

Arbitration In The Construction Industry

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Arbitration has become recognized as the dispute settlement mechanism in the construction industry. It is seen as the final mode of dispute resolution which is beyond the usual attractions of arbitration, such as privacy, speed, flexibility and choice of the arbitrator.

In the construction industry, arbitration is the norm because firstly, the prevalence of arbitration clauses in standard forms of contract; secondly, the technical content of disputes, leading to the use of arbitrators skilled in technical disciplines; and finally the need in many disputes for the arbitrator be empowered to open up, review and revise decisions or certificates, arising from the architect's or engineer's judgment in administering the building contract.

ARBITRATION AGREEMENTS

The Malaysian construction industry almost universally relies on the use of standard forms of contract

conditions in particular sectors. The principal ones are the PAM, IEM, JKR and CIDB forms. The PAM Form is recommended by the Institute of Architects, the IEM Form is that recommended by the Institution of Engineers. The PAM and IEM have their origins from architects and engineers who have traditionally acted as construction contract administrators.

The CIDB form is that issued by the Construction Industry Development Board. The public sector uses the JKR forms. All of these provide for arbitration as the final form of dispute resolution. The use of these standard forms has produced a *de facto* universality of arbitration as the normal method of settling disputes.

TECHNICAL DISPUTES

The construction industry generates disputes that arise from matters of considerable scientific or technical difficulty. Two points working in combination increase the technical

content and the utilization of technically qualified arbitrators in their resolution which are further enhanced by the consultant's discretion in the various standard forms of building contracts.

Firstly, the various standard form of building contracts instead of determining matters of uncertainty by prior contractual arrangements, tend to postpone them. The architect or engineer is given the discretion to decide on them later. This at times gives rise to uncertainty as regard to the scope of work to be undertaken, the time or schedule it should be completed, and the payment due to be paid on it. The architect or engineer when administering the contract may make evaluations. The disputes that arise from such determination are normally technical in nature although they may involve legal and contractual issues.

Secondly, nowadays these *ex post facto* technical evaluations involve not only the consultants but also claim consultants. The latter are involved in promoting, preparing, arguing, defending, appealing claims and disputing technical evaluations. Eventually, given the frequency and experience of participants in such disputes encourages them to be more specialists in their resolution, and make their careers in construction arbitration.

The circle is completed: the contract style creates the occurrence of technical disputes; the disputes require specialist technical support; these claim consultants aspire to become arbitrators; and arbitration becomes an industry by itself. This is further exacerbated by professional



Construction in progress

interest groups like project managers wanting to position themselves as technical specialist wanting to resolve the technical uncertainties in the building project.

The style and practices of the standard form contracts are assumed to be descriptions of good industry practices and are accepted as the industry standard as to colour even the bespoke and *ad hoc* contract forms. This again reinforces the tendency towards arbitrations being conducted on certain set assumptions flowing from practice in technical disciplines. The challenge for the construction industry is to keep these factors in proper balance and perspective. However, there remains considerable scope for improvement in the drafting of standard form construction contracts for the prevention and avoidance of disputes; and where they arise, for their better management and resolution.

POWER TO REVISE CERTIFICATES

Since the decision of the English Court of Appeal in *Northern Regional Authority vs Crouch* [1984] QB 644, arbitration has become the essential mode of dispute resolution for certain kinds of construction disputes. The decision drew a fundamental distinction between the powers of arbitrators and the powers of the courts. Most standard form of building contracts give the arbitrators express power to open up, review and revise certificates, decisions, etc, of the architect or engineer. The Court of Appeal opined that no such power was within the court's jurisdiction, nor could it at that time be conferred on the court by agreement of the parties.

Although the decision has been over-ruled in recent years and that courts have such power, standard



Residential houses

form contracts continue to require reference to arbitration. Such arbitration agreements continue to explicitly empower the arbitrator to revise project decisions and certificates. It follows that every construction dispute will be submitted to arbitration if it requires for its resolution the revision of an earlier certificate, decision, etc. of an architect or an engineer exercising professional judgment.

DISTINCTIVENESS OF CONSTRUCTION CONTRACTS

There are a number of characteristics which are common to, and largely distinctive of, almost all construction projects. It is this distinctive characteristics that contribute to the higher occurrence of disputes in the industry and hence, the use of arbitration in resolving them.

● Delivery procedure

Delivery of a construction project is a process requiring the involvement of many parties. There is normally a main contractor, a host of sub-contractors, a consultant team and the client employer organization. The consultant team would include architects, engineers from

various disciplines (civil, structural, mechanical, electrical, etc) and quantity surveyors.

The actual works on almost all construction projects exhibit recurrent distinctive characteristics such as: the prototypical nature of the works (except for recurring ; split responsibly for specification and/or design; high degree of inter-activity between purchaser and supplier; expectation of, and provision for, substantial levels of change to the specified scope of work; complexity of sequencing of activities, and dependencies on other activities and supplies; site specificity; interaction with neighboring fixed infrastructure; exposure to, and dependence on, weather conditions; longevity of the products, and lateness of revelation of defects; and the diversity and sheer volume of evidentiary material.

Apart from recurring housing development, the great majority of construction projects produce structures which are, if not unique, still a prototype. While other industries can design out of the problems associated with the prototype phase and move on to

serial production of finished items, the construction industry does not seem to move into such a plane. The responsibility for design is accentuated by this prototypical characteristic of building projects.

● The consultant team

The Consultant Team consisting of the architect, engineer and quantity surveyor engaged by the Employer to assume responsibility for both specification of the supplies and design of the structure. The contractor then uses his skill, labour and workmanship to build the works according to those instructions. The Consultant Team is able to complete the design in all its details if the structure is simple or the commercial circumstances are ideal and the price and programme are fixed before the contract is let.

The reality is normally very different for employer designed work. The design is often not complete when the tender is let out. As such, it would require changes during its implementation particularly to meet more realistic budget considerations. The scope of the work evolves as it is executed.

Increasingly, construction works are being given out on a design-and-build basis with the imposition of the fit for purpose obligation on the contractor. Here the main difficulty is that the employer must specify in some way what he wants. He will still have to set up his Consultant Team or Advisors to check the contractor's design, and more likely to intervene in that process with potentially disastrous results in terms of responsibility for the end result.

Construction requires high degrees of inter-activity in the design and construction process, between the Employer, his Consultant Team and Agents, and the Contracting Team. Construction projects are not simple. There are issues of communication, management of the works relative to time and budget. The manner or sequence of which the work is carried out may bring about changes to the delivered scope of obligations.

In practice, most contracts provide for the architect or engineer to direct changes by way of variations which have to be implemented before their impacts in time and/or cost

have been resolved. The cumulative effect of such instructions can undermine the whole economy of the project. When they exercise the power to make such changes, its impact on the time for completion of the works, and their out-turn cost can be greatly disproportionate to the extent of any particular change especially when *ex post facto* claims, arguments, justifications lead to eventual dispute over what is an appropriate adjustment to the contract programme and contract price. These form the many problems that are brought to arbitration.

● Programme obligations

Works programmes are used in all but the most simple of projects. A successful contractor is able to programme a complex sequence of activities and their dependencies. It is interesting to note that the contractual provisions of most construction contracts place little obligation on the programming of activities.

The traditional forms generally only require the contractor to complete the totality of the works by a particular date. It normally does not integrate the programming of activities into the structural obligations. This weakness is compounded by the instruction of variations or changes. Delay and the attendant impacts are normal disputes which is brought to arbitration. There is no obligation on either party to identify the causes of such delay at the time when they occur.

● Site specificity

The characteristic of site specificity goes beyond the uniqueness and prototypical nature of most construction works. The nature of the site can be tested often only to a limited degree economically. When the contractor does his work on site, it may often reveal unexpected features, or represent difficulties like unexpected soil conditions



Construction team



TNB substation

or encumbrances to overcome. For example, site possession may be affected by the existence of squatters. These have their consequences in the development and execution of the design. The interactions lead to changes and programme consequences which in turn give rise to disputes to be arbitrated.

● Neighbouring fixed infrastructure

It is rare for a physical structure to exist in isolation. The building project must for all practical purposes exist in interaction with the neighbouring external environment. Others may own the neighbouring sites and this in turn will constraint and affect the process of design and carrying out of the construction works. Laws relating to nuisance, planning, environmental impact and neighbouring proprietary interests bring third party influences in the design and execution of the works. The project will need to secure essential supply and communication utilities from third party like TNB, Telecoms and Waterworks. The supply of these utilities are dependent on fire safety certification, building regulation approvals, and other appropriate regulatory signing-off only as the work progresses or are completed. In all these steps which

have an impact on time and cost, there is potential for dispute for the question of the design, or of its execution.

● Weather conditions

Malaysian weather is generally predictable. However, in arbitration, the impact of poor weather is raised regularly. Most standard form of construction contracts leave this risk to be resolved in the eventual discretion of the Architect/Engineer/SO. The issue that is normally

arbitrated is regard to the fairness and appropriateness of the exercise of that discretion.

● Late revelation of defects

The term defects either relate to premature failure or to conditions that result from improper construction, installation, application or manufacture. Defects in buildings present special problems for the system of law and limitation as compared to other goods. It is normally in most legal systems for the limitation period of building defects to be handled differently. Finger pointing is usual when defects do arise long after completion. The contractor may blame the design whereas the employer may point to poor workmanship or materials. In arbitration, the issue becomes a matter of retrospective forensic identification.

● Volume and diversity of evidentiary material

Construction projects generate a vast volume of records. They may be as diverse as site investigation reports, feasibility studies, specifications,



Telephone lines

drawings, tender submissions, estimating and pricing details, diaries, minutes of meetings, formal instructions, test data, payment applications and certificates, weather records, job sheets, inspection reports, programming data and reports, correspondences between parties, management accounting reports, press publicity, and so on. These records may contain clues as to the causes of disputed matters to be arbitrated.

● Payment arrangements

The standard forms construction contracts provide five principal elements to allow price determination:

- (1) The tendered price for which the contractor is willing to do the work
- (2) The method of assessing the suitability of that price, by way of a breakdown
- (3) The method or schedule of pricing of any additional works or changes to be made to the scope within the tendered price
- (4) The timing of the payment
- (5) Some retention for the final stage of assessment of outstanding works or defects.

While waiting for his payment, the contractor has to finance part of the work. In Malaysia, anyone can be a contractor in that the market entry qualifications for those offering contracting are very low. Large capitalization is not required. The contractor is very dependent on interim payments. However, such interim payments are assessed by the consultants on a judgmental basis and impacts on the financing of the contractor's works foster arguments of under certification, contradiction, claim and eventual

dispute to be arbitrated. These may be further exacerbated by disputed variations.

SPECIFIC DISPUTES BROUGHT TO ARBITRATION

Fenn and Gameson in their *Construction Conflict Management and Resolution*, pages 209-218 have identified the various disputes which are brought for resolution in arbitration which is equally applicable in Malaysia. They are as follows:

● Determination of Agreement

Disputes caused by the determination of the agreement are as follows:

- (1) The failure of the contractor or sub-contractor to proceed in a competent, diligent and satisfactory rate
- (2) The contractor or sub-contractor ceasing work on site
- (3) The employer repudiating the contract by denying contractor access to site, not making progress payment, being insolvent or claiming to determine the contract.

● Payment and time

Disputes caused by the payment issues are as follows:

- (1) Non-payment of variation claims by contractor or sub-contractor
- (2) Non-payment of progress claims by contractor or sub-contractor
- (3) Non-payment of amount certified in final account
- (4) Extension of time costs claims by contractor or sub-contractor
- (5) Liquidated and ascertained damages charged against the contractor or sub-contractor

(6) Retention monies not held in separate account by contractor

(7) Validity of final account and certificate

(8) Contractor claim sums for fluctuation of prices.

● Execution of work and delay

Disputes caused by site and execution of work issues are as follows:

- (1) Changes in sub-structure design and lack of temporary support during excavations
- (2) Defective materials and claims of negligent manufacture and supply
- (3) Poor quality of workmanship including defects in brickworks, tiling, footing and wall construction
- (4) Delays and extension of time due to local authorities' requirements
- (5) Negligence and nuisance.

CONCLUSION

Construction is an amalgam of complex activities requiring a careful allocation of resources and preparation. The lack of such allocation and preparation can bring about workmanship and quality control problems. It may arise from personality clashes and differing goals espoused between various parties and members of the consultant team. This can poison the atmosphere without proper communication between the parties. The consultants may end up issuing unclear and/or late instructions. Parties may lack good faith to resolve disputes on an amicable basis thus leading on to arbitration. 