

APPEA CONFERENCE, PERTH 11-13 April 2011

Concurrent Session 3: Legal and Commercial

Dispute review boards: expensive or priceless? | J McVeigh and K Walters (Minter Ellison)

DISPUTE REVIEW BOARDS: EXPENSIVE OR PRICELESS?

J. McVeigh and K. Walters

Minter Ellison Lawyers
Level 22 Waterfront Place
1 Eagle Street
Brisbane, Qld 4000

Jennifer.mcveigh@minterellison.com

Karen.walters@minterellison.com

ABSTRACT

The soft skill of dispute management is often overlooked. Our paper explores the benefits that a dispute review board can bring to a project. Traditional attempts to resolve disputes once they have arisen will be hampered by the parties' attitudes to each other and the dispute resolver's ability to understand the specific nature of the project.

We explore the growth in use of dispute review boards (DRB) - a small body of experts engaged at the commencement of a project, who become very familiar with the project and who can act as dispute managers. We contrast this model with traditional dispute resolution methods.

As well as exploring the benefits that a dispute review board can bring to a project our paper also discusses the costs associated with it. The paper also discusses practical matters such as how to structure, appoint and engage with a DRB.

KEY WORDS

Dispute resolution – dispute review boards – construction industry disputes – membership of dispute review boards – costs associated with dispute review boards.

PAPER

Introduction

A factor for the success of a project, large or small, is the ability of the participants to effectively manage and, if necessary, resolve any disputes which may arise. Dissatisfaction with the cost and time involved in traditional forms of litigation and, over time, arbitration, has led to the development of a range of alternative dispute resolution models. No matter the talents of the expert or mediator engaged to assist in the resolution of a dispute, any dispute *resolution* model is inherently inefficient: the model is only activated *after* a dispute arises.

Over the past ten years the Australian construction industry has begun to adopt the concept of 'dispute review boards' (DRBs) from large, international projects. In contrast with dispute *resolution* models, DRBs are premised on a notion of dispute *management*—or, more particularly, dispute *avoidance*. DRBs are established contemporaneously with the construction contract, and their members become intimately familiar with the project participants, conditions and challenges. The DRB is well placed to provide advice on the progress of the project while maintaining neutrality and empowering the project team to proactively solve problems.

Excellent project outcomes are likely when all project participants work within a positive project culture in an environment that encourages proactive issue resolution. DRBs have proven themselves to be a very effective means of efficiently resolving difficulties before they become large-scale disputes.

Despite all its advantages, a DRB is not inexpensive. For this reason, not every project would benefit from engagement of a DRB. This paper identifies the type of project which might benefit from a DRB by discussing how a DRB functions and the costs and benefits involved in using one. It also discusses recent research which has led to recommendations that significant construction projects utilise DRBs as part of a strategy of excellence in project delivery.

Adoption of DRBs in oil and gas projects resonates with the *Principles of Conduct* developed by APPEA: demonstrating leadership and good business practices.

History

Intense competition for construction contracts in the USA following World War II led to an increase in adversarial relations between principal and contractor. This, together with increased regulatory complexity in the construction process (such as environmental regulations and government requirements) and tighter margins saw contractors looking for ways to protect their positions (Dispute Resolution Board Foundation, 2007).

This culture of claims and disputes lead to the US National Committee on Tunnelling Technology to commission a report 'Better Contracting for Underground Construction'. The report, published in 1974, made 14 recommendations about how to improve underground construction, one of which was the use of DRBs (United States Department of Transportation Federal Highway Administration, 2009).

The earliest reported use of a DRB was on the Boundary Dam project in Washington in the 1960s, where a 'Joint Consulting Board' made decisions in relation to disputes that arose on the project (Chapman, 2004; Peck and Dalland, 2007). The concept reached maturity in its use in connection with the construction of the second bore of the Eisenhower Tunnel in Colorado. The DRB successfully heard three disputes and promoted an effective relationship between the parties throughout construction (Dispute Resolution Board Foundation, 2007). These projects formed the foundation of the growth of the use of DRBs in the USA.

From 1975 to 2000 the Dispute Review Board Foundation (DRBF) recorded 1434 projects which had used DRBs (Dispute Resolution Board Foundation, undated). The DRBF reports that 1,860 disputes were recorded as being heard by the DRBs on these projects. Of these, 1,718 of the disputes were settled while a mere 52 progressed to another form of dispute resolution (Dispute Resolution Board Foundation, undated). This gives DRBs a 92% success rate.

The use of DRB has rapidly expanded on the international stage. The concept is an essential aspect of FIDIC contracts and those of all multilateral development banks (such as the World Bank) (Peck and Dalland, 2007). In 1990, the World Bank incorporated provisions for the use of DRBs in its 'Procurement of Works'. In 1995, FIDIC introduced a new version of its Design-Build Contract which included an option for 'Dispute Adjudication Boards'. The concept has been further developed by these bodies over the years, as well as being adopted by the ICE, ICC and EU (Peck and Dalland, 2007).

What is a DRB?

A DRB is purely a creature of contract. There is no legislation governing DRBs. Generally, a DRB will comprise of three independent persons who are charged with overseeing the operation of the contract and assisting the parties with speedy, efficient resolution of any difficulties that arise.

What does a DRB do?

The DRB will generally be established when the contract is formed: a DRB which is established later in the progress of a project loses one of the benefits which a DRB otherwise brings. This is because the fundamental role of the DRB is to provide an objective, independent panel of experts who sit alongside a project and are therefore able to provide immediate, relevant advice when it is sought. This level of involvement is achieved through regular (generally, four times a year) site visits with the owner and

the contractor, including briefing on the progress of the project and inspecting the works. These regular informal site visits not only allow the DRB members to gain an in-depth understanding of the project, but also provide a forum where potential disputes can be addressed at the job site, with the DRB giving an informal, advisory opinion (Charrett, 2010).

On a more formal level, either party may refer a dispute to the DRB, after which the DRB will hold a conference to decide a timetable which may lead to a hearing. A DRB is well placed to provide its determination within a short period of time given its familiarity with the project, meaning the parties can achieve an outcome in a matter of days or weeks as opposed to months or years (Chapman, 2009).

A DRB hearing is much less formal than an arbitration hearing. The usual practice is for each party to submit a position paper to the DRB and the other party prior to the hearing. These are not formal pleadings and are designed to avoid the adversarial nature of traditional court proceedings (Chapman, 2009). The position papers are short overviews of each party's position.

Generally, the parties will not be legally represented at the hearing, thereby preserving the informality of the event. The DRB may raise questions and ask a party to respond to points in the other's position paper however it is the DRB's role to ensure the proceedings are as non-confrontational as possible (Chapman, 2009). The DRB may then adjourn and hold private discussions and might reconvene if further information is required however, the minimal amount of formality required for a DRB hearing means the members will be able to give a determination very quickly.

DRB or DAB?

The term 'Dispute Adjudication Boards' (DABs) refers specifically to the form of DRB mandated by the FIDIC contracts. The FIDIC contracts which mandate DABs include: Red Book (Construction), Yellow Book (Plant and Design/Build), Silver Book (formerly, 'Orange Book') (EPC/Turnkey), FIDIC Harmonised Edition of the Construction Contract for Multilateral Development Banks, Gold Book (Design, Build and Operate) and the Green Book (short form contract) (Chapman, 2009, and Shnookal and Charrett, 2010).

DABs differ from DRBs in a number of significant respects, with the result that the process for resolution of disputes under the FIDIC contracts is far more formal (Gerber, 2001). For example, there are strict time periods within which a dispute must be referred to the DAB otherwise the party is time barred from pursuing its claim. Most significantly, a matter cannot be referred to the DAB unless it is actually in dispute. This severely limits the role of the DAB in dispute *avoidance* in that the parties are not able to seek an advisory opinion in relation to an issue and thereby prevent its escalation into a full dispute.

The DAB must give its decision within 84 days of receiving the notice of dispute, a much longer timeframe for the resolution of disputes when compared with the decisions of a DRB, which are usually produced within a matter of weeks, if not days, of the dispute arising.

Establishing a DRB

When establishing a DRB the following provisions are suggested to be 'essential' inclusions in a project contract (Dispute Review Board Foundation, 2007):

- a selection procedure that ensures neutrality of the DRB members (see further comments on appointing DRB members below);
- a requirement for regular meetings;
- an agreement to be signed with each DRB member;
- equal cost sharing, but sole-source payment of DRB invoices;
- establishing informal hearing procedures in addition to the more formal procedures;
- allowing the DRB to hear disputes on all aspects of the contract;
- allowing either party to refer a dispute to the DRB;
- providing a streamlined process for hearing disputes;
- providing that recommendations are not binding (although in practice many parties agree to be bound by recommendations up to an agreed value);
- ensuring that recommendations are admissible as evidence in case of later litigation; but that DRB members cannot be called as witnesses in future litigation;
- absolving DRB members from personal or professional liability arising out of their actions on the DRB (subject to a requirement to act in good faith); and
- a process for termination of DRB membership only by agreement by both parties.

While it might be argued that the Foundation prepared this list with a degree of self interest, it is also the case that the list is a product of considerable experience. Some suggestions are obvious and demonstrate even handedness in establishing and administering a DRB. Others are incorporated from more adversarial methods of dispute resolution to provide protection for the DRB members who may no longer carry significant professional liability insurance.

Appointing DRB members

DRB members do not represent the parties, all DRB members are independent. The independence and impartiality of the DRB is crucial if it is going to be able to provide resolutions which both parties will respect (Chapman, 2009). Each DRB member will be under an on-going obligation to make complete disclosure of any relationship or interest which could impact on their ability to be (or be perceived to be) independent (Golvan, 2010).

A DRB is intended to be a panel of experts, each with decades of experience in construction projects, which means it is crucial to appoint the right people with the right skill sets. People with experience in similar projects, in the resolution of disputes and construction industry experience are desirable DRB members. Some projects have insisted on one of the members being a lawyer (for example, the DRB agreement for the Sydney Desalination Plant required the chairperson to be a QC or SC of the New South Wales or Victorian Bars (Golvan, 2010). Golvan QC sees a significant potential for construction lawyers to take on roles in DRBs in the future (Golvan, 2010). This contrasts with a history of controversy in the United States as to whether lawyers are appropriate for DRB membership (Dispute Review Board Foundation, 2007). Some parties have been concerned that the inclusion of lawyers will make proceedings more formal and the broader legal community, once it becomes more involved in DRBs, may seek to alter the process in ways that detract from its speed and informality. These fears seem to be unfounded, at least in the Australian experience. The inclusion of a lawyer in the Sydney Desalination Plant's DRB certainly did not detract from the DRB's success, and it is now common for multinational projects to include lawyers in their DRBs (Dispute Review Board Foundation, 2007).

A key attribute of a DRB member is their availability. A DRB retainer is likely to last for a number of years and will require a level of commitment during that time to ensure the DRB is fully aware of the progress of—and potential issues in—the project. By accepting a position as a DRB member a member may be unable to work for another owner or construction company involved in the project during the term of the member's DRB retainer.

The usual approach (internationally) to appointing DRB members is for each party to nominate one member, and for those two members to appoint the third to be the chairperson (although all three members should be approved by both parties). Other approaches include the owner providing a list of 5 nominees at the time of tender, and tenderers selecting 3 preferred members (or perhaps suggesting their own), or the owner nominating all members with the contractor having a limited right of objection. In Australia the parties commonly agree all 3 members. Easton (2010) suggests that, where the parties cannot agree, an independent, external appointer such as the President of FIDIC may be used as a back-up option. While this might be appropriate for FIDIC's DABs, one must query the usefulness of this suggestion for DRBs: after all, if the parties

cannot agree who will sit on the DRB, this is not a good omen for the project.

DRBs are not limited to three members. The Channel Tunnel project used a DRB with a panel of five members, while there were six members plus a convenor on the DRB used for the Hong Kong Airport (Gerber, 2001). This demonstrates the flexibility of the concept, especially on extremely large complex projects. The Hong Kong Airport project involved approximately 20 contracts, all of which were covered by the one DRB. The six DRB members formed panels of between one and three members, depending on the nature of the dispute. Gerber (2001) points out that this 'moving membership' structure allows members with the right qualifications to hear the right disputes: engineers to resolve technical disputes, quantity surveyors to resolve issues of quantum, and legal members to resolve matters such as contractual interpretation.

As not all projects are sufficiently large or complex to allow the luxury of a DRB as diverse as that used on the Hong Kong Airport project, members with dual qualifications (engineer/lawyer, for example) could be particularly appropriate.

Costs

The cost of a DRB is usually between 0.05% (for relatively smooth projects) and 0.25% (for troublesome projects) of the final contract price (Dispute Review Board Foundation, 2007).

The expense associated with DRBs has traditionally been a deterrent to their use, especially on smaller value projects. The direct costs include the DRB members' retainer and fees as well as the costs associated with conducting site visits and holding meetings. In addition, there are the costs associated with any hearing that might be held, including document review and preparation time, hearing time, and preparing a recommendation. Indirect costs associated with a DRB include the employees' time in preparing for and participating in DRB meetings (Dispute Resolution Board Foundation, 2007).

Benefits

While it is relatively easy to measure the cost of a DRB it is difficult to measure savings and other benefits that may have resulted from having a DRB. Historically, DRBs have provided an effective means of dispute *avoidance* or, at the very least, *minimisation*. In this way they are analogous to insurance. If operating effectively, they should dramatically reduce the risk of a serious and costly dispute (Charrett, 2010).

If a dispute cannot be avoided litigation may occur. Litigation can be protracted and costly and might have been avoided had the parties used a DRB throughout the project. A 2006 Blake Dawson Waldron report 'Scope for improvement – a survey of pressure points in Australian construction

and infrastructure projects', (Blake Dawson Waldron Lawyers, 2006) based on an analysis of 183 responses received to an industry wide survey, indicated an estimated industry wide weighted average value of matters in dispute of about 8.4% of contract price. The Cooperative Research Centre (CRC) for Construction Innovation (2009) project team estimated an industry wide weighted average value of avoidable costs that end up in dispute of about 5.9% of contract price (ie 70% of the 8.4% of contract price identified by the Blake Dawson Waldron report).

The CRC project team's analysis of available industry data regarding the direct cost of resolving disputes, and feedback from clients, contractors and legal practitioners, indicated an industry wide general magnitude estimate of the direct cost of resolving disputes of between about \$560 million and \$840 million per year. When the direct cost of resolving disputes was added to the avoidable costs the total waste exceeded \$7 billion per year (based on construction industry turn over of \$120 billion in 2008-09) (Cooperative Research Centre for Construction Innovation, 2009). Whether the costs of disputation (and consequently the benefits of avoiding disputes) in the petroleum projects industry are similar to those costs in the construction industry may well be a topic for future research. However, it cannot be denied that time and therefore costs, spent in disputation brings no benefit to any business.

The CRC Guide (2009) identified clear and strong leadership as essential in minimising the risk of disputation. While cultural benefits are not easily measured they cannot be easily dismissed. The CRC suggests that strategic decisions made early in the life of the project by the owner and other project sponsors can either limit, or promote the likelihood that the project will avoid significant disputes. The Guide suggests that a constructive delivery environment from the outset is vital. The owner has the opportunity, before the contract documents are finalised, to determine how it will create that environment and to reflect it in the contract. If an owner includes a DRB on a project it gives a strong indication to bidders of the culture that it is trying to create. It indicates that it is seeking to minimise the impact of disputes on the project (Dispute Resolution Board Foundation, 2007). This approach can help reduce bid costs by reducing the contingency bidders will otherwise build into their prices to cover the cost of traditional dispute resolution (Dispute Resolution Board Foundation, 2007). There is evidence internationally to suggest that contractors have lowered their bid price by up to 10% as a result of the inclusion of a DRB (Dispute Resolution Board Foundation, 2007).

The CRC suggests that the way in which problems are addressed on site is substantially dependent on the way the contract has been drafted, the skills and experience of the key project team project leaders and their problem solving capability. The CRC argues that if appointed early in the life of a project, a DRB has the ability to motivate individuals, as a matter of professional pride, to resolve issues promptly rather than be seen to require the service of the DRB.

Every project is an exercise in risk allocation and all projects, particularly large complex projects must deal with changing circumstances encountered as the project progresses. Unfortunately, being task focussed and outcome driven, the practices used in the construction industry to manage risk are typically less than sophisticated when it comes to motivating people to work together. While the construction industry may be particularly competent at managing physical challenges and providing appropriate engineering solutions it is not as well versed when it comes to managing the impact of unforeseen events on the organisations people and project. Significantly, the CRC identifies as regrettable the fact that there are still occasions when a contract can operate with the consequence that people on site do not have the authority to act rationally. Frustration and discontent can develop onsite and eventually seriously dysfunctional behaviours among project team participants have been identified.

Research undertaken by Crow and Barda (2001) found that the common features of excellent projects (excellence being defined in terms of wealth/value created) were:

- avoiding the underlying causes of disputes;
- a strong focus on informed owner leadership, creating project environments within which all parties were able to focus on common project objectives; and
- creating an environment where people enjoyed working together.

A culture of dispute avoidance or early resolution is an outcome of using a DRB and puts a project on the path toward excellence.

DRBs in Australia

Until recently, Australians have not demonstrated the same level of enthusiasm for DRBs as has been seen internationally. In the twenty-year period between 1987 and 2007, only 12 projects were recorded as using a DRB (Dispute Resolution Board Foundation, undated). Of those 12 projects, 5 were traditional 'construct only' contracts (Sydney Ocean Outfall Tunnels; Warragamba Dam Upgrade; Dandelup Dam; Harvey Dam and City West Cable Tunnel), 6 were 'design and construct'/ 'design, construct and manage'/ 'design, build, operate and maintain' (D&C: Sydney Airport Third Parallel Runway, Sydney International Terminal Upgrade, Ipswich Road/Logan Motorway. DC&M: Gateway Arterial Upgrade. DBOM: Sydney Desalination Plant.) and one was an 'engineer, procure and construct' style contract (Burrup Fertilisers Liquid Anhydrous Ammonia Production Plant Project). Only one was close to what could be described as a 'relationship based contract', and that was the \$94 million Ross River Dam project.

Explanations for this slow take-up, include:

- the preference for non-traditional styles of construction contracting;
- costs; and
- a lack of familiarity with the process.

Unlike the UK and the USA, until recently Australia has not had a significant number of large-scale, multi-billion dollar projects, nor is work in Australia funded by the World Bank. FIDIC contracts are not commonly used for projects on mainland Australia. Since the 1980s large complex projects in Australia have often been delivered using relationship based contracting methods: partnering, PPPs and (more recently) alliancing.

Offshore oil and gas projects led the way for alliancing in Australia. In 1994-1997 the Wandoo B Offshore Oil Platform was developed under a project alliance between Ampolex, Brown & Root, Keppel Fels, Leighton Contractors and Ove Arup & Partners. In 1995 – 1996 the East Spa Development was delivered by an alliance between Western Mining Corporation, Kvaerner R J, Brown Pty Ltd and Clough Ltd (Australian Contractors Association, February 1999).

The governance framework coupled with the compensation framework of pure alliances mean the parties have no need for a DRB. Having joint on-site and off-site management teams and a 'best for project' ethos provides an environment for early resolution of disputes, while the 'soft dollar' compensation framework means contractors are less likely to be seeking to vary the price through multitudinous claims.

As a consequence of the global financial crisis and as speculation as to the value for money in projects delivered by alliances has increased there has been a move back to more traditional hard dollar methods of project delivery and with that an increased take up of the DRB model in Australian projects. Since 2008, 11 projects have been recorded that have used DRB, and there are a handful of projects which are currently considering using DRBs (Dispute Resolution Board Foundation, undated).

While fewer projects are being delivered using the pure alliance model the principles that underpin alliancing are being transposed into 'early contractor involvement' (**ECI**) styles of contracting. The use of DRBs in this style of relationship contracting makes sense: it promotes the relationship between the parties by catching problems before they turn into disputes and replaces the joint management teams that contributed to the success of alliances. Relationship style contracts include requirements for collaborative dispute resolution and requirements for the parties to act in good faith, typically with an hierarchical dispute resolution process. A DRB can provide an independent and impartial means of project monitoring and review. The contract framework facilitates the DRB in resolving issues and avoiding disputes (Peck and McLennan, 2010). Peck and McLennan identify

7 recent examples of the use of DRBs in road, rail and infrastructure projects; including the Sydney desalination plant.

As participants in the construction industry take up the recommendations of the CRC for construction innovation in the Guide to Leading Practice for Dispute Avoidance and Resolution (p29) for the use of DRBs for larger projects (greater than \$30 million contract value) as an effective strategy to avoid disputes, participants in the industry will become increasingly more familiar with the concept.

Conclusion

The benefits of DRBs have been displayed on the international stage for over 30 years but it is only recently that Australian projects are taking advantage of the process. DRBs offer a mechanism for the avoidance and early resolution of disputes on a project. Use of a DRB by an owner signals the culture of dispute management expected on a project. For the right project, the costs associated with a DRB are far outweighed by the benefits it can bring.

REFERENCES

- AUSTRALIAN CONSTRUCTORS ASSOCIATION – Relationship Contracting, 1999.
- BLAKE DAWSON WALDRON LAWYERS – Scope for Improvement: A survey of pressure points in Australian construction and infrastructure projects. Accessed 4 November 2010.
<http://www.blakedawson.com/Templates/Publications/x_publication_content_page.aspx?id=54519>
- CHAPMAN, PJH, 2009—Dispute Boards on Major Infrastructure Projects. In: Proceedings of the Institute of Civil Engineers, 162.
- CHAPMAN, PJH, 2004—Dispute Boards. Accessed 4 November 2010.
<www1.fidic.org/resources/contracts/docs/chapman_25feb04.rtf>.
- CHARRETT, Dr D, 2010—Dispute Boards and Construction Contracts. In: Australian Construction Law Newsletter, 132, 18-30.
- COOPERATIVE RESEARCH CENTRE FOR CONSTRUCTION INNOVATION, 2009 - Guide to Leading Practice for Dispute Avoidance and Resolution.
- CROW, T and BARDA, P, 2001 – Projects as Wealth Creators, Property Council of Australia.
- DISPUTE RESOLUTION BOARD FOUNDATION, 2007—Practices and Procedures Manual. Accessed 4 October 2010. <http://www.drb.org/manual_access.htm>
- DISPUTE RESOLUTION BOARD FOUNDATION (undated)- Publications. Accessed 20 October 2010. <<http://drb.org/>>
- EASTON, G, 2010— The Selection and Appointment of Dispute Board Members. Dispute Resolution Board Australasia Workshop, Sydney, Australia, 10 April 2010.
- GERBER, P, 2001 – Dispute Avoidance Procedures ("DAPs") – The Changing Face of Construction Dispute Management. In: The International Construction Law Review, 122, 125 - 129
- GOLVAN, G QC, 2010—Practical Issues in the establishment and operation of a dispute resolution board – some reflections on Sydney’s Desalination Plant Project Dispute Resolution Board. In: Australian Construction Law Newsletter, 132, 30-36.
- PECK, G and DALLAND, 2007—The Benefits of Dispute Resolution Boards for Issue Management of Medium to Large Construction Projects. In: The Arbitrator and Mediator, 26 (1) , 13-29.
- PECK, G and McLENNAN, A, 2010 – Experience with DRBs in relationship contracts in Australia, paper presented to the 10th Annual DRBF International Conference in Istanbul.
- SHNOOKAL, T and CHARRETT, D, 2010 – Standard Form Contracting; the Role for FIDIC Contracts Domestically and Internationally, accessed 17 November 2010.
<http://www.mtccc.com.au/uploads/papers/Shnookal_Toby.pdf>
- UNITED STATES DEPARTMENT OF TRANSPORTATION FEDERAL HIGHWAY ADMINISTRATION, 2009—Technical Manual for Design and Construction of Road Tunnels - Civil Elements. Accessed 4 October 2010.
<<http://www.fhwa.dot.gov/bridge/tunnel/pubs/nhi09010/14.cfm>>