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Dispute Boards and Construction Contracts

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DISPUTE BOARDS AND CONSTRUCTION CONTRACTS

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**PRACTICAL ISSUES IN THE ESTABLISHMENT AND OPERATION OF A DISPUTE
RESOLUTION BOARD: SOME REFLECTIONS ON THE OPERATION OF SYDNEY'S
DESALINATION PLANT PROJECT DISPUTE RESOLUTION BOARD**

George Golvan QC

Sydney's Desalination Plant Project

1. The Project is for the design, construction, operation and maintenance of a desalination plant in the Kurnell Peninsula, near Botany Bay, Sydney with the capacity to generate 250 megalitres of water a day, and the potential to scale up to 500 megalitres in the future if required. The Melbourne Desalination Plant by comparison has a proposed capacity of 440 megalitres a day.
2. The cost for construction of the Project (not including the pipeline which is under a separate alliance contract) is in excess of \$1b and is a conventional design and construct (D&C) contract between Sydney Water as the principal and Blue Water Joint Venture, which comprises the plant constructor John Holland Pty Ltd and the designer and plant operator Veolia Water Australia Pty Ltd (although they have contracted as a joint venture with joint and several liability).

3. The D&C Contract provides for a dispute resolution process which includes the establishment of a Dispute Resolution Board (DRB). The purpose of the DRB is to prevent disputes arising in the first place and if this is not successful to assist and facilitate the parties in the equitable resolution of disputes.
4. In relation to a formal dispute submitted to the DRB by a party, after receiving submissions from the parties and hearing from the parties at a hearing, the DRB is required to make a written recommendation for the resolution of the dispute. If neither party rejects the recommendation within 30 days, the DRB recommendation is binding on the parties. If either party rejects the recommendation within the time period, then the dispute is referred to arbitration before a third party arbitrator.
5. An issue arises whether a decision of the DRB should be a binding or non-binding determination? There are competing views. However, there are good reasons, in my opinion, for a DRB recommendation not to be automatically binding:
 - (a) there is a strong preference for the parties to resolve disputes between themselves if possible, assisted, if required, by recommendations of the DRB, rather than the DRB imposing binding solutions on the parties;
 - (b) the experience is that generally a recommendation of the DRB results in a resolution of the dispute, particularly if the recommendation is unanimous and well reasoned following a hearing;
 - (c) the DRB is required to make reasonably speedy determinations in the event of a dispute (although the procedural issues are under the control and direction of the DRB). If a decision of the DRB is automatically binding then that will undoubtedly encourage the parties to engage legal counsel and adopt a legalistic and potentially an adversarial approach aimed at winning, which is likely to hamper the speed of the decision;
 - (d) if a decision of the DRB is automatically binding, then it may be treated by the parties as equivalent to an arbitration, with all of the requirements of a

formal arbitration hearing. On the other hand, an informal hearing before the DRB is less likely to be acrimonious and opens up the dispute for more detailed consideration by the parties, hopefully leading to consensual resolution.

- (e) a DRB determination under the D&C Contract is agreed to be “with prejudice” and may be admitted into evidence in subsequent arbitration or litigation (subject to appropriate admissibility issues). This is regarded as a powerful reason why most DRB decisions have been accepted by the parties or resulted in a negotiated settlement between the parties.
6. Although a DRB is appointed as a dispute resolution body with the jurisdiction to make recommendations or determinations to resolve disputes, dispute boards invariably focused on dispute prevention and avoidance throughout the Project.
 7. Of the twenty or so projects using dispute resolution boards in Australasia (regrettably none in Victoria) only four disputes are known to have been referred to dispute resolution boards for recommendation or determination since 1987, and no disputes have progressed beyond the DRB stage¹.
 8. It is also the experience of DRBs internationally, that very few disputes have led to further dispute processes beyond the DRB, whether or not the determinations of the DRB are binding or not or non-binding.² The experience of over 1,400 DRB projects worldwide indicates that some 97% of decisions made by DRBs have been directly accepted or have led to a party to party negotiated settlement³.
 9. In relation to the Sydney’s Desalination Project, no disputes have been referred to the DRB since the Project was commenced in late 2007. The Project is still

¹ The Use of DBs in Special Purpose Contracts in Australia and New Zealand, by Graham Easton, Ronald Finlay and Graeme Peck – April 2009 [at para 1] (A Presentation to the DRBFA International Conference, London – May 2009)

² The Benefits of Dispute Resolution Boards for Issue Management on Medium to Large Construction Projects, by G.M. Peck and Peer Dalland, March 2007 [at para 3.6].

³ G.M. Peck and Peer Dalland, *supra* [at para 3.6].

ongoing and the first water is expected to be produced in the summer of 2009-2010.

10. Although the Sydney Desalination Project is approaching its concluding stages, and most apparent potential issues have been addressed, both parties have requested the DRB to continue its regular on-site meetings until the Project is completed, after commissioning stage. This confirms the very important role that the parties see the DRB as playing throughout the Project until its completion.

Nomination and selection of DRB members

11. The Sydney Desalination Project DRB is a three member Board consisting of one independent member nominated by the principal and approved by the contractor, one independent member nominated by the contractor and approved by the principal and the third member to act as the Chairman, nominated by the first two members and approved by the principal and the contractor. All members of the Board are required to have the approval of both parties, and the Chairman is the agreed appointee of the other two Board members, and is also required to have the approval of both parties. This creates a strong basis for confidence in the impartiality and integrity of the DRB by the parties, and also between the Members themselves. As the Nominee Chairman, I was required to meet with both parties before my nomination was formally approved.
12. It is critical that all members of the DRB are perceived as independent and impartial, even though some members may be party-nominated at the outset. Potential members of a DRB are required to make complete disclosure of any interest or relationship that could in any way impact upon their independence and impartiality. This remains a continuing obligation for the life of the Board. The existence, or entering into, of a relationship at any time by a Board member which might compromise independence and impartiality is a disqualifying factor unless fully disclosed and accepted by all parties and other members of the DRB.

It should also be appreciated that participation as a member of a DRB, which may last several years, may preclude other employment or retainer during that time with a government instrumentality or large private construction organisation involved with the Project.

13. The experience required of the DRB members was experience in similar construction projects, interpretation of large scale project documentation and involvement in resolution of construction disputes. The parties recognised the importance of DRB members having dispute resolution expertise in addition to technical and legal skills.
14. The DRB agreement executed by the three members provides for the Chairman to be a QC or SC of the New South Wales or Victorian Bars. The goal in selecting the Chairman is to complement the experience of the other members, and provide leadership for the Board's activities. The Chairman of the Adelaide Desalination Project is an Adelaide Silk. There is therefore a significant potential role for construction lawyers with dispute resolution experience to play in the operation of dispute boards in Australia.
15. In selecting a DRB it is vital that the members have complementary skills and experience. The Sydney Desalination Plant DRB consists of Graeme Peck, who is a very experienced consulting engineer of large infrastructure projects, Ronald Finlay, a senior lawyer and consultant on infrastructure and construction projects, and as the third member I supply construction law and ADR expertise. The combination of technical, management, legal and dispute resolution experience is a good one. Similarly, the Adelaide Desalination Project has also focused on appointing a Board with complementary skills, including technical engineering, project management and construction law.
16. The Chairman chairs the regular on-site DRB meetings with the parties, and in the case of the Sydney Project is also responsible for preparing the Minutes and acting as the reference point for communications between the Board and the

parties. Therefore, considerable expertise in conducting effective meetings, sometimes in difficult circumstances, is desirable.

17. There is no absolute need for a three person DRB. Whilst this seems to be the norm, a single person DRB remains a viable option on smaller projects where costs may be a factor, although a three member board permits a wider range of expertise and is preferable. World Bank contracts prescribe a single person DRB on contracts valued at US\$10m. The DRBA considers that around A\$40-50m is a sensible cut-off, but it depends on technical complexity.
18. Each of the DRB members enters into their own separate financial arrangements with the parties in relation to fees and expenses, which can be on a retainer basis or on time spent and expenses incurred.
19. The Sydney DRB has met on site, generally at three monthly intervals, from the commencement of the Project after contract award, with some flexibility as to when meetings are to take place. If there is some key event or events about to occur on the Project which may give rise to potential issues, for example the commencement of marine drilling operations or commissioning works, a meeting has been arranged to take place shortly after the event to enable any potential issues to be discussed as soon as possible.
20. It is to be appreciated that the DRB is not simply available in the event of a formal dispute arising during the course of the project, but has an ongoing role in monitoring the progress of the project, and encouraging a pro-active mutual approach to dealing with potential disputes or disputes at the earliest possible time, as well as assisting the parties to find creative solutions to issues on a "*best for project*" basis.
21. In D&C contracts the experience has been that serious disputes can occur at the early design stage, where there can be significant differences in expectations concerning design outcomes. If a design dispute is not resolved rapidly there can be an antagonistic climate throughout the project. It is of great benefit for the

DRB to be in a position to work with the parties in the resolution of ambiguities and differences in performance and design requirements at the design development stage, when problems can manifest themselves.

22. The DRB conducts itself in an informal way, but respects the principles of procedural justice. In other words, all meetings are in the presence of both parties and the DRB does not accept private ex parte submissions or representations. All communications to and from the Board are provided to all parties. This is something that has to be explained because lay parties do not necessarily appreciate the implications of procedural justice and they may want to approach the Board or individual members on an ex parte basis with concerns which they have.
23. The Sydney DRB established a requirement from the outset, as part of its operational procedures, that both key site representatives and non-involved senior party representatives should be present at all DRB meetings. This has meant that high level senior off-site representatives are present when issues are raised, which opens up communications and enables on-site problems to be aired and resolved before parties positions become too entrenched. Many issues of concern can be rapidly resolved at a DRB meeting involving the presence of off-site senior executives whose primary focus is on successful project delivery.
24. In the Sydney Desalination Project, as part of the operating procedures all significant Project documents are sent to DRB members, such as Site Meeting Minutes, Design Review Minutes, Contract Control Group Reports and Meeting Minutes and the Monthly Reports of the Independent Verifier, so that the DRB can identify for itself whether there are potential issues that need to be 'put on the table' at the next DRB meeting. The DRB has an adopted a pro-active approach to the identification of possible issues of concern at the earliest possible stage, to the extent of questioning the parties about possible issues which the parties have not raised at the DRB meeting but which have been

raised in Site Minutes, and encourages the parties to raise issues of concern for open discussion and hopefully resolution between the parties themselves.

25. The DRB has requested as part of its operating procedures that at the commencement of each meeting the parties should provide a joint presentation/report, usually in the form of a Power Point presentation from senior on-site representatives, which includes:
 - work accomplished since the last meeting;
 - current status of the work program and the schedule for the future works;
 - anticipated or potential claims and disputes and proposed solutions to outstanding issues;
 - the state of current potential disputes, claims or other controversies.
26. The joint meeting requires the parties to meet before the DRB meeting and reach agreement on site progress and key issues of concern, and bring forward for discussion controversial issues which the parties might at first be reluctant to raise.
27. It is also an established protocol at each meeting that there is a site visit to key on-going site works in the presence of representatives of each party, which also opens up potential issues for discussion. The Board usually meets with the parties after the site visit to discuss any additional issues of concern that may have been identified during the site visit.
28. The DRB prepares its own Minutes of Meeting, containing the various directions or suggestions that have been made at DRB meetings, which are circulated to both parties.
29. The periodic meetings of the DRB with the key party on-site and off-site representatives has meant that the parties and the DRB members have got to

know each other very well during the course of the Project; which acts as a catalyst for open and constructive communications.

The use of DRB procedures for dispute avoidance

30. The experience has been that the early identification and clarification of issues or potential issues, the discussion of competing views in a frank and open environment, the presence of senior off-site executives at DRB meetings, and the focus on Project delivery has invariably resulted in rapid and pragmatic solutions to problems or potential problems shortly after they have been identified.
31. The DRB has also encouraged frank and open discussions by determining that all communications involving the DRB are 'without prejudice' enabling the parties to explore solutions to disputes without fear that a possible concession may be used against a party in a subsequent dispute resolution process. The 'without prejudice' status does not, of course, apply to documents produced or exchanged in the normal course of business by the parties but only to discussions and documents in the context of the operations of the DRB.
32. The DRB has also acted in a facilitation capacity by encouraging, where appropriate, suitable short term dispute avoidance procedures, including:
 - meetings of designated individuals (such as persons responsible for design co-ordination) to discuss such matters as improving delays in design approvals;
 - exchanging detailed written position papers on a technical issue;
 - establishing a joint sub-committee;

- creation of a joint workshop to deal with the possible scenarios to address a potentially complex issue. For example, the timing of the interface between the completion of the Project works and the completion of the separate water delivery alliance works to bring the water by pipeline from the Desalination Plant under Botany Bay into the Sydney Water supply tunnel.
33. The Board has set timelines for discussions to take place and reporting obligations back to the DRB on the progress of the discussions. In every case, the processes encouraged by the Board have resulted in a pragmatic solution or an on-going process to deal with problems, or potential problems, before the parties positions were permitted to become entrenched.
34. If the DRB considers that a particular issue is proving difficult to resolve by direct negotiations between the parties, the DRB can propose that the parties refer the dispute to the DRB for recommendation, unless resolution takes place within a designated timeline. This can accelerate resolution by focusing the attention of the parties on the fact that unless some solution is arrived at within a reasonable time the DRB will become involved in the dispute.

Conduct of DRB hearings

35. The DRB hearing in the Sydney Desalination Agreement is not a judicial process. It is intended to be conducted in an informal manner without application of the rules of evidence. Oaths are not administered and cross-examination does not occur. Legal representation at the hearing is permitted at the request of any party.
36. Each party is entitled to make presentations, provide documentation, call evidence and provide rebutting submissions, with the Board members entitled to ask questions and seek clarification, if necessary.

37. The emphasis is on informality, openness and efficiency, in which each party is given a reasonable opportunity to present its case and rebut information and submissions provided by the other party, whilst avoiding legalistic and procedural formalities.
38. The DRB then makes its deliberations in private with the aim of reaching a unanimous recommendation, if possible, based on the parties' contractual and legal obligations. If a unanimous recommendation is not possible a majority recommendation can be made.
39. A reasoned written recommendation is required to be made within 10 business days of the completion of the hearing, unless the time is extended by mutual agreement of all the parties, as a result of the matter being of some unusual complexity or size.
40. There are no recommendations as to cost orders. However, each party shares the DRB costs regardless of outcome.
41. Acceptance of the DRB's recommendation is entirely voluntary. Of course, the reasoning process in the hopefully unanimous DRB recommendation should encourage the parties to accept the merits recommendation of the DRB, without recourse to further dispute resolution processes, as experience has shown it invariably does.
42. It is significant, that if the recommendation of the DRB does not resolve the dispute, the Board's written recommendation is admissible in subsequent proceedings to resolve the dispute. This is fairly typical provision in DRB agreements. As noted, admissibility of the recommendation of the DRB is a significant factor in the effectiveness of the DRB because it gives the arbitrator or judge access to a reasoned recommendation of experienced party selected experts with intimate knowledge of the Project.

Conclusion

43. Knowing how destructive litigation can be in large and complex construction and infrastructure projects, which are a fertile arena for uncertainty and disputation, it is not surprising that the DRB concept, which seeks to encourage dispute avoidance and rapid resolution, has flourished internationally and to a limited extent in Australia.
44. My own experience is that DRBs work remarkably well as a dispute avoidance mechanism because they encourage parties to focus on maintaining project relationships and '*best for project*' solutions at the workplace, not on the building up of claims and antagonisms, which are destructive for conduct of the project and often culminate in costly and acrimonious litigation following the conclusion of the works.
45. The DRB monitors performance, encourages the early identification and clarification of issues, which if left to escalate can result in disputes, encourages open and frank discussions of concerns and pragmatic '*best for project*' solutions, including the involvement of senior off-site personnel. If necessary, the DRB can make rapid and expert (and hopefully unanimous) reasoned recommendations for the resolution of the dispute based on a detailed familiarity with the project, which are likely to be highly persuasive in assisting the resolution of the dispute without recourse to further litigation.
46. On a personal level, the most significant feature which I have observed during my involvement with the Sydney Desalination Project DRB is the mutual problem solving environment which exists at DRB meetings to facilitate the success of the Project. Issues are able to be identified at an early stage and are aired between the parties in a frank manner. The dialogue takes place under the guidance of, and with the support of, the DRB which assists the parties to find ways to seek solutions between themselves, in the knowledge that if they do not do so the DRB itself will rapidly become involved.

47. Certainly there are cost implications, which have been found generally to be between some 0.2% to 0.5% of project value.⁴ However, it seems to be very cheap insurance, bearing in mind the considerable savings of legal costs and time spent by executives and site personnel if disputes can be avoided. Also, the damage to commercial relationships and reputations, as well as the inevitable decline in site morale and project performance, if a dispute is permitted to fester and becomes litigious.

⁴ G. M. Peck and Peer Dalland *supra* [at para 3.7].