ARBITRATION AS AN ALTERNATIVE DISPUTE RESOLUTION METHOD IN THE CONSTRUCTION INDUSTRY OF SRI LANKA

Mahesh Abeynayake* and Chitra Weddikkara
Department of Building Economics, University of Moratuwa, Sri Lanka

ABSTRACT

The construction industry in Sri Lanka covers a complex and comprehensive field of activities. Disputes might arise at any point during the construction process. Dispute resolution systems are changed with the interaction of the parties. Arbitration is a voluntary procedure available as an alternative resolution to litigation, however not enforceable as the means of settling disputes except where the parties have entered into an arbitration agreement. Construction claims tend to be of the most technical nature - intensive and multifaceted than most other commercial disputes. The desirable features of arbitration are fast, inexpensive, fair, simple, flexibility, confidentiality, minimum delay. Sri Lanka Arbitration Act No. 11 of 1995 stated arbitration principles and UNCITRAL Model Law. However, there is a necessity to reviewing and improving of the arbitration practice periodically in order to minimise the cost and complexity of the procedure.

This research is ultimately aims to assess significant attributes of arbitration in construction industry of Sri Lanka. This paper reports on findings gained from the literature review and preliminary survey conducted to explore the current status of arbitration as an alternative dispute resolution method in Sri Lankan construction industry. Current findings indicate that the construction professionals have minimum level of satisfaction on the current arbitration practice; however, they believe that arbitration is an effective mechanism for dispute resolution. The results of this study enabled to gain an understanding on the current arbitration practice and its significance and offer suggestions to improve current arbitration practices in the Sri Lankan construction industry.

Keywords: Arbitration, Construction Industry, Dispute Resolution.

1. INTRODUCTION

Dispute has been defined (Collin, 1995) as disagreement and argument about something and also as a difference between two or more beliefs, ideas an interests’ since, conflict is ‘inevitable in human relationships’ (Rhys Jones, 1994). Construction contracts have evolved significantly in recent times, mainly as a result of the enormous growth of buildings, economic infrastructure and urban development. Disputes connected with construction contracts are becoming a common feature in the industry and number of disputes within this sphere continue to increase. If the dispute resolving mechanism becomes too expensive or too slow or otherwise fail to meet the legitimate requirements of the clients, they will become frustrated and decide to take their enterprises elsewhere to greener pastures. On the other hand, conflicts and the ensuing matters signify a general state of hostility between parties. The possibility of disputes and claims are illustrated in Figure 1, which sets out the basic relationship between conflicts, interests, ADR methods and Litigation in construction sceneries, Disputes are taken to imply prolonged disagreements on unsettled claims and protracted unresolved conflict.

* Corresponding Author: E-mail - abey92@hotmail.com
Arbitration Legislation of the most countries (including those following the UNCITRAL Model Law) usually allows 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 Sri Lankan courts refused to incorporate the arbitration agreement into a subcontract. Sri Lanka arbitration process has become very adversarial and very expensive. Therefore is important to review and improve the process. Justice Saleem Marsoof (2006) suggested that there should be a change of attitude of parties concern to improve the arbitration procedure and it is better to improve the effectiveness of proceeding to obtain its advantages.

The main aim of the research was to review the current situation of arbitration practice in the construction industry of Sri Lanka and introduce new legal amendments to arbitration legislation. That means analysis the arbitration legislation and its procedure and suggests improvements to the legislation and arbitration procedure in Sri Lanka in order to make arbitration procedure more effective or viable. The construction industry has generally used arbitration rather than the courts as the means of settling any disputes which arise between the contractor and the employer. This arise because the disputes were more generally of a technical nature and the parties were happier to refer their dispute to a person who understood the technical problems involved and who could bring a knowledge of the usual practices of the industry to the formation of his judgment as well as it is a method of private, binding and enforceable dispute resolution.

2. **Main Reasons for Disputes in Sri Lankan Construction Industry**

Main reasons for the construction disputes are,

- Breaches of contracts by any party to the contract.
- Inadequate administration of responsibilities by the client or contractor or sub contractors.
- Some plans and specifications that contain errors, omissions and ambiguities.
- Sudden tax and cost increase.
- Negligence and poor performance of the construction professionals.

Generally, construction contracts disputes are more lengthy and complicated than ordinary civil cases in Sri Lanka. As projects increase in size and complexity so the risks of cost and time overrun, which invariably lead to disputes. In certain circumstances, lack of skills amounts to negligence. Where this is so, it is because a person has voluntarily engaged in some activity which is likely to cause danger to other. The negligence does not consist in the lack of skill but in undertaking the work without skill. Where a person has engaged in a profession which calls for special skill, the degree of skill which is required of him is that reasonably to be expected of a person engaged in such profession. Negligence and poor performance of the construction professionals is a reason for dispute. Sometimes professionals’ disputes
cannot be resolved only by negotiation between the parties. Resolution of the matter can be facilitated by the use of Arbitration techniques. Arbitration is a voluntary procedure available as an alternative to litigation. 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 or foreign investment law.

3. Remedies for Breach of Construction Contracts

Construction Law is a part of civil law and construction contracts are legally binding and legally enforceable agreements. Whenever there is a breach of contract by one party, the other is entitled to bring an action for damages which are calculated in accordance with the civil law provisions. The aim of the damages is to put the innocent party in the same financial position as he would have been if the contract had been performed according to its terms. When there is a breach of construction contract the following remedies may be available for the innocent party.

- 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 right to get Restitutio in Intergrum
- A refusal of any further performance by the injured party

Above remedies can be gotten from the use of litigation system by the innocent party. In such cases the right of either party to have disputes resolved by arbitration will no doubt be beneficial to the economy.

4. Arbitration as an Alternative Dispute Resolution Method

4.1. Legal Definition for Arbitration

Arbitration is a legal technique for the resolution of disputes outside the courts, wherein the parties to a dispute refer it to the Arbitrator (Sims et al., 2003). 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 and whose award has the legal force by a Commercial High Court order.

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 seal of arbitration and the rules of procedure to be followed by the arbitrators (Articles 10, 19 and 20 of the United Nations Commission On International Trade Law [UNCITRAL] model law) (UNCITRAL, 2008). The ability the parties have to choose their arbitrator taking into consideration inter alia their special expertise in the relevant field.

5. Arbitration Practice in Sri Lanka

5.1. Sri Lankan Arbitration History

Among the legal practices that crept into Sri Lankan law, especially in the commercial field was arbitration. Even though, Arbitration was a legal dispute resolution method in the Roman law it did not find its way in to Roman Dutch law as was practiced in Sri Lanka. Arbitration was deliberately introduced by the British as a less formal dispute resolution mechanism in 1866 by the adoption of the Arbitration Ordinance No.15 of 1866. Prior to the enactment of the Act No. 11 of 1995, Arbitration was formally linked to the legal system of Sri Lanka in the 19th century by the enactment of two statutes viz:
Under these two statutes Arbitration was categorised into two groups:

- Voluntary, and
- Compulsory

Whilst the Arbitration Ordinance dealt only with compulsory Arbitration the Civil Procedure Code governed both types of Arbitration.

### 5.2. 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 into consideration the value of contract or the disputed amount. Preamble of the Act is stated, one of its objects is to make “Comprehensive legal provisions” for the conduct of arbitration proceedings and the enforcement of arbitral awards. The 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. The 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 also 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 and material part of section 24(1) provides “An arbitral tribunal shall secede the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute”. 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. 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. Therefore Sri Lankan courts refused to incorporate the arbitration agreement into a subcontract.

#### 5.2.1. Arbitration Agreement

According to the Act, an arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement. Further, Kanag-Isvaran (2006) stated that most of arbitration agreements are made before a dispute arises as included in many standard conditions of contracts such as SBD, FIDIC, JCT forms. According to the SBD, any dispute arising out of the agreement, on the interpretation, rights, duties, obligation or liabilities of any party, operation, breach, termination, abandonment, foreclosure or invalidity thereof shall be referred to by either party for final settlement in accordance with the Arbitration Act No. 11 of 1995 or any amendment. However, Arbitration Act stated that arbitration shall be deemed to have been commenced if a dispute to which the relevant arbitration agreement applies has arisen or if a party receives a notice requiring the arbitration from another party.

#### 5.2.2. Constitution of the Arbitral Tribunal

Under SBD, the arbitral tribunal shall consist of a sole arbitrator. The party desiring arbitration shall nominate three arbitrators out of which one to be selected by the other party within 21 days of the receipt of such nomination. If the other party does not select one to serve as Arbitrator within the stipulated
period, then the Arbitrator shall be appointed in accordance with the Arbitration Act. Further, according to the Arbitration Act, the parties shall be free to determine the number of arbitrators of an arbitral tribunal. If no such determination is made, the number of arbitrators shall be three. Where the parties appoint an even number of arbitrators, the arbitrators appointed shall jointly appoint an additional arbitrator who shall act as chairman. Further, if the parties failed to agree or appoint the arbitrator, the arbitrator shall be appointed by the High Court on the application of a party.

The Act stated an arbitral tribunal shall deal with any dispute submitted to it for arbitration in an impartial, practical and expeditious manner. In addition to that, Arbitration Act stated that, an arbitral tribunal shall afford all the parties an opportunity, of presenting their respective cases in writing or orally and to examine all documents and other material furnished to it by other parties or any other person. Further, the arbitral tribunal may, at the request of a party, have an oral hearing before determining any question before it is based, unless the parties have agreed that no reasons are to be given on the award is an award on agreed terms. After the award is made, a copy signed by the arbitrators shall be delivered to each party. Further, the award made by the arbitral tribunal shall be final and binding on the parties to the arbitration agreement.

5.2.3. ENFORCEMENT OF AWARD

According to the Arbitration Act, a party to an arbitration agreement pursuant to which an arbitral award is made may, within one year after the expiry of fourteen days of the making of the award, apply to the High Court for the enforcement of the award. In addition to that, an arbitral award made in an arbitration held in Sri Lanka may be set aside by the High Court, on application made within sixty days of the receipt of the award is based, unless the parties have agreed that no reasons are to be given on the award is an award on agreed terms. After the award is made, a copy signed by the arbitrators shall be delivered to each party. Further, the award made by the arbitral tribunal shall be final and binding on the parties to the arbitration agreement. The Act is mentioned a party to an arbitration agreement pursuant to which an arbitral award is made may, within one year after the expiry of fourteen days of the making of the award, apply to the High Court for the enforcement of the award. In addition to that, an arbitral award made in an arbitration held in Sri Lanka may be set aside by the High Court, on application made within sixty days of the receipt of the award.

5.2.4. PROVISIONS OF THE SBD AND FIDIC CONDITIONS OF CONTRACTS

Further, arbitration is introduced to construction industry by Federation Internationale Des Ingenieurs-Counseils (FIDIC) for international contracts and by Standard Bidding Document (SBD) for local contracts. However, arbitration practice is discussed according to the Arbitration Act and Standard Bidding document (SBD).

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). Conditions of Contract provide an Arbitration Clause No. 67 for building disputes. According to the arbitration agreement recommended by ICTAD the period for commencement of arbitration must take place within a maximum of 90 days. 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. However, Sri Lankan Act does not specify a time limit. Section 48.1 of the Standard Bidding Document (SBD) 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. A FIDIC condition of contracts 1999 has introduced Dispute Adjudication Board (DAB) system as a pre-Arbitration requirement. Accordingly dispute between client and contractor shall be referred to Dispute Adjudication Board as a pre-Arbitral step before reference same for arbitration according to the 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 is concerned, involvement of more parties than two in a single dispute can be seen, e.g. involvement of client, contractor and number of sub-contractors in construction contracts and disputes relevant to them. Generally ICTAD-
SBD documents are applicable to the only Sri Lankan Construction industry. On the other hand, British Forms of Conditions and some provisions of the FIDIC Forms are not applicable to the Sri Lankan construction industry due to its limitations for international related contracts.

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 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. With the introduction of the Arbitration Act No. 11 of 1995, construction disputes are more likely to move towards the arbitration in Sri Lanka.

6. DISADVANTAGES OF THE LITIGATION SYSTEM AND ADVANTAGES OF THE ARBITRATION PRACTICE

6.1. DISADVANTAGES OF THE LITIGATION

Breach of 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. All too often the effects of litigation are,

- 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
- Sometimes 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

6.2. ADVANTAGES OF ARBITRATION

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. Advantages of Arbitration are,

- Economical – Arbitration is cheaper than a court action.
- Simplicity – Procedure is simple.
- Mutual agreement – 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.
- 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.
7. **NEW TRENDS BY CASE DECISIONS IN SRI LANKA**

Most arbitration awards in Sri Lanka are challenged by the parties at commercial high court. Following two cases were developed and interpreted arbitration procedure of Sri Lanka and courts observed that Arbitration is a voluntary procedure available as an alternative dispute resolution method to litigation.

*Mahaweli Authority of Sri Lanka vs. United Agency Construction (Pvt.) Ltd.* (Sri Lanka Law Reports, 2002) 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.* (Sri Lanka Law Reports, 2002) 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.

8. **SURVEY FINDINGS**

To explore the current practice in construction industry, a preliminary survey was conducted to collect data from the industry practitioners, who have a good experience on the arbitration practice. The findings are reported below.

8.1. **EFFECTIVENESS OF ARBITRATION AS AN ADR METHOD**

First, through this survey, ADR methods were ranked in Table 1 considering mean rating of their effectiveness in the present practice.

<table>
<thead>
<tr>
<th>ADR Method</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiation</td>
<td>1</td>
</tr>
<tr>
<td>Adjudication</td>
<td>2</td>
</tr>
<tr>
<td>Mediation</td>
<td>3</td>
</tr>
<tr>
<td>Arbitration</td>
<td>4</td>
</tr>
</tbody>
</table>

Arbitration got the fourth place of ranking, however, the practitioners believed that it should still serve as an ADR method in order to settle disputes, which have complex scope and to avoid litigation for different kinds of disputes.

8.2. **DRAWBACKS OF ARBITRATION**

Next, drawbacks of arbitration were ranked based on the mean weighed rating worked out by the questionnaire survey as shown in the Table 2.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher involvement of lawyers</td>
<td>1</td>
</tr>
<tr>
<td>Less concentration on technical issues of the matter</td>
<td>2</td>
</tr>
<tr>
<td>Delay of the solution or remedy</td>
<td>3</td>
</tr>
<tr>
<td>Same procedure apply for all disputes</td>
<td>4</td>
</tr>
<tr>
<td>Cost of the arbitrators and other facilities</td>
<td>5</td>
</tr>
<tr>
<td>Weak arbitral tribunal</td>
<td>6</td>
</tr>
<tr>
<td>Similar to court procedures</td>
<td>7</td>
</tr>
</tbody>
</table>
Sometimes award is dragged for long period and finally the award is based on those unfruitful hearings. In construction disputes, there are some inherent characteristics which did not recognised by the Act and by leading Arbitrators in Sri Lanka. Parties have great autonomy to control procedures and select Arbitrators, but in practice they do not use this opportunity to increase the effectiveness of the arbitration.

It was noted that in Sri Lanka, arbitration process has become very adversarial and 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 serious criticisms against the arbitration in Sri Lanka are the time factor. The Arbitration agreement incorporated in the ICTAD conditions 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 arbitration must take a minimum 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. Unawareness of professionals’ and parties involve in construction is major problem for better practice of arbitration. When Sri Lanka considers about disputes in the construction field, concerning or involving subjects relevant to Architecture, Engineering and Law, appointment of a Lawyer, an Architect and an Engineer to the Arbitral tribunal may be very successful.

### 8.3. SUGGESTIONS TO IMPROVE ARBITRATION PRACTICE IN SRI LANKA

Suggestions given by the survey participants were ranked based on the mean weighted rating as shown in the Table 3.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adopting qualified arbitrators</td>
<td>1</td>
</tr>
<tr>
<td>Change the attitude of professionals</td>
<td>2</td>
</tr>
<tr>
<td>Conducting awareness programmes</td>
<td>3</td>
</tr>
<tr>
<td>Involvement of expertise from construction industry as arbitrators</td>
<td>4</td>
</tr>
<tr>
<td>Introduce recommended arbitration clause and agreement</td>
<td>5</td>
</tr>
<tr>
<td>Introduce construction industry arbitration rules</td>
<td>6</td>
</tr>
</tbody>
</table>

The suggestions which were ranked above were descriptively analysed in order to create broad scope of them. The parties should select qualified Arbitrators considering the nature of the dispute. Further that awareness should focus on changing attitude of professionals on arbitration and promote the correct practice of arbitration as alternative dispute resolution method. Professionals involved in the construction have the knowledge and suitable background to give the most suitable and fair award for disputes. Thus Engineers, Quantity Surveyors and Architects should develop their knowledge on arbitration and try to involve as Arbitrators and increase the effectiveness of this method. FIDIC and SBD forms of contracts provide arbitration clause, but it should describe more than that in the conditions of contract in construction contract in order to understand easily. Therefore qualified arbitrators and professionals should draft and publish an arbitration agreement. Further they should prepare model arbitration rules and guideline for the parties and arbitrators who wish to use arbitration as dispute resolution method.
9. CONCLUSIONS

This study has identified the current arbitration practice in construction industry. Among ADR methods, Arbitration is generally regarded as one of the best methods. Because of its flexibility, wide range of disputes can be resolved, not only the construction industry disputes, but every kind of commercial disputes without going to the litigation system. Flexibility, privacy and the time are the most important factors. Cost for the arbitration process is considerably high, but it hides automatically with its number of advantages. However, it is noted that these advantages are not reaped by the Sri Lankan construction industry and arbitration is not very effective due to several drawbacks identified in its current practice. Several suggestions are offered in this paper to overcome this situation. Finally, Government of Sri Lanka should repeal existing provisions of the Act and introduced new arbitration legislation and permanent arbitration tribunals (courts) to increase the effectiveness of the arbitration procedure.

10. REFERENCES


