Benefits of Institutional Arbitration and their role in Construction Industry

CA. Rajkumar S Adukia

B.Com(Hons.) FCA, ACS,MBA, AICWA, LLB ,Dip In IFRS(UK)

rajkumarfca@gmail.com

www.caaa.in

9820061049/9323061049

To receive regular updates kindly send test email to rajkumarfca-subscribe@yahoogropups.com

Disputes are unpleasant but unavoidable part of any relationship or organisation. However, where there is dispute there must also be a mechanism for resolution of these disputes. Broadly speaking, disputes can be resolved either through litigation i.e. in court of law or through Alternative Dispute Resolution (ADR) Mechanism. Alternative dispute resolution in India is not new and it was in existence even under the previous Arbitration Act, 1940. The Arbitration and Conciliation Act, 1996 has been enacted to accommodate the harmonisation mandates of UNCITRAL Model. The act provides two alternate method of ADR: Arbitration and Conciliation. Arbitration is a method for settling disputes privately, but its decisions are enforceable by law. Arbitration offers greater flexibility, prompt settlement of national and international private disputes and restricted channels of appeal than litigation. On the other hand Conciliation is a less formal form of arbitration. This process does not require an existence of any prior agreement. Any party can request the other party to appoint a conciliator.

Arbitration may be conducted ad hoc or under institutional procedures and rules. Institutional Arbitration is conducted under the guidance and well-tested rules of an established arbitral organization whereas under Ad hoc arbitration, the parties have to draft their own rules and procedures to fit the needs of their dispute. There are number of national and international organisations set up with the main object of settling commercial disputes by way of Arbitration and other Alternative Dispute Resolution mechanism. These organisations lay down rules for the conduct of arbitration. These rules, however, cannot override the Act. These organisations handle the arbitration cases of the parties and provide valuable services like administrative assistance, consultancy and recommending names of arbitrators from the panel maintained by them. Since these organisations have experience and proper infrastructure to conduct the arbitral proceedings, it is quite often beneficial to parties to avail of their services.

Benefits of Institutional Arbitration over Litigation

- The arbitration process is private, between the two parties and informal, while litigation is a formal process conducted in a public courtroon.
- The arbitration process is fairly quick. Once an arbitrator is selected, the case can be heard immediately. In a civil litigation, on the other hand, a case must wait until the court has time to hear it; this can mean many months, even years, before the case is heard

- A court case is a costly affair. The claimant has to pay advocates, court fees, process fees and other incidental expenses. In arbitration, the expenses are less and many times the parties themselves argue their cases. Arbitration involves few procedural steps and no court fees.

- Judicial settlement is a complicated procedure. A court has to follow the procedure laid down in the Code of Civil Procedure, 1908 and the Rules of the Indian Evidence Act. In arbitration, the procedure is simple and informal. An arbitrator has to follow the principles of natural justice. The Arbitration and Conciliation Act, 1996 specifically states that the Arbitral Tribunal shall not be bound by The Code of Civil Procedure, 1908 and The Indian Evidence Act, 1872.

- Section 34 of the Act provides very limited grounds upon which a court may set aside an award. The Act has also given the status of a decree for the award by arbitrators.

The award of the arbitrators is final and generally no appeal lies against the award. While in a regular civil suit there maybe an appeal and an appeal against an appeal.

- In arbitration, the dispute can be resolved without inflicting stress and emotional burden on the parties which is a common feature in court proceedings.

- In a large number of cases, 'Arbitration' facilitates the maintenance of continued relationship between the parties even after the settlement.

- The parties in the arbitration process decide jointly on the arbitrator; in a litigation, the judge is appointed and the parties have little or no say in the selection. The parties may have some say in whether a case is heard by a judge or a jury.
- The people with knowledge of particular industry can be appointed as arbitrator. Thereby, fostering more competent judgement.
- The arbitration process has a limited evidence process, and the arbitrator controls what evidence is allowed, while litigation requires full disclosure of evidence to both parties.
- The venue of arbitration can be a place convenient to both the parties. It need not be a formal platform. A simple office cabin is enough. Likewise the parties can choose a language of their choice

Institutional Arbitration Vs. Ad hoc Arbitration

Arbitral Institutions claim that ad hoc arbitrations suffer from a number of problems which cause inordinate delays and high costs in actual practice. Since, the arbitral institutions have advantage of well developed arbitration machinery, organisational set up and a comprehensive set of rules and procedures, it saves parties from avoidable delay, expenses and uncertainty. Needless to say in Ad hoc arbitration, the disputant parties themselves have to arrange for venue of meetings, secretarial services and other administrative measures.

As compared to ad hoc arbitration institutional arbitration provides the following advantages:

- In institutional Arbitration a set of pre-established rules and procedures are available therefore, it saves parties and their lawyers the effort of determining the arbitration procedure and also the effort of drafting an arbitration clause. Once the parties choose the institution, all they need to do is incorporate the draft clause of that institution into

their contract. This expresses their intention to arbitrate under the institution's rules, which provide for every conceivable situation that can arise in an international commercial arbitration. Moreover, the draft clause is revised periodically by the institution, drawing on experience in conducting arbitrations regularly and approved by arbitration experts, taking account of the latest developments in arbitration practice. This ensures that there is no ambiguity in relation to the arbitration process. On the other hand, ambiguous arbitration clauses in ad hoc arbitration compel parties to seek court intervention in order to commence or continue the arbitration.

- The parties to institutional arbitration gets administrative assistance from institutions providing a secretariat or court of arbitration;
- The institutions also provide lists of qualified arbitrators, often broken out by fields of expertise. In institutional arbitration, the arbitrators are selected by the parties from the institution's panel of arbitrators. This panel comprises of expert arbitrators, drawn from the various regions of the world and from across different vocations. This enables selection of arbitrators possessing requisite experience and knowledge to resolve the dispute, thereby facilitating quick and effective resolution of disputes. Whereas in ad hoc arbitration, the appointment of arbitrators is generally based on the parties' faith & trust in the arbitrators and not necessarily on the basis of their qualifications and experience. Thus, an incompetent arbitrator may not conduct the proceedings smoothly and this could delay dispute resolution, lead to undesirable litigation and increased costs.
- Moreover, institution arbitration also provides for appointment of arbitrators by the institution if the parties request it
- The institutions also provide the physical facilities and support services for arbitrations proceedings. The parties and the arbitrators can seek assistance and advice from the institutional staff, responsible for administrating international commercial arbitrations under the institutional rules. Thus, doubts can be clarified or a deadlock can be resolved without court intervention. Whereas in ad hoc arbitration, the parties would be compelled to approach the Court, in order to take the arbitration forward and consequently, the perceived cost advantage of ad hoc arbitration would be negated by the litigation expenses.

- The institutional arbitration also has the advantage of constant monitoring of the proceeding to ensure that the arbitration is completed and an award is made within reasonable time and without undue delay.
- Another merit of institutional arbitration is One of the advantages of arbitration is that it provides for final & binding determination of the dispute between the parties. In other words, no review or appeal lies against an arbitral award to ensure finality. This involves an inherent risk that mistakes committed by the tribunal cannot be corrected, whereby one party would inevitably suffer. However, some institutional rules provide for scrutiny of the draft award before the final award is issued and some provide for a review procedure. The latter entitles the dissatisfied party to appeal to an arbitral tribunal of second instance, which can confirm, vary, amend or set aside the first award and such decision in appeal is considered to be final and binding upon the parties. Contrasting this to ad hoc arbitration where there is no opportunity for appeal or review and the parties have to be prepared to suffer for the mistakes of the arbitrators, this is a redeeming feature of institutional arbitration as it allows the parties a second chance of presenting their case and also permits the rectification of mistakes made by the tribunal of first instance. It also serves as a check on the actions of the arbitrators and restrains them from making arbitrary awards.

Institutional Arbitration and Construction Contract

Construction sector is one of the pioneer sectors in any developing economy like India. This sector has shown such a growth in recent past that now it is second largest employer of manpower in the country and nearly half of the planned expenditures are spend on construction and infrastructure. Construction industry, with its backward and forward linkages with various other industries like cement, steel bricks etc. catalyses employment generation in the country. Construction is the second largest economic activity next to agriculture. Broadly construction can be classified into 3 segments – Infrastructure, Industrial and Real Estate.

Infrastructure segments involve construction projects in different sectors like roads, rails, ports, irrigation, power etc. Industrial construction is contributed by expansion projects from various manufacturing sectors. Real estate construction can be sub-divided into residential, commercial, malls/multiplexes etc.

The construction activity involved in different segments differs from segment to segment. Construction of houses and roads involves about 75% and 60% of civil construction respectively. Building of airports and ports has construction activity in the range of 40-50%. For industrial projects, construction component ranges between 15-20%. Within a particular sector also construction component varies from project to project.

Construction sector contributed about 8.5% to the country's GDP in FY 08. Over past few years, growth of the construction has followed the trend of economic growth rate of the country. The multiplier factor between growth rates of construction and GDP has been about 1.5X-1.6X. Over past 3 years, construction as a percentage of GDP has increased from 8.0% in FY 06 to 8.5% in FY 08. Construction activity being labour intensive has generated employment for about 33 million people in the country.

Therefore, the importance of smooth functioning of this industry cannot be overstated as Construction projects are the cutting edge of development and provide industrial and social infrastructure. Dispute being a very common phenomenon is such industry, it is very important to have proper dispute resolution mechanism in place to prevent and resolve disputes. Successful implementation depends largely on carrying out the constituent tasks in a proper sequence, and deploying the resources to the best advantage. All measures like land acquisition, funding position, law and order problems should be taken care, well in advance before commencing the project so that the disputes at later stage can be avoided. Many projects suffer from inadequacies in project formulation and implementation, leading to time and cost overruns, and affect the viability of the projects. In addition, improper organisation due to lack of coordination, communication, and effective management result in disputes and hamper the overall progress. To prevent disputes, a systematic study is required at the beginning of the project in all aspects and a detailed procedure is to be adopted related to the projects.

Types of disputes peculiar to Construction Sector

- Claims on delay in execution of work
- Differing site condition claims
- Design and construction defect claim

- Suspention and termination of contract claims
- Dispute arising on blacklisting of contractors e.tc.
- Non payment of dues
- Variation in quantity

- Escalation of material
- Idle labour/material

- Unforeseen difficulties in the execution of work
- Claims for compensation of extra expenditure increased or losses suffered by the contractor due to delays and hindrances caused by the owner and on account of breaches of contract committed by the owner.
- Change in design.
- Claim for additional and extra works.
- Claim for more than permissible reduction or increase in quantity of work.
- Claim due to revision and change in specifications for quality workmanship or materials.
- Claim for refund of amount wrongly recovered or reduced by the owner.
- Interest on delayed payments.
- Interest on various claim amounts.
- Claims on account of delayed supply of materials.
- Claims for loss of business and profit for delays.

Reasons for Disputes

The global economy has created an environment in which construction firms are forced to bid for projects at or below minimum profit levels. At the same time, owners are demanding contractors to execute complex projects without incorporating the details in contract documents. This has placed an additional burden on the individual contractor to construct increasingly sophisticated projects with limited capital resources and with lower quality. Under these circumstances, it is not surprising that the number of disputes within the construction industry continues to increase at an alarming rate.

In building contracts, the completion certificate is an important document. A contract cannot be treated as completed, until certified by competent authority and furnished. It is one of the main criteria for non-fulfilling the agreement condition and is treated as a breach of contract Construction industry contains complex activities, with a signed agreement contract. The need for the arbitration in construction industry may be due to many reasons and they can be classified as follows:

- Breach of contract
- Non-settlement of payment as per time schedule
- Lack of proper communication
- Insufficient specifications, drawings, designs and plans
- Non-provision of safety practices and job site injuries
- Alterations in the works without proper orders
- Improper management and non-coordination between parties

Time and cost over-runs and Dispute Resolution :

- Analysis of the causes of delay in contracts shows that one of the major factors resulting in time over-runs, and resultant cost over-runs, is the ineffectiveness of Dispute Resolution Mechanism and of penalty clauses in Contract documents now in use.
- A Survey conducted by CIDC in January 2000 shows that disputes amounting to a large sum (over Rs. 51,000 crores) are pending with Arbitrators / Conciliators for periods ranging between 2 and 10 years. Updated version shows an exponential increase of about 100% during past 6 years, as per 2006 survey.

Mechanism of resolving Dispute

With a view to providing an institutional mechanism for resolution of construction and infrastructure related disputes, the Construction Industry Development Council, India (CIDC) in cooperation with the Singapore International Arbitration Centre (SIAC) has set up an Arbitration Centre in India called the Construction Industry Arbitration Council (CIAC). It registered as a separate body in June 2006 and officially launched by the President of India in November 2006.

Speed in Resolving Disputes

- Statement of Claim to be filed by the Claimant within 30 days of filing the Notice of Arbitration
- Respondent to file a Statement of Defence and Counter Claim within 30 days of service of Claimant's Statement of Claim
- Claimants to file their reply to the Statement of Defence and Counter claim within 30 days
- The Chairman of the EC of CIAA will appoint the arbitrator within 21 days from the date of the Respondent's Statement of Defence and Counter Claim
- Arbitrator has to give a reasoned award within 45 days after close of hearing

Trained Arbitrators

- The panel of arbitrators consists of professionals from the construction industry as well as the legal fraternity
- Formal training before being admitted to the panel
- 155 arbitrators have been trained and certified in arbitration workshops conducted in India and Singapore

Strict Code of Ethics for Arbitrators

- Conflict of interest audit conducted before appointment
- All arbitrators have to execute CIAA's Code of Ethics

CIAA Model Arbitration Clause

- "All and any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration in [New Delhi or any other place in India]* in accordance with the Arbitration Rules of the Construction Industry Arbitration Association ("CIAA Arbitration Rules") for the time being in force at the commencement of the arbitration, which rules are deemed to be incorporated by reference in this clause."
- Choose as appropriate - If the matter is domestic (between Indian parties) then New Delhi or any other place in India can be chosen. If the matter is international (between

an Indian party and foreign party or between two foreign parties) then Singapore is to be chosen.

Conclusion

Resolving construction disputes is not a easy and straight forward task, especially when the available resources are limited and the dispute is complex. The use of institutional dispute resolution mechanism in construction if properly implemented can go a long way in overcoming the shortcomings of litigation.