LETTERS TO THE EDITORS

Dear Sirs:

In an article entitled "*FIDIC's 1999 Editions of Conditions of Contract for 'Plant and Design-Build' And 'EPC Turnkey Contract'. Is The 'DAB' Still a Star?*", which appeared in your January 2000 issue, Mr Gordon Jaynes criticizes FIDIC because the new Yellow and Silver Books (as he calls them[1]) do not provide in their respective General Conditions for a Dispute Adjudication Board ("DAB") to be established at the outset of the contract (this type of DAB being referred to as a permanent or standing DAB). Instead, the General Conditions provide for a DAB which would only be constituted if and when a dispute or disputes arise and which would normally cease to operate once a decision on the dispute or disputes had been issued (this type of DAB being referred to as an *ad hoc* DAB). On the other hand, the "*Guidance for the Preparation of Particular Conditions*" of the new Yellow and Silver Books provides that:

> "... for certain types of project, particularly those involving extensive work on Site, where it would be appropriate for the DAB to visit Site on a regular basis, it may be decided to retain the services of a permanent DAB. In this case, [the relevant provisions of the] General Conditions, and the Dispute Adjudication Agreement, should be amended to comply with the corresponding wording contained in the FIDIC's "*Conditions of Contract for Construction*" [the new Red Book]."

As Mr Jaynes notes, the permanent DAB continues to be provided for in the General Conditions of the new Red Book. In particular, Mr Jaynes states that:

> "1. no explanation for this 'script revision' (as compared to the 1998 Test Editions of the new Books) has been given publicly yet by FIDIC, and
> 2. based on discussions 'among various persons', some possible explanations had been suggested as reasons for this change, which Mr Jaynes then discusses, seeking to refute each one of them."

He then concludes by stating that:

> "Obviously, the reader who uses the new Yellow or Silver Books is urged to try to establish the DAB at the outset of the contract ..." (page 46)

As Legal Advisor to the FIDIC Task Group responsible for preparing the new editions, and as an advocate of this change from the Test Editions, I would like briefly to respond to Mr Jaynes by this letter.

Mr Jaynes is mistaken when he states that no explanation to this "script revision" has been given publicly yet by FIDIC. I gave an explanation of why this change from the Test Editions was made at public conferences organized by FIDIC to introduce the new editions in The Hague in September 1999 and

[1] For convenience, I shall use Mr Janynes' terms here. Their full names are *Conditions of Contract for Plant and Design-Build* and *Conditions of Contract for EPC/Turnkey Projects.*

in London in October and December 1999. I understand from FIDIC that my paper on this subject has been available on the FIDIC web site since October 1999.

As to the reason for this change, I cannot do better than to refer to my paper which was published, with minor changes, as an article entitled "*FIDIC's New Standard Forms of Contract, Force Majeure, Claims, Disputes And Other Causes*" in the April 2000 issue of the ICLR. There I explained the basic reason for the change as follows:

> "The main reason for standing [or permanent] DAB is to deal with disputes on or related to the construction site. But, when the contract provides mainly for the design and manufacture of electrical or mechanical equipment in a factory rather than construction work on the site (as is true of many projects for which the new Plant and EPC Contracts would be used), the incidence of disputes should be much less and, hence, it is much more difficult to justify the time and expense of maintaining a standing DAB in such a case. Accordingly, FIDIC has opted for an *ad hoc* DAB in the General Conditions for these types of contracts."

As Messrs Matyas, Mathews, Smith and Sperry recognize in their authoritative book, "*Construction Dispute Review Board Manual*", the Dispute Review Board or "DRB" (and there is no reason to distinguish a Dispute Adjudication Board or "DAB" in this respect) is a "method for avoiding and resolving disputes at *the job site*" (emphasis added).[2] If for much of the contract period relatively little work is done at the site, much of the justification for a permanent DRB or DAB falls away. In the case of the new Yellow and Silver Books, FIDIC anticipates that much of the work under those forms of contract will be done off the site, often in another country. Accordingly, it appears inappropriate, in the case of those Books to provide for the use of a permanent DAB as a general rule, by providing for it in the General Conditions of these contracts. Instead an *ad hoc* DAB is provided for in the General Conditions of those Books. On the other hand, the *Guidance Note* for each such Book makes it clear (as mentioned above) that, where there will be considerable site work, then a permanent DAB may be appropriate instead of an *ad hoc* DAB.

As an example, take a natural gas-fired power plant which is one of the most popular types of power plants being built these days and which would be a project to which the Yellow and/or Silver Books would be suited. In the case of a recent project in Africa that I am familiar with, for at least half of the construction period the turbine units were being built in a factory in Europe and little work was being done on site apart from the construction of foundations and the base plate. Thereafter, the units needed to be installed, equipped and made operational on site, but this work on site was relatively minor compared to the equipment supply, as indicated by the price for each type of work. Whereas the price for installation and construction was US$15 million, the price for the equipment supply was US$95 million. When, during the contract negotiations, a permanent DAB was suggested, it was rejected

[2] Matyas, Mathews, Smith and Sperry "*Construction Dispute Review Board Manual*", McGraw-Hill (New York, 1996), page 3.

out of hand by both parties to the contract as being an unjustified expense, given the relatively small portion (and value) of the work being done on site. Accordingly, the parties opted for an *ad hoc* DAB.

There are many other types of projects where manufacture is the largest component of the work to be done and, therefore, where a permanent DAB would be unjustified for the same reason. There is another consideration which may be relevant in projects for which the new Yellow and Silver Books may be used. In the case of a lump sum turnkey contract, containing only an overall functional specification, and where the contractor has the responsibility to supply an entire functioning plant, the risk of disputes, and, therefore, the need for a permanent DAB, will normally be reduced compared to the usual civil works project for which the Red Book is used.

The initiative for this change from the Test Editions did not come solely from the FIDIC committees concerned with preparing the new Books. It was also one that had been proposed by commentators on the Test Editions.

I note that there is precedent for the use of an expert determination procedure similar to that of an *ad hoc* DAB in other international forms of contract. Thus, the forms of contract published by the Engineering Advancement Association of Japan ("ENAA") for process plants (1992) and power plants (1996) and, hence (like the new Yellow and Silver Books) for relatively limited work on site, provide as an option for disputes to be decided, before arbitration, by an expert who is appointed if an when a dispute arises. While a decision of the expert is not binding on the parties when made (as is the case of the decision of a DAB), the decision will become final and binding on the parties if it is not challenged by one of them within a fixed time period, as is the case of the decision of a DAB.

It is unnecessary to comment on Mr Jaynes' speculation about the other reasons for the change in the new Books, given that the basic reason is the one I have described above. However, I would like to comment on one point Mr Jaynes makes. He argues against the use of an *ad hoc* DAB on the grounds that:

> "... once disputes have reached the point that negotiations have failed, it is likely to be difficult or impossible to agree to establish a DAB".

The new FIDIC Books provide a solution to this difficulty. Sub-Clause 20.3 provides that if a party fails to participate in establishing a DAB by a specified date, then an appropriate neutral person (the *Guidance Note* provides that this could be the President of FIDIC or a person appointed by the President) will make the appointment in place of the defaulting party. Thus, the refusal of a party to participate in the establishing of a DAB should not prevent the formation of the DAB.

Moreover, a party would normally be ill-advised to refuse to participate in establishing a DAB. If a party should fail to appoint a member of a three-person DAB within a fixed time period, the appointment would be made without the defaulting party, placing such party at a disadvantage as,

unlike the other party, it will not have its own candidate on the DAB. A well-advised party would not ordinarily allow itself to be placed in such a position. Accordingly, I believe this is not a serious problem.

There is no doubt that, as I have argued,[3] the standing or permanent DAB represents a great advance over the former system under the FIDIC and other civil engineering contracts whereby disputes were resolved, on an interim basis (at least), by the Engineer. However, at the same time, its undoubted merits should not be exaggerated. It is not suitable for all projects.

No one, to my knowledge, has advocated the use of a standing DAB in a contract purely for the manufacture and/or supply of equipment. Accordingly, why should a standing DAB be advocated as being the preferred procedure for a form of contract that is primarily or largely for the manufacture and supply of equipment rather than for construction on site, as is the case of the new Yellow Book and Silver Book? The additional expense and administrative work may not be justified.

Rather than being criticized, I believe that FIDIC should be congratulated for being among the first to recognize and advocate that, where much of the work on a construction project is done off-site, a less onerous pre-arbitral dispute resolution system may be justified than the one that should apply to a large civil works project with extensive work on site. The need for a less "heavy" system on this ground is one that other forms of construction contract should recognize as it is, I believe, one of the numerous contributions to improved contract practice made by the new Books.[4]

Mr Jaynes has, by his comments both written and oral, made valuable contributions to the development of international construction contract practice over the years and all of us working in the international construction industry owe him a debt of gratitude. But he is wrong in urging users of the new Yellow and Silver Books to establish a permanent DAB regardless of the type of construction project concerned and, in particular, the extent of work involved on site.

Yours faithfully,

CHRISTOPHER R. SEPPALA

Legal Advisor, FIDIC Contracts Committee

Dear Sirs,

Thank you for the opportunity to respond to Mr Christopher Seppala's letter to you regarding my article in the January 2000 issue.

Twice his letter suggests that my article criticizes FIDIC. Certainly it was not

[3] *See,* Seppala, "*The New FIDIC Provision For A Dispute Adjudication Board*" [1997] ICLR 445.

[4] By way of anecdotal evidence, a member of the FIDIC Contracts Committee has been appointed by the International Chamber of Commerce on two occasions recently to act as an *ad hoc* expert to resolve disputes under international turnkey contracts before arbitration. In neither of the cases he was involved with did he consider that he would have been better equipped to deal with the disputes if had been appointed earlier and made regular visits to the site.

my intention to criticize FIDIC. As an advocate of Dispute Boards, I am delighted that FIDIC supports the use of them. Also, I am an enthusiastic supporter of FIDIC and the use of its Conditions of Contract: I have long been an Affiliate Member of FIDIC, and as Mr Seppala knows, have participated in pre-publication review of some FIDIC Conditions. I serve on FIDIC's Assessment Panel for Adjudicators, assist as a faculty member in some of its Adjudication Training Workshops, and have arranged for the use of FIDIC's Conditions in the training of lawyers from developing countries carried out by the International Development Law Institute. However, being a "friend of FIDIC" does not, and should not, prevent me from offering constructive criticism of FIDIC documents. Criticism of a publication is not a criticism of its publisher.

Turning to Mr Seppala's specific points, I regret that I was unable to attend the seminars he mentions, and note that his paper is available on the FIDIC website, which I did not think to consult before preparing my article.

The reasons given (in his paper and in his letter) for the decision to relegate the DAB to *ad hoc* status in two of the three new major documents are, in summary:

1. in contracts called "mainly" for work off site, "the incidence of disputes should be much less"; and
2. in such contracts, "it is much more difficult to justify the time and expense of maintaining a "standing" DAB.

These are statements of opinion, not fact. It is not necessarily the case, for example, that EPC Contracts will be "mainly" for work off site, nor is it clear that they will be any less subject to disputes than a Construction Contract.

Reason 1 is supported in Mr Seppala's letter by reference to

(i) a natural gas-fired power plant in Africa where parties opted for an *ad hoc* DAB becasue a "standing" DAB would be "an unjustified expense";
(ii) proposals by "commentators on the Test Editions"; and
(iii) precedent in the ENAA forms.

It is impossible to make helpful comment regarding what Mr Seppala terms "anecdotal evidence" since no details of the situations are available to the reader on which to base judgment. One also can provide "anecdotal evidence" that design-build turnkey (and EPC) contracts produce a healthy harvest of disputes, including ones arising off site.

Similarly, the remarks of the referenced "commentators" are not available to the reader, so no meaningful comment can be made, except perhaps to note that (as I assume Mr Seppala knows) among those commentators there were at least two who urgently tried to persuade the FIDIC Contracts Committee to reconsider its last-minute decision to switch from the Test Edition treatment of DABs to that in the 1999 Editions. Also, those commentators who did not make the suggestion on which Mr Seppala relies

presumably concurred with the Test Editions, which had the "standing" DAB provision.

Also, it is worth noting the view of the European International Contractors, in its "Guide" to the Silver Book (published in March, 2000, and therefore after my article was written). In its Executive Summary, the "Guide" states: "Despite FIDIC's claims to the contrary, the Silver Book is likely to give rise to disputes between the Parties unless several of its provisions are modified during negotiation." On Clause 20.2, it comments: "It is very likely that adjudication by a DAB in large and complex EPC Projects would be much more effective under a standing body rather than one convened on an ad hoc basis. It would be particularly beneficial for the DAB to become conversant with the Contract and the Works at an early stage and to familiarise itself with the progress of the Works on a regular basis. Undoubtedly this will result in speedy and well informed judgments and consequently the procedures and draft agreements set out in the Red Book are to be preferred for such projects. Under these rules the DAB is appointed at the start of the Contract and remains in existence for the duration of the Contract unless agreed otherwise by the Parties.

Regarding the excellent ENAA forms the post-dispute appointment of an Expert faces the same difficulty of any post-dispute selection, namely that when Parties are in dispute, it can be difficult to get them to agree on much of anything, including the selection of an Expert. This is the point that I was trying (apparently unclearly) to make regarding an *ad hoc* DAB—it is likely that disputing Parties will not agree on the DAB Members. I recognize that Sub-Clause 20.3 has the sort of default provision common to institutional arbitration Rules, but to operate it is to force upon a Party a procedure which a Party is resisting. This gives rise to difficulties which I think are so obvious as not to merit detail here except to say that at the heart of the Dispute Board concept is the aim that it operate by consent and cooperation, with both Parties wishing it to succeed.

Also, I wish to repeat my point that the *ad hoc* DAB does not possess one of the key characteristics of a Dispute Board, namely that it is appointed and familiar with the project before the disputes arise, and it is in place to help resolve potential disputes before they become formal disputes to be processed under the procedure of the contract. An *ad hoc* DAB cannot share those characteristics, and instead becomes a kind of pre-arbitration arbitral tribunal, and has little of substance to distinguish it from any other form of third-party dispute resolution except the binding nature of its adjudications, pending arbitration.

Perhaps my differences with Mr Seppala arise from differing assessments of the impact of the inclusion of the *ad hoc* DAB in the General Conditions (with an option for the user to substitute a "standing" DAB), instead of leaving FIDIC's "order of preference" the reverse, as it was in the Test Editions of the Yellow and Silver Books. My assessment (based upon my experience) is that an inexperienced user may hestitate to change a General Condition (even if

provided with an alternative Condition). The consequence with the new Yellow and Silver Books is that the inexperienced user who does not have an expert adviser may enter a contract for "the design and execution of engineering works" on a turnkey basis (the Yellow Book), or a contract for an EPC Contract "within a BOT or similar type venture . . . [or] projects . . . on a fixed-price turnkey basis" (the Silver Book), using an *ad hoc* DAB without appreciating the risks of the election, and the potential benefits of having a "standing" DAB.

It seems to me that inexperienced users would be aided by having the "standing" DAB, with the option given to change it to an *ad hoc* DAB. Obviously, my experience leads me to believe that disputes under these two kinds of contract are more likely to arise on and off site (including during the design phase) than Mr Seppala's experience leads him to believe.

As for BOT-type projects, it should be noted in passing that on larger ones, examples are appearing of *two* "standing" Boards, one for design and construction issues, another for financial issues. On such projects, there can be disputes that do not arise "on site" and Boards can assist in early resolution. Also, it merits emphasis that while, as noted by Mr Seppala, the Dispute Board concept developed for "on site" disputes, it has developed to include other kinds of disputes, including design disputes arising prior to (and during) "on site" work. If the Dispute Board concept works, why seek to constrain its use to the original one?

Mr Seppala gave as one of the reasons for *ad hoc* DABs that they save money. His letter refers to the "Construction Dispute Review Board Manual" and although I do not have a copy to hand while writing this letter, it is my recollection that the Manual sets forth a clear case that what FIDIC calls "standing" Boards save money compared with dispute resolvers who enter the constractual scene after the disputes have arisen. The economy of using Dispute Boards is a matter which is researched as much as possible by the Dispute Review Board Foundation as Board usage increases, and its findings are available to anyone who is interested.

I do not intend to suggest that a "standing" DAB is necessary for all projects. I continue to suggest that in the new Yellow Book (combining as it does the old Yellow and Orange Books) and the new Silver Book, both of which are stated to be for use which can include complex and lengthy projects, it is preferable to provide for "standing" DABs, with the option to switch to an *ad hoc* DAB rather than the other way round. Hopefully, FIDIC's Contract Committee will revisit the matter before the Second Edition is published in the future. Meanwhile, Mr Seppala may continue to disagree with me, but I am not yet convinced that he has sustained his allegation that my view is "wrong".

Yours faithfully,
GORDON JAYNES

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THE INTERNATIONAL CONSTRUCTION LAW REVIEW

CONTENTS