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SESSION 3 – THE DAB ADJUDICATION:
DECIDING DISPUTES BY PROPERLY BALANCING CONTRACT AND GOVERNING LAW

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INTRODUCTION

1. This paper addresses some of the issues likely to arise in disputes reaching a Dispute Adjudication Board (DAB) where a particular governing law has been selected by the parties.

2. Some of the potentially relevant differences that might arise from the choice of governing law are highlighted.

3. Reference is also made to the approach of courts in a common law jurisdiction (UK[1]) and in a civil law jurisdiction (Switzerland[2]) to the question whether the requirement to refer a dispute to adjudication at FIDIC clause 20 is mandatory.

THE RELEVANCE OF THE GOVERNING LAW

4. Disputes coming before a DAB may involve technical issues and not raise difficult questions of law. However, many disputes will have to be decided by the application of legal principles arising from the contract terms and/or the governing law.

5. Part of the commercial bargain agreed between the parties will normally have involved an agreement as to the governing law which will determine the legal principles by which a dispute must be decided.

6. This will be of particular importance where parties come from different cultural and legal backgrounds and may have very different expectations as to how the terms of their contract should work or the legal implications of the conduct of the parties.

7. Sometimes the choice of governing law will have been deliberate and the result of advice and careful consideration or the result of negotiation. Sometimes the

[1] Peterborough City Council v Enterprise [2014] EWHC 3193
[2] Swiss Federal Supreme Court Case no. 4A_124/2014

decision may have been fortuitous or little attention paid to the implications of the choice of law and the results of its application to the issues in a dispute may turn up surprises.

8. In some cases the DAB may be faced with an unclear or ambiguous choice of law clause and have to resolve the governing law before then applying it to the dispute.

9. In all cases attention must be paid by any decision making body, including a DAB, to the relevant principles of the governing law. The correct approach to the interpretation of contract terms and the possible inclusion of implied terms may also be affected by the choice of law.

STRAIGHTFORWARD DISPUTE OR DECEPTIVELY COMPLEX LEGAL PROBLEM

10. More often than not what appears initially to be a straightforward claim for payment of outstanding invoices during the course of a project, raising apparent performance/defects issues, can raise complex factual and legal issues made all the more difficult to resolve by a rapid dispute resolution process.

11. For example, in a Rapid Adjudication involving a claim for allegedly outstanding invoices made by a contractor against an employer during the course of a fabrication contract for modules for an FPSO project, the following issues required addressing:

    a. Whether there was a side-agreement providing for a stay of payment.

    b. Whether any such agreement was void for uncertainty/lack of consideration/economic duress.

    c. If valid, what was the proper interpretation of the terms of any such agreement.

    d. Whether certain terms such as an obligation to cooperate were to be implied into the contract.

e. Whether the legal concept that a party should be prevented from benefitting from its own wrong applied.

f. Fortunately, there were no complications arising from the governing law!

THE NEED TO GET THE DECISION RIGHT

12. Where a dispute raises a question of legal principle it could well be a costly mistake for a tribunal/DAB not to address head-on an issue involving the correct position under the governing law because this could then set in train a lengthy and costly dispute resolution process that would be inconsistent with the purpose of the DAB process.

13. The UK has nearly 20 years of jurisprudence arising from the widespread popularity of the adjudication process in the construction industry. Whilst most disputes proceed no further than adjudication, where the adjudicator gets it wrong and either a large amount is at stake or the result will affect a long term contractual relationship, the dissatisfied party is likely to take the matter further and this could lead to costly or time consuming arbitration and/or litigation.

14. A classic example arose in the case of Atkins v Sec State Transport TCC [2013] in the context of a highways maintenance contract in the UK based upon the NEC3 form. The dispute involved the question whether the fact that a contractor faced a higher than expected frequency of potholes amounted to a "compensation event" entitling it to more money. This was a question of interpretation of the relevant provisions of the NEC3 contract in the context of the contractual allocation of risk. The parties hoped to resolve their dispute by adjudication. The adjudicator held that an excess volume of potholes amounted to a "defect" entitling the contractor to compensation. The employer disagreed and referred the issue to arbitration, as a result of which the arbitrator came to the opposite conclusion. The court supported the arbitrator's conclusion when a challenge was brought on the basis of "serious irregularity". A question of contractual interpretation originally referred to a 28 day adjudication process took a year and three forms of process to determine.

EXAMPLES OF DIFFERENCES ARISING FROM THE CHOICE OF GOVERNING LAW

15. A very broad comparison of the laws of a common law jurisdiction (for example, the UK), a civil law jurisdiction (say, France or Germany) and a jurisdiction from the Far East, more often than not based upon civil law (Korea, for example) reveals a number of respects where the choice of governing law may affect the determination of an issue in a typical international construction or infrastructure dispute.

16. To set the scene let us take the following (hypothetical) project:

    a. The construction of a desalination and power plant in a North African jurisdiction with a local government/state Employer and, for example, a Korean Contractor.

    b. Initial difficulties are experienced by the Contractor with mobilisation, visas, customs clearance of equipment all causing delays.

    c. The costs of steel increase beyond all expectation; the Contractor requests an increase in the contract rates for "exceptional circumstances".

    d. Personnel cannot be issued with visas to enter the country because of civil unrest. This situation threatens to continue for an extended period and the Contractor seeks to be excused from performance because it cannot mobilise essential management personnel.

    e. Works eventually proceed, but the Contractor meets unforeseen ground conditions and delays with obtaining permits. The Contractor fails to meet programme milestones and there are quality issues over the work. Works reach a point where the Employer determines the Contract and appoints a replacement Subcontractor to complete the works.

f. The Contract terms relating to termination are unclear. The Employer contends that it can determine for convenience or without cause.

g. The Contractor contests this entitlement and contends that it would be a breach of good faith for the Employer to determine because it has fully mobilised and is proceeding with the works.

h. The Employer claims damages including liquidated damages for delay. The Contractor contests this and contends in any event that the rate is excessive and cannot be justified by any loss the Employer might have suffered.

i. The Contractor itself claims damages for the Employer's breach of contract in terminating the Contract covering a range of categories of alleged loss including valuation of work done, additional costs, disruption costs, prolongation costs, loss of profits and loss of goodwill and reputation. In response the Employer relies upon a limitation/exclusion clause exempting it from liability for indirect or consequential loss.

17. The purpose of this scenario is to highlight the potential impact of the choice of governing law upon the resolution of issues referred to the DAB. Seven possible areas of difference are flagged as examples with brief comments below:

(1) DIFFERENT APPROACH TO INTERPRETATION OF CONTRACTS

18. Common law and civil law jurisdiction take a different approach to the interpretation of contract terms, which may or may not be significant in a particular case. The approach under English common law has been recently expressed in the Supreme Court in the 2011 case of Rainy Sky v Kookmin Bank[3]. This case, concerning shipbuilding refund guarantees, involved a clarification of the fundamental principles of contract interpretation and the confirmation that where a

[3] [2011] UKSC 50

clause is open to more than one interpretation the one which is most consistent with business common sense should be adopted.[4]

19. The most recent statement of the approach of the courts to the question whether terms should, as a matter of English law, be implied in a contract was by the Privy Council in 2009 in the case of AG of Belize v Belize Telecom Ltd[5]. The PC held that the answer to the question whether a term should be implied in a contract is whether the provision would spell out in express words what the instrument read as a whole against the relevant background would reasonably be understood to mean.[6]

20. I defer to my colleagues on the panel for the correct approach under civil law.

(2) EXCEPTIONAL CIRCUMSTANCES

21. If circumstances change through no fault of the parties, will the contract be varied, for example in relation to price? English law does not recognise any such doctrine of "exceptional circumstances" unless the situation amounts to frustration of the contract. It is understood that this may be a possibility in certain civil law jurisdictions, for example in Germany (per section 313 of the Civil Code) and exceptionally in Korea (based on the principle of "good faith").

(3) EXCUSED FROM PERFORMANCE/FORCE MAJEURE

22. Under English law, there are no default rules of force majeure entitling a contractor to relief in the absence of a contractual provision. FIDIC clause 19 provides such a structure whilst preserving further grounds allowed by the applicable governing law under Clause 19.7.

(4) TERMINATION FOR CONVENIENCE

23. Under English law (and that of Korea), termination for convenience is only possible if there is a contractual provision to that effect.

[4] At paragraphs 29 and 30
[5] AG of Belize v Belize Telecom Ltd [2009] UKPC 10
[6] Paragraph 21 of the judgment.

24. It is understood that this may be a possibility in certain civil law jurisdictions, for example in Germany (per section 649 of the Civil Code), subject to compensation. This entitlement can be excluded by agreement.

25. FIDIC clause 15.5 entitles the Employer to terminate for convenience (with the stipulated consequences) but with the limitation that this shall not be done with the intention of executing the works itself or to employ another contractor to do so.

(5) DOCTRINE OF "GOOD FAITH" AND IMPACT ON THE EXERCISE OF A CONTRACTUAL DISCRETION TO TERMINATE

26. Under English law, an Employer's contractual entitlement to terminate for convenience would not be affected by any implied duty of "good faith".

27. A partnership contract will often include a term suggesting an obligation on the parties to act in good faith. For example, the NEC3 Contract[7] requires the parties to "*act as stated in this contract and in a spirit of mutual trust and co-operation*". But the English courts construe any such clause narrowly. English law has historically refused to recognise an implied contractual duty of good faith. Recently, in TSG Building Services v South Anglia Housing Limited, the TCC was faced with a case involving a partnering agreement for a term of four years for the maintenance of housing stock for a Housing Association Company.[8] The contract included a clause requiring the parties to work "*in mutual cooperation to fulfil their agreed roles and responsibilities and apply their agreed expertise in relation to the Term Programme…*".

28. The issue was whether the obligation to cooperate qualified the apparently unfettered contractual right of the Employer to determine the contract for convenience. The Court considered prior cases[9] that had examined the issue of implication of a term of good faith, but reached the clear conclusion that the express term requiring mutual cooperation did not affect the right of the Employer

[7] NEC3 Engineering and Construction Contract April 2013
[8] TSG Building Services v South Anglia Housing Limited [2013] EWHC 1151
[9] Yam Seng v ITC [2013] EWHC 111, and Mid Essex NHS Trust v Compass Group [2013] EWCA Civ 200

to terminate and further decided that there was no room for an implied term of good faith in the light of the parties' clear agreement. Some of the current cases are of interest in that some judges are more sympathetic to the issue of implication of a term of good faith similar to the law in some other jurisdictions. It is not however the case yet under English law.

29. Most civil law jurisdictions (including France and Germany) recognise a duty of "good faith" which may qualify a party's entitlement to exercise its contractual rights in certain circumstances. It would be interesting hear whether a French or German court would have reached a different answer in the circumstances of the TSG case.

(6) LIQUIDATED DAMAGES

30. Under English law the enforceability of a liquidated damages clause is subject to the doctrine of penalties. Traditionally, this rule has been to the effect that if the figure for liquidated damages was not at the time of the agreement a genuine pre-estimate of loss but was extravagant and unreasonable in amount then the clause would be struck down and would be unenforceable. The Court of Appeal has recently re-stated the law on penalties in the case of Makdessi v Cavendish[10] albeit in the context of a clause in an agreement for the sale of shares. In doing so it helpfully reviewed in detail the cases on liquidated damages applicable to construction contracts.[11] The case has added a gloss on previous statements of the rule in that even if the clause was not a genuine pre-estimate and appears to be a penalty then it may be saved if there was a sound commercial justification for it[12]. In the Makdessi case itself the clause was struck down.

31. In many civil law jurisdictions, the courts will have a discretion to modify a liquidated damages clause without striking it down. In France, such a clause can be modified if manifestly excessive or if derisory. In Germany a court will adjust the

[10] Makdessi v Cavendish Square Holdings BV [2013] EWCA Civ 1539
[11] Paragraphs 54-83
[12] Paragraph 104

rate if too high. In Korea also, a court may adjust such a clause in accordance with the Civil Code.

(7) EXCLUSION CLAUSES

32. In the interest of achieving certainty in capping potential liability, parties frequently include limitations clauses including financial caps on liability, limitation by reference to the type of loss, and exclusive remedies clauses.

33. As a matter of English law, the case of Elvanite v AMEC[13] addressed the first two types of clause. A claimant landowner claimed damages for breach of contract and/or negligence against the defendant advisory company arising out of the timing and content of an application for planning permission. The claimant alleged that but for the defendant's breaches of duty in relation to the application for planning permission it would have been able to sell the site at a profit to a specific buyer. The contract between the claimant and the defendant contained a clause which provided that the defendant: "*shall not be responsible for any consequential, incidental or indirect damages*". The Judge concluded that the claim in that case arose not from the defective planning advice but from the alleged profitability of the site and was therefore a claim for indirect loss and damage that was prohibited by the clause. Whilst loss of profit can often be construed as direct loss it was in this case treated as indirect and covered by the exclusion.

34. The precise coverage of such a clause may cause uncertainty for foreign parties in international contracts subject to English law, in respect of which there is case law addressing the definitions.

35. Although civil law systems generally recognise contractual exclusion and limitation clauses the losses covered will generally need to be expressly identified.

[13] Elvanite Circle Ltd v AMEC Earth and Environmental Ltd [2013] EWHC 1191

CIVIL AND COMMON LAW APPROACHES TO THE INTERPRETATION OF FIDIC DISPUTE BOARD CLAUSES

36. In the context of Dispute Boards having received high profile endorsement in NEC3 contracts for the 2012 London Olympic Games where a novel and successful approach to dispute avoidance was adopted with the use of two sets of dispute board panels[14], the Technology and Construction Court was recently required to interpret whether the obligation to refer a dispute to a DAB under FIDIC clause 20 (in this case the Silver Book) was mandatory[15]. The court granted a stay of proceedings in order to allow the contractual machinery to be operated and the dispute first to be referred to an ad hoc DAB.

37. An interesting comparison can be made between this approach and that taken by a civil law court, the Federal Supreme Court in Switzerland[16] in connection with a dispute subject to Romanian law. In that case, the Contractor sought to refer a dispute to a DAB. After 18 months the DAB had not been formed and the Contractor commenced arbitration. The Owner challenged jurisdiction on the basis that the FIDIC procedure had not been followed. The Supreme Court rejected the owner's challenge. Although the court confirmed that the DAB procedure was mandatory, it held that the Owner was precluded from insisting on referral to the DAB on grounds of breach of "good faith" because it had been primarily responsible for the delays in constituting the DAB.

38. In principle it appears that courts from both legal traditions support the role of DABs as first tier decision makers where provided for by contract.

[14] Comprising a Dispute Avoidance Panel and a Dispute Adjudication Panel
[15] Peterborough City Council v Enterprise [2014] EWHC 3193
[16] Swiss Federal Supreme Court Case no. 4A_124/2014

CONCLUSION

39. Given the difficulty of some of the legal issues that accompany claims and defences before DABs and given the differences that might exist under different systems of governing law, it is advisable for a DAB to be equipped to address such situations.

40. If a lawyer from the relevant jurisdiction is on the panel then he/she might address issues arising from the governing law as necessary. If not, then advice will need to be taken by the DAB from a lawyer from the appropriate jurisdiction.

41. I am in any event an advocate of DABs formed of both technical professionals and lawyers!