

Special Features and Experiences of the Construction Industry- Arbitration in Sri Lanka

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Abstract

The construction industry in Sri Lanka covers a complex and comprehensive field of activities involving many operative skills and conditions, which vary considerably from one project to another. The dispute might arise at any point during the construction process. Generally, there is a low standard of contract formation and of contract administration in the construction industry, which lead frequently to unnecessary problems and disputes. The contract parties usually enter into a dispute as a result of differing expectations or misinterpretations of the contract documents.

Arbitration is a voluntary procedure available as an alternative resolution to litigation but not enforceable as the means of settling disputes except where the parties have entered into an arbitration agreement. In such cases the right of either party to have disputes resolved by arbitration will no doubt be beneficial to the country in the context of construction law and the foreign investment. Construction claims tend to be of the most technical nature - intensive and multifaceted than most other commercial disputes. Hence construction industry needs a fast and cost effective means for dispute resolution. The desirable features of arbitration is fast, inexpensive, fair, simple, flexibility, confidentiality, minimum delay. The main feature of arbitration is that it is consensual in nature and private in character. Sri Lanka Arbitration Act No 11 of 1995 stated various concepts or arbitration principles and UNCITRAL Model Law.

Keywords: Arbitration, Construction Industry, Special Features

1. Background

Disputes in the construction industry in Sri Lanka are normally those that arise under contracts for the procurement of supplies and services and the installation of equipment. In the early days of construction industry in Sri Lanka most disputes were settled on the job site at an informal meeting between the client and contractor with residential engineer on handshake. Nowadays construction disputes are more lengthy and complicated than ordinary civil cases in Sri Lanka. Most Arbitration Acts of world (including those following the UNCITRAL Model law) usually allow parties to change the substantive law to be applied, if it is a transactional contract. The Arbitration Act of Sri Lanka goes a little further.[1] The Sri Lankan courts refused to incorporate the arbitration agreement into a subcontract.[2] (Courts will in each case examine or interpret the language of the contracts in question to see

whether general principles of construction are applicable. Arbitrators may keep away from writing reasons for the award and only the final decision of the Arbitrators will be enough for a valid award. This will be very useful for the settlement of disputes relevant to construction industry. Sri Lanka arbitration process has become very adversarial and very expensive. It is important to review and improve the process.

1.1 Conflicts, Claims and Disputes in Construction industry

Conflict has been defined (Collin – 1995) disagreement and argument about some thing “Serious important” and also as a difference between two or more beliefs, ideas an interests’ since, conflict is ‘inevitable in human relationships’ (Rhys Jones) it is predictably preponderant in projects where human relationships proliferate as in construction. Figure 1 illustrates the many interacting potential sources of conflict in construction. Despite the potentially unpleasant connotations and consequences of conflict, beneficial aspects of conflict have also been recognized and conflict management has been said to be a major component in construction project management (Gardiner and Simmons- 1999).

Claim will be used to mean simply a request, demand, applications for payment or notification of entitlement to which the contractor, rightly or wrongly at that stage, considers himself entitled and in respect of which agreement has not yet been reached. Some construction claims are unavoidable and in fact necessary to contractually accommodate unforeseen changes in project conditions or unavoidable project conditions or unavoidable changes in client’s priorities. While such claims may be settled amicably the prior presence of unhealthy conflict can trigger degenerations into unnecessary disputes. Such sceneries can in turn generate unnecessary and unreasonable claims that further escalate unhealthy conflict and disputes.

The possibility is also illustrated in Figure 1, which sets out the basic relationships between conflicts, claims and disputes in construction sceneries, Disputes are taken to imply prolonged disagreements on unsettled claims and protracted unresolved conflict.

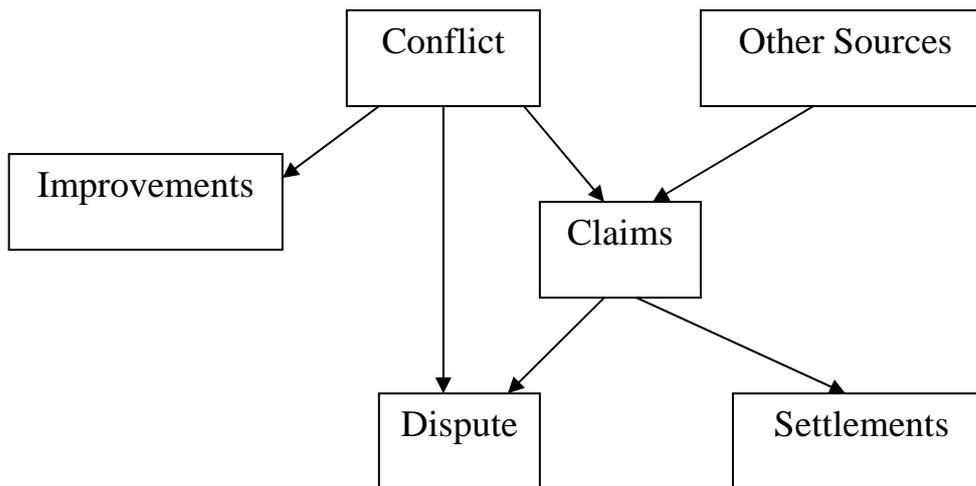


Figure 1: Basic relationships between conflicts ,claims and disputes

1.2 Reasons for construction industry disputes in Sri Lanka

Disputes in the construction industry in Sri Lanka are normally those that arise under contracts for the procurement of supplies and services and the installation of equipment. Main Reasons for disputes in Sri Lanka construction industry are namely,

- Breaches of contract by any party to the contract.
- Inadequate administration of responsibilities by the owner or contractor or sub contractors.
- Some plans and specifications that contain errors, omissions and ambiguities.
- Sudden tax and cost increase.

In the early days of construction industry in Sri Lanka most disputes were settled on the job site at an informal meeting between the Resident Engineer or owner or contractor by a handshake. Nowadays construction contract disputes are notoriously more lengthy and complicated than ordinary civil cases in Sri Lanka. Most construction disputes are resolved by negotiation. However , a dispute cannot be resolved only by negotiation between the parties. Resolution of the matter can be facilitated by the use of Arbitration techniques. Most of the contractors of Sri Lanka are unaware of the arbitration process, its benefits and low cost. Foreign investors particularly with foreign construction companies were reluctant to enter into contract agreements with local contractors due to an absence of an easy , accessible construction arbitration institute as well as specialised construction arbitrators in the country. As projects increase in size and complexity so the risks of cost and time overrun, which invariably lead to disputes.

1.3 Remedies for Breach of construction Contracts

When there is a breach of construction contract the following remedies may be available.

- ❖ A right of action for damages (the most common remedy)

- ❖ A right of action on a quantum meruit.
- ❖ A right to sue for specific performance
- ❖ A right to for an injunction.
- ❖ A right to ask for rescission of the contract.
- ❖ A refusal of any further performance by the injured party.

Construction Contract Law is part of civil law and concern the enforceability of agreements entered into between two or more persons. While all contracts are based on an agreement, all agreements may not result in contract. A construction contract is a legally binding and legally enforceable agreement. Whenever there is a breach of contract by one party, the other is entitled to bring an action for damages which is calculated in accordance with the special circumstances. Damages are the common law remedy consisting of a payment of money and are intended as compensation for the plaintiff's loss and not as punishment for the defendant. The plaintiff should not be put in a better position than if the contract had been properly performed. The aim is to put the injured party in the same financial position as he would have been if the contract had been performed according to its terms. The client is trying to achieve the best – finished product possible within budgets, time and quality. The builder is trying to achieve this with the economic and market forces while trying to maintain builders profitability. If either party feels that the other party is hindering their goal a dispute may arise. Hence arbitration is a voluntary procedure available as an alternative to litigation but not enforceable as the means of settling disputes except where the parties have entered into an arbitration agreement. In such cases the right of either party to have disputes resolved by arbitration will no doubt be beneficial to the country in the context of construction law and foreign investment .

2. Disadvantages of litigation

Construction contract litigation is so common at present that District courts in Sri Lanka and the two Commercial High Courts in Colombo , Sri Lanka are unable to cope with the large volume of cases . The result is that today our courts are not in a position to dispense justice expeditiously to those litigants who have recourse to them .Construction claims tend to be of the most technical nature - intensive and multifaceted than most other commercial disputes. Hence construction industry needs a fast and cost effective means for dispute resolution. In this regard the Arbitration Act of Sri Lanka was enacted by Parliament of Sri Lanka, which became law on 1st August 1995. It expects to make the arbitration process more definitive, streamlined and effective. Today Arbitration is an alternative to litigation in Sri Lanka . It originated as a method of resolving disputes quickly and without legal formality.

Sri Lanka's court system and litigation method is based primarily on the British judicial system modified to some extent to suit our country's needs. After independence in 1948, the court system and litigation system was reformed to a great extent by the Administration of justice Law of 1973. Later, the Constitution of 1978 made several important changes for litigation method and these changes apply today.

District Courts have unlimited original jurisdiction in all civil litigation matters such, claims for breach of contracts ,breach of bonds and guarantees, applications for damages such as construction tort cases.

All too often the effects of litigation is ,

- Long – drawn – out proceedings (lengthy hearing)
- Cost of litigation are far too high (High legal cost)
- Wastage of the client’s managerial time
- Damaged commercial relationships
- Some times judgment that is impossible to enforce .
- Use of deliberate delaying tactics by a defendant or respondent who knows how to play the system .
- Parties must comply with formal rules of procedure or evidence for litigation
- Possible over – simplification of complicated technical and legal issues

3. Advantages of Arbitration

There are several advantages in certain instances for the parties to dispute to refer it to arbitration rather than to commence an action in the courts. The principal advantages are,

- Economical – Arbitration is cheaper than a court action.
- Simplicity- Arbitration procedure is simple.
- Mutual agreement- Arbitration meetings can be conducted anywhere and at any time which is suitable for the parties. Parties do not have to wait for the court’s free dates.
- When the dispute concern a technical matter such as a building contract, person chosen to arbitrate generally possess the appropriate special qualifications.
- The process can be speedier than a court case.
- There can be a saving in costs.
- Unwanted publicity can be avoided.-The arbitrator can view the subject in dispute at any reasonable time.
- Private- The entire hearing takes place in private.
- Speedily- Arbitration is speedier. A court action will take at least one or two but in arbitration can be agreed to settle the disputes within 6 months.
- Expertise- Arbitrator is normally selected for his expert knowledge but the judge will not have the knowledge of technical side of each field.

The desirable features of Arbitration is, Fast, inexpensive, fair , simple, flexibility, confidentiality , minimum delay. The main feature of arbitration is that it is consensual in nature and private in character. The concept of “Party autonomy” associated with arbitration not only allows the parties to select their arbitrators, the seat of arbitration and the rules of procedure to be followed by the arbitrators. (Article 10, 19 & 20 of the UNCITRAL Model Law) UNCITRAL – Arbitration Rules) The composition of the arbitral tribunal is critical for a good arbitration. The ability the parties have to choose their arbitrator taking into consideration *inter alia* their special expertise in the relevant field. Most countries have legislative provisions which enjoin the court to facilitate the process of constituting the arbitral tribunal. [3]

4. Arbitration Act of Sri Lanka and its Procedure

The Arbitration Act of Sri Lanka No. 11 of 1995 provides for a legislative framework for the effective conduct of arbitration proceedings as well as the most practicable or methodical mechanism for the enforcement of arbitral awards thereby making arbitration a viable and expeditious alternative to litigation for the resolution of commercial disputes. This Act treats arbitration in the field of construction without taking in to consideration the value of contract or the disputed amount.

As stated in the preamble of this Act, one of its objects is to make “Comprehensive legal provisions” for the conduct of arbitration proceedings and the enforcement of arbitral awards. The second object is to make legal provision to “give effect”, to the principles of the convention on the recognition and enforcement of foreign award of 1958 (The New York Convention). This Sri Lankan Act to a great extent follows the UNCITRAL Model Law. The Sri Lanka Act Provides that by an agreement “any dispute” can be determined by arbitration “unless the matter in respect of which the arbitration agreement is entered into is contrary to public policy or is not contrary to determination of Arbitration. [4]The Sri Lanka Act provides that an arbitration agreement shall be in writing. It can be contained in a single document or in an exchange of letters telexes, telegrams or other means of telecommunication which provide records of the agreement. It mentions challenge to jurisdiction, duties of the arbitrators, corrections and interpretation etc.

Most Arbitration Acts (including those following the UNCITRAL Model law) usually allow these parties to change the substantive law to be applied, if it is a transactional contract. The Arbitration Act of Sri Lanka goes a little further. The material part of section 24 (1) provides “An arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute”. The construction industry appears to favour the resolution of disputes by arbitration proceedings. These proceedings enable a determination by a respected person usually from a discipline apart from the dispute, and will be resolved in a manner, which reflects the contractual and commercial aspects of the project.

Applicable law will be the Sri Lankan Law and the proceedings should be held in the English language. Therefore parties can carefully draft an Arbitration Agreement to include Arbitration Clauses. It has to be done after careful scrutinizing the clauses that are in the English language. When there is an arbitration clause the aggrieved parties concerned cannot seek a remedy in courts because in such case the jurisdiction is ousted by virtue of the arbitration agreement. [5]

An arbitration agreement must be in the duly prescribed up or formulated form. There should be in the form an arbitration clause in Institute of Construction Training and Development/ICTAD condition of contract category provides an arbitration clause No.67 for building disputes). According to the arbitration agreement recommended by ICTAD the period for commencement of an arbitration must take place within a maximum of 90 days and in accordance with the *Federation Internationale Des Enginieurs* /FIDIC the maximum period to appoint an arbitrator is 154 days to arrive at the final decision. Sri Lankan present

Act does not specify a time limit .Section 48.1 of the Bidding document of the ICTAD (Guidelines of the Government of Sri Lanka) provides Arbitration clause for construction contracts . In Sri Lanka all disputes arising out of contract agreements should be dealt with in accordance with the provisions of Arbitration Act No: 11 of 1995.

FIDIC condition 1999 has introduced Dispute Adjudication Board (DAB) system as a pre-Arbitration requirement. Accordingly dispute between employer & contractor shall be referred to Dispute Adjudication Board as a pre-Arbitral step before reference same for arbitration –Clause 20 of FIDIC 1999. When there is no settlement before DAB only the same dispute can be referred for Arbitration.

As far as the nature of some contracts are concerned, involvement of more parties than two in a single dispute can be seen, e.g. involvement of employer, contractor and number of sub-contractors in construction contracts and disputes relevant to them. Construction projects usually involve sub contractors and a common problem is whether the term in a main contract, including the arbitration clause, have been incorporated into a sub contract.

The Sri Lankan courts refused to incorporate the arbitration agreement into a subcontract. Courts will in each case examine or interpret the language of the contracts in question to see whether general principles of construction are applicable.

Arbitrators may keep away from writing reasons for the award and only the final decision of the Arbitrators will be enough for a valid award. This will be very useful for the settlement of disputes relevant to construction industry. However, if the parties do not agree, the Arbitrators shall give reasons for the award under section 25 (2) of the Arbitration Act of Sri Lanka No: 11 of 1995. This Sri Lanka Arbitration Act treats arbitration in the field of construction on the same basis without making any distinction in the value of contract or the disputed amount

4.1 Arbitration institutes in Sri Lanka

Arbitration is a private means of dispute resolution whereby the parties agree to be bound by the decision of an arbitrator of their choice whose decision is final & whose award has the legal force of a high court judgment or order. In Sri Lanka there are several arbitration .They bonded with obtain the rules& they are guide how to arbitrate matters related to any field.

Some of them are,

- Institute for the Development of Commercial Law & Practice (ICLP)
- (Sri Lanka National Arbitration Centre (SLNAC)

ICLP is set up in 15th march 1995 as separate body but in 1992 it established in as corporate body under the companies act of No: 17 of 1982 of Sri Lanka. This is non-profit organization funded by sum private sector companies in Sri Lanka.

The centre provides free general information on dispute resolution by arbitration & maintains a growing library of books & publications which are available for reference to interested

members of the public. The **Centre** is able to assist and make names available to potential parties who are unable to decide on suitable Arbitrators. In the event where the parties fail in agreeing on the appointment of a sole Arbitrator, the **Centre** shall act as the appointing authority. A list of qualified Arbitrators who have registered with ICLP is available for selection of arbitrators.

The Sri Lanka National Arbitration Centre is the institution in the country in the administrations of arbitration for the resolution of construction and commercial disputes. It was established and incorporated in the year 1985. The fundamental responsibility of the centre is to popularize the operation and practice of arbitration matters .

This is service by the ICCSL in Sri Lanka. The panel of SLNAC is consisted with,

- Retired judges of the court of appeal.
- Supreme Court & high court judges.
- Other professionals (Attorney-at-law, Engineers, Quantity surveyors)

5. New Trends by case decisions in Sri Lanka

Mahaweli Authority of Sri Lanka Vs. United Agency Construction (Pvt.) Ltd.[6] case was an appeal to the Supreme Court from an order of the Commercial High Court under section 37 of the Arbitration Act No: 11 of 1995 and it decided the time period necessary for leave to appeal.

In **Southern Group Civil Construction (Pvt.) Ltd Vs. Ocean Lanka (Pvt) Ltd.** Case [7] application for setting aside arbitral award under section 32 of the Arbitration Act of Sri Lanka . The need to set out in the application the grounds for setting aside the award period for making the application – whether grounds set out in written submission after lapse of that period can be considered.

These two cases were developed arbitration procedure of Sri Lanka . Hence we have seen Arbitration is a voluntary procedure available as an alternative dispute resolution method to litigation and disputes resolved by arbitration will no doubt be beneficial to the country in the context of construction law and foreign investment .

6. Loopholes of Arbitration and Recommendations

Sri Lanka arbitration process has become very adversarial and expensive. It is important to review and improve the process.[8]

Become very expensive. It is important to review and improve the process since construction is a process where people come together for a short period of time and then disburse after the construction. The proper appointment of the arbitrators with concurrence of the two parties, agreeing of the costs of arbitration. In the submission of the claim the parities have adhered to the procedure. Most professionals are not fully aware of the arbitration process. When we consider about disputes in the construction field, concerning or involving subjects relevant

to Architecture, Engineering and Law , appointment of a Lawyer, Architect and an Engineer to the Arbitral tribunal may be very appropriate.

The serious criticisms against the arbitrations in Sri Lanka is the time factor. The Arbitration agreement incorporated in the ICTAD category of contract under clause No. 67 stipulates that the period within which the award should be made in 4 months, although the Arbitration Ordinance of 1948 stipulates a period of 3 months . The present Arbitration Act does not specify a time limit. Parties are free to fix a desired time period for proceeding and award the agreement. However this may be an extension if done with the consent of the parties. According to the arbitration agreement recommended by ICTAD the period for commencement of an arbitration must take a maximum of 90 days and in accordance with the FIDIC the maximum period to appoint an arbitrator is 154 days. Hence the time factor remains a major drawback in the arbitration process. Also, there are no facilities for construction arbitration other than in Colombo- the commercial capital city in Sri Lanka .

Arbitration Act of Sri Lanka (1995) should promote the formation of an association of arbitrators whose objective is to educate and train professionals in the field of arbitration and also promote special continuing development of skills of arbitrators . For example when Sri Lanka consider about disputes in the construction field, concerning or involving subjects relevant to Architecture, Engineering and Law , appointment of a Lawyer, Architect and an Engineer to the Arbitral tribunal may be very successful.

7. Conclusion

Alternative Dispute resolution methods are most popular dispute resolution methods in any legal system. Among those methods Arbitration is one of the best methods. Because of its flexibility wide range of disputes can resolve, not only the construction industry disputes, but every kind of commercial disputes without going to the court system. Flexibility in the sense, privacy & the time are the most important factors. Everyone in the business field likes to solve their controversies by having privacy to that problem & as soon as possible. So the arbitration is one of the most suitable ADR methods. Cost for the arbitration process is considerably high, but it hides automatically with its number of advantages. Sometimes there may be problems when hearing the Awards from arbitration tribunal. However clauses in arbitration act clearly describe how to react when having unexpected situations from tribunal. Arbitration is the most effective & famous method in resolving international disputes in any kind of corporation.

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