

ANGLES

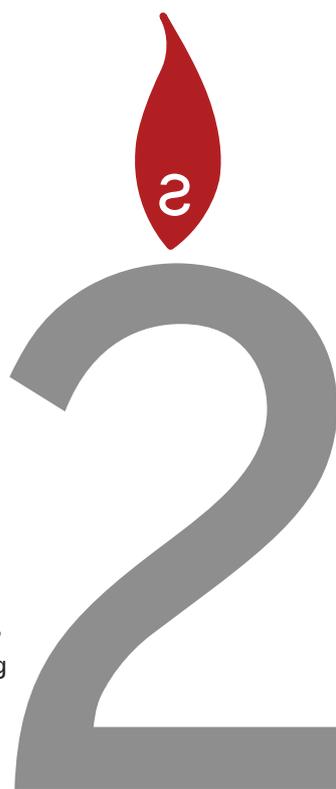
SENSE STUDIO NEWSLETTER OCTOBER 2014

Welcome to the fourth edition of "ANGLES" our triannual newsletter which we hope you will find a source of interesting information and news. We welcome feedback and contributions so please **let us know what you think**. We hope you will enjoy this and future editions. **Murray Armes**

Sense Studio Celebrates its 2nd Birthday

Sense Studio celebrates its second birthday this month. It's been another busy year since Murray Armes launched the company two years ago, and thanks to our clients we have been instructed as expert witnesses, adjudicator, arbitrator and mediator in many interesting cases in both the UK and internationally. We have moved to bigger offices and we have welcomed Mark Phillips, Debbie Paterson and Jon Satow joining Murray Fordham and Frances Forward to further enhance our expertise.

Please visit our website www.sensestudio.co.uk for our latest news.



THE MANDATORY NATURE OF DABs – THE CASE OF Enterprise Managed Services Limited and Peterborough City Council

The FIDIC General Conditions of Contract anticipate that a DAB will be established either at the outset of a contract or when a dispute arises¹, and that disputes will be referred to it as a precondition of a referral to arbitration². Sub Clause 20.8 permits a party to refer a dispute straight to arbitration where no DAB is in place or where its appointment has expired.

On the face of it, unless caught by the sub clause a party has to refer a dispute to the DAB first, although a recent case involving Swiss law suggests that in certain circumstances (for example where a party has tried to frustrate the DAB process) this might not always be necessary, at least where arbitration is concerned³.

Despite this possible uncertainty a recent case in the TCC, between **Enterprise Managed Services Limited and Peterborough City Council**⁴ has clarified the position under certain circumstances, at least for England and Wales. The contract, for the provision of solar energy plant, was based on the FIDIC Silver Book which provided for an ad hoc DAB. The final forum for dispute resolution was to be litigation rather than arbitration.

Continued

ANGLES SENSE STUDIO NEWSLETTER OCTOBER 2014

Having attempted mediation, the Council commenced litigation, claiming just over £1.3m in liquidated damages, because the installation did not provide at least 55kW, thus denying the Council payment of a higher government tariff for supplying energy. EMS applied for a stay of the litigation; the Council argued that the parties could not be under a mandatory obligation to appoint an adjudicator and also asserted that Sub Clauses 20.4 to 20.7 were unenforceable due to lack of certainty and the lack of finality of the DAB's decision⁵.

The Court was not persuaded that these difficulties existed where arbitration had been replaced by litigation as the final means of dispute resolution. It was argued that Sub Clause 20.8 could only be effective where a standing DAB was contemplated, because an ad hoc DAB would only ever be appointed after a dispute had been notified⁶. In this case a nominating body⁷ had appointed the adjudicator, and it was clear the dispute could not be referred until that had been done and therefore the Court decided that Sub Clause 20.8 did not provide a unilateral right to opt out of the adjudication process.

The Council also said that there could be no DAB in place if a Dispute Adjudication Agreement had not been concluded and become effective. In this case, however, as is usual, the General Conditions of Dispute Adjudication Agreement had been included within the Silver Book Contract and thus the Judge found that all the relevant terms had been agreed save only for the adjudicator's fees. He said that these could "readily be assessed by the Court in default of agreement". Further, a failure to sign the Dispute Adjudication Agreement could not be relevant because the recalcitrant party could be compelled to sign by an order for specific performance.

In support of its assertion that the Court should exercise its discretion against granting a stay, the Council said that any decision by the DAB would probably result in a Notice of Dissatisfaction from one of the parties and therefore the procedure was a waste of time and money. The court was not persuaded that a complex dispute such as this could not be dealt with by adjudication, but sympathised with the idea that a single, albeit more expensive, form of dispute resolution (ie litigation) was preferable

to two sets of consecutive proceedings. However, in deciding whether to grant a stay, the Court considered that there was a presumption in favour of leaving the parties to resolve disputes in the manner set out in their contract. Furthermore, it was not known what positions the parties might adopt following the adjudicator's decision and in any case that decision might be the basis for negotiation and settlement of the dispute. As a result the Court stayed the litigation, leaving the parties to resolve the dispute using the DAB.

The UK Courts actively support adjudication which, for construction contracts at least, is considered an unfettered right. Although an agreement to arbitrate will normally result in a stay of litigation, nothing in the UK legislation prevents a party from pursuing a claim in both litigation and adjudication, because the latter is not final and binding like arbitration. This case not only supports the DAB process but suggests that in the UK at least, litigation will be stayed pending a decision of the adjudicator. ●

1. Sub Clause 20.2
2. Sub Clause 20.4 provides for a Notice of Dissatisfaction following the DAB decision as a precondition to arbitration.
3. Swiss Federal Supreme Court Decision 4A_124/2014 (decision of 7 July 2014).
4. Enterprise Managed Services Limited and Peterborough City Council, [2014] EWHC 3193 (TCC).
5. Much has previously been written about the lacuna in all FIDIC contracts except the Gold Book, which led to the Singapore case of PT Perusahaan Gas Negara (Persero) TBK v. CRW Joint Operation [2010] SGHC 202.
6. As per Sub Clause 20.2 in the Silver Book: "...The Parties shall jointly appoint a DAB by the date 28 days after a Party gives notice to the other Party of its intention to refer a dispute to the DAB...".
7. This was the very first appointment made by the RICS as appointing body, of an adjudicator from its list.

Out of the frying pan...

In the UK the CDM Regulations are set to change again in April 2015. The CDM Co-Ordinator is to be replaced by a "principal designer". The Approved Code of Practice is to be replaced with a more general requirement for appropriate information, training and supervision. Whilst the HSE says it aims to provide increased worker protection by making the new regulations shorter, certain current prescriptive requirements are to be replaced with more generic guidance.

This is the second major revision to the CDM regulations and it remains to be seen whether the proposed broad brush approach will in fact improve safety on site.

Pass the parcel – Who is responsible for specifying basement waterproofing?

There are certain types of disputes between architects and clients and contractors that seem to reappear on a periodic basis. One such are disputes about who is responsible for specifying and designing basement waterproofing. Architects sometimes consider that basement waterproofing is the responsibility of the structural engineer, or the contractor and may annotate their drawings to that effect. The engineer may well have added a note to its drawings that it is the architect who is the specifier. Problems inevitably arise where neither specifies anything.

Causes of leaks in basements can be extremely difficult to find and identify, very costly to rectify and in an occupied basement can do an enormous amount of damage.

If it is considered from the start, designing and specifying basement waterproofing need not be difficult and professionals will find an army of manufacturers and suppliers ready and willing to give their advice, all of course tailored to their particular products. However, the first step should be to consult BS8102:2009. This British Standard provides valuable guidance on how to design and specify basement waterproofing, and depending on the type chosen will determine exactly who specifies it.

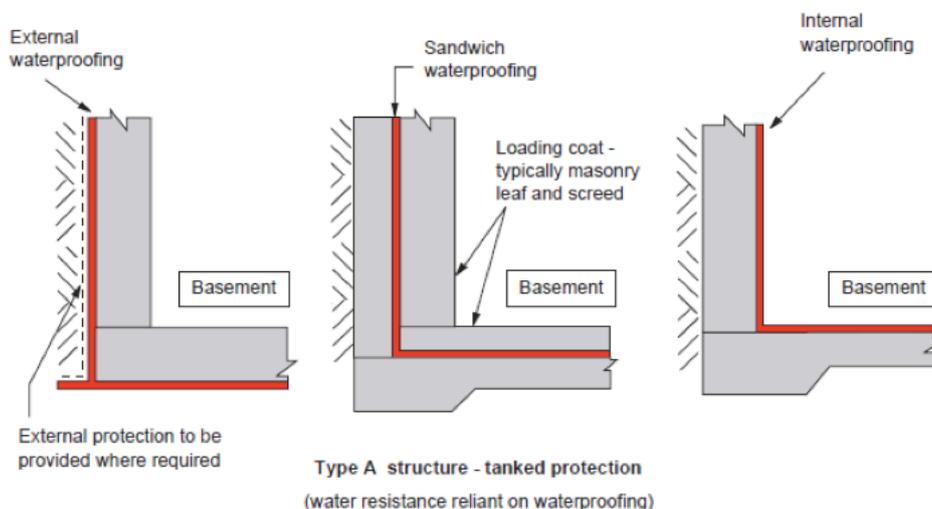
The BS suggests that a desk study be carried out to assess the risks associated with ground water. In the case of existing structures surveys should be carried out because solutions will be more limited. For a new basement there are three choices of waterproofing:

- Type A: Barrier Protection, where a membrane is located on either the outer or inner faces of the basement (or sandwiched between an inner and outer layer).

- Type B: Structurally Integral Protection: where chemicals are added to concrete to render it water resistant.
- Type C: Drained protection: Where the basement is constructed using two layers with a drained cavity between the two.

The BS suggests that consideration should be given to combined protection: Types A and B together, or Types A and C or Types B and C, the advantage being that the second line of protection should resist water ingress should there be any inadequacies in the first. Table 2 of the BS also lists three grades of basement, from Grade 1 (car parks, some plant rooms, etc) where some seepage of water is acceptable, through Grade 2 (plantrooms and workshops) where seepage is not acceptable but some damp patches are, to Grade 3 Residential and other occupied areas) where no water penetration is acceptable. This table needs to be interpreted carefully because some car parks accommodate very expensive cars and so Grade 2 or even 3 would be appropriate.

Continued

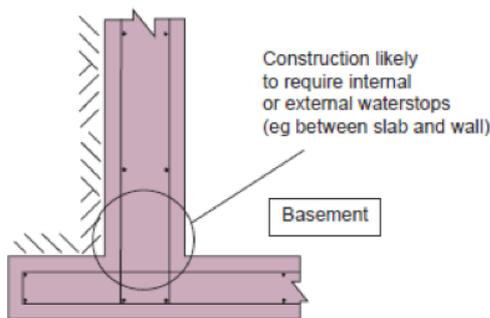


ANGLES SENSE STUDIO NEWSLETTER OCTOBER 2014

All occupied areas should comprise Grade 3 accommodation which also anticipates the need for ventilation and dehumidification to control the environment.

Where ground water levels or hydrostatic pressure is high a land drain located at the foot of the basement foundations may assist in lowering the water level and pressure, although these can be prone to blocking.

Provided it is agreed at the outset, waterproofing may be specified by either the architect or structural engineer, and sometimes by both. However, as design leader and lead consultant it is normally for the architect to decide on the waterproofing strategy, although on the basis that two heads are always better than one it is a good idea to discuss this with the engineer.



Type B structure - structurally integral protection (water-resistant concrete)
(water resistance reliant specifically on the the concrete construction but may be combined with additional waterproofing)

Where Type A protection is to be used this requires the specification of a membrane. This type of waterproofing is applied to the structure and it is usually the responsibility of the architect to specify. The architect may need to consult the engineer to ensure continuity of the waterproofing if the membrane is to be used to protect pile caps and ground beams and other structural features. The architect is also normally responsible for specifying Type C protection, although again this can be done with the help of the engineer.

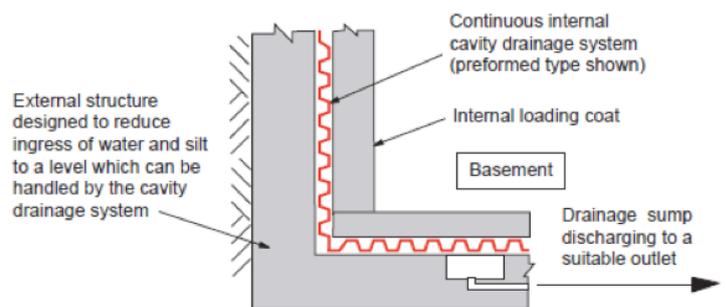
Type B protection though is different. Whilst the architect retains the responsibility for the overall waterproofing strategy and possibly specifying the manufacturer of the Type B concrete additive, this method of protection must be designed by the engineer. This is because Type B requires design in accordance with BS EN 1992 and 1993 which require careful specification of the type of concrete, the reinforcement and the way in which joints are sealed using waterbars. These are all aspects of the structural design.

Where Type B is combined with either Type A or C the design responsibility will be shared by both architect and engineer".

Whereas the architect will retain responsibility for inspecting the workmanship in relation to Type A and C waterproofing, the structural engineer will be principally responsible for inspecting Type B, the effectiveness of which relies heavily on the quality of workmanship during placement and compaction of the concrete. Of course where combined protection is specified the inspection regime will be the responsibility of both the architect and the engineer.

If the contractor is to be responsible for the design of basement waterproofing it is useful to find out how it intends to do it and whether it has the right experience. The method of basement construction will be entirely dependent on the method of waterproofing chosen and the two are completely inseparable. Failure to consider one without the other will almost inevitably lead to problems and therefore it is important the contractor knows from the outset that it will be responsible to give it a chance to design the right type of protection.

In a recent case works to an existing building were carried out in two phases: the first were the structural works including the basement shell in reinforced concrete, the second included the application of the waterproofing as part of the contractor's design portion supplement. By the time the contractor was aware it was responsible, the options for the types of protection were very limited and in fact it had become impossible to properly protect all areas of the basement because some protection should have been installed before the concrete had been placed.



Type C structure - drained cavity
(water resistance reliant on collecting any water within internal cavity system)

So, unless there are clear words to the contrary, the architect will be responsible as design leader for establishing the waterproofing strategy and will almost always remain responsible for specifying Types A and C protection. The structural engineer will inevitably have the larger part to play in specifying Type B protection which is integral with the structural works. The contractor may be responsible to a greater or lesser extent depending on the type of contract and the way in which it is worded. ●

Counting the cost

Litigation has always been expensive but the signs are that it is becoming increasingly so. A survey conducted by the US Chamber Institute for Legal Reform and others¹ showed that costs were increasing at a faster rate than increases in hourly rates.

In the UK cost budgeting introduced by the Jackson Reforms has made participants more aware of the need to control costs but it is too early to say whether this has actually reduced them². Things are little better with international arbitration where both delay and costs appear to be rising³. The costs of litigation, and by implication, arbitration, also have a wider impact (some say they do actual economic harm) to society as a whole as a larger part of company budgets, resources and productivity are invested in litigation rather than productively in research, capital investment and market development⁴. Anything that might help to reduce both the actual and consequential costs of disputes must be beneficial.

The way to reduce the cost of disputes is to try to avoid them in the first place and I have written previously about how that can be achieved⁵, namely by the use of Dispute Boards. So, if Dispute Boards offers such advantages why are they not more widely used, and surely the DB process itself must involve costs?

There are a number of barriers to the wider use of DBs:

- Lack of knowledge of the process
- Lack of knowledge about effectiveness
- Lack of locally available DB members
- Suspicion about another layer of dispute resolution
- Employer: previous adverse decisions
- Not final and binding
- Enforceability
- Concerns about the costs

There are a number of organisations which are working to address most of the list above⁶, this article is concerned with the last item on the list: costs. For anyone concerned with costs and faced with the choice of using a DB a few questions might arise:

- What does a Dispute Board cost?
- Why do I need one before any disputes arise?
- It must be expensive to have three members?

- It must be expensive for them to travel?
- Why should I not stick with arbitration or litigation?
- What is the cost of a DB compared to the alternatives?

Whether promoters of DBs like it or not, DBs are perceived to be expensive. Firstly the DB is constituted at the beginning of the contract, before any disputes have arisen. Secondly, DBs, especially for larger projects, comprise three or, sometimes, more members⁷. Traditionally board members have not been appointed from the local area, meaning travel and accommodation costs are a significant part of the cost of the process. This has been because experienced DB members were simply not available in some parts of the world⁸ and there may also have been concerns about the impartiality of local members in a market that in some countries can be very small. This all led to members being recruited from abroad and often from countries where the costs of living and therefore incomes were higher. Thirdly, parties might be concerned that the costs of the DB are incurred, even if there are no disputes. Of course, the fact the board was in place might be the reason that was the case!

Figures have been cited for years that have suggested the costs of a typical DB was around 0.1%-0.25% of the total construction costs of a project. The typical cost of a DB can be calculated by reference to past experience. For instance, in Florida member rates are typically \$1500-\$3000 per day. In order to control costs some public bodies only allow half day meetings. Study time⁹ of about four hours per month is allowed in addition. Assuming a daily rate of \$2000, and a three person board, each meeting costs \$6000, twelve meetings per year cost \$72,000. Taking account of study time, travel¹⁰ and writing of decisions, the annual cost is about \$75,000. The authorities report that the cost is about the same despite the size of the project, so clearly the DB will be more cost effective on larger projects. The Florida Department of Transport has used DBs on about 750 projects, typically of \$15m and above. The total value of the projects is about \$17bn and the cost of DRBs to date amounts to

about \$17.5m, or, on average, about 0.1% of the construction cost of each project.

For a DB the costs amount to:

- Daily fees for board members for site visits
- Retainer fee (or hourly/daily rate for reviewing documents and keeping up to date)
- Daily fees for board members for hearings
- Cost of producing the decision
- Travel and accommodation costs

Added to this are the costs for each party of representation and the costs of the venue for hearings. Site visits usually take place using facilities already available on site. A study of the costs of international DBs published in the Journal of Management and Engineering in April 2010¹¹ suggested that for most projects site visits were carried out 3-4 times per year; that disputes were referred in 0-51% of projects; the cost of site visits assuming a DB of three members with fees of \$3000 per day¹² was \$81,000 per annum. The cost of the retainer, assuming one day per month at \$3000 for each DB member was \$108,000 per year. The cost of the DB per Annum, assuming no disputes, was therefore \$189,000. It was suggested each dispute would cost about \$54,000¹³. It was estimated that for a project with a value of \$100m-\$400m lasting four years the total cost with no disputes amounted to \$756,000, the cost of, say, five disputes would be \$270,000, so the total cost of the DB was \$1,026,000 amounting to 0.2-0.04% of the cost of the project for projects worth \$100-\$500m. For comparison, a single ICC arbitration with a value of \$5,000,000 would cost in the region of \$300,000¹⁴.

In Australia¹⁵ research has shown that the cost of a typical three man DB is around 0.15% for a A\$300m contract, falling to about 0.09% for a project larger than A\$400m. One man DBs work out on average to be about 0.09% of the cost of a project below A\$100m.

Continued

ANGLES SENSE STUDIO NEWSLETTER OCTOBER 2014

This all points to the costs of the DB being insignificant compared to the cost of the project itself, and very good value when compared with the costs of international arbitration. Even so, there are times when DBs are still difficult to afford. For instance most international development banks will not include the cost of the DB as part of the loan for projects in developing countries. Such countries may simply be unable to afford the DB and may have insufficient access to foreign exchange to pay the DB even if it were affordable. Although most banks classify the DB process as "litigation", one does allow the borrower to include the costs within its loan and also provides the means by which the costs can be estimated. That bank is the Japan International Co-Operation Agency ("JICA") which in 2012 published its enormously influential JICA Dispute Board Manual¹⁶. The pro forma used to calculate DB costs includes two examples, the first for a single person DB:

- DB member is a resident in the country.
- Daily Fee is US\$2,000/day and Retainer Fee is US\$2,000/month.
- Construction Term: 2 years
- Number of DB Members: 1
- Frequency of site visits: 3 (6 total in 2 years)
- Termination: at expiry of Defects Notification Period and 1 year after TOC, fee is two thirds daily rate
- Assume 2no Referrals to DB during construction

The total cost was calculated to be \$145,000. For the three person DB JICA assumed:

- DB members are from foreign countries.
- Daily Fee is US\$3,000/day and Retainer Fee is US\$3,000/month.
- Construction Term: 4 years
- Number of DB Member: 3
- Site visit: 3 days and average travel time: 3 days
- Frequency of site visits: 3 (9 total in 3 years)
- Termination: at expiry of Defects Notification Period and 1 year after TOC, fee is two thirds daily rate
- Assume 3no Referrals to DB during construction

In this case the total cost was calculated to be \$1,368,000.

Clearly the project where the three man board was appointed would have been much larger

than that with the single person. Assuming the costs were about 0.1% of the project costs the values would have been about \$14.5m and \$137m respectively. Evidence suggests that 60% of disputes have a value of 0-10% of the project cost¹⁷ For the two examples this amounts to disputes worth \$725,000 and \$6.85m assuming the value is 5% of the construction cost. For the two man board we have assumed two Referrals of \$725,000, which the ICC costs calculator predicts¹⁸ would each cost about \$50,000 in arbitrators and administrative costs, so about \$100k in total. For the three man board three disputes valued at \$6.85m would cost about \$340,000 each, a total of \$1,020,000 in arbitrator's fees¹⁹ and administrative costs. These figures assume quite conservative estimates for the value of the disputes.

Although both scenarios work out to be less than the fees for the DB, remember they do not include the costs to the parties for representation and the internal management time need to deal with the disputes. This adds a large amount to the costs and means the costs of the DB are less than the alternative. The DB process has the added benefit that it is usually much quicker to resolve disputes than arbitration, and the real reason the DB is used is to prevent the disputes, and the costs and disruption they entail, from crystallising in the first place.

Although the proponents of DBs claim they are good value, just like in litigation, with the Jackson Reforms in the UK, there is pressure to keep costs down. So, how can DBs be made cheaper? Firstly, a single person DB is cheaper than three persons but the parties should always remember the expertise required to deal with dispute avoidance and resolution for complex projects. Sometimes a single person is a poor investment. Secondly, the use of locally based members reduces travel and accommodation costs and if local living costs are lower then savings can be made on the fees charged by foreign DB members. It should be remembered though that properly trained, high quality and neutral DB members are not always (or at least not yet) readily available in some parts of the world. The DB can assist by ensuring the DB processes, whether dispute avoidance or dispute resolution, are not too legalistic and do not require an army of lawyers and legal advisors.

One of the real sticking points to the wider use of DBs though, and one often quoted by

the development banks, is the retainer fee. This evolved from a provision in the World Bank 1995 edition of its "Procurement of Works" document in which the DB members were required to be available at seven calendar days' notice. The original fee to compensate for that availability was three times the daily rate, which based on ICSID rates of the time was about \$750. However, since then the requirement to be available at very short notice has been relaxed, but at the same time the daily fees for ICSID arbitrators, which were the basis for DB fees, increased dramatically to \$3000 per day. For a three person DB the retainer fees alone could amount to \$27,000 per month, which for a three year project amounts to almost \$1m, and that is without daily fees, which for three site visits per year would amount to about \$567,000. Those figures do not include travel and accommodation which are seldom insignificant.

So, should DB members consider dropping the Retainer Fee? There are arguments both for and against. There is no doubt the members will have to keep up to date with the project and preparatory work is required if the site visits are to run smoothly. But should such substantial amounts be paid regardless of whether the DB members actually do any work in any particular month? If the DB has a substantial amount of work to do each month the fixed \$9000 per month could be seen as good value but not all months are going to require work by the DB members. My own view is that a better approach would be charge for what the DB members actually do by applying an agreed hourly rate for work done outside site visits and hearings.

Despite the apparent pressure from employers for retainer fees to be dispensed with, the recent overhaul of the ICC Dispute Board Rules have kept them intact, except they are termed "Monthly Management Fees" rather than retainers. Although the DB will carry out some management, that is primarily the role of the Chair and the individual members may not be called upon to do very much. There is no doubt that all the DB members will have to stay up to date but its arguable whether an agreed time charge would not be a better, fairer and more transparent way of charging for time away from the site.

Continued

ANGLES SENSE STUDIO NEWSLETTER OCTOBER 2014

If Retainer Fees were excluded from the two examples above from the JICA Manual the costs would be reduced by \$63,600 for the single man board and \$504,000 for the three man board, or 43% for the one man and 37% for the three man board. Although something would be added back for time charges for work outside the regular site visits and hearings, the psychological effect this might have on potential users might persuade them that DBs are very good value after all. Dispensing with retainer fees also makes the DB process much more cost favourable when comparing the process to ICC arbitration, something which Employers are going to notice.

It has been suggested that DBs are rather like an insurance policy against the cost of traditional methods of dispute resolution.

Potential users though have to be persuaded the insurance cost is good value when comparing it with the alternative. In this article so far I have looked purely at financial costs. Research carried out in Australia²⁰ suggests that the use of DBs has a beneficial effect in reducing delays and cost overruns, not just in reducing the costs of disputes which in many projects do not arise. The figures are startling. The research suggests that the chance of an "industry norm project running late is 2.3 times greater on projects that do not have a DB and the chance of such a project running more than three months late is 6.5 times greater than projects with a DB and that there is a greater than 80% chance that a project with a DB will be completed at, or shortly after, the contract date for Practical Completion, compared to less than 50% for

the industry norm. The research also suggests that final contract cost of a project with a DB is 3-5% lower than a project without a DB in place.

The research done to date suggests that DBs really can provide excellent value for money with savings in time and money, not only in reducing disputes, but in actual savings in time and money of the project itself. It just remains for DB members to change their approach to fees so that retainer fees are replaced by transparent hourly rates to make the whole package as attractive as possible for potential users. ●

©2014 Murray Armes

1. Litigation Cost Survey of Major Companies, by Lawyers for Civil Justice, The Civil Justice Reform Group and the U.S. Chamber Institute for Legal Reform, 2010.
2. Litigation Trends-The Jackson Effect, Revolutionary Road, new Law Journal, 2013
3. CIArb Costs of International Arbitration Survey 2011, The Chartered Institute of Arbitrators and International Arbitration Research based report on perceptions of document production in the arbitration process, by Berwin Leighton Paisner, 2013
4. Excessive Private Litigation: The Impact on Business and Consumers, EU private Litigation Paper, published by the IBA, 2005.
5. Everybody Has Won and All Must Have Prizes, by Murray Armes, Construction Law Journal, November 2011 and The Concept of Dispute Avoidance, by Murray Armes, paper given at the Kings College Annual Conference 2011 and published in the DRBF "Forum" journal in December 2011.
6. Such as the Dispute Resolution Board Foundation: <http://www.drb.org/>
7. For comparison most international arbitration tribunals also comprise three arbitrators.
8. Although training programmes by such organisations as the DRBF is changing this.
9. To allow the DB to review site visit reports, contract documents and to generally keep up to date with the project.
10. Most public bodies in the US use locally available members and place limitations on the distance between where the board, member resides and the project, or place limitations on the amount of travel cost which is reimbursable.
11. Analysis of Dispute Review Board Application in US Construction Projects from 1975-2007" by Manassa and Feniosky Pena Mora, 2010.
12. Which is on the high side.
13. Allowing for 6 days including travel, site visit and hearing and decision; note that depending on the complexity this may under estimate the time required to produce the decision.
14. ICC Arbitration Cost Calculator: <http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/cost-and-payment/cost-calculator/>
15. The Benefit/Cost Equation for Dispute Boards-Australian Experience, paper given by Graeme Peck at the DRBF International Conference, Singapore, May 2014.
16. JICA Dispute Board Manual, March 2012, available from: http://www.jica.go.jp/activities/schemes/finance_co/procedure/guideline/pdf/DisputeBoardManual_201203_e.pdf
17. The Benefit/Cost Equation for Dispute Boards-Australian Experience, paper given by Graeme Peck at the DRBF International Conference, Singapore, May 2014.
18. Assuming a one man arbitration tribunal.
19. Assuming a three man arbitration tribunal.
20. The Benefit/Cost Equation for Dispute Boards-Australian Experience, paper given by Graeme Peck at the DRBF International Conference, Singapore, May 2014.