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Insight into resolving construction disputes by mediation/adjudication in Hong Kong

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Abstract

Resolving construction disputes using an adversarial approach is considered to be in opposition to the maintenance of a harmonious relationship between two parties. The modern arbitration process may emulate the litigation proceeding leading to delay and cost escalation. During the past decade, the Hong Kong Government has implemented a mediation clause as an alternative mode for settlement of construction disputes. In this paper, the experience and insight into resolving construction disputes by integrating mediation and then arbitration in Hong Kong are highlighted. The state-of-the-art modern mediation process and its philosophical origins are reviewed. The shortcomings of the present system are pinpointed. The success of the adjudication now practised in the United Kingdom may suggest that there is a place for another process of dispute resolution, which may help improving the situation. The prospect of the proposed mediation/adjudication and then arbitration mechanism is discussed with particular reference to the construction industry in Hong Kong.

Keywords: Arbitration, construction industry, dispute resolution, Hong Kong, mediation

Introduction

Arbitration was conventionally employed as the means to resolve disputes arising from civil engineering or building contracts in Hong Kong. As is customary in all construction contracts, there is often an arbitration provision (Hong Kong Government 1985). However, arbitration in construction disputes, which was promulgated to be an informal, fair, and swift form of justice, has become a mirror of high court proceedings, with both parties often represented by senior legal experts. These attorneys, who are trained to be adversarial and to use every tactic to win during the proceedings, are often employed to represent the parties. They consider the maintenance of the relationship between the two parties to be of secondary importance. While arbitration was initially not intended to be adversarial, in some cases, the modern arbitration process may emulate the litigation process, and lead to procrastination and cost escalation.

Resolving construction disputes using an adversarial approach, such as modern arbitration, was considered to be in opposition to the maintenance of harmonious relationships between the parties (Brooker and Lavers 1997; Harmon 2003). The parties often prefer alternative dispute resolution to avoid ruining this business relationship (Treacy 1995; Cheeks 2003). Moreover, arbitration is only available at practical completion of the whole of the works, which means that the two parties may have to bear a poor relationship for a long period, in particular if the dispute happens during the early stages of the project. Attention is gradually focused on various dispute resolution alternatives such as mediation, which provides potential for both time and cost savings. Disadvantages of arbitration have prompted a return to more rough and ready dispute resolution alternatives.

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In 1984, the Hong Kong Government, being aware of the various disadvantages of arbitration and urged by the industry, implemented mediation on a trial and selected basis in some public sector contracts in order to gauge its effectiveness (Hong Kong Government 1984; Hong Kong Institution of Engineers 1985). Trial mediations were carried out and the outcome of the pilot scheme was extremely encouraging. In 1989, the Government, having acquired sufficient insight from the pilot mediation scheme, implemented a mediation clause as a Special Condition of Contract in all large building and civil engineering contracts, and electrical, mechanical and building services contracts, as an alternative mode for settlement of construction disputes (Hong Kong Government 1989). The customary arbitration provisions for construction disputes in the contracts were replaced by a two-tier mechanism, i.e., should mediation not succeed, then arbitration would be used.

In this paper, the current setting in resolving construction disputes by integrating mediation and then arbitration during the past decade in Hong Kong are presented. The state-of-the-art modern mediation processes and its philosophical origins are reviewed. The shortcomings of the present two-tier system are pinpointed. The reported success of adjudication now practised in the United Kingdom may suggest that there is a place for another process of dispute resolution in Hong Kong which may help to improve the situation. The prospect of a proposed mediation/adjudication and then arbitration mechanism is then discussed.

Literature Review

During the past decade, studies have been undertaken to identify problems of the construction industry (Latham 1994; Egan 1998). The proliferation of construction disputes is found to be one of the fundamental causes of project failure. It may be due to the surge of an increasingly complex nature of recent construction projects and intense competition among contractors. While arbitration was initially thought to be an inexpensive, efficient, prompt, private, and informal process with decisions made by experienced industry professionals (Stipanowich 1997), it evolved gradually over the years and now appears to emulate conventional litigation, with regard to its speed, cost, procedural complexities, and frustration levels (Cheeks 2003; Harmon 2003). It involves a confrontational and adversarial process with a win-lose premise (Cronin-Harris 1996; Brooker and Lavers 1997) while engineers prefer to use a problem-solving style to find mutual win-win resolutions to conflict (Singh and Johnson 1998). All these are also common features of the construction industry in Hong Kong (Soo 2001; Molloy 2003).

The perceived shortcomings of litigation and arbitration encouraged the rapid growth of alternative dispute resolution processes: conciliation, mediation, adjudication, etc. (Battelle 1995; Cronin-Harris 1996; Keil 1999) Alternative dispute resolution methods have been used extensively around the world and are found to function well for many types of disputes. Particular success has been recorded in such areas as purchasing, supply, banking, insurance, personal injury disputes, partnership disputes, consumer disputes, maritime, divorce and family matters (Folberg and Taylor 1984; Rouse 1988; Holland 1989).

Mediation

Mediation is a voluntary, non-confrontational, informal, private and non-binding dispute resolution process in which an impartial and independent person, called a mediator, helps the parties to try to reach a settlement by avoiding time-consuming and costly litigation/arbitration (Chau 1992). Mediation can be considered as a half-way house between conciliation and

arbitration in that a mediator goes further than a conciliator in the degree of involvement in judgment decisions. Mediation attempts to resolve disagreement and focus on settlement by applying extra-legal principles rather than rigid legal rules, with due regard given to the trade customs, previous business connections and the prevailing circumstances.

Mediation avoids an adversarial arbitration or court proceeding, which tend to polarize the parties and harden them in their respective positions. Mediation seeks to ease hostilities by fostering co-operation in a structured way through dispute resolution. Besides, it provides significant potential savings in both time and cost in the settlement of disputes, provided that parties are determined to resolve their disagreements by non-adversarial methods. Another advantage of mediation is the freedom to withdraw from it when one party is dissatisfied with the attitudes adopted by or the style of the mediator. In such circumstances, the recommendations of the mediator can be disregarded. Its non-binding nature can be an attraction since it allows the parties to objectively evaluate the personal qualities of the mediator and his recommendations in determining whether or not to accept his opinion or proceed to arbitration. Thus the appointment of a mediator in whom both parties have faith and respect is a prerequisite.

Historical origin of philosophy of mediation

In ancient China, mediation was the primary method of settling disagreements. The Confucian view was that a disagreement would best be resolved by moral persuasion and compromise instead of by sovereign coercion (Tu 1985; Li 1986). Law, in Chinese custom, played a secondary role. The foundation of the community is the code which prescribes that human beings behave in all conditions in conformity with the natural order and that the state of a natural harmony in human affairs should not be disrupted. It was strongly believed that laws, being abstract, are not the appropriate way to regulate daily life and other circumstances (Johnston 1934; Creel 1960).

In accordance with Chinese tradition, personal rights established by laws are, *a fortiori*, against the natural order. Unilateral self-help and adversarial proceedings ruin harmonious relationships and thus would be antithesis of peace. The practice of devoting oneself to the duties due to mankind and rightness in moral life is of utmost significance. It is the obligation of every citizen, and in the common interest of the community, to avoid court proceedings, which are considered to be detrimental to the natural social order and ought to be the very last resort (Creel 1960). This last step may be taken only after exhausting all other possibilities of dispute resolution. It would be unwise for a friend to resort to constant reproof which inevitably renders friendship remote. If there exists a conflict of interest between two parties, it is essential to acquire an accommodation or a compromise, with due consideration to the interests of both parties without making one of them the winner and the other the loser. 'Reciprocity' may serve as a rule of life. A wise man recognizes that one should not do unto others what one would not wish done unto oneself.

All these are the pre-requisites of Chinese philosophy, originating from Confucius (B C 551-479) and his successors (Johnston 1934; Cheng 1947; Creel 1960; Lau 1983; Tu 1985; Li 1986). This is, in essence, a philosophy of harmony, of peace, and of compromise. Indeed, Confucian thought emphasized the supreme significance of the training and development of one's character. Nowadays, many investigators, not just limited to Chinese, subscribe to the prevalent Confucian thought, which can be reflected in voluminous translations to other

languages (Louie 1980; Hall and Ames 1987; Strathern 2002). It comprises one of the most important components in current Chinese studies, not just a choice of convenience in itself.

The Hong Kong Government Mediation Rules

Mediation is a contractual prerequisite to binding arbitration in government contract. The Hong Kong Government Mediation Rules (Hong Kong Government 1991) are a set of twenty three rules used extensively for mediations in the construction industry. The mediation service is administered by the Hong Kong International Arbitration Centre (HKIAC), which is an independent and non-profit making company limited by guarantee. The HKIAC was established in 1985 by a group of leading business and professional people in Hong Kong to provide advisory and support services for the resolution of local and international disputes by mediation, conciliation and arbitration as well as to become the focus in Asia for dispute resolution. It has been generously funded by both the Hong Kong Government and the business community, yet remains financially self-sufficient.

The mediation process begins when a claimant serves a written request, copied to the HKIAC, to the other party for mediation. A concise statement of the nature of the disagreement, the quantum in dispute, any associated remedies, names and addresses of all parties, nomination of a mediator are included. Within 28 days, the respondent should inform the serving party and the HKIAC whether it is also his intention to proceed in this direction. The mediation is only initiated if all parties have expressed their intention to do so.

Current setting in Hong Kong

Since the implementation of pilot mediation by the Hong Kong Government, arbitration proceedings have been significantly reduced while increasing numbers of mediations have been initiated (Soo 2001). Figure 1 shows the statistical data on the numbers of construction disputes involving the HKIAC against year. Table 1 shows the statistics on the percentage of construction disputes that were settled by different means. It has been noted that a very large proportion, eighty two percent, of the mediation cases were settled with agreements based on the mediators' findings.

Disputes in construction are, by their very nature, usually complex and can be very expensive with costs in the millions of dollars. Apart from cost, the time involved in the arbitration process in the construction field is also very long. Under the HKIAC system, the mediator is expected to conclude the process within 42 days for general disputes and, in no case, shall his appointment be extended beyond a period of three months without the consent of both parties. Hence it is natural that the mediator's own fees run only to a fraction of that in a full scale arbitration. In general, it is found from the Hong Kong experience that mediation is far less costly and less time consuming than arbitration by a factor of perhaps ten.

Currently, arbitration is still prevalent in disputes on private developments and those between contractor and subcontractor. The majority of disputes that arise between large public sector employers (such as Hong Kong Government, Mass Transit Railway Corporation and Kowloon-Canton Railway Corporation) and contractors are first referred to mediation. Initially, the Conditions of Contract of the Hong Kong Government's Airport Core Programme contracts in the 1990s introduced adjudication, in addition to mediation, as a condition precedent to the parties commencing arbitration proceedings. Figure 2 shows the framework of the enhanced two-tier structure, namely, mediation or adjudication followed by arbitration, in resolving the

disputes.

Problems with current setting

Experience in Hong Kong construction disputes indicates that one of the principal reasons for mediation failures concerns the attitude of the parties rather than the issues in dispute. It is crucial to the success of mediation that the parties have thoroughly prepared and were informed of their own case in order to be in a position to consider settlement of the dispute. They should be acquainted with the nature and process of mediation. The parties should enter the mediation in good faith and be prepared to be directed by the mediator towards productive negotiation. The representatives of the parties should be vested with real authority to settle. The ideal representatives should focus in presenting their case and acknowledge the feeling of the other side during the process. They should actively participate in the process and possess a realistic view of the prospects of success of the case. They should be willing to settle and remain flexible throughout the mediation process.

Moreover, mediation is still not common in private development contracts or sub-contracts. No mediation provisions are incorporated in these sub-contracts and hence arbitration, which can be available at substantial completion stage, is the only recourse. It can be imagined how poor their relationships will become if a small sub-contractor is withheld payment by a large main contractor on early stage of the contract.

Furthermore, the non-binding nature of mediation has both advantages and disadvantages. As a matter of fact, no single dispute resolution method will be suitable to all cases and the form of dispute resolution should be amenable to the nature of dispute. In some situations, a binding decision may be required. In such cases, adjudication may enter the scene following its reported success in the United Kingdom (Cottam et al. 2002), although the situation may not be exactly the same here since it has no mediation provision there.

Lewis (1997 and 1999) detailed the background information on adjudication in the United Kingdom. Commissioned by the United Kingdom Government, Latham (1994) produced a report on identifying problems in the construction industry and then giving recommendations. He noted that arbitration had become a mirror of high court proceedings and that cash flow is the lifeblood of the construction industry. He recommended a move away from arbitration to a speedy mechanism of dispute resolution, adjudication, with the key objective of freeing up cash flow with the British construction industry. The mandatory adjudication enables an aggrieved party to get, within 28 days, a very quick decision on whether or not payment is due. It was reported that, since its implementation in the United Kingdom in 1996, adjudication is successful in the sense that arbitration proceedings have been reduced significantly (Vaughan 2000a, 2000b, Cottam et al. 2002, Molloy 2003). Table 2 shows the trend on the number of appointments of arbitrators and adjudicators per month made by the Institution of Civil Engineers from 1997 to 2000 (Cottam et al. 2002). It can be seen that the number of arbitrators decreases gradually while its counterpart of adjudicators increases drastically. Moreover, the adjudication decisions had been supported by the courts.

Adjudication

Adjudication is similar to mediation, except that it is binding and that all parties are given a statutory right, through legislation, to it without the consent of the other. In the United Kingdom, part 2 of the United Kingdom's Housing Grants, Construction and Regeneration Act 1996 gives

an automatic right for a party to give notice at any time for a 28-day adjudication to settle disputes over payment. It involves the resolution of disputes by an independent specialist nominated or agreed by the parties who acts as an expert in the determination of disputes referred to him/her. Either party may apply to an 'adjudicator nominating body' – a body holding itself out publicly as willing and able to appoint an adjudicator. The adjudicator is required to focus on essential issues, hear evidence and arrive at a prompt decision within 28 days of the appointment, relying on his/her own specialist knowledge of the subject matter of the dispute.

The decision is binding, unless and until the dispute is finally determined by legal proceedings, or by arbitration. In *Herschei v Breen* [2000], the judge expressly stated the right of a party to refer to adjudication at any times prior to the commencement of court or arbitration proceedings. He agreed that there could be inconsistent findings in adjudication and arbitration/litigation, but he believed that this was inherent in the scheme. In *Project Group v Gray Trust* [1999], the judge formulated principles for enforcement of adjudication decisions, which were later supported in *Northern v Nichol* [2000]. The courts determine that they will only enforce an adjudicator's decision which addresses the referred matters, but will not support a decision which is beyond his/her jurisdiction. Kennedy and Milligan (2005) gathered extensive amount of data on statutory adjudication in the United Kingdom between 1998 and 2004, including number of adjudicators, trends in adjudication, number of adjudication referrals, number of complaints against adjudicators, subjects of the disputes, amounts of money involved in dispute, etc. The data is able to support the proposition of the success of statutory adjudication in the United Kingdom.

Prospect of mediation/adjudication/arbitration in Hong Kong construction industry

Since the Hong Kong Government has drawn up the rules and procedures for mediation and/or adjudication, the private sector is likely to follow suit, as evidenced by the trend shown in Table 2 above. Moreover, the United Kingdom experience indicates that most adjudication disputes involve a sub-contractor and main contractor. The parties may experiment with mediation or adjudication for their disputes due to many grounds; for example, time and costs savings, cultural tradition, reliability of a negotiated accommodation, desirability to continue amicable business relationships, willingness to settle without laying blame upon either party, etc. Table 3 shows the questionnaire results of the involved parties on the principal reason for experimenting with mediation or adjudication in construction disputes. It can be noted that time and costs savings and amicable business relationships are their major considerations.

Mediation is worth considering as a form of assistance where the parties are unwilling to commit themselves to arbitration and accept a binding award. Mediation is most suited to conflicts of a polycentric nature and between those with a continuing relationship, as in the construction industry since it reduces interference, stresses co-operation, and encompasses self-determined criteria of resolution. Adjudication will be appropriate in situations where a binding decision may be required, particularly at an earlier stage of a construction project.

However, one must be reminded that no single dispute resolution mode can be universally applied successfully to every individual case and the choice of the most suitable means to resolve the dispute depends on various factors including the attitudes of both parties, the nature of the dispute, the quantum in dispute, etc. There inevitably exist some disagreements which are unable to be successfully resolved by mediation or adjudication, and hence arbitration will be initiated. Thus, the recent popularity of mediation or adjudication will not substitute for

arbitration in total, but their use will contribute greatly towards dispute resolution in the construction industry. With the successful application of mediation/adjudication procedures, it is anticipated that there will be demand for its usage in the Hong Kong construction industry as was seen following its introduction in the United Kingdom.

Conclusions

This paper presents the current setting in resolving construction disputes by integrating mediation and then arbitration during the past decade in Hong Kong. The state-of-the-art modern mediation process and its philosophical origins were reviewed. It might be argued that a reason for avoiding court judgments in ancient times was that the law was not developed. However, today the well-developed rules and regulations (right of discovery and examination of documents before hearings, extended hearings, etc.) but with concomitant escalation of costs, delays and adversarial relationships, detract from both arbitration and litigation. The shortcomings of the present two-tier system are pinpointed. The reported success of adjudication now practised in the United Kingdom may suggest that there is a place for another process of dispute resolution, which may help improve the situation. The implementation of the enhanced two-tier structure, namely, mediation or adjudication followed by arbitration, in resolving construction disputes in Hong Kong allows more flexibility to the parties as well as renders incentives for the improvement in the conduct and the procedures of the conventional arbitration process. Based on the successful results and experience, it is believed that there will be a large increase in mediation or adjudication usage in Hong Kong both for construction disputes.

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Figure Captions

Figure 1. Statistical data on number of construction disputes involving HKIAC against year

Figure 2. Framework of the enhanced two-tier structure in resolving construction disputes in Hong Kong

Table 1. Statistics on the percentage of construction disputes settled by different means

Means	Percentage (%)
Mediation	82
Arbitration	13
Litigation	5

Table 2. Trend on the number of appointment of arbitrators and adjudicators per month

Year	Average appointments per month	
	Arbitrators	Adjudicators
1997	3.5	0
1998	3.0	0.5
1999	3.0	4.0
2000	2.0	10.0

Table 3. Questionnaire results on principal reason for experimenting with mediation or adjudication in construction disputes

Principal reason	Percentage (%)
Time and costs savings	33
Cultural tradition	6
Reliability of a negotiated accommodation	13
Desirability to continue amicable business relationships	25
Willingness to settle without laying blame upon either party	20
Others	3

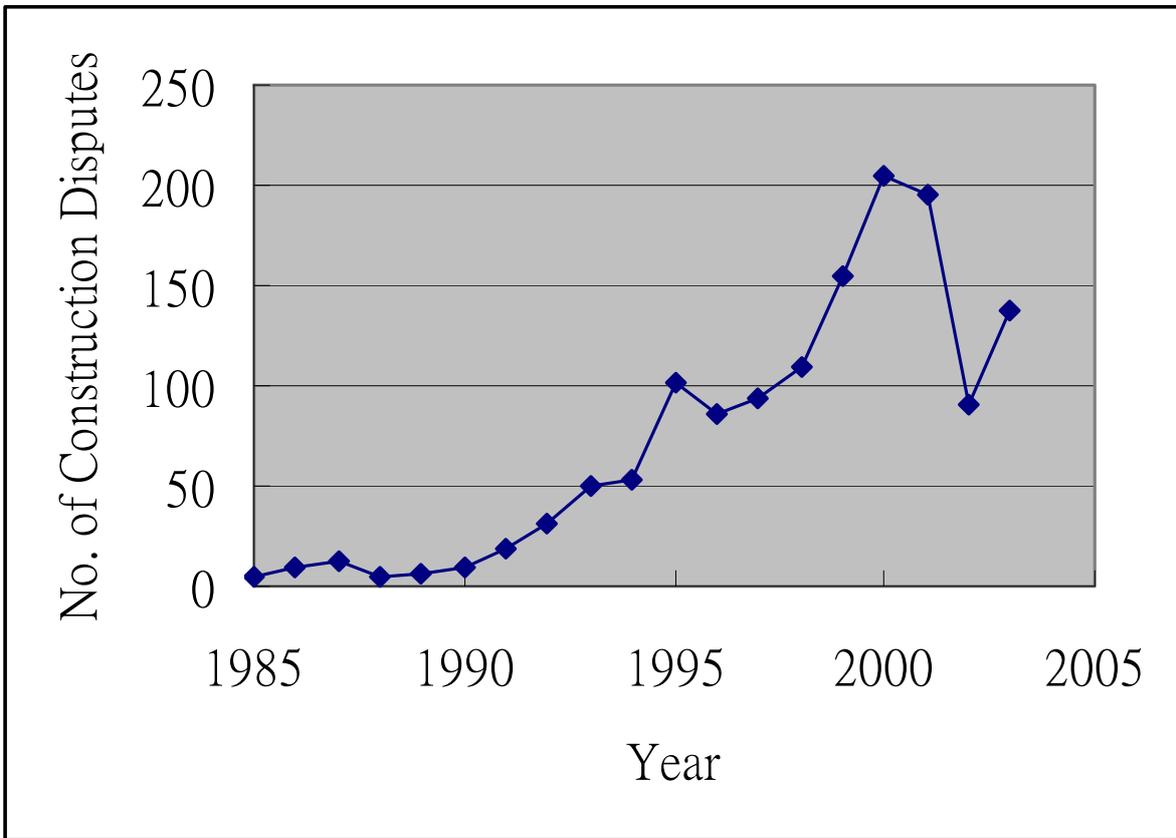


Figure 1. Statistical data on number of construction disputes involving HKIAC against year

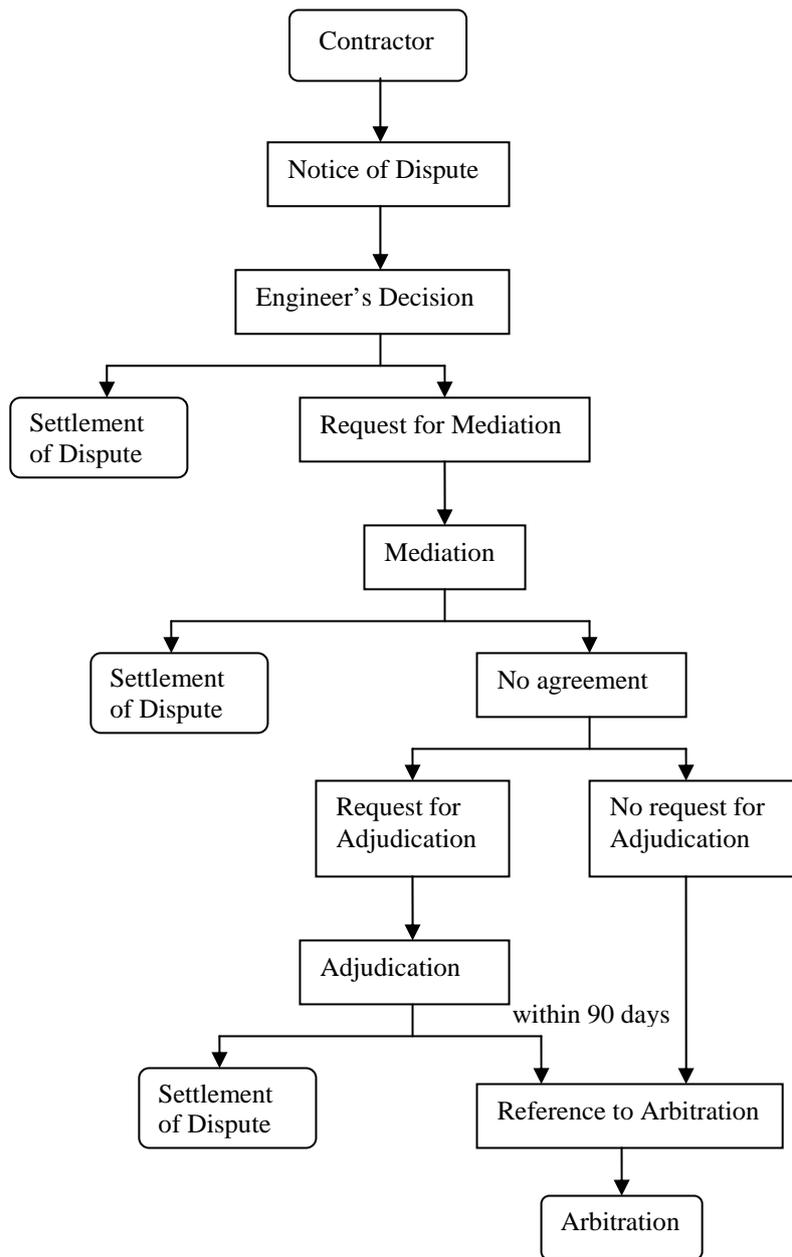


Figure 2. Framework of the enhanced two-tier structure in resolving construction disputes in Hong Kong