PROPOSED AMENDMENTS TO
MDB PROCUREMENT GUIDELINES
FOR CONSTRUCTION CONTRACTS

AND

PROPOSED AMENDMENTS TO THE
FIDIC YELLOW, SILVER AND DBO CONDITIONS OF CONTRACT
AFFECTING THE DISPUTE BOARD PROVISIONS

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Introduction

There are very few building or construction projects that do not give rise to some form of dispute during either the design or construction stages.

Disputes can be expensive and disruptive, particularly if they are allowed to become entrenched and to proceed to formal determination by a court or a tribunal. There are more often than not, no clear winners unless the dispute can be settled early and with finality.

Disputes are often embedded in the tender and construction documentation, only waiting for the right opportunity to materialise. Typical examples may be information missing from the specification or the drawings, or conflicting information only discovered after construction has commenced and which requires a determination by either the design consultant or the Engineer. In either situation it is likely that some part of the project will suffer a delay whilst the omissions and discrepancies are being rectified, and the Contractor will want to be compensated for any loss of time and perhaps also want to negotiate new rates for the affected works.

The Design Consultant and the Employer will want to minimise any cost increase.

The Engineer is generally an employee of the Employer and will frequently determine a matter in favour of the Employer, rather than making a fair determination, which is required by FIDIC 1999 contract condition.

This generally triggers a Notice of Dispute from the Contractor and under traditional conditions of Contract the Dispute is referred to arbitration, litigation or some form of Alternative Dispute Resolution procedure. Regularly these disputes are still being heard long after the contract works have been completed, consuming large amounts of time and money.

The indirect costs of a dispute, such as loss of productivity of the staff engaged in resolving the dispute, interruptions to the daily activity of running a business and even the stress and inconvenience which may be caused to either or both parties to the dispute, can rarely be quantified and are never fully recouped by the winning party, and of course the losing side has often suffered heavy losses which can sometimes cause the business to go bankrupt.

Disputes can also ruin established and prosperous business relationships and partnerships, which has a further detrimental effect on businesses.

There are many steps that can be taken to minimise the number and severity of disputes on any project, but these steps must be taken at the very inception of the project if they are to be effective.

The most effective and cost efficient tool over recent years to avoid and minimise the extent, time delay and cost of construction disputes is the establishment of Dispute Boards.

INTRODUCTION TO DISPUTE BOARDS

There have been numerous articles written and seminars conducted to promote the use of Dispute Review Boards (DRBs) or Dispute Adjudication Boards (DABs) and to praise the phenomenal success that it is claimed the process has achieved in reducing the number of formal disputes on Construction Projects and the consequential reduction in cost of claims and time delays. There are far fewer articles that I am aware of dealing with Dispute Boards, which have for one reason or another been almost ineffective, or worse, where the process may have been misconducted to such an extent that the parties would have been better off with a conventional determinative process such as Arbitration or Expert Determination.

Overview

Before I deal with potential problems arising from the less successful Dispute Boards I have had experience with, a brief overview of the recognised Dispute Board models in general use in various parts of the world will assist in the evaluation of a successful formula for DBs. I have used the term Dispute Board (DB) to collectively refer to all types of Boards including Dispute Review Boards and Dispute Adjudication Boards all of which I shall briefly describe in before addressing what I see as potential difficulties with the FIDIC 4 and MDB models.

Some of the following background information has been extracted from a paper by Peter Chapman titled Dispute Boards on Major Infrastructure Projects and presented at the DRBF Budapest Conference in 2006. This paper, which Peter Chapman kindly gave me permission to include and present at three ACEA/DRBA seminars conducted in Australia in 2006/07, has been widely referred to since in Australia by various presenters.

Brief History

The World Bank (WB) promoted the use of a Dispute Board on El Cajon project in Honduras in 1980 and has been advancing the use of DBs on its projects since, mainly through the FIDIC contract provisions, culminating with the adoption of the MDB (Multilateral Development Banks) Harmonised FIDIC Conditions of Contract in March 2006 as the standard form of contract for all new projects. Under the MDB Harmonised FIDIC Contract, the establishment of a Dispute Board is mandatory. The Procurement Rules of eight of the major international development banks have now accepted the MDB contract, which requires the establishment of DBs before commencement of the contract.

The DRB Foundation was established in the USA in July 1996 and has been promoting and developing the use of Dispute Review Boards on numerous projects in the US.

So what is a Dispute Board and why has the concept been so widely accepted as the preferred dispute resolution process on construction contracts around the world?

A Dispute Board generally consists of 1 or 3 impartial, experienced and suitably qualified individuals.

The Employer and the Contractor each selects one member subject to approval by the other party – the two members so selected then agree on a third member (subject to the approval of the other two contracting parties) who becomes the chairman.

There are three main international models for the establishment, use and operation of Dispute Boards.

DRB – Dispute Review Boards - Dispute Resolution Board Foundation

DRBs receives submissions, conduct hearings and provides non binding recommendations which will become contractually binding within a certain time period (28 days) if neither party to the dispute issues a “Notice of Dissatisfaction”. Non-compliance may be breach of contract. Enforcement is through arbitration or litigation.

The DBRF keeps data on DRBs, which now (2007) total over 1,200 in North America “aggregating more than US$90 billion in construction cost. Roughly 1,500 DRB recommendations have been issued, and, of these, all but a handful has been adopted by the parties, thereby avoiding costly time consuming arbitration and litigation.” (DRB Foundation - 2007).

DAB – Dispute Adjudication Board – FIDIC and WB

FIDIC first provided for the optional inclusion of Dispute Adjudication Boards in 1995 -96 as part of the 1987 Fourth Edition of the Red Book and Part II Conditions of Particular Application.

In 1999 FIDIC published three new Standard Conditions of Contract, all of which provides for Dispute Adjudication Boards to resolve contractual conflict.

The DAB may conduct hearings, request submissions, receive evidence, examine witnesses and adopt an inquisitorial approach. The DAB can decide on its own jurisdiction. The DAB under the FIDIC contract provisions delivers decisions, which are binding in the interim. That is, unless a Notice of Dissatisfaction is issued by one of the parties within 28 days, the decision becomes contractually final and binding. If a Notice of Dissatisfaction has been issued the parties must attempt amicable settlement before the matter can proceed to Arbitration.

The **Red Book**, **Conditions of Contract for Construction** provides that a DAB is established at the beginning of the contract unless the parties agree otherwise. It does not contain specific provisions to ensure that a DAB is established at the start of the contract.

This has been addressed in the MDB Harmonised version of the Red Book, the initial Draft of which was released in 2005. Under this contract the Commencement Date

for the contract cannot start until a Dispute Board (DB) has been established. Whilst the name of the Board is different, the rules for the conduct of the Board and the adjudication agreements are almost the same as for the Standard 1999 Red Book.

Gordon Jaynes, in an article headed “Dispute Boards – Good News and Bad News” published in The International Construction Law Review in 2006, discussed and compared the 2005 Draft Harmonised Conditions of Contract with the FIDIC 1999 Conditions of Contract. In his comparison and evaluation of the two contract conditions, Gordon Jaynes flagged possible misunderstandings or arguments flowing from the deletion of the certain text from the MDB Harmonised contract document allowing the parties “at any time the Parties so agree”, to refer a matter to the DAB for it to give its opinion. In FIDIC 1999 Conditions of Contract this very important provision is stated in Sub-Clause 20.2 of the contract.

In the Draft MDB Harmonised version, as is the case in the FIDIC 4 1995 provisions, the authority of the DB to give advise and/or opinions if requested to do so jointly by the Parties, is only contained in the Agreements.

The Agreements are not always available in the site copies of the Contract documents and the Employer, Contractor and Engineer through their site representatives are often not aware of their existence. I have seen many instances where the Agreements, which are nearly always signed after the Contract has been executed and work commenced, are not even part of the Contract documentation. In these situations problems and disagreements over the Engineer’s decision on many matters have been referred directly to the DAB for determination, circumventing the Dispute Resolution/Avoidance function of the DAB.

The article by Gordon Jaynes must have influenced the authors of the MDB Harmonised version, because the text was reinstated in Sub-Clause 20.2 in the Final version of the MDB Harmonised Conditions of Contract dated March 2006, but not so in the FIDIC 4 Conditions of Particular Application which are now superseded, yet FIDIC 4 has been, and still is, extensively used on many projects in the Asia/Pacific area despite the various revised MDB Procurement Guidelines which require the MDM Harmonised Conditions of Contract to be used. Most MDB funded projects that I am aware of, where the procurement process was substantially underway in March 2006 when the Harmonised version was published, have FIDIC 4 contract provisions.

There are also projects, which have been procured at least 12 months after the MDB Harmonised Conditions of Contract was published, i.e. during 2007, where the MDB funding the project has insisted that FIDIC 4 be used.

The FIDIC 4 DAB provisions, when considered by the Parties in isolation from the Tripartite Agreements, can cause major problems on a project and reduce the DB to just another Arbitration tribunal.

FIDIC DAB PROVISIONS REGARDING ADVISORY OPINIONS

The main features of the MDB Harmonised and FIDIC 1999 DAB provisions which make the process different from other determinative processes such as arbitration

and litigation is the ability for the Employer and the Contractor to jointly obtain advisory/informal opinions on any simmering issue before it develops into a fully blown dispute requiring a determination (win/lose situation). Advisory opinions, or informal opinions as they are also called, give the parties the benefit of expert advice, which will generally give the parties a platform on which to discuss the matter further, and, hopefully, reach an amicable settlement.

Once an issue has been referred to the DB as a dispute, the DB cannot be asked to give advisory or informal opinions and the matter must be determined. It is therefore important that the advisory opinions be sought before a dispute is submitted to the DB for determination, or else the most important purpose of the DB is lost; namely the Dispute Avoidance function.

Although the parties have another opportunity to reach an amicable settlement after the DB has issued its Determination, it is more expedient and more beneficial for the relationship between the parties if the matter can be informally determined and a basis for negotiations established without proceeding to a formal determination.

The opportunity for further amicable discussions after a determination arises from the provision that either the Employer or the Contractor may issue a Notice of Dissatisfaction within 28 days after the DB's decision has been issued. The Notice of Dissatisfaction allows the dissatisfied party to have the matter re-determined by an arbitral tribunal, but only after further attempts to reach amicable settlement or agreement have been explored.

It must also be remembered that the Board's decision is binding on the parties, as well as the Engineer, in the interim. That is, the Employer and the Contractor must comply with the decision until it has been reviewed and/or revised by an arbitration process.

Thus, the importance of involving the Dispute Board at the earliest possible stage whenever a disagreement or an unusual or unscheduled event occurs cannot be overemphasised.

It is the very basis of the Dispute Avoidance process.

Recommendations

These recommendations have arisen as a direct result of my evaluation of the performance of DBs on several major road projects, including one on which 80% of decisions handed down by the DAB over a certain period of time have been invalid.

In considering possible future options and amendments to the DB provisions in the FIDIC Yellow, Silver and DBO Contracts, apart from the rather obvious requirements for consistency between the contracts, the main emphasis must be on ensuring that the implementation of the DB provisions generally accord with the intentions of the DB concept and are not thwarted by either the Employer or the Contractor. The mere fact that the Employer is a major Public Authority with tens of thousands of employees is no guarantee that the DB provisions in a contract will be properly

implemented, or that the bureaucrats administering and controlling the project understand the concept. Political interference may further erode the process.

Similarly, a well known and well established international contractor is only as informed and as competent as the Project Manager and the Team appointed to run the Contract and none of whom may have any previous experience of Dispute Boards.

The main reason, and often the only reason that DB provisions are included in a Contract in a developing country, is that the project is a major infrastructure project financed by one of the major Multilateral Development Banks (MDBs) and the Procurement Guidelines of these MDBs provides that standard FIDIC Contracts are used which makes the inclusion of DB provisions compulsory and therefore a condition of the loan approval.

That is generally the only involvement the Bank will have with the DB process, and if, or when, the parties fail to properly appoint a Board, or refer matters which should properly have been brought to the Board's attention, to the Board, the Bank has no contractual involvement and very little influence if dealing with a recalcitrant Employer and/or Contractor. Mostly the Project Staff of the Bank associated with the Project have no in depth experience with Dispute Boards and are generally no better informed than the Employer and the Contractor as to the proper function and operation of a Dispute Board.

The MDBs can only influence the DB process at the pre-loan approval stage, and there are no effective provisions which allows the MDB to interfere with or ensure that the DB continue to perform once the members of the Board have been appointed and the Board has been established.

The Board member selection process is often flawed resulting in members with insufficient experience and understanding of the process being appointed, often because a local member is far cheaper than an international well-known adjudicator. In some jurisdictions a qualified lawyer/arbitrator may happily accept fees of US$200 per day whilst the accepted international fee for DB members may be US$3,000 per day. There can understandably be resentment by the Employer to agree to expat Board members earning 10 -15 times more than local candidates, who both the Employer and the Contractor may also consider to be more suitable because of their intimate knowledge of local language, culture and customs. Two local board members are of course more likely than not to propose a local chairman.

Assuming that most of these members can be, and often are, accredited arbitrators in their own jurisdictions, this can result in a highly qualified Dispute Board which can tackle most problems as they arise, in particular those associated with local issues such as land acquisition and relocation of affected persons.

However, this is not always the case, and my experience is that the DB will not always be effective unless the individual Board Members as well as the staffs of the Employer and the Contractor have some understanding of the DB concept. Many developing countries have had limited exposure to the DB concept, and the Employer in particular may not have had any previous experience with DBs. It is in such situations that problems may arise.

In order to improve the process in situations where one or more of the participants are unfamiliar with the DB concept, one option is to provide an introductory Training Workshop at the outset of the contract.

The MDB, which provides funding for the project is in the best position to control the implementation of the DB process and is also in a position to persuade the Employer to arrange for Training Workshops to be conducted.

By amending the Procurement Guidelines and Loan conditions, a MDB may insist that suitable Training Workshops, run by one or more experienced and qualified adjudicators, are conducted before the project starts. The MDB may also allow itself to monitor the DB process to ensure that the DB members as well as the parties comply with the contract provisions and the Tripartite Agreements.

Regular site visits at intervals not more than every 140 days are not only strongly recommended to keep the DB members informed of the project, but such site visits are also mandatory under the Tripartite Agreements regardless of which version of FIDIC contracts are used, except for the Yellow and Silver books. The latter Contract Documents as well as the recently released FIDIC DBO Conditions of Contract, also have no reference in Sub-Clause 20.2 for advice or opinions.

The concepts considered may involve separate finance by the MDB to cover the cost of an international Chairman (similar to the way that the Supervision Consultants are funded), as well as financing training packages for the contracting parties and the DB members, with particular emphasis on training for local inexperienced DB members, as local members often seems to be the preferred option by the Employer in particular. The project staff of the relevant MDB ought also to participate in the Training Workshops, as they must be in a position to determine if the process is running smoothly.

It is clearly preferable that the Chairman at least, should be seen as being independent with no ties to either the Employer or the Contractor, but if the contracting parties are not agreeable to this, it is advisable that in this situation the Arbitration tribunal should be seated outside the country of the project and consist of internationally appointed arbitrators in accordance with the default provisions in the FIDIC contracts.

An expat Contractor may justly feel at a disadvantage if the DB consists of three members of the Employer’s nationality as the Employer and the Arbitrators are also to be appointed by a local national authority and the arbitration conducted in the country of the project.

The establishment of Dispute Boards as part of standard contract conditions on major international infrastructure projects have proven very successful in reducing formal disputes and reduce the costs associated with more formal dispute resolution processes such as litigation and arbitration. It is a relatively new process which is still developing, and this report has addressed problems which may not occur regularly on construction projects, but when they do, are difficult to overcome with the present contract and procurement provisions.

The inclusion of the proposed provisions will have no effect on contract conditions and the proposed amendments to the Dispute Board provisions in the Yellow and

Silver Contracts, is merely to bring these into line with the MDB Harmonised and 1999 FIDIC Contract conditions relating to the advisory role of the DB by specifically including the provision in the General Conditions of Contract as well as in the Tripartite Agreements. All Contracts ought to state within Sub-Clause 20.2 that the Tripartite Agreements (General Conditions of Dispute Adjudication Agreement) will be part of the Contract once signed, regardless of when they are signed.

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