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The 10th Annual Winnie Whittaker Memorial Lecture

What is the future of arbitration in the Hong Kong construction industry?

by

Michael Charlton

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- Winnie died on 26 May 2005
- A firm and strong supporter of arbitration
- Active committee member of CIArb for many years
- Particularly keen on education and worked on the Entry Courses for many years
- A sound and experienced technical arbitrator

Winnie was typical of the type of arbitrators often appointed in 1980s up to 2000s

Frequently technical and not legally qualified

Often QSs or Engineers, occasionally architects

Experienced in the industry and knew what to expect from contractors, subcontractors and employers

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- What has happened to the technical arbitrator?
- Apart from a few lawyers who happen to be technically qualified, there are now very few technical appointments
- Appointments dominated by lawyers and barristers
- If Winnie was with us today would she receive so many appointments?

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- Reasons to arbitrate construction disputes
  - privacy, speed, flexibility, economy
- Traditionally main reason - to use appropriate technical expertise on technical problems
- Few of the other reasons survive – arbitration does not offer speed, flexibility, and certainly not economy
- Since most arbitrators now appointed are lawyers – inevitably they follow court procedures

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- does this shift away from technical arbitrators matter?
- why is it the case?
- is it what the industry wants and needs?
- Is arbitration in Hong Kong providing the results the industry expects?
- Will arbitration still be the preferred means of resolution in the next few years? If not what is the likely future for dealing with construction disputes in Hong Kong?
- this is the theme of my lecture today

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The traditional approach to construction disputes

- From 1970 up to 1985, relatively few disputes arbitrated
- Always some arbitrations, generally dealt with by senior architects, QSs or engineers
- Claims proliferated from 1973 – the oil crisis prompted them in UK
- Claims then became a specialist business
- Plover Cove was an early project which was arbitrated HK constructed 1968 to 1973, (judge arbitrator appointed in this case, (Judge Edgar Fay))
- *Mitsui Construction Co Ltd v Attorney General of Hong Kong CA (1984) and PC (1986)* was a major case

- Traditional approach and reason for including arbitration in construction contracts was to allow for judgment by peers - a technical experienced man who understood the issues and could form a view which would be respected by the parties was important
- It avoided the difficulties of explaining technical matters to judge
- Parties and arbitrator would know what technical documents meant, and had good practical working knowledge of contract
- Award would be something the parties anticipated and understood and which resonated with their experience and expectations – offered some predictability

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- Not generally necessary for technical arbitrator to rely upon experts

- Experts may help in providing opinions on detailed valuations or assessments of EOT, exceptionally explanations on highly technical topics

- Solicitors use experts to provide opinion evidence, giving them flexibility in presenting the case, but that is different point

- If the arbitrator got the law wrong, there was a proper procedure to have the award dealt with by way of a special case stated for the decision of the courts

Traditional values and behaviour

- Professional men and women had freedom to exercise their judgment
- Engineers and architects could certify and value work and EOT without fear of employer or auditor interference
- Settlement of large amounts under the contract were commonplace without need for full explanations and documentation now required
- Reality is that analysis is not always practical or sensible

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- Construction disputes are dominated by delay, disruption, costs related to changes and quality of work
- Interpretation of documents may be important
- Technical documents are province of experts, ie professional men
- Lawyers may have difficulty in understanding (say) SMM or specification
- Meaning of words taken to be what those who normally use them understand and take them to mean, the construction professions has its own understanding of documents and procedures which may be a problem for lawyers

Example

- Loss and expense in JCT traditionally understood to mean costs determined by reference to BQ preliminaries
- In recent years this has changed to follow legal understanding of damages, causing much confusion and misunderstanding *(Minter v Welsh Technical Services Organisation (1980) 13BLR1, CA)*
- but now see *Walter Lilly & Co Ltd v Mackay and Another (No 2) [2012] EWHC (TCC)* and comments by Akenhead J)

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Interpretation points

The law has changed in respect of the rules adopted in interpreting documents

- Lord Hoffman cases
  - Investors Compensation Scheme Ltd v West Bromwich Building Society [1997] UKHL 28
  - Jumbo King v Faithful Properties Ltd [1999] 3HKLRD 757 CFA

Lord Hofmann provides the following guidance from ICS case

- What a reasonable person having all the background knowledge would have understood
- Where the background includes anything in the “matrix of fact” that could affect the language’s meaning
- But excluding prior negotiations, for the policy of reducing litigation
- Where the meaning of words is not to be deduced literally, but contextually
- On the presumption that people do not easily make linguistic mistakes

This approach is now more subjective and less predictable that old rules of interpretation

Lord Hofmann provided the following guidance on Jumbo King

"An attempt to discover what a reasonable person would have understood the parties to mean. And this involves having regard not merely to the individual words they have used, but to the agreement as a whole, the factual and legal background against which it was concluded and the practical objects which it was intended to achieve"

Parties often use words which they understand to mean something different from what appears to be so on the face of the words

It does not matter whether precise words are used provided each party takes the same understanding from the words.

Eg words used in the SMM may mean one thing to the technical man but another to a non technical man

This may pose a problem for lawyers

A technical arbitrator may have a better understanding of this

The lack of technical arbitrators has brought about a reliance upon experts

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Reliance upon experts in dispute resolution

- It is difficult for a lawyer to deal with specialist matters without assistance from experts
- Experts offer flexibility in presenting case so that opinions rather than facts are required – this is not the primary role of an expert
- Technical arbitrator may reduce extent of reliance upon experts
- Experts may be more realistic in the evidence they give when faced with technical arbitrator

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Criticism of experts

- Experts are heavily criticised by legal fraternity
- Generally complaints concern bias and competence
- Sensitivity of legal profession relates to their total reliance on experts
- See MCC article in Asian DR 2012 *"Expert Witnesses: Are Courts and Arbitral Tribunals Asking too much of them?"*
- *Meadows v General Medical Council [2007] QB462 CA(England and Wales)*
- *Jones v Kaney [2011]UKSC 13, (Supreme Court UK)*

Chevalier (Construction) Co Ltd v Tak Cheong Development Ltd [2011] 2 HKLRD

- Experts criticised for failing to reach agreement or say why they could not agree
- Assessor appointed to explain expert reports
- Judge came to some conclusions which might surprise technical professionals eg judge considered BQ preamble requiring all features on skirting to be included in rate would cover additional features added by architect even though none shown on tender drawings
- Difficulty for lawyer to understand what is taken for granted by technical people

- Lam J struggled with detailed VO (not surprisingly).
- a QS arbitrator may not, and may not have needed experts for ordinary matters

Problems faced by non technical tribunals

Sam Woo Bored Pile Foundations Ltd v China Overseas Foundation Engineering Limited 2006

- Dispute over wording of BQ item for toeing in of piles
- BQ item contravened SMM requirements
- SMM required item to be categorised according to depth in 0.5 m steps
- BQ item
  - "Extra over 1500mm diameter vertical pile shaft for toeing-in to bedrock 1.50 min depth (min.)

    48 nr $36,000 $1,728,000.00 "
- Reyes J considered this to represent an amendment to the SMM, and that all depths exceeding 1.5m are deemed to be covered by the rate

- No experts were appointed
- Reyes J takes view that amendment effected by BQ item description, Court of Appeal agreed with him, and leave to appeal against that decision was also refused
- Not accepted by Court of Appeal that SMM required PP to be included in BQ because of special condition ("save expressly stated otherwise")
- Would technical people would take this view?
- This view renders SMM ineffectual since any BQ description which fails to comply with SMM may be deemed to amend the SMM so that nobody need follow SMM
- MCC considers this a surprising view which few technical people would take

Hung Wan Construction Limited v Hong Kong Housing Authority (2010) Application for leave to appeal before Saunders J

- Arbitration concerning an error in the quantity stated in a BQ description, the arbitrator (a lawyer) concluded that:-
- quantities in the description were a matter of description, not quantity. Saunders J agreed with this
- No recognition that quantity albeit in the description is measured according to SMM and is accepted as a quantity by technical professionals
- Would technical arbitrators would take such a view?
- Arguably QSs may now avoid responsibility for quantities in BQ by placing them in description

The Hoffman cases on interpretation may have caused even more difficulty

- The reason for appointing a legal arbitrator would be to obtain a proper ruling on interpretation
- Now that interpretation must be contextual rather than literal, it is more subjective
- Tribunals may feel free to change the meanings of words to suit and to arrive at their view of what is just
- Eg BQ items and their coverage may be interpreted so as to avoid windfall gains or seemingly unjust consequences

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Additional difficulties faced by non technical arbitrators on construction disputes

- Preference for limited discovery *(Compagnie Financiere du Pacifique v Peruvian Guano Company (1882) 11QBD 55)*
- Quantum experts need full disclosure of accounts to arrive at proper valuation – judges and lawyers may not appreciate this
- Difficulty for legal tribunals to understand the normal duties of engineer and architect in valuing variations or work done without tender analyses
- May result in inappropriate disclosure – eg *Maeda Corporation and Others (in Joint Venture) v HK Government SAR* (Civil Appeal No 230 of 2011(CACV 230/2011), [2014] BLR22) – Tender analyses.

- In Maeda case, court said no rule of law or evidence, or contractual provision which prohibits use of tender build-up, arbitrator entitled and obliged to look at build-up of original rate
- A surprising view - no rule of law or evidence or contract provision requires such disclosure – this view opens up all BQ rates (contrary to Henry Boot case which found contractors have no obligation to give tender build-ups *(Henry Boot Construction Ltd v Alstom Combined Cycles Ltd [QBD(TCC)][1999] BLR123)*)
- Technical arbitrator would understand duty of engineer or architect to carry out valuation without tender analysis
- This view renders interpretation of contract a function of disclosure – surely a bizarre conclusion?

- Courts may not always appreciate the importance of many of the construction points

For example

- Maeda case had very important points to be decided, in particular the disclosure point, and the reference to pre tender documents in determining a rate – surely a vital point on interpretation, but it was not understood or accepted, and court appeared very dismissive

- Courts appear to have difficulty in understanding the normal approach to strategic pricing
- Strategic pricing is an inevitable result of the tendering system used in HK, particularly in Civil Engineering
- Strategic pricing has been accepted by many legal authors.
- See BLR commentary on *Mitsui v AG of HK (PC)* decision
- UK courts seem to have a better grasp – *(Henry Boot Construction Ltd v Alstom Combined Cycles Ltd [QBD(TCC)][1999] BLR123*), see Humphrey Lloyd on strategic pricing and disclosure of tender analyses

Commentary in BLR on Maeda case

"Whilst the court did not find there was a question of honesty engaged in (profit loading the rate), *it did consider the fact that a result in the JV's favour would, in effect, give rise to a "windfall" demonstrated why, "simply as a matter of fairness" the arbitrator's interpretation and application of the contract was preferred. Accordingly one might query whether such a strong statement of principle, and merit, is really what guided the result, and whether the majority of the Court of Appeal in Henry Boot would have reached the same conclusion as to what fairness required"*

"…..The question thus posed is why it was fair that the JV should then be deprived of such an advantage, and opportunity, that it had identified?".

And

"Finally, it is of note that the JV made what was essentially an appeal to (in)feasibility of the exercise undertaken by the arbitrator, namely whether there would be some form of never ending enquiry as to how a tender was calculated (if a tender buildup was required and admitted as evidence). *Unsurprisingly, the court rejected such argument, courts being accustomed to undertaking complex exercises as best they are able to with the information available – as the court put it, it was simply a question of "how the matter is dealt with in terms of evidence"*.

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Would a technical man make a better job of this?

- He is unlikely to make basic mistakes about what the BQ items mean and how to value them
- He should appreciate the difficulty of engineer or architect pricing work but would understand what might be expected from them
- He should understand the normal strategic pricing of BQs and would not be surprised at it (see *Henry Boot*).
- He should not need to rely extensively on experts
- He may try to contrive a fair or just result notwithstanding the terms of the contract – but so do lawyers!

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Appealing against arbitration awards (Mustill & Boyd, second edition pages 27 and 431 etc)

- Prior to 1979, the old arbitration act or ordinance allowed for special case stated on matters of law
- An example was the Mitsui case
- Parties could not validly exclude right to recourse to Courts
- Prevented arbitrator applying his view of law or the view of those in the trade
- Courts considered there was no room for parallel view of the laws of contract
- Parties had anyway contracted to have disputes dealt with according to the relevant law (English or Hong Kong)

- Control maintained by way of special case stated
- Question of law set out in award for consideration of court
- Losing party had absolute right of appeal
- This procedure was criticised by certain parties
- They felt there should be withdrawal from judicial control
- 1979 UK act changed this
- Difficulties of mixed fact and law with case stated procedure
- Case stated procedure abandoned

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Reasons for criticism of special case procedure (M&B P453)

- Merchants considered that involvement of lawyers in arbitration gave them the worst of all worlds, courts should be kept out of award matters
- Disputes became more complex, arbitrators more skilled and do not need involvement by courts
- Large disputes with supra national companies, no allegiance to any legal system, should be treated as extra territorial
- Parties should be empowered to contract out of recourse to courts on questions of law
- Special case stated being used for delay
- Foreigners do not like court involvement
- Commercial considerations of international arbitration being held in UK etc were important

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We now have a position in Arb Ordinance C609 which allows for a transitory arrangement for 6 years from 2011 that the domestic regime will apply unless parties opt out (Cap 609 s100 and 102)

After 6 years (from 2011) there will be a need to opt into the domestic regime

Under the domestic regime (Schedule 2) there is a right of appeal on questions of law (s.5 and 6)

This is restricted under S6(6) to questions of general importance and questions which form for some special reason should be considered by the Court

It is now very difficult to appeal against any award on a matter of law

- The courts restrict such appeals and consider the matter on a sliding scale ranging between one off cases, which require that the arbitrator is obviously wrong, taking into account whether the arbitrator is a lawyer, to the other end of the spectrum where it is a standard form of contract, and/or a matter of public interest and the arbitrator may be prima facie wrong
- Applications are dismissed readily
- Courts apply the criteria for appeal rigorously
- They apply indemnity damages in HK as a matter of course so as to deter parties from applying for leave to appeal

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- Whilst the reasons for concern at the old special case stated arrangements are understood for international cases involving foreign persons etc, where is the justification for abandoning appeal in domestic construction arbitrations?
- It is important that there is a right of appeal and that the appeals are fully and thoroughly reviewed
- Industry no longer has proper guidance on many important points of law affecting the construction industry in Hong Kong
- Do parties to a construction dispute commonly say they do not wish to have any right of appeal, or sign an exclusion agreement or say they do not require reasons for the award (Cap609s2)?

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Comments by Sir Vivian Ramsey at CIArb dinner 29 April 2015 Hong Kong

- Changes required in arbitration
- Arbitration originally brought in because of chaotic state of courts – offered alternative means of dealing with disputes
- Courts can now deal effectively with construction disputes, no real need for alternative
- Will be necessary to use “lay” arbitrators and there may be less involvement of legal fraternity

MCC agrees with need for change but questions some of Sir Vivian's reasoning

- It was always the case that arbitration in construction was intended to be judgment by peers, using technical people who understood the issues – safeguarded by right of appeal on matters of law (using special case)
- Not aware of need for alternatives because of chaotic state of courts – surely arbitration process precedes any such difficulties
- Arbitration included in JCT etc in order to avoid referral to courts for usual reasons, privacy, speed, flexibility, economy and most important, use of technical tribunal
- Is it the technical people or lawyers who are "lay arbitrators"?

It is submitted that Sir Vivian is correct in conclusions, there must be change, and the likelihood is that there will be a shift towards “lay” arbitrators if matters are not dealt with in court

At present there seems no advantage in using arbitration as compared with court proceedings

- lawyers or barristers are appointed as arbitrators, not technical people
- the process is (or more or less) the same as the court,
- it takes at least as long,
- it is far more expensive,
- there is no right of appeal,

What is the alternative?

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- Mediation has been tried but with limited success in the construction industry, the problems are too complex and detailed
- Often used by Government but the need for decisions does not make it suitable for Government staff
- Government Finance Branch and Auditor involvement are a negative influence
- It is time consuming, and expensive, and the possibility of failure to settle is ever present
- There have been some spectacular failures on major disputes referred to mediation in Hong Kong
- Some mediations are extremely time consuming – 2 or 3 years being known
- Unlikely to be of much value on private construction disputes – they can resolve their own problems usually

Expert determination has been tried to some extent but is unsuccessful as a contractual remedy, being subject to many restrictions especially by Government on the finality of the Expert's decision

Obvious alternative is adjudication

Evidence from other jurisdictions is favourable

UK, Australia, Ireland, Singapore, Tasmania, Malaysia, New Zealand

UK is longest established following Housing Grants, Construction and Regeneration Act 1996

Results have been overwhelmingly successful

See the Consultation Document for Adjudication in Hong Kong

The proposed adjudication provisions in HK provide for a structured process with an adjudicator appointed and required to provide his decision within 20 working days of receipt of the respondent's submissions, extendible to 55 working days from the date of appointment of the adjudicator by decision of the adjudicator and beyond that by agreement of the parties

There are obvious difficulties, particularly possible ambush by Claimant given limited time allocated for Respondent to respond

Evidence is that this is not a major issue in UK

There have been many legal cases on jurisdictional problems in UK

Sir Peter Coulson said in recent seminar on UK adjudication:-

"Adjudication has been described as a parallel universe in which decisions which everyone knows to be wrong are solemnly upheld by the courts, and where potentially important disputes are decided at a gallop, with no time for the adjudicator to think very hard about any one problem before the next one arises for his/her decision"

In UK most adjudicators are appointed from the construction professions.

In Singapore appointments are often from legal profession with experts being appointed to assist

Adjudicators undergo training and the appointments are controlled by the professional bodies

The decisions may be rough and ready

The majority of cases in UK are not referred to arbitration, even though many are large disputes

Many reasons for not pursuing cases to arbitration

- parties are not looking for Rolls Royce system, they just want a decision, they are content to accept a rough and ready conclusion from a respected professional – notwithstanding Sir Brian Coulson's observations
- parties do not wish to risk the costs in arbitration when they have a preview of result from adjudication

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- The Consultation Document produced and presently under review by the industry in Hong Kong is impressive and thorough
- There will be vested interests which may object to the change, in particular the abandonment of pay when paid provisions, and potential loss of control once the adjudication process is implemented.
- The advantages are evidenced from other jurisdictions
- The problems with the status quo using arbitration are clear, and have been addressed in this lecture to some extent
- It will be important to have a proper panel of trained adjudicators, and to avoid the pitfalls of arbitration, with the system gravitating towards the court system with experts and full witness involvement
- It is time to try something else and **Adjudication is the obvious way to go.**

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