

# COMPARATIVE ANALYSIS OF ADJUDICATION AND ARBITRATION METHODS IN SRI LANKAN CONSTRUCTION INDUSTRY

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## ABSTRACT

*Construction claims are more technical intensive and multifaceted than other commercial disputes. The construction industry needs a fast and cost effective method for dispute resolution. Although the area of dispute resolution has been widely discussed and heavily researched, few studies have been conducted with respect to this research area in the Sri Lankan context. The aim of this study is to compare and contrast adjudication and arbitration methods use in Sri Lankan construction industry. To accomplish this aim, a literature survey would be conducted to find out available dispute resolution methods and the extent to which research has been carried out on arbitration and adjudication method. The developed questionnaire would be used to gather primary data from the professionals and the collected data would be analyzed using of statistical tools. Further, factors that can be used to compare arbitration and adjudication methods are presented in the latter part of the literature review. Semi structured interviews were carried out using the factors identified from literature review. The results of this research enable researchers to gain a better understanding on the current adjudication and arbitration methods, recognize significance of critical factors and suggestions for the development of adjudication and arbitration methods in the construction industry of Sri Lanka. The findings of this research indicate that the professionals who involve in the construction industry have overall average level of satisfaction on the current practice of adjudication and arbitration, however they believe that adjudication is an effective mechanism for dispute resolution rather than arbitration. It further revealed that the modernised stair-step model of dispute resolution strategy is the best. The research further makes recommendations in order to make ADR methods more effective and efficient.*

**Keywords:** Adjudication; Arbitration; Dispute Resolution; Success Factors.

## 1. INTRODUCTION

Alternative Dispute Resolution (ADR) methods are a term usually used to refer to informal dispute resolution processes in which the parties meet with a professional third party who helps them to resolve their disputes in a way that is less formal and often more consensual than what is done in the courts. ADR methods can be used to reach an agreement fair to all parties in an atmosphere of co-operation and mutual respect. Institute for Construction Training and Development' (ICTAD) (Now named as Construction Industry Development Authority - CIDA) introduced the adjudication process to Sri Lankan construction industry as an immediate step of construction dispute resolution in their first revised edition of 'Standard Biding Document' (SBD) in 2007. According to ICTAD conditions of contract, the adjudicator is a single person appointed by agreement between the parties. If parties are unable to reach the agreement within 14 days of such request of agreement, the adjudicator would be appointed by ICTAD. Arbitration is also a commonly used method to resolve construction disputes in Sri Lanka. Arbitration, in the law, is a form of alternative dispute resolution specifically a legal alternative to litigation whereby the parties to a dispute agree to submit their respective positions to a neutral third party for solution. Most construction contracts contain arbitration clauses requiring the parties to refer any dispute to arbitration (Cheung, 1999).

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### **1.1. RESEARCH PROBLEM**

In Sri Lanka, most of the construction contracts are based on Standard Bidding Document (SBD) of ICTAD (2007) or Conditions of Contracts of *Federation Internationale Des Ingenieurs* (FIDIC) (1999). Most of the construction contracts stated that appointment of Dispute Adjudication Board (DAB) or arbitration clauses. Frequently the question is how to systematically determine whether DAB or arbitration adopt the nature of dispute. Therefore it gives rise to the question that “What are the critical factors affecting adjudication and arbitration considering the nature of the disputes arises in Sri Lankan construction contracts?” Although the topic of dispute resolution has been heavily researched in Sri Lanka, no researches have been conducted with respect to this question.

## **2. RESEARCH METHODOLOGY**

To accomplish the aim of this study, a literature survey was conducted to find out the available literature and the extent to which research has been carried out on adjudication and arbitration method. A survey was conducted among group of construction industry experts who are closely engaged with dispute resolution in the construction industry. The developed questionnaire was used to gather information from the professionals who are engaged in the construction industry. Collected data was analysed using statistical tools.

### **2.1. SCOPE AND LIMITATIONS**

This research is limited to evaluate the arbitration and adjudication method in the construction industry of Sri Lanka. However, legislations in other countries were referred in order to study their applicability to Sri Lankan construction industry. Data was collected from the professionals who are having experience on construction dispute resolution in Sri Lanka.

## **3. LITERATURE SYNTHESIS**

Andrew (1986) and Harmon (2003) have stated that construction industry is generally considered complex and have resulted in increasingly complex contracts. Turner and Turner (1999) stated that the factory production is a line of work, going through people and a site production like construction work is a line of people going through work. That requires the coordinated effort of a multiple member organisation of many discrete groups. This situation was analyzed in case called *Emson Eastern vs. EME Development Co* (1991) 55 BLR 114. In this case, the court held that ‘...*the building construction is not like the manufacture of goods in a factory. The size of the project, site conditions, use of many materials and the employment of various kinds of operatives make it virtually impossible to achieve the same degree of perfection that a manufacturer can.....*’. Therefore, not only within the contractual relationship in between client and contractor, some disputes that occur with the neighbour of such construction.

### **3.1. DISPUTES IN THE CONSTRUCTION INDUSTRY**

The unresolved disputes can lead to project delay, increased tension, and can damage long term business relationships as a result (Cheung and Suen, 2002). Sir Michel Latham concluded his ‘*constructing the team*’ report (1994 cited Turner and Turner, 1999, p.4) that the number of disputes that arose in the industry was a major factor which perpetuated poor relationships and poor performance in the industry. The most important prerequisite for successful ADR method is the desire for the parties to explore the possibility for settlement. There are other certain prerequisites which are and adopted by the users. According to Brown and Marriot (1999) the philosophical prerequisites of ADR method can be identified as follows:

- All ADR methods are compromise.
- ADR methods must involve a "win/win" solution to the dispute.
- Parties must be realistically aware that ADR methods are best alternative to negotiated agreement.

- There must be realistic administrative procedures to encourage ADR methods.
- ADR methods will be inappropriate where one party does not want a settlement.

There are two groups of ADR methods in construction industry as formal- binding methods and informal-nonbinding methods. Binding ADR method is predominantly arbitration, and in some extent Adjudication. Nonbinding ADR methods include basically negotiation and mediation. When considering the suitability of ADR method, it is suitable for technical disputes where a third party can choose with a technical ability.

#### 4. ALTERNATIVE DISPUTE RESOLUTION METHODS

Brown *et al.* (1998) suggested that the term "ADR" method is often used to describe a wide variety of dispute resolution mechanisms that are short of, or alternative to, full-scale court processes. Cheung (1999) is developed model for use of different ADR methods and it is shown in Figure 1.

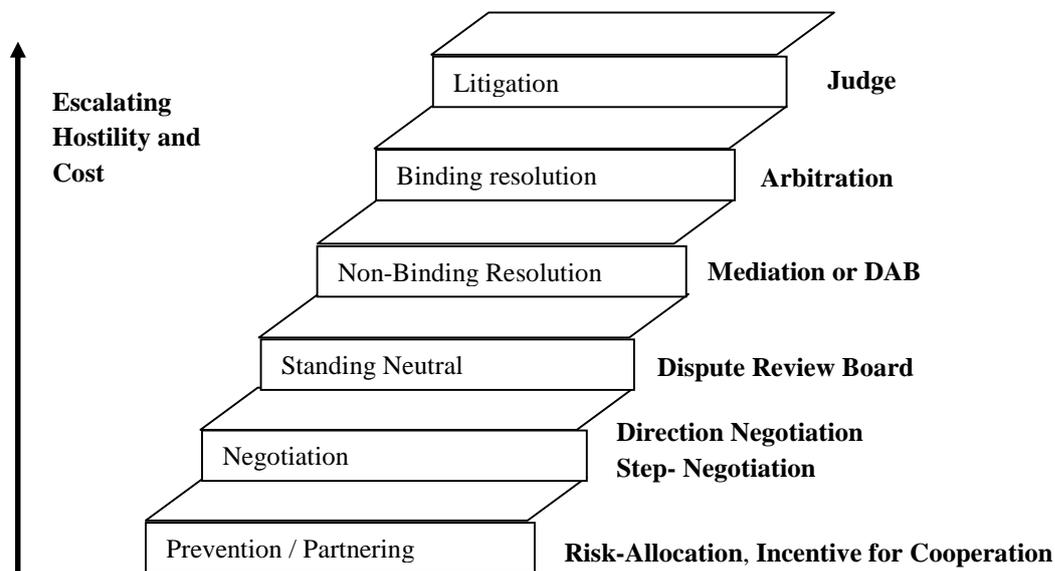


Figure 1: Construction Dispute Resolution Stair Step Model

##### 4.1. ADJUDICATION

Adjudication is an ADR method by which disputes are referred to the neutral third party, for a decision which is binding on the parties only until the dispute is finally resolved by arbitration or litigation. Statutory Adjudication has been created in England by Housing Grants, Construction and Regeneration Act 1996, which came into force on 1<sup>st</sup> May 1998. However, in Sri Lanka there is no such statutory authority for adjudication and the adjudicator's award has no legal recognition. However, adjudication is recognised by the newly enacted Construction Industry Development Act of Sri Lanka No. 33 of 2014.

In Sri Lankan construction industry, Adjudication practically proceeds mostly according to FIDIC and ICTAD conditions of contract. At the commencement of the contract, parties agree to the appointment of an adjudicator known as the Dispute Adjudication Board (DAB) or as sole adjudicator. Most significant factor of adjudication is that the adjudicator or the DAB is required to act as impartial experts and not as arbitrators. Therefore the adjudicator must only be a person suitably qualified to interpret technical and contractual matters.

ICTAD Conditions of Contract provide for reference of any dispute arising between the parties of any kind what so ever to a DAB comprising one or three persons for decision, which is to be given within 84 days or such other time as is proposed by the DAB and approved by the parties. The decision is to be reasoned and, as with other forms of adjudication, is binding until resolved by one of the other methods of dispute resolution provided for in the conditions. If either party is dissatisfied with the decision, or the

DAB does not deliver its decision within the specified time limit, it may give notice of dissatisfaction to the other party within 28 days after the decision or after the specified time limit, and the dispute will be referred to the next stage which is called as arbitration. According to the FIDIC conditions if either party does not refer the dispute to the arbitration within specified time period, the Adjudicators' decision becomes final and binding upon the employer and the contractor. According to *Azis vs. Thondaman* case this kind of enforcement can argue by courts of law. ICTAD conditions the adjudicator shall be a single person appointed by agreement between the parties. If parties are unable to reach the agreement within 14 days of such request of agreement, the adjudicator shall be appointed by the ICTAD. Either party may initiate the reference of the dispute to the adjudicator by giving 07 days notice to the other party. Then the adjudicator shall give his determination about dispute within 28 days or such other period agreed by the parties - of receipt of such notification of a dispute.

#### **4.2. ARBITRATION**

The Arbitration can be defined as, the submission of a dispute to one or more impartial persons for a final and binding decision. According to the Arbitration Act No. 11 of 1995 provides for a legislative framework for the effective conduct of arbitration proceedings in Sri Lanka. The desirable features of arbitration are fast, inexpensive, fair, simple, flexibility, confidentiality, minimum delay. The main feature of arbitration is that it is consensual in nature and private in character. Sri Lanka Arbitration Act No 11 of 1995 stated different arbitration principles and UNCITRAL Model Law. The Arbitration Act of Sri Lanka stated that how to resolve disputes arise in any industry. The Act stated that an arbitration agreement shall be in writing. The main objectives of this Arbitration Act are as follows.

- To make comprehensive legal provisions for the conduct of arbitration proceedings and the enforcement of arbitral awards.
- To make legal provision to give effect to the convention on the recognition and enforcement of foreign award.

##### **4.2.1. CONTENTS OF ARBITRATION ACT NO.11 OF 1995 IN SRI LANKA**

According to Kanag-Isvaran (2006), followings are the basic contents of the Arbitration Act No. 11 of 1995 in Sri Lanka,

- **Enhancing its finality** - No review of an arbitral award thus enhancing its finality. There is only a possibility of having it set aside on very narrowly defined grounds as per Section 32 and 34.
- **Waive appeal by exclusion agreement** - Right to waive appeal to the Supreme Court by exclusion agreement as per Section 07, 10, 11, 13, 20, 21 and 39.
- **Arbitration agreement bar to court** - valid arbitration agreement constitutes a bar to court proceedings if so pleaded. Court cannot ignore such agreements as per Section 5.
- **Limited court intervention** - Once arbitration has commenced, court intervention is limited to specific instances supportive of arbitration Section 05 section 32, 34.
- **Party autonomy** - Party autonomy is a golden tread that runs through the web of arbitration law. Acceptance of parties autonomy to the largest extends is possible in conducting the arbitration. As per section 6, 7, 16 and 17 parties have autonomy to decide number of arbitrators, the procedure for appointing arbitrators, the place of arbitration and procedure to be followed by arbitral tribunal respectively.
- **Recognition and enforcement** - Clear, unambiguous and efficient procedure for the recognition and enforcement of foreign arbitral awards as provided for by the New York Convention of 1958.

In Sri Lanka arbitration is a legally enforceable ADR method backed by the Act No 11 of 1995. The Act was enacted as a comprehensive Act on arbitration to replace the outdated legislation in existence, which was inadequate to settle disputes through arbitration. Further there are some cases which were decided by Superior Courts of Sri Lanka and now those have become a part of arbitration law as a judicial precedent. As an example *Southern Group civil construction private limited vs. Ocean Lanka private limited* case

discussed the grounds for setting aside an arbitral award and the time limitation for challenge the arbitrator's award. In *State Timber Corporation vs. Moiz Goh (pvt) Ltd* case, court held that the district court has no jurisdiction to enter in to the arbitration proceeding.

## 5. CRITICAL FACTORS OF ARBITRATION AND ADJUDICATION

Several researchers attempted to identify the selection criteria of dispute resolution strategies based on identical factors such as cost, time duration, degree of control by the parties, flexibility, confidentiality, voluntariness, enforceability, binding decision, privacy etc. (Cheung and Suen, 2002). Considering the factors of dispute resolution identified by researches, comprehensive list of factors affecting ADR methods can be summarized as in Table 1.

Table 1: Summary of Success Factors

| Success Factor  | Explanation of the Factor   |
|---|---|
| 1. Confidentiality of the information and the process | Parties to the dispute, control the process by avoiding expose any information or material to business community .  |
| 2. Consensus agreement                                | Ability of working within a common ground throughout the dispute resolution process                                 |
| 3. Control by parties                                 | Degree to control the process, format and the content of the resolution by parties                                  |
| 4. Cost   | Total amount of direct indirect and hidden cost   |
| 5. Creative solution                                  | Does the solution satisfy the needs of both parties?  |
| 6. Enforceability of the decision                     | Binding nature of the decision  |
| 7. Fairness   | Ability of both parties to disclose the relevant facts  |
| 8. Flexibility in the proceedings                     | Degree of using strict rules and procedures in the process  |
| 9. Overall duration/ Speed                            | Amount of time taken to resolve the dispute   |
| 10. Preservation of relationship                      | Ability to protect the relationships between the parties after the final decision of the dispute resolution process |
| 11. Professional culture and ethics of parties        | Culture and ethics of the professionals involve in the dispute resolution process                                   |
| 12. Time required of parties                          | Time for submissions, to prepare submissions and to react according to the proceedings is strict or not             |

For this research detail survey and semi-structured interviews were conducted to collect data from the industry. The data collected from literature review was the guidance to define the sample for the detail questionnaire survey and semi-structured interviews. Many professionals who have got more experiences on construction industry and they have clear understanding on present adjudication and arbitration practices.

## 6. SATISFACTION OF THE CURRENT PRACTICES OF ADJUDICATION AND ARBITRATION

Current practice of adjudication and arbitration methods are evaluated according to the seven most critical factors identified from questionnaire survey. The results are shown in Tables 2 and 3.

Table 2: Satisfaction of Current Practice of Adjudication Considering the Critical Factors

| Rank | Critical Success Factor                            | Adjudication (Mean) |
|------|--|---------------------|
| 1    | Fairness   | 4.47                |
| 2    | Flexibility in the proceedings                     | 3.84                |
| 3    | Confidentiality of the information and the process | 3.74                |
| 4    | Preservation of relationship                       | 3.26                |
| 5    | Creative solution                                  | 2.58                |
| 6    | Overall duration/ Speed                            | 2.58                |
| 7    | Enforceability of the decision                     | 1.11                |

Table 3: Satisfaction of Current Practice of Arbitration Considering Critical Success Factors.

| Rank | Critical Success Factor                            | Adjudication (Mean) |
|------|--|---------------------|
| 1    | Enforceability of the decision                     | 4.95                |
| 2    | Fairness   | 4.74                |
| 3    | Confidentiality of the information and the process | 3.63                |
| 4    | Overall duration/ Speed                            | 2.16                |
| 5    | Preservation of relationship                       | 1.68                |
| 6    | Creative solution                                  | 1.58                |
| 7    | Flexibility in the proceedings                     | 1.47                |

It was identified that four out of seven success factors scores the weighted mean greater than 3.00 in adjudication. Only three factors have scored weighted mean greater than 3.00 in arbitration. Also out of that four, only “Enforceability” and “Fairness” scored greater weighted mean in arbitration than adjudication. So, by evaluating critical factors, adjudication can consider as best method to resolve disputes.

Industry experts in the industry are having moderate view on adjudication, they highlighted that it would be better if the local standard conditions of contract included the provisions for fulltime Dispute Adjudication Board. In addition they said that it will be better if the Adjudication has given legal assent through legislation.

## 7. RECOMMENDATIONS TO IMPROVE THE ADJUDICATION AND ARBITRATION METHODS

Most of the professionals in the industry have overall average satisfaction of both methods. It was revealed that both adjudication and arbitration should be improved to achieve the utmost outcomes of the processes to enhance the satisfaction. Most of the experts suggest to having a professional statutory institute for construction adjudication and arbitration practices.

In the light of the experts’ interviews and the results of the questionnaire survey, the following recommendations can be made to enhance the standard of arbitration and adjudication methods in Sri Lankan construction industry.

- Arbitration is costly and requires longer duration for the award. Therefore it should be reviewed and modified.
- Introduction of DAB from concerned professional institutions to settle disputes.
- Require immediate review of existing standard conditions of contracts practiced in the construction industry. Without implementing international standard conditions alone, it is required to assess the suitability of those conditions to the Sri Lankan construction industry.

- Instead of having several sets of rules by several institutes, for construction disputes, ICTAD (CIDA) must have dominant set of rules for govern construction dispute resolution using by adjudication and arbitration.
- Introduce well-structured professional courses on dispute resolution, adjudication and arbitration practices for the universities and construction training institutions.
- Awareness is the finest way of empowerment. Conduct awareness programmes on adjudication and arbitration related to the construction industry regularly.
- In the construction industry in Sri Lanka, there does not appear to be much concern given as to how the fundamentals of engineering and law must be used in the process of managing these disputes. Importance of adopting fundamentals of engineering principles as adopted in other aspects of construction processes must be emphasised in every instance of the dispute management process as well. There has to be a contribution to the industry by way of using scientific methods for programming, monitoring, evaluations, analyses which should form the basis of scientific dispute resolution. The professionals should persuade the stakeholders to adhere to the fundamentals of engineering, law and ethics in the process of dispute management in order to have a more sustainable and healthy construction industry.
- Introduction of sensible dispute management practice is important to negotiate disputes and settle disputes quickly. If a settlement cannot be achieved through negotiation, arbitration or adjudication methods should be considered.
- Partnering works well to prevent disputes. According best adjudication or arbitration approach for construction projects would be start with partnering and relay on direct negotiation.

## 8. CONCLUSIONS

The detailed analysis of identified critical factors of adjudication and arbitration practices were carried out relating to the construction industry of Sri Lanka based on the preliminary data and secondary data gathered through the questionnaire. According to the rank order seven most critical factors were “Overall duration (Speed)”, “Flexibility in the proceedings”, “Enforceability of the decision”, “Preservation of relationship”, “Confidentiality of the information and the process”, “Cost” and “Fairness”. It was identified that most experts are preferred to resolve dispute through adjudication rather than from arbitration, according to their experience and knowledge. From the results of the survey also revealed and emphasised that adjudication is better than arbitration as a dispute resolution.

A pivotal conclusion of this research is that the stakeholders in the construction industry prefer “adjudication” as an ADR method. Professionals had a low level of satisfaction on the current practice of arbitration. It was revealed that construction industry expects quick remedy on than the less cost solution. It further revealed that the modernised stair-step model of dispute resolution strategy is the best.

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