SQUIRE PATTON BOGGS

Construction & Engineering Update

Summer 2017

To W3 or Not to W3: Dispute Avoidance Under NEC4

This year has been the year of the update for industry standard forms of engineering and construction contract. A new suite of JCT contracts has been introduced, FIDIC is due to publish the second edition of its "rainbow suite" later this year and, most recently, we have seen the arrival of the new NEC4 family.

A theme of the NEC4 contract and the proposed revamp of the FIDIC forms is the concept of dispute avoidance. For NEC4, this appears to be part of its continued push towards a more international audience, traditionally the domain of FIDIC. For FIDIC it is perhaps recognising this threat, and the special "pre-release" version of the new Yellow Book which was made available at last year's FIDIC International Users' Conference includes features commonly more associated with the NEC contracts such as early warnings and the resolution of disputes as the project progresses.

In this update, we examine the new dispute avoidance provisions in NEC4 and how the changes might work in practice.

Introduction

In recent years, our international engineering and construction clients have increasingly sought our advice not only for the "resolution" of disputes but also for "avoidance" of disputes. Clearly a dispute is often better avoided if the alternative could, in the worst cases, mean commencement of court or arbitral proceedings which, in addition to the inevitable time and cost involvement, can often lead to a breakdown of relationships, diversion of resources and possibly harmful consequences for the project and any on-going work.

It is perhaps against this backdrop where the motivation behind NEC4's new "Option W3" becomes clear. Option W3 is wholly new to the NEC4 and allows contracting parties to choose a Dispute Avoidance Board (the "**NEC DAB**") to assist the parties "in resolving potential disputes before they become disputes"[1]. That this is the intention is amplified by the NEC4 User Guide, "Managing an Engineering and Construction Contract Volume 4" (the "**User Guide**"), which explains that the aim is to guide the parties "towards an early resolution of the issues before positions become entrenched and considerable sums of money are spent"[2].

Option W3 may be used where the UK Housing Grants, Construction and Regeneration Act 1996 (as amended) (the "**Act**") does not apply. In other words, Option W3 will be relevant for projects outside the UK or for those within the UK which may otherwise be excluded from the Act or where there is not a "construction contract" for the purposes of the Act. In doing so, this appears to match NEC's stated key objective to "inspire increased use of NEC in new markets and sectors"[3].

Analysis: More Than a Name Change

The apparent change of emphasis towards dispute avoidance can immediately be seen in the change of the Option W section heading, from the NEC3 "Dispute Resolution" to the less confrontational "Resolving and Avoiding Disputes" in NEC4. However, to what extent are the changes (in the words of Edwards-Stuart J) another example of an NEC contract representing "a triumph of form over substance"[4]? Whilst the spirit behind this change may be to seek to avoid formal dispute resolution, how does this translate into the new Option W3?

Similar to the 1999 FIDIC version of the Dispute Adjudication Board ("**FIDIC DAB**"), the NEC DAB is comprised of a one or three member standing board. The Contract Data identifies the members and if there are three, the third member is jointly chosen by the parties.

In an attempt to ensure familiarity with the project, the NEC DAB visits the project site at agreed intervals during the project (unless the parties agree that a visit is unnecessary), with a dual purpose to firstly "inspect the progress of the works" and secondly to "become aware of any potential disputes"[5]. In comparison to FIDIC, "access to the site" is only made available to the FIDIC DAB once a dispute has arisen and been referred[6].

This suggests that the role of the NEC DAB is to be inquisitorial and perhaps to an extent interventionist in seeking to "become aware of any potential disputes". This is supported by Option W3.2(6), which states that the NEC DAB "can take the initiative in reviewing potential disputes, including asking the Parties to provide further information".

1 W3.2(1)

2 At page 84

3 Peter Higgins, chair of NEC4 Contract Board, NEC4 preface page

4 *Anglian Water Services v. Laing O'Rourke Utilities Ltd* [2010] at para 28

5 W3.1(5)

6 For example, FIDIC Silver Book First Edition 1999 at Clause 20.4

Interestingly, and something which does not reflect the approach in the 1999 FIDIC suite, the NEC DAB is obliged to review "all potential disputes" and help parties "to settle them without the need for the dispute to be formally referred"[7]. Although what might constitute potential disputes may be unclear, the prospective nature of that phrase seeks to promote dispute avoidance at a very early stage – i.e. before a dispute has even come into existence.

Questions will therefore surely arise as to the required degree of "crystallisation" (or formation) of a "*potential dispute*" for this purpose and the prospect for disagreement between parties as to whether there exists a "*potential dispute*" or not. Equally though, the intention appears to be that the NEC DAB is to operate within the confines of the pre-dispute arena, where the earliest stages of a dispute can be dealt with and, if possible, resolved so as to avoid full dispute 'crystallisation'.

This is in contrast to a FIDIC DAB, where the full dispute will have already crystallised before referral. The 2017 pre-release FIDIC Yellow Book does however include provision for the parties to jointly refer a matter to the FIDIC DAB to assist and/or "*informally discuss*" any issue or disagreement in an attempt to resolve them[8]. This is also extended by the proposed new FIDIC DAB having the power to invite parties to make a joint referral if they "*become aware*" of an issue or disagreement[9].

Both new contracts therefore propose an interventionist board to a lesser (FIDIC pre-release Yellow Book) or greater (NEC4) extent.

The NEC DAB is clearly set up to deal with pre-emptive dispute avoidance (as opposed to actual dispute resolution which is left to the tribunal).

A "potential dispute" in Option W3 is one arising "under or in connection with the contract"[10]. It appears there could be some uncertainty around the boundaries of the NEC DAB's jurisdiction, especially in the scenario where a "potential dispute" quickly evolves into a dispute.

Depending on the frequency of the NEC DAB's pre-agreed site visits, one would expect that only the most involved and committed NEC DABs will perhaps make proper and meaningful use of their powers of intervention, a comment which may equally apply to the FIDIC pre-release Yellow Book DAB's level of "awareness" and the possibility for it to invite parties to refer an issue or disagreement to them.

Parties are not able to refer any dispute under or in connection with the contract to the tribunal (either court or arbitration, as specified by the parties) before it has been referred as a "potential dispute" to the NEC DAB[11]. A party dissatisfied with the NEC DAB's recommendation must give notification (within a four-week window of notification of the NEC DAB's recommendation) to the other party that it intends to refer the dispute to the tribunal[12]. One area of concern may be situations where a dissatisfaction notice has not been provided within this timeframe and whether the "recommendation" becomes binding.

As to the second question, the use of the word "recommendation" suggests a non-binding outcome, and indeed this is confirmed in the User Guide, which states unequivocally "[t]his recommendation is not binding on either Party". As to the first question, strictly construing the words in W3.3(2) suggests that there can be no reference to the tribunal in the absence of the notification. Therefore, it seems the parties must go through the NEC DAB process (even though the outcome recommendation is non-binding), in order to preserve a right to refer the dispute to the tribunal, with a consequent time-bar if the party misses the four-week window following the recommendation for the notification of dissatisfaction. That this requires a "potential dispute" to arise, this could create an area for debate.

Option W3 is also silent on what happens if the DAB does not give a recommendation at all (for whatever reason).

Finally, the NEC DAB is required to be impartial[13] and is somewhat immune from complaint in that the members of the NEC DAB, their employees and agents are not liable to the parties for any action or failure to take action in resolving a potential dispute unless the action or failure to take action was in bad faith[14]. The NEC4 does not define what is meant by "bad faith", meaning it could mean different things in different jurisdictions, depending on the applicable law.

7 W3.2(5)

8 2017, Clause 21.3

9 2017, Clause 21.3

10 W3.2(2)

11 W3.3(1)

12 W3.3(2)

13 W3.1(3)

14 W3.1(7)

Conclusion

The NEC DAB is in our view a genuine attempt at innovation. While it shares some features of the well-known FIDIC DAB, it operates in a different, pre-dispute arena. If used, it would appear to create a unique opportunity for pre-emptive dispute avoidance. On a large and complex project, where the costs of the NEC DAB may be more justifiable, we can see the potential attraction.

It will be interesting, however, to see how many parties elect to use Option W3 given the likely costs of a standing board and the management time involved in dealing with NEC DAB visits, for example. A key concern of ours in relation to the new scheme is what constitutes a "potential dispute". In some cases it would appear that there can immediately be an actual dispute without there first being a "potential dispute" – e.g. a failure of one party to pay, which is not perhaps envisaged by Option W3 and in which case the process must nonetheless be followed.

No doubt project teams will look to early adopters, and ultimately early court cases (if any), to see how Option W3 is likely to work in practice. In our view, NEC4 in general will still be amended by contracting parties and it remains to be seen to what extent Option W3 might be subject to adjustment. It also remains to be seen if parties will opt to use Option W3 instead of the contractual adjudication process detailed in Option W1, which, in our view, probably provides a generally cheaper and quicker route for dispute resolution. However, as both NEC and FIDIC are introducing dispute avoidance concepts, it appears in the international projects arena, depending on uptake, such processes may increasingly become the norm.

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