

Dispute Review Boards and Other Standing Neutrals

Achieving “Real Time”
Resolution and Prevention
of Disputes

BY RANDY HAFER
& CPR CONSTRUCTION ADVISORY
COMMITTEE DISPUTE RESOLUTION
BOARD SUBCOMMITTEE

ABOUT CPR

Our Mission

CPR Institute is a nonprofit organization based in New York City. Our mission is to spearhead innovation and promote excellence in public and private dispute resolution, and to serve as a primary multinational resource for avoidance, management and resolution of business-related and other disputes.

To fulfill our mission, CPR is engaged in an integrated agenda of research and development, education and advocacy. We are also the leading proponent of self-administered ADR and serve as an appointing authority for parties in need of neutrals.

Fulfilling the CPR Mission

CPR was founded in 1979 as the Center for Public Resources from a coalition of leading General Counsel dedicated to identifying and applying appropriate alternative solutions to disputes thereby mitigating the extraordinary costs of lengthy court trials. That determination is still at the heart of CPR's activities today.

We are pioneers and leaders in the area of dispute resolution. We were the first organization to bring together Corporate Counsel and their law firms to find ways of mitigating the extraordinary costs and delays of litigation, while achieving more satisfying and lasting results through appropriate alternatives, like negotiation, mediation, and arbitration.

We believe that the culture and practice of the way in which businesses settle disputes, nationally and internationally, needs vast revision in order to untie the bonds of lengthy and excruciatingly expensive litigation.

We believe that every effort to promote the appropriate use of mediation, arbitration, and other strategies must continue to be explored and used. And, we believe that CPR has an unparalleled role in exacting these changes.

We fulfill our mission by:

- Convening high-level meetings between General Counsel, Deputy General Counsel, Senior Partners, and Managing Partners at members-only meetings and programs, as well as through the efforts of our member committees and task forces.
- Providing up-to-the-minute research information and case law in our other printed publications, online materials, and CPR in-person or electronic counseling on ADR procedures and drafting.
- Resolving disputes via our Panels of Distinguished Neutrals, our non-administered procedures, and our unparalleled ability to get parties to the table.

CPR Construction Advisory Committee

Principal Authors

Randy Hafer
Kilpatrick Townsend & Stockton LLP

Sub-Committee Members

Andrew Aglionby
Baker & McKenzie LLP

Stephen D. Butler
Parsons Brinckerhoff, Inc.
(Co-Chair, CPR Construction Advisory Committee)

Louis Coffey
Wolf, Block, Schorr and Solis-Cohen LLP

Jennifer W. Fletcher
Sutherland, Asbill & Brennan LLP

James P. Groton
Sutherland, Asbill & Brennan LLP (Retired)

Larry D. Harris
Greenberg Traurig, LLP

Richard L. Reed
Coats Rose

Robert A. Rubin
McCarter & English, LLP

George Anthony Smith
Weinberg Wheeler Hudgins Gunn
& Dial LLC
(Co-chair, CPR Construction Advisory Committee)

Robert J. Smith
Akerman Senterfitt Wickwire Gavin

Thomas J. Stipanowich
Straus Institute for Dispute Resolution at
Pepperdine University School of Law

Cathy Cronin-Harris
Project Director
CPR Senior Consultant
New York, New York

Table of Contents

CPR Introduction	1
Dispute Resolution Stages and Steps	2
Construction Contract Options	3
Construction Fact Sheet	4
Dispute Review Boards (DRBs) and Other Standing Neutrals.....	5
• What are DRBs and Standing Neutrals?.....	5
• The Need for “Real Time” Neutral Advice.....	5
• The “Standing Neutral” Concept.....	5
• Composition and Functioning of a DRB	6
• Examples of Other Standing Neutrals.....	7
• Where are DRBs Used?	8
• DRB Costs: Direct and Indirect	8
• DRB Success Statistics	8
• DRB Benefits	9
Putting DRBs to Use.....	10
• Building a DRB into the Contract	10
• Selecting DRB Members	11
• Normal Operation: Staying Current as Project Develops	12
• Informal Advisory Opinions	12
• Dispute Referrals and DRB Hearings	13
• Confidentiality of DRB Recommendations: Admissibility in Subsequent Proceedings	14
• Common Issues and Suggested Solutions	15
Use of Standing Neutrals in Other Businesses	16
Prospects for the Future	17

CPR Introduction

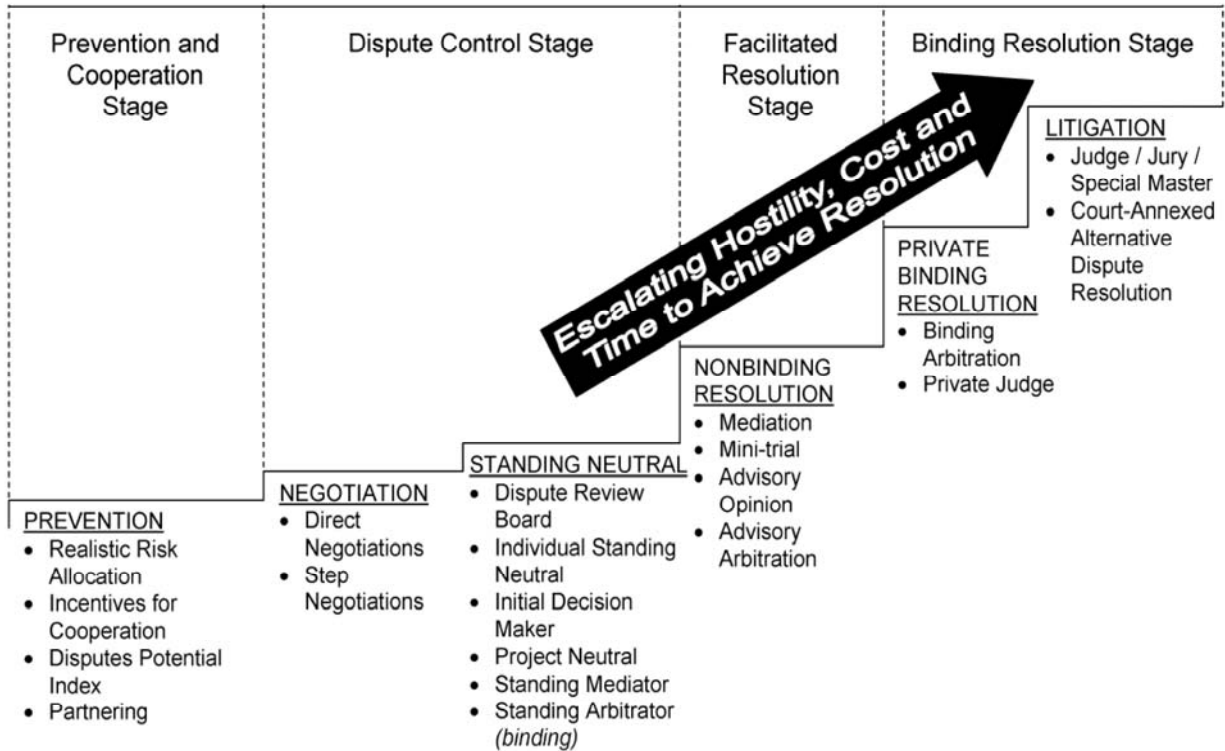
This Briefing offers information about the use of Dispute Review Boards (DRBs) and other Standing Neutrals, which have proven so successful in managing conflict in construction projects. Companies outside the construction arena, who are involved in long-term contractual arrangements prone to conflict or any other “relational” type of contract, may also find this Briefing useful. They may be able to adapt the DRB/Standing Neutral concept to their own needs as they continue to refine their conflict management processes.

CPR has continually fostered knowledge of cost-effective resolution devices such as mediation. It has also maintained a focus on conflict management systems that push problem solving up to the earliest possible time in the life of a dispute. Such systems include conflict prevention mechanisms and conflict control mechanisms that promote collaboration between business partners so they can solve problems early and avoid more costly end-point conflict resolution processes.

The DRB model (by far the best-developed form of Standing Neutral) that is described in detail in this Briefing offers parties a process of real-time conflict control by using experts on-site to address and resolve disputes rapidly. By agreeing to use one or more neutrals as a DRB, parties commit to deal realistically with disputes when they erupt, and thereby avoid the kinds of resentments that develop when disputes are allowed to fester throughout the project. In the international arena, FIDIC and ICC Dispute Board procedures are commonly used. Broader use of DRB and Standing Neutral mechanisms can help control conflict and preserve the profits, relationships and reputations that provide a competitive business advantage.

The following complementary charts, showing dispute resolution steps and construction contract options, demonstrate how DRBs and other Standing Neutrals fit into a system of superior conflict management that starts with prevention and ends with efficient conflict resolution devices. They provide a guide for the construction sector and may prove useful in other industries.

Dispute Resolution Stages and Steps¹



¹ The original version of this Step Chart appeared in the 1991 CPR Publication “Preventing and Resolving Construction Disputes.” It was later reformatted by the Dispute Avoidance and Resolution Task Force (“DART”), and more recently revised and updated by James P. Groton for presentations at international dispute prevention conferences in China, Finland and England.

Construction Contract Options

To effectively prevent and manage disputes, contracting parties should consider selecting and using at least one process from each of the following multi-step conflict management categories. When entering into contracts, parties can agree to use initial collaboration and preventive practices, to be followed by one or more efficient on-site conflict management techniques such as Step Negotiations, DRBs or Standing Neutrals, before resorting to costlier external non-binding or binding processes.

Contract for Dispute Prevention

- Equitable Risk Allocation Provisions (See *CPR's Realistic Risk Allocation Briefing*)
- Incentive Agreements for Cooperation
- Disputes Potential Index (Created by the *Construction Industry Institute*)
- Partnering (See *CPR's Partnering Briefing*)

Contract for Early Non-Binding In-Project Processes to Control Disputes

Additional contract terms allow early in-project non-binding intervention appropriate to the particular project and can enhance ability to solve problems efficiently:

- Negotiation
- Multi-Step Negotiation
- Single Standing Neutral or Dispute Review Board (See *CPR's Dispute Review Board and Standing Neutral Briefing*)
- Initial Decision-Maker (See *AIA Forms, 2007*) or Project Neutral (See *Consensus.DOCS Forms, 2007*)
- Dispute Review Board
- Alternatively, in special situations the Standing Neutral could be a Standing Arbitrator or Standing Mediator
- Arbitrator or Standing Mediator; or the parties could name a dispute specialist to recommend processes when disputes arise.

Contract for External Non-Binding Resolution Processes

Contract provisions can incorporate external non-binding processes if in-project intervention fails, such as:

- Mediation
- Early Neutral Evaluation
- Expert Non-Binding Evaluation
- Mini-Trial
- Advisory Arbitration (Non-binding)

Each of these can loop back to negotiation

Contract for External Binding Resolution Processes

Binding processes are available if in-project intervention or external non-binding processes fail:

- Private Judge
- Arbitration or
- Litigation

Before final decision, each of these can loop back to negotiation

Construction Fact Sheet

A. Facts about Construction, from a 2009 National Research Council Study ²

Yearly U.S. construction	\$1.16 Trillion
Yearly worldwide construction	\$4.6 Trillion
Value of U.S. construction as % of GDP	10%
Percentage of U.S. workforce employed	8%
Estimated yearly transactional costs of disputes	\$4 Billion to \$11 Billion

B. Mean Transaction Costs of Negotiation, Mediation & Arbitration ³

In his 2006 Ph.D thesis researcher Richard J. Gebken reported on a study of the direct and indirect transactional costs required to resolve disputes on 44 projects involving 57 contracting organizations. The dispute resolution methods used to resolve those disputes were Negotiation, Mediation, and Arbitration. He found that the relative mean transaction costs of resolving disputes through these three methods were:

Negotiation Cost Mean in 18 projects:	\$330,199
Mediation Cost Mean in 15 projects:	\$1,212,433
Arbitration Costs Mean in 11 projects:	\$1,167,182

While Gebken found that the stand-alone processes of Arbitration and Mediation differed only slightly in costs, Negotiation costs were 75% less than the costs of Mediation. He attributed the relatively higher costs of Mediation in large part to the fact that the mediations of the disputes that were resolved by that method occurred late in the dispute resolution process, and involved prolonged discovery and depositions.

C. Percentage of Various Transaction Costs for Resolving Disputes via Negotiation, Mediation & Arbitration ⁴

During the course of analyzing the sources of transactional costs incurred in the three methods of dispute resolution that he studied, Mr. Gebken found that as the hostility of dispute resolution increased from Negotiation to Arbitration (see page 1, above), outside counsel fees increased. He also found that expenditures for Negotiation involved substantial in-house costs.

Transactional Costs in Construction Disputes	Aggregate Costs of Arbitration, Mediation & Negotiation	Only Arbitration Costs ⁵	Only Mediation Costs ⁶	Only Negotiation Costs ⁷
Outside Counsel	61%	75%	58%	40%
Management & Staff	16%	8%	8%	41%
Consultants/Expert Witnesses	11%	6%	6%	10%
In-House Counsel	5%	3%	3%	6%
Forum Fees	3%	8%	8%	1%
Other Costs	4%	8%	0%	2%

² *Advancing the Competitiveness and Efficiency of the U.S. Construction Industry*, National Research Council, National Academies Press, 2009, at pages 11 and 18.

³ Richard J. Gebken, *Quantification of Transactional Dispute Resolution Costs for the U.S. Construction Industry*, at pages 115, 127 and 156 (May 2006, Ph.D Dissertation at The University of Texas at Austin). (Mr. Gebken's study did not evaluate the costs of preventing or resolving disputes through Partnering or Dispute Review Boards.)

⁴ *Ibid.*, p. 111

⁵ *Ibid.*, p 110.

⁶ *Ibid.*

⁷ *Ibid.*

Dispute Review Boards and Other Standing Neutrals

What are DRBs and Standing Neutrals?

The Need for “Real Time” Neutral Advice

Every construction project (and indeed every other long-term business enterprise that potentially can experience problems) can benefit from the availability of some neutral source of outside advice to whom the parties can turn for assistance in case of a potential dispute.

The construction industry has always recognized the need for a speedy method of dealing with problems on construction projects, because unresolved problems are likely to delay and disrupt the smooth flow of the construction process. Beginning over 100 years ago, the standard method for resolving problems at the project site was a combination of two dispute resolution methods: (1) a nonbinding decision by the project architect or engineer, rendered immediately upon the appearance of a problem; and (2) an informal *ad hoc* arbitration convened promptly at the project site to provide a quick decision on any disputed issue arising out of the architect or engineer’s decision that the parties could not resolve through negotiation. These two techniques complemented each other: The architect or engineer’s awareness that its decision could quickly and easily be challenged by a prompt arbitration gave the architect or engineer an incentive to be scrupulously fair in making decisions. As a result, relatively few decisions by architects or engineers needed to be challenged, and those that were challenged were resolved quickly and expertly.

About a generation ago, for reasons that are beyond the scope of this monograph, this traditional method of speedy single-issue job site resolution job ceased to function efficiently. Architects’ and engineers’ decisions were frequently ignored, and the resolution of disputes tended to be postponed until they could be dealt with in a project-end arbitration or law suit.

The “Standing Neutral” Concept

The most promising development in the construction industry to improve upon the deficiencies of traditional construction project-site dispute resolution has been the movement to establish at the beginning of the construction process a pre-selected neutral to serve the parties as a “real time” dispute resolver throughout the construction process. This concept, using what has been referred to in various forms as a “dispute review board,” “standing neutral,” “project neutral,” “referee,” “standing arbitrator,” “standing mediator,” or more recently “initial decision maker,” contemplates that at the inception of the construction phase of the project, the parties select one or more independent construction industry experts to be available as a standing board, panel, or single neutral throughout the project, to act immediately to resolve any disputes which the parties cannot resolve themselves.

There are a number of variations on this concept, but essentially it involves the following typical steps:

1. At the outset of the project, usually when the owner and contractor enter into the general construction contract, the parties select one or three persons in whom they have trust and confidence to serve as dispute resolver’s – the “neutral” – throughout the course of the project.
2. In some cases, the neutral will be entirely independent. In other cases, each party will nominate one member, and the two nominated members will select a third member; however, even in such cases it is typically required that every panel member be acceptable to both parties, and that all panel members be independent and impartial, without any special allegiance to the nominating party.
3. Depending on the wishes of the parties, the neutral will be given authority to act on disputes by rendering either a non-binding evaluation or recommendation or a binding decision.
4. The neutral is initially given a basic introduction to the nature, scope and purpose of the project, and equipped with a basic set of contract materials and documents.

5. Sometimes the neutral is requested to meet periodically at the project site with key project personnel for a basic review of project progress, even if there are no disputes to be dealt with at the time.
6. Whenever the contracting parties and the architect are unable to resolve a dispute, that dispute is immediately referred to the neutral for a prompt recommendation or decision.
7. If the neutral is empowered to make only a recommendation rather than a binding decision, in the event that a party wishes to challenge the neutral's recommendation, the neutral's recommendation will typically be admissible as evidence in any subsequent arbitration or litigation.
8. The expenses of the neutral are generally absorbed equally by the owner and contractor.
9. The existence of the pre-selected neutral, already familiar with the business relationship between the parties and its progress, avoids many of the initial problems and delays that are involved in selecting and appointing neutrals after a controversy has arisen. The ready availability of the neutral, the speed with which he or she can render decisions, and particularly the fact that this neutral will hear every dispute which occurs during the life of the relationship, all provide powerful incentives to the parties to deal with each other and the neutral in a timely and frank manner, by discouraging game-playing, dilatory tactics, and the taking of extreme and insupportable positions. The mere existence of the neutral results in minimizing – and often totally eliminating – the number of disputes that have to be presented to the neutral. In effect the standing neutral serves not only as a standby dispute resolution technique but also as a successful dispute prevention device. Even though some expense is involved in the process of selecting, appointing, initially orienting, and periodically keeping the neutral informed about the relationship, the costs are relatively minimal, even in those rare cases where the neutral has to be called on to resolve disputes – especially when compared to the potential costs of resolving a dispute in litigation, arbitration, or even mediation.

The Standing Neutral concept in practice is exemplified in a number of different forms. The original, most prevalent and by far the best-developed form is the Dispute Review Board (a/k/a Dispute Resolution Board or DRB), which was first used in 1976. Since the essential elements of most Standing Neutral processes are well exemplified by the DRB, this Monograph will principally use the classic DRB as a model to illustrate the practical workings of the Standing Neutral process.

Composition and Functioning of a DRB

The classic Dispute Review Board, as envisioned by the widely-used standard forms developed by the Dispute Resolution Board Foundation, is a neutral body, typically composed of three impartial construction industry professionals who are experienced in the type of construction at issue. Parties contractually agree to use a DRB while negotiating a project agreement, and members of the DRB are then jointly selected by the owner and contractor immediately after contract award. DRBs are available throughout the project to assist in the prompt resolution of disputes. The DRB is given contract documents and relevant project information at the outset of the project.

Then:

- The DRB stays abreast of project developments and potential disputes through regular periodic site meetings with the owner and contractor and review of progress reports and project documents;
- The DRB encourages parties to resolve disputes that are brewing at the job level;
- The DRB can issue advisory opinions about disputes, at parties' request, to guide prompt party-controlled negotiation and resolution;
- Ultimately, disputes that cannot be resolved by the parties may be referred to the DRB to conduct "real-time" resolution: hearings where parties present their positions and answer questions from the DRB. The DRB then issues a non-binding recommendation for resolution of the dispute. The recommendation is usually admissible in subsequent arbitration or litigation if the parties choose not to accept it, but parties can agree otherwise in their contract. (See "Confidentiality of DRB Recommendations" at p. 14, below.)

Examples of Other Standing Neutrals

One DRB member. One Standing Neutral variation of the DRB that is used by one public authority addresses “small monetary claims” by using only one member of the three-person DRB to address such claims. (See “Should Dollar Thresholds Limit DRB Use?” at p. 15, below).

Single Standing Neutral. In smaller projects, a single individual Standing Neutral can be a substitute for the three-person DRB, and function in exactly the same manner as the classic DRB.

Project Neutral. A single Standing Neutral (called a Project Neutral) is one of the dispute resolution options that are recognized in the ConsensusDOCS contract forms that were released in 2007. Those forms call for a tiered approach to dispute prevention and resolution that starts with direct discussions between the parties at various levels within specified time frames; if the problem is not resolved at that level, the parties can choose to refer it to either a previously-selected single Project Neutral or a DRB. If the parties do not choose to use a Project Neutral or DRB the dispute goes to mediation, and then if mediation fails, to a binding dispute resolution process such as arbitration or litigation. Under these provisions, decisions by the Project Neutral or DRB are admissible in any subsequent binding process.

Initial Decision Maker. A Standing Neutral type of arrangement is also contained for the first time in the 2007 edition of the American Institute of Architects (AIA) Documents. Instead of simply continuing to have the architect be the sole authority for making initial decisions, these forms allow the parties to agree to designate a truly independent neutral third-party “Initial Decision Maker” (IDM) in the contract if they do not wish the architect to serve in that capacity. If an independent IDM is named in the contract, that person is the person who will, within 10 days make an initial decision on all claims (other than a few specifically delineated exceptions, such as aesthetic effect). The initial decision is binding upon the parties subject to either party initiating mediation (within a specified time frame), and, if that fails, arbitration or litigation. Because the AIA Documents do not specify the IDM process in any detail, the American Arbitration Association has promulgated IDM Procedures, effective January 1, 2009, which parties can use to select and appoint a trained individual who will serve under the terms and conditions of the AAA Procedures as IDM.

Standing Arbitrator. A variant of the standing neutral process, useful in a situation where it is important to achieve early decisions that are binding, is to give the neutral the power to render binding decisions, thus acting as an arbitrator. Because this process shifts control of the dispute to the arbitrator, it has the disadvantage of taking away the ability of the parties to cooperatively work out their own mutual resolution of the dispute. Also, parties faced with the prospect of a binding decision are usually represented by lawyers, tending to add expense, cause delay, and escalate adversarial attitudes.

Standing Mediator. Another variant of the standing neutral process is the designation by the parties of a mediator at the commencement of the relationship to assist the parties in negotiations to resolve disputes. In the construction industry this technique is rarely used, probably because what the parties need when a problem arises is not a facilitator to encourage them to compromise every issue, but rather an objective expert who can administer the “dose of reality” that is more likely to give the parties a principled basis for resolving the dispute. Also, since parties involved in mediation are likely to seek the assistance of lawyers, this can add expense and cause delay.

Where are DRBs Used?

DRBs are used on construction projects all over the world and their use is growing. Once the province of the underground construction industry, DRBs are now found on all types of construction projects. In the United States, a number of state highway departments use DRBs on all of their substantial projects. Transit authorities in several major cities specify some form of DRB, and DRBs can be found on significant construction projects such as heavy civil, wastewater, medical, and manufacturing plants, as well as airport, power plant, sports complexes and office building construction, among others. Single Standing Neutrals are beginning to be used on a number of smaller projects.

Abbreviated case studies of DRBs can be found at www.drb.org under the "DRB Practices and Procedures Manual" section.

DRB Costs: Direct and Indirect

The costs of DRBs are minimal and are far outweighed by the benefits they provide.

- **Direct Costs include Fees and Expenses of the DRB Members**
DRB members and Standing Neutrals typically charge an hourly rate commensurate with their experience. These rates are typically split between the parties and can range from \$150 to \$400 per hour depending on the expertise of the member and the area of the country. DRB agreements require that expenses be reasonable and well-documented. According to the DRB Foundation, total cost for a three-member DRB range from about .05% of final construction contract cost for a relatively disputes-free project, to about .25% for so-called "difficult" projects with a number of DRB hearings, for an overall average of about .15% of final construction contract costs. These percentages typically apply to projects whose costs range from \$50 million to \$100 million. In projects greater than \$100 million, percentages are lower; conversely, in smaller projects, the percentages for three-member DRBs are higher. The expense of a single Standing Neutral is of course commensurately lower, and there have been instances where the cost of a single Standing Neutral are as little as a few hundred dollars.

- **Indirect Costs of Participants' Time**

Indirect costs of the process will include most notably the time for members of the owner and contractor teams to prepare for and participate in the DRB process, to attend periodic site meetings and to provide ongoing project information to the DRB members.

Because hearings before a DRB are held while facts are still fresh and witnesses are readily available and are currently familiar with the facts, the transactional costs of hearings can be expected to be substantially lower than the costs associated with more adversarial proceedings.

However, perhaps the greatest source of cost savings on projects that use a DRB is the elimination of disputes, as exemplified in the following discussion of success statistics.

DRB Success Statistics

The DRB is generally recognized as one of the most efficient and effective means of preventing and resolving claims and disputes on a construction project. Supporters of the DRB process point to its near perfect track record of avoiding litigation or arbitration on projects where it is used.

According to the DRB Foundation,⁸ which has a database of over 1200 projects since 1975 that have used DRBs:

- 60% of projects with a DRB had no disputes (this statistic attests to the “dispute prevention” benefit that accompanies any Standing Neutral process).
- 98% of disputes that have been referred to a DRB for hearing result in no subsequent litigation or arbitration.
- The worldwide use of DRBs is growing in excess of 15% per year, and through the end of 2006 it was estimated that over 2000 projects with a total value in excess of \$100 billion had used some form of DRB.
- Dr. Ralph Ellis, a University of Florida civil engineering professor, has studied the use of DRBs by the Florida Department of Transportation involving over \$10 billion of that agency’s construction projects. He concluded that use of DRBs resulted in:
 - Net cost growth savings equal to 2.7% of construction costs; and
 - Net time growth savings of 15.1%.

The American Society of Civil Engineers conducted a study of DRBs in the mid 1990s and found that DRBs heard a total of 225 disputes on 166 projects worth \$10.5 billion. They resolved 208 of the 225 disputes and the only one that actually proceeded to litigation and was eventually settled.⁹

DRB Benefits

Properly used, DRBs can lead to the following multiple conflict management benefits. They:

- **Provide an Informal & Non-Adversarial Process.** The DRB is essentially informal and non-adversarial and typically produces a non-binding recommendation by experts in construction for the parties’ consideration.
- **Serve a Preventive Function.** The very existence of the DRB has been shown to create a cooperative relationship that provides impetus to settle disputes without taking them to the DRB.
- **Preserve Relationships.** DRBs help preserve and promote productive project relationships by focusing on the resolution of problems quickly at the source before they escalate.
- **Enhance Communication.** DRBs provide a logical extension of partnering, because they foster open communication, trust and cooperation between parties.
- **Address Disputes Rapidly while Construction Continues.** DRBs offer “real-time” disputes resolution contemporaneous with performance of the construction contract.
- **Avoid “End-of Job.” Claims.**-For owners DRBs help reduce the possibility of the big “end-of-the-job” claim.
- **Address Change Orders Quickly and Efficiently.** For contractors, DRBs encourage the prompt and relatively inexpensive resolution of claims and changes.
- **Reduce Bids.** Some commentators have asserted that for owners, DRBs often lead to more and lower bids since contractors are less likely to include large contingencies in their bids if the contract provides for a DRB. They find that some contractors maintain that they are hesitant to bid certain projects, e.g., tunnel jobs, when there is no DRB provision.
- **Provide a Useful Imprimatur.** For public owners, the written DRB recommendation provides the often needed credibility to justify a claim resolution or settlement to oversight bodies such as a city councils, county commissioners, or boards of directors.

⁸ See www.drb.org/manual_access.htm for information on the DRB Foundation’s database; statistics on the database are reported by the Texas Chapter of the DRB Foundation (at www.drbtx.org) in “The Impact of a DRB on a Construction Project.”

⁹ “Industry Pounds Away at Disputes”, *Engineering News-Record* 24 (July 11, 1994).

Putting DRBs to Use

Building a DRB into the Contract

Contract As Early As Possible for a DRB

Agreements to use a DRB should be addressed as early as possible, preferably when the initial contracts for the project are being negotiated and well in advance of when disputes might arise. The provisions regarding a DRB will usually be integrated into the contract's claims/changes and general disputes resolution provisions. DRB provisions will address:

- Qualifications for Members of the Board, including absence of conflicts of interest;
- Member selection process;
- Termination or replacement of DRB Members;
- DRB operation during construction;
- When and how disputes will be referred to the DRB, how hearings will be conducted, and the DRB's report/recommendation requirements;
- Confidentiality provisions regarding materials submitted to the DRB (See page 14, below);
- Small claim procedures with possible monetary caps or fast-track claims in some projects.

A host of sample contract forms are available at www.drb.org. However, one must exercise great care in using form agreements and terms that may not be suitable for particular projects. Seek the advice of skilled counsel in drafting DRB agreements and provisions given the complexity and idiosyncratic nature of construction projects and the long-term consequences of contractual agreements.

Assure Prompt DRB Member Selection

Even when early agreements to use a DRB are made, DRB use can be stymied by failure to select the DRB members promptly. Once a dispute erupts, selection processes may be more contentious. Consequently, parties should seriously consider mechanisms in the project contract that propel member selection in a timely fashion. Mechanisms that have been used include:

- Agreeing to deadlines such as requiring selection no later than the first Partnering meeting if Partnering is to be employed on the project. (See CPR's *Partnering Briefing*).
- Requiring that the members be selected as an express condition precedent to commencing contract performance.
- Naming a default appointing authority. If the parties fail to select DRB members by a specified deadline, the appointing authority will proceed to do so. This practice is common in arbitration where ADR organizations, such as CPR, serve as the default appointing authority and the same concept can be used in the DRB setting.

Inform Project Personnel for Buy-In

It is also useful to alert project and field personnel about the existence of the DRB agreement and how the DRB operates, to both educate them and get their buy-in to the process when disputes arise.

Three-Party Agreement

The relationship between the DRB, the owner and the contractor is memorialized in the so-called "three-party agreement," which sets forth the duties and responsibilities of all three parties. The three-party agreement will be appended to and made a part of the contract documents.

Selecting DRB Members

Impartiality and Lack of Conflicts of Interest

Selection procedures must assure appointment of a DRB that is completely impartial to provide credibility to their recommendations and party respect and confidence in reports. The success of the DRB process on any given project will turn in large part on the credibility of the Board Members. The importance of a thorough and complete qualification and selection process cannot be overstated.

- As part of the selection process, parties should demand complete disclosure of any relationships or potential conflicts of interest that might affect a member's impartiality. Disclosures of past or present employment, consulting, financial, professional or personal relationships with the parties or the project that might indicate bias or might even create the perception of bias should be disclosed. Such disclosures should include relationships with the primary contracting parties but also with those who will become involved in the construction, such as construction managers, sub-contractors, architects, engineers and other consultants and suppliers who are known. As new players come into the project, such disclosure obligations should continue.
- Disclosures should cover past DRB service on a project in which the parties or other key players were involved.
- DRB members should avoid potential discussion with any participant in the project of future employment with such participant while the DRB is in existence to avoid the perception of bias.
- Additional requirements may apply to DRB members who are attorneys including disclosure of representation of contract participants by other members of the attorney's firm. Lawyers are aware of such requirements mandated by ethics codes and ADR case law.
- Once disclosed, parties can evaluate whether such disclosures render the DRB member acceptable or not; a party can always waive conflicts, once they are disclosed.

Given the continuing evolution of law regarding disclosure and conflicts of interest in the ADR field, it behooves DRB members, because they are functioning as third-party neutrals, to be scrupulous regarding disclosures of conflicts of interest or potential conflicts. Disclosures assure party acceptance of recommendations, and are even more critical if DRB recommendations are admissible in any later adjudication proceedings. (See p.10).

Generally, the best approach is to err on the side of complete disclosure to allow parties to assess whether any potential conflicts are trivial or significant enough to bar selection of the proposed member. Reducing the disclosures and the parties' consent to the DRB's service in writing is recommended.

Expertise of DRB Members

In addition to complete neutrality, and an absence of any conflicts of interest, it is vitally important that DRB members have significant experience and expertise in the type of construction at issue. Members should also be experienced in the interpretation and application of construction contracts and the resolution of construction disputes. The quality of DRB members, and the respect that they have from the parties, are vital elements in encouraging realistic and reasonable behavior by the project participants.

Selection Methods

The most common selection process involves a "joint selection" process which requires representatives of the parties to meet and jointly select the Board members, thereby eliminating any perception that a party-selected Board member is that party's advocate or has allegiance to any party. Another common method has the owner selecting a member who is subject to the approval of the contractor, the contractor selecting a

member subject to the approval of the owner, and the two members thus selected choosing the third member, who is also subject to the approval of the parties. In some cases, the third member is contractually designated the chair of the panel; in other instances, the three Board members decide amongst themselves who will be chair, again subject to the approval of both parties.

Other selection methods include, for example, having each party propose a list of several candidates after which each party selects one member from the other party's list and those two selected members then choose the third, subject to approval of the parties.

Normal Operation: Staying Current as Project Develops

Ongoing Review of Progress and Project Reports

Once in place, the members of the Board review the contract documents and become familiar with Project procedures and the key players for both the owner and the contractor. A detailed and up-to-date understanding of the project, along with early establishment of a relationship of trust and confidence with the project participants, will become the cornerstones on which a successful DRB process is built. The DRB stays current with the progress of the work, as well as any problems that arise, through its on-going review of construction progress reports, project meeting minutes, and other key information provided by the parties.

Periodic Site Visits

The Board also visits the site periodically on a regular basis to meet with the parties, discuss progress and any problems, and observe first-hand the status of the project. In many instances the Board can contemporaneously observe a differing site condition or other claim-related problem in the field. Even if the project is relatively problem free, it is important to maintain the practice of periodic meetings and site visits.

Scheduled DRB Meetings

The frequency of meetings with the DRB varies from project to project. In most cases quarterly meetings will suffice, although monthly meetings are the norm on some larger or fast-track projects. Special meetings can be scheduled if and when the need arises. At the DRB meetings the owner and the contractor discuss the progress and status of the work, perceived problems, change orders, looming issues, and any claims or disputes that have arisen. The discussion includes the parties' assessment of the likelihood that a dispute or claim will be resolved, and any assistance the DRB might offer.

Informal Advisory Opinions

When requested, and with the approval of both parties, the DRB may issue informal "advisory" opinions to assist the parties in resolving a dispute in its early stages, outside the formal DRB hearing process. Advisory opinions do not prevent the issue from being presented subsequently at a DRB hearing. A typical advisory opinion process might involve about an hour of presentations by the parties, followed by DRB questions, and a short DRB caucus, after which the DRB issues its oral opinion. These opinions offer parties a multi-tiered process to avoid the expenditures of the full blown DRB process. In some cases the contract will specifically address the advisory opinion function and specify the circumstances under which it may be invoked. If not, the parties can raise it at the first opportunity with the DRB.

Advisory opinions can be useful in situations where the parties disagree over the interpretation or application of a contract provision. A quick, informal "preview" of how the DRB might assess a particular issue can avoid the expenditure of time and resources required to take the dispute through the contractual DRB referral and hearing process. If parties can't resolve the dispute with the advisory opinion, neither the DRB nor the parties are bound by that opinion in the formal DRB hearing nor can the parties refer to it at the hearing. Knowing in advance how the DRB is likely to decide an issue or dispute also provides a strong incentive for the parties to reach a negotiated resolution and avoid a DRB hearing. (See "Confidentiality of DRB Recommendations" below at p. 14.)

Dispute Referrals and DRB Hearings

Referral to DRB for Hearing

When the parties are unable to resolve a dispute, the dispute may be referred to the DRB for a hearing and non-binding recommended resolution. Either party may refer an issue to the attention of the Board – parties do not have to agree to submit an issue. Although DRB proponents contend that the DRB process should be invoked as soon as it becomes clear that a dispute exists which cannot be resolved by the parties, when and how a dispute may be referred to the DRB usually will be addressed in the contract documents. Contracts typically provide that claims and disputes will be referred initially to the owner's representative (typically the architect or engineer) for review and recommended action. If the contractor (or in a rare case, the owner) is unhappy with that recommendation, the dispute/claim may be referred to the DRB. Contracts sometimes specify a time within which that decision must be made, and if no referral is made to the DRB within that period, the decision of the owner's representative becomes final and binding.

DRB provisions typically empower the Board to establish its own procedures. In most cases, those procedures will establish a time line and require submission of position papers and a set of "common reference documents" – background materials, relevant portions of the plans and specifications, contract provisions, correspondence, daily reports, etc. Each side puts in what it thinks is necessary and the package thus assembled is submitted by the parties as one set of common reference documents. After reviewing these submissions, the DRB will schedule a hearing at which the parties present their positions and respond to questions from the DRB Members. Ideally, hearings will be conducted at or near the jobsite.

Hearings

Hearing participants should include decision makers and representatives of the parties with first-hand knowledge of the project and the issues underlying the dispute. The parties are usually required to disclose in advance the individuals who will attend the hearing on their behalf, in order to permit both parties an opportunity to adequately prepare. DRB hearing procedures often prohibit the participation of lawyers in the hearing process, although in some instances, lawyers are allowed to be "seen but not heard." Cross examination is not permitted, although parties are allowed to challenge each other's positions in a professional, non-confrontational manner. When outside experts are used by the parties, DRBs have been known to employ a "point-counter point" approach to expose the differences in the experts' opinions. Every effort is made to allow the parties a full and fair opportunity to present their arguments, although most hearings tend to be relatively short in keeping with DRB goals of efficiency and economy.

While DRB presentations are typically made by project personnel with first-hand knowledge of the facts and occurrences on the project, it may be necessary at times to have an attorney make such presentations. For example, if project participants have language difficulties then the use of an attorney may be desirable. When drafting DRB agreements, it might be wise to specifically grant the DRB discretion to determine, for good cause shown, that persons other than project personnel would make the presentations as part of the DRB's control over its own procedures.

Report Requirements

After the hearings, the DRB Members meet to discuss and decide how the dispute should be resolved. The contract will often provide the guidelines or context within which the DRB is to deliberate (e.g., that the recommendation must be based on the relevant contract documents and project records, the arguments and facts presented, and, in some cases, applicable law). The contract will also specify the time in which the DRB is to issue its recommendation. That time may be extended as circumstances require. In some cases, the DRB process is set up by the parties so that initially the DRB's recommendation deals only with the merits of a dispute, giving the parties the opportunity to negotiate the quantum based on that recommendation. If the parties are unable to reach agreement on quantum, they can return to the DRB for assistance. This bifurcation of entitlement and quantum is seen as a way to minimize the issues before the DRB. When these key issues are bifurcated, the entitlement determinations are not as time consuming or as costly as quantum

determinations which demand substantial additional information to allow the DRB to address them. With the parties' consent, the DRB will provide the parties with guidelines for presenting quantum issues when it issues its entitlement determination.

(On the other hand some see this approach as prolonging the ultimate resolution of a dispute. According to this view, it's better to have one hearing and get one recommendation on the entire dispute – entitlement and quantum.)

The Board will provide a written recommendation containing a statement of the key points raised by the parties and its supporting rationale. Typically, the recommendation is not binding on the parties. These written reports can be of particular value to public owners, who must provide a rational basis for resolution of a claim or dispute to various oversight agencies and boards. What better than the reasoned opinion of three impartial, experienced professionals who have first hand knowledge of the project and the issues underlying the dispute?

Confidentiality of DRB Recommendations: Admissibility in Subsequent Proceedings

First and foremost, the DRB report/recommendation is used by the parties to negotiate a resolution. In most cases, as the statistics show, that is what occurs. If it doesn't, the issue of using the report in litigation/arbitration comes into play. While the DRB recommendation, including any minority report, may be admissible in subsequent litigation, arbitration or other binding dispute resolution procedure, all information provided to the DRB is generally treated as confidential. Moreover, the three-party agreement usually precludes DRB Members from being called to testify in any subsequent adjudicatory proceedings. Contracting parties should seriously consider the issue of potential admissibility or inadmissibility of DRB recommendations when they are negotiating the DRB agreement. The following considerations may be helpful:

- **Admissible?** Most contracts provide that the DRB recommendation is admissible in subsequent litigation or arbitration if not accepted by the parties. It is believed that the substantial risk that a judge, jury or panel of arbitrators will place great weight on the DRB recommendation deters the losing party from filing a lawsuit and taking another bite at the apple. DRB Foundation statistics and anecdotal evidence tend to support that belief.
- **Inadmissible?** Others argue that there is reason to believe that the admissibility provision sometimes results in a more formal and contentious DRB process. Knowing that the DRB recommendation might be a part of subsequent legal proceedings could cause some parties to demand more extensive information exchange and hearing time, and take other actions to "protect their rights." Some owners simply will not agree to the admissibility provision – opting instead for a purely consensual DRB process. If the process works – great. If not, owners will take their case to court without the threat of admissibility of the recommendation hanging over their heads. A typical contract provision to avoid admissibility and protect the confidentiality of the DRB recommendation might state:

All information presented to the DRB and all deliberations and recommendations, shall, except as provided herein, be kept strictly confidential. The DRB Members shall not, during their tenure as Members, and at any time thereafter, reveal any information presented to the DRB or obtained in their capacity as DRB Members, or disclose any recommendation, to any third-party.

Common Issues and Suggested Solutions

Scope of Issue Referral - Everything or Just Technical Issues?

Should all disputes, whatever their nature be referred to the DRB? Some owners, even those who are otherwise very comfortable with the DRB process, elect not to refer all disputes to the DRB. Those owners believe that the DRB, most often a panel of engineering and construction professionals, is not well-suited to providing a reasoned recommendation capable of passing muster with various oversight agencies on disputes involving pure legal or contractual issues. This is particularly true when there is no lawyer on the DRB. To address this concern, some DRBs call for a lawyer in the Chair position. DRB purists, on the other hand, contend that the DRB process is most effective if all disputes are referred to the DRB. Experienced construction professionals who qualify to serve on DRBs are quite capable of dealing with construction contract interpretation and consequences, as well as the law applicable to construction projects. As with most things, what is right for your project will depend on the circumstances.

When to Activate the DRB Hearing Process?

Should the process be activated at the first sign of a dispute or after exhaustion of some number of contractual prerequisites? Some users contend that the most successful, *i.e.*, the most disputes-free projects, are those where the contract provides that disputes may be referred to the DRB by either party as soon as that party deems it necessary – usually after job-site level efforts have failed. Some public contracts require that the dispute first be presented to the engineer or other decision maker for resolution, and only if the contractor disagrees with that decision can the DRB process be activated. While there may be good reasons for this approach, it must be recognized that positions are likely to become entrenched by the time the DRB becomes involved.

Should Dollar Thresholds Limit DRB Use?

Owners have also drafted DRB provisions that establish a monetary threshold for disputes to be heard by the DRB, for example, \$100,000. The reasoning is that smaller disputes do not justify convening the three-person DRB panel and incurring the associated costs and expenses. One recent DRB agreement by a state Department of Transportation provided a “small claims” procedure for claims under a dollar threshold amount which would be heard only by the Chair of the DRB. As any trial lawyer can attest, small disputes taken to litigation can sometimes lead to legal fees many times the value of the dispute.

Replacing a Member

In most DRB contract provisions, when a Member of the DRB resigns during the project due to illness and the like, his replacement is selected using the same procedure initially employed. Thus, if the contract provides that the owner and the contractor each select a Member that is acceptable to the other, the vacant position is filled in the same manner. The more difficult issue arises when one of the parties loses confidence in the impartiality of one of the DRB Members or the Board as a whole. To state the obvious, if a DRB recommendation is perceived by either party to be rooted in bias, it is likely it will not be accepted. A loss of confidence in the Board, whether based on fact or perception, will most surely lead to litigation. Most DRB provisions provide that a Member can only be removed or replaced by the party who appointed him, or, in some instances, if both parties agree. On the one hand, allowing a party to remove any of the Board Members, for any reason, any time, can lead to an abuse of the process by a party seeking to gain a strategic advantage. On the other hand, the inability to address the perception of bias can seriously jeopardize the Board’s ability to “sell” its recommendations to both parties, and ultimately avoid litigation. Obviously, utmost care should be taken in the selection of Board Members at the outset. (See Select DRB Members, at p. 11, above). Serious thought also should be given to a mechanism for addressing a loss of confidence in the Board – in the unlikely event it occurs – especially on long term projects.

Binding or Non-Binding Recommendations?

Almost all domestic DRB provisions provide for a non-binding recommendation on any dispute referred to the DRB. The non-binding approach is perceived as creating a less adversarial process more conducive to preserving project relationships. Conversely, "binding" DRB recommendations have been interpreted by the courts to transform the traditional DRB process into binding arbitration, with all the associated procedures and legalities. As a result, the process becomes much more formal and adversarial. On at least one well-known project where the binding approach was implemented, virtually every DRB decision became the subject of litigation.

Advocates of the traditional non-binding approach contend that experience shows non-binding recommendations have the practical impact of a binding decision because parties accept the recommendations in the vast majority of cases. When the non-binding decision contains the reasoning used by the DRB in reaching that result, it can further propel acceptance by the parties.

Internationally, parties to construction contracts may encounter DRB provisions that call for a DRB recommendation to be binding unless objected to within a specified period of time – a so-called "binding in the interim" recommendation.

Should Attorneys Serve on a DRB?

In most matters, non-attorneys serve on DRBs given their actual expertise in the particular type of construction at issues and its unique problems. In some cases, the parties choose to have an experienced construction lawyer serve on the DRB. This can be very beneficial with respect to issues involving contract law and interpretation consistent with the parties' intent when the contract was written. Attorneys might also assist in the effective administration of a hearing, and the drafting of written recommendations. Some users believe that the presence of attorneys can lead to longer, more formal and more adversarial proceedings with more litigation-like procedures. All things considered, the more reasoned conclusion is that experienced construction lawyers, knowledgeable and supportive of the DRB and other alternative disputes resolution processes, can fill a valuable role on the DRB.

Use of Standing Neutrals in Other Businesses

The standing neutral concept is appropriate for many type of continuing business relationships. Examples include joint ventures, long-term supply contracts, corporate governance, or various other types of long-term business relationship. The neutral, who could be a trusted experienced business person, expert accountant, neutral attorney, or other "wise person," would serve as a standby resource to assist in the resolution of disputes. The neutral should be initially informed of the purpose and nature of the business relationship, and kept up to date through routine progress reports or meetings with the parties, so the neutral will be aware of the evolution of the relationship. If the parties should later have a problem that they cannot readily resolve by themselves they can call in the neutral, explain the problem, and ask the neutral to furnish promptly an expert opinion as to how the problem should be resolved.

There can be many variations of the use of standing neutrals in a business context. For example, in the case of a closely-held corporation where there might be deadlocks between equal owners, there are a couple of techniques that can be employed when drafting the corporate charter and by-laws that can avoid the paralysis of a deadlock by using one or more outside directors as standing neutrals:

One technique is for the stockholders who have evenly-divided interests to elect as a director a neutral outsider who is knowledgeable about the business and has a reputation for integrity. (An example of such a person could be the Dean of a local business school.) This outside director is paid a significant director's fee, is furnished the key management reports that are provided to other directors, and is expected to attend all board meetings, ask questions, participate in discussions, and get a good perspective on the affairs of the company. However, this outside director has a vote only in the case of a disagreement among the "inside" directors, in which case the outside director has the deciding vote.

Another technique is to establish a five-person board of directors, two of whom represent the evenly-matched “insiders” and three of whom are independent “outside” directors. They all function as a real board, and each director has a vote. The advantage of the arrangement is that in any case where the two inside directors disagree, it takes the votes of at least two of the three outside directors to carry the vote.

In both of these situations, because the independent outside director(s) will make the deciding vote, there is an incentive for all directors to exercise good judgment, be on the same page, and be aligned.

An example from an ongoing real estate development should help to illustrate how versatile the standing neutral process can be. In 2007 the developer of a large multi-use complex wanted to secure its financing and commence construction of the complex. Unfortunately the signature element of the complex, a luxury hotel, had not yet been designed. Through creative use of the standing neutral concept the developer and the hotel chain which would own the hotel after the developer completed construction found a way to get the project started. They reached general agreement on the overall scope, size and quality criteria of the hotel, agreed to collaborate on the design of the hotel, and agreed on a price and time of delivery of the completed hotel; then, in order to encourage mutual collaboration during the entire course of the design and construction of the hotel, they named in the contract an expert “development arbitrator” to make sure that no dispute would delay or disrupt the project. Under the development arbitrator terms of the contract, in case the parties had any disagreement over any element of design or construction of the hotel the development arbitrator is required to meet briefly with the parties within five days to see whether the disagreement could be immediately resolved, failing which the arbitrator is required to schedule a hearing to be held within the next 21 days, at which the parties would present their respective positions, following which the arbitrator would make a final and binding decision, not subject to appeal, within the next two days. The resolution process is enhanced by a requirement that any disputes have to be presented to the development arbitrator in a “baseball arbitration” format. Eighteen months into this project, this “resolution” system has turned out so far to be a completely effective dispute “prevention” system, because during the entire process of design of the hotel and all of its interiors, and through more than 50% completion of construction, the parties have resolved every potential dispute between themselves and have not had to call on the development arbitrator to resolve a single dispute.

Prospects for the Future

By all accounts, the use of DRBs and other forms of Standing Neutral in construction is growing domestically and internationally, the process is expanding into all areas of construction, and the success rate in preventing litigation, arbitration and mediation is remarkable. The Standing Neutral concept is beginning to be used in other forms of business. Consider whether its use would help your proposed project or other long-term cooperative business venture.