

Settlement of Disputes in Construction Contracts

B. B. Deoja
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Dispute Settlement by Arbitration in Nepal

34 Years of History of Arbitration Based on
Alternate Dispute ADR Mechanism

- Arbitration Act 1999 (2055 BS)
- Arbitration Act Nepal 1981(2038BS)

Nepal Council of Arbitration

- Established in 1991

Rules of Arbitral Proceedings, 2003

Adjudication Guidelines, 2013

Institutional Arbitration rules, 2072

Presentation Structure

1. Pre-arbitral dispute settlement mechanism
2. Arbitration Issues:
3. Conclusion and Recommendations
4. Discussions

1. Pre-arbitral Dispute Settlement Mechanism

Legal Basis for the various types of Pre-arbitral Dispute Settlement Mechanisms

- Conciliation/Mediation/Adjudication
/Dispute Board
 - Creature of Contract
 - Statutory provisions

Enforcement of the Decision of the Pre-arbitral Dispute Settlement Mechanisms

- Contractual provision state:
 - Binding , dissatisfaction may be filed withindays
 - Binding with immediate effect until the decision of arbitral tribunal or court (Provisionally binding)
(Employers do not enforce / Courts do not order the enforcement in the absence of law related to adjudication or DB)
- Truly Binding provisionally in case of Statutory Provisions

Redundancy of Adjudication/ Dispute Board Process

- Enforcement of DB decision – 98 % in USA
- India - 98 % ?
- Enforcement of Adjudicator/DB's decision in Nepal – almost NIL,
 - Fear of CIAA, NVC

Statutory Provisions for Pre-Arbitral Dispute Settlement Mechanisms

Country	Mediation	Conciliation	Adjudication	Dispute Board	Act	
U.K.			X		Housing Grants, Construction and Regeneration Act 1996	Provisionally Binding Decision
India		X			Arbitration and Conciliation Act 1996	No decision by Conciliator but is Final and Binding , if settlement is signed by parties
Nepal			X	X	Procurement Act 2007	Non-binding

.... Statutory Provisions for Pre-Arbitral Dispute Settlement Mechanisms

Country	Mediation	Conciliation	Adjudication	Dispute Board	Act	
Singapore			X		BUILDING AND CONSTRUCTION INDUSTRY SECURITY OF PAYMENT ACT 2004/2006	Provisionally Binding Decision
Malaysia			X		Construction Industry Payment and Adjudication Act 2012 (Malaysia)	Provisionally Binding Decision

Benefit of Effective Pre-arbitral Dispute Settlement Mechanisms

Effective Pre-arbitral Dispute Settlement Mechanisms are able to address technical complexities without delaying the project:

- Experts related to the project
- Shorter Time
- May help the non-technical Arbitrators

Pre-arbitral Dispute Settlement Mechanisms in Nepal

Public Procurement (First Amendment) Ordinance 2071 :

58. Dispute Settlement Mechanism

(1) To settle by amicable settlement (PPA 2063)

Add

“ (१क) उपदफा (१) बमोजिम आपसी सहमतीबाट विवाद समाधान हुन नसकेमा प्रचलित कानून बमोजिम मध्यस्थताको माध्यमबाट विवाद समाधान गर्ने कुरा खरिद सम्झौतामा उल्लेख गर्नु पर्नेछ ।”

(२) उपदफा (२), (३), (४) र (५) भिकिएका छन् ।

2. Arbitration

Advantages of Arbitration by ADR Mechanism

- Contractual Basis
- Confidentiality
- Flexibility
- Party Autonomy
- Finality of Award
- Enforceability of Award

General Issues in Arbitration

Belief that the Arbitration is Quicker and Cheaper than litigation in Court is being questioned due to:

- Reputed International Arbitrators are booked for 2 to 3 years in advance
- Rate of international arbitrator – \$ 300 to 400 per hour
- Major construction dispute may take 3 to 5 years or even more for award
- Awards go mostly in favor of private parties

Specific Issues

- 1 Public Sector Agency as a Party
- 2 Non-technical Arbitrators
- 3 Technical Sources of Disputes
- 4 Confidentiality and Research
- 5 Enforcement
- 6 More on Quality Arbitration

1. Public Agency as a Party

Public Agencies

Public agencies have inherent disadvantages in handling disputes as compared to the private parties:

- Longer chain of command
- Smaller authority levels
- Many actors
- Low incentive levels
- Lack of ownership and indifference.
- Engagement of less expensive and low standard counsel\
- Delayed submissions of formal responses, and inadequate collection of evidence from the employer's side.

..... Public Agencies

Arbitration awards tend to go mostly in favor of the contractors.

- Therefore, the assumptions that parties are at equal footings in the litigation or ADR process is not normally correct.

Activities for the Employer in Arbitration

Pre-arbitration :

- receiving or filing the claim,
- determination of the claim,
- referring the claim to adjudicator/dispute board,
- replying the Adjudicator/dispute board

Arbitration Activities:

- enforcing the decision of the adjudicator or filing dissatisfaction,
- issuing notice to commence arbitration/ responding to the notice for arbitration,
- Initiating amicable settlement,

Activities for the Employer in Arbitration

- filing request for arbitration/responding to the request for arbitration
- appointing arbitrator,
- appointing counsel for arbitration,
- making payments for arbitration,
- approving the terms of reference of arbitration,
- submitting statement of claim/defense to statement of claim/counter claim,
- replying to the defense to the counter claim,
- providing oral or written evidence in the hearing,
- presenting witnesses in the hearing,
- providing post-hearing written and or oral briefs, and
- exploring the possibility of award by consent

2. Non-technical Arbitrators

The Importance of Related Engineering Experience in the Quality of Dispute Settlement

- Arbitrators are generally lawyers unlike Adjudicators and dispute board members who are required to have related technical experience.
- Understanding the effects of Variations and Time Extension in major projects could be a difficult task involving complicated Delay Analysis for the non-engineers.
- Focus tends to be on matter of law and principles rather than the matter of facts due to the technicalities in complex projects

Case 1 Variation

“Supply and laying of 500 mm dia PVC perforated pipe in the gravel at the bottom of trench for the penstock” 500 m @ Rs. 17,000 per meter.

Substitute by

“Supplying and laying of two nos. twin pipes of 200mm dia PVC perforated pipe in the gravel at the bottom of trench for the penstock” 500m @.....?.

- Engineer’s valuation: Weight per m of 500mm pipe = 4.8 x wt per m of 200 mm dia pipe
Therefore , rate for 4 nos. 200mm dia pipe = $4 \times 17000 / 4.8 = \text{Rs } 14,166/\text{m}$
- Contractor ‘s claim: On this basis, he claimed a rate of $4 \times 17000 \times 1/2.5 = \text{Rs. } 27,200$ per meter.
- Arbitration = Contractor’ argued that there is no basis for calculating the thickness of the 500 mm dia PVC pipe
- What was the awardAs per Engineer or Contractor ?

Case 2. Interpretation of BOQ Item

The Bill of Quantities (BOQ) consists of the following items:

- Item 100(a): Trench excavation in soil (Class B) for Penstock, temporary stockpiling aside, supply of suitable material for backfill, removal of surplus up to a distance of 2000 m., backfill in compacted layers as specified – 15,000 cu.m @ **Rs 1100 per cum.**
- Item 100(b): Approved random fill material from stock pile to be spread in layers and compacted. Source mucking material from rock excavation or river deposit, a distance of 2000m. Location: Cover for the Penstock – 12,000 cu.m @ **Rs 2200 per cu.m.**

.. Case 2. Interpretation of BOQ Item

Payment of excavation and backfilling of Penstock trench

- The contractor claimed :

100(a), excavation and stockpiling Rs 1100

+ 100(b), Backfilling Rs 2200

= Rs 3300 per cum

for 13,000 cum

- The Engineer certified for payment item 100(a) only

= Rs. 1100 per cum

for 13,000 cum excavation and backfill

.. Case 2. Interpretation of BOQ Item

Payment of excavation and backfilling of Penstock trench

- DB = upheld Engineers valuation
- Engineer argued that i) the item 100(a) includes cost of backfill also, and ii) 12,000 cum of backfill in item 100(b) was a mistake in the BOQ for the actually required quantity of 120 cum for an intersection of road and the penstock(cover for Penstock).
- Contractor argued that in the method statement he had considered a total of 13,000 cum of backfill as a separate item, the location in item 100(b) is stated as cover for penstock , and there is no evidence in the contract to prove that the backfill in item 100(b) was mistakenly indicated in the BOQ.
- Both the Engineer and the Contractor agreed in the hearing that the backfill in the trench and in the road intersection were actually from the excavated trench material.
- Arbitration: Award 3300/cum for 13,000 cum ?

3. Technical people as source of claims and disputes

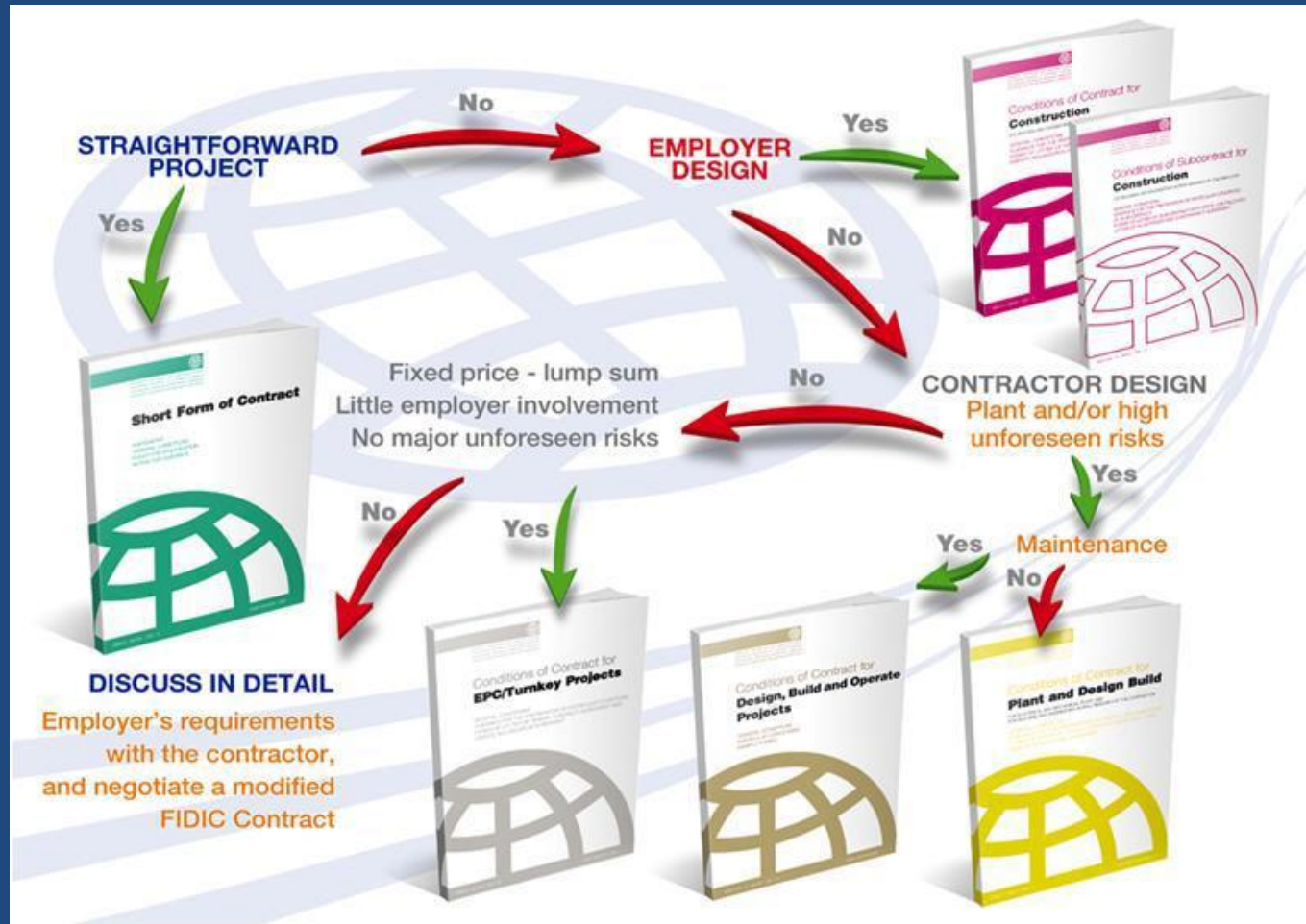
Sources of Claims and Disputes in Construction Contracts

Design Issue, VO Issue, and TE Issue generally arise due to imperfections in project planning, design, and procurement.

SBDs for the following type often get mixed up creating many vulnerabilities in the implementation phase:

- Employer Design CC
- Plant, Design and Build CC
- EPC/Turnkey CC
- PPP/BOT Concession Agreement

FIDIC



Hasty Procurement and Unrealistic Cost Estimate

- Annual Budgets
- Outdated Norms
- Over dependency on Consultants
- Hit and run / Procure and Transfer
Culture of Public Servants

Cost Estimates

Employer Design

- Bare Cost = $C = \text{labor} + \text{material} + \text{equipment}$
+ 15 % of $(l + m + e)$
- Budgeting Cost = $1.13 \times 1.20 \times (1.05C)$
= $1.4238 \times C$

Design & Build

- Bare Cost = $1.1 C$
- Budgeting Cost = $1.13 \times 1.20 \times (1.1 \times 1.05C)$
= $1.57 \times C$

EPC

- Bare Cost = $1.55 C$ (15%Dgn+10%Supervision+30%time &cost overrun Risks)
- Budgeting Cost = $1.13 \times (1.05 \times 1.55C)$
= $1.84 \times C$

4. Confidentiality and Research

Confidentiality

- **UNCITRAL Rules** : An award may be made public with the consent of all parties.
- **ICC Rules** : President or the Secretary General of the Court may authorize researchers subject to undertaking to respect the confidential character of the documents, refraining from publishing anything contained therein without prior approval of the Court.
- **London Court of International Arbitration:**
The parties undertake as a general principle to keep confidential all awards in their arbitration, together with all materials in the proceedings created for the purpose of the arbitration and all other documents produced by another party in the proceedings not otherwise in the public domain
The deliberations of the Arbitral Tribunal are likewise confidential to its members,

..... Confidentiality

- Indian Council of Arbitration

The Council may print, publish or otherwise circulate any award made under its rules or under its auspices, in any arbitration journal, magazine, report, etc. for the purpose of creating arbitration jurisprudence or precedents for the benefit and guidance of future arbitrations.

- NEPCA

The award shall not be made public without consent of the parties.

No systematic research so far in Nepal in construction disputes

As per NEPCA records, 2012-014, in Nepal:

- Almost all disputes went through DB and Arbitration
- About 90 % of arbitral awards are appealed in the Courts
- Disputes in about 5 to 7 % of total construction contracts
- Claims = 15 % of Contract price, appx
- Awards = 16 % of Claim amount, appx
- Annual contracts = NRs 100 billion/yr (appx)

Research

- 2005 Survey by Harris Interactive conducted for the U.S. Chamber of Commerce Institute for Legal Reforms found wide satisfaction among individuals who chose arbitration over litigation to resolve a dispute.
when comparing arbitration to litigation:
 - 74% of respondents found arbitration to be faster;
 - 63% of respondents found arbitration to be simpler;
 - 51% of respondents found arbitration to be less expensive; and
 - 66% percent of respondents said they would likely use arbitration again.

Research

- Study by CIDC in India in 2001 have shown that over 540 billion rupees was blocked in the construction sector disputes. It must be much more in 2014.

Research Areas

- Time and cost overruns of projects due to disputes.
- Time and cost overruns of projects due to delay in settlement of disputes.
- Effectiveness of the Adjudication and Dispute Boards ?
- Comparison of Arbitration versus Litigation.
- Magnitude of disputes, Claim, awards and their growth
- Perception of the quality of justice in the arbitral awards ?

5. Enforcements

Court Case Against Arbitral Award

मध्यस्थता ऐन दफा ३०.

निर्णय बदर हुनसक्ने : (१) यस ऐन बमोजिम मध्यस्थको निर्णय सुनी पाएको वा निर्णयको सूचना पाएको मितिले पैंतीस दिनभित्र त्यस्तो निर्णयमा चित्त नबुभ्ने पक्षले सो निर्णय बदर गराउन चाहेमा सम्बन्धित कागजातहरू र निर्णयको प्रतिलिपि समेत संलग्न गरी पुनरावेदन अदालतमा निवेदन दिनु पर्ने छ र त्यसको प्रतिलिपि मध्यस्थ र सम्बन्धित पक्षलाई दिनु पर्नेछ ।

....Court case

मध्यस्थता ऐन दफा ३०.

(२) उपदफा (१) बमोजिम निवेदन परेकोमा मध्यस्थताको निर्णयमा देहायका कुनै कुरा रहेको निवेदन गर्ने पक्षले प्रमाणित गरेमा पुनरावेदन अदालतले त्यस्तो निर्णय बदर गर्न वा आवश्यकतानुसार पुनः निर्णय गराउन आदेश दिन सक्नेछ :-

(क) सम्झौताका कुनै पक्ष सम्झौता गर्दाका बखत कुनै कारणले सम्झौता गर्न असक्षम रहेको वा पक्षहरु जुन मुलुकको कानूनको अधीनमा रहेका छन् सो कानून अनुसार वा त्यस्तो कानून स्पष्ट हुन नसके कोमा नेपाल कानून बमोजिम सो सम्झौता वैध नरहेको ,

... Court case

- (२),(ख) निवेदन गर्ने पक्षलाई मध्यस्थ नियुक्त गर्न का लागि वा मध्यस्थताको कारबाहीका सम्बन्धमा समयमा नै रीतपूर्वक सूचना नदिएको,
- (ग) मध्यस्थलाई नसुम्पिएको विवादसंग सम्बन्धित विषयमा वा मध्यस्थलाई सुम्पिएको शर्त विपरीत वा मध्यस्थलाई सुम्पिएको क्षेत्रबाहिर गई निर्णय भएको ,
- (घ) नेपाल कानून प्रतिकूल सम्भौता भएको मा बाहेक मध्यस्थताको गठन विधि वा त्यसको काम कारबाही पक्षहरु बीच सम्पन्न सम्भौता अनुरूप नभएको वा त्यस्तो सम्भौ ता नभएकोमा यस ऐन अनुसार नभएको ।

... court case

(३) उपदफा (२) मा जुनसु कै कुरा लेखिएको भए तापनि उपदफा (१) अनुसार निवेदन परेको मा पुनरावेदन अदालतले देहायका अवस्थामा मध्यस्थताको निर्णय बदर गर्न सक्नेछ :-

(क) मध्यस्थले निर्णय गरेको विवाद नेपाल कानून बमोजिम मध्यस्थद्वारा निरोपण हुन नसक्ने भएमा ।

(ख) मध्यस्थले गरेको निर्णय सार्वजनिक हित वा नीति प्रतिकूल हुने भएमा ।

Court Case Against Arbitral Award

मध्यस्थता ऐन दफा ३९: अदालतको क्षेत्राधिकार नहुने : प्रचलित कानूनमा जुनसुकै कुरा लेखिएको भए तापनि यस ऐनमा अन्यथा व्यवस्था भएकोमा बाहेक यस ऐनद्वारा नियमित भएका विषयमा कुनै अदालतको क्षेत्राधिकार हुने छैन ।

6. More on Quality of Arbitration

Factors Influencing Quality of Arbitration

- Cultural and Ethical issues in the Party nomination process and in interpretation of the governing laws.
- Confidentiality of ADR arbitration deprives the public of their right to information on the matters of public interests pertaining to projects funded by public funds.
- Ad hoc + Institutional Arbitration
- Training
- Ethics
- Human face of the arbitration.

Model Arbitration Clauses

A. Goods

- amicable settlement within 30 days
- adjudication in accordance with the Rules of Adjudication (“The Rules”) stated in SCC
- If the Contract amount exceeds the amount stated in the SCC, then the dispute shall be referred to a three member Dispute Resolution Committee (DRB) or sometimes called Dispute Board (DB).
- The Parties may, however, refer the dispute **directly to Arbitration** through a notice to commence arbitration, in case the contract is terminated or is substantially completed or is complete more than eighty percent or the Parties jointly choose to refer the dispute directly to Arbitration without the need for Adjudication/ DB process.

The Arbitration proceedings shall be as follows:

- “In case of dispute between the Purchaser and the Supplier who is national of Nepal, the dispute shall be referred to arbitration in accordance with the rules of Nepal Council of Arbitration” or,
- “In the case of a dispute between the Purchaser and the Foreign Supplier, the dispute shall be settled by arbitration in accordance with the provisions of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.”
- The numbers of Arbitrators shall be three.
- The governing arbitration law shall be the Arbitration Act, 2055 of Nepal.
- The Place of Arbitration shall be any place in Nepal.
- The language of arbitration shall be English for ICB Contracts and Nepali for NCB Contracts.

Model Arbitration Clauses

B. Consultancy

Similar to Goods

Model Arbitration Clauses

C. Works

- The Parties may, however, refer **the dispute directly to Arbitration** through a notice to commence arbitration, in case the contract is terminated or is substantially completed or is complete more than eighty percent at the time of dispute or the Parties jointly choose to refer the dispute directly to Arbitration without the need for Adjudication/ DB process.
- **The decision of the Adjudicator/Dispute Board 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. If either Party is dissatisfied with the Adjudicator or the DB's decision, then either Party may, within 30 days after receiving the decision, give notice to the other Party of its dissatisfaction and intention to commence arbitration.**
- The Arbitration proceedings shall be as follows:
 - “In case of a Contract based on National Competitive Bidding (NCB), the dispute shall be referred to arbitration in accordance with the rules of Nepal Council of Arbitration” or,
“In case of a Contract based on International Competitive Bidding (ICB), the dispute shall be settled by arbitration in accordance with the provisions of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules for small amounts of claims/ disputes or for unclear value of claims.
 - For ICB Contracts involving claims over three million U.S. Dollar, the dispute shall be settled by arbitration in accordance with the provisions of the Arbitration Rules of International Court of Arbitration(ICA) / International Chamber of Commerce (ICC). The Parties may, however, choose to arbitrate under the NEPCA rules of Arbitration through a joint request to NEPCA before the request for Arbitration is filed by any of the Parties.

3. Conclusion and Recommendations

1. Disputes in democratic societies are natural.
2. Disputes in Construction Contracts are the outcome of differing perception of process, responsibilities, risks and rewards in the Contract between the parties. Quality dispute settlement process requires understanding of all these areas before and after the occurrence of dispute. Arbitral institutions must therefore involve in conducting training in all areas of project planning and implementation with a view to minimize the disputes on a continual basis.

3. Efficient and efficacious settlement of disputes is essential to enhance the climate of investment and the pace of economic development.
4. Strong private sector controlled and facilitated by weak public sector cannot produce the optimum outputs. Therefore, strengthening of public sectors agencies with a core highly competent manpower in project planning, design, implementation, and dispute settlement must receive due attention.
5. SBDs, CCs, and Cost Estimates for employer–design type, Design & Build type, Turnkey/ EPC type, DBO type, and PPPs must be thoroughly evaluated to select the appropriate type of Contracting .

6. Contract packaging and preparing procurement documents cannot be detached from the socio cultural value system in order for their implementation to be practicable. Lump sum contracts with absence of dispute management procedure in Japanese grant aid projects, and unilateral decision on time and money compensation for variations in Japanese public works are some examples of minimizing disputes in certain cultures.
7. Arbitrators must be self-actualized, highly ethical and technically sound people committed to the cause of professional advancements and societal benefits.

8. Arbitration must be organic, and have a human face, to impart a truly inexpensive, quick and impartial justice to the parties and the people at large.
9. Government must spend adequately on research on arbitral cases and awards, strengthening of arbitral institutions, dissemination of findings of research, conduct of training on procurement and construction management, updating of pre-arbitration and arbitration statutes, and promotion of transparency and ethics in project design and implementation.
- 10. Statutory Pre-arbitral dispute settlement mechanism must be provisioned to improve conducive environment for investment and infrastructure development.**
- 11. Repeal the Amendment Sub-Clauses of the Public Procurement Ordinance 2071**

Thank You