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The 2017 FIDIC dispute resolution procedure:

Part 2 - are Dispute Adjudication Boards worthwhile: benefits, problems, and advice on FIDICs security-of-payment regime

Introduction

I In Part 1 of this paper we reviewed the dispute resolution procedure included in FIDIC's second edition of Conditions of Contract for Plant and Design Build (Yellow Book), Construction (Red Book), and EPC/Turnkey (Silver Book) (together the "2017 Contracts") which affirms and expands the infamous Dispute Adjudication / Avoidance Board ("DAB") mechanism.

DABs are used widely in international construction contracts and they can be very effective. However, if either party refuses to comply with its obligations under the DAB provisions it can be difficult and at times impossible to enforce them. Defective drafting of the FIDIC Rainbow Suite, or 1999 Conditions of Contract, has led to a proliferation of disputes as to whether as a matter of contract it is possible to summarily enforce binding but not-final DAB decisions, notwithstanding that FIDIC has explicitly stated this was its intention. The problematic wording has been resolved in the 2017 Contracts, however, even where the contractual position is clear a further issue is whether not-final DAB decisions are able to be enforced as a matter of law in a number of jurisdictions. Many contractors have signed up to the FIDIC Conditions on the understanding that the DAB provides a security-of-payment regime, only to find it act as a barrier to payment instead. The reality is that DABs often do not provide the straightforward relief that FIDIC intended.

This paper considers the practical effect of FIDIC's DAB mechanism as a security of payment regime, and in doing so addresses the benefits, pitfalls, how not-final DAB decisions are treated in different jurisdictions, and potential solutions for a workable DAB mechanism, and by implication the proposed new binding Engineer's determinations, as a contractual pre-condition to arbitration

The intended DAB "security of payment" regime

"DABs," under the FIDIC form and as they are commonly understood, refer to: a board consisting of one or three people, appointed by parties to a contract to assist in the resolution of issues or disputes arising in relation to that contract, as a first step before any dispute can be referred to arbitration or court proceedings.

Whereas DABs under the 2008 Gold Book and the 2017 Contracts also provide a dispute avoidance role during the contract[1], this paper focusses on the "security of payment" regime of binding decisions. The key features of FIDIC's security of payment regime are as follows[2]:

- when any dispute arises in relation to a contract either party may refer the dispute to the DAB;[3]

1. Parties should use caution in asking the DAB to act as a quasi-mediator, but the development should generally be viewed positively.
2. Which are provided in Sub-clause 20.4 of the 1999 Conditions of Contract, Sub-clause 20.6 of the 2008 Gold Book, and Sub-clause 21.4 of the 2017 Yellow Book.
3. "Dispute Board" in the FIDIC Pink Book.

- the DAB must issue a decision within 84 days of the dispute being referred to it;

- the decision *"shall be binding on both Parties, who shall promptly give effect to it;"* and

- obtaining a DAB decision is a condition precedent to referring that dispute to arbitration.

Either party may issue a "notice of dissatisfaction" ("NOD") with a DAB decision within 28 days of it being issued, which will preserve the parties' ability to refer the underlying dispute to be finally determined in arbitration. If neither party issues a valid NOD then the decision will become final, and the decision itself will be enforceable in arbitration without the merits of the underlying dispute being looked at any further.

FIDIC has repeatedly affirmed that its intention is that any DAB decision, whether subject to an NOD or not, be able to be enforced summarily in arbitration in the first instance;[4] i.e. "*pay now, argue later.*" This was explained by the Singapore courts in the Persero II proceedings[5] as creating[6]:

> *"a contractual security of payment regime, intended to be available to the parties even if no statutory regime exists under the applicable law...[and under which] When a dispute over a payment obligation arises, the regime facilitates the contractor's cash flow by requiring the employer to pay now, but without disturbing the employer's entitlement (and indeed also the contractor's entitlement) to argue later about the underlying merits of that payment obligation."*

In addition, and as explained in Part 1 of this paper, the 2017 Contracts add a further layer to this security of payment regime whereby as a pre-condition to referring any dispute to the DAB, parties must first refer the dispute to the Engineer (or the other Party under the Silver Book) who will have 84 days to resolve the dispute or failing that to issue a binding Engineer's determination.

Benefits of the DAB mechanism

The benefits of this functioning DAB mechanism include that:

1. If a DAB is set up early in the contract, it will be able to provide immediate assistance once a dispute arises, and should already have a good knowledge of the project.

2. Disputes must be referred to a DAB timeously, meaning the issues will still be fresh in the parties' minds and should be able to be resolved without unduly disturbing the carrying out of the project.

3. Decisions must be issued within 84 days, which is much, much faster than can be achieved in arbitration[7].

Similar security of payment regimes have been implemented by legislation in a number of jurisdictions, such as the United Kingdom, Australia, New Zealand, and Singapore[8]. In these jurisdictions the ability to receive fast and enforceable adjudication decisions, while not appropriate for every dispute, has dramatically decreased the number of construction disputes that proceed to substantive court or arbitration proceedings.

4. For instance in the FIDIC Guidance Memorandum of April 2013.
5. Which culminated in subsequently the Singapore Court of Appeal in PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation [2015] SGCA 30.
6. PT Perusahaan Gas Negara (Persero) TBK ("PGN") v CRW Joint Operation (Indonesia) ("CRW") [2014] SGHC 146, at paragraphs 22 and 24.
7. With the exception of emergency arbitration procedures, which provide only urgent and temporary relief.
8. For instance, the Housing Grants, Construction and Regeneration Act 1998 in the UK, or in Singapore where the Building and Construction Industry Security of Payment Act 2006 goes as far as to state that an application for review of an adjudicator's decision can only be heard if that decision has actually been paid.

However, despite FIDIC's best intentions, there are a number of practical issues which have done and will continue to plague its contractual security of payment regime.

Problems with the DAB mechanism

The practical difficulties we have experienced with the FIDIC DAB mechanism can be broadly broken down into following; (1) defective contract wording, (2) jurisdictional issues, (3) a lack of will from employers and project-funders to adhere to the contractual DAB mechanism. These are addressed below.

1. Defective contract wording

Defective contract wording has been a major problem with the DAB mechanism under the 1999 Conditions of Contract. The issue is that although those Conditions provide for final DAB decisions to be directly enforced in arbitration, there is no express provision for not-final DAB decisions to be enforced. This has led to extensive debate and a multitude of competing options as to the correct way, if at all, to enforce a not-final DAB decision.

FIDIC sought to clarify the position through a Guidance Memorandum issued on 1 April 2013 which provided wording for an amended Sub-clause 20.7 that expressly provides for not-final decisions to be enforced in arbitration, and which can be incorporated into the 1999 Conditions of Contract. This same wording has been included in the 2008 Gold Book, whereas the 2017 Contracts use similar albeit further refined wording to address the contractual issues with the DAB mechanism.

Parties using the FIDIC form therefore now have the tools to avoid the contractual issues set out above, provided they have the will to include them.

2. Not-final DAB decisions are not be enforceable in some jurisdictions

A more critical issue with the FIDIC security of payment regime is that irrespective of how clear the contract is, not-final DAB decisions are simply not enforceable in a number of jurisdictions. In those cases parties will still be required to go through the mandatory DAB procedure but will then have no ability to enforce the resulting DAB decision in the event the losing party refuses to comply.

DABs are purely creations of contract and therefore, unlike adjudication decisions under statutory regimes[9], DAB decisions are not recognised as an enforceable title in and of themselves. The two key issues we have experienced with this are whether an arbitral award enforcing a not-final DAB decision:

- Will comply with the definition of an enforceable arbitral award in a jurisdiction's arbitration legislation, given that such an award (a) will not review the underlying merit of the dispute and (b) will be followed by a final substantive arbitral award on the underlying merits; and

- Will be prevented by the principle of *res judicata* (that a matter which has already been decided cannot be decided again), because the final substantive arbitral award will need to decide the same matters that are subject to the enforced DAB decision.

9. Housing Grants, Construction, and Regeneration Act 1996.

Other practical issues including how the enforcement of a not-final award should be taken into account in the final substantive arbitral award.

A snapshot of how some jurisdictions have dealt with these issues is set out below.

Romania

As of January 2017 the position in Romania appears to be that not-final DAB decisions cannot be enforced. The position has been unsettled for a number of years, and we are aware of not-final DAB decisions that have been enforced and commentators who support this,[10] however, the majority of reported arbitral awards have declined to enforce not-final DAB decisions. In the most definitive statement to date a High Court decision issued in January 2017 found that not-final DAB decisions cannot be enforced under Romanian law.

The reasons for the Romanian position are as summarised above, namely that any arbitral award enforcing a not-final DAB decision will not comply with Romanian legislation,[11] and *res judicata*.

Singapore

Following the *Persero* series of cases[12] the Singaporean position is perhaps the best known in the world. In those cases the claimant contractor was able to enforce a not-final DAB decision, albeit after going through two sets of arbitration, High Court, and Court of Appeal proceedings, and over a period of six years. The difficulty with that case related to the defective contract wording of the 1999 Conditions of Contract, and if we assume that this defective wording has now been resolved it might be expected that a not-final DAB decision would be enforced promptly.

However this is not a certainty. The Singapore International Arbitration Act defines an "award" as a decision "*on the substance of the dispute and includes any interim, interlocutory or partial award.*" While this is a wider definition than the Romanian legislation, the Minority of the Court of Appeal in Persero II considered that not-final DAB decisions amount to provisional relief only and therefore cannot be enforced under this definition. It is conceivable that a court might also reject such an award as not being on the "substance" of the dispute.

The position in Singapore today therefore is that not-final DAB decisions should be expected to be enforced, but there is no guarantee that they will.

South Africa

By contrast to the positions above, in South Africa the courts have had no problems giving effect to the intention of the contract. The position is set out in the case of *Tubular Holdings (Pty) Ltd v DBT Technologies (Pty) Ltd (06757/2013)* [2013] ZAGPJHC 155; 2014 (1) SA 244 (GSJ) (3 May 2013). In that case the court focussed only on the question of the intention of the contract, from which basis it had no difficulty in giving effect to what it described as the *"perfectly clear"* intention that the parties are *"obliged to promptly give effect to a decision by the DAB…[and] that the issue of a notice of dissatisfaction does not in any way detract from this obligation."*

10. C. Leaua, Arbitration in Romania: A Practitioner's Guide, Kluwer Law International, 2016.
11. Article 1.121(3) of the Romanian New Civil Procedure Code requires arbitral awards to be "final" in order to be enforceable.
12. Although the Persero series were decided under Indonesian law, the applicable arbitration law was based on the seat of arbitration; Singapore.

United Arab Emirates

The position in the UAE, and which is representative of the Middle East generally, is untested (so far as we are aware) but is very unlikely to permit not-final DAB decisions to be enforced. While UAE law does recognise arbitral awards, the UAE Civil Procedures Law only recognises final awards and therefore any bifurcation would likely jeopardise the entire arbitration agreement[13], whereas we would expect not-final awards would also be disputed on grounds of res *judicata*.

3. Lack of will from employers and project-funders to adhere to the contractual DAB mechanism

The biggest issue we have experienced with FIDIC's security of payment regime is recalcitrance from employers to adhere to DAB decisions, and a lack of will or ability from project funders, such as development banks, to encourage compliance.

Solutions

There are a number of solutions and steps parties can take in response to the issues described above. Remedies to the defective contract wording have already been well canvassed. In addition, there are a number of contract amendments that could effectively ensure compliance or at least a release from the DAB mechanism in jurisdictions where enforcement will be difficult. These include making it a condition precedent to issuing a valid NOD that the issuing party has fully complied with the corresponding DAB decision, or allowing the DAB mechanism to be deleted upon non-compliance by the other party.

However many of these amendments will not be acceptable to employers, and the extent to which concerns are able to be addressed will be a matter of negotiation. Consequently the most important thing parties can do is ensure that prior to entering into any contract they have discussed, understood, and agreed their obligations under the dispute resolution mechanism. This should include discussions with any project funder as to their position and role in enforcing the security of payment regime.

Conclusion

Our answer to the question "are DABs worthwhile?", perhaps unsurprisingly, is "it depends".

FIDIC's promotion of dispute avoidance is a good thing and should be viewed positively, albeit carefully. The security of payment regime will not suit every contract. Where parties are confident that decisions by the DAB and/or Engineer will be complied with or will be enforceable in the applicable jurisdiction, then the DAB mechanism is likely to be worthwhile. Conversely, where DAB decisions are unlikely to be enforceable serious questions will need to be asked about what other steps might be available to ensure the security of payment regime is workable. In some cases no satisfactory assurances will be available and the DAB mechanism may well be a waste of time, effort and money.

13. We are aware of one case that has endorsed the right of arbitral tribunals to issue partial awards where this is provided in the parties' arbitration agreement, Dubai Court of Cassation, Petition No. 274 of 2013, dated 19 January 2014, but as the UAE does not have a system of binding precedent, it is questionable whether this can be relied upon in light of the body of law against it.

In summary, FIDIC's DAB mechanism is very good when it works, but is often a waste of time when it does not. Parties looking to enter into any FIDIC contract should consider very carefully whether this mechanism is suitable for their particular circumstances, what can be done to minimise the risk of the security of payment regime being ineffective, and whether this mechanism or parts of it should be deleted altogether. If appropriate steps cannot be taken, parties should at least understand the risks they are signing on to.

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