

A DAM GOOD THING

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Glj4law@aol.com

“The world requires at least ten years to understand a new idea, however important or simple it may be.” -- Sir Ronald Ross

Sir Ronald was a 19th century English physician. While a junior “Doctor” and not yet a “Sir” he worked for the Indian Medical Service in a field hospital in Secunderabad, India. At that time, it long had been thought that the worldwide killer disease, malaria, was transmitted by “noxious effluvium,” or bad air. Dr. Ross thought not. He was drawn to the hypothesis that mosquitoes propagated the disease.

In 1894, he began experimental investigation and in 1897, confirmed that malaria was transmitted by the *Anopheles* mosquito. But his findings were not generally accepted until after 1903. Then, largely for his work on malaria, he was awarded the Nobel Prize for Medicine in 1904, ten years after his investigation had begun.

Even after that recognition, there were doubters that such a tiny insect could be the carrier of the dreadful disease and despite the deaths of many workers on the construction of the Panama Canal over a period of more than a year and a half, it was not until the Autumn of 1905 that the Canal project physicians overcame disbelievers and got funding to rid the Canal area of mosquitoes. The much-publicised success of thereby stemming malaria in the Canal Zone finally led to general acceptance, worldwide, that it was the mosquito, not bad air, which transmitted the disease.

Ross was right: no matter how important or simple it may be, it seems to take about 10 years for the world to understand a new idea. In the case of the “new idea” we are discussing today – Dispute Boards -- it took almost exactly 10 years for The World Bank to “sell” the Dispute Board to all of its colleague Multilateral Development Banks.

That story begins more than two decades ago when what I have called a “dam good thing” happened: The World Bank experimented with the use of the Dispute Board concept on the contract for the construction of Latin America’s highest concrete high arch dam, for the El Cajon Hydroelectric Project in Honduras.

The use of the Board was a success, which was good for the dam, good for the Contract Parties, good for the Bank, and eventually good for the international construction industry: all disputes on El Cajon were resolved amicably by the time construction was complete. There was no resort to arbitration. Indeed, the Parties arranged for the Board to be available during a one year period after construction, in case any disputes arose during what used to be called the “Maintenance Period” (now called the “Defects Liability Period”) for the dam.

After that experience, the Bank studied further the use of the Dispute Board as a tool for amicable settlement of disputes, and after due consideration introduced the tool permanently into the January 1995 edition of its Standard Bidding Document “Procurement of Works.”

Just over 10 years later, in May 2005, the Bank introduced the new “FIDIC MDB Harmonised Edition of the Conditions for Construction” as part of the Bank’s SBD “Procurement of Works and User’s Guide.” That introduction was the culmination of much effort by the Heads of Procurement of the Multilateral Development Banks (or “MDB”) and International Financial Institutions to establish “harmonised” Conditions of Contract, as part of the overall “harmonisation” of their procurement practices, pursuant to their 2003 Rome Declaration on Harmonisation.

The current edition of the FIDIC MDB Harmonised Edition was published in March 2006 and is available on line at www.fidic.org/bookshop as part of the contents of the “Supplement” to The FIDIC Contracts Guide.

Although Dispute Boards have developed in various forms since their inception, this paper addresses only the form established by the MDBs.

What is the Dispute Board?

It is an entity created pursuant to Clause 20 of the MDB Conditions, at or near the start of a Works contract for the purpose of dispute *prevention* and, for any dispute which cannot be prevented, making a decision on that dispute. It can be one person or three persons, typically depending upon the complexity of the Works and the amount of the Contract Price. The number of persons is to be stated in the Contract Data sheets which form part of the Invitation to Bid. The Board serves for the life of the Works contract.

Who are the “ persons” ?

The individuals are required to be “professionals “experienced in the type of construction involved in the Works and with the interpretation of contractual documents.” They must be “fluent in the language for communication defined in the Contract.” Also, in serving as DB members they undertake to abide by (and be liable for failure to observe) various commitments made in the Agreement which they sign to govern their service to the Parties to the Works contract. (These commitments primarily relate to maintenance of independence from, and impartiality toward, the Parties and the Engineer engaged by the Employer to supervise the construction of the Works.)

What is the definition of “professionals”?

The MDB Conditions do not define the term. Generally DB members have been senior engineers with strong experience in the engineering disciplines involved in the contract Works. However, other professions serve, too: architects, contract specialists (for example, UK Chartered Surveyors), and some lawyers (although lawyer members typically also are qualified as engineers or their law practices have been devoted to the engineering and construction industry). Because of the powers the Parties are conferring on them the DB members are apt to be prominent in their professions.

How are DB Members selected?

For a three person DB, each Party to the Works contract – the Employer, the Contractor – nominates one candidate for the approval of the other Party. The first two agreed Members propose a third person for the Parties' approval. The approved third person serves as Chairman. For a one person DB, selection is by agreement of the Parties.

The MDB Conditions include provisions regarding selection in the event there is a failure to nominate or an inability to agree, and provisions regarding replacement of a DB Member in the event of death or disability, or resignation. Neither Party to the Works contract can terminate a DB Member's contract without the prior agreement of the other Party.

How does the DB operate?

At or near the start of construction on Site, it makes the first of its regularly scheduled Site visits. These visits are to be at intervals of not more than 140 days. For a large or complex project, a visit every 3, or perhaps 4, months would be normal. The DB also can be summoned to the Site by either Party for an unscheduled visit at the time of "critical construction events." This is intended to cater to an event which either Party considers may give rise to a dispute, and in circumstances where progress of construction may impede the DB's ability to assess the event if assessment is deferred until the DB's next scheduled Site visit.

Between regular Site visits, the DB receives the typical monthly reports of progress, including statistics, charts, photos, key correspondence and Minutes of Meetings relating to the Works' progress, technical problems, claims, Variations, and any revisions to the Programme. The DB is obliged to become and remain familiar with the Contract Documents and the progress of the Works. It is common also for the DB to receive copies of the typical monthly report of the Engineer to the Employer, although information confidential between the Engineer and the Employer may be omitted.

During regular Site visits, the DB is accompanied by representatives of the Parties to the Works Contract and the Engineer. Typically, a visit begins with a "tour" of the Site which is followed by an informal meeting at which the progress of the Works is discussed, during which the DB will explore whether there are any disagreements among the Works Contract participants, and if there are, will seek details, and try to assist toward amicable resolution of the disagreements. The MDB Conditions include the express duty of the DB "to endeavour to prevent potential problems or claims from becoming disputes."

Claims by either the Contractor or the Employer are processed by the Engineer, who is obliged to make a timely determination of each claim. If either Party is dissatisfied with that determination, and if the DB cannot prevent the matter from becoming a dispute, the dissatisfied Party can refer the dispute in writing to the DB, which is obliged to produce a written decision.

How does the DB process a dispute which is referred to it?

The MDB Edition requirements are set forth on less than one page. The DB has full power to establish the procedure to be applied in deciding a dispute, including making decisions on its own jurisdiction, and according provisional relief such as interim or conservatory measures. It can open up, review or revise actions of the Engineer relevant to the dispute. It can conduct any hearing on the dispute as it sees fit, not being bound by any rules or procedures other than those contained in the Works contract and that one page of Procedural Rules.

Under those Procedural Rules, the DB must “act fairly and impartially as between the Parties, giving each a reasonable opportunity of putting his case and responding to the other’s case” and must “adopt procedures suitable to the dispute, avoiding unnecessary delay or expense.”

Typically a DB will require each Party to make written submissions to the DB regarding the dispute, and more often than not, the DB will hold a hearing (especially if either Party has requested one). At the hearing, the DB will wish to hear from those persons engaged in the day-to-day construction of the Works, and the DB likely will be inquisitorial. The hearing will be informal compared to an arbitral hearing where lawyers conduct the proceedings.

The DB is required to endeavour to reach a unanimous conclusion, but if it cannot, the decision is made by majority. The majority may require the minority to prepare a written report for submission to the Parties, along with the written decision of the majority. Written decisions are required to be “reasoned” and must be delivered within 84 days after the DB receives the written reference to it of the dispute.

The decision is immediately binding on the Parties and they must “promptly give effect to it unless and until it shall be revised in an amicable settlement or an arbitral award” pursuant to the Works Contract.

What are the steps to obtain such revision?

Either Party and give notice of dissatisfaction with the DB decision and if that is done within 28 days of receipt of the decision, even though the decision is binding and must be given effect in the interim, the Parties are obliged to attempt amicable settlement before the commencement of arbitration. The minimum duration for such attempts is 56 days. Thereafter either Party is free to commence arbitration. Of course, even after commencement of arbitration the Parties have the power to settle amicably.

Why do the MDBs want their borrowers and aid recipients to use DBs?

Broadly, because of the success of DBs in avoiding disputes, and when disputes are unavoidable, issuing decisions which lead to amicable resolution without arbitration. According to statistical analysis of records assembled by the Dispute Resolution Board Foundation, or “DRBF,” some \$90 billion of construction disputes have been resolved by DBs. (www.drb.org)

What is the cost of a DB?

The cost is shared equally between the Parties. It can be argued that because the Bidders know there will be a DB, and that half of its cost will be met by the Contractor, Bidders may include some amount for that in the Contract rates and prices which it bids; however, in some Bids, the Bidders have undertaken not to do so.

Obviously, the cost of a DB varies between a one person DB and a three person DB. Cost also varies with the length of the Contract Programme. The DRBF statistical analysis indicates that cost ranges from 0.05 to 0.24% of the final Contract Price, with an average of 0.15%. However, it should be noted that the DRBF statistical analysis includes a large number of domestic USA DBs, which tend to be less expensive than international ones, in part because of higher travel costs of international work.

The major cost arises from the fees paid to the DB members. The MDB DB members receive a monthly retainer fee plus a daily fee for Site visits, study of written submissions of the Parties regarding disputes, hearings on disputes, and private meetings for preparation of the written decisions on disputes.

Although the MDB Edition does not contain guidance on the amount of reasonable fees for DB members, The World Bank has indicated in earlier editions of the "Procurement of Works" SBD that unless the Parties agree otherwise, the daily fee should be the same as the daily fee for arbitrators under the procedures of the International Center for Settlement of Investment Disputes ("ICSID"), currently \$3000 per day, and the monthly retainer should be three times the daily fee.

Arbitration

The MDB Edition prescribes arbitration as the ultimate method of final settlement of disputes. For domestic contractors, arbitration is to be under the laws of the Employer's country. For foreign contractors, international arbitration administered by the institution named in the Contract Data, conducted in accordance with the arbitration rules of that institution or the UNCITRAL Rules, at the choice of the named institution. It is yet to be clarified which arbitration procedure will apply to joint ventures of domestic and foreign contractors.

For those unfamiliar with international arbitration, UNCITRAL is the acronym for the United Nations Commission on International Trade Law. Examples of popular institutions for administration of international arbitration are the International Chamber of Commerce International Court of Arbitration, the London International Court of Arbitration, the American Arbitration Association, and the Swedish Chamber of Commerce.

Two important points should be noted. First, international arbitration of international construction contracts has become a lengthy and very expensive process, and in many cases the expense includes having to pay at least a substantial part of the costs of the winning party. It is quite possible for the expenses of a losing party to exceed the amount originally in dispute. Second, under the MDB Edition, the written decision of the DB is stipulated as admissible in evidence in any arbitration. Experience suggests that the burden of proof on the party challenging the DB decision is heavy indeed.

Turning from our review of the DB and its role in dispute resolution under MDB-financed Works contracts:

What problems have arisen in use of DBs for MDB-financed contracts?

1. Lack of training: Especially among borrowers and aid recipients, there is seldom full understanding of the DB and how to use it successfully. The MDBs have recognised also that their own staffs need such training. It is hoped that the MDBs will fund and oversee training for not only their staffs but also the staffs of borrowers and aid recipients.

Meanwhile, persons serving as DB members should assure that early meetings with the parties and the Engineer include detailed review and discussion of the DB provisions of the Works Contract, and how they will be implemented successfully.

2. Misguided efforts to “economise” on DBs: For DBs to function properly, it is crucial that they be established at the outset of a contract and make regular Site visits at intervals matching the pace of construction. Past errors of borrowers and aid recipients include:

(i) asking the Contractor to defer DB establishment until disputes arise, so avoiding the cost of DB member fees and travel expense until there are disputes to resolve;

(ii) reducing frequency of Site visits or even eliminating Site visits;

(iii) eliminating the monthly retainer fee for DB members, and ignoring the fact that without a retainer fee the DB members will be reluctant to agree to availability on only 28 days notice;

(iv) seeking to pay the lowest possible daily fee to DB members. In some instances, borrowers or aid recipients have used price competition and contracted with the lowest bidder which is not conducive to securing optimal service from a DB member.

The Future

DBs seem likely to remain a feature of Works Contracts which have financing from the the MDBs. Probably refinements will be made to the MDB Edition of the FIDIC Red Book as experience in use increases, including refinements to the DB provisions. However, now is the time to become familiar with the details of the establishment and operation of DBs, as they already are “a dam good thing”!

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