Pre-arbitral Decisions and Their Impact on the Arbitration: The Decisions Made by the Consulting Engineer

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I. INTRODUCTION

I have been asked to discuss the pre-arbitral procedure for the settlement of disputes by the Engineer which is provided for by Clause 67 of the FIDIC International Civil Engineering Contract (see Annex I, pp. 567–568). This is probably the most widely used standard form of contract in the field of international construction.

I propose to address this topic 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, advantages and disadvantages of this procedure for the settlement of construction disputes?

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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?

II. THE PRE-ARBITRAL PROCEDURE IN THE FIDIC CONTRACT

First, 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 this contract. In addition to the two parties to the FIDIC construction 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 contract.

The Engineer does not only design the works to be constructed and supervise their execution on behalf of the employer, as is true of the *maître d'oeuvre* in France. Under the FIDIC contract, he is also assigned an independent and administrative quasi-judicial role. Although not himself a party to the construction contract, the Engineer is empowered by that contract, among other things:

(a) to vary or change the works (Clause 51)
(b) to stop or suspend them (Clause 40)
(c) to determine when they are compete (Clause 48) and
(d) to 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 special interest to us, *the Engineer – although 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. This he does under Clause 67 of the contract. The Engineer's decisions will be binding on the parties until overturned by an arbitral award*, if any.

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

What is the procedure in Clause 67? Very briefly, there are six steps in this procedure under the current FIDIC Conditions, 4th edition (see Annex I, pp. 567-568):

(a) For this procedure to apply, there must be a dispute between the contractor and the employer – not just a claim under the contract, but a claim that has been rejected by the Engineer and which the contractor wishes to pursue. A typical example would be a case where the contractor claims that the employer delayed in giving possession of the site and requests the reimbursement of its additional costs and an extension of time. If the Engineer rejected this claim, saying that the contractor had sought possession of the site earlier than he was entitled to under the contract, and if the contractor disagreed, there would then be a dispute that could be referred under Clause 67.

(b) Once there is a dispute, one party – usually the contractor – refers such dispute to the Engineer for his decision under Clause 67.

(c) 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 an 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 specified period, 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.

(d) 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. The effect of giving such notice, in the example which I have cited, would be to entitle the contractor to have his possession of the site claim arbitrated at a later time. If no notice has been given by either party within 70 days of the Engineer's decision, the decision rejecting the claim in my example is said to be final and binding on both parties, implying that it may no longer be challenged whether by arbitration or before the courts.

Thus, it is clear under the current edition of the FIDIC Conditions (4th) that a party does not need to begin arbitration, for example, by submitting a request for arbitration to the International Chamber of Commerce (ICC) within a given number of days of receiving the Engineer's decision to preserve its right to arbitration. This was unclear under the prior editions.

(e) When the requisite notice of intention to commence arbitration of the dispute has been 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).

(f) After such 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.

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 I have given above, the claimant's rights would be cut off completely.

The positive side of this forfeitary procedure is, of course, that it cuts down on or reduces the 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 run the gauntlet, so to speak, of Clause 67. When a dispute is referred to the Engineer under the Clause (e.g., the possession of the site dispute mentioned above) the Engineer gives a decision of *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 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.

I emphasize this point because, on a large project, there may be fifty or even hundreds of disputes. In this case, each of the fifty or one hundred or more disputes must (unless grouped into one or more large disputes) have satisfied each of the conditions in the Clause to be admissible to arbitration. 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 I have indicated, 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 other party's, and once the Terms of Reference have been signed, the arbitrators' consent.

III. ARGUMENTS OR REASONS FOR AND AGAINST THE ENGINEER'S ROLE

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

1. Reasons for the Engineer's Quasi-judicial Role

(a) The Engineer's role under FIDIC owes much to history and tradition. In England, from where this system is derived, its development is attributed to various factors:

(i) the professional engineer's traditional stature and reputation for integrity (there was a belief that he could be trusted in such matters);

(ii) the need on construction projects for some procedure to settle disputes quickly and provisionally so that the works are not stopped – inasmuch as the adverse financial consequences of a work stoppage could often far exceed the value of the matter in dispute;

(iii) the obvious convenience for the employer to engage the technician who designed the works and who is already on the site to settle disputes. As the employer is the party who had ordered the works and who typically had drawn up the contract documents, he was in a position to see his interest 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.

(b) This procedure allows the Engineer the opportunity to reconsider, with detachment, an earlier position that he may have taken hastily and possibly erroneously before all facts were known. 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, may assist arbitrators called upon subsequently to review it.

(c) As we have seen, the time bar in Clause 67 operates as a filter, cutting down and reducing the number of disputes that need to be submitted to arbitration – an obviously desirable objective.

(d) In the case of a FIDIC contract, the employers are often from developing countries, may be unsophisticated in construction matters and may, consequently, need the protection of the Engineer to assess claims and decide disputes with the contractor, at least in the first instance.

(e) Even though the procedure is an imperfect system of justice – it is not an arbitration – any abuses can be corrected later, at the stage of arbitration. At all events, the alternatives of having the employer decide disputes directly would normally be worse. Therefore, with all its shortcomings, it is still almost always better than no system at all.

2. Criticisms of the 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 by lawyers from the Continent unfamiliar with, and understandably suspicious of, this Anglo-American tradition. The following are some of the principal criticisms:

(a) A person who has been hired and retained by one party, the employer, cannot be expected to be impartial. These critics thus assume that it is necessary that the pre-arbitral decision maker be completely independent like a judge or arbitrator.

(b) 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"[1] as the Engineer usually will not depart from an earlier decision he may have taken.

(c) The system is criticized because the Engineer is not obliged to observe any special procedural rules when giving a decision under Clause 67, which is true, as I have observed, because the Engineer is not an arbitrator.

(d) 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.

(e) 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 which is acting as 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, which are discussed above by Mr. Sigvard JARVIN (see this volume, pp. 385-405).

1. I.N. Duncan WALLACE, *The International Civil Engineering Contract* (Sweet & Maxwell, London 1974) p. 169.

IV. EVALUATION OF THE ENGINEER'S ROLE IN SETTLING DISPUTES

Is the Clause 67 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, have seen the successful decisions as well as the failures) tend to favour the clause. Faced with these different perceptions and the absence of 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* used in France and the other Continental European countries.

However, I would like to comment upon (1) certain practical difficulties with the procedure itself, and (2) the impact of the procedure – positive and negative – upon any subsequent arbitration.

1. Some Practical Difficulties with the Procedure

a. Inherent limits of the Engineer's decision process

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:

(a) *Disputes that call directly into question the Engineer's own conduct*, for example, a dispute about a claim by the contractor on account of delay in the issuance of drawings by the Engineer or on account of excessively high standards of completion required by the Engineer. Is it reasonable to expect the Engineer to act fairly between the employer and the contractor and decide such a dispute objectively when the Engineer is himself faced with a conflict of interest and exposed to liability if he decides against himself in effect? There are certain 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 is inconclusive.[2]

(b) *Disputes concerning purely legal questions*, for example, a claim for breach of contract, repudiation or misrepresentation. Clearly, the Engineer is not competent to decide them 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 carves out certain disputes from the Engineer's decision-making role, one then creates the potential for jurisdictional arguments

2. See C. SEPPALA, "The Pre-Arbitral Procedure for the Settlement of Disputes in the FIDIC (Civil Engineering) Conditions of Contract", 3 ICLR (1986) p. 315 at pp. 327–329. See also C. SEPPALA "FIDIC (4th Edition 1987) – The Principal Changes in the Procedure for the Settlement of Disputes (Clause 67)". 6 ICLR (1989) p. 177.

over whether a particular dispute needs to be submitted to the Engineer under Clause 67 before arbitration or not. 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 Maintenance Certificate has been issued, the Engineer may have no other duties under the 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.

b. The procedure can also lead to anomalous results when transposed into another legal system, e.g., civil law

As I have mentioned, 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. In principle, neither party can refer the matter to arbitration or the court. However, in 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.

(a) For example, under US 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.[3]

(b) Under English law, a time limit to take some step 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 their arbitration statutes from England.[4] In several reported cases, such provisions have been used precisely to extend the time limit in Clause 67 of the FIDIC contract.[5]

However, perhaps because such contractual time bars to arbitration are rare, if not unknown, in civil law countries, (e.g., 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 subject to widely varying systems of law, merits greater attention.

As a result of dissatisfaction with the procedure for the settlement of disputes

3. C. SEPPALA, supra n. 2; 3 ICLR (1986) p. 315 at pp. 332–3.
4. See, e.g., Correspondent Reports – Hong Kong, 6 ICLR (1989) p. 463 at pp. 467–468.
5. See, e.g., *International Tank and Pipe S.A.K. v. Kuwait Aviation Fueling* [1975] Q.B. 224; 5 BLR (1977) 147.

by the Engineer, there have been proposals to replace the Engineer as a dispute settler by, for example, a neutral board of experts or by an arbitral referee. But why would employers accept such a proposal? In practice, employers are able successfully to impose more onerous conditions on contractors than are contained in FIDIC. Often they are much more onerous. In fact, the FIDIC contract represents for contractors as favourable a form of contract as they can usually obtain internationally. Why then would most employers accept another system that is less favourable to them and likely to cost them more money? Unless any other system can satisfactorily address this question, it risks remaining a lawyer's theoretical exercise.

2. *Impact of the Engineer's Decision Procedure on the Subsequent Arbitration*

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

a. *Positive side*

The arbitral tribunal receives the benefit of a decision on the dispute by an engineer 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 minimize the risk of error or unfairness. In addition, this procedure, especially the time bar in the Clause, cuts down and reduces the number of disputes that need to go to arbitration.

b. *Negative side*

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

The clause is so complex and difficult for the uninitiated to understand that, in almost every arbitration case under a FIDIC contract I know of, 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 conditions precedent to arbitration in the Clause 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.

These jurisdictional issues usually have then to be addressed by a partial award at the outset of the arbitration. Given the time necessary for submissions and hearings, the time for the rendering of a partial award on jurisdiction by the arbitral tribunal and its review by the ICC International Court of Arbitration, the tribunal will ordinarily not be able to reach the merits of the arbitration (if at all) until at least one or two years after proceedings have begun.

The time and expense often expended on such jurisdictional disputes, therefore, need to be weighed against the benefits to be derived from the Clause.

Annex I

Fédération Internationale des Ingénieurs-Conseils (FIDIC)
Conditions of Contract for Works of Civil Engineering Construction.
Part I General Conditions, Clause 67

Fourth Edition 1987 as reprinted 1988

Settlement of Disputes

67.1 Engineer's Decision

If a dispute of any kind whatsoever arises between the Employer and the Contractor in connection with, or arising out of, the Contract or the execution of the Works, whether during the execution of the Works or after their completion and whether before or after repudiation or other termination of the Contract, including any dispute as to any opinion, instruction, determination, certificate or valuation of the Engineer, the matter in dispute shall, in the first place, be referred in writing to the Engineer, with a copy to the other party. Such reference shall state that it is made pursuant to this Clause. No later than the eighty-fourth day after the day on which he received such reference the Engineer shall give notice of his decision to the Employer and the Contractor. Such decision shall state that it is made pursuant to this Clause.

Unless the Contract has already been repudiated or terminated, the Contractor shall, in every case, continue to proceed with the Works with all due diligence and the Contractor and the Employer shall give effect forthwith to every such decision of the Engineer unless and until the same shall be revised, as hereinafter provided, in an amicable settlement or an arbitral award.

If either the Employer or the Contractor be dissatisfied with any decision of the Engineer, or if the Engineer fails to give notice of his decision on or before the eighty-fourth day after the day on which he received the reference, then either the Employer or the Contractor may, on or before the seventieth day after the day on which he received notice of such decision, or on or before the seventieth day after the day on which the said period of 84 days expired, as the case may be, give notice to the other party, with a copy for information to the Engineer, of his intention to commence arbitration, as hereinafter provided as to the matter in dispute. Such notice shall establish the entitlement of the party giving the same to commence arbitration, as hereinafter provided, as to such dispute and, subject to Sub-Clause 67.4, no arbitration in respect thereof may be commenced unless such notice is given.

If the Engineer has given notice of his decision as to a matter in dispute to the Employer and the Contractor and no notification of intention to commence arbitration as to such dispute has been given by either the Employer or the Contractor on or before the seventieth day after the day on which the parties received notice as to such decision from the Engineer, the said decision shall become final and binding upon the Employer and the Contractor.

67.2 Amicable Settlement

Where notice of intention to commence arbitration as to a dispute has been given in accordance with Sub-Clause 67.1, arbitration of such dispute shall not be commenced unless an attempt has first been made by the parties to settle such dispute amicably. Provided that, unless the parties otherwise agree, arbitration may be commenced on or after the fifty-sixth day after the day on which notice of intention to commence arbitration of such dispute was given, whether or not any attempt at amicable settlement thereof has been made.

67.3 Arbitration

Any dispute in respect of which:

(a) the decision, if any, of the Engineer has not become final and binding pursuant to Sub-Clause 67.1, and
(b) amicable settlement has not been reached within the period stated in Sub-Clause 67.2

shall be finally settled, unless otherwise specified in the Contract, under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed under such Rules. The said arbitrator/s shall have full power to open up, review and revise any decision, opinion, instruction, determination, certificate or valuation of the Engineer related to the dispute.

Neither party shall be limited in the proceedings before such arbitrator/s to the evidence or arguments put before the Engineer for the purpose of obtaining his said decision pursuant to Sub-Clause 67.1. No such decision shall disqualify the Engineer from being called as a witness and giving evidence before the arbitrator/s on any matter whatsoever relevant to the dispute.

Arbitration may be commenced prior to or after completion of the Works, provided that the obligations of the Employer, the Engineer and the Contractor shall not be altered by reason of the arbitration being conducted during the progress of the Works.

67.4 Failure to Comply with Engineer's Decision

Where neither the Employer nor the Contractor has given notice of intention to commence arbitration of a dispute within the period stated in Sub-Clause 67.1 and the related decision has become final and binding, either party may, if the other party fails to comply with such decision, and without prejudice to any other rights it may have, refer the failure to arbitration in accordance with Sub-Clause 67.3. The provisions of Sub-Clauses 67.1 and 67.2 shall not apply to any such reference.