

Dispute Prevention, Management and Resolution: Can We Do it Better?

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Recent Hong Kong headlines decry the high cost of legal fees. Developers are nervous about unexpected costs, delays and overruns. Contractors worry about nasty surprises, and about getting paid. But everyone can play a part in reducing the incidence, the gravity and the length of construction industry disputes. Arbitration consultant Louise Barrington explores the options available for their prevention, treatment and resolution.

The Inevitability of Disputes in Construction Projects: Myth or Reality?

Mention any given construction project in Hong Kong, and it's certain the conversation will soon get round to the legal battles that seem endemic to the industry. Everyone agrees that these disputes tie up and waste colossal resources, and everyone wishes there were a better way.

It is a cold hard fact that construction contracts involve enormous capital costs, as well as complex and often innovative designs and processes. Dozens of parties play a role in the chain from feasibility study through design, financing, sourcing, site preparation, foundations, building, finishing and operation of the project. Each has its own expertise to contribute, and each wants the largest possible share of the financial pie. Joint venturers make marriages of convenience that often hide vastly disparate goals and interests.

The tender process, designed to promote competition and optimum utilization of available resources, may actually have the opposite effect. A "survival of the cheapest" attitude tempts some contractors to submit unrealistically low bids, fully intending to recuperate the initial loss on "extras" down the line.

The common practice in Hong Kong, where the contractor agrees to an "all in" price, has the effect of placing the risk of unforeseen problems — such as ground fissures — squarely on the shoulders of the party with the least to gain by making them good. In fact, really serious problems can end up bankrupting an unhappy

tender "winner." And, as Jesse Grove III pointed out, "The real disadvantage ...of forcing the risk of the unforeseeable on the contractor is that ... gamblers and claims artists will predominate among the winners of contract awards." ⁽¹⁾

Our new airport is a dream: it's attractive, secure and functional. Yet we are all still trying to live down its nightmarish premature opening in July 1997. Owners, in their enthusiasm to make a commercial or political splash, may insist on unrealistic time constraints, forcing a contractor to cut corners in order to finish on schedule. Labour disputes or political upheavals, mercifully uncommon in Hong Kong, can tie up a construction project for days, weeks or even months.

Add to all that the possibility of fraud or corruption such as we've been seeing in the recent short piling scandals. All of these factors combine to produce a stressful environment that lends itself to quick fixes and communications lapses. In short, a recipe for discord.

But perhaps we needn't remain hopelessly locked in the adversarial posture.

Prevention and Treatment Of Disputes

The size and complexity of construction projects should provide the incentive to take "preventive" measures — right from Day One. By establishing good communications channels right from the start, the parties can often prevent the communication gaps and misunderstandings that are usually the beginning of larger disputes. When differences arise, as they inevitably do,

quick effective treatment may mean the difference between a happily continued project and an expensive and acrimonious dispute, mired for years in legal quicksand. To keep even large and complex projects from getting out of hand, there are some simple basics to consider.

- *Clarity: Say what you mean and mean what you say*

It's all too easy for parties to hammer out an agreement orally, "in principle," only to find when it is reduced to writing, that they haven't agreed at all. Or that one side has "moved the boundaries". Common law being what it is, everyone needs to ensure that the agreement they thought they had is the one actually incorporated into "the four corners of the contract" — before it is put into writing. All too often, in Hong Kong, the real negotiations don't start until after the contract is signed.

Another very common pitfall is not reading the fine print. Countless disputes originate with parties who blissfully agree to a specific term of the contract which completely contradicts the general terms contained on the following pages.

Vague, confusing or downright contradictory wording is a major source of disputes. Negotiating parties should take care to use precise words and short, clear sentences to express their agreement. Contract drafting is not a vocabulary test; using three or four different terms to express the same idea only clouds the issue. Convoluted sentence structure is challenging for a native speaker; think how difficult it will be for someone whose usual language is not that of the contract!

The specialized nature of construction law has produced its own jargon to express the ideas and relationships involved in a major complex project. BOT, BOO, demand bonds, hardship, frustration, impossibility, force majeure — to mention just a few. To add to the confusion, the definition of these terms may vary from one jurisdiction to another. A perfect example took place during a mock project finance negotiation I ran some years ago in Paris. One team of negotiators was from Singapore while the other was from Cote d'Ivoire. The two sides agreed that the law to be applied to their contract was that of the place of "execution" of the contract. Trouble was, the French word "execution" translates into English as "performance" while the English word "execution" means the act of signing, sealing and delivering the contract. The project was to be built in Cote d'Ivoire but the

contract was signed in Paris. In the end the facilitator intervened to point out to the teams that they really hadn't agreed at all!

- *A balanced agreement*

The employer or contractor who walks away from the negotiating table rubbing his hands in glee at having obtained a massive advantage for his own side, may not be grinning for long. Experience shows that the best contracts — the ones that produce the fewest disputes — are realistic agreements where each party can live with the deal from beginning to end. Impossible time constraints, hiding relevant but expensive legal or physical defects in the property, shifting the risk of hidden ground conditions to the contractor, insisting on draconian performance guarantees — these are strategies that all too often backfire by making the contract commercially, if not physically unviable. A few months down the line, a party that realizes it is losing money on a project because of some nasty surprise is going to do its darnedest to get out of the deal. Or failing that, will cut corners and produce a building that isn't at all what the owner expected. The contractor who submits a rock-bottom tender, counting on extras and overruns to recuperate its loss, is guaranteeing himself an expensive legal battle.

"Balance" in a contract also implies a logical and realistic allocation of risk. Who has most to lose if the risk materializes? Which party can best prevent the risk from materializing? Who can best handle the event if it does occur? Who should bear the risk if it cannot be controlled? Is insurance available, to whom, and at what cost?

- *Put it in writing!*

Construction projects, by their nature, take many months or years to complete. The French have a saying, "The written word remains." While we may disagree later on what we meant, or have vastly different recollections of what we said, a note scribbled on the date of the event can make a huge difference years later in ascertaining just what did transpire. If however, the note is cryptic, undated or illegible, it may be worse than nothing, as parties all waste time trying to interpret it in the light most favourable to themselves. A note that "the ceiling needs another coat of paint" does not help determine whether that final coat was indeed an "extra" to be paid over and above the contract price, or simply a rectification on an initially sub-standard job. If that coat of paint

happens to be to the ceiling of an international airport, at a cost of \$15 or \$20 million, the engineer scribbling the note might well have considered adding a few clarifications!

- *Partnering*

A relatively new preventive measure imported from the U.S., partnering establishes from the start of the parties' working relationship, a system of regular communications between those responsible on both sides for the implementation of the contract. Often guided by an outside facilitator, specifically designated executives from both sides have the responsibility to keep lines of communication open and to work together to solve problems as they arise, before they can deteriorate into full-blown disputes. Many firms, skeptical at first of the added investment of time and management energy, have noticed that fewer serious disputes translate into tremendous savings in time, energy and legal fees further along the road. In fact partnering can be a powerful factor in realigning the parties from their traditional adversarial stance to a more productive partnership with common goals and a "win-win" attitude.

- *Mediation / Conciliation*

If a dispute does arise, and the usual negotiating channels prove ineffective, the parties may ask for outside help. The Hong Kong Mediation Council can testify that this option has become very popular here. Mediation and conciliation are non-binding processes for resolving disputes using a neutral party to facilitate party-to-party negotiations.

Unlike a judge or arbitrator, the mediator or conciliator has no power to impose a legally binding solution. The process is flexible. It may be simply an evaluation process. Or the neutral may more actively guide the parties' negotiations by evaluating the parties' arguments and suggesting possible solutions.

Some people distinguish between mediation and conciliation by the degree of involvement of the neutral, with a mediator being a facilitator only, and a conciliator taking a more active role in suggesting a solution. In other circles, the two words are used interchangeably. In any case, the process may be private and completely voluntary, or it may be attached to and imposed as part of a national court system. In either case, the parties can speak directly to each other to explore both

judicial and more original extra-judicial possibilities for solution, while maintaining complete control over the decision-making process. The mediator or conciliator does not decide, but will manage the process, keeping channels of communication open, while trying to uncover the positions and interests of the parties and explaining to them the implications of failing to reach a settlement.⁽²⁾

- *Mini-trial*

In a mini-trial, the non-binding dispute process is taken a step further. First, key decision-makers from both sides — not those directly involved in the dispute, but generally the chief executives — need to be involved. The neutral has each party's counsel present an abbreviated version of its best case. Then the neutral and two executives sit down, generally without their lawyers, to discuss the issues.

Part of the charm of the mini-trial is that in many cases, the process is the first time that the senior executives actually have a clear and realistic picture of their own case and that of the other side. Once faced with the real situation, devoid of the personal and political embellishments of those intimately involved in the dispute, the executives can frequently arrive at a commercially acceptable solution. Given the "hands-on" management style of many Hong Kong corporations, some of which are still family-operated, we may not have the same necessity for involving the senior directors; they are often intimately involved from the outset. The cost of mini trials can vary wildly, but a "guesstimate" might be in the neighbourhood of HK\$200,000. That outlay may make parties hesitate in all but the most costly and complex projects.

- *DRA and DRB: Dispute resolution advisors and boards*

Another high price-tag option is the DRA, or even more expensive, the DRB. On some major contracts, notably those under the 1999 FIDIC conditions, the parties jointly appoint an outside advisor or panel to become familiar with the project, meet those responsible for its implementation, and attend monthly site meetings. The Hong Kong Architectural Services Department first used a DRA in the construction of the Queen Mary Hospital extension as a pilot project. Since then, it has

used DRAs on 24 completed projects and 12 others which are not yet finished.

The Hong Kong Airport was one of the first major projects where a dispute resolution board was constituted. A board of eminent neutrals visited the site and received regular progress reports and were advised of issues arising throughout the life of the project. Because they were involved from the start, they were always "up to speed" and thus able to react quickly and realistically to decide disputes as they arose — while the information is readily available, and memories are fresh. The neutral, independent person or body may also offer objective insights and guidance to head off a potential problem, and may discourage the posturing and polarization that frequently occur on sites. A party who is unhappy with the decision of the board or advisor can file a notice of appeal to a judge or arbitrator, usually within a few weeks, and the question will be revisited — once the project is completed. According to Peter Turner, the success of the Hong Kong DRA pilot project will probably lead the government to implement it in other areas where it is important to minimize the adversarial stance often assumed by the parties to a construction dispute. ⁽³⁾

Nevertheless, the cost factor makes this option feasible only for mega-projects that can profit from enormous savings when disputes are avoided or settled efficiently.

• *Non-binding Expertise*

The parties appoint a recognized expert to give an opinion on a specific issue. The opinion is not legally binding, but in the event the dispute does not settle, either side may use the opinion as evidence in the ensuing litigation or arbitration proceedings. This method can be very useful in circumstances where the disputed issue is a narrow and technical one. If the parties cannot agree on a suitable expert, they may refer to an appointing body such as a professional association or the ICC's Centre for Technical Expertise.

• *Litigation*

The usual forum for obtaining a binding legal decision in a domestic case is a court in the country where the dispute is located. Hong Kong's court system is quite efficient, and judges are familiar with the issues that arise repeatedly in construction cases. It can take anywhere from

9 months to two years, but it is possible to get a fair and binding decision in our courts. In other countries the court system may be overloaded, unfamiliar with the technical issues, or — at worst — partial to one side. In some countries, it can take over 15 years for a case to be heard and all levels of appeal exhausted. Nationals of a country should know whether or not to trust their court systems; Hong Kong companies working in a country for the first time should make it their business to get local advice about what to expect from the local justice system.

• *Adjudication*

The Woolf law reforms of 1996 in the United Kingdom brought in a system of court-annexed adjudication for a variety of contractual disputes including construction. Before a dispute can be set down for hearing in the court, it must be heard by an adjudicator whose decision is final unless one of the parties appeals within a brief time span. Among its advantages is that the parties must prepare their cases far in advance. Early analysis of the strengths and weaknesses of both sides may produce more realistic expectations and encourage the parties to settle and avoid the risk of a less favourable judgment down the road. In the few years since its initiation, adjudication has drastically reduced the number of cases reaching trial. So far, although there has been discussion in Hong Kong legal circles, current wisdom holds that adjudication is more effective in smaller simpler cases, rather than for the complex and technical construction disputes. Hong Kong has not implemented the system.

• *Arbitration*

The usual method of resolving disputes in international cases is by arbitration, a system of private justice where the parties agree to use a private decision-maker instead of going to court. The arbitrator or arbitral tribunal derives power not from any state government, but from the parties' agreement. The resulting arbitral award will be enforceable as if made by a judge.

Why Arbitration is Popular

By agreeing to use a private system of justice, the parties are in effect subtracting their dispute from the jurisdiction of the national court

system that would normally be competent to decide their case and having a private person do the job.

Contrary to widespread belief, arbitration is not just a system of "cutting the baby in half" or reaching a compromise solution. The arbitral panel is usually mandated to decide on legal grounds and to give written reasons justifying their decision. Only if the parties specifically authorize it can the panel impose a decision which is not based in law but on some notion of what is fair and commercially viable.

Considering the cost of paying the arbitral tribunal's fees and expenses as well as the administrative expense of the administering institution, the expense of private justice can at first appear daunting. Since the parties (or at the end of the day, at least one of them) are expected to pay for this service, what advantages would lead them to take on this extra financial burden?

In fact, arbitration used to be considered as a "faster, cheaper, simpler" procedure than litigation in national courts. As cases become more complex, the stakes get higher, and lawyers resort to procedural arguments, this may no longer be particularly accurate. Whether arbitration is indeed "faster, cheaper and simpler" than litigation will depend largely on the dispute, the attitude of the disputants, and which national court system is being compared.

In jurisdictions like Hong Kong, which has one of the most modern and functional arbitration laws in the world, judges favour the use of arbitration, and the system works well. However, in countries where the judiciary still insists on "overseeing" the process, and out-moded laws limit the authority of the tribunal, the arbitration process can still become entangled in lengthy court battles.

Arbitration does however, offer certain advantages, especially when the parties come from different countries and legal cultures.

- It generally takes place in a neutral forum so that neither side feels disadvantaged by unfamiliar courts, procedures, and language.
- Parties need not "queue up" for a space in a crowded court calendar where the first available trial date may be years after both parties have declared themselves ready. What they may have to wait for however, is

for the arbitrators and their counsel to find time in their crowded diaries to allow everyone to get together.

- The parties can be confident that the decision-making procedure will be custom-designed with them, their situation, and their convenience in mind. They are at liberty to agree, with the arbitral tribunal, on a flexible process, with or without discovery, with or without formal testimony and cross-examinations, with simplified pleadings and time limits that suit them.
- Without formal procedural or traditional requirements, neither party will have to have its relevant documents translated, or swear a religious oath that means nothing or is repugnant.
- The parties are able to choose the person or agree the process for appointing the arbitrator(s) who will decide their case. Depending on the nature of the dispute, they may require that the decision-maker have engineering, quantity surveying, design, legal or other technical background. With a decision-maker who knows the industry and has practical experience in dealing with the players, parties don't need to "educate their judge" before being able to put their cases forward. This shortens the process and tends to produce a commercially practical solution.
- Novel or different techniques such as witness statements and video-conferencing, may be used to facilitate the process.
- A private and usually confidential process, arbitration is not subject to the public scrutiny of an open court, and thus is a more confidential process that can be important in shielding sensitive technical or political information from the media and can tend to facilitate settlement rather than further polarize the parties.
- In most cases the parties will agree that the arbitrator's decision is final, renouncing their rights to lengthy and costly appeals. Since generally the decision of the arbitral tribunal is not subject to review by another court or tribunal, it is important that the decision be of good quality. Thus, the arbitrators should be carefully chosen. The decision must result from a fair procedure before a properly constituted and impartial tribunal, which has used the authority vested in it by the

parties — but has not exceeded that authority by deciding issues it was never asked about. Some matters are not capable of being settled by arbitration, although the list is shrinking. For example, an arbitral tribunal cannot grant a decree of divorce. And of course, since the arbitral panel's authority comes from the parties' agreement, the parties must express that agreement clearly and unambiguously, usually by inserting an arbitration clause into their contract.

The New York Convention on the Recognition and Enforcement of International Arbitration Awards of 1958

The New York Convention is doubtless the most successful commercial treaty in history. Now ratified by over 120 countries, it provides a theoretically simple system for the nearly universal recognition of arbitration awards, a clear advantage of arbitration over state court judgments. Nearly all major trading nations are parties to the Convention. Today it is rare to find an international construction contract that does not have an arbitration clause. Under the terms of the Convention, if parties have chosen in their contract to refer their dispute to arbitration, national judges will in most cases decline to hear the case. When it comes to enforcement, the party attempting to resist the award has the onus of proving why it should not be executed. There are very few grounds available under The New York Convention to persuade a judge in a contracting state not to enforce an arbitral award.

Nevertheless, in some countries the theory (ratification of the convention) is not matched by the reality (getting the award enforced). Anyone working in a foreign country for the first time is well advised to get early local counsel to find out just what kind of attitude the local courts have to arbitration.

Basics: What to Consider When You've Decided to Use Arbitration

Having covered the "What" and the "Why?" of arbitration, let's now examine some of the other basic questions:

How? Basically parties have a choice between arbitration administered by an institution (such as the International Court of Arbitration of the ICC, ICSID, the HKIAC or a

host of other international or regional centers) and "ad hoc" arbitration, which simply means that the parties' lawyers and the arbitrators work out all the administrative details. The initial up-front cost of an institution is generally a good investment in all but the simplest of cases, and indeed may end up saving everyone a great deal of money. Institutional arbitration, with its own set of rules, is particularly useful for parties or their lawyers who have not previously been involved in arbitration.

Who? We've already pointed out that since the award is final and binding and not subject to review, so it had better be a good one! Hence, the decision-maker's impartiality, qualifications, experience and management abilities will be crucial. Look for someone familiar with your industry, with a solid and respectable reputation. Knowledge of the legal background of the dispute and linguistic abilities can make or break the arbitration. The person also must be available to give your case attention within a reasonable time period. The best arbitrator in the world is useless if you can't get an appointment for two years! In choosing an arbitrator, ask colleagues in the industry who has done a good job for others. If you are using an institution such as ICC, or LCIA or one of the regional dispute resolution centers, you can have the institution appoint the tribunal or its chair.

Where? Each party will probably prefer to have the case heard on its own territory, and will resist going to the country of the other. The stronger negotiator may win out, or there may be a stalemate in which case the institution can decide where to hold the proceedings. Generally the institution will not choose a venue in the jurisdiction of either party, but a neutral forum, as the official site of the arbitration. However, if the case requires site visits, hearing of multiple witnesses or voluminous documents, the tribunal can usually decide to have one or more meetings in other locations. In any case, the legal venue of the arbitration can have a great bearing on the efficiency of the process. By inadvertently choosing a jurisdiction with archaic laws, the parties may be letting themselves in for months and years of interim proceedings and interference by the local judges.

When? Neither too early nor too late. If your contract specifies that negotiations or

expert valuation or conciliation proceedings must precede the arbitration, it should also stipulate a clear and finite time period, after which either party is at liberty to request arbitration. If you jump the gun, the other party will respond saying the arbitrators have not jurisdiction until you've "finished" negotiating. If you leave your claim too late though, it may be time-barred.

The really important "When?" however, is when to think about all these things. Certainly, not once the dispute has arisen! The best time to consider all of these factors is at the beginning, when you are putting the deal together. The dispute resolution clause is often referred to as the "midnight clause" because it's generally around then that the negotiators get to thinking of it. Everyone is enthusiastic about the new project and no one really wants to spoil the party by suggesting that they may have a falling out. However, if it is difficult to address the issue of dispute resolution then, how much more difficult it will be when the parties are no longer friends!

Other considerations

Parties choosing "ad hoc" arbitration will need to think about how to manage the case from a procedural point of view. The UNCITRAL Rules for Arbitration, first published in 1976, provide an acceptable framework for administering the arbitration, while allowing considerable flexibility. Some partners choose to establish their own rules. This is an exercise fraught with danger, where the parties risk finding themselves inextricably tangled in a procedural nightmare. In the first place, it will necessitate a clear and detailed arbitration clause, failing which the parties will not be able to proceed at all. Institutions on the other hand, all have their own "model" clause, which can be used as is or adapted according to the parties' wishes. With ad hoc arbitrations, the parties and their lawyers need to focus more on the procedure instead of concentrating on the issues they are arguing over.

In an international case, each party will naturally want its own law and language used in the procedure. While the advantage of using your own language is clear, it may be less so if all the evidence is in another language and needs to be translated for the tribunal.

Before deciding which law you want to apply to the dispute it is a good idea to know something about the effect it will have. Many a strong but unprepared negotiator has found to its horror that by "winning" the right to have a dispute judged under its own law, it has in fact given up a wonderful advantage that would have been available under the other party's law!

Coming Full Circle...

If you've stayed with me up until now, you should have a distinct impression that the time to think about resolving disputes is not when they arise, but at the very beginning, when everything is going well and you're about to sign that contract. As well as all the important bits about prices and risks and valuations and overruns and quality and the rest, consider the value of an initial investment in dispute prevention and resolution. That is the time when you and your partners can be really creative in maintaining communication and a spirit of cooperation, and in dealing with small lapses and misunderstandings before they balloon into major acrimonious disputes. Clarity of thought, good drafting, built-in mechanisms during the life of the contract, and a variety of avenues to explore solutions to problems — it may seem like an awful lot of homework, but if you can reach the end of the relationship without a serious fight, chances are you'll have saved your company an awful lot of money and grief. More important, you may have made a new friend who will be eager to be your partner on the next project! ☐

- 1 Grove, Jesse, *Consultant's Report on Review of General Conditions of Contract for Construction Works for the Government of Hong Kong SAR*, September 1998 (Agreement CE 99/97) at p. 9
- 2 See Scanlon, K.M., *Mediator's Deskbook*, CPR Institute for Dispute Resolution, NY 1999 p.1-2
- 3 For more information about DRAs, see Turner, P., *Dispute Review Advisers in Hong Kong*, in *Asian Dispute Review*, Sept. 2000

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