits and demerits of such legislation in Malaysia.

Perhaps it would be helpful to understand the rationale as to why the Australian state of New South Wales (NSW) introduced adjudication. The NSW Minister responsible for introducing the Bill in the NSW State Legislative Assembly had wholeheartedly echoed Lord Denning's views on cash flow in the construction industry during its First Reading. The Hansard in the NSW State Legislature recorded this statement by the Minister:

> *"Cash flow is the lifeblood of the Construction Industry. Final determination of disputes is often very time consuming and costly. We are determined that, pending final determination of all disputes, contractors, sub-contractors should be able to obtain a prompt interim payment on account as always intended under the Act[8] ".*

It is clear that this Australian state had enacted this intermediate dispute resolution process believing that it could solve the cash flow crunch in the construction industry. Is Malaysia ready to join this select group of common law countries in introducing this intermediate dispute resolution process? The construction industry will surely be awaiting with abated breath.

ARBITRATION

Construction projects are often inundated with paper trails. The huge amount of documents generated by a construction project naturally becomes the documentary evidence in construction arbitration. It is not uncommon in construction arbitration to have truck loads or voluminous amount of documents being transported to the proceeding each time the tribunal sits.

Although in the past, arbitral tribunal often order full discovery or disclosure of documents, such is not the case today. The practice of submitting voluminous documents is no longer an indication of the strength of the case but quality of the evidence is. The English Court of Appeal in *Glaxo Group Ltd v Dowelhurst Ltd*[9], issued a salutary warning to the parties and the lawyers alike who failed to consider what documents are actually needed to determine a dispute. Jacob LJ said:

[4] *Dawnay v Minter [1971]1WLR 1205*

[5] *[1972]1 MLJ 75 at p76*

[6] *Gilbert-Ash(Northern) Ltd v Modern Engineering (Bristol) Ltd [1974]AC689*

[7] *[1995]2 MLF 57*

[8] *NSW Legislation Assembly Hansard, 12 November 2002, at 6541*

[9] *[2004] All ER 129*

"I do not wish to part with this case without entering a strong protest about the bundles. We were originally sent 50 bundles of document. After the court made inquires as to what they were for, many of them were taken away. We were nonetheless left with half. Of these, by my calculation, ten were never opened. In the case of others a page or two were looked at. No attempt was made to comply with Practice Direction which requires core bundle of essential document… the consequence of all this undoubtedly made the hearing more cumbersome and the writing of judgment more difficult."

The English Court of Appeal's warning is a timely reminder to the parties and the solicitors alike to refrain from swamping the tribunal with a huge load of documents. On the contrary, the issues could be successfully argued using the core bundles as the primary evidence rather than a voluminous bundle of documents.

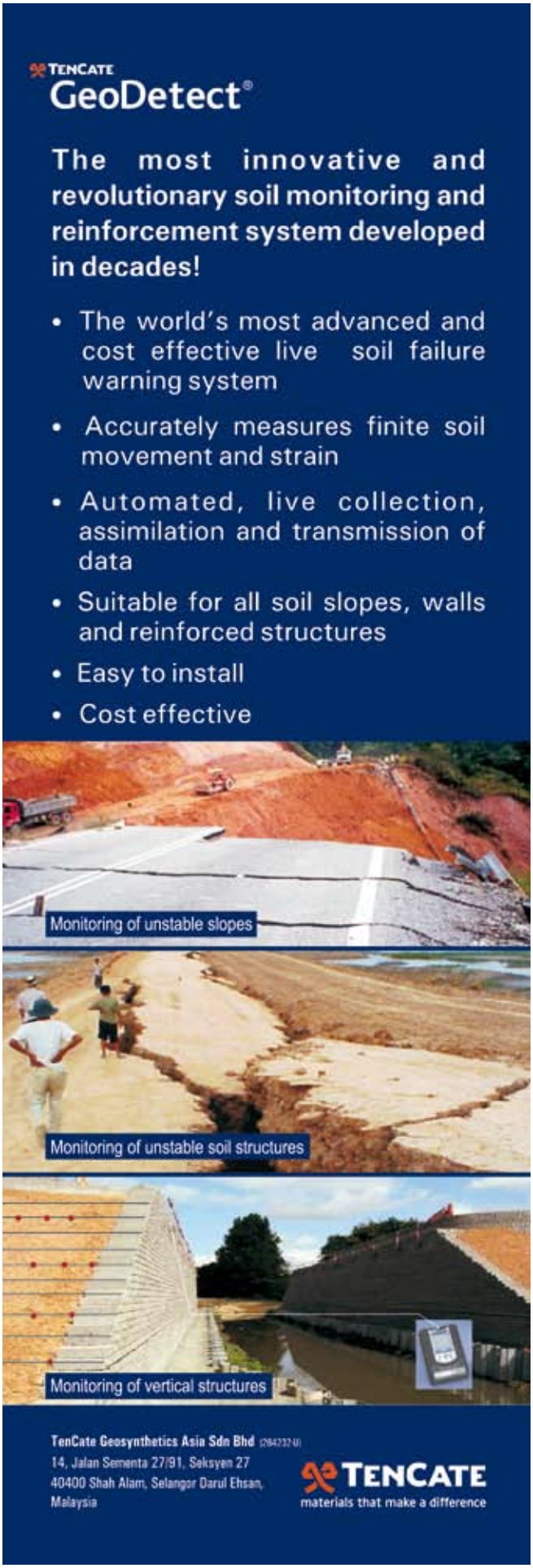
Subcontracting is an indispensable part of a construction contract. Generally, 70% of the work in a construction project is executed by subcontractors. Frequently, disputes between the contractor and the subcontractors spawned disputes between the employer and the contractor. The common pitfalls in the arbitral processes between the contractor and subcontractor, and between the employer and the contractor on identical issues by different tribunals are adverse decisions by the two tribunals on one party, usually the contractor, being the common party.

It is conceivable that such anomaly could occur because evidence adduced in one tribunal cannot be imported into another tribunal even if they are dealing with the same issues between different parties. Such prohibition due to the law on privacy and confidentiality of arbitration proceedings could skew the tribunal's decisions. In such a case, the solution is for the parties to invoke Section 40 of the Malaysian Arbitration Act 2005 to consolidate the two arbitrations into one proceeding.

Hence, in a project where multiple subcontractors are involved in the work, it is wise for the subcontracts to include a clause agreeing to consolidate arbitrations between the employer and the contractor as well as between the contractor/subcontractor. Alternatively, the parties could adopt arbitration rules which allow the arbitration to be consolidated. SIAC arbitration in Rule 8 allows multi-party appointment of arbitrators.

CONCLUSION

The dispute resolution landscape in the construction industry has metamorphosed over years to include several intermediate methods of dispute resolution in addition to arbitration and litigation. It was thought that these intermediate processes will be more cost effective and expeditious in resolving construction disputes.

The introduction of statutory adjudication has similarly altered the landscape of dispute resolution in the construction industry in the UK, Australia, New Zealand and Singapore. The varied form of adjudication processes introduced in the UK, Australia (NSW), New Zealand and Singapore have reportedly been effective in improving cash flow in the construction industry, but how the process will impact the Malaysian construction industry will remain a moot point for now.

In the arbitration process, many changes in the procedures have been instituted to better manage the process, thereby reining in on the cost and time factor. For example, the parties should not swamp the tribunal with voluminous documents, rather they should utilise core bundle to prove the case. Similarly, the disadvantage of arbitration in including a third party in the proceedings could now be effectively circumvented by using the consolidation option in our arbitration law. ■