ARTICLE

Resolving Your Construction Disputes in Hong Kong – What Are Your Options?

An article entitled "2020 Review & 2021 Outlook Of Construction Arbitration & Dispute Resolution In Hong Kong",[1] which appeared in the online publication "Hong Kong Lawyer"[2] in June 2021 observed:

"With the ever-booming development of the construction industry both in Mainland China and in Hong Kong, the number of constructions disputes have also been observed to be on a steady rise. As a result, in order to ensure speedy dispute resolutions for all such matters (so as to avoid project interruptions where applicable), a sharp increase in services specifically catered for the construction industry is also on the rise".[3]

The article went on to conclude:

"All in all, with the ever-increasing/resumption of mega construction projects in Hong Kong, China and the Belt and Road realm, the increase for demand of construction arbitration will continue to increase and Hong Kong provides one of the best and most robust dispute resolution centres in the region which remains unmatched. A further expansion of this market is therefore expected to continue".[4]Whilst the supporting evidence for the above is largely anecdotal (on the basis that many construction disputes in Hong Kong are referred to arbitration and are therefore not reported), it is nevertheless widely accepted in the industry that there is a high occurrence of disputes on construction projects in Hong Kong.[5] Most, though not all, commonly relate to project time and cost overruns and the valuation of additional works. Such disputes can arise between an employer and a contractor, or between a contractor and its subcontractors or suppliers and between subcontractors and sub-subcontractors and sub-suppliers further down the supply chain.

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[1] Article dated June 2021: https://www.hk-lawyer.org/content/2020-review-2021-outlook-construction-arbitration-dispute-resolution-hong-kong

[2] "Hong Kong Lawyer" is the Official Journal of the Law Society of Hong Kong: https://www.hklawsoc.org.hk/en/

[3] Introductory paragraph to the article cited at footnote 1

[4] Final paragraph of the article cited at footnote 1

[5] Hong Kong Special Administrative Region of the People's Republic of China

Whilst the introduction of measures to avoid disputes across the industry is laudable and is to be encouraged, all forms of construction contracts should include a robust and practical dispute resolution mechanism to be in place to ensure that disputes that arise, and which cannot be resolved in their infancy through dispute avoidance measures, are addressed and resolved in a structured and expeditious manner to avoid protracted and costly resolution of the parties' grievances.

This article does not seek to advise on the most appropriate form of dispute resolution for a particular type of project or dispute, nor does it seek to highlight the advantages or disadvantages of one particular form of dispute resolution over another, but rather, takes a look at some of the common forms of dispute resolution available to parties to a construction contract in Hong Kong who find themselves unable to overcome their differences.

Party Autonomy

The freedom of parties to consensually execute a dispute resolution agreement is known as the principle of party autonomy.

Whilst it recognised that party autonomy is important to allow parties to a construction contract to agree on how disputes that arise between them are to be resolved, most standard forms of contract in use in Hong Kong, including those in use by the Government,[6] usually contain pre-determined dispute resolution mechanisms.

Accordingly, contractors who enter into construction contracts with such provisions will, in reality, have little or no input into the dispute resolution provisions and proposals to include alternative dispute resolution clauses or amendments to the standard provisions are unlikely to be well received. This brings into question whether true party autonomy exists with regards to the agreement of dispute resolution provisions, where in the majority of contracts, the party drafting the contract has usually unilaterally decided on its preferred dispute resolution mechanisms, to the extent that specific rules for the conduct of such processes often form part of the contract.

Dispute Resolution – What Are the Options?

Over recent years there has been a significant increase in popularity of various forms of Alternative Dispute Resolution (ADR) particularly in respect of construction projects/contracts. Parties are becoming increasingly aware of the benefits of alternative forms of dispute resolution to litigation, whilst at the same time courts are becoming increasingly supportive of ADR, a shift which is fully supported by the Government, the Judiciary[7] and the private sector. Although where the parties have agreed to settle their disputes through litigation, the courts cannot compel parties to enter into ADR, the courts' overriding objective to actively manage cases, may include encouraging the parties to engage in ADR.[8]

ADR is often attractive to parties who would prefer a private and confidential dispute resolution process where, unlike in litigation, the parties' differences will not be aired in the public domain.

So, what ADR options are available to parties to a construction contract in Hong Kong?

The following, though not exhaustive, is a brief overview of alternative dispute resolution options available where the parties do not want to refer their differences to the courts

Negotiation

During the negotiation process the parties communicate on a without prejudice basis regarding the issues in dispute in an attempt to reach a resolution. Negotiation is openly accessible to the parties at any stage of a dispute, subject to any pre-existing contractual obligations that may require them to confer within a pre-determined period of a dispute arising.

The benefits of negotiation cannot be under-estimated. Often the differences between the parties can be resolved through open and frank discussion before they develop into fully fledged disputes. Most negotiations are not structured and usually start at site level and progress through to senior management representatives of the parties. Negotiation will assist the parties in reaching their objectives if there is a genuine desire to settle the differences on both sides. Negotiation is usually best

[6] As published by the Development Bureau of theGovernment of the Hong Kong Special Administrative Region of the People's Republic of China: https://www.devb.gov.hk/en/publications_and_press_releases/publications/standard_contract_documents/index.html

[7] The Judiciary of the Hong Kong Special Administrative Region of the People's Republic of China: https://www.doj.gov.hk/en/legal_dispute/index.html

[8] The Judiciary of the Hong Kong Special Administrative Region of the People's Republic of China: https://www.doj.gov.hk/en/legal_dispute/litigation.html

suited to relatively simple matters where there are no underlying, technical, contractual or legal issues that could complicate and protract the discussions. It is particularly effective in the settlement of commercial matters where the value or cost of an item or items is in question and lends itself to settlement of range of commercial matters, for example, as a step towards an overall 'wrap-up' settlement agreement at the final account stage of a project.

In addition to negotiation being the most cost-effective way of resolving a dispute, parties that are looking to preserve an ongoing relationship often benefit from adopting this process, as it avoids more formal proceedings and encourages the parties to look at the commercial benefits of a non-confrontational process that delivers a mutually acceptable outcome.

Mediation

Mediation is fundamentally a form of structured negotiation which may be voluntary or be required under the provisions of the contract. Mediation can usually be initiated at any stage of a dispute and is a confidential process that allows the parties to attempt to negotiate a settlement by appointing an independent third-party mediator to assist the parties to reach a mutually acceptable settlement.The mediator will assist the parties to identify and crystalise the issues in dispute; discuss ways to address the issues; help the parties develop options for resolving the dispute(s); and facilitate agreement, where appropriate, to resolve the issues.

The mediator is neutral and does not offer legal, commercial or other expert advice, nor does he/she make decisions on the matters in dispute. Some mediators may encourage the parties to agree on an outcome themselves, whereas others may express views about the merits of a party's case or give an indication of how the dispute may be viewed, should the issues be referred to a formal hearing.

Mediation, however, allows the parties to consider all options in reaching a settlement and is not restricted to the remedies that a court or arbitrator would be able to order if the dispute(s) were to proceed to a formal hearing.

Parties typically agree for mediation to take place on a without prejudice basis, and to keep matters discussed during a mediation private and confidential. The terms of any settlement will therefore also remain confidential.

In Hong Kong, mediation is governed by the Mediation Ordinance (Chapter 620)[9] and the applicable mediation rules stipulated in the contract. The Hong Kong International Arbitration Centre (HKIAC)[10] maintains a panel of suitably qualified and experienced construction mediators and can assist parties in the search for appropriate individuals to mediate their disputes.

Adjudication

Adjudication is a simple and effective method of resolving differences between the parties and is common in construction disputes.

Adjudications are conducted by a sole adjudicator in accordance with the rules and terms of the contract that the parties have entered into and the applicable law.

Adjudication is intended to provide a quick process for the resolution of disputes which arise during the currency of a contract, with any decision to remain binding until any fuller consideration in subsequent arbitration.The object of adjudication is to obtain the fair resolution of any dispute arising under the contract without unreasonable delay or expense and which is binding on the parties unless challenged at a later stage.

The recent introduction of Security of Payment provisions (SOP)[11] in Hong Kong for public works contracts awarded after 31 December 2021, will amongst other requirements, see the introduction of payment dispute adjudication.

Under these provisions adjudication decisions will be binding on the parties and enforceable as a contractual obligation, until the payment dispute is resolved in writing between the parties or is determined by the dispute resolution mechanism set out in the main contract/sub-contracts.

The HKIAC maintains a panel of both Hong Kong based and international construction Adjudicators.

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[9] Mediation Ordinance (Chapter 620) - An Ordinance to provide a regulatory framework in respect of certain aspects of the conduct of mediation and to make consequential and related amendments. [1 January 2013] L.N. 167 of 2012: https://bom.so/rCyICv

[10] The Hong Kong International Arbitration Centre (HKIAC) is a company limited by guarantee and a non-profit organisation established under Hong Kong law, providing alternative dispute resolution services from administered and ad hoc international arbitration to mediation, adjudication and domain name dispute resolution. It was founded in 1985: https://www.hkiac.org/

[11] The Government of the Hong Kong Special Administrative Region, Works Branch Development Bureau Government Secretariat - Development Bureau Technical Circular (Works) No. 6/2021 Security of Payment Provisions in Public Works Contracts, dated 5 October 2021: https://www.devb.gov.hk/filemanager/technicalcirculars/enupload/386/1/C-2021-06-01.pdf

Arbitration

The Hong Kong Arbitration Ordinance (Chapter 609)[12] is based on the UNCITRAL Model Law.[13]

To be enforceable in Hong Kong, arbitration agreements must be made in writing or recorded in any written form, or by the reference in a contract to any documents containing an arbitration clause.[14]

Similar to a court hearing, arbitration is an adversarial process. It differs from other forms of ADR in that it is more formal and structured. Accordingly, due to its adversarial nature, the arbitration process can put pressure on the parties' relationship.

Arbitration involves the parties presenting their respective cases and evidence on a dispute or disputes, usually through legal advocates, before a suitably qualified and experienced arbitrator or arbitral tribunal that makes a determination on the matters in dispute. The resulting arbitral award is final and binding and enforceable in the courts.In many respects, presenting arguments before an arbitrator is similar to a court hearing, with the exception that the process is confidential, and parties can agree on their choice of arbitrator or tribunal and can agree to a process that meets their particular needs, subject to any pre-existing rules or requirements set out in the contract or the governing law.

Parties are entirely free to choose arbitrators with the qualifications or experience required to meet the needs of their disputes, which might include expertise in the substantive subject matter. The HKIAC maintains a panel and a list of arbitrators to assist parties in the search for appropriate arbitrators for their disputes. The pool of arbitrators in Hong Kong is large and experienced and capable of dealing with the most complex construction arbitrations.[15]

Arbitrations can be particularly appealing where confidentiality of the dispute and the award is important to the parties.

Depending on the form and duration of the hearing, arbitration may involve significant costs and the process may be cost prohibitive for many parties, particularly where the amounts in dispute are relatively modest.

Early Neutral Evaluation

Early Neutral Evaluation (ENE) is a dispute resolution technique that typically sits somewhere between without prejudice mediation and binding arbitration. It can be a stand-alone process or be integrated with other dispute resolution processes such as mediation. ENE is a process in which the parties present their respective cases to a neutral third-party (usually an experienced legal practitioner with expertise in the area of the dispute) who renders a non-binding reasoned evaluation on the merits of the case.

The process attempts to avoid some of the pitfalls of arbitration or litigation, such as the failure of lawyers and clients to assess their cases early, the lengthy pleadings process and unfocused discovery, all of which often lead to unnecessary costs and delays for the parties. ENE may also include inter-party discussions on the issues, that may contribute to the settlement process.

One of the key attractions of ENE is that it provides the parties with an early indication of the relative strengths and weaknesses of their positions, thus encouraging, early settlement. It may form part of a contractual dispute resolution mechanism or may be instigated through voluntary arrangements between the parties.

Whilst ENE may be initiated at any time in the life of the dispute, an assessment of the case early in the dispute resolution process is preferable and it may be triggered as soon as a deadlock arises in connection with a particular dispute. Even where ENE is not specifically provided for in the contract, the parties may still be able to agree to commence ENE, on seeing the benefit of having an early

[12] Arbitration Ordinance (Chapter 609) - An Ordinance to reform the law relating to arbitration, and to provide for related and consequential matters. [1 June 2011] L.N. 38 of 2011: https://wipolex-res.wipo.int/edocs/lexdocs/laws/en/hk/hk185en.html

[13] UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006. United Nations Commission on International Trade Law: https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-09955_e_ebook.pdf

[14] Arbitration Ordinance (Chapter 609) Part 3 – Arbitration Agreement – Clause 19(2): https://www.elegislation.gov.hk/hk/cap609

[15] The Hong Kong International Arbitration Centre (HKIAC): https://www.hkiac.org/arbitration/arbitrators/panel-and-list-of-arbitrators

evaluation of their respective positions.

The central features of ENE involve an informal, confidential, impartial and cost-effective evaluation of a dispute, that may take place at any time, but preferably as early in the dispute as possible to promote exploration of a potential settlement.

Expert Determination

Parties may also agree for a discrete issue to be determined by an expert, with the parties agreeing whether they will be bound by such a determination. This can be particularly useful where there is an impasse between the parties on technical issue which is an obstacle to moving matters forward. An expert with relevant experience, and who is acceptable to both parties, can be brought in to determine it.

Expert Determination allows for discrete issues to be resolved quickly and like most forms of ADR, the process can be adapted to suit the needs of the parties and/or the specific dispute.

Difficulties may however be experienced if there are factual matters in dispute, or issues which fall outside the appointed expert's technical expertise.

Dispute Resolution Advisors

The majority of Government construction contracts and those of the Hong Kong Housing Authority (HKHA)[16] include provisions for appointment of a Dispute Resolution Advisor (DRA). Under the Architectural Services Department (ASD)[17] contracts, the DRA is referred to as the Dispute Resolution Advisor (DRAd), whilst under HKHA contracts the appointee is referred to as the DARA – Dispute Avoidance and Resolution Advisor. Notwithstanding the different titles, the role of DRA is essentially the same under both sets of provisions.[18]

Following the execution of the main contract between the employer and contractor, an individual is appointed by joint agreement of the parties at the outset of the project to assist the parties in facilitating early identification and resolution of the parties' differences as they arise. The underlying contract contains a set of rules which outline the DRA mechanism, and which govern the conduct of the DRA's appointment and the process to be followed.

The primary objective of the DRA system is to foster co-operation between all parties to the contract including the employer, the contractor and any nominated sub-contractors or specialist sub-contractors. The system is also intended to minimise the extent of claims, disputes and disruption to the project, and to ensure the cost-effective and expeditious resolution of disputes that do arise.

The process is a precursor to the parties' elevating their differences to formal 'Dispute' status under the respective contracts and sub-contracts and is intended to promote the early identification, discussion and resolution of any differences between the parties at site level, where possible.

The parties may refer their differences to the DRA at any time, who will give his/her opinions on the merits of the issues and advise the parties accordingly. The DRA may be called upon to provide his/her opinion in the form of a written report, though the report is non-binding and neither party is obliged to accept the DRA's findings on any particular issue, nor to accept the DRA's proposals to resolve issues or settle disputes.

Should the parties fail to resolve their differences through facilitation by the DRA, a Short Form Arbitration[19] process may be invoked, which is generally limited to a single dispute. For multiple or complex issues, the dispute(s) may be referred to mediation or a full arbitration process in accordance with the relevant rules in the contract.

The DRA is not compelled to divulge any information or documentation referred to him or to testify in regard to the DRA process in any subsequent litigation or arbitration involving the parties to the contract.

Additionally, the DRA cannot be appointed as adjudicator, arbitrator, consultant or advocate in any subsequent adjudication, arbitration or court proceedings between the parties on any matter arising out of the contract, unless the parties agree in writing.

Based on the authors personal experience, variants of the DRA system are increasingly being adopted in private sector construction contracts in Hong Kong.

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[16] The Hong Kong Housing Authority is the main provider of public housing in Hong Kong. It was established in April 1973 under the Housing Ordinance and is an agency of the Government of Hong Kong Special Administrative Region: https://www.housingauthority.gov.hk/en/

[17] The Architectural Services Department is a department of the Government of Hong Kong Special Administrative Region responsible for the design and construction of public facilities. It is subordinate to the Works Branch of the Development Bureau and was founded in April 1986: https://www.archsd.gov.hk/en/home.html

[18] HKHA DARA System- Clause 17 of General Conditions of Contract for Capital Works: https://www.housingauthority.gov.hk/common/pdf/business-partnerships/resources/general-conditions-of-contract-for-capital-works/Building-GCC.pdf and ASD DRAd System: https://www.archsd.gov.hk/en/consultants-contractors/dispute-resolution-advisor-(drad)-system.html

[19] Short Form Arbitration Rules set out at Appendix 4.1 to the Architectural Services Department's - The Dispute Resolution Advisor (DRAd) System Handbook. Current revision August 2021.

Tiered Dispute Resolution Mechanisms

It is not uncommon for both public and private sector construction contracts in Hong Kong to contain tiered dispute resolution mechanisms, often referred to as "escalation clauses". Such clauses usually require the parties to negotiate and/or mediate their dispute(s) prior to initiating formal proceedings such as litigation or arbitration.

The tiered dispute resolution process usually follows this typical route, though there are variants, depending on the preference of the parties or the particular contract in use:

Senior Site Personnel → Senior Executives → Mediation → Arbitration

The process allows for senior personnel familiar with the issues to initially attempt to resolve the dispute at site level. Should such efforts fail, then the matter is referred to the parties' senior management executives to attempt resolution. If this stage is also unsuccessful the matter is referred to mediation. If attempts at mediating a settlement also fail, the matter is finally referred to arbitration for a final and binding decision on the parties' differences. Whilst the above simple example does not allocate a timeframe to each of the stages, in reality, each stage will often have to be carried within a prescribed period, for example a 14-day period for senior executives to meet to attempt to resolve the issues before mediation can be invoked.

FTI Consulting is regularly asked whether it is necessary to have such complex dispute resolution provisions in construction contracts, whether such provisions need to be strictly followed and, if the parties do not adhere to the process what are the consequences.

The answer to the first part of the question is that the parties are not obliged to "contractualize" attempts at settlement. However, structured or tiered provisions are designed primarily to facilitate early dispute resolution and thereby avoid expensive and time-consuming arbitration or litigation, which is ultimately in the interests of both parties.As to the second part of the question - where the parties have entered into a contract that contains tiered dispute resolution provisions - whether such provisions are to be strictly followed without deviation will depend on whether undertaking each stage in the process is a condition to moving on to, or invoking, the next stage, in effect each stage becoming a condition precedent to embarking on the next. If, based on the specific language of the contract, each stage is a condition precedent, any premature attempt to, for example, refer a dispute to arbitration before attempting to mediate, may be considered a breach of the dispute resolution process. Accordingly, further disputes often arise when a party alleges that the escalation procedure has not been followed, with the ensuing legal arguments.

In principle, escalation or multi-tiered dispute resolution clauses can create a condition precedent to the commencement of formal proceedings. However, if the provisions are not drafted carefully and are not sufficiently clear and certain, they may not be enforceable. The overriding message is, that when drafting contract clauses for a multi-tiered dispute resolution procedure, the terms need to be clear, precise and unambiguous.

There have been a number of recent important legal cases both in Hong Kong and overseas which address these issues, which will be considered in future articles.

Conclusion

There are a variety of ADR options available to parties in Hong Kong who would prefer not to have their differences resolved in court. These options range from straightforward negotiation between the parties to full arbitration proceedings.Currently, based on the author's personal experience, mediation and arbitration are regarded as the 'go to' dispute resolution options for most construction disputes arising in Hong Kong, though it is anticipated this will change in the short to medium term, at least in respect of public works projects, with the advent of the SOP regime with adjudication gaining traction as parties become more familiar with the newly introduced scheme. With the anticipated introduction of full SOP Legislation for all construction project in Hong Kong in the not-too-distant future, it is anticipated that adjudication will quickly surpass both mediation and arbitration as the most prevalent dispute resolution format.

Each different ADR method however has its own particular characteristics. It is therefore imperative that the method(s) adopted in the dispute resolution agreement align with the parties' strategic goals. This is something that is often overlooked by the parties when grappling with their risks, responsibilities and obligations in the broader contract conditions.

Most ADR methods can be adopted at any time during the project and can therefore provide the parties with greater flexibility and more cost-effective options for resolving disputes than the traditional litigation process.

Multi-tiered dispute resolution agreements or 'escalation clauses' have been under the legal spotlight recently and have come in for a good deal of court scrutiny. It is therefore important that if the parties to a construction contract include such provisions in their dispute resolution agreement, they are clear and unambiguous. If the parties intend for each tier in the process to be a condition precedent to undertaking the subsequent tier, they should include express wording that says exactly that.

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