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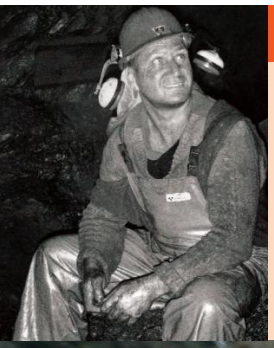

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# Arbitration

**Ulrich Helm, Partner, and Fabian Bonke, Associate, in the Frankfurt Office of the international law firm Hogan Lovells International LLP discuss the pros and cons of arbitration during tunnelling construction disputes**

**IT MIGHT NOT BE** in any of the parties' interests, but experience shows that in tunnelling projects disputes are a regular occurrence. There are various reasons for this: tunnelling projects typically face many uncertainties such as unreliable predictions of ground conditions, complex technological challenges and the need for intensive investigations before and during construction. Furthermore, many parties with different interests are either directly or indirectly involved.

It is, therefore, key to include specific dispute resolution clauses within the construction contracts. Firstly, all parties are interested in a steady work progress due to high ongoing construction costs. Disputes should thus not intervene in this work progress and preferably be solved within the short term.

For the purpose of ensuring efficient solutions of conflicts, contracting parties in the construction industry are making more use of alternative dispute resolution solutions such as Dispute Adjudication Boards (DABs). A DAB is normally a body established to settle the dispute and usually made up of three people with construction experience nominated by the parties involved. In many cases, these Boards help achieve fast and, often, final solutions. DABs are often constituted by technical specialists, which is advantageous when it comes to handling complex technical issues. However, this technical focus can also limit the use of a DAB, as these members will in most cases be less familiar with complex legal issues.

The abovementioned challenge means that contracting parties need to implement further methods of resolving disputes. The FIDIC Books, issued by the International Federation of Consulting Engineers, that are most frequently used in construction projects provide for a three-step procedure in resolving disputes. The Engineer first renders a decision, which can then be referred to a DAB and lastly be made subject to a final decision in arbitration proceedings. In this article, we will explain what arbitration is and present its advantages and disadvantages in comparison to court litigation. We will then illustrate what parties have to consider when formulating arbitration agreements. Finally, we will provide by way of examples some typical issues that frequently occur in tunnelling arbitration cases.

## Arbitration's advantages/disadvantages compared to court litigation

Arbitration, in addition to litigation, is one of the most popular ways in which to finally resolve a dispute. The contracting parties will submit their dispute to an arbitral tribunal typically consisting of a sole arbitrator or three arbitrators who then make a final decision on the conflict. Compared to litigation that takes place in front of state courts, arbitration can offer various advantages. For instance, the parties are relieved of the decision to select a state court of one particular country to hear the dispute. This will often be a source of conflict between the parties when they originate from different jurisdictions, since they will often not want to bring an action before a national court in one of the parties' home country. Additionally, arbitration proceedings can be conducted quite independently without interference from local state courts. This is particularly important in countries where judicial independence is not fully guaranteed. Furthermore, and unlike litigation in front of state courts, arbitration proceedings are normally not public and are confidential. This means that details of the dispute will not be disclosed, which includes the fact that there even was a dispute between the parties. Lastly, arbitral awards are often easier to be recognised and enforced worldwide compared to court decisions. This is because of the so-called New York Convention on the Recognition and Enforcement of Arbitration Awards which, to date, has been signed by 157 states, amongst them all major trading countries worldwide.

Parties will, however, have to essentially make the choice between litigation and arbitration also with the disadvantages of arbitration in mind. One such disadvantage is that arbitrations are not always - particularly in complex construction cases - the fastest and cheapest method of resolving a dispute. Parties have to consider that various costs for the arbitral tribunal and administrative costs for the arbitral institution will arise. Moreover, it is also important to note that arbitral awards are generally not binding on third parties who did not sign the arbitration agreement. This can be particularly problematic in construction cases where subcontractors might be held liable. How to ensure the binding of all key parties potentially involved in a tunnelling project is thus a key question that needs to be addressed when first contractually setting up a project.

Despite these disadvantages, arbitration is very often the best dispute resolution system in high value international construction projects. In 2015, 21% of the total caseload of arbitrations conducted by the renowned International Chamber of Commerce (ICC) were cases with a background in the construction industry. ICC statistics of the year 2016 confirm that arbitration in construction accounts for the greatest impact amongst ICC arbitrations. There are currently no indications that this increase will not continue in the forthcoming years.

## What do parties have to consider in arbitration agreements?

In an arbitration agreement the parties have to specify what kinds of disputes shall be covered and which rules of arbitration shall be applicable in the event of a dispute. The parties also have to decide between institutional or ad hoc arbitration,

the seat of the arbitration and how the arbitral tribunal shall be constituted.

***Institutional or ad hoc arbitration***

Typically, there are two forms of arbitral tribunals: institutional or so-called ad hoc arbitral tribunals. Institutional arbitration means that the parties agree on institutional rules which shall be applicable in case of a dispute. These rules regulate the arbitration proceedings. Such rules are for example provided by the ICC, the London Court of International Arbitration (LCIA) or the Arbitration Institute of the Stockholm Chamber of Commerce (SCC). On the one hand, institutional arbitration entails additional costs since the administrative services provided by the institution have to be paid for. On the other hand, however, the parties benefit from a professional organisation administering the proceedings.

In an ad hoc arbitration, the parties will either draft bespoke rules for the arbitration proceedings or they will adopt rules provided by international institutions similar to those provided by arbitral institutions (for example UNCITRAL Arbitration Rules). Unlike institutional proceedings, ad hoc proceedings, however are not supervised by an institution and are therefore more dependent on the parties' willingness to cooperate. Ad hoc arbitration that does not rely on model rules might further be particularly problematic, for example when problems arise as to the appointment of the arbitral tribunal. Thus, ad hoc arbitration is generally to be recommended only when choosing rules such as UNCITRAL Arbitration Rules.

***Seat for the arbitration***

In the arbitration agreement parties will also have to consider where the arbitration shall have its legal seat. The choice of seat determines which compulsory procedural rules will be applicable to an arbitration. The seat of the arbitration can prove to be important since national courts of the country remain responsible for some

decisions. This includes support of the arbitral proceedings, for example the selection of arbitrators in cases where the parties have not agreed on how to appoint the arbitral tribunal or if that agreement is invalid. Additionally, preliminary injunctions often have to be made by state courts even though parties agreed on arbitration. Lastly, it is also important to note that only courts at the seat of the arbitration are competent to annul arbitral awards. For these reasons, the choice of the seat of the arbitration is particularly important.

***Number and selection of arbitrators***

With respect to the selection of arbitrators, two decisions have to be made by the parties.

First, they have to decide on how many arbitrators shall decide on the dispute. An arbitral tribunal will typically be composed of one or three members. Particularly in international construction projects, tribunals consisting of three members offer the advantage of a greater mix of cultural, legal and technical expertise. It is also more likely that three arbitrators will take into account all of the relevant issues to decide the case. However, tribunals consisting of three arbitrators are of course more costly than a sole arbitrator, for example when it comes to inspecting the site of the project. In order to minimise costs, the parties could also agree that only one of the three arbitrators attends the inspections. In the end, the decision as to how many arbitrators shall decide on the dispute is generally up to the parties.

The ICC recommends the choice of a sole arbitrator in projects not exceeding €20M. The new ICC Expedited Procedure Rules now foresee the decision by a sole arbitrator, even if the parties have contractually agreed on a three member tribunal. These ICC Expedited Procedure Rules came into force in March 2017 with the aim to reduce the time and costs of international commercial arbitrations. They mainly address small claims for they will be automatically applicable if the amount of the claim does not exceed US$2M. However, all parties have the option to choose the application of the expedited rules for their arbitration proceeding.

Second, the parties have to decide who will be chosen as arbitrators in the matter. The arbitrator should be well experienced in international construction arbitration. Arbitrators have to be familiar with the most common standard contract forms in construction cases, such as the FIDIC Books. Since the disputes are generally very complex, and the parties will often have completely different points of view, arbitrators have to be able to ensure a sensitive handling of the case and maintain a dialogue with both parties throughout the process. Construction cases are even more challenging than many other arbitrations cases since they often address challenging legal issues and require technically-complex and fact-intensive investigations. To master the technical issues, the arbitrator does not need to be a technical specialist but he or she should be willing to understand the technical issues. Good understanding by the arbitrators of both technical and legal issues will help to achieve a fast and mutually satisfying solution. In an arbitration chaired by one sole arbitrator that person would have to possess all of these skills, whereas in an arbitration chaired by a three-member tribunal it can also be sufficient that at least one arbitrator has a good level of technical understanding.

**Typical issues in tunnelling arbitration cases**

There are some issues that frequently occur in tunnelling project disputes into which we would like to take closer look. First, parties often argue about the responsibility for unexpected ground conditions and the consequences thereof. Second, the choice of experts for the arbitral procedures concerning tunnelling projects can be challenging. And third, in many international arbitrations document production will be requested, which is especially unusual for parties who come from jurisdictions where document production is not commonly known.

***Responsibility for unexpected ground conditions***

Tunnelling projects, even if prepared with the highest possible diligence, always bear a risk of not knowing exactly what the underground will be composed of. Most subsurface project disputes involve aspects of unknown ground conditions. The main controversial issue in connection with

**Against this divergent cultural background document production can become a contentious issue in international arbitration**

ground risks is who is responsible for unexpected ground conditions. Unforeseen ground conditions often cause significant delays to projects and therefore result in significant additional costs. The best way to avoid these disputes is to clearly allocate the risks in the project agreements.

***Choice of experts***

In nearly every tunnelling dispute it will be necessary for the arbitral tribunal to select experts in order to examine specific technical issues (primarily geological and geotechnical). This will apply even if the arbitrators themselves are technically-experienced since they will still not be able to fully understand the technical issues in-depth and will require experts. The difficulty is that in a very specialised industry such as the tunnelling sector, it is challenging to find experts with experience in international arbitration cases. This difficulty in finding litigation-experienced experts also applies to expert witnesses appointed by the parties. These expert witnesses are however particularly important in order to investigate the case and to develop sound arguments together with the legal team.

***Document production***

Document production is a well-known practice nowadays in international construction arbitration proceedings. It means that the parties may request the production of documents from the other party (or even a third party). This comes as a surprise especially to parties who come from so-called Civil Law jurisdictions (for example Germany and France) since such a document production does not exist in court proceedings in these countries. In these countries the parties are generally not entitled to request the opposing party to disclose documents or to request court-ordered document production. Parties are not obliged to tender documents that may be detrimental to their position. This is in contrast to the so-called Common Law jurisdictions (for example the United Kingdom, the United States etc.). In these jurisdictions the parties have to produce all evidence available to them – even if it is damaging to their position.

Against this divergent cultural background document production can become a contentious issue in international arbitration. Although a certain balance between the opposing traditions has been established, the extent of the document production still differs from case to case. This is due to the fact that the parties normally do not specify detailed rules on the production of documents. The tribunal thus has a broad discretion as to its scope. To avoid surprises for one party and to allow limited document production, it seems advisable to refer in the arbitration agreement to the Rules of the International Bar Association on Taking of Evidence in International Arbitration. It seems further prudent to specify the exact requirements and the extent of the document production once the proceedings have commenced in order to adapt to the specifics of each individual case.

**Conclusion**

The three-step dispute mechanism provided by FIDIC Books is convincing. Hereafter, disputes are first decided by the Engineer resolving many technical or less contentious issues. Disputes arising from the Engineer's determination can then be resolved by a DAB, which can prove to be successful for many technical issues. If a conclusive resolution by a DAB cannot be achieved, the parties can bring the dispute to arbitration. Since the DAB serves as a "filter", there is a tendency that arbitral cases are becoming larger, more complex and that the amount at stake is increasing.

As foreseen by the FIDIC Books, arbitration is often preferable over litigation. There are a variety of reasons for this, including confidentiality of the proceedings, the length of time until a final decision can be reached or the choice of the arbitrators according to their experience. This general preference of arbitration for disputes in tunnelling cases is in line with the recommendation of the International Tunnelling Association.

Notwithstanding these advantages, certain points need close consideration when it comes to agreeing on arbitration. First, the choice of an institutional instead of an ad hoc arbitration is often preferable because of the administration of the dispute by the competent arbitral institution. Second, as to the seat of the arbitration it is advisable to agree on one of the major hubs for international arbitration. This is also because the choice of the seat of the arbitration determines the applicability of the procedural law. Third, the parties have to consider how many arbitrators are appointed and who is selected as arbitrators. Generally, it seems advisable to agree on a three-member tribunal. However, specifically in cases with smaller amounts in dispute, it might be preferable to appoint a single arbitrator in order to save costs. The main criterion to select the arbitrators should be relevant experience in construction or – at best – tunnelling projects.

Finally, parties should be aware of issues that frequently arise in arbitration cases within the tunnelling sector. This includes the responsibility for unexpected ground conditions, the choice of experts, and document production. To address these issues, it is key to prepare in advance with the support of technical and legal experts.

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