The Suitability of the Use of Mediation in the Settlement of Construction Disputes in Malaysia

Nur Ezan Rahmat1 and Nazirah Abdul Rahim2

1Faculty of Law, Universiti Teknologi MARA (UiTM), 40450 Shah Alam, Selangor, Malaysia
2Eastlink Consulting, B-3A-12 Gateway Kiaramas, No. 1 Jalan Desa Kiara, Mont Kiara, 50480 Kuala Lumpur, Malaysia

(Nurezanrahmat,nazirahim)@gmail.com

Keywords: Alternative Dispute Resolution, Construction Dispute, Mediation.

Abstract: Construction projects are increasingly complex, resulting in complex contract documents. Complex construction projects can likewise often result in complex disputes, which mainly arise from the intricacy and magnitude of the work, multiple prime contracting parties, poorly prepared and/or executed contract documents, inadequate planning, financial issues, and communication problems. Traditionally, resolving construction disputes were predominantly relied on adversarial approach. The result is often leads to delay and cost, not to mention escalation in the maintenance of a harmonious relationship between parties. In the Malaysian construction industry, the present practice of Alternative Dispute Resolution (ADR) is focusing mainly on arbitration and most recently adjudication. However, with mediation clauses regularly incorporated into the standard forms of construction contracts and the introduction of Malaysia Mediation Act 2012, mediation is also set to be one of the main mechanism in resolving construction disputes in Malaysia. This article highlights the application of mediation as an alternative route in construction dispute resolution in major construction standard form of contracts in Malaysia. It is also aims to give the readers an overview of the suitability in application, advantages and disadvantages of mediation in construction dispute.

1 INTRODUCTION

The construction industry is one of the mainstays of a country’s economic progress. However, construction dispute is found to be a very common issue in construction industry and it has brought negative impacts to each of the participants in a construction project.

The nature of construction industry is such that will always be disputes between various contracting parties. Disputes are something that construction project personnel will have to face several times during the life of a project and it may continue long after a project has ostensibly finished. Carmichael (2002) and Singh (2009) found that the contracting parties in construction project are basically working for a common target of completing the project which shows that they are not in competition with each other, but different of opinions and conflicts do arise at times. Immaturity and unhealthy discussions do expedite the parties into conflicts and disputes. It was argued that a conflict is actually a catalyst which can create dialogue, promote creative thinking, and inspire people to sustainable solutions if a conflict is able to be well-handled (Richbell, 2008). A conflict or dispute can be settled by a free frank discussion if it is handled expeditiously in a mature, non-emotional manner with a judicious approach (Singh, 2009). Therefore, Cox & Thompson (1998) contended that disputes should be avoided. If it is not possible to be avoided, disputes must be minimized or resolved as efficiently as possible because disputes are always wasteful for organization’s resources. Dispute prevention, flexibility, early dispute intervention, use of alternative dispute resolution methods, and a predetermined plan as to how disputes will be handled are identified as the best practices for resolving construction disputes (Cox & Thompson, 1998 and Winkler, 2009).

Dispute may be defined as a class or kind of conflict, which manifests itself in distinct and justifiable issues (Bower, 2003). However, Fulton (1989) alleged that conflict and dispute are not synonymous although the two words are used interchangeably. Conflict means an inter-reaction between people who are pursuing incompatible or competing claims, and in fact conflict is the precursor to a dispute (Fulton, 1989). A contractual dispute
arises when one party claims something, and the other party rejects the claim, or disagrees over liability either expressly or by conduct (Carmichael, 2002). It is also stated that, when a claim or assertion made by one party is rejected by the other party and that rejection is not accepted, the dispute arises (Kumaraswamy, 1997). Conflict management is important to prevent a conflict turns into a dispute. However, disputes are still occurring as a result of conflict escalation. Therefore, dispute resolution plays a crucial role at most of the time, especially in construction industry which is widely known as a risky business.

Wright (2004) stated that a disagreement in any of a construction project must be settled quickly before it develops into a dispute. Emmitt (2010) also found that conflict is necessitate to be managed so that it does not suppress information or become personal and affect relationships. According to Murdoch and Hughes (2008), contractors are very keen to preserve a good relationship with clients. Therefore, some of the parties will often seek effective and quick resolution on points of disagreement even if that implies giving up a claim that would have good chances to succeed in court for the sake of future business. (Murdoch & Hughes, 2000).

Disputes are wasteful of a firm’s resources and therefore should be avoided, wherever possible (Cox & Thompson, 1998). This is because, the nature of dispute is costly, lengthy, and complex and eventually the cost of resolving the dispute always exceeds the amount of the initial claim (Feld & Carper, 1997). An owner will suffer the additional costs such as increased financing costs, increased architectural and engineering costs, lost revenue, and incurrence of a delay claim from the contractor for his increased costs of performance if a dispute is not resolved efficiently. On the other hand, as the impact of construction dispute, a contractor will also suffer additional costs such as increased labour costs, costs of extended equipment usage, additional construction financing expenses, additional cost of extended home and field office overhead, and lost revenue (Rossi, 1991).

Resolution of disputes always consumes much of the construction professional’s time than is usually justifies. From the point of filing of a legal claim by a contractor, the time required to follow the legal settlement process consumes valuable time that can usually be spent more profitably in other areas of the organization’s work (Stephenson, 1996). Edgerton (2008) also agreed that the contract disputes are lengthy and costly to all of the contracting parties. These adversarial disputes severely degrade productive working relationships and consume time and money.

It is very often to see the disputes between contractors and owners escalate into litigation, or the contractors may absorb a major loss in order to avoid lengthy disputes proceedings and damaged business relationships (Pinnell, 1998).

Edgerton (2008) encouraged for the disputes to be resolved at the lowest possible level so that the dispute escalation may be eliminated. For example, a dispute might first be taken to the superintendent or the inspector at the field level. Then, it would be escalated to the project level and the project manager. Next, if it still could not be resolved at that level, the dispute could move to the executive level. Subsequently, the final step would be arbitration or litigation with an outside party facilitating resolution.

2 DISPUTE RESOLUTION IN THE CONSTRUCTION INDUSTRY

The construction industry is regarded as one of the most conflict and dispute ridden industries, which has resulted in it being one of the most claim orientated sectors. Traditionally, parties would enter into litigation, often a costly and longwinded means of resolving a dispute. Over the years, various methods of ADR have been introduced into the construction industry as mechanisms to avoid lengthy and expensive litigation.

2.1 Adjudication

In certain types of contract, adjudication is a mandatory pre-step before final process may be commenced (Simmonds, 2003). The adjudication process usually commences when it is more to be achieved by discussion and negotiation, and that the issue is important enough to warrant the time and expense of adjudication. In addition, the dispute may involve matters claimed by either or both parties (John, 2008). One of the benefits of adjudication is that it can often lead to a settlement without the matter going any further due to the party that has lost in adjudication will think very carefully before proceeding with very expensive litigation or arbitration. They might well lose again, with the additional penalty of paying the other side’s costs (Ashworth & Hogg, 2007).
2.2 Arbitration

Fisher (2017) stated that binding arbitration is by far the most often used alternative to litigation in construction disputes, and arbitrated construction hearings usually involve two parties who are having a contract dispute and an arbitrator they jointly choose to resolve the dispute. It is also found that an arbitrator is usually someone familiar with the construction industry and most large claims involve three arbitrators instead of one. Arbitration in construction is usually performed by experts in the construction industry such as architects, engineers, or construction management professionals (Fisher, 2017). Wright (2004) identified that arbitration is a better route than litigation for solving serious disputes because an arbitrator with appropriate knowledge and experience must always have a greater chance of understanding the complex engineering or process questions that are likely to arise than a court.

2.3 Dispute Review Board (DRB)

According to Edgerton (2008), dispute review board is a panel of three experts from construction industry who follow the progress of a construction project by visiting the site and attending project meetings. The conditions precedent for establishing DRB are usually described in the contract documents. The owner, contractor and members of dispute review board have to sign a three-party agreement before using the DRB to resolve any disputes while construction is ongoing. Selection of the DRB members is critical and several selection processes are available. Normally the board members themselves will choose the chairperson. By reaching this consensus process, the perception of any board members being biased can be avoided (Edgerton, 2008).

2.4 Expert Determination

Expert determination is carried out primarily in a technical nature of disputes. The expert is required to use his or her own skills and knowledge to make necessary enquires or conduct their own investigations. The process of expert determination usually provides a fast and final solution to the matters in dispute and has been used successfully for many years in property disputes concerning valuations (Ramsey, Minogue, Baster & O’Reilly, 2007). The use of expert determination has been encouraging, particularly for single issue, essentially technical or valuation disputes. This is because an expert can bring his experience and professional knowledge directly to resolve a dispute. Moreover, technical issue is proven extremely difficult for a legal arbitrator or arbitral tribunal, even when assisted by expert witnesses (Ramsey, Minogue, Baster & O’Reilly, 2007).

2.5 Negotiation

Negotiation is the art of reaching an agreement or understanding through bargaining. There are no formal rules for negotiation, but it is culturally accepted style (Carmichael, 2002). Since there are no formal rules, the procedures of negotiation begin by setting up a forum so that the parties can attempt to find a way out of the problem, looking for mutual benefits that can be gained from resolving the problem in a different way, or look for compromises in order to overcome the problem (Egbu, Ellis & Gor, 2004). Wright (2004) identified that negotiation is always going to produce the best chance of a satisfactory solution to any dispute since it is quick and the bruising encounters that come with arbitration, litigation or adjudication can be avoided. If there is an event that complete satisfaction could not be reached, the objective of negotiation is to reach a solution that will be acceptable to both parties. The advantage of negotiation is the cost of both sides is very much less if compared to other dispute resolutions and the money that does not have to go in legal fees can then go towards funding the settlement (Wright, 2004).

The prevalence of construction dispute indicates that the current approach to dispute resolution is not effective enough. First, construction contracts tend to address dispute resolution by specifying the resolution methods to be used. Second, dispute resolution methods are too frequently viewed as a selection of stand-alone choices. What construction contract and the persons drafting these frequently overlook is that dispute prevention and dispute resolution methods can be effectively combined into more comprehensive dispute prevention and resolution processes, where the benefits of synergy can be exploited to successfully prevent or resolve the dispute.

3 MEDIATION IN THE CONSTRUCTION INDUSTRY

Mediation is a method of dispute resolution involving a neutral third party who tries to assist the disputing parties in reaching a mutually agreeable solution.
(Klinger & Susong, 2006). Mubarak (2010) revealed that the mediator can be an individual or a team.

A preliminary meeting will be arranged by the neutral third party to discover the substance of the dispute and to decide how best to proceed with a mediation (Ashworth & Hogg, 2007). In the essence, a mediator must demonstrate neutrality and patience, and must collect all the facts before making any recommendation (Mubarak, 2010). Fenn, O’Shea & Davies (1998) found that the mediation has proven to be most effective when used immediately after the parties have determined that conflict management techniques have failed and it has been highly successful in resolving construction disputes at a fraction of the time and expense required for litigation.

In the Malaysian construction industry, the practice of mediation is not new and has persistently been as part and parcel of the industry. Even though it has been introduced by several standard forms of contract, the use of mediation in Malaysia has not been considered popular. Contrary to other developed countries such as Australia, Hong Kong, Singapore, United Kingdom and Kuwait, mediation process has been recognized as one of the popular techniques of dispute resolution.

The Chairman of the Mediation Committee of the Bar Council Malaysia emphasised that business industry should actively adopt mediation in settling business related disputes. Mediation process can ease in reducing the agglomeration of commercial cases waiting to be judged in the court for the purpose of expedition in the process of resolution. At its best, mediation is getting perceived to be one of dispute resolution techniques for settling construction disputes.

However, in Malaysian construction industry, mediation is not a popular method compared to other types of ADR such as arbitration and adjudication. Although there are efforts to introduce mediation in construction industry through several standard forms of contract, its usage in Malaysia is considerably low (Arain & Low, 2007).

Mediation is also known as a private, informal process in which parties are assisted by one or more neutral third parties in their efforts towards settlement. The new and distinguishing feature here is the addition of a neutral third party who aids the parties in dispute towards settlement. A further important factor is that the mediator does not decide the outcome; settlement lies ultimately with the parties (Rahmat, 2017).

A distinction is often made between styles of mediation that are facilitative and those that are evaluative. During a facilitative mediation, the mediator is trying to reopen communication between the parties and explore the options for settlement. The mediator does not openly express his opinions on the issues. If, on the other hand, the mediator is called upon to state his or her opinion on any particular issue then he is clearly making an evaluation of that issue.

3.1 Mediation Clause in Malaysian Standard Form of Construction Contract

Mediation can be classified into two types: mandatory mediation and optional mediation. The former is when the parties are by court sanction or by agreement between the parties make it mandatory for the parties to attempt mediation to settle the dispute between them and the later, is an option between the parties. For example, in the context of standard construction contracts, Malaysian Institute of Architects (MIA) Standard Form for Building Works 2006 provides for an optional mediation under Clause 35 whereas the Construction Industry Development Board (CIDB) Standard Conditions of Contract for Building Works (2000) provides for a mandatory mediation where the parties must first attempt mediation and can only commence arbitration in the event that the mediation fails. On the other hand, under Clause 35 of Asian International Arbitration Centre (AIAC) Form of Contract 2017, it appears to have similar principle to MIA 2006.

In general, the parties to a dispute will most likely not resort to mediation if the agreement only provides an option for the parties to do so or for one of the parties to initiate the process. The trend is however towards the enforceability of mediation clauses. In England, the courts had held that if a party to the contract which contains a mediation (ADR) clause commences legal action, costs would not be awarded to his favour if he did not attempt mediation or ADR. (see Dunnett v. Railtrack Plc (In administration) [2002] 2 All ER 850. See also Cable & Wireless Plc v. IBM UK Ltd [2002] 2 All ER 1041.

Further, in a multi-tiered dispute resolution clause, it can be said that an attempt at mediation is a condition precedent to the commencement of the remaining binding dispute resolution mechanism in the clause itself, frequently arbitration.

There are pitfalls and problems that can arise in enforcing poorly or badly drafted mediation clauses. Boule & The (2000) have helpfully listed that the following factors should be paid due attention by draftspersons of mediation clauses:

i. mediation clauses should be clear and certain in their own right, or it should be possible to derive certainty from extrinsic
documents expressly referred to in the clauses;
ii. they should be complete and comprehensive;
iii. they should specify the procedures to be followed by the parties in setting up and undertaking the mediation, with some reference to the identity of the mediator and timetables to be followed;
iv. alternatively, they should incorporate by reference the Mediation Agreement or Mediation Rules of an agency providing mediation services;
v. they should uphold the non-ouster principle by stipulating that the parties should first submit their dispute to mediation before they institute court proceedings; and
vi. they should avoid provisions requiring participation in good faith.

With a good and clear mediation clause incorporated into a construction contract, it will help the disputing parties to decide when the problem arises.

### 3.2 Mediation Act 2012

In Malaysia, Mediation Act 2012 has received the royal assent on 18 June 2012 and was gazetted on 22 June 2012. The act was enforced by the ministry in August 2012 and has been applied in order to promote and encourage mediation as a method of ADR.

In the absence of any specific Mediation Rule mentioned in a construction contract, the Mediation Act 2012 seeks to facilitate this mediation process. Generally, the parties are free to agree on the appointment of any person as their mediator. If parties cannot come to a consensus, they can request the Malaysian Mediation Centre of the Bar Council (MMC) to appoint a qualified mediator from its panel.

According to the Mediation Act 2012, parties may resort to mediation either before or during the court proceeding (section 4). In fact, it is in the Practice Direction No. 4 of 2016 (Practice Direction on Mediation), issued by the Chief Registrar of the Federal Court of Malaysia, which mentioned that judges may encourage parties to settle their disputes even after a trial has commenced.

Disputing parties may decide the terms of mediation. Preferably, parties may come out with a mediation agreement in writing and signed by both parties setting out the terms of mediation. For instance, in respect of which mediation forum to go, parties’ choice of mediator, as well as express term that mediation communication is to be treated with utmost confidentiality and privilege from court proceedings.

Mediator shall have no decision-making power whatsoever. He shall only play the role in facilitating communications and negotiations between parties and in identifying their needs, and developing options amongst them for amicable solution.

All disclosures, communications and even admissions made under a mediation session are strictly without prejudice or privilege. It is not subject to discovery or be admissible in evidence in any proceedings unless parties consented to it. It shall be noted that regardless of choice of forum, parties must fix a return date of not more than one month from the date the case referred to mediation to report to the court on the progress and outcome of mediation. (Practice Direction No. 4 of 2016)

### 3.3 The Roles of AIAC and MMC

In Malaysia, the construction court has been established in Selangor and Kuala Lumpur on 1 April 2013 in which it operates to assist the administration and instantly resolved any matters or cases regarding construction or connected with construction. Prior to that, Malaysian Bar has established the MMC in 1999 to introduce mediation in order to provide a proper solution for successful dispute resolutions and to provide avenue for successful dispute resolutions.

The centre provides mediation services and trained mediators who have been accredited and appointed to the Panel of Mediators of the MMC.

In 1978, The Kuala Lumpur Regional Centre for Arbitration (KLRCA) was established and offers facilities and assistance for the conduct of arbitral proceedings, including the enforcement of awards made in the proceedings held under the auspices of the Centre. The Rules for arbitration under the auspices of the Centre are the UNCITRAL Arbitration Rules of 1976 with certain modifications and adaptations. The Centre provides mediation services and rules which allows the parties to freely choose their mediator or from its list of accredited mediators, or failing which the Director of the Centre shall assist in the appointment of mediator. Recently, KLRCA has changed its name to AIAC.

### 3.4 Advantages and Disadvantages of Mediation in Construction Dispute

Mediation is faster and less expensive than litigation and arbitration. Mediation sessions usually take no more than a day or two, compared to a court trial or arbitration hearing that can take weeks. Mediations
can be scheduled as soon as the parties are ready, while arbitration hearings and court trials often take years to be scheduled. This time advantage is particularly important when the mediation takes place while a project is still under construction because resolution of disputes clears the way for more cooperation between the project participants (Ooi, 2017). Recognizing the effectiveness of mediation in resolving construction disputes, many construction industry standard contracts require that the parties make a good faith attempt to settle their dispute through mediation prior to instituting litigation or arbitration. Examples of construction disputes that are most frequently mediated are:

i. Contractor’s defective work
ii. Architect’s defective plans and specifications
iii. Delays in project completion and other schedule issues
iv. Payment issues
v. Changes to the scope of work
vi. Differing site conditions
vii. Property damage to the project
viii. Disputes arising from termination of a contractor or subcontractor.

This list is however not exhaustive. After there is a settlement, if other items come into dispute, a new mediation can be scheduled without affecting the prior settled items. If a major dispute develops in the early stages of a construction project, a quick, low cost mediation can be scheduled which will allow the project to continue in a timely manner. If binding mediation is specified, there will be a final and binding decision and the project will continue in a timely manner. It is not unusual to have multiple mediations in larger construction projects.

Mediation is so informal that if a construction contract does not recognize an ADR option; mediation may be scheduled by mutual agreement of both parties to the contract. Both parties have the opportunity to check the background and experience of the mediator unless the mediator is specified in the dispute resolution section of their contract. Most contractors specify an ADR provider when they find a mediator or arbitrator who is knowledgeable and experienced in construction matters and who is fair and equitable to both parties. In civil litigation, you have no options in the choice of your judge.

Mediation is a private process and not subject to public knowledge and possible media attention as can be the case with civil litigation. Parties can request various actions, including restructuring of existing contracts, structured payment terms and even apologies. Mediation is often successful as it takes into account the personal and commercial interests of both parties. Mediation settlements usually have a high degree of longevity, given that they are constructed by the parties. (Boulle & Teh, 2000)

For disadvantages, mediation does not always end with a settlement agreement. Despite the parties’ best efforts, the dispute may not always be resolved after attending a few mediation sessions. If the mediation does not produce a resolution, each party may know information regarding the other party’s allegations and possible evidence that may be used in court at a later date.

The informality of mediation could prove to be a detriment when the parties involved have a disparate level of sophistication, power, and/or resources which could possibly result in an un-favourable settlement for the party that lacks the sophistication, power, and/or resources to properly understand and resolve the dispute. Example, between main contractor and a subcontractor or between a client and a consultant.

4 CONCLUSION

The use of mediation to resolve construction disputes can thus be said to be the continuing international trend. At least in Malaysia, it may be premature at this stage to agree with the following statement of George H Golvan QC but given time and with the increasing popularity of mediation as a means of dispute resolution, and with all infrastructures for the use of mediation properly in place, a concurring note may be unreservedly given. The statement is this: “Mediation is such a suitable process for resolving commercial disputes that it may well be arguable in the future that a lawyer who fails to take advantage of an available mediation procedure, and has instead committed his or her client to protracted and expensive litigation, could well be guilty of a breach of professional duty.”

Mediation is particularly well suited to construction dispute because this dispute tends to occur as a result of a breakdown in communication between the parties and, as such, mediation provides the setting for parties to communicate and negotiate effectively with the presence of a neutral third party. It is submitted that, with regard to small, low value construction disputes, mediation is strongly recommended and advised where conventional negotiation methods have failed.

The finality of the mediation could also be questioned. Parties to a settlement agreement may attempt to dispute the settlement agreement and still end up filing suit in court regarding the legitimacy of
the settlement agreement. By filing suit, the party has created a new dispute and denied the resolution of the underlying dispute that led the parties to a mediator. One way to ensure that the parties will not have to spend future time still dealing with the same dispute is to ask the parties to agree that the resolution reached during mediation will be binding on all parties involved.

It is submitted that the use of mediation as dispute settlement mechanism in construction cases should be promoted and its popularity should be enhanced.

ACKNOWLEDGEMENT

This research is financially supported by the Faculty of Law, Universiti Teknologi MARA (UiTM), Shah Alam, Selangor.

REFERENCES


Fisher, W.H. 2017. The Use of Arbitration in the Construction Industry in England and Wales: An Evaluation of its Continuing Role Following the


