THE SOCIETY OF CONSTRUCTION ARBITRATORS

10 February 2009

"THE CREDIT CRUNCH: ARE ARBITRATORS UP TO THE CHALLENGE?"

by

John Rushton

Until relatively recently there were effectively three ways in which disputes were resolved – by a judge in Court proceedings, by an arbitrator if there existed a contract between the parties providing for such a means of dispute resolution or by negotiation. Over the years a more multi-dimensional approach has evolved. This is reflected by the change in the object of the Chartered Institute of Arbitrators, as stated in its Charter a few years ago. Its being is no longer simply to promote arbitration but "to promote and facilitate world wide the determination of disputes by arbitration and alternative means of private dispute resolution other than resolution by the Court (collectively called "private dispute resolution")" It is also reflected in the ICE Conditions of Contract, which recognise expressly negotiation, mediation, conciliation, adjudication and arbitration as means of dispute resolution. There are numerous other examples.

Why has there been a growth in other forms of dispute resolution in this country?
It is due in part to the introduction of various ADR techniques from the US (eg: dispute boards, early neutral evaluation and mini-trials); in part to legislation, as witness the provisions for adjudication in the Housing Grants, Construction and Regeneration Act 1996 ("**Construction Act") ;** and in part to pressure from the courts on the parties to find ways to resolve disputes other than by hearings before judges. But I suggest that it is also probably due to the perceived slowness (and thus expense) of the traditional means of dispute resolution. Many will argue that litigation and arbitration are not seen to respond sufficiently to the needs of modern business. Those needs are all the more acute in a recession, where cash is king and there is increased urgency to recover it promptly. Compliance with pre-action protocols delays the start of court proceedings; and even when they are under way, it is difficult for a claimant to secure early payment. The test

for obtaining summary judgment – the defendant has no realistic chance of successfully defending the proceedings – is a high one. It is also difficult to obtain any form of interim financial relief. The picture for a claimant in arbitration seeking early redress is scarcely rosier.

Attempts have been made to address the issues of delay and expense in both court and arbitration proceedings. In arbitration, in particular, there are institutional rules which provide for different procedures for disputes of differing complexity and allow arbitrators considerable discretion when it comes to dealing with costs. There are the so-called 100-day arbitration rules (although this term is a bit of a misnomer given that the period of 100 days only starts to run once a defence has been served).

The principal driver in English arbitration seems to be getting the right answer in the form of an arbitrator's award, even though it might take time to do so, with a view to publishing an award which provides the minimum scope for subsequent challenge. This is an admirable objective. But is it sufficient in an age where cash is increasingly and critically king? Is the ultimate objective rendered otiose or of somewhat limited value if the means of achieving it are open to criticism?

Section 1(a) of the Arbitration Act ("**Act**") sets out clearly that the object of arbitration is "to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay". Note here the use of the word "unnecessary". Some delay appears to be acceptable! The language of section 1 is reflected in section 33 which requires the tribunal to "adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay or expense". Section 40(1) is couched in somewhat more pressing terms. It requires the parties to "do all things necessary for the proper and expeditious conduct of the arbitral proceedings". Section 40(2) (b) goes on to state that this includes "where appropriate, taking without delay any necessary steps to obtain a decision of the court on a preliminary question of jurisdiction or law". Does the less urgent language of sections 1 and 33, when compared with that of section 40, set the tone? Or does this use of different language simply serve to confuse?

It is unrealistic to suppose that the Act, which was enacted after the last recession and is therefore untested in turbulent economic times, will be amended to pick up linguistic anomalies such as the one which I have highlighted. And, even if were to be, it would probably make no difference.

If arbitration is to survive in any credible form – and in the context of domestic construction, where there are well-used alternatives which can (and are) followed, it is close to extinction – there is nothing to be lost and potentially much to be gained, if arbitrators test the wide range of powers which they have under the Act with greater regularity and with expedition, whilst of course recognising that too much speed might lead to mistakes in awards which might not be capable of correction subsequently, given a party's very limited right to challenge effectively an arbitrator's decision.

Section 33 requires the tribunal to "act fairly and impartially as between the parties, giving each party a reasonable opportunity of putting his case and dealing with that of his opponent" There is no judicial guidance on the meaning of "reasonable" opportunity in the context of section 33. Since arbitration is a private process it is impossible to say how often an arbitrator goes out of his way to debate the meaning of this term with the parties when discussing the date by which the reference to arbitration is to be completed. I suggest that he should always do so. What is, and what is not, "reasonable" will depend not just on the amount in dispute but also on the complexities of the arguments to be advanced by the parties and the fairness of keeping one party out of the money to which he considers himself entitled. If a contract requires a claim to be made within a defined period, a certificate to be paid within 14 days and the final account to be prepared and settled within three or six months, then those time limits, too, must have some bearing on what is, and what is not, a "reasonable" opportunity for the purpose of section 33 of the Act.

Arbitrators need to deal head on with the perception that the wide powers which they are given to award interest on late payment and/or penalising a party in costs compensate for

the length of the arbitral process provide sufficient comfort to the party which is out of pocket. They do not. In an age of tight credit those powers might be pretty meaningless in practice in any event, simply because they are exercised at a late stage of the proceedings as a whole.

Nor do I think that arbitrators can regard cost-capping orders as a sufficient way of ensuring that the arbitration is conducted with the requisite speed and with a sufficient eye on overall expense. They are a tool in the process, but no more. Cost capping orders will not necessarily deter a party intent on drawing the process out.

It is certainly open to argument that an arbitrator, especially if the underlying contract was entered into before the present economic climate took hold, has an even higher duty than before to interpret and test rather more robustly than he has perhaps done in the past some of his powers, particularly those in section 34 of the Act, with a view to seeing that cash is in the right hands at the earliest opportunity. He should, perhaps, be more proactive in deciding whether and, if so, what questions should be put to and answered by the parties and when and in what form this should be done (see section 34 (2)(e)). He should consider carefully the need to apply strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material sought to be tendered on any matter of fact or opinion, within the meaning of sub-section (f). He might test more vigorously what is meant by sub-section (g) which requires him to consider whether and to what extent the tribunal should itself take the initiative in ascertaining the facts and the law. He might also wish to consider at the outset the application of his power to appoint experts or legal advisers to report to it and the parties, pursuant to section 37 of the Act. An arbitrator might flag up more forcefully in the future than he has in the past that he may exclude statements of case etc which are delivered late.

Given the privacy of the arbitral process it is difficult to say how often these powers are actually exercised. There is very little judicial comment on their deployment. This tends to suggest that they are used with a very light touch or not used at all. Whatever may be the position, it seems that, in the context of construction disputes, which are heavy on

facts, arbitrators can test them with relatively little risk of a successful challenge to the Courts. As Lord Justice Steyn put it in *The Baleares* [1993} I Lloyd's Rep 228:

> "The arbitrators are the masters of the facts. On an appeal the court must decide any question of law arising from an Award on a full and unqualified acceptance of the findings of fact of the arbitrators. It is irrelevant whether the court finds those findings of fact right or wrong. It also does not matter how obvious a mistake by the arbitrators on the issues of fact might be. That is, of course, an unsurprising position. After all, the very reason why parties conclude an arbitration agreement is because they do not wish to litigate in the courts. Parties who submit their disputes to arbitration bind themselves by agreement to honour the arbitrator's Award on the facts. The principle of party autonomy decrees that a court ought never to question the arbitrator's findings of fact".

In *Demco Investments & Commercial SA v S E Banken Forsakring Holding Aktiebolag* [2005] EWHC 1542 (Comm) Mr Justice Colman refused an application for leave to appeal when the arbitrators, after considering 222 applications of mis-selling of pensions and hearing evidence from two investors only, concluded that there had been mis-selling in all the cases in question. He ruled that it was not open to the sellers to contest the finding of fact thus involved by maintaining that there was no evidence to support it. He also decided that there was evidence upon which the arbitrators could properly and reasonably reach the conclusion which they did. Essentially, the sellers' case rested on an alleged insufficiency of evidence or lack of evidence of a particular kind. The Judge took the view that the challenge was plainly directed to the facts and, as such, was impermissible.

Besides exercising the powers expressly accorded to him under the Act more vigorously than perhaps hitherto, an arbitrator should also consider inviting the parties with greater regularity to consider other ways of resolving the underlying dispute or to give him powers which he does not expressly have, in the interest of getting cash flowing. For example, an arbitrator might proactively spell out the attractions to a party of, say,

adjudication or mediation more forcefully than he reputedly does, whilst recognising that he runs the risk of one or both of the parties politely (or otherwise) saying to him that he has been appointed to resolve the parties' dispute by arbitration; that he is actually at risk of breaching his obligation under section 33 of the Act by proposing alternative and speedier means of resolving the underlying dispute since they may lead to unnecessary expense and delay in reaching a final conclusion if they are unsuccessful; and that it is not for him in any event to suggest other ways in which their differences might be resolved.

Similarly, an arbitrator might consider quizzing a party forcefully about why he is not prepared to allow him power to make a provisional award, when faced with an objection to him doing so. Remember, section 39 of the Act only allows the arbitrator to make a provisional award if both parties allow him to do so. In this respect it is reassuring to see that Rule 10 of the Construction Industry Model Arbitration Rules expressly states that the arbitrator has power to order payment of a "reasonable proportion of the sum which is likely to be awarded finally in respect of the claims to which the payment relates after taking account of any defence or counterclaim that may be available". He also has power to order payments on account of costs and any other relief. He may exercise those powers after application by a party or on his own motion. Rule 10.3 states that an order for provisional relief must be based on "formal" evidence and may require payment to be made to a stakeholder on such terms as he considers appropriate.

Article13 of the UNCITRAL Model Law also provides that, unless otherwise agreed by the parties, the arbitral tribunal may, at the request of one party, order a party to take such interim measures of protection as it may consider necessary in respect of the subject-matter of the dispute. Such interim measures presumably include the payment of part or all of the sum in dispute into a stakeholder account. Article 10 is in effect an "opt out" provision and is therefore more effective than section 39 of the Act in an age where cash flow is all important.

In the international context arbitrators might expressly mention the pre-arbitral referee procedures which the International Chamber of Commerce has formulated, before embarking upon arbitration. Whilst it is, of course, open to one or both parties to say that those procedures only apply if both parties expressly agree that they should do so, an arbitrator should give some thought to pressing the parties to explain why they are not prepared to use them, even if they are not expressly contained in the contract concerned whilst being mindful that, if he does so too forcefully, he runs the risk of losing the confidence of the party or parties resisting the suggestion.

In the international context, too, the FIDIC Conditions for EPC/Turnkey Contracts require a party to obtain a decision from a dispute adjudication board ("**DAB**") before proceeding to arbitration. The DAB is empowered to take the initiative in ascertaining the facts and matters required for a decision, make use of its own specialist knowledge (if any) and, significantly in the context of the credit crunch, decide upon any provisional relief, such as conservatory and interim measures. So far so good. The DAB is required to make its decision within 84 days, and a notice of dissatisfaction is to be served within 28 days if a party wishes to refer to arbitration a DAB decision. Clause 20.4 expressly provides that the DAB decision "shall be binding on both Parties, who shall promptly give effect to it unless and until it shall be revised in an amicable settlement or an arbitral award". Again, so far, so good. But what happens if a party fails to comply with the decision of a DAB? Clause 20.7 says that such failure might be referred to arbitration. That seems a rather weak response. What the Conditions do not expressly state is that the non-complying party's right to be heard in any subsequent arbitration proceedings is dependent upon prior compliance with the DAB's decision. Nor do they expressly state whether such non-compliance is to be taken into account by the arbitrator in such proceedings.

The FIDIC Conditions are not the only ones to contain dispute escalation provisions which appear at face value to be useful but which on closer examination are somewhat toothless. To what extent is it open to an arbitrator to take it upon himself to give them

some bite? Should he take the cell-like approach that the DAB's decision has nothing to do with him and proceed de novo, taking the line that the DAB decision is, in reality, an irrelevance or a distraction? Or should – or can - he impose on the defaulter some penalty for non-compliance or indeed deny him the right to pursue his case in arbitration until he complies with it? If he does not, is the DAB process anything more than a means of giving the defaulter nearly three months' extra use of cash to which he may not be entitled? At the very least it seems to me that an arbitrator can communicate his concern about a party's reluctance to look at potentially speedier, less expensive ways of settling their differences and thereby place some gentle psychological pressure on the defaulter that he has incurred his displeasure.

It will be said that it is not for an arbitrator to seek to fill the lacunae in the dispute resolution provisions in the relevant contract and/or to do the job of the advisers of the parties to arbitration in suggesting alternative means of getting cash flowing. However, is there any reason why he should not and weigh in the balance the responses he receives from the parties to such suggestions?

It will also be argued that, notwithstanding the credit crunch, an arbitrator is on balance less likely to be criticised for not raising some of the issues highlighted above with the parties than for doing so. After all, section 1(b) of the Act specifically states that "the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest".

Yet it seems to me that, in these current harsh economic times, arbitrators owe it to the parties and to themselves to suggest potentially speedier and less expensive ways of settling their differences and/or examine and test the powers which they have under the Act with perhaps greater imagination and force than they appear to have done in the past, whilst obviously taking care not to misconduct themselves in the process.

So I leave you with the thought that there are three ways in which the Society of Construction Arbitrators ("**Society**") might be able to make its mark in these difficult economic times.

First, the Society may wish to take the initiative in producing some kind of protocol, initially for consultation purposes, which emphasises the intention of its members to apply more robustly the provisions of the Act in the light of the harsh economic conditions in which we are living. At least those parties to an arbitration who find that they have as their arbitrator a member of the Society will know from the outset where they stand.

Secondly, the Society may wish to initiate a debate on the extent to which an arbitrator can, and should, take into account a party's failure to comply with other dispute resolution procedures in the underlying contract (eg: the decision of a DAB in the FIDIC Conditions) or refusal to give him power to get money moving (eg: a refusal on the part of one party to allow the arbitrator to make a provisional award) if he thinks fit.

Thirdly, even if the Society concludes that there is no particular need for arbitrators to respond in any particular or different way to the credit crunch, its members should nevertheless bear in mind that Parliament is in the process of amending the Construction Act to permit the adjudication of disputes arising under so-called construction contracts which are not just in writing but also made orally. In an age when cash is king, why not legislate for the adjudication of all disputes arising under every contract, whether it falls within the present definition of a construction contract or not, where such contract is governed by English law and/or involves performance in England and/or by a party carrying on business in England? There is no reason why the adjudicator nominating bodies should not include professional or other business organisations which are not tied up with the construction industry (eg: the Law Society, Lloyd's and the CBI). Nor is there any reason why the County Court and the High Court should not adopt the same approach to the enforcement of adjudicators' decisions as the Technology and Construction Court has done.

Adjudication is not a perfect instrument but it has provided a way of getting cash flowing within the construction industry. In the vast majority of cases, adjudicators' decisions have been accepted without the need to fall back on the more time-consuming and expensive processes of litigation and arbitration. Indeed, it seems that litigation and arbitration are now only used when an adjudicator's decision is so substantially flawed that one party is prepared to incur yet further expense in challenging it. Is there any good reason why disputants in part only of the construction industry should have the right to obtain an adjudicator's decision?

Adjudication will not help a party seeking to enforce a decision against a party without assets which can be readily attached. Nor, for that matter, will arbitration and litigation. However, non-compliance with an adjudicator's decision may be a factor to be taken into account in deciding whether the non-complying party should provide security for costs in any subsequent court or arbitration proceedings.

It seems to me that members of the Society should actually be encouraging the Government to broaden the scope of adjudication as a means of settling commercial disputes in view of its relatively solid history of success in the last eleven years in the construction industry.

I can think of no more appropriate body that this Society to explain what the process of adjudication is all about and try and allay the understandable concerns of those presently unfamiliar with the process.

J M Rushton
February 2009