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SESSION 3 *THE DAB ADJUDICATION - DECIDING DISPUTES BY PROPERLY BALANCING*

CONTRACT AND GOVERNING LAW

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IS THE DAB THE PROPER FORUM WHERE TO DEBATE ISSUES OF LAW?

I. THE DAB MAY BE REQUESTED TO DECIDE IN LAW

1. No contract may stand alone in the absence of a governing law.
2. Sub Clause 1.4 of FIDIC Model typically provides that "*the Contract shall be governed by the law of*" State X.
3. Why is a governing law needed?
 - Contract clauses may need to be interpreted: only a national law provides for rules of contract interpretation.
 - The effectiveness or validity of certain clauses might be disputed: the answer to the question must be found in the governing law.
 - The contract might not be self-standing, *i.e.* might fail to address certain matters: to the extent these matters need to be ruled, the guiding rules are found in the governing law.
 - The contract might not be exhaustive in dealing with different categories of breaches and the consequent liability in law or under the contract: the governing law will provide for the necessary supplementary rules of law.
 - The contract might not be exhaustive in dealing with damages compensation: the governing law will provide for the necessary rules to apply.
 - Pursuant to civil law jurisdiction, contracts must be construed and applied in good faith: in order to understand the implications of this principle in the

matter in dispute, reference shall be made to the governing law and the case law developed thereunder.

- Certain specific clauses might conflict against public policy: whether this is so is established in the governing law, which provides for the relevant consequences.
4. A DAB is appointed to adjudicate “disputes” arising from contractor’s claims (Sub Clause 20.2 - *Appointment of the Dispute Adjudication Board*). The disputes referred to the DAB are better described in Sub Clause 20.4 (*Obtaining Dispute Adjudication Board’s Decision*).
 5. In brief, disputes arise whenever contractor’s claims made under Sub Clause 20.1 are rejected by the Employer’s Representative under Sub Clause 3.5. An inextricable link exists, therefore, between “Disputes” and “Claims”: the disputes referred to DAB have the same object as the claims made by the contractor under Sub Clause 20.1.
 6. Under Sub Clause 20.1, the contractor’s claims are made “*under any Clause of these Conditions of Contract or otherwise in connection with the Contract*”. The “*otherwise in connection with the Contract*” proviso includes claims made in law.
 7. Conclusion: claims made in law may be referred to the DAB either independently, or jointly with claims made under the contract.

II. THE DAB’S PRACTICE WHEN REQUESTED TO DECIDE IN LAW

8. I will focus on some examples taken from cases known to me in order to understand how the DABs address the relevance of the governing law when expressly required to decide the dispute by applying such a law.
9. **Case A:** The contractor contended that the employer had misguided the tenderers through incorrect and misrepresenting information on the suitability of certain materials on site to be used by the contractor during performance phase. According to the contractor, under the governing law this amounted to gross negligence (or even willful misconduct) so that the exculpatory clauses by which the employer had shifted to the contractor the risks on the quality of the materials in question were invalid and not enforceable pursuant to the governing law. Consequently, the DAB was required to apply the domestic law and establish that the disputed clauses were invalid or, in any

case, not enforceable in the specific referral, given the circumstances of the case.

10. Surprisingly, the DAB reasoning was as follows:

[...] the DAB has reached its decision on the merits of this referral without having to decide on the contested interpretation and operation of [domestic] law. This has resulted in the DAB not needing to seek the views of its legal consultant subsequent to the Hearing. It is evident that the interpretation of [domestic] law is still a matter in issue between the Parties and insofar as the matters in this referral are concerned it will, if necessary, be left to other tribunals to finally decide the strongly contested legal issues. This should not be taken by either Party as the DAB shirking its duty to decide disputes, merely that the referring Party has advanced its case on alternate bases and [...] the DAB is alive to the possibility that in subsequent referrals to the DAB the [State X] law issues might arise again but by that time, further guidance from the [State X] courts might be available to the DAB.

[...] As alluded to above, the DAB has found that it is not required to give a decision on the application and operation of [domestic] law in order to reach its Decision on this referral and this matter is not further discussed in this Decision document.

11. Thus, the DAB elected to leave the law aside and reach its decision based on the “alternative” grounds of the claim. It is unclear why the DAB declined to simply apply the law, as requested by the contractor. As seen above, this is part of its mission. In brief, this does not seem to be a satisfactory precedent.

12. However, and this is also unsatisfactory, later on the reasoning the DAB changed its mind. By contradicting the reasoning quoted above, the DAB endorsed the contractor’s allegations of negligence and, on this basis, refused to enforce the contractual limitations of the employer’s liability by making express reference to the law of State X, which provided that in case of negligence by the party benefitting of the limitations the clause ceased to apply.

13. The second (inconsistent) part of the reasoning is worded as follows:

Although the DAB is reluctant to classify any acts of either party as negligent owing to the connotation of the word, in this case the DAB finds that both Parties at the time of tendering anticipated using the [materials in question] as the primary source [for the works]. This intent was fundamental to the viability of the project and as such should have been better investigated by the Employer before the [material in question] was indicated as being suitable [...]. This was not done [...]. The only

organization that could have done this was the Employer and by electing not to perform such investigations whilst encouraging and inducing the tenderers to prepare tenders on the basis of using [the materials in question] the Employer was negligent.

The Employer argues that [...] all the risks relating to the materials found on site were those of the Contractor and that the various caveats in the contract rendered the Employer harmless from any responsibility. In the present case, the DAB cannot accept this position. An Employer, such as [...], has an implied duty not to provide information as being correct that was so fundamental to accurate tendering processes that significant loss or expense would be caused if the information was later found to be erroneous. In other words, the DAB cannot subscribe to the view that the Employer can indicate pre-tender that the intent is for [the materials in question] to be used and that it would therefore be suitable for [the works] and then, later, when the material proved to be unsatisfactory in several ways, seek refuge behind the exclusionary clauses in the Contract and argue that it had no responsibility for misleading the Contractor into a lower price bid in reliance of the Employers intent.

In the opinion of the DAB, the Employer should have known, actually or constructively, of the reliance to be placed by Contractor on the suitability of [the materials in question]. If the Employer had wanted the risk to be taken by the Contractor that the material was unsuitable [...], statements to this effect should have been clearly and unambiguously stated. This was not the case and the tenderers, including [the contractor], were led to believe that they were secure in pricing the Works on the basis that [the material in question] generally were good. Alternately, [the employer] should have undertaken more extensive investigations into the overall suitability, practicality and feasibility of the use of this material before inviting tenders. [The contractor] relied on the [material in question] as being the most appropriate source of feedstock material. And did not allow in its price for any risks in covering the consequences should the material not prove suitable. The DAB considers it is unjust in any system of law to allow a party to benefit by exclusory clauses in a situation which, by its own negligence, it created.

Consequently, the DAB accepts as correct the assertion that where a party has conducted its business under a contract in a negligent manner, a fortiori when the innocent party has significantly suffered to its detriment as a result of that negligence, the negligent party is responsible to the innocent party for damages. This assertion is captured in [State X] Civil Code at Article [XY].

14. Comparing the preamble with the conclusions in the reasoning, it appears that the decision is somewhat contradictory and that the contradiction is due to the DAB's reluctance to directly resolve the matter by strict application of the law. One fails to understand on what grounds the DAB has considered that it belongs to "*other tribunals*

to finally decide the strongly contested legal issues”. The dispute must be first referred to the DAB by the clear provisions of the contract and this also includes “*strongly contested legal issues*” if the claims are made in law. Accordingly, it is a primary duty of a DAB to address the law issues and to do it with the degree of analysis required under the circumstances. Refraining to do so, might amount to a “*minus quam petitum*” or to an impermissible omission to exercise the decision-making powers mandated by the parties.

15. **Case B:** The employer contended that the DAB lacked jurisdiction over a dispute because the underlying facts were the same as those forming the subject matter of a previous decision made by the same DAB. The employer’s allegations were based on the *res judicata* principle set forth in the law governing the contract, according to which the same dispute, between the same parties, arising from the same facts and from the same contract cannot be litigated or arbitrated twice.
16. The contractor objected that the breaches referred to DAB were distinct in nature from those considered under the previous DAB decision and therefore the “identity of object”, the most important requirement for achieving a *res judicata* effect, was not satisfied.
17. The DAB upheld jurisdiction on the following reasoning:

[The employer’s] argument which relies upon [Article XY] of the [State X] Civil Code fails. [The employer] informs me that the Code of [State X] provides that the *Res judicata* provisions in [State X] are subject to three elements namely, object, cause and parties. Clearly in this case, as I have outlined above, the primary identity of object test has failed and as such the provisions of [State X] Code at Article [XY] do not apply. However, notwithstanding this failure, I am persuaded that the Contractual provisions are sufficient for me to arrive at a conclusion with regard to my jurisdiction.

I consider that I do have jurisdiction to consider the matter referred which is undoubtedly a new dispute which has not previously been referred to me and I shall proceed to do so.”

18. This is, therefore, a case in which the DAB has correctly construed and applied the governing law. Since an essential element of *res judicata* was missing, the DAB rightly concluded that the claim referred to it amounted to “a new dispute” over which the DAB had an uncontested jurisdiction. However, this conclusion should have been

sufficient to establish the DAB's jurisdiction. It is unclear why the DAB also resorted to the alternative theory according to which, irrespective of the governing law, its jurisdiction was established in some obscure contractual provisions, never invoked by the parties.

19. After the DAB had correctly acknowledged that the provisions of the governing law on *res judicata* did not deprive it of the authority to make decisions on the second referral, one wonders why a vague reference to unspecified contractual provisions was either needed or "*sufficient*" to reinforce its jurisdiction. The only plausible explanation is that the DAB had not exactly understood the meaning of the law provisions on *res judicata* and, probably, had inadvertently reached the correct decision in law without being aware of its precise implications.

20. **Case C:** The contractor claimed that it was entitled to recover interest on the sums due for performance of the works which were wrongfully deducted by the employer from payment certificates. The contractor relied upon the provisions of the applicable domestic law for quantification of interest. Conversely, the employer contended that reliance on applicable domestic law was misconceived as such provisions only refer "*to the method to be used in the Court of Law when [...]the problem of due interest in a commercial matter is left at the judge's decision*" and requested the DAB to decide the interest issue in accordance with the method "*that the DAB thinks fit for this particular instance*". This was because, pursuant to local legislation in the field of public works, in the case in question the contractor was entitled to much higher interest than those normally applied.

21. The DAB decided in favor of the contractor and applied the local legislation:

[...] I consider that the application of Articles [XY of the Civil code of State X] are correct and that furthermore the interest rates and mechanism provided for under Article [Z] of Governing Ordinance [Z] is applicable and correct. [...] By considering the above I decide that [the contractor's] claim is well made and succeeds in the sum claimed.

22. The DAB correctly decided the matter according to the governing law. This decision does not seem surprising, given that the contractual provision did not cover the issue in dispute and that the DAB had necessarily to rely on a certain method of calculation

of interest, predictably, the DAB opted for the “safest way” and applied the governing law instead of discretionarily choosing another method “*fitting for this particular instance*”.

23. **Case D:** The contractor requested the DAB to make an adjustment of the level of delay damages arguing that the DAB’s power was based on the domestic law provision according to which “*a penalty may be reduced by the judge*”:

[The contractor] requests that I make an adjustment to the level of DDs based upon the powers which I may have under Article [X] of the Civil Code of [State X]. Under that Article, ... “*a penalty maybe reduced by the judge*”. At the hearing some considerable discussion was undertaken related to this issue which revolved around my capacity to have the Article considered to be applicable to DAB proceedings and as to whether a “penalty” may be considered to be equivalent of Delay Damages.

I have considered the arguments put forward to me and find that my jurisdiction is limited [...] to those matters which may arise out or in connection with the Contract. [...] Accordingly whether the terms of Article [X] are applicable to me or not, or indeed whether I need to consider whether DDs are to be regarded as “penalty”, I consider that I would not need at this time to change the Agreement of the Parties which specified the quantum of DDs. As such I will decline to either consider or apply any purported powers which I may have under Article [X] of the Civil Code of State [X].

24. A simple reading of the quotation shows that the DAB’s reasoning is somewhat inconsistent. The DAB declined jurisdiction and refrained from adjusting the level of delay damages for two reasons: (i) the DAB’s powers are confined to interpret and enforce the Contract and (ii) the DAB “*would not need at this time to change the agreement of the parties which specified the quantum of DDs*”.
25. This reasoning is flawed. First, it is highly debatable that the matters related to reconsideration of the amount of delay damages do not arise from the Contract. The DAB’s decision to decline jurisdiction on this ground appears superficial and inadequately motivated.
26. Second, when the DAB declares that it “*would not need at this time to change the agreement of the parties*”, it reveals that, in reality, it assessed the merits of the claim and concluded that the level of delay damages set forth in the contract was appropriate. It thus mixed jurisdiction with merits, addressing them jointly and confusedly. If the assessment of the merits was correct, the DAB should have accepted jurisdiction and dismissed the

claim by simple application of the law.

27. Once again, the inconsistency in the DAB's reasoning shows a reluctance to apply domestic law provisions fully and correctly, a signal of the DABs' traditional reluctance to depart from the contract, which is generally considered the "exclusive" source from which their decisions derive.

III. GENERAL REMARKS

28. The above examples do not exhaust the cases in which the DABs show to have difficulties in approaching the law. For instance, I am told that in some other cases DABs have declined jurisdiction in respect of the application of the statutory limitation provisions set forth in the State law governing the contract, or faced serious obstacles in establishing whether suspension of works or termination of the contract by one party was legitimate or arbitrary pursuant to the law governing the contract and confined the decision on this point on the contract clauses dealing with suspension / termination, which were however incomplete and should have been read in the light of the law.
29. Such a tendency is probably due to the usual prevalence of technical or commercial or purely contractual nature of the matters referred to the DAB, which also explains their usual mixed composition, comprising engineers and lawyers. This might also be due to the widespread contractors' and employers' conviction that DAB and arbitration are two different tools, tending to different results and implying different tasks.
30. It is absolutely true that the DAB is primarily the "judge of the contract", its fundamental mission being to obtain the parties' correct and permanent compliance with the contract terms, specifications, conditions and prescriptions of whatever nature. This was the reason why it has become so popular and this explains its fortune.
31. However, the examples discussed above are at the origin of certain dissatisfactory results. If the DAB's jurisdiction is partial, resort to arbitration after exhaustion of the DAB phase becomes inevitable. I doubt that this corresponds to the expectations of the founders of the DAB system, whose target was to introduce a tool capable to avoid arbitration.

32. I am not advocating the idea that the DABs should be regularly composed by lawyers. This would be a terrible mistake and impede prompt resolution of the many technical and commercial disputes that the DABs tend to manage much more efficiently than lawyers, nor do I have a clear idea on how the problems highlighted hereinabove might be remedied.
33. Most probably, the correct response should be that whoever is appointed as DAB member must be aware that he may receive claims in law and must be prepared to make decisions in law, sometimes in respect of rather complex issues of law. This reason should be sufficient to induce the parties to appoint at least one lawyer (the chairman) as DAB member.
34. The DAB should then face the law issue as one of the many issues referred to it and provide the correct response, avoiding the dilemma of whether the law is its own business or the business of the arbitrators.
35. In theory, one might think of an alternative system based on the distinction between “technical” or “commercial” disputes, on the one side, and “legal” disputes on the other side. Several contracts try to make this distinction and refer the first type of disputes to a DAB or a technical adjudicator and the second to an arbitral tribunal. But I am not at all sure that this system works. The dividing line is rather hard or impossible to draw because all above categories of dispute are, most of the times, inextricably intertwined.
36. Conclusion: the FIDIC DAB model is probably the best we may have. We must learn how to coexist with it, try to improve its functioning and try to avoid to use both DAB and arbitration at all times. In any case, in my experience the DAB mechanism puts an end to the dispute and makes arbitration superfluous at least in the 30 or 40% of the cases, where the DAB decisions have a predominant technical or commercial nature and the parties accept them as final. This outcome is, by itself, amply sufficient to justify the appointment of a DAB in construction contracts.