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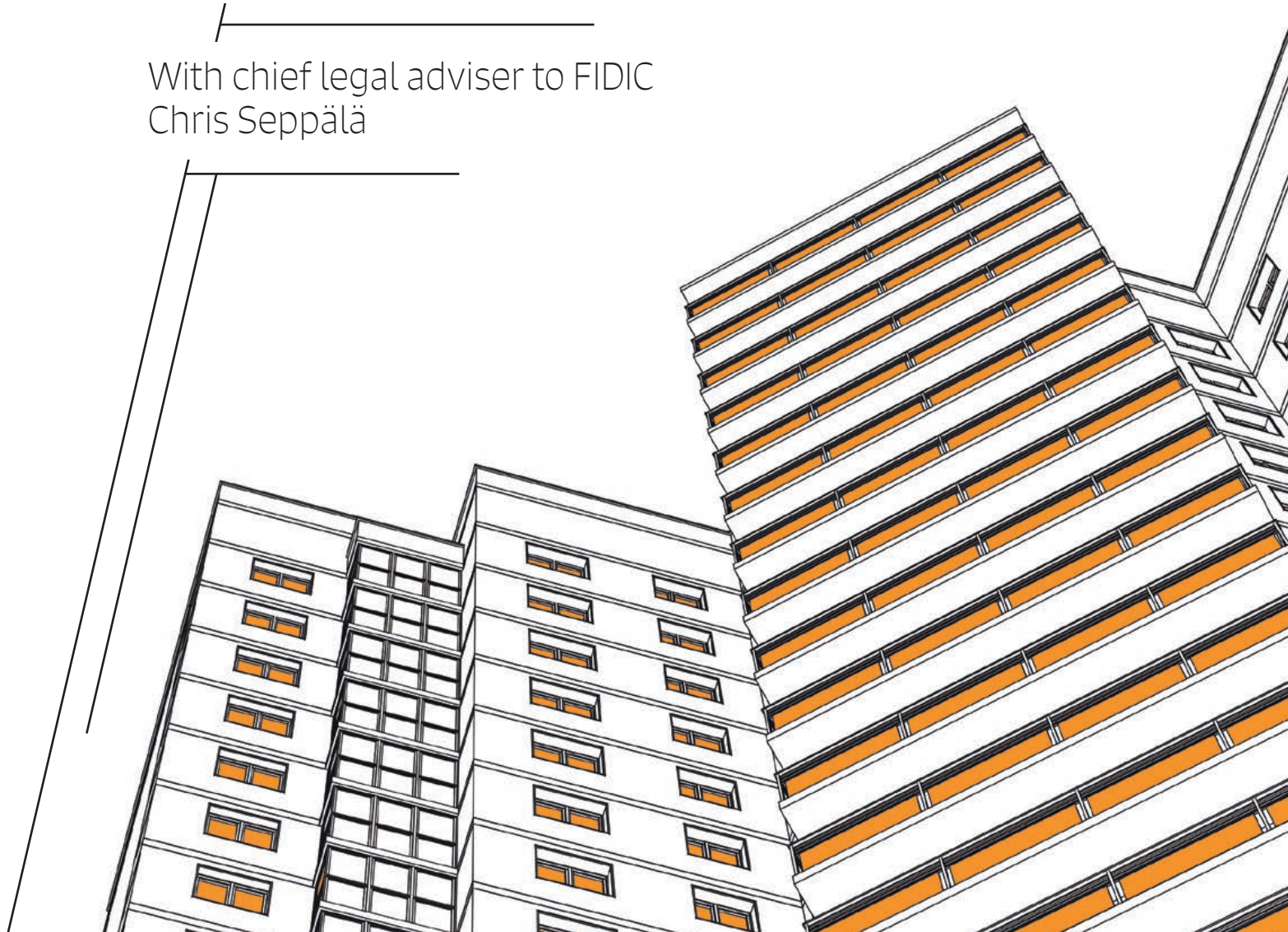
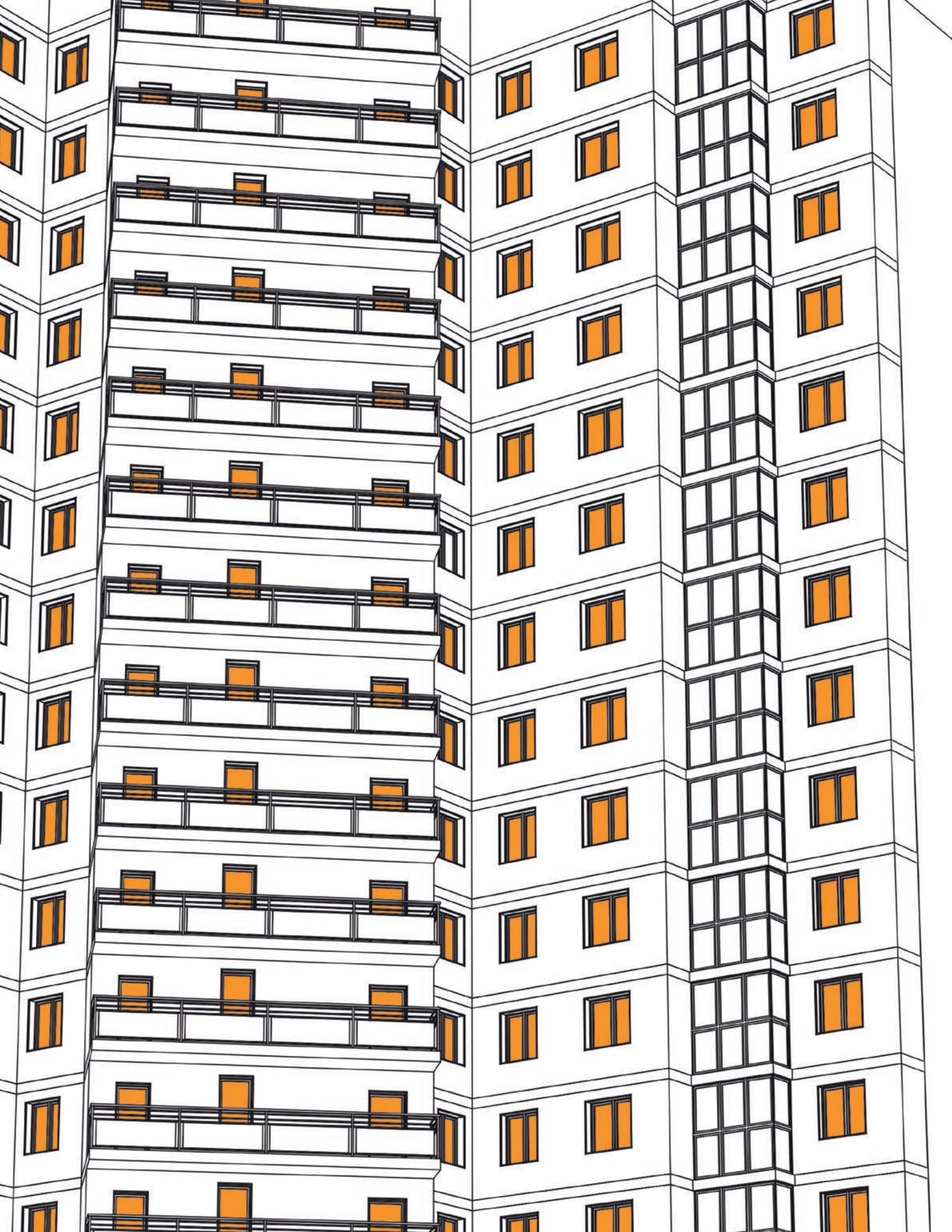
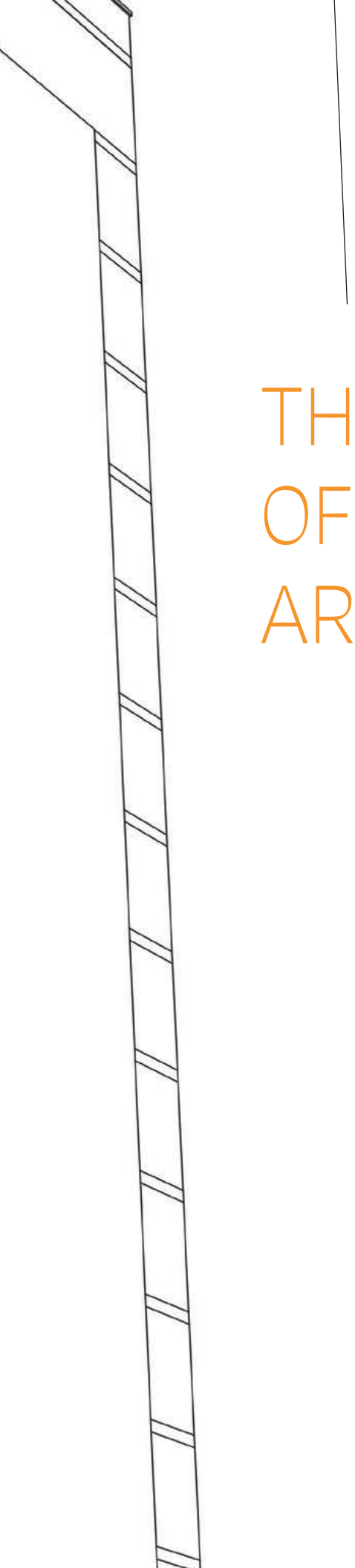
THE PAST AND FUTURE OF CONSTRUCTION ARBITRATION

With chief legal adviser to FIDIC Chris Seppälä







THE PAST AND FUTURE OF CONSTRUCTION ARBITRATION

Chris Seppälä – the chief legal adviser to FIDIC – gave the keynote address at GAR Live: Construction Disputes 2018, on construction arbitration's past and the future.

In a talk rich in history and colour, Seppälä clarified how a humble New York Capital markets lawyer in 1972 could "accidentally" become chief legal adviser to FIDIC (the International Federation of Consulting Engineers) and a doyenne of the international construction bar; shared memories of Paris in the 1980s when international arbitration was taking off ("you had enormous freedom . . . Practically, anyone could practise in the field . . . You just had to be an adult!"); and gave predictions of the future.

Above all, he explained how an activity, international construction, that was once shunned as "too risky" and sent one respectable company to bankruptcy – had been galvanised by the oil price hike of the 1970s and the construction boom it fuelled in the Middle East, to become the industry of today, and all of the changes for disputes lawyers that had meant.

"[In the early editions of FIDIC] a claim (réclamation in French) was even a nasty word that you didn't want to use, whether in English or in French," Seppälä remembered. There were only two sentences on claims in the first FIDIC contract: "It was considered embarrassing actually to have to refer to claims at this time. Engineers sought to avoid the subject."

Today – the disputes mechanism stretches to "22 pages" – and there are still areas of debate.

The following is an edited transcript of the speech, with introductory words from Peter Rosher, co-chair of the conference.

GAR Live: Construction Disputes took place on 12 April 2018 at Allen & Overy, Paris. It was sponsored by 3 Verulam Buildings, Clyde & Co, FTI Consulting, Herbert Smith Freehills, HKA, Pinsent Masons, Reed Smith, Vannin Capital and Vinson & Elkins.

Continued overleaf

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Christopher Seppälä

Peter Rosher: The choice of Chris Seppälä was instant for both Jane (Davies Evans) and myself, and a very natural choice, and we were delighted when Chris accepted. A special pleasure for me because Chris was my first boss when I arrived in Paris back in the mid 90's. Even back then Chris's reputation was already stellar in the construction disputes field and he has been associated with FIDIC ever since I can remember. He advised in the preparation of the fourth edition of the Red Book. He was then a legal adviser, a member for the FIDIC update task force which prepared the 1999 editions of the Red, Yellow and Silver Books and, of course, Chris has been involved in the more recent editions of the FIDIC contracts that came out last year. We deliberately, Jane and I, didn't say much to Chris about what he might want to cover in his keynote speech. What we did ask, however, or rather we invited, is that he share with us the evolution that he has seen of construction disputes over the last decades. So with that, I'll pass it over to Chris.

Seppälä: Thank you very much, Peter, and thank you very much, Jane, for inviting me here. I am very flattered and feel very honoured to be here, and to be addressing you this morning. I was going to talk about FIDIC - the new FIDIC contracts – but Jane quite firmly told me no, there are a lot of other people speaking about that. What we want to hear from you, she said, was how you have seen construction arbitration change over the years and how you anticipate it will be developing in the future. And Peter Rosher was saying the same thing. How has construction arbitration changed over the years would, he said, be a good topic. And I think it is, so let us turn to that subject: specifically I shall address *The Evolution of Claims and Disputes Procedures in relation to FIDIC contracts since 1957*, when the first edition of the FIDIC Red Book was published.

Let me just say a word about myself, which relates to this. I began practicing in New York in 1967 doing capital markets work with a Wall Street law firm. I came to Paris for personal reasons in 1972. There was no capital markets work in Paris in 1972. So, a foreign lawyer here in Paris had obviously to find something to do. Fortunately, I speak English and I had New York bar qualifications and I eventually got Paris bar qualifications but, frankly, it wasn't clear what my practice would be here. I only knew that I wanted to be here in Paris

The 1973 oil shock

But it just so happened that, in 1973, the world changed - at least the business world did. It changed between September and December of 1973 when the world oil price quadrupled. This was an extraordinary event with a global economic impact (though I did not appreciate this at the time). If you look at the relevant statistics, you can see that from about 1880 to about 1973, the price of oil was no more than an average of US$3 a barrel. And then see what happened in 1973 – the oil price went from US$3 per barrel in September 1973 to US$12 per barrel in December 1973 and the oil price has remained at a much higher level than US$3 per barrel since! If you look at the oil price after the early 1970s, you will see that it continues to be far above the original US$3 a barrel price, going up even to US$125 a barrel.

I won't spend more time on that, but I would say that that was the critical event in the development of international construction in our time and so of international construction law and also, to a large extent, in the development of international arbitration – whereas before the 1970s, international construction law and international arbitration were practically unknown as practice areas, at least in Paris.

This oil price shock and its aftermath led to the transformation of much of the Middle East – at least the oil producing countries – from being a series of desert kingdoms to being modern looking countries, having the latest facilities, equipment and infrastructure.

Four seminal developments in international construction law

Following the oil price shock, I would say there were four seminal developments in the development of international construction law. They all, to my mind, result from the impact of the dramatic increase in oil prices beginning in the early 1970s and the corresponding dramatic increase in international construction in the oil producing countries which followed.

First, Ian Duncan Wallace's *The International Civil Engineering Contract*, published in 1974. This was the first commentary on a FIDIC contract. It was a commentary on the second edition of the FIDIC Red Book published in 1969. All of us practicing in the field – there were not many of us - were aware of this book, as it was the only book on the subject. It was supplemented in 1980 to cover the third edition of the Red Book published in 1977.

Second, in 1975, there was the first meeting of the IBA's international construction law committee, chaired by an American lawyer resident in London, Gordon Jaynes, who had the idea for this initiative.

I remember attending this first meeting in Paris as I was just beginning to get my feet wet in this field. On the podium was Robert Fitt, who was an engineer and a recent President of FIDIC – he was a very distinguished looking man. At the back of the room, was Ian Duncan Wallace himself, a brilliant and seemingly cantankerous English barrister, who was heavily criticising FIDIC's contracts and everything (apparently) that Mr Fitt had to say about them. It was a most

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interesting and unexpected debate - witnessing verbal jousting of an English barrister with an English engineer over essentially an English form of contract. I think that the international audience at the IBA was quite taken aback and fascinated by it.

As the same meeting, there was a talk by the Chairman of Rio Tinto Zinc, who stated that international construction was too risky a business and that therefore his company was withdrawing from it entirely. I also remember a talk by a US contractor at the same meeting, describing how, on a project in Latin America, due to underground conditions, his company had been driven bankrupt. I found all this tremendously dramatic and interesting! Attending this meeting was one of the events that fascinated me in my early days of practice.

I would say the third key event was the English case of *Edward Owen Engineering Ltd v Barclays Bank International Ltd*, a decision of Lord Denning in 1977 where he said that a performance bond in the form of a first demand guarantee, which is such a standard feature today of international contracts, "is a new creature so far as we are concerned". The English Courts had apparently not been presented with such a document for interpretation before. This case continues, I believe, to be perhaps the leading case in the field and very influential worldwide.

The fourth seminal development was the first issue of *The International Construction Law Review* in 1983, which was the first law journal devoted to publishing significant legal writing in the field of international construction. It was edited then by Humphrey LLoyd and David Wightman.

Those, to me, are the four seminal events in our field and they all follow from the oil price shock of 1973.

Impact of FIDIC contracts

Let's take a look at what happened then to the FIDIC conditions. The first edition of the Red Book was issued in 1957 – the General Conditions were just 16¼ pages long. They were almost identical to the English Institution of Civil Engineers' Conditions at that time. The 1957 edition even had a clause providing for the English legal doctrine of frustration, and nothing could be better evidence of its common law origins than that. So, very little effort had been made to make it an international contract.

The same was true of the second edition published in 1969 as it was almost identical to the first edition. Then, with the effect of the oil shock I have been describing being felt, you begin to see the change. With the third edition in 1977 the Red Book becomes somewhat longer and a bit more international. But the biggest change comes with the fourth edition in 1987, which was nearly twice as long as the third edition and which was really the first to reflect experience from the impact of work in the Middle East where, of course, so much oil was being exploited.

Impact on FIDIC claims procedures

Let's look at the provisions on claims. If you look at the early editions of the Red Book, you will see that claims were covered in just two sentences at the end of clause 52, which dealt with the valuation of variations. Claims were barely discussed. A claim (réclamation in French) was even a nasty word that you didn't want to use, whether in English or French. It was considered embarrassing actually to have to refer to claims at this time. Engineers sought to avoid the subject.

However, things evolved. In the third edition of the Red Book published in 1977, claims were discussed in three sentences. In the fourth edition in 1987, there was an entire clause dealing with claims, clause 53, but only with contractors' claims. Then in the 1999 edition, there was recognition that employers could also have claims and that those should be subject to some kind of procedure. But contractors' claims were still given the most attention, occupying one entire page. There was also a provision, sub-clause 3.5, in the 1999 contracts, as you know, for the engineer to make determinations on claims.

Now if you look at the new 2017 Red Book you will see that, going from just two sentences dealing with claims in 1957, we now have seven pages which deal with claims, in various different ways.

Impact on FIDIC dispute procedures

What about disputes, which have always been a distinct subject from claims in a FIDIC contract (a dispute being commonly defined as a claim that has been rejected by the engineer but which the claimant decides to pursue)? In the early editions of the Red Book, there was a very famous clause, which everyone in the industry knew, clause 67, which dealt with disputes and provided for the mandatory reference of disputes to the engineer who was given 90 days to decide them. There was then a subsequent 90-day period in which, if you were dissatisfied with the engineer's decision, you could express dissatisfaction and "require" arbitration. It was never very clear what "require" arbitration meant. Could you do that with a notice, or did you have to file a request for arbitration? These was a long discussion about that. That's history today. The point here is that it was an elaborate clause which often itself

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"THE VERY LIMITED MATERIAL AND GUIDANCE AVAILABLE ON THE SUBJECT OF ARBITRATION MEANT, IN EFFECT, THAT MORE OR LESS ANYONE COULD PRACTISE ARBITRATION, INCLUDING SOMEONE TOTALLY UNQUALIFIED LIKE MYSELF, A CORPORATE LAWYER."

led to disputes as still seems to be true of the disputes clause in FIDIC's contracts today.

The disputes procedure has evolved from occupying half a page in 1957 (clause 67) to occupying 22 pages in 2017 (clause 21 and related provisions). Let's look at that a bit more closely.

Not only was this 90 day procedure carried over from the English Institution of Civil Engineers' Conditions, but also other language was carried over, which was very difficult for people outside England to understand. It was provided that any dispute "in respect of which the decision (if any) of the Engineer has not become final and binding", may be referred to arbitration. This is totally different, of course, from a normal ICC arbitration clause which provides that any and all disputes relating to a contract may be referred to arbitration. The channel for getting to arbitration in the Red Book was (and still is) very narrow. Only a dispute in respect of a non-final and binding decision could at that time be referred to arbitration. What did that mean? Why was it there? Whatever the reason, it was in the Red Book unchanged for a number of years as I shall discuss shortly. Another feature was that you could not begin arbitration, generally, until the completion of the works, except in very limited cases such as where the engineer had withheld a certificate or withheld retention money.

In 1987, FIDIC took the decision that all time periods in its contracts should be divisible by 7. So, in the Red Book fourth edition published in 1987, there was 84 days (instead of 90 days) for the engineer to give its decision and 70 days for a party to give a notice of dissatisfaction with it.

I had been faced with a problem of having a final and binding decision which the employer wasn't paying and we needed to get the employer to pay the decision but the FIDIC clause said (as I have mentioned above) that you could only take disputes to arbitration where the decision of the engineer has not become final and binding. So, how did one get to arbitration if one had the benefit of a final and binding decision?

The provision that you could only take disputes which had not become final and binding to arbitration arose because in England, if the decision was final and binding, you just went to the courts and got summary judgment from the court. That would be the most effective remedy in an English domestic construction contract.

But that's totally incompatible with the way international arbitration developed, as it foresaw that all disputes under a contract should be settled by arbitration without exception. So, in the Red Book in 1987 we resolved this drafting issue by providing that one could go to arbitration even in the case of a failure to comply with a final and binding decision. But that led later to further problems, as is well known (what happened in the case of a failure to comply with a binding but not final decision?).

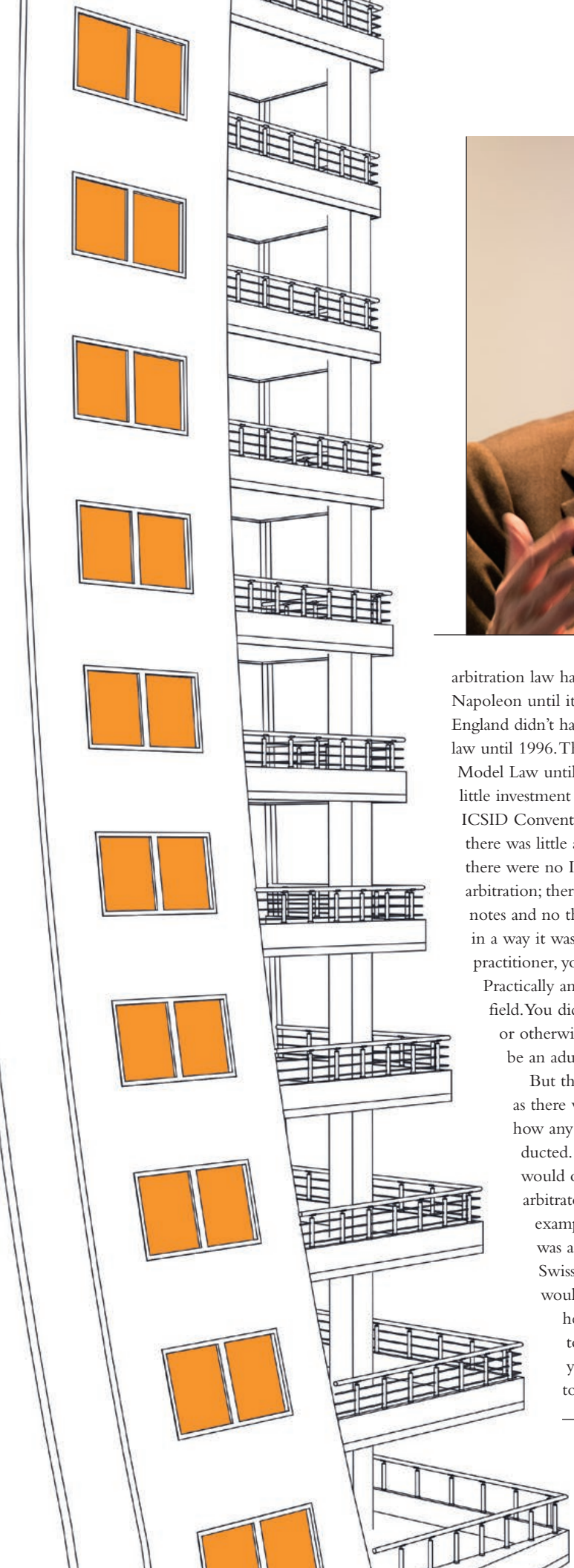
To resolve this last issue, in 2017 we have provided that not just final and binding decisions but also just a binding decision may be referred to arbitration. There is also now a provision in the 2017 books that you can go to arbitration directly (and avoid a reference to the Dispute Avoidance/Adjudication Board (DAAB), which has replaced the engineer, and avoid the mandatory amicable settlement period which follows the DAAB's decision procedure) in two cases – when there's been an agreement of the parties under sub-clause 3.7 of the conditions and in the case of a final and binding determination of the engineer under the same sub-clause. So that's new in the new FIDIC contracts and, as you will have noted, since 1999, the Dispute Adjudication Board is now called a Dispute Avoidance/Adjudication Board or DAAB.

Impact on ICC arbitration

What about ICC arbitration? The FIDIC contracts have normally provided that arbitration would be conducted under the Rules of Arbitration of the ICC, generally by one or more arbitrators. Well, when I began practice in Paris in the early 1970s, the applicable rules were the 1955 rules, and they were just eight pages long! There was also not much literature in the field of arbitration. Thus, on French arbitration law there was just a single book by Jean Robert, as I recall. The very limited material and guidance available on the subject of arbitration meant, in effect, that more or less anyone could practise arbitration, including someone totally unqualified like myself, a corporate lawyer. All of us in Paris at the time were generalists and arbitration was just one small area of practice like any other small area. It was not the speciality practice area which it has become today.

But, of course, all that has changed since and you can see how even the ICC arbitration rules, which the ICC tries deliberately – and correctly - to keep brief and flexible, have evolved and how they have become more and more complicated and more and more detailed.

Just to recall to you how dramatic the changes have been over the last 45 years or so, please note that there were no modern arbitration laws in the early 1970s. French



arbitration law had been unchanged since Napoleon until it was reformed in 1980-81. England didn't have a modern arbitration law until 1996. There was no UNCITRAL Model Law until 1986 and there was very little investment arbitration – while the ICSID Convention had existed since 1965, there was little activity in relation to it; there were no IBA rules or guidelines on arbitration; there were no UNCITRAL notes and no third-party funding. So, in a way it was great! As an arbitration practitioner, you had enormous freedom. Practically anyone could practise in the field. You did not have to be a lawyer or otherwise qualified. You just had to be an adult, that is 21!

But this freedom came at a price as there was also uncertainty as to how any arbitration would be conducted. As a practical matter, this would often depend on who your arbitrators were going to be: for example, whether the arbitrator was a former English judge or a Swiss or German lawyer. Each would apply, instinctively, his (or her) national civil procedure to the process. Therefore you had better be ready to cope with that because that's often the only procedure that they would know about. So, the freedom which we had was not without its problems.

Well, you all know how arbitration has developed since those times. It has increasingly adopted common law procedures in relation to document production (though not common law discovery) and direct and cross-examination of witnesses by counsel. To see the contrast with the past, you must just compare the IBA Rules on the Taking of Evidence in 2010 with the first edition of those rules in 1983 and you can see the changes. Advocacy and litigation skills are now critically important in arbitration. None of that was important in the old days. You did the best you could, as a generalist, with your case. There were some English barristers who came over to Paris sometimes but otherwise there were few specialists in advocacy.

Constructions projects themselves, and so construction arbitrations, are today growing bigger, more complex and more fact- and document-intensive. They increasingly involve multiple parties and contracts. As a consequence, arbitrations are taking longer and becoming more expensive than ever. Yet, at the same time, there are mitigating factors. We have under the new ICC arbitration rules: the expedited procedural rules, the emergency arbitrator rules, case management meetings

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and procedures, sanctions of arbitrators, if they are too slow, as they have been, and the sealed offer procedure, which is now, I hope, increasingly accepted in international arbitration. (The ICC has a current note to parties and arbitral tribunals dealing with sealed offers.) There is also a widening pool of arbitrators, and a movement for greater diversity and greater participation of women in arbitration. All these things may help arbitration to be more efficient.

The future

What about the present and the future? Well, I don't want to hazard much about the future. But what I am seeing, myself, is a continued emphasis on more prescriptive, detailed and longer construction contracts. What was implicit in a standard form of construction contract, like a FIDIC contract, is becoming more and more explicit. For example, in the early editions of the FIDIC contract there was no clause describing the duties of the engineer. The engineer was like God – he was invisible but all powerful. As everyone was expected to know that, there was no need – or so it was felt – to write down and inform people of what the engineer was meant to do. However, in an international contract, these things must be explained as the parties often come from widely different cultures and it cannot be assumed that they will necessarily be familiar with English legal culture upon which FIDIC contracts are based.

In addition, I think contract administration is going to become much more important, given the more complicated and detailed claims procedures which modern construction contracts provide for. The emphasis today is also on dispute avoidance rather than dispute adjudication which explains the change in the title of the Dispute Adjudication Board in the new FIDIC contracts, which is now called a Dispute Avoidance/Adjudication Board.

In an ideal world, I think the best system, by far, is where a Dispute Board just gives recommendations rather than binding decisions, as it should provide parties with the guidance that they need and is less adversarial. But that often does not seem to work internationally, because public bodies, who are often the employers, particularly in the Middle East, but also elsewhere, say that they want to have a binding decision because they cannot pay just based on a recommendation. If a Dispute Board just issues a recommendation then a government civil servant is going to have to take the responsibility of accepting, or not, that recommendation and perhaps making a payment based on it. Government officials frequently don't want to take that responsibility for fear of being accused of corruption.

So we have Dispute Boards making binding decisions instead of making recommendations. This appears to be the best that we can manage in our world today. The most intractable disputes will go, nevertheless, to international arbitration, as in the past.

So, I think that we will see more and more specialisation in the area of contract administration and more emphasis on dispute avoidance, especially by Dispute Boards. We are also going to see more and more regulation and guidelines dealing with these subjects and with international arbitration. This is what current trends seem to indicate.

Thank you very much.

The 2nd Annual GAR Live: Construction Disputes took place on 4 April at Hotel du Collectionneur in Paris. Held in association with Paris Arbitration Week, it was sponsored by Freshfields Bruckhaus Deringer, Herbert Smith Freehills, 3 Verulum Buildings, Pinsent Masons, FTI Consulting, Reed Smith, BDO, Vinson & Elkins and Profile Investment.