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Arbitration of Disputes in the Construction Industry

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Arbitration is best defined as a process by which parties consensually submit a dispute to a non-governmental decision-maker, selected by or for the parties, to render a binding decision resolving a dispute in accordance with neutral, adjudicatory procedures affording the parties an opportunity to be heard.

G Born *International Commercial Arbitration* (Kluwer, The Netherlands, 2009) at 217

1. Introduction

Dispute resolution in the construction industry is a subject viewed with the deepest of suspicion by all but construction law specialists. At the time that contracts are drafted, no one wants to discuss disputes avoidance, let alone setting procedures for settling with full blown disputes when they eventuate.

Over the last 35 years of drafting contracts, I have drafted complex multi-tiered disputes procedures, required chief executives to negotiate directly before formal steps are taken, deferred arbitration till project completion, and provided for disputes boards, project mediation and mandatory mediation. I have even tried putting the disputes clauses at the front of documents in the hope they would be read and considered during contract negotiation. In no case have I managed to stimulate any meaningful discussion over how disagreement is to be dealt with.

I confess, I find this odd. Construction contracting requires the parties to enter into binding commitments in relation to work which is, at best, vaguely defined, minimally designed and generally full of uncertainty, yet we deal with disagreement over the unforeseen in the most haphazard fashion.

It is my suspicion that the reason for this is optimism at the start of the project, a reluctance to consider disputes at the start of the project, and an innate, though misguided, belief in project managers that they can negotiate any difficulties as they arise. Experience suggests otherwise.

The fundamental nature of construction projects, and ICT development as well, is that they need a framework to deal with uncertainty. These are high value, long term projects where disagreement is inevitable and the cost of project failure numbing. The reality is that,

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unless more sophisticated procedures like disputes boards are adopted, construction contracts need a staged process for dealing with such disagreement:

(1) *direct negotiation* – pretending a disagreement will go away is unrealistic, and the earlier the parties identify and deal with disagreement the better.

(2) *binding interim determination* – there is much to be said for deferring formal, final determination until either the project is completed or the contract terminated. For that to be effective, the parties must have a neutral, trusted and competent procedure for interim binding determination of disputes. Adjudication has the potential to provide this, if used effectively.

(3) *arbitration* – once the project is completed, or worse the contract terminated, arbitration will provide a final and binding determination of any disputes.

The alternative of disagreement evolving into full blown dispute during the project is surely unattractive to all involved.

2. The end of the road

Arbitration, or litigation in court, is literally the end of the road in any disputes resolution process. At that point, any chance of completing the project has flown and the parties' resources are devoted to prosecuting their respective cases rather than procuring a successful project outcome.

Due to the complexity of construction disputes, regardless of the preferred procedure, this will involve:

(1) reviewing the cause of action or defence to it (and any possible counterclaim) and likelihood of success;

(2) reviewing and disclosing relevant evidence;

(3) interviewing witness and assisting with the preparation of witness statements;

(4) instructing experts, and reviewing their reports;

(5) preparing pleadings and submissions;

(6) reviewing legal authorities;

(7) presenting the case, including leading evidence, cross-examination and presenting argument at a hearing; and

(8) reviewing the decision.

None of this comes cheap, but we are encouraged, certainly by our legal advisors, to present the case as well as possible and get the law roughly right.

Arbitration has the edge over traditional court litigation for a number of reasons.

Historically, arbitration was preferred in the construction industry as it was considered technically challenging, requiring specialist arbitrators. With the increased use of experts,

and the development or arbitration, much of that justification has fallen away. Arbitration has become, for lawyers, a specialist field of practice of its own.

Today, arbitration offers:

(a) the ability for the parties to agree on an arbitrator of their choice;

(b) the freedom to select a procedure which best suits the matters in dispute;

(c) the flexibility to argue the substance of the dispute with less procedural delay, and overall achieve a binding decision on the substance more promptly; and

(d) confidentiality.

Ultimately, the aim of the final forum in any disputes resolution process is for the substance of the dispute to be dealt with in a manner which is proportionate and enables the parties to present their cases, have them considered and a durable, final and binding decision made.

This is something which the court system struggles to achieve. For the calendar year ended 31 December 2016, there were 2,602 new civil cases lodged in the High Court, with a mean waiting time for a hearing of 286 days.[1] By way of comparison, the District Court had 666 new civil cases for the 2016 year, they disposed of 788 cases and had 523 active cases; the Family Court, conversely, had 59,449 new cases, 58,338 disposals and 23,848 active cases over the same period.

Where cost is a factor of time, the savings of prompt arbitration should be apparent.

While the comment can be made that arbitration is indistinguishable from court litigation from the cost and time perspective, that criticism must surely rest with counsel and arbitrators for not taking robust control of the process.[2] As UK Technology and Construction Court Judge Rupert Jackson has observed in relation to the Wembley Stadium redevelopment:

> *… both parties bicycled over the edge of the precipice and plunged into the abyss. Costs were escalating. Huge amounts of management time were being deployed to no useful purpose. Neither party was going to escape from the abyss with any financial benefit.*

In NZ, our longest running High Court action was the Carter Holt Harvey dispute with Rolls Royce in relation to the Kinleith cogeneration plant. That case ran for 12 months, with nothing more achieved than the experts reading through their evidence in chief.

The point about arbitration is that it gives the parties the ability to avoid jumping through procedural hoops before getting the substance of the dispute before the arbitrator, and it allows the parties to select an arbitrator who has the capacity and necessary skills to determine the dispute effectively.

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[1] Source - https://www.courtsofnz.govt.nz/publications/annual-statistics/latest-december-2016/high-court

[2] See for example the robust criticism of Jackson J over £1 million of photocopying costs and £12 million in expert costs incurred in relation to the case of *Multiplex Constructions (UK) Ltd v Cleveland Bridge UK Ltd* [2008] EWHC 2280 (TCC).

3. How does arbitration work

As carefully described in the Gary Born quote at the head of this article, arbitration is a consensual process by which the parties chose their decision-maker to determine the dispute in a fair manner.

In NZ, arbitration is governed by the Arbitration Act 1996, which outlines as its purposes:[3]

(a) to encourage the use of arbitration

(b) to promote international consistency based on the Model Law[4]

(c) to promote consistency between domestic and international arbitration in NZ

(d) to redefine and clarify the limits of judicial review

(e) to facilitate enforcement and recognition of arbitral agreements and awards

(f) to give effect to the NZ Governments international commitments[5]

The Act is divided into three essential parts – the Act itself, which outlines the overarching laws in relation to arbitration; Schedule 1, which sets out the Model Law provisions applicable to both domestic and international arbitrations; and Schedule 2 which sets out the default domestic rules applicable to arbitration (opt-out), which may be adopted for international arbitrations by agreement (opt-in).

The provisions of the Model Law are largely procedural, covering issues like the requirements for the agreement to arbitrate, appointment of the arbitral tribunal, interim measures and preliminary orders, conduct of the arbitral proceedings and provision of the award.

Schedule 2 deals with the default procedure for appointment of the tribunal, consolidation of arbitral proceedings, powers of the tribunal, determination of preliminary points of law by the High Court, appeals on questions of law, and costs; each of which may be adopted or varied by agreement.

Procedurally, a typical arbitration will take the following form:

(1) Agreement to arbitrate

The agreement to arbitrate may be in writing or it may be oral.

Most arbitration clauses in construction contracts are reasonably spare. Clause 13.4 of NZS3910:2013 provides:

> *13.4.1 If either* [the parties are dissatisfied with the Engineer's decision or no decision is forthcoming] *then either the Principal or the Contractor may by notice require that the matter in dispute be referred to arbitration.*

[3] Section 5 of the Arbitration Act 1996

[4] Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law, 21 June 1985, amended in 2006.

[5] See in particular the New York Convention on the Recognition and Enforcement of Foreign Awards 1958.

13.4.2 A notice requiring arbitration shall be in writing and shall be given … within 1 month … after the Engineer's formal decision … [the conclusion of mediation] or … *a relevant Adjudicator's Determination …*

13.4.3 The dispute shall be referred to a sole arbitrator …

13.4.4 The arbitrator shall have full power to open up, review, and revise any decision, opinion, instruction, direction, certificate, or valuation of the Engineer …

13.4.5 No decision given by the Engineer … shall disentitle him or her from being called as a witness …

13.4.6 Where the matter has been referred to mediation, the mediator shall not be called by either party as a witness. No reference shall be made to the decision, if any, given by the mediator in respect of the matter in dispute.

13.4.7 The award in the arbitration shall be final and binding on the parties

NZIA's SCC1 includes an arbitration agreement, providing for a sole arbitrator (unless the parties cannot agree, in which case the parties appoint an arbitrator each, and the arbitrators then appoint an umpire). The tribunal has similar powers as in NZS3910.

FIDIC provides for arbitration by a three member tribunal, in accordance with ICC Rules. Unusually, NEC3 leaves it to the parties to choose whether to refer disputes for final determination in arbitration or in court.

In default of agreement, the Arbitration Act provides for the arbitral tribunal to be appointed by the Arbitrators' and Mediators' Institute of NZ.[6]

(2) Notice of dispute

In most cases, the arbitral procedure is commenced by the issue of a notice outlining the dispute. It is that dispute which the arbitral tribunal is seized of, and ultimately is the limit of the tribunal's jurisdiction.

(3) Emergency arbitration

The Act contains provision for the appointment of an emergency arbitrator for the purposes of granting preliminary measures and/or preliminary orders.[7]

The procedures for the appointment of the emergency arbitrator are either to be by agreement or in accordance with any institutional rules agreed by the parties (see the discussion below in relation to the AMINZ Arbitration Rules).

For construction disputes, interim measures could include such issues as the protection of the site, goods and materials and design documents, and in some cases restraining the making of demand under a performance bond or other guarantee.

[6] The Arbitration Amendment Act 2016 substituted a nominating body, appointed by the Minister, for the High Court in relation to all such appointments. AMINZ was appointed in March 2017.

[7] See articles 17 to 17M of Schedule 1 to the Act.

(4) Appointment of the arbitral tribunal

The selection and appointment of the arbitral tribunal is, for many, one of the most important steps in the process.

Yet, most agreements are perfunctory at best in dealing with this issue.

Article 11 of Schedule 1 to the Act provides that the parties are free to agree a procedure for appointment and if they fail to reach agreement, the appointment is to be made by AMINZ. The default procedure in clause 1 of Schedule 2 to the Act (the *quickdraw* procedure) provides for the parties to try to agree, and if they fail to agree, for either party to serve notice on the other nominating their preferred arbitrator. If the parties then fail to reach agreement, the nominated arbitrator is appointed by default.[8]

(5) Submissions and disclosure

Following appointment of the arbitral tribunal (including accepting the terms of appointment and payment of any security for the arbitrator's costs), the first step is the preliminary conference, which deals with preliminary issues and timetabling matters.

The issues covered during the first preliminary conference include:

- details of the parties and their lawyers
- the signature of the arbitrator's terms of engagement
- setting security for the arbitrator's costs
- finalisation of the agreement to arbitrate
- discussion of the issues in dispute
- timetabling the exchange of pleadings, disclosure of evidence, submission of witness briefs, submission of agreed bundles of documents and authorities relied upon
- requirements for experts
- timetabling of the hearing, and likely witnesses to be cross-examined and any hearing requirements
- costs and agreement on appeals on questions of law

It may well be, and frequently is the case, that further conferences are required. After each conference, a minute is issued, recording matters agreed and also issuing any directions to the parties.

[8] See the discussion of Hansen J in *Hitex Plastering Ltd v Santa Barbara Homes Ltd* [2002] 3 NZLR 695, and Muir J's minute in *Body Corporate 200012 v Naylor Love Construction Ltd* CIV-2017-404-247, High Court Auckland, 26 April 2017.

Any jurisdictional challenges should be raised and dealt with as soon as practicable, so the tribunal can dispose of such challenges before the process has gone too far, and significant costs incurred.[9]

The parties are generally free to agree on the procedure to be followed,[10] and a failure to comply with the procedural requirements may result in the proceedings being terminated or being continued, without the defence.[11]

(6) Hearing(s)

The overarching obligation of the arbitral tribunal is to treat the parties equally and to give each of them the opportunity to present their case.[12]

In most cases, counsel give a brief opening statement summarising their case, then proceed to presenting their evidence.

While some counsel will insist on having the opportunity to present their client's evidence in chief, that is the exception. Typically, witness statements are sworn, witnesses are asked if they wish to add to anything, and then the parties proceed directly to cross-examination and re-examination.

After the presentation of evidence, the claimant then the respondent are given the opportunity to make their submissions (and the claimant then submissions in reply).

In complex cases, it can be helpful to have a transcript taken of the evidence; in more straightforward cases, a recording will usually suffice.

(7) Award(s)

The arbitral tribunal then issues its award.

There is no time requirement for the issue of the award (unless agreed by the parties), however in most cases an award should be forthcoming in a matter of months, if not weeks.

Unless the parties agree, the award must contain reasons. Previously, the courts have made a distinction between technical arbitrations, for example grain prices or "baseball" arbitrations, where no reasons need be given, and more complex arbitrations where evidence needs to be weighed up and arguments and other submissions considered. That position has changed.

The general test for the adequacy of reasons is that the tribunal needs to show that it has considered the factual evidence provided to it, weighed it and justified any findings of fact in such a manner that satisfies the parties that their evidence and submissions have been considered, and it must show that it has also properly taken into account any legal

[9] See article 16 of Schedule 1 to the Act – any challenge to jurisdiction must be raised before the submission of the statement of defence.

[10] See article 19 of Schedule 2 to the Act.

[11] See article 25 of Schedule 1 to the Act.

[12] See article 18 of Schedule 1 to the Act.

argument and provided sufficient legal analysis to also show that all arguments were taken into account.[13]

4. Making the most of it

Much of the cost and delay in court proceedings can be avoided in arbitration by counsel and arbitrators taking a more robust approach to what arbitration has to offer, and by not simply mirroring court procedures; arbitration is not "court litigation in drag".

Agreement to arbitrate – the Arbitration Act covers a number of issues which are subject to agreement. While providing for all disputes to be determined by a sole arbitrator in accordance with the Arbitration Act is a good start, it is possible to do more.

Appointment of the arbitral tribunal – the appointment of the arbitral tribunal can be problematic, typically to no real benefit of the parties. Consider simply requiring the tribunal to be appointed by AMINZ.

Arbitral procedure – truncate the procedure by outlining the process of submissions, exclude the traditional rules of evidence providing instead that the parties are to disclose all information relied upon by them, require the parties to provide memorials setting out their cases rather than statement of claim/statement of defence in the traditional manner.

Issues hearing – prior to the evidential hearing, and after submission of the pleadings, require counsel to present their submissions at a preliminary hearing. This has the benefit of forcing counsel to consider their cases in more detail than is otherwise the case.

Agree the issues in dispute – at the outset, get counsel to agree the issues in dispute, and to provide an agreed bundle of documents and, if possible, identify matters of fact in dispute.

Experts – explore using tribunal appointed experts, where possible.

Witnesses – dispense with evidence in chief, and get key witnesses to confirm their evidence, add anything that may be relevant and go directly to cross-examination and re-examination. Direct examination of witnesses by the tribunal can also be helpful.

Hearing – require counsel to exchange their opening submissions prior to the hearing, and set time at the end of the hearing for them to present their final submissions. There will be occasions where the final submissions have to be presented later, but it is helpful for them to be presented in writing and orally, so they can be discussed.

Partial awards – where issues of jurisdiction, liability and quantum are linked, consider splitting the hearings and submissions and issuing sequential partial awards.

Appeals – exclude appeals on questions of law, but if the parties are insistent, the provide for all such appeals to be heard by the AMINZ Arbitration Appeals Tribunal.

[13] See the recent Court of Appeal decision in *Ngāti Hurungaterangi & ors v Ngāti Wahiao* [2017] NZCA 429

5. AMINZ Rules and procedures

Over the last few years, AMINZ has adopted a number of procedures to make arbitration more attractive to users:

AMINZ appointments policy – AMINZ is mandated to make a number of appointments whether by statute or agreement. In order to provide for more transparency over such appointments, and to provide comfort to the parties that the best person is being appointed to the role, AMINZ has established an appointments advisory panel, comprising practitioners from all fields of dispute resolution. Prior to making an appointment, the President or the Executive Director (as appropriate) consults with selected members of the panel over the best appointment to make from the relevant panel.

AMINZ stakeholder account – AMINZ runs a stakeholder account to hold payments on account of members' fees. Typically, parties are required to pay an estimate of the fees into the account as security for the member's costs and expenses. The moneys are then paid out on production of an invoice.

AMINZ Arbitration Rules – earlier this year, AMINZ promulgated its Arbitration Rules. The Rules follow international best practice, as appropriate for both domestic and international arbitration in NZ. In particular, the Rules provide for:

- The use of emergency arbitrators for the award of interim measures and preliminary orders.
- Agreement on the appointment of the arbitral tribunal, including the UNCITRAL procedure for the nomination and ranking of candidates by the parties.
- Expedited arbitration for disputes under $2 million and with no complex legal or factual issues in dispute.
- Summary dismissal of hopeless claims.
- Guidance by IBA rules and guidelines on conflict of interest, party representation and evidence.
- The option to have the arbitration administered by the AMINZ Registrar.
- Defined procedures for submission of documents.
- The use of tribunal secretaries by the arbitral tribunal, where appropriate.
- The exclusion of rights of appeal on questions of law.

AMINZ Rules and Guidelines on Awarding Costs in Arbitration – clause 6 of Schedule 2 to the Act provides for the arbitral tribunal to *fix and allocate* the costs and expenses of the arbitration, including parties' costs.

This is an issue which can, and ideally should be agreed between the parties at the first preliminary conference. If left to the tribunal and counsel, there has been a habit of simply providing for *reasonable contribution* to the winning party's costs, in the same manner as civil litigation in the courts. There is little justification for this approach, and on that basis AMINZ has produced rules and guidelines on the award of costs in terms of clause 6.

AMINZ Arbitration Appeals Tribunal – clause 5 of Schedule 2 to the Act provides, by default, for appeals on questions of law to the High Court. Appeals on questions of fact are not permitted.

Ideally, the parties should give serious consideration to excluding appeals. They are lengthy, expensive, frequently uncertain, and they simply provide the unsuccessful party with the opportunity to defer the inevitable by rolling the dice on appeal. In the alternative, AMINZ has established an Arbitration Appeals Tribunal to hear such appeals instead of the High Court. All such appeals are to be heard by retired High Court judges, and the procedure is prompt and maintains the confidentiality of the arbitral process.

6. Conclusion

Arbitration has considerable benefits over court litigation, the most obvious being *party autonomy*. This enables the parties to have their dispute finally resolved by an arbitrator of their choice, following a procedure best suited to the matters in dispute.

If used pragmatically, and administered robustly, arbitration has the potential to distinguish itself from traditional court litigation by getting the substantive issues in dispute before an arbitrator more promptly than would be the case in court and resulting in a durable, enforceable award more cost effectively.

Ultimately, that is in the hands of the parties. The construction industry has a long history of the successful use of arbitration. To make the most of it, the participants (counsel and arbitrators) need to avoid simply mirroring the procedures of court litigation and use the process more effectively.

Both the Act and the procedures and guidelines AMINZ has developed from it do provide for the parties to do just that.

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