Construction

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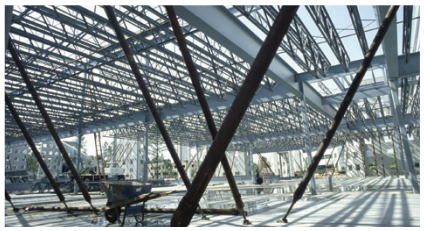
CONSTRUCTION BULLETIN



Welcome to the March edition of our Construction Bulletin

In this edition we cover a broad range of contractual and legal issues relevant to the construction industry:

- **New ICC Mediation Rules:** These were updated and re-issued in January 2014 as part of the ICC's drive to update all of its procedural rules, a process which started in 2012 with its new arbitration rules.
- **Statutory adjudication in Hong Kong:** The Government of Hong Kong is investigating the possibility of introducing a statutory adjudication regime. Vincent Liu examines how characteristics of other existing adjudication regimes may influence that adopted in Hong Kong.
- **EPC contracts:** Robert Blundell reviews some of the key provisions contained in EPC contracts with particular reference to the FIDIC Silver Book.
- **HFW offshore wind seminar:** We hosted a seminar on 29 January 2014 that considered the important contractual issues relevant to this industry. Max Wieliczko discusses the main topics that were debated.

At the end this Bulletin we provide a list of the events at which members of the HFW construction team will be presenting over the coming months.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

Michael Sergeant, Partner, michael.sergeant@hfw.com
Huw Wilkins, Associate, huw.wilkins@hfw.com

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New ICC Mediation Rules

The ICC is part way through the process of updating all its procedural rules, such as its Rules of Arbitration which it re-launched in 2012. We consider the most recent set of procedural rules to be updated: the ICC's Mediation Rules.

The ICC Mediation Rules 2014 (the Rules) came in to force on 1 January 2014, replacing the ICC ADR Rules (2001). The ICC are holding launch events worldwide throughout 2014, starting in London in March and presently scheduled to end in Tokyo in October. Other venues hosting launches this year include Hong Kong (25 March) and Dubai (1 May).

Mediation (the focus point of the Rules) is a voluntary, flexible and confidential dispute resolution procedure in which a neutral third party (the Mediator) facilitates the parties towards a negotiated settlement of their dispute. It differs from litigation, arbitration and adjudication because the Mediator has no authority to make an award in favour of either party. For a settlement to be binding, the parties must agree its terms.

Contracts increasingly provide for a tiered dispute resolution procedure which often incorporates mediation as an intermediate step prior to formal litigation or arbitration proceedings. Acknowledging this, parties are free to specify in their contract that any dispute will be referred to mediation pursuant to the Rules. However, the Rules can equally be adopted on an ad hoc basis once a dispute has arisen, even though not included in the contract (Article 3).

The intention of the Rules is to create an environment to facilitate a negotiated settlement.

HUW WILKINS

The new Rules in fact cover all consensual dispute resolution procedures, rather than just mediation. The parties can, under the Rules, also opt for conciliation or neutral evaluation. Both of these processes allow a third party to give a view on the merits of the case, but without this being binding. This process can lead to settlement as it may lead to the parties taking a more realistic view of their position. As with mediation, no decision, or settlement, is forced on the parties.

The Rules provide that the parties to the dispute retain control of the process.

Once the process under the Rules is started, it is the parties who jointly appoint a mediator (Article 5); agree the location of any hearings (Article 4); and agree the language in which any mediation is to be conducted (Article 4). These matters are only referred to the ICC where the parties cannot reach agreement.

Once appointed, the Mediator is required to discuss with the parties how the mediation will be conducted, and to set this out to the parties in written form. Parties are free to withdraw from the procedure if they do not agree with the Mediator's proposals for conducting the mediation. This right reinforces the parties' control of the mediation procedure.

As one would expect, the Mediator is required to confirm his impartiality and independence. In addition, the parties are required to act in good faith throughout the mediation procedure. The intention of the Rules is to create an environment to facilitate a negotiated settlement.

Parties to a dispute often wish to keep the existence and/or nature of the dispute confidential. The Rules again provide for the parties to reach agreement as to the extent of confidentiality provisions. The Rules also include a default position in which although the fact that a mediation is taking place will not be confidential, particulars of the actual proceedings and any settlement reached will be (Article 9).

Whilst it is common to see a set of arbitration and/or adjudication rules expressly stated to apply to disputes in a contract, rules of mediation are less frequently referred to. Often parties agree the rules governing a mediation on an ad hoc basis. It will be interesting to see whether the new ICC Mediation Rules alter this trend, and whether parties start incorporating a reference to them in their contracts.

For more information please contact Huw Wilkins, Associate, on +44 (0)20 7264 8488, or huw.wilkins@hfw.com, or your usual contact at HFW.

Statutory adjudication in Hong Kong

The Hong Kong Government is considering introducing a statutory adjudication regime. This article considers existing statutory regimes in England and Australia, which may influence the form of the regime adopted in Hong Kong.

Currently, parties in Hong Kong voluntarily agree to an adjudication process rather than one prescribed by legislation. The Hong Kong Government has now appointed legal consultants and a working group of 14 stakeholders to explore the implementation of security for payment legislation in Hong Kong having regard to similar legislation overseas. The security for payment regimes in England and Australia may provide some guidance as to the form the Hong Kong regime may take.

The primary aim of security for payment legislation is to address delays and problems in payment of contractors and subcontractors during construction projects. A rapid adjudication regime is intended to operate in parallel with other dispute resolution procedures such as arbitration or litigation and to provide a provisional determination of the dispute so as to keep cash flowing in the Project.

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VINCENT LIU

Under both the English and Australian regimes, a party to a construction contract is entitled to refer payment disputes to adjudication. The right to adjudicate cannot generally be excluded by contracting parties. However, the right to adjudicate does not apply to certain contracts, such as those for mining and the processing of minerals.

Different regimes incorporate different methods for making a payment claim. Under the regimes in England, Western Australia and Northern Territory, a written claim for payment is made as required under the contract. Under the New South Wales regime, a contractor is required to make a payment claim in the prescribed form.

A payment dispute arises when a payment claim is either expressly rejected or when it is unpaid by the final date for payment under the contract. In New South Wales, a payment dispute arises when the employer issues a payment schedule in the prescribed form certifying an amount which is less than the sum claimed.

The regimes in England and Australia both provide for a contractor to commence an adjudication by way of written notice. In England, the written notice is required to set out only the prescribed information, such as the nature of the dispute and the nature of the remedy sought. The contractor is then required to serve a referral notice together with supporting evidence within 7 days. In Australia, a contractor commences an adjudication by serving an adjudication application on the other party and on a prescribed appointer within the prescribed period of time after a payment dispute arises with all of the information, documentation and submissions relied upon. An adjudicator must dismiss an adjudication application made out of time.

In England, the statutory regime states that the response is required to be served within 7 days of the Referral Notice albeit that changes to the timetable are commonly agreed. In Australia, the other party is required to serve its response within 14 days of an adjudication application with all information, documentation and submissions relied upon. The 14 days deadline cannot be extended.

Generally speaking, an adjudicator is required to reach his decision within 28 days after commencement of the adjudication process. However, this deadline may be extended by agreement between the parties.

In England and Wales, an adjudicator may use his initiative to conduct an adjudication. English adjudicators in larger cases regularly call meetings at which they ask questions of the parties. In other cases, there are hearings where the parties are represented by lawyers. In Australia adjudications are determined strictly on the papers.

An adjudicator's award may be enforced as a judgment of the Court either by way of registration of an award or leave being granted by the Court to enforce. It is exceptionally difficult to resist enforcement of an award.

Whatever regime is implemented in Hong Kong, we consider that an adjudication process is likely to provide a further avenue to assist parties in settling their disputes before they progress to arbitration or litigation.

For more information please contact Vincent Liu, Partner, on +852 3983 7682, or vincent.liu@hfw.com, or your usual contact at HFW.

EPC contracts: key characteristics

Engineer, Procure and Construct (EPC) contracts are the standard form of procurement worldwide for large infrastructure projects. We consider the principal characteristics of such contracts with a particular focus on the provisions of the FIDIC Silver Book.

The FIDIC Silver Book is the most popular standard form EPC contract in the international market. It is also arguably the only truly "turnkey" form under which the contractor's scope for adjustment of his price is generally only limited to express variations made by the employer. Entitlements to extensions of time for performance are also very limited.

The ICC Turnkey Conditions of Contract are a well established form, albeit not used as widely as FIDIC. It is also a more balanced form, leaving more risks explicitly with the employer and also introducing extensive obligations in respect of the exercise of good faith in dealings between the parties.

The Engineering Advancement Association of Japan (ENAA) Model form is the preferential form used by the major Japanese EPC contractors, for obvious reasons. It has a significant advantage over the FIDIC approach in that it is dedicated for use for process and power plant and so has greater flexibility built into its terms for these projects. Without the need for further amendment it already contains distinct concepts such as pre-commissioning, commissioning, mechanical completion, and acceptance. This is important in contracts where physical completion of the works may have little worth to an employer who is seeking the performance of a particular process. The inclusion of such detail in the ENAA forms highlights the need for substantial amendment to the corresponding provisions in FIDIC.

Other forms can be adapted to create an EPC risk profile, but this is usually a more detailed task than simply deleting grounds on which the contractor may make claims for time and money. Instead, the primary focus of an EPC contract form should be the identification of the requirements and the appropriate apportionment of design and procurement risk. Forms which are originally drafted with a split in design responsibility, or a requirement for further design input from the employer will not lend themselves easily to EPC procurement.

Single point responsibility

It is said that EPC contracting gives 'turnkey' responsibility. By this it is meant that an employer gains the benefit of a single point of responsibility for the satisfaction of the performance specification that he has provided. After the contract is signed there is nothing for the employer to do other than turn up on the expected completion date, turn the key in the plant and operate it.

Crucially this highlights an essential requirement of true EPC works: that the project must be capable of standing on its own and not dependent on the completion of other, related works. Once interfaces are introduced there is a degree of responsibility for performance of the works that is not assumed by the contractor, and so the works cannot be truly labelled 'turnkey'.

In any EPC form, the risks of design and the methodology of procurement remain with the contractor. Some forms then go further by qualifying the standards of this liability.

FIDIC Silver obliges the contractor to accept a 'fitness for purpose' obligation. This is on the assumption (erroneous in practice) that the purpose is clearly, briefly and objectively set out. If the purpose is not clearly set out there is a danger that the supplier is expected to undertake, at his own cost, significant design development to ascertain whether the purpose is in fact achievable.

A contractor would be well advised to amend this term to define exactly what is meant by 'fitness for purpose' within the context of the particular project.

Where the Silver Book goes a step further than most other forms is that it also expressly transfers to the contractor the liability for the content and accuracy of the Employer's

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ROBERT BLUNDELL



Requirements. This is a significant burden, as the contractor cannot reasonably price for the risk that the requirements are actually unachievable.

In a competitive market, contractors will build in to their tender returns certain margins for identifiable risks, but the FIDIC approach means that the risk of achievability of the requirements will be a leap of faith for many contractors. The contractor will only be able to assess and price for the risks in the Employer's Requirements if he is afforded the time and opportunity to analyse the Requirements in the tender stage. Otherwise conservative, yet capable, contractors will be discouraged from tendering whilst others will be encouraged to gamble with low bids.

Performance risk

EPC contracting really suits technically complex projects where works may be defined by specified performance criteria, rather than by the production of a detailed design. This should mean that the choice of engineering solution is left entirely to the contractor.

Within the agreed construction period, there should be much less scope for the employer to determine how the contract work is actually delivered, what the detailed design for the project is, and less scope again for the employer to make changes during construction.

A significant driver for EPC contracting in the international market is the nature of project financing. An EPC contract is thought, rightly or not, to be more bankable due to the perception that it is less risky for the employer. Of course this is not necessarily the case, as the risk of passing all liabilities to a contractor is only ever going to be as strong as the contractor's balance sheet. And even where an employer is buying cost certainty, this itself comes at a very high price. There is usually a very significant premium to be paid (perhaps 30-40%) over and above the cost of a non-EPC construction route.

Where EPC contracting really comes into its own is the area of power and process plants. In these sectors, there are a number of specialist contractors who are skilled and adequately knowledgeable to manage, let alone price, the major risk of failure in performance of the end product. Many of these contractors also hold the necessary intellectual property rights to bring bespoke solutions to discharge the particular requirements, such as proprietary refining processes and turbine designs.

Ground risk

Ground risks may be frequently left with the employer, and the ease with which this is passed to the contractor depends on the degree to which the contractor is afforded the opportunity to scrutinise this risk during the tender period.

The reasoning behind this is that ground risks are inherently impossible to quantify exactly prior to commencing the works. To approach them otherwise is to encourage the risky tendering activities mentioned above.

The FIDIC Silver Book approach of allocating ground risk entirely to the contractor is probably out of step with most other industry practice in this regard, as it even omits the practice (found in other FIDIC forms) of permitting the claim in respect of those conditions which were unforeseeable.

Contract Administration

A further point of distinction in EPC contracts is that they generally contain onerous obligations with respect to the contractor's right to bring claims. These administrative restrictions are piled on top of the express limitations of entitlement and further restrict the contractor's ability to claim successfully for what is due.

Many of these restrictions are founded on the principle that an EPC contractor should be taking the lead in administration as well as procurement. As a result, it is common to see strict time periods and formats for claims to be raised, with the contractor forfeiting his rights if a claim is brought outside the time period or in the wrong form.

FIDIC Silver Book sets the benchmark by imposing a 28 day period for notification of any claims, but also expressly providing for the contractor to notify all potential claims within a strict time limit from taking over or otherwise forfeiting his rights. This doesn't sit well with defects liability obligations, and potentially forces a contractor into quite an aggressive position of notifying all potential claims upon completion just to preserve his rights.

Whilst EPC contracting may seem like a simple means of transferring risk for an employer, it may ultimately come at a much greater cost later in the project if an imbalanced risk serves only to stimulate disputes.

For more information please contact Robert Blundell, Partner, +44 (0)20 7264 8027, or robert.blundell@hfw.com, or your usual contact at HFW.

HFW offshore wind seminar

On 29 January HFW hosted an offshore wind seminar at our London office. The event attracted delegates from a wide range of market participants and involved discussion on many of the key contractual challenges facing this emerging niche industry.

HFW organised the event with the aim of fostering thought leadership in advance of the procurement process for the UK Round Three contracts. The issues discussed at the event are summarised below.

The possibility of a move towards EPC/turnkey contracts was discussed in the context of the inevitable seam risk that exists where WTGs, foundations and cabling are all currently procured using parallel contracts creating a number of interfaces. It was recognised however that this was probably not the wish of project sponsors, nor were the particular benefits of adopting a classic EPC model – with a single EPC contractor – appropriate to the industry.

There was some discussion about whether there would be support in the industry for a hybrid procurement route. This would involve a split between smaller "turnkey" packages, perhaps led by a foundation or turbine contractor who takes on procurement and co-ordination responsibility for the remaining part of the other works, but not the satisfaction of outputs of the other part. Suppliers raised concerns as to the scope for costs to be reduced where excessive control over the design and procurement of the project was retained by project companies. Difficulties reducing costs were exacerbated by unrealistic standards, such as excessive cable burial depths being maintained.

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MAX WIELICZKO

The forms of contract available in the market was a subject of debate. It was generally thought that there needed to be better developed procedures for collaborative management of risks, including for rapid, contemporaneous resolution of disputes. Existing forms based on a strict, yet broad, allocation of risks are considered too adversarial by many participants.

Delegates considered whether the unconventional procurement policies adopted by the main developers of offshore wind across Europe were adequately transparent. Concerns were raised that without transparency of costs of successful bidders and tender evaluation criteria for offshore wind, suppliers were not provided with information that would let them learn and improve on future tender submissions.

For the majority of contracts to date, the risk of "normal" adverse weather (as opposed to exceptionally adverse), in one form or another, has been passed to the supplier. With the arrival of larger and more remote developments, the question was raised as to whether the necessary allowances that would inevitably need to be made in the contract were either necessary or affordable.

One of the main concerns, which will not be of any surprise in the construction industry as a whole, was a fear that developers were not taking enough time to work with the supply chain to develop the design and to de-risk the procurement of offshore wind. In particular, the novel nature of co-ordinating new ways of working far offshore will mean that early supplier involvement will be key to reducing risk and cost. There was also a discussion as to the need to challenge traditional thinking on the best way of carrying out certain activities, such as cabling.

It was acknowledged that the UK still needs more suitable port infrastructure to facilitate handling, onshore manufacturing and servicing activities for the new remote developments.

This particularly affects foundation component manufacture. There was thought to be an element of "chicken and egg" with ports being unwilling to invest without a supply chain, and UK subcontractors not establishing themselves without suitably modified port facilities.

The standards of health and safety in the offshore wind sector have come on in huge steps over the last five to ten years, and this is welcomed in the industry, but still great leaps have to be made in the sector to achieve the levels of operation found in the oil & gas industry.

The seminar proved to be an ideal opportunity for discussing the risks and to share experiences with participants from across the industry. HFW plan to host such an event annually so as to promote ongoing discussion in the industry on these important contractual issues.

For more information please contact Max Wieliczko, Partner, on +44 (0)20 7264 8036, or max.wieliczko@hfw.com, or your usual contact at HFW.

Conferences and events

LNG Seminar
Perth
13 March 2014
Presenting: Nick Longley and Matthew Blycha

APRAG Conference
Melbourne
28 March 2014
Presenting: Nick Longley
Attending: Chris Lockwood and Damian Honey

Society of Construction Law
Cambridge, UK
8 April 2014
Presenting: Michael Sergeant

LNG Seminar
Singapore
10 April 2014
Presenting: Chanaka Kumarasinghe and Matthew Blycha

EPC Contracts Seminar
Seoul
23 April 2014
Presenting: Nick Longley and Max Wieliczko

Informa Conference: Subsea Cabling Contracts
Kensington Close Hotel, London
30 April 2014
Presenting: Robert Blundell

Quarterly Construction Law Seminar
HFW London
1 May 2014
Presenting: Michael Sergeant and Robert Blundell

SCL Gulf
Dubai
19 May 2014
Presenting: Michael Sergeant

Society of Construction Law
National Liberal Club, London
3 June 2014
Presenting: Michael Sergeant

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