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Making Dispute Resolutions Arbitrary: Arbitration Clauses buried under Construction Contracts

The Back-to-Back Principle

In complex construction projects, there are numerous project participants with different roles and responsibilities. Subcontracting is a common practice in the modern construction industry. Whilst the contractual arrangements are complex and the contractual chains are long, it is very common for sub-contracts and supply agreements to be back-to-back with the main contract provisions.

The back-to-back principle would mean that all or part of the obligations of the main contractor under the main contract are replicated in the sub-contract; all or part of the obligations of the main contract and sub-contract are replicated in the sub-sub-contract and so on down the contractual chain.

On one hand, the main contractors could avoid gaps in obligations and liabilities amongst the various project participants. On the other hand, it is commercially justifiable as it ensures consistency of the work throughout the whole construction project.

Whilst the back-to-back principle is rather straight forward, problems often arise in practice from the way in which the various different contracts are documented. Poorly drafted contracts can be difficult to interpret leading to disputes. The problem is further aggravated when most of the time these main contracts have never been available to the sub-contractors to begin with. The reality is that the subcontractors would not have sighted the main contract at all until a dispute arises.

These main contracts certainly have its dispute resolution clause to resolve any arising disputes by way of mediation, expert determination, arbitration or a combination of the dispute resolutions and etc.

However, what the contractors failed to see is the legally binding effect of such dispute resolution clause or arbitration clause, which will eventually stifle their claims in Court against an employer.

Meaning of Arbitration

The term “arbitration” if looked up on the internet would inter alia simply mean “the hearing and determining of a dispute or the settling of differences between parties by a person or persons chosen or agreed to by them”. It does not say one will lose the option of pursuing their case in Court if the parties have agreed to arbitration. Most contractors, even if they had taken the effort to look up the meaning of it, they may not be aware of the legal effect of an inclusion of such clause in their contracts. Furthermore, the wordings of such arbitration clause may not be clear and obvious to show the binding effect of an arbitration agreement given by the Arbitration Act 2005.

Section 9(1) Arbitration Act 2005 defines “arbitration agreement” as;

> *“In this Act, “arbitration agreement” means an agreement by the parties to submit to arbitration all or certain*

> *disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not."*

Merely by looking at Section 9(1) Arbitration Act 2005, one would understand that it is an agreement that parties agree to submit their disputes to arbitration proceedings.

However, Section 10(1) Arbitration Act 2005 further stated that;

> *"A court before which proceedings are brought in respect of a matter which is the subject of an arbitration agreement shall, where a party makes an application before taking any other steps in the proceedings, stay those proceedings and refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed."*

Notice the word "shall" used in Section 10(1) Arbitration Act 2005. This means that Section 10(1) Arbitration Act 2005, being the operative provision, provides for a mandatory stay of court proceedings where there is an arbitration agreement unless the arbitration agreement is null and void, inoperative or incapable of being performed. In layman terms, this means that the Court must stop or suspend one's legal claim, if there is an arbitration agreement found between the parties unless the arbitration agreement is "null and void, inoperative or incapable". However, the exception, i.e. "null and void, inoperative or incapable" is rarely invoked by the Court to strike down arbitration agreements due to a liberal approach that majority of the Courts have adopted in interpreting one arbitration clause *(See heading below for further discussions; The Court's approach (i): Interpreting an "Arbitration Agreement")*.

Why Mandatory and Binding?

There is a global significant shift to arbitration. This can be seen from the signing and ratification of various pro-arbitration international treaties by a large number of countries. For instance, the New York Convention and the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration, where Malaysia is a Contracting State of both the treaties.

On 30 December 2005, Malaysia enacted the new Arbitration Act 2005 based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration. The new Act comes into force on 15 March 2006 and it repeals and replaces the previous Arbitration Act 1952. The stay provision Section 10, which follows Model Law article 8, basically makes the stay mandatory where there is a bona fide dispute and removes the discretion to retain the proceedings in court given by s 6 of the old Act. In addition, Article II.3 of the New York Convention requires a mandatory stay to be provided where the arbitration is to be held in a convention country.

However, such intention for mandatory arbitration may not be well served simply because the high fees and costs of initiating one, which is very much higher than commencing a claim in Court. Furthermore, it must not be forgotten that arbitration proceedings are not any less adversarial than legal proceedings. In fact, arbitration proceedings can be overly technical and complex. At least in litigation, the Courts have maxims of equity and inherent court's jurisdiction to avoid injustice that come into play to allow some flexibility in interpreting the law which such rules are not apparent in arbitration proceedings.

The Court's approach (i): Interpreting an "arbitration agreement"

Standard arbitration clauses seen in standard form contracts such as the PAM 2006 Form of Building Contract, the CIDB Standard form of Contract for Building Works, the PWD 203A Form, FIDIC Form and etc. are less likely to create any issues, because the intention for a mandatory and binding arbitration is clear and

obvious.

However, there are some contracts adopted by the employers have "bad" arbitration clauses that lacks clarity and some even appear to be ambiguous. For example, in the case of Mangistaumunaigaz Oil Production Association v United World Trade Inc. [1995] 1 QBD 617, the agreement provided for "Arbitration, if any, by I.C.C. rules in London" which the Court upheld such clause as an arbitration agreement. The problem is that there is a growing trend that the Courts would uphold such "bad" arbitration clauses. The Court is of the views that "An arbitration agreement, being a term of the contract between parties, every effort must be made to uphold it" (Thien Seng Chan Sdn Bhd v Teguh Wiramas Sdn Bhd and YL Design Consultancy Services [2017] 1 LNS 1066). The Courts believe that such approach is a business sense approach. However, this would lead to an abuse of ambiguous arbitration clauses intentionally drafted by employers to trap contractors.

This means that without clear intention of the parties in a contract, the mere reference of the word "arbitration" would mean ousting the Court's jurisdiction momentarily prior to resorting to arbitration. This is contrary to the very root of contract law, namely the intention of the parties and the fundamental principles of interpretation of contracts.

The Court's approach (ii): Incorporation of an "arbitration agreement" by reference

Apart from the liberal approach that the Courts have adopted in interpreting an arbitration agreement, by virtue of section 9(5) Arbitration Act 2005 and the development in common law, the position now is that a general reference of a foreign document in the construction contract would allow incorporation of any arbitration agreement found in the said foreign document (Ajwa for Food Industries Co (MIGOP), Egypt v Pacific Inter-Link Sdn Bhd [2013] 5 MLJ 625).

Again, this would create injustice at times as the law is again open for abuse. Employers could easily incorporate an arbitration agreement without a clear sign on the original contract by making many subtle references to many foreign documents that were not made available to the contractors where one of the foreign documents would have an arbitration agreement. In effect, such arbitration agreement is hidden in the contract but has full legal force on the parties.

Multi-tier Dispute Resolution clause

If this is not worse enough, there are scenarios where contracts provide for a multi-tier dispute resolution clause that would require the contractor to comply to certain requirements, for instance to submit a report to an officer from the employer, to take part in mediation and etc. before being able to initiate arbitration proceeding whilst already being hindered from filing a legal suit. Such pre-requisite requirements are binding on the parties as seen in the case of Usahasama SPNB-LTAT Sdn Bhd v Abi Construction Sdn Bhd [2016] MLJU 1596 which held that such preconditions are mandatory to be adhered before one can refer to arbitration. The contractor will be stopped from filing a legal suit or an arbitration proceeding unless the steps as stipulated under the said multi-tier arbitration clause has been satisfied. An example would be Clause 67 of the PWD Form DB (Rev 2007).

Conclusion

In short, most of the time contractors think arbitration to mean sitting down and settling the case, but they did not know the mandatory and binding nature of arbitration. They did not know the fees and costs. They certainly did not know that courts when interpreting contracts, did not need to consider what they think are the clauses they had agreed on. Bottom line, they have "an arbitration clause" shove down their throat. Reality is that this would end up stifling the contractors' suits, whom they seek to claim for payments from the employers. Already they were out of pockets, they cannot afford to pay more for dispute resolution. Yet, the courts slammed its doors at their faces.

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