HFW

CONSTRUCTION BULLETIN
MARCH 2021

Welcome to the March 2021 edition of our Construction Bulletin.

In this edition we cover a range of recent developments in international construction law:

- Experts and Conflicts of Interest
- The Pre-Estimate of Loss Test for Liquidated Damages is Alive and Well in Singapore
- Hong Kong Court of Appeal Confirms Strict Approach to Notice as a Condition Precedent to Entitlement
- Sampling Variations: An Acceptable Approach in Construction Disputes?

The inside back page of this bulletin contains details of team news and webinars at which the members of the construction team will be speaking over the coming months.

Michael Sergeant, Partner
michael.sergeant@hfw.com

Katherine Doran, Senior Associate
katherine.doran@hfw.com

ANDREW ROSS
ASSOCIATE, LONDON

"While acknowledging that fiduciary duties were not incompatible with an expert's role, the court considered this was an *"inapt"* description of the relationship ."

EXPERTS AND CONFLICTS OF INTEREST

Appointing the right expert is critical to achieving a satisfactory outcome in construction disputes. Consequently, clients are increasingly proprietorial about the experts they instruct. However, the 'supply' of suitable experts is decreasing due to consolidation of international consultancy firms. This creates a tension, which was tested in a recent case exploring the nature of experts' duties to their clients.

Case Background

The developer of a petrochemical plant was the respondent in two arbitrations. In the first (commenced by a contractor), it instructed Secretariat Consulting Pte Ltd (SCL) (part of the Secretariat group) to provide arbitration support and expert services. In the second, commenced by the project manager, the project manager asked Secretariat International UK Ltd (SIUL) (another Secretariat company) to provide quantum and delay expert services. The developer sought an injunction to prevent SIUL from acting for the project manager, arguing that SCL's engagement on the first arbitration created a conflict of interest.

The court concluded that the Secretariat group owed the developer a fiduciary duty of loyalty, requiring it to act unselfishly in the developer's best interests, preventing SIUL from acting in the second arbitration.

The decision was unprecedented and sparked concerns about far-reaching consequences, for example, impacting experts' duties to tribunals.

Court of Appeal decision

On appeal, the Court of Appeal took a pragmatic approach.[1] While acknowledging that fiduciary duties were not incompatible with an expert's role, the court considered this was an *"inapt"* description of the relationship and that importing the *"legal baggage"* of a fiduciary relationship may have *"unseen ramifications"*. The court sought an alternative solution.

SCL and the developer's contract (partly contained in a letter from SCL) provided that solution. SCL stated, ***"we will not…undertake any… engagement that…might [create an] actual or perceived conflict."*** The court concluded that ***"we"*** meant the entire Secretariat group because 1) the group marketed itself as a single outfit; 2) SCL's conflict searches spanned the group; 3) group companies shared owners and directors; and 4) profits were shared group-wide. Additionally, the court thought that interpreting ***"we"*** as SCL alone could allow Secretariat companies to act for rival parties in the same arbitration, undermining the clause's purpose.

Implications

Similar scenarios could occur on any large construction project. It is entirely understandable that parties to a case will want to ensure there is no risk of their expert having a conflict of interest or of information inadvertently leaking to an opponent. This case reassures parties in that regard by clarifying that courts will generally take a strict approach to apparent conflicts of interest across global consultancies. The court also clarified that parties can actively manage this risk by including appropriate obligations prohibiting conflicts of interest in their appointments.

While the court avoided importing fiduciary obligations into this expert/ client relationship, it did not completely rule out doing so in future, despite the potentially uncertain and wide-ranging consequences. Potential conflict situations like this are likely to become more common as expert consultancies grow and adopt a more corporate outlook. This decision provides reassurance to users of expert services that they won't be prejudiced as a result.

ANDREW ROSS
Associate, London
T +44 (0)20 7264 8048
E andrew.ross@hfw.com

1 [2021] EWCA Civ 6

THE PRE-ESTIMATE OF LOSS TEST FOR LIQUIDATED DAMAGES IS ALIVE AND WELL IN SINGAPORE

In *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd*,[1] the Singapore Court of Appeal affirmed the traditional pre-estimate of loss test for liquidated damages continues to apply in Singapore.

In doing so, they declined to follow the wider "legitimate interest" test now applied in the English and Australian courts. This case is likely to be of great interest to both contractors in Singapore and to international contractors whose contracts are subject to Singaporean law and will open the door to challenges to liquidated damages clauses.

Background

The case concerns contracts for the supply of electricity rather than construction, but the principles are equally applicable. In brief, Seraya contracted to supply electricity to Denka. Denka wrongfully terminated the contracts and Seraya claimed damages. The contracts included liquidated damages clauses for breach. Denka alleged that the liquidated damages were unenforceable penalties.

The Decision

The Court of Appeal decided that the liquidated damages in the Seraya contracts were not penalties and were enforceable. In doing so, the court conducted a wide ranging review of the law on penalties. Firstly, the court considered whether the rule against penalties applies only to secondary obligations (i.e. breach of contract claims) as in England or whether the rule applies to primary obligations, as is the case in Australia. The court went on to address the applicable test for enforceability of liquidated damages provisions, i.e. whether to follow the wider legitimate interest test, which now applies in English law.

Scope of the Penalty Rule

The Australian High Court in *Andrews*[2] extended the application of the penalty rule to apply not only when there is a breach of contract but also to breaches of primary contractual obligations. The Singaporean Court of Appeal declined to extend the penalties rule to primary obligations. The Court said that by extending the penalties rule to primary obligations, the court was interfering with the parties' freedom to contract.

Pre-Estimate of Loss Test

However, the Court of Appeal did not apply the test for penalties set out in the English Supreme Court decision of *Cavendish v Makdessi*.[3] In Cavendish, the English court found that liquidated damages will be enforceable unless the clause is a secondary obligation which imposes a detriment which is unconscionable or out of all proportion to the legitimate interest of the innocent party.

This test was widely considered to be an attempt by the Supreme Court to give greater autonomy to the parties to agree liquidated damages and to seek to reduce unmeritorious challenges to liquidated damages.

The Singaporean Court of Appeal refused to apply this test. Instead, they affirmed the traditional "pre-estimate of loss" test in the *Dunlop Pneumatic Tyre Co* case.[4] The Court in *Denka v Seraya* concluded that the "genuine pre-estimate" test is consistent with the nature of liquidated damages, which is to compensate for monetary loss. A rate of liquidated damages fixed higher than a pre-estimate of loss *"must necessarily be penal"*.

Commentary

The court did stress that in the majority of cases, the application of the two tests (pre-estimate of loss and legitimate interest) is likely to be the same. However, the likely results of the decision in *Denka* will be that the Singapore courts have opened a door to challenging liquidated damages that other jurisdictions have already tried to close.

CHRIS CHO
Associate, Melbourne
T +61 (0)3 8601 4514
E chris.cho@hfw.com

1 *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd* [2020] SGCA 119

2 *Andrews v Australia and New Zealand Banking Group Limited* (2012) 247 CLR 205

3 *Cavendish Square Holding BV v Makdessi* [2016] AC 117

4 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79

CHRIS CHO
ASSOCIATE, MELBOURNE

"The traditional pre-estimate of loss test for liquidated damages continues to apply in Singapore."

JULIE-ANNE MALLIS
ASSOCIATE, HONG KONG

"For contracts that are already on foot, it is imperative that parties, in particular, contractors and subcontractors carefully comply with all conditions precedent when giving notice of claims."

HONG KONG COURT OF APPEAL CONFIRMS STRICT APPROACH TO NOTICE AS A CONDITION PRECEDENT TO ENTITLEMENT

The decisions of the Court of First Instance, and Court of Appeal, in relation to an arbitral award concerning the validity of claim notices has generated significant interest within the construction industry in Hong Kong and other common law jurisdictions.[1]

The latest decision of the Court of Appeal confirms that a party to a construction contract must strictly comply with all conditions precedent when notifying the other party of its claim(s) under the contract regardless of how stringent the conditions precedent may be or how meritorious their case is. Failure to comply with conditions precedent will put a party at risk of being time-barred.

Background

The Employer, MTR Corporation (MTRC), awarded a contract to a joint venture which comprised Maeda Corporation and China State Construction and Engineering (JV) for the construction of tunnels for the Hong Kong to Guangzhou Express Rail Link. The JV, in turn, entered into two subcontracts with Bauer Hong Kong Ltd (Bauer) to carry out excavation works for, and the installation of, diaphragm walls for the tunnels.

During the excavation works, Bauer encountered unforeseen ground conditions causing it to excavate more rock than it had initially anticipated. Bauer submitted various notices to the JV stating that it was entitled to a variation under clause 19 of the subcontract in respect of the unforeseen ground conditions.

The dispute was referred to arbitration. In the arbitration Bauer argued that it was entitled to a variation under clause 19 of the subcontract (as was set out in its claims notices issued under the subcontract). In addition, Bauer argued that it was entitled to additional payment or loss and expense under clause 21 of the subcontract. Clause 21 was a 'like rights' clause, predicated on the JV's entitlements under the main contract with MTRC. The clause 21 argument had not been included in Bauer's claims notices.

Clause 21.1 of the subcontract contained the following notice provision: *"... as a condition precedent to [Bauer's] entitlement to any such claim, [Bauer] shall give notice of its intention to the [JV] within fourteen (14) days after the event..."* Further, clause 21.2.1 of the subcontract, required Bauer to submit a further notice in writing within 28 days of the notice provided under clause 21.1 stating *"the contractual basis together with full and detailed particulars and the evaluation of the claim"*.

When the case went to arbitration, the arbitrator rejected Bauer's claim for a variation as it had failed to follow the contractual mechanism and obtain a formal instruction from the Engineer. However, the arbitrator – who was sympathetic to Bauer's claims – found that Bauer had complied with the requirements of clause 21 of the subcontract by setting out the factual basis of its claim (notwithstanding that it had not set out all of the contractual bases for its claim). In particular, the arbitrator held that *"as a matter of sympathy and as matter of construction, the contractual basis of the claim stated in the clause 21.2 notice did not have to be the contractual basis on which the party in the end succeeds in an arbitration. First, to expect a party to finalize its legal case within the relatively short period and be tied to that case through to the end of an arbitration is unrealistic. Secondly, what is important from the point of view of the Contractor is to know the factual basis for the claim so that it can assess it and decide what to do."*

The JV was granted leave to appeal the arbitrator's decision, in a case which came before both the Court of First Instance and the Court of Appeal.

Court of First Instance

Madam Justice Mimmie Chan disagreed that clause 21 of the subcontract should be construed sympathetically to Bauer. In particular, she found that, *"however much sympathy the contractor may deserve, Clause 21 employs clear and mandatory language for the service*

and contents of the notices to be served, with no qualifying language such as "if practicable", or "in so far as the sub-contractor is able"".[2] Madam Justice Chan also noted that the language used in clause 21.1 of the subcontract was *"clear on its plain reading"* and that it is not for *"a court or tribunal to re-write the Sub-Contract or Clause 21 for the parties after the event".*[3]

In light of her findings above, Madam Justice Chan held that Bauer had failed to give proper notice of its claims under clause 21.2 of the subcontract. Concluding that the arbitrator's decision to allow Bauer's claim of 'like rights' was wrong in law, Madam Justice Chan stated that the arbitrator *"failed to pay heed and give effect to the express provisions of Clause 21.2, which is clearly stated to be a condition precedent for any claim to additional payment or loss and expense, and is required by the express provisions of clause 21.3 to be "strictly complied with".*[4]

Bauer was granted leave to appeal to the Court of Appeal.

Court of Appeal

The Court of Appeal comprising Madam Justice Susan Kwan VP, Madam Justice Maria Yuen and Justice Aarif Barma unanimously upheld the first instance decision.

Finding that the wording of clause 21.2.1 of the subcontract was *"clear and unambiguous"*, the Court of Appeal emphasised that Bauer was *"required to give notice of the contractual basis [within the stipulated time], not any possible contractual basis which may turn out not to be the correct basis."*[5]

The Court of Appeal also noted that the phrase *"the contractual basis"* in clause 21.2.1 of the subcontract did not preclude Bauer from identifying more than one contractual basis for its claims. Bauer could have stated more than one contractual basis in the same notice or submitted separate notices for each contractual basis it intended to rely upon.[6] However, such action was required to be taken within the time prescribed by the subcontract. Bauer could not, at a later stage, substitute one contractual basis for another.

Key Takeaways

The decisions provide a salient reminder that courts will not re-write the plain language of parties' contracts. They are in line with recent English and Australian authorities that where it is sufficiently clear that a notice provision is a condition precedent to entitlement, strict compliance is required.[7]

Parties should ensure that their contracts are drafted using clear and unambiguous language. If it is intended that a notice provision be strictly complied with, then expressly identify the provision as a 'condition precedent', and state the consequences of failure to comply.

For contracts that are already on foot, it is imperative that parties, in particular, contractors and subcontractors carefully comply with all conditions precedent when giving notice of claims. In addition to time limits for notices, the content of the notice can also be important. If it is a condition precedent to specify the contractual basis of the claim, that is what the claiming party must do. Parties should not expect to be able to rely on different or additional, contractual bases at a later stage. Attention should also be paid to requirements concerning the form of notice (for example, if it must be in writing; whether email will suffice; if it must be in a separate document).

Where notice provisions are similar or identical to those in *Maeda Corporation v Bauer*, contractors and subcontractors must set out all of the contractual bases they intend to rely upon within the prescribed time and in the correct notice otherwise they are at risk of being time-barred from pursuing their claim(s).

It is anticipated that Bauer may seek leave to appeal to the Court of Final Appeal.

JULIE-ANNE MALLIS
Associate, Hong Kong
T +852 3983 7695
E julie-anne.mallis@hfw.com

1 *Maeda Corporation and China State Construction Engineering (Hong Kong) Limited v Bauer Hong Kong Limited [2019] HKCFI 916* and *Maeda Corporation and China State Construction Engineering (Hong Kong) Limited v Bauer Hong Kong Limited [2020] HKCA 830.*

2 *Maeda Corporation and China State Construction Engineering (Hong Kong) Limited v Bauer Hong Kong Limited* [2019] HKCFI 916, [31].

3 Ibid.

4 Ibid, [18].

5 *Maeda Corporation and China State Construction Engineering (Hong Kong) Limited Joint v Bauer Hong Kong Limited* [2020] HKCA 830, [53].

6 Ibid.

7 See, for example, *Towergate Financial (Group) Ltd v Hopkinson* [2020] EWHC 984; *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar* [2014] EWHC 1028 and *CMA Assets Pty Ltd v John Holland Pty Ltd [No.6]* [2015] WASC 217.

CHRIS UTTON
ASSOCIATE, LONDON

"In arbitration and adjudication, it has become commonplace for the contractor to select a representative sample of the variations and use extrapolation to establish the full extent of the claim."

SAMPLING VARIATIONS: AN ACCEPTABLE APPROACH IN CONSTRUCTION DISPUTES?

On large projects, disputes between the employer and contractor can often involve hundreds or even thousands of variations. Clearly, it is not practical to resolve the dispute by dealing separately with each variation, and the cost involved would be prohibitive.

Sampling and Extrapolation

In arbitration and adjudication, it has become commonplace for the contractor to select a representative sample of the variations and use extrapolation to establish the full extent of the claim. Often, when there is a large number of variations, there will be distinct themes that make it possible to group them together. An example of such a grouping might be where a contractor's claim relies on orally instructed variations which the employer rejects because the contract permits written instructions only. In this situation, the contractor may select a representative sample of the variations explaining why (by reference to detailed particulars) they should be allowed. For example, the contractor may argue that the employer expressly waived the need for a written instruction. The findings by reference to the sample can then be extrapolated and inferences drawn in relation to the other variations.

This pragmatic solution has been widely accepted by arbitrators and adjudicators. Judges, on the other hand, have tended to take a more cautious approach. A recent decision in the High Court of England and Wales suggests that the courts are now warming to the idea.

Standard Life Assurance Limited v Gleeds (UK) & Others[1]

Standard Life (the employer) paid its contractor £146 million in settlement of the final account. Standard Life alleged that 3,600 variation instructions, issued negligently by its design team, had resulted in the sum being £38 million higher than it ought to have been.

Standard Life analysed a sample of 122 instructions and maintained that the court's findings could be extrapolated to draw inferences with regard to the remaining instructions. The defendants rejected this approach and asked the court to strike out the claim. They objected to Standard Life's approach to sampling which they submitted had focused on the higher-value variations and was not suitable for a professional negligence claim.

The judge confirmed that extrapolation is permissible as a matter of law and that it is a critical tool for case management. He also explained that the key issue for claimants is to demonstrate the sample selected is sufficiently representative to enable the court to place reliance upon it.

The judge held that the sample selected was not representative and gave draft directions. Standard Life would first have the opportunity to remove any variations upon which it could not genuinely rely. The defendants would then be permitted to nominate a sample of 160 variations for analysis and extrapolation.

Conclusion

The case provides clear judicial support for the use of sampling in claims where there are large numbers of variations. In this instance, the claim was for professional negligence but the judge confirmed extrapolation may be legitimate in other kinds of cases, particularly when the same error has been mass-produced. For contractors on large projects involving thousands of variations, this is good news because it validates the use of sampling in circumstances where a claim would otherwise be unmanageable.

CHRIS UTTON
Associate, London
T +44 (0)20 7264 8059
E chris.utton@hfw.com

1 [2020] EWHC 3419 (TCC)

Upcoming events:

HFW Offshore Wind Webinar Series: February to March 2021

Equitable and other Remedies

2 March 2021 (9am - 10am GMT)

Speakers: Max Wieliczko, Michael Sergeant, Richard Booth, Katherine Doran

Game Changer: The Emergency Arbitrator and Legal Strategy

4 March 2021 (8.30 am – 9.30 am GMT)

Speakers: Ben Bury, Chanaka Kumarasinghe

HFW Offshore Wind Webinar Series: February to March 2021

Case Studies

16 March 2021 (9am - 10am GMT)

Speakers: Max Wieliczko, Michael Sergeant, Richard Booth, Katherine Doran

Kuwait Construction Contracts Forum Webinar

Opportunities and Challenges for Kuwait's Construction Industry in 2021

16 March 2021 (7am – 8am GMT)

Speakers: James Plant, Rula Dajani Abuljebain, Michael Sergeant

Construction Law Update Webinar

28 April 2021 (9am – 10am GMT)

Speakers: Michael Sergeant, Max Wieliczko, Richard Booth, Chris Philpot, Daniel Johnson, Andrew Ross, Katherine Doran

Construction Law Update Webinar

29 April 2021 (4pm – 5pm GMT)

Speakers: Michael Sergeant, Max Wieliczko, Richard Booth, Katherine Doran, Chris Philpot, Daniel Johnson, Andrew Ross, Katherine Doran

International Construction Arbitration Webinar

26 May 20201 (9am – 10 am GMT)

Speakers: Max Wieliczko, Michael Sergeant, Ben Mellors, Kijong Nam, James Plant, Katherine Doran

If you have any queries regarding any of these upcoming webinars, or to register your interest in attending, please contact us at events@hfw.com.

Our recent team news:

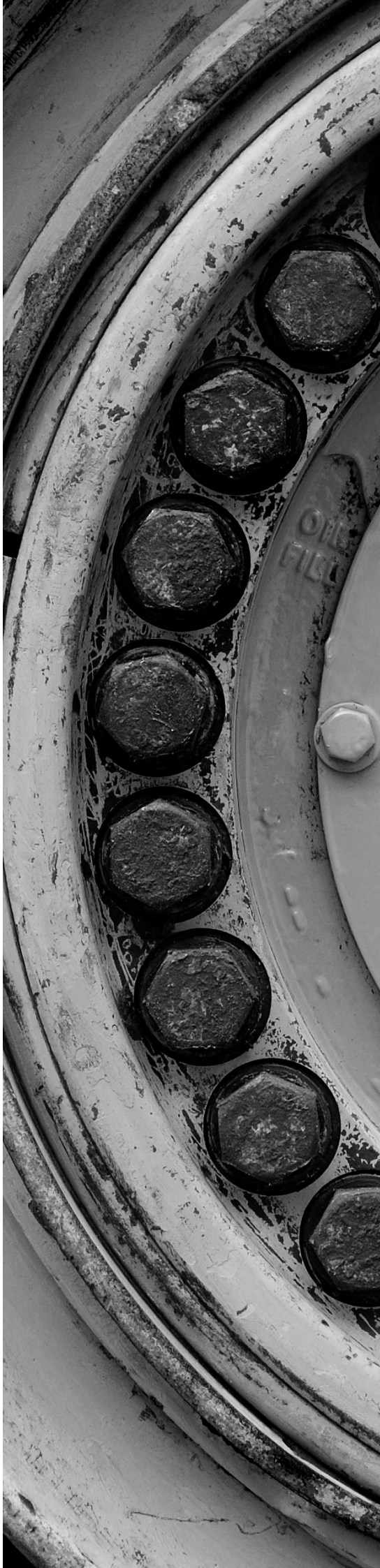
Our London team moved up to Band 2 in Legal 500.

Our Australia team moved up to Tier 4 in Legal 500 Asia-Pac.

Our Kuwait office was ranked in Chambers for the first time, with special reference for its construction work.

In October 2020, construction partner Antony Riordan joined our Sydney office from a rival firm. His team includes four associates: Brooke Gilbey, Natasha Joukhdar, Rachel Irwin and Jacqueline Borgese.

In the last year we have added three new associates to our London team: Andrew Ross, Chris Utton and Roxanne Langford.



HFW has over 600 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our construction capabilities, please visit hfw.com/Construction

hfw.com

Americas | Europe | Middle East | Asia Pacific