

CONSTRUCTION BULLETIN



Welcome to the September edition of our Construction Bulletin.

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

- **NEC3: what documents take priority?** Richard Booth examines a recent English Court of Appeal judgment providing helpful guidance on how to resolve contract inconsistencies in the description of the scope of works.
- **Clutching at straws:** Robert Blundell considers a recent case relating to the enforcement of an arbitration award in relation to a project in Dubai.
- **Demands under performance bonds:** Matthew Blycha considers some of the key issues relating to performance security and particularly calls on such security.
- **Sanctity of contract rates:** James Plant examines when contract rates will be binding on the parties when valuing variations.

The inside back page of this Bulletin contains a listing of the events at which members of the HFW construction team will be speaking 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



hfw NEC3: what documents take priority?

A recent English Court of Appeal case has confirmed that the courts will try to make sense of a contract by reading contract documents together as setting out the commercial intention of the parties. An order of priorities clause will only be referred to in the event of an irreconcilable difference.

Construction contracts often incorporate a number of documents which can result in internal inconsistencies leading to a dispute. If internal inconsistencies exist a party should give effect to the contract as a whole, endeavouring to reconcile conflicts using the common law rules of construction. If a difference remains then an “order of priority” clause may provide for certain documents to prevail.

The use of such a clause was considered in the recent Court of Appeal decision of *RWE Npower Renewables Limited v J N Bentley Limited*¹ which was an appeal of Mr Justice Akenhead’s decision in the Technology and Construction Court.

A dispute had arisen under an amended NEC3 Engineering and Construction Contract incorporating Option B and secondary options X5 and X7 providing for sectional completion and liquidated damages.

The dispute was the extent of JNB’s obligation to complete certain pipelines for Section 2 of the works. The ‘Contract Data Part One’ document required completion of “such” of the pipelines as would be “necessary” to allow hydro plant to be installed. Whereas, the ‘Works Information’ document required the pipelines to be fully completed.



This case is a useful reminder that it is unnecessary to refer to a priorities clause if the documents can be read together as expressing the parties’ intentions in a clear and sensible way.

RICHARD BOOTH, ASSOCIATE

An order of priority clause had been included in the contract agreement which stated “*the following documents are deemed to form and be read and construed as part of this Agreement in the following order of precedence...*”.

JNB argued that the two documents contained irreconcilable differences so that the priorities clause engaged, meaning that the Section 2 work required was determined by ‘Contract Data Part One’ (i.e. only part of the pipelines). RWE did not agree and commenced court proceedings seeking a declaration that the pipelines had to be fully completed and tested.

RWE submitted that if the contract was construed as a whole then it did not contain an internal inconsistency requiring the priorities clause to be engaged. JNB argued that it was necessary to refer to the priorities clause because there were clear and largely irreconcilable differences.

Mr Justice Akenhead agreed with RWE that it was unnecessary to refer to the priorities clause because “*...this is a contract which is to be construed in the usual way by reference to all the documents forming part of the contract. It is only if there is an*

ambiguity or discrepancy between one or more contract documents that one then needs to have regard to the order of precedence” and issued a declaration that JNB had to complete and test all the pipelines for Section 2.

JNB appealed and the Court of Appeal unanimously dismissed the appeal on the basis that the contract documents should be read as complementing each other as far as possible and “*only in the case of a clear and irreconcilable discrepancy would it be necessary to resort to the contractual order of precedence*”.

This case is a useful reminder that it is unnecessary to refer to a priorities clause if the documents can be read together as expressing the parties’ intentions in a clear and sensible way. Only if an irreconcilable discrepancy remained would it be necessary to utilise the priorities clause and, even then, precedence is only to be considered for the discrepancy and is not to be used to choose an entire clause or document over another.

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1 [2014] EWCA Civ 150



hfw Clutching at straws

A recent decision in the Technology and Construction Court (TCC) has highlighted the difficult situation a party may find itself in if it raises new technical points late in proceedings to escape liability. Such arguments may get short shrift from the court.

When seeking to enforce an international arbitral award, there is a longstanding rule that it will be enforced by a competent court of a country which is a signatory to the New York Convention. Most countries in the world are signatories.

Only on six limited grounds can a court choose to decline to enforce an award. And although expressed as a choice, realistically if any of these circumstances does arise a court would almost certainly decline to enforce. These express grounds are set out in Section 103 of the Arbitration Act 1996. A further ground is also reserved for the court to decline to enforce if to do so would be “contrary to public policy”.

Meydan had procured works at the Dubai Racecourse in 2008 for which



Allegations that the underlying contract was void for having been procured through bribery were completely new and there was no convincing reason why they should not have been raised before.

ROBERT BLUNDELL, PARTNER

Honeywell was to be engaged as a subcontractor. After time, relations between Meydan and its main contractor soured and that relationship was terminated. Honeywell was then retained directly to carry out the installation of a low voltage electrical system.

When a dispute arose between the parties, Honeywell referred the matter to the Dubai International Arbitration Centre (DIAC) and won an award after Meydan refused to participate for technical reasons. Honeywell applied successfully to the TCC for enforcement of the award in the UK.

Meydan tried to have the TCC Order set aside by citing eight issues which between them called upon all six of the express grounds, and it also called upon the court to invoke general rules of public policy to stop the enforcement. As the Order had already been granted, a hearing was held to decide whether the application had a realistic prospect of success.

Claims brought under s.103 will merit a degree of analysis and examination of evidence, but it is disproportionate to hold a full trial of the matters. To do so could result in a situation where an applicant seeking to enforce an award (which may have already been fought over long and hard) then needs to jump through unnecessary additional hoops to seek enforcement.

The procedure adopted by courts is, as a result, very similar to the rough and ready approach used in assessing

summary judgment applications. The court will need to assess whether there is a real prospect of a party establishing one of the grounds for refusal, or if there is some other compelling reason why the matter should have a full trial.

The TCC took quite a dim view of the issues raised. Allegations that the underlying contract was void for having been procured through bribery were completely new and there was no convincing reason why they should not have been raised before.

Similarly, technical arguments on the exact identity of the respondent party had already been rehearsed and dismissed in previous exchanges and so were not considered persuasive by the court. The fact that the original arbitral award was being contested in the Dubai courts was regarded as immaterial to the enforceability of a DIAC award.

Appeals to the court to invoke doctrines of public policy also failed. Even the bribery allegation was disregarded on the basis that this would not render the contract unenforceable, merely that Meydan would be able to void the contract and claim damages.

Where a party is obliged to take part in an arbitration it should consider as early as possible the various grounds that it may seek to raise at a later date to prevent enforcement of an award should the need arise. Where the award comes out of uncontested proceedings the belated appearance of new reasons why the award should not be permitted are unlikely to get any sympathy in court.

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hfw Demands under performance bonds

Bank guarantees, banker's undertakings and performance bonds are all types of security that are offered by contractors to employers. Though differently described, and quite often different in form, they are given for the same purpose. That purpose is to provide protection to an employer in the event of a default of the contractor or the contractor's insolvency.

Making a demand on a contractor's security of this sort generally signals the death of the relationship between an employer and contractor. Such situations arise infrequently, though it is important to know where you stand if a demand is on the horizon.

Taxonomy

The term 'performance bond' is used here to refer to all types of bonds that are contractually required to be issued by a contractor and which are payable on demand. This term is used for convenience and it is equally common for a performance bond to be described as a "performance guarantee" or, as mentioned above, a bank guarantee. However, these documents are not guarantees; they are primary obligations which lie with the issuing bank or surety, and operate entirely independently of the underlying construction contract. Similarly, the term "performance" is something of a misnomer, as the obligation to pay exists irrespective of the performance or non-performance of the contractor.

The term 'performance bond' is used to capture all forms of bonds that are intended to be irrevocable, unconditional and payable on demand.

As good as cash

The intent of the terms "unconditional" and "on demand" is to indicate that proof of default under the construction contract is not required in order to enforce the performance bond.

With this in mind, performance bonds are often seen as being as good as cash in the sense that, at any time and for any reason, an employer can issue a demand and receive payment.

In theory this is how performance bonds operate, though there are a few practical issues to be borne in mind when drafting performance bonds, and also when considering whether to make a demand.

Making a demand

In the context of a construction contract, making a demand on a performance bond is a significant event. A demand will have an immediate and (often) sizeable impact on a contractor's finances. It is also common that the market in which the contractor and employer operate will learn that a demand has been made and this can have consequences for each party's reputation.

If a decision is made to call on a performance bond it is usually advisable to move quickly to make the demand. The requirement for speed arises as the contractor who provides the performance bond is generally aware that a demand could be made, and as a result, will often take steps to prevent the proceeds of any demand finding their way to the employer.

The most common step taken by contractors in this situation is to head to court to seek an injunction, that is, a court order that either the employer be restrained from making a demand on the performance bond, or, that the issuer of the bond be restrained from paying the employer. Timing becomes crucial if an injunction is sought as

a delay of a few days or even hours could result in the demand being made and funds being transferred to the employer (it is for this reason that contractor's often seek to be given advance notice before an employer can issue any demand; a few hours is all that can be needed to instruct lawyers and rush to court).

Courts will not prevent a party calling on a performance bond or receiving the funds under a performance bond unless the party in whose favour the performance bond is given is acting fraudulently or unconscionably, or, more commonly, because the party has made a contractual promise not to call on the bond.

Does the contract prevent a demand being made?

Making a demand on a performance bond is not simply a matter of completing a demand notice and awaiting payment (though more on this below). It is first necessary to understand whether the contract permits such a demand being made.

Courts take the view that if a party in whose favour the performance bond has been given has made a contract promising not to call on the performance bond, breach of that contractual promise can be prevented by injunctive relief. For example, if an underlying contract states that demands can only be made where there has been a material default of the contractor, if there has been no such material default and a demand is made purely for the convenience of the employer, a court can restrain the employer from making any demand on the performance bond. This restraint will apply notwithstanding that the bond itself is described as being unconditional and payable on demand. Courts grant injunctions in this situation principally because the demand is not made in good faith, and to permit the demand being made would see the court actively permit a breach of contract.



Making a demand on a contractor's security of this sort generally signals the death of the relationship between an employer and contractor. Such situations arise infrequently, though it is important to know where you stand if a demand is on the horizon.

MATTHEW BLYCHA, PARTNER

In the case of *Clough Engineering v Oil & Natural Gas Corp Ltd*¹, the construction contract stated that the performance bond could be called "in the event of the Contractor failing to honour any of the commitments entered into under this contract".

The contractor sought to restrain the employer's demand on the performance bond arguing there was a genuine dispute about whether the contractor had in fact failed to honour its commitments. The court ultimately held that the demand could be made but did so by looking at both the construction contract and the wording of the performance bond (which stated that payment should be made "notwithstanding any disputes pending").

The issue encountered above can most easily be overcome if the construction contract expressly deals with when demands can be made. For instance, wording that provides that the employer may have recourse to the performance bond if it believes

that the contractor has not performed its obligations under the contract, and that the contractor will not take steps to restrain the employer from having recourse to the performance bond will go towards ensuring performance bonds are "unconditional and on demand".

Of course, contractors who fear having demands made on performance bonds issued on their behalf should seek to include conditions within the construction contract which specify the circumstances in which a demand can be made. This would provide some ammunition, should the need arise, if a demand was to be made without proper cause.

How is a demand made and paid?

Performance bonds are often explicit in noting that they are payable on demand and without regard to the performance or non-performance of the contractor under the contract. However, they are often less clear about how, in practice, demands are made and how and when monies are to be paid. For instance, performance

bonds often specify demands are to be made "in writing on the bank". Does this mean a demand needs to be made on the bank's head office, or will the local branch suffice? Does the demand need to specify that the contractor has breached the contract, and, if so, what level of detail is required? Is a demand to be physically delivered to the bank or can a demand be made by email? Does the original performance bond need to be presented when making a demand? Can payment be made by cheque and should the original performance bond be released in return for payment by a cheque?

Where the performance bond is silent or unclear on these issues most employers will take steps to ensure their demand is viewed as valid and in compliance with all contractual requirements. These steps can involve locating the original guarantee, having the employer's representative and/or one or more directors sign the demand letter, and hand-delivering the guarantee and accompanying demand on a bank's head office. This process can take time.

It is not suggested that performance bonds be drafted to address each of the procedural issues that could arise in the context of making a demand. However, including a template notice of demand along with the performance bond is sensible. This template can include who can make a demand on behalf of the employer, where demands are to be sent, when payment is to be made and how funds are to be transferred. Addressing these issues can ensure that, once the difficult decision to call on a performance bond is made, the actual process of receiving payment is a mere formality.

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1 [2008] FCAFC 136



hfw Sanctity of contract rates

The rates in a construction contract are central to the commercial bargain between the parties. But do these rates always have to be used when valuing variations?

Most fixed price contracts contain a breakdown of the contract sum from which rates can be extracted or a standalone schedule of rates for valuing changes to the scope of works. Similarly, measurement contracts are centred around a priced bill of quantities or schedule of agreed rates used to determine the final contract sum based on the measured quantities. However, contractors and employers alike will often try to argue that the rates are not applicable when their use results in the contractor being paid more or less than it considers fair.

Fixed price contracts sometimes allow for a 'fair valuation' of variations where it is not possible to extrapolate a rate from the contract sum, and this will typically involve a cost based approach. However, where a fixed price or measurement contract specifies a rate for a particular type of work, the rate is normally considered sacrosanct. The rates are at the centre of the commercial bargain reflected in the contract and parties cannot escape that bargain because they perceive the result to be unfair.

Unless a contract provides otherwise the agreed rates are strictly applicable to additional work where it constitutes 'more of the same' of the type of work contemplated by the contract. It does not matter if a unilateral error was made when fixing the rates, which results in the contractor gaining a windfall



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JAMES PLANT, ASSOCIATE

or suffering a loss. The English Court of Appeal has confirmed that errors in pricing do not enable the parties to adjust the rates (see *Henry Boot Construction Ltd v Alstom Combined Cycles Ltd*¹).

A contractor will sometimes try to claim higher rates where the additional work is not of a 'similar character' or is not executed under 'similar conditions'. Some contracts (e.g. ICE Conditions of Contract 6th Edition) allow for reassessment of rates in these circumstances. However, in the absence of a clause specifically providing for re-rating, changes to the character or conditions may give rise to a loss and expense claim (which must be substantiated), but such changes will not typically allow the contractor to apply new rates.

Similarly, some measurement contracts state that the contract rates will only apply up to a maximum or down to a minimum final measured quantity, or a maximum percentage change to the estimated quantities. If the final quantities are outside these limits, measurement contracts often allow for a reassessment of rates or a fair valuation.

However, where a contract allows for either reassessment of rates or a fair valuation of additional/varied works, this does not mean that the parties can abandon the commercial bargain embodied in the rates altogether. English courts have held that where a contractor becomes entitled to a fair valuation based on rates or actual costs, those rates/costs must be 'tempered' so that they are "*not too far out of line with the contract rates*" (see *Weldon Plant Ltd v Commission for the New Towns*²).

If a party can justify departing from the contract rates, then any fair valuation or reassessment of rates must therefore strive to preserve the essence of the original bargain. So, for example, if a contractor offers rates in its tender that were particularly keen, it may follow that any subsequent 'fair' valuation under the contract should also be on the low side. Conversely, if an employer agrees to pay over the odds under the original contract, a 'fair' valuation could in the circumstances mean a generous valuation when compared to market rates.

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1 [2000] BLR 247

2 [2001] 1 All ER (Comm)



Conferences and events

IBC Construction Law Summer School

Variations under FIDIC contracts
Cambridge, UK
2 September 2014
Presenting: Michael Sergeant

Society of Construction Law

Birmingham, UK
9 September 2014
Presenting: Michael Sergeant

LNG Seminar

Brisbane
18 September 2014
Presenting: Nick Longley and Andrew Dunn

MBL Construction Law Conference

Buildability and Design Risk
London
23 September 2014
Presenting: Michael Sergeant

Lighthouse Club Conference

Hong Kong
27 October 2014
Presenting: Nick Longley and Michael Sergeant

Hong Kong Society of Construction Law

Hong Kong
13 November 2014
Presenting: Nick Longley and Michael Sergeant

CWC Oil & Gas EPC Conference

Dubai
18/20 November 2014
Presenting: Michael Sergeant, Max Wieliczko and Robert Blundell

Society of Construction Law

Bristol, UK
27 November 2014
Presenting: Michael Sergeant

Construction Quarterly Seminar

HFW London
3 December 2014
Presenting: Max Wieliczko and Michael Sergeant

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