Construction Dispute Settlement: Decisions Made By The Engineer Under The FIDIC Contract

by Christopher R. Seppala, Esq.

The FIDIC international civil engineering contract, fourth edition (1987), is probably the most widely used standard form of contract in the field of international construction.[1] Clause 67 of the FIDIC Contract provides procedures for settlement of disputes by the Engineer before commencement of arbitration.

This pre-arbitral procedure can best be addressed in three parts:

- First: What is this pre-arbitral procedure? Who are the participants and how does it work?
- Second: What are the principal reasons for, and the advantages and disadvantages of, this procedure for the settlement of construction disputes?
- Third: What conclusions, if any, can one draw about this procedure? Does it contribute to the prompt and efficient settlement of disputes before arbitration? Does it make arbitration more efficient if and when it occurs?

Pre-Arbitral Procedure In FIDIC Contract

What is the pre-arbitral procedure in the FIDIC Contract?

To answer this question, it is necessary first to say something about the special role of the Engineer under the FIDIC Contract. In addition to the two parties to the FIDIC Contract—that is, the Employer, for whom the works are to be executed, and the Contractor, who is to execute them—a third person, the Engineer, whose contract is solely with the Employer, is given special powers under the FIDIC Contract.

The Engineer not only designs the works to be constructed and supervises their execution on behalf of the Employer, as is true of the *maître d'oeuvre* in France, but he is also assigned by the FIDIC Contract an independent, administrative and quasi-judicial role. Though the Engineer is not himself a party to the contract, he is empowered by the contract, among other things, to:

- vary or change the works (Clause 51),
- stop or suspend them (Clause 40),

(Continued on page 22)

Christopher R. Seppala is a Partner with White & Case, Paris. He was Chairman of the Subcommittee on the FIDIC (Civil Engineering) Conditions of Contract of Committee T (International Construction Contracts) of the Section on Business Law of the International Bar Association (1985 to 1989). This article is a modified version of a paper delivered by Mr. Seppala at the ICCA (International Council for Commercial Arbitration) Congress in Stockholm, Sweden, in May 1990.

Reconstruction In Kuwait: Investment And Tax Rules

The Kuwaiti government has indicated it will grant up to complete tax exemptions to certain projects that aid in the rebuilding and redevelopment of Kuwait. Exemptions will be negotiated on a contract-by-contract basis and will vary significantly from case to case. The extent of any tax exemption will depend on the extent to which the project will contribute to the country's reconstruction and on the government's need for a specific contractor to perform the work.

Foreign companies interested in participating in Kuwaiti projects should begin the prequalification process now (discussed below), and appoint an agent in Kuwait. In the absence of negotiated concessions or an exemption granted by the government, the Kuwaiti investment and tax laws will apply to foreign firms involved in reconstruction projects. These laws as of mid-1990 are discussed below. A revision of the tax laws was being considered before the invasion last August. Currently, there is no indication as to whether any of these revisions will be made.

Investment Factors

Restriction on Foreign Investment. Non-Kuwaitis wishing to engage in commercial or business activities in Kuwait must either obtain a license through a Kuwaiti agent, in whose name the license is given and the work carried out, or establish a Kuwait-registered entity. The Kuwaiti partner or partners in a Kuwait-registered entity must own at least 51 percent of the capital.

A foreign company may not establish a branch or carry on commercial activities in Kuwait except through a Kuwaiti agent. Only Kuwaiti individuals or legal entities may act as commercial agents.

Kuwaiti oil and oil-related industries are all government owned and controlled. Contractors are expected to buy specified materials from the local market and subcontract work to local companies wherever possible.

Government Contracts. Government ministries and departments normally award contracts to the lowest bidder, whether the contractor is Kuwaiti or foreign. The contractor receives a 10-percent advance payment to enable him to assemble the necessary equipment and meet other initial expenses.

Import and Export Controls. Most imports require an import license and all import business must be conducted through Kuwaiti individuals or companies. The export

(Continued on page 12)

This article was prepared by the firm of Jassim A. Al-Fahad & Company, Kuwait, a member of the Saba & Co. Group, which is a member firm of DRT International. Jassim A. Al-Fahad & Co. has reestablished its office in Kuwait. This article was provided by Fuad Saba, a Senior Tax Manager in the New York International Tax Group of Deloitte & Touche.

Trademarks, Software, GCC Patent Office

When asked whether trademark registration should be administered by KACST rather than the Ministry of Commerce, Dr. Al Rashid said that this is under discussion as a future possibility. In response to a question about the possibility of including computer software under the Patent Law, he said that software is protected under the Publications and Publishing Law, Royal Decree No. M/17 issued on 3/4/1402 H (January 28, 1982) and its Implementation Regulations, Ministerial Decree No. 473 DS issued on 3/11/1409 H (June 6, 1989).

Dr. Al Rashid also mentioned again the possibility of establishing a future GCC Patent Office similar to the European Patent Office.

INTERNATIONAL CIVIL ENGINEERING

Construction Dispute Settlement

(Continued from page 9)

- determine when they are complete (Clause 48),
- determine the amounts that the Contractor is to be paid—the Employer being committed to pay on the basis of the Engineer's certificates (Clause 60).

Of particular interest, *the Engineer—though hired and paid by, and under contract with, the Employer—is empowered to decide disputes between the Employer and the Contractor on an interim basis.* He does this under Clause 67 of the FIDIC Contract. The Engineer's decisions are binding on the parties until overturned by an arbitral award, if any (see Clause 67).

When performing this quasi-judicial function, the Engineer is required to act impartially between the Employer and the Contractor. He is required to "hold the balance" and act fairly between the parties. Consistent with this neutral position, the role of Engineer has traditionally been filled by an independent consulting engineer or firm of such engineers.

Clause 67 Procedure: Six Steps

What is the procedure in Clause 67? Very briefly, there are six steps under the current FIDIC fourth edition:

- ***Step 1.*** First, for this procedure to apply, there must exist a "dispute" between the Contractor and the Employer—not just a claim by the Contractor, but a claim that has been rejected by the Engineer and which the Contractor pursues. A typical example would be a case where the Contractor claims that the Employer delayed in giving possession of the site and requests reimbursement of its additional costs and an extension of time. If the Engineer rejected the claim, saying that the Contractor had sought possession of the site earlier than he was entitled to under the contract, and if the Contractor refused to acquiesce in such rejection, there would then be a dispute that could be referred under Clause 67.
- ***Step 2.*** Second, once there is a dispute, one party—usually it will be the Contractor—refers the dispute in writing to the Engineer for his decision under Clause 67.
- ***Step 3.*** Third, the Engineer has 84 days in which to decide the dispute. While the Engineer is bound to act fairly and impartially, he does not decide as arbitrator. He is not bound, for example, to hear or receive submissions from both parties before reaching his decision.

Assuming that the Engineer gives his decision within the 84 days, both parties are required to give effect to it forthwith whether either thinks it right or wrong, subject to the right of each to refer the matter to arbitration. Thus, in my example, if the Contractor's possession-of-site claim is again denied, the Contractor has to accept such denial for the time being, at least. He is not entitled, for example, to stop or slow down work.

- ***Step 4*** Fourth, if either party is dissatisfied with the Engineer's decision, or the Engineer fails to give a decision within 84 days, then either may during a subsequent period of 70 days give notice to the other party of his intention to commence arbitration with respect to the dispute. In the example cited above, the effect of such notice would be to entitle the Contractor to have his possession-of-site claim arbitrated at a later time. If no notice is given by either party within 70 days of the Engineer's decision, the decision rejecting the claim, in my example, is final and binding on both parties, implying that it is no longer open to challenge whether by arbitration or before the courts.

Thus it is clear under the current (fourth) edition of the FIDIC Contract that a party does not need to begin arbitration (that is, by submitting a Request for Arbitration to the ICC) within a given number of days of receiving the Engineer's decision in order to preserve its right to arbitration. This was unclear under the prior editions.

- ***Step 5.*** Fifth, where the requisite notice was given, arbitration may not be commenced for 56 days in order to allow the parties time to settle the dispute amicably. Arguably, there may even be a duty during this period to attempt amicable settlement (the Clause is unclear on this point).
- ***Step 6.*** Sixth, after this 56-day period, the dispute may be referred to arbitration under the ICC Rules or any other arbitration rules agreed to by the parties. In any such arbitration, the arbitrators have the power to open up, review and revise any decision or action of the Engineer related to the dispute. Neither party is limited in the arbitration to the evidence or argument put before the Engineer for the purpose of obtaining his decision under Clause 67.

Two Important Aspects

There are two aspects of this procedure that need to be emphasized:

The first is its forfeitary aspect. If no notice to challenge a decision of the Engineer is given within 70 days of receipt of the decision, the decision is final and binding. There is, in principle, no legal recourse against the decision, whether by arbitration or otherwise. In the example given above, the claimant's rights would be cut off completely.

The positive side of this forfeitary procedure is, of course, that it reduces the number of disputes that need to go to arbitration.

The second aspect that needs to be emphasized is that no dispute under the contract will be admissible to arbitration unless it has traveled the gauntlet, so to speak, of Clause 67. When a dispute is referred to the Engineer under the Clause (say, the possession-of-site dispute

mentioned above), the Engineer gives a decision on *that dispute* and, thereafter, if a party is dissatisfied with that decision, it gives a notice of intention to commence arbitration as to *that same dispute*. Whatever other disputes there may be between the parties, none may be arbitrated unless it has gone through Clause 67. If the arbitrators embark on another dispute, without the parties' consent, they will be exceeding their jurisdiction.

This point needs to be emphasized because there may be 50 or even hundreds of disputes on a large project. In this case, each of these 50 or 100 or more disputes must have satisfied each of the conditions in the Clause in order to be admissible to arbitration, unless they are grouped into one or more large disputes (for example, grouping the possession-of-site claim mentioned into an overall claim for delays caused by the Employer). The fact, for example, that the parties are already in arbitration with respect to certain disputes will not entitle a party to bring into the arbitration other disputes under the same contract which have not passed through Clause 67. Once an arbitration is underway and the Terms of Reference, in the case of an ICC arbitration, have been signed, it is not unusual for the claimant (usually, as indicated above, a contractor) to discover other claims it wishes to assert in the arbitration. Nevertheless, it cannot do so unless these claims have, as disputes, passed through Clause 67, except with the consent of the other party and, after the Terms of Reference have been signed, the arbitrator(s).

Arguments For And Against The Engineer's Role

What are the principal reasons or arguments advanced for and against this quasi-judicial procedure?

Reasons For Quasi-Judicial Role

First: The Engineer's role under the FIDIC Contract owes much to history and tradition. This system derives from England, where its development is attributed to various factors:

- the traditional stature and reputation for integrity of the professional Engineer, resulting in a belief that he could be trusted in such matters;
- the need on construction projects for some procedure to settle disputes quickly and provisionally so that the works would not be stopped, inasmuch as the adverse financial consequences of a work stoppage could often far exceed the value of the matter in dispute; and
- the obvious convenience for the Employer to engage the technician who designed the works, was supervising their execution and who, consequently, was already on the site, to settle disputes; as the Employer was the party who had ordered the works and who typically had drawn up the contract documents, he was in a position to see his interests accommodated.

While the system has its critics in England and the United States, it has nevertheless continued in general use in both countries for over a century.

Second: This procedure allows the Engineer the opportunity to reconsider, with detachment, an earlier position that he may have taken hastily, or before all facts were known, and thus possibly erroneously. It allows him to make a fresh assessment. Moreover, if the Engineer gives reasons in his decision, his reasons may promote settlement of the dispute or, at least, assist any arbitrators called upon subsequently to review it.

Third: As we have seen, the time bar in Clause 67 operates as a filter, reducing the number of disputes that must be submitted to arbitration—an obviously desirable objective.

Fourth: In the case of FIDIC Contracts, the Employers are often in developing countries and relatively unsophisticated in construction matters and consequently need the assistance of a consulting engineer or firm of consulting engineers to assess claims and decide disputes with the Contractor, at least in the first instance.

Fifth: Even though the procedure is an imperfect system of justice—it is not, as we have seen, an arbitration—any abuses can be corrected later at the arbitration stage. In any event, the alternative of having the Employer decide disputes directly would normally be worse. Therefore, with all its shortcomings, it is almost always better than no system at all.

Criticisms Of Engineer's Quasi-Judicial Role

Since the FIDIC Contract came into wide use internationally in the early 1970s, the Engineer's role has been hotly contested, especially (but not only) by lawyers unfamiliar with, and hence understandably suspicious of, this Anglo-American tradition. The principal criticisms have been:

First: A person who has been hired and retained by one party, the Employer, cannot be expected to be impartial (these critics assume, tacitly, that the pre-arbitral decision-maker must be completely independent like a judge or arbitrator).

Second: This procedure is said to be a waste of time in view of the provision for subsequent arbitration. Mr. Duncan Wallace, the well-known English authority, says it is often "an irritating and time-wasting formality"[2] as the Engineer usually will not depart from an earlier decision he may have taken.

Third: The system is criticized because the Engineer is not obliged to observe any special procedures, such as hearing both parties, when giving a decision under Clause 67, which is true, as previously mentioned, because the Engineer is not an arbitrator.

Fourth: The time limits and their effect as a time bar to arbitration are said to be contrary to the flexibility and informality usually associated with arbitration proceedings.

Fifth: Increasingly, in practice, no independent firm of consulting engineers is appointed as Engineer by the Employer. Instead, the Engineer is often merely an employee of the government ministry that is the Employer. In these circumstances, the reference of a dispute back to the Engineer is meaningless (it is claimed).

As a result of these criticisms, a number of alternative procedures for settling construction disputes on an interim basis have been proposed. Discussion of these proposals, however, is beyond the scope of this article.

Engineer's Role In Settling Disputes: An Evaluation

Is the procedure effective? Lawyers often view it as a waste of time. In their view, the sooner the dispute gets to arbitration and the parties have their heads knocked

together, the quicker it is likely to be resolved. On the other hand, consulting engineers (who, of course, see the successful decisions as well as the failures) tend to favor the clause. In the absence of statistics or criteria that would permit an objective assessment, it is difficult, if not impossible, to arrive at a definitive conclusion either way.

The system reflects one construction contract philosophy, namely the one prevailing in the Anglo-American countries. It is not inherently better or worse than, for example, the system of the *maître d'oeuvre* in use in France and the other Continental European countries.

However, two aspects merit comment: Certain practical difficulties with the procedure itself, and the impact of the procedure—positive and negative—upon any subsequent arbitration.

Practical Difficulties

1. Inherent limits on the Engineer's decision procedure.

There is no express limit in Clause 67 on the range of disputes that need to be submitted to the Engineer. In principle, all disputes under or in connection with the contract must be submitted to him. However, it may be inappropriate for the Engineer to decide at least two types of disputes:

- Disputes that call directly into question the Engineer's own conduct—that is, a dispute about a claim by the Contractor of delay in the issuance of drawings by the Engineer or of excessively high standards of completion required by the Engineer. Is it reasonable to expect the Engineer to decide such a dispute objectively when he is himself faced with a conflict of interest and exposed to liability if he decides against himself in effect? There are English legal authorities which suggest he should decide such disputes, whereas there are American cases that suggest he should not. Thus, the answer provided so far by the courts and authorities is inconclusive.[3]

- Disputes concerning purely legal questions—for example, a claim for breach of contract, repudiation or misrepresentation. Clearly, the Engineer is not competent to decide such disputes without legal advice. Should he be deciding them upon the basis of legal advice? Again, the FIDIC Contract does not clearly answer this question.

On the other hand, if one were to carve out certain disputes from the Engineer's decision-making role, one would then create the potential for jurisdictional arguments over whether a particular dispute needed to be submitted to the Engineer under Clause 67 before arbitration. Because of the delays and costs involved in jurisdictional arguments, it may, on balance, be preferable for the Engineer to retain the power to decide *all* disputes, as is the case now. At the least, these issues should be given more attention.

Another uncertainty is determining for how long after the completion of the works the Contractor is bound to refer disputes to the Engineer as a condition precedent to arbitration. The FIDIC Contract places no express time limit on the need to do so. On the other hand, after the works have been completed and the Taking-Over Certificate has been issued, the Engineer may have no other duties under the FIDIC Contract, and his own contract with the Employer will usually have come to an end. In these circumstances, should there be any continuing need to refer disputes to the Engineer as a condition to arbitration? This point needs to be clarified.

2. The procedure can also lead to anomalous results when transposed into another legal system (such as the civil law system).

As memtioned, if a party does not challenge the Engineer's decision properly within 70 days, the decision is said to become "final and binding" on the parties. After this period, in principle, neither party can refer the matter to arbitration or the courts. However, in the common law countries, where such contractual time bars to the commencement of arbitration are common, there are also well established rules to moderate their effect:

- For example, under U.S. law, so-called "final and binding" decisions can be overturned in cases of fraud, bad faith, gross mistake or failure by the Engineer to exercise honest judgment or on the ground that the decision was made arbitrarily or capriciously.[4]

- Under English law, a time limit for taking some steps to commence arbitration may be extended by the courts if "undue hardship" would otherwise be caused. Similar provisions are contained, I believe, in the arbitration statutes of Australia, Hong Kong and other countries that derive such statutes from England.[5] In several reported cases, such provisions have been used precisely to extend the time limit in Clause 67 of the FIDIC Contract.[6]

However, perhaps because such contractual time bars to arbitration are rare if not totally unknown in civil law countries such as France, there may be few if any rules to moderate their effects there. Consequently, in the case of a FIDIC Contract governed by the law of a civil law jurisdiction, the time bar in Clause 67 may be applied literally and have far harsher consequences than in common law jurisdictions from which it derives. This anomaly, which results from transposing a common law procedure into an international form of contract that may be made subject to varying systems of law, merits greater attention.

As a result of dissatisfaction with the procedure for the settlement of disputes by the Engineer, there have been proposals that the Engineer be replaced as a dispute settler by, for example, a neutral technical expert or board of technical experts, or by a pre-arbitral referee.[7] But why would Employers accept such a proposal? Until now, the international construction market has tended to be a "buyer's market." Employers have generally been successful in imposing more onerous conditions on contractors than are contained in the FIDIC Contract. Often they are much more onerous. The FIDIC Contract is as favorable a form of contract as contractors have been able to obtain internationally. Why then would Employers accept another system less favorable to themselves and likely to cost more money? Any other system that does not satisfactorily address this question risks remaining a lawyer's theoretical exercise.

Impact On Subsequent Arbitration

The procedure tends to have both a positive and negative impact on subsequent arbitration.

1. Positive side.

The arbitral tribunal receives the benefit of a decision

on the dispute by a technician who was on the site at the time, may have witnessed relevant facts and is familiar with the project and the contract documents. Moreover, a two-tiered procedure for the resolution of disputes (Engineer's decision and arbitral award) should reduce the risk of error or unfairness. In addition, this procedure, especially the time bar in Clause 67, reduces the number of disputes that need to go to arbitration.

Negative side.

On the other hand, the procedure also often has a serious negative impact on the arbitration.

Clause 67 is so complex and difficult for the uninitiated to understand that in almost every arbitration under a FIDIC Contract of which this author is aware, it has been arguable that one party or the other, often both, have failed to comply in some respect with Clause 67.

Typically, the defendant will argue that the claimant has not satisfied the Clause's conditions precedent to arbitration or, alternatively, that the claimant's claims have been the subject of final and binding decisions of the Engineer and should be dismissed. The claimant will usually advance similar arguments with respect to the defendant's counterclaims, if any.

These jurisdictional issues usually then have to be addressed by a partial award at the outset of the arbitration. Even if the tribunal upholds its jurisdiction, it will ordinarily not be possible to reach the merits of the case for at least one or two years after proceedings begin, given the time necessary for written submissions and hearings, and for the arbitral tribunal's rendering of a partial award on jurisdiction and its review by the ICC's International Court of Arbitration. The cost of settling these jurisdictional issues may also be substantial.

Therefore, the time and expense that need to be expended on jurisdictional disputes must we weighed against the benefits to be derived from the Clause.

Footnotes

[1]FIDIC is the *Fédération Internationale des Ingénieurs-Conseils*. For more on dispute settlement under the fourth edition of the FIDIC Contract, called the Conditions of Contract for Works of Civil Engineering Construction, *see* Seppala, "New FIDIC Contract For Civil Engineering—Principal Changes In Procedure For Settlement of Disputes," *Middle East Executive Reports* (*MEER*), February 1990, p. 8.

[2]I. N. Duncan Wallace, The International Civil Engineering Contract (Sweet & Maxwell, London 1974), p. 169.

[3]*See* Seppala, "The Pre-Arbitral Procedure For Dispute Settlement In The FIDIC Civil Engineering Contract," *MEER*, July, August, September and October 1987. *See also*, Seppala, *supra* note 1, "New FIDIC Contract For Civil Engineering—Principal Changes In Procedure For Settlement Of Disputes."

[4]Seppala, *supra* note 3, "The Pre-Arbitral Procedure For Dispute Settlement In The FIDIC Civil Engineering Contract."

[5]*See e.g.* Correspondents' Reports—Hong Kong (1989) 6 I.C.L.R. 463, 467-68.

[6]*See e.g.* International Tank and Pipe S.A.K. v Kuwait Aviation Fueling [1975] Q.B. 224; (1977) 5 B.L.R. 147.

[7]*See* Rules in force as of January 1, 1990 for an ICC Pre-Arbitral Referee Procedure.

TEXTS

UNITED ARAB EMIRATES—Section A

Armed Forces Tenders and Auctions Regulation: Amendments Made By Resolution No. 27 of 1990

Resolution No. 12 of 1986 of the Deputy Supreme Commander of the Armed Forces Concerning the Regulation for Armed Forces Tenders and Auctions--articles amended by Resolution No. 27 of 1990. Text added by amendment is in italics; text deleted by amendment is bracketed. Translation provided by Chadbourne, Parke & Afridi, Abu Dhabi.

(First installment)

Article 2. With the exception of weapons materials and equipment, the purchase and supply of items and performance of contracts for works and related services and contracts for transportation shall be conducted by means of public tenders. Nevertheless, as an exception, a purchase, contract or related service may be conducted by means of a limited tender, *local tender*, negotiation or direct order in accordance with the provisions of this Resolution.

Article 6. Contracting by way of direct order:

Contracting by means of issuing a direct order to the supplier or contractor without resort to other means of contracting, provided that the contracting take place with the approval of [the Main Purchases and Projects Committee or] the Purchases and Projects Sub-Committee. Contracting for works or transportation may be conducted through direct order.

Article 7. The [Deputy Supreme Commander of the Armed Forces, the] General Commander of the Armed Forces or the Chief of Staff of the Armed Forces may issue a purchase order or order performance of works by or through Arab or foreign *governments or* armies at the price agreed, when necessary and to the extent not exceeding Dh 50 million. *Anything in excess thereof shall be within the authority of the Deputy Supreme Commander of the Armed Forces.*

Article 13(8). Any other additional information.

Foreign companies shall be exempted from the provisions of Paragraphs 3, 4 and 7 *and from submission of the Commercial Register number and the registration entry number in one of the Chambers of Commerce and Industry in the State.*

Article 58. Unless the contracting is done by way of issuing a "purchase order" to the supplier *or a "work order" to the contractor*, the concerned department shall enter into a contract with the successful supplier or contractor after deposit of the performance bond. The contract must include all of the conditions of contract and must refer to the tender number. With regard to contracts for supply of equipment, the contract must provide that the supplier shall be required to supply spare parts needed by the Armed Forces at the agreed price within two years from the date of final handing over, provided that this be included in the tender conditions.

Article 73 (first paragraph). [As an exception to the provisions of Article 2 of this Resolution,] Contracting by way of negotiation [may] *shall* be by resolution of the Chairman of the [Main] *concerned* Purchases and Projects Committee for the supply or purchase of articles or the execution of works, if contracting by this means is necessary, in the following circumstances: