

## **Discussion paper**

### **Dispute Boards – A Great Idea or a Shocking Waste of Money?**

#### **Background**

Back in the good old days of the FIDIC Red Book 1987/92 Edition, construction contract disputes were settled by the Engineer. The whole dispute resolution process was built around the independence of the Engineer and his ability to act impartially. But the reality was often quite different. The fact that the Engineer was paid by the Employer led to the perception that he was biased in the Employer's favor, whether or not that was actually the case, and there is no doubt that many Engineers found it very difficult to issue decisions against, or critical of, the Employer. Thus, over a period of time the process came into disrepute and new approaches for the settlement of disputes on construction projects had to be found.

#### **FIDIC 1995 Design-Build & Turnkey**

In 1995, FIDIC introduced the idea of a jointly employed one- or three-member Dispute Adjudication Board into its Design-Build & Turnkey contract conditions (the FIDIC Orange Book). This contract form had no "Engineer" and day-to-day administration of the project was put into the hands of an Employer's Representative, who though required in terms of the contract to be fair and reasonable, and to determine value, cost and extensions of time in accordance with the Contract, was not required to be impartial<sup>1</sup>. The duty of impartiality was imposed on the Dispute Adjudication Board Members who were required to visit the site on a regular basis (suggested at once every four months) during the course of construction and to be available for hearings at short notice (suggested as 28-day) in the event of a dispute. The Dispute Adjudication Board would give binding and final decisions on disputes referred to them. Amicable settlement and arbitration would remain an option in the event that either party was dissatisfied with the decision given by the Board, subject to notice being given within 28-days of the decision being issued.

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<sup>1</sup> On the face of it there may appear little difference between being "fair" and "reasonable" and being "impartial". A legal dictionary defines impartial as "Favoring neither, disinterested, treating all alike, unbiased, equitable, fair and just". One has to question whether the duty to act impartially imposes some other requirement over and above the need to be fair and reasonable.

The principle behind the Dispute Adjudication Board appointments in the 1995 FIDIC Orange Book was that each party would appoint one member of the Board who would in turn meet and, in consultation with the parties, agree between them the appointment of a third Board member to act as their chairman in a three-member board. Payment for each Board member would be shared between the Employer and the Contractor, and would be on the basis of a daily fee for traveling to and attending at site visits and hearings, plus a monthly retainer to cover the obligation to be available at 28-days notice and for “...becoming conversant with all Project developments and maintaining project files...”. An indication was given by FIDIC that the fees charged should equate to those charged by arbitrators acting for the International Centre for the Resolution of International Disputes (currently running at USD 3,000 per day), and that the monthly retainer should be equivalent to three days fee at the same rate during the construction period reducing to one day during the maintenance period.

#### **1996 FIDIC Red Book**

The 1995 FIDIC Orange Book was clearly well received to the extent that in 1996 FIDIC introduced the idea of one- or three-member Dispute Adjudication Boards as an acceptable alternative to the Engineer’s Decision approach for the settlement of disputes under the FIDIC Red Book, i.e., for civil engineering contracts where the design is prepared by the Employer.

#### **1999 FIDIC Red Book**

In 1999, FIDIC completely updated their contract conditions adopting the one- or three-member Dispute Adjudication Board concept for the settlement of disputes in what have become known as the “Rainbow Suite” of contract forms. In the new Red Book the Engineer, though retained as a first line of decision making in the event of any claim for extension of time or additional payment, acts as little more than a funnel to get the dispute as fast as possible in front of the Dispute Adjudication Board. The Engineer is still required to be “fair” in any determination that he is required to make in relation to claims. However, Clause 3.1 of the 1999 Red Book states that “...*whenever carrying out duties or exercising authority, specified in or implied by the Contract, the Engineer shall be deemed to act for the Employer...*”, thus leaving the Contractor in no doubt where the Engineer’s sympathies are expected to lie.

## **2006 FIDIC Harmonized Edition**

In 2006, FIDIC issued a new MDB Harmonized Edition of the Red Book which is now used for most civil construction projects funded by the international financing agencies, World Bank, EBRD, etc. where the design is prepared by the Employer. Only the European Union appears resistant to the change to these new conditions, still preferring to use the EU Works Contract for projects in many places.

The 2006 Harmonized Edition is very largely based on the 1999 Red Book though the Dispute Adjudication Board is now renamed as the Dispute Board. The operation of the Dispute Board under the 2006 Harmonized Edition is, for all intents and purposes, identical to that of the Dispute Adjudication Board under the 1999 Red Book. Current guidelines from the World Bank are that projects value above USD 50 million should have a full three-member board. A one-member board (sometimes also called a Dispute Review Expert, or DRE) is recommended for smaller projects.

### **Dispute Adjudication Boards vs Dispute Review Boards**

The Dispute Board concept, including the approach to remuneration, appears to have been taken from experience in the United States where such boards have, since the late 1960's, been routinely convened for large projects in many states. However, there are significant differences between the boards used in the United States and that now advocated by FIDIC.

In the United States the boards are typically referred to as Dispute Review Boards (DRBs). They usually make recommendations not decisions, and quite often these recommendations are given verbally, not in writing. These recommendations are neither final nor binding, and the process appears fairly informal. It is very much an Engineer/Architect led process.

Decisions given by FIDIC's Dispute Adjudication Boards (DABs), on the other hand, are final and binding, unless either party gives notice of dissatisfaction within 28-days of the decision being issued. A DAB tends to be a slightly more formal than a DRB and, for better or worse, has become adjudicator led. The fact that the DAB's decision is final and binding appeals to many Employers, as it relieves them of the responsibility for deciding whether or not to implement a DRB's recommendation<sup>2</sup>.

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<sup>2</sup> Readers should be aware that under International Chamber of Commerce (ICC) rules a third type of board called a Combined Dispute Board (CBD) can be convened. This appears to straddle the ground between DRB

### **Benefits of using Dispute Boards**

It is generally agreed that the introduction of Dispute Boards has led to a significant reduction in the number of projects that end up in court or in front of an arbitrator. The usage of boards is quite wide spread and includes such prestigious contracts as the Channel Tunnel in United Kingdom, Hong Kong Airport and many of the largest dam and hydro-electric plant projects in the world. The general view is that the board's regular visits provide a focus for the parties to discuss disputes and potential disputes, and give a tremendous opportunity for dispute avoidance.

Data available from the Dispute Resolution Board Foundation suggests that the average speed of dispute resolution using boards is about 56 days and that 98% of disputes are successfully resolved at board level.

But there are difficulties...

### **Cost considerations**

So, the Engineer as an independent decider of disputes under the Contract is now dead and the Dispute Board has become all powerful. Not surprisingly, contractors are very much in favor of the new regime as it clears the air and sets dispute resolution on a truly even keel. Employers, on the other hand, are not so keen. No longer can the Employer expect preferential treatment in the settlement of disputes just because he is paying the Engineer's fees. Nor do Employer's react too favorably to what they see as an increase in the cost of dispute resolution, much of which has to be committed even before a dispute arises.

A typical MDB financed project package may have a construction value of about USD 50 to 80 million thus requiring a three-member Board under World Bank guidelines. Very few project packages are below USD 50 million as it is difficult to get competitive bids for small value packages of work.

The cost of a three-member Board is not difficult to evaluate. Assuming a 30-month project duration and 12-month maintenance period (figures that are typical for many MDB financed projects) the

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and DAB in that the CDB issues recommendations that can be turned into binding decisions on the request of either party.

Board is likely to visit the site about 7 times. The likely costs for a project in (say) Central Africa with the board members flying from Europe or North America would break down as follows:

Site visits        3-members x 5 days x 7 visits @ USD 3,000 per day        = USD 315,000

Air fares         3-members x 7 tickets @ (say) USD 2,500 per ticket        = USD 52,500

Hotel accommodation    3-members x 7 visits x 2 nights @ USD 250        = USD 10,500

Retainer (Construction period)    3-members x 30 months @ USD 9,000        = USD 810,000

Retainer (Maintenance Period)    3-members x 12 months @ USD 3,000        = USD 108,000

The total cost of a 3-member board would be USD 1,296,000 or 2.6% of the construction cost (if this was for a USD 50 million value project). And this assumes that no disputes ever arise. The cost of time spent by the board at any hearings would be over and above this figure!! On this basis many Employers prefer to run the risk of their disputes ending up in court. As a result in many cases the boards are never appointed or are only appointed after a dispute has arisen. But this is a pity as the basic idea is excellent and a good Dispute Board can be proactive in dispute avoidance not just settling disputes once they have arisen.

### **Suggestions for keeping the costs under control**

The question is how can these boards be convened and set to work without the huge price tag.

The first thing to appreciate is that the legal profession is an expensive one. Employers should not imagine that USD 3,000 per day buys the time of a top flight construction lawyer. For that level of expertise you would need to almost double the rate. But does this kind of work need a top flight construction lawyer to be on the Dispute Board? And would such a person be of any use in this type of forum? Is one qualified adjudicator on a three-member board not sufficient? Or would it not be better to appoint just experienced engineers, architects and quantity surveyors, albeit ones with a good grasp of construction law, rather than adjudicators, possibly allowing them access to legal advice on a hearing-by-hearing basis, if they need it?

The biggest cost issue appears to be the monthly retainer. At a recent Dispute Resolution Board Foundation conference Gordon Jaynes pointed out that the origin of the retainer in the United States was when board members were expected to be available at 5-days notice, not the 28-days notice now required. Is the payment of a retainer still appropriate? Could it not be replaced with a monthly

standing charge that covers the time that needs to be spent by each board members between site visits?

### **Advice on appointing boards**

The following suggestions are made with respect to the selection and appointment of Dispute Board members with a view to getting the best performance from them.

1. Firstly, both the Contractor and the Employer need to select their board members wisely. After selection, both have to act and be seen to act impartially. There is little point, therefore, in the Employer selecting an engineer recently retired from his own office in the expectation that he will have the right “attitude”, and will know when and how to fight the Employer’s corner. He will not be seen as being able to be impartial and the contractor will have every right to object to the appointment, thereby dragging out the whole selection process and possibly leaving the project without a board for several months. Likewise the continual selection by contractors, time after time, of the same names taken from their own national contracting industry, is often not helpful. Be sure, therefore, that the person put forward can genuinely act, and be seen to act, impartially.
2. Secondly, ask yourself what expertise level is appropriate for the members on each board. Do not run to get a top flight construction lawyer as your board member, or even a “listed” arbitrator or adjudicator unless the nature of the project demands that level of expertise. Consider appointing an engineer, architect or quantity surveyor. These may be able to bring more appropriate experience to the project, particularly if the final board includes a mix of people from different backgrounds.
3. Let the board members you have appointed do their jobs without undue interference. They cannot be seen to act impartially if they have to “report back” at frequent intervals, or at all. Having selected a board member, and had that selection agreed to by the other side, let them do their job. This becomes increasingly problematic where a board member is appointed by an Employer from within the engineering community of the country concerned. Can he genuinely avoid running into the Employer’s senior staff socially when other members of the board are many miles away? And if he does so, can he avoid talking about the project?
4. Next, rather than asking board members what they expect by way of remuneration why not tell them at the time of the invitation what fee structure is proposed and what it is expected to

cover. Be reasonable about the fee rates you wish to pay and do not expect board members to provide time inputs without payment. If you do not pay a retainer or monthly standing charge, is it reasonable to expect the board members to spend time checking monthly reports, etc., between site visits? And, can you expect them to re-schedule other work at short notice to attend a hearing?

5. Make sure the fee rates being paid to both the contractor's and the Employer's board members are identical. This applies irrespective their origin. The argument that a board member from Europe or North America needs to be paid more than one from a developing country does not fit comfortably with either member once work commences. If one board member is selected from within the country and the other comes from overseas the saving will be in terms of the travel time that has to be paid. It should not be by virtue of a reduced daily rate.
6. It is often suggested that all three board members should receive equal fee rates and conditions. But that seems unnecessary. Why can't the chairman receive an enhanced rate to reflect his seniority and/or the levels of leadership he needs to display? Possibly he needs to spend more time between site visits acting as a sounding board for the concerns of his fellow board members. In such cases he should perhaps receive an enhanced retainer or monthly standing charge, as well.
7. Finally, try to run boards for several projects together. Even though different contractors may be involved, each with different ideas about who to appoint, there is no reason why an Employer with several similar projects in one geographic area cannot rationalize their board member selection and suggest site visit timings that run consecutively.

So, irrespective whether we like the idea or not, the fact is that Dispute Boards are here. They are being successfully operated and, based on the information already available, are making a real and positive contribution to the successful completion of projects. Do not under-estimate their importance.

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