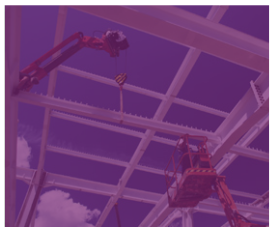
Construction

September 2015

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:

- **FIDIC Red Book right to arbitrate?:** James Plant reviews a recent case concerning a project in North Africa in respect of a contractor's entitlement to arbitrate under the FIDIC Red Book.
- **Extension of time and time bars:** Gerard Moore considers a recent Australian judgment relating to compliance with contractual notice provisions when making EOT claims.
- **Hong Kong security of payment legislation:** Vincent Liu considers the Hong Kong Government's recent consultation paper on proposed security of payment legislation and considers the key elements by reference to other such regimes around the world.
- **Frustration – the radical change in obligation test:** Richard Booth looks at a decision of the Singaporean Court of Appeal which is a rare example of the doctrine of frustration being applied to a construction contract.

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 with 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.

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FIDIC Red Book: right to arbitrate?

A recent case, involving a project in North Africa, has analysed the contractor's right to arbitrate under the FIDIC Red Book.

In this case, the court implied terms into the FIDIC Red Book[1] to prevent an employer from relying on a condition precedent to deny the contractor's right to arbitrate.

In *Al Wadden Hotel Ltd v Man Enterprise Sal (Offshore)*[2] the employer, Al Wadden, challenged the jurisdiction of an arbitrator appointed to determine a dispute under a contract for refurbishment of a hotel in Tripoli. The contractor (Man) had referred the dispute to arbitration when the original engineer under the contract advised that it had ceased to be the engineer under the contract (the Engineer) and would not determine the dispute.

Clause 67.1 of the Red Book required Man to refer any dispute to the Engineer, who was obliged to issue a decision within 84 days. Clause 67.1 allowed Man to refer the dispute to arbitration only after the Engineer had issued his decision or after 84 days had expired. The court held it to be well established law, in relation to arbitration clauses such as this, that the Engineer's decision (or expiry of the requisite period) is taken to be a condition precedent to the arbitrator's jurisdiction.

The original Engineer's response to Man's notice was that he was no longer retained as Engineer and would not issue any decision. Man asked Al Wadden to appoint a replacement Engineer. Al Wadden did not, and Man referred the dispute to arbitration *before* the 84 days had expired.

Al Wadden contested the arbitrator's jurisdiction on the basis that, even though there would be no Engineer's decision, Man was still required to wait for the requisite period of time for a decision before commencing an arbitration. The court therefore had to construe the contract to determine if this was really the effect of clause 67.1.

When construing the contract the judge adopted the firmly established approach in *Attorney General of Belize v Belize Telecom*[3] in which Lord Hoffman said:

"There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"

The judge held that, in accordance with the Belize approach and other authorities, certain terms are often implied into construction contracts to determine what the contract could reasonably be understood to mean. Those include implied terms that:

- The parties will cooperate in the performance of the contract.
- Each party will do whatever is necessary to enable the other to perform its duties under the contract.
- No party can take advantage of non-fulfilment of a condition, the performance of which has been hindered by himself.

By failing to appoint a replacement Engineer, Al Wadden had breached the first two implied terms. Al Wadden had also breached express terms of the contract, which required it to engage the Engineer and ensure he performed his obligations.

Al Wadden could not take advantage of Man's failure to obtain a decision from the Engineer to deny its right to refer the dispute to arbitration.

JAMES PLANT, ASSOCIATE

In accordance with the third implied term, Al Wadden could not take advantage of Man's failure to obtain a decision from the Engineer to deny its right to refer the dispute to arbitration. Al Wadden could not enforce the condition precedent and Man was entitled to arbitrate without waiting for the requisite 84 days to expire.

This situation could not arise under the current suite of FIDIC contracts because clause 20 now provides for disputes to be referred to a dispute adjudication board (DAB), and expressly states the consequences of the DAB's refusal to act. Nevertheless, this case remains relevant because the 1987 suite is still preferred by many employers, especially in the Middle East and North Africa.

For more information please contact James Plant, Associate on +971 4 4230543, or james.plant@hfw.com, or your usual contact at HFW.

1 4th edition, 1987
2 [2014] EWHC 4796 (TCC)
3 [2009] 1 WLR 1988

Extension of time and time bars

The recent Australian court decision in *Champion Homes Sales Pty Ltd v DCT Projects Pty Ltd*[1] is a useful illustration of the issues that arise in relation to contractual notice provisions when assessing the merits of extension of time (EOT) claims.

DCT Projects Pty Ltd (DCT) engaged a builder, Champion Homes Sales Pty Ltd (Champion), to build eight townhouses in Sydney. The works were delayed and Champion made a number of claims for variations, which led to disputes between the parties. As a result, Champion suspended work. These disputes were settled, but further disputes arose and Champion suspended work on another three occasions. The relationship between the parties broke down completely, with both parties arguing that the other had repudiated the contract.

There were a number of issues arising in this dispute. Champion claimed that it was entitled to EOTs for the variations it had carried out, whilst DCT claimed liquidated damages for delay. Under the contract, Champion was entitled to an EOT if the works were delayed by a cause beyond its sole control. However, the contract required Champion to give written notice to DCT of the cause of delay (and the EOT claimed) within 10 working days of becoming aware of both "*the cause and extent of the delay*".

DCT had two main defences:

- That Champion had failed to comply with the contract's notice requirements and the claims were therefore time-barred.
- That in any event, EOTs should be calculated by reference to the critical path but, since the contract program had been abandoned, this was not possible.

The New South Wales Supreme Court largely sided with Champion. It decided that in respect of many of the EOT claims reliant on variations, Champion had complied with the contractual notice requirements. The contract required Champion to claim an EOT within 10 working days of becoming aware of both the cause and extent of the delay. Although some notices may have been issued 10 days after Champion had known the cause of the delay, it may only become aware of the extent of the delay after the varied work was completed. It also concluded that since the question of whether delay occurred, and who was responsible for causing it, is a factual issue - it is not necessary to have a program in order to make an assessment.

The case highlights the importance of reviewing the precise contract terms when it comes to considering the merits of EOT claims. Although under many standard form contracts Champion's claim for an EOT would have failed because the notices were late, under the terms of this contract the contractor was given greater leeway. The contract allowed a notice of a claim to be given a significant time after the variation was instructed and indeed after the varied work had begun. Consequently, the employer was deprived of the benefit of the notice provision, even though the purpose of such a provision is to give an employer the opportunity to assess the effect of the variation instruction from both a cost and time perspective before it is confirmed.

Employers would be best advised to draft their contracts to require contractors to make EOT claims as early as practicable or at least to require a contractor to give notice when it becomes aware that the variation may cause delay. The employer would then have an opportunity to consider the effect of any variation in context and either reconsider or instruct delay mitigation measures.

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GERARD MOORE, ASSOCIATE

1 [2015] NSWSC 616

hfw Hong Kong security of payment legislation

Since the United Kingdom introduced statutory adjudication and payment legislation nearly 20 years ago, many other jurisdictions, including Australia and Singapore, have followed suit. Hong Kong is now gearing up with its own proposed security of payment legislation.

In 2012, the Hong Kong Government established a working group of 14 industry stakeholders to evaluate options for security of payment legislation. A consultation paper was issued by the working group on 1 June 2015 setting out key aspects of the proposed legislation, with interested parties being invited to give comments by 31 August 2015.

The aim of any such legislation is two-fold. Firstly, to stop unjustified delay of cash flowing through the supply chain by seeking to ensure that contractors and subcontractors have a right to periodic payments. For example, a comprehensive and industry wide survey in 2011 on payment practices in the local construction industry reported that 45% of main contractors and 57% of subcontractors experienced serious delays to payment. Secondly, to introduce a fast track dispute resolution process to ensure problems are resolved quickly during a project.

Scope

The proposed legislation will apply to contracts related to construction activities carried out in Hong Kong regardless of the nationalities of the parties, or the prescribed governing law. It will apply to all contracts entered into by the government for the procurement of construction activities or related services, materials, or plant and subcontracts of any tier. It will also apply to private sector contracts in the same manner but limited to new building works where the original contract value is more than HK$5 million. If a private sector main contract is subject to the legislation, then all lower tier subcontracts will be similarly caught.

The proposed legislation will also apply to professional services contracts but not employment, insurance, guarantee, loan, and investment contracts. Consistent with the legislation in the United Kingdom, the proposed legislation will apply to oral and partly oral contracts.

Requirements concerning payment clauses

Under the proposed legislation, "pay when paid" clauses and clauses of similar effect will be unenforceable. This is the standard position taken in security of payment legislation overseas.

Parties are free to agree payment intervals for progress payments, provided that such intervals do not exceed 60 days for interim payments and 120 days for final payments. Similar provisions are implied in construction contracts which do not provide for payments. This approach is consistent with legislation in New South Wales, Western Australia and Singapore.

Statutory payment claim procedure

Both claiming and paying parties are entitled to claim progress payments by way of statutory payment claims. The statutory payment claim procedure is intended to operate in parallel with contractual payment procedures. The paying party must serve his payment response within 30 days of a payment claim. If the paying party ignores a payment claim, then he will not be able to raise any set off or counterclaims during an adjudication. The proposed legislation will imply the payment claim procedure operating on a monthly basis into contracts which do not provide any payment provisions.

As the proposed legislation will prescribe the required form and content of payment claims, it is queried whether compliance with such prescribed requirements would determine the jurisdiction of the adjudicator. In New South Wales, adjudicators have been found to lack jurisdiction when the requisite footer was not included in a payment claim.

Statutory adjudications

Statutory adjudication is a process which operates in parallel with other legal and contractual remedies. Even after an adjudication determination has been issued, the parties to a dispute are still entitled to proceed to mediation, arbitration or litigation for final resolution of the dispute. The purpose of the adjudication process is to provide a provisional determination and on account payments so as to keep the cash flowing in a project.

Under the proposed legislation, both parties will be able to refer disputes concerning payments, set off/ deductions and extensions of time to adjudication, but not quantum meruit or breach of contract damages claims. The proposed legislation does not make clear when time disputes arise which may result in disputes concerning an adjudicator's jurisdiction to deal with such disputes.

Within 28 days of non-payment of the amount admitted as due in a payment response; rejection of all or part of a payment claim; failure to serve a payment response; or a time dispute arising, a claiming party may commence an adjudication by serving a notice of adjudication. The notice must set out brief details of the parties, the nature of the dispute and the redress sought. It is queried whether an adjudicator would lack

jurisdiction if an adjudication notice was issued out of time, as is the case in Western Australia where an adjudicator is required to dismiss such an adjudication application.

An adjudicator is then either appointed by agreement, or by nomination by an agreed or default nominating body, such as the Hong Kong International Arbitration Centre, within five working days. The adjudicator is not bound by the rules of evidence and can conduct the adjudication in such manner as he thinks fit. The consultation document suggests that adjudicators should decide matters on documents only, rather than requiring hearings and cross examination of witnesses and experts.

The claiming party must serve submissions together with all supporting evidence relied upon on or before the appointment of the adjudicator. An interesting issue facing the claiming party is that he must provide all submissions and documents and anticipate and address any arguments which might be raised by the paying party as he might not get another chance to address them.

The paying party must respond with his own submissions and supporting evidence within 20 working days, with the possibility of extensions by the adjudicator. This is in stark contrast with the Australian legislation which provides no possibility for extensions.

Paying parties often complain that adjudication is inherently unfair and exposes them to ambush by claiming parties who have had substantially more time to prepare their submissions and evidence. The proposed legislation seeks to address ambush concerns by providing an adjudicator with discretion to extend the deadline for serving an adjudication response and providing that an adjudicator may disregard any submissions or evidence not made in the notice of adjudication which should reasonably have been made earlier. However, the claiming party will always have a strategic advantage as he could simply withhold making his payment claims until they are properly prepared and substantiated (or immediately before a public holiday), and the paying party will still have to respond within the limited timescale of the adjudication.

Adjudications assist the parties in resolving disputes without arbitration or litigation because requiring the making of on account payments helps narrow the gap of the disputes between the parties and provide parties with a provisional determination so that they could better assess their positions.

VINCENT LIU, PARTNER

The adjudicator is required to reach and publish his decision within 20 working days, extendable by the adjudicator up to 55 working days, and in excess of 55 working days if the parties agree. The adjudicator is entitled to resign if he considers that it is not possible to decide the dispute fairly in the time available.

Right to suspend

The proposed legislation also introduces a right for parties to suspend all or part of the works, or reduce their rate of progress in the event of non-payment of a sum determined in an adjudicator's decision or non-payment of an amount admitted as due in a payment response.

Use of statutory adjudications

Adjudications assist the parties in resolving disputes without arbitration or litigation because requiring the making of on account payments helps narrow the gap of the disputes between the parties and provide parties with a provisional determination so that they could better assess their positions. It is hoped that statutory adjudications will become one of the common means of resolution of construction disputes in Hong Kong.

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

Frustration – the radical change in obligation test

The doctrine of frustration discharges parties from further performance of a contract if a supervening event occurs after the contract has been entered. The event must not be contemplated by the contract, or be the fault of either party, and it must fundamentally change the nature of the contract obligation so further performance is impossible.

The doctrine of frustration is an exception to the norm of sanctity of contract and only applied in exceptional circumstances, where there has been a radical change in obligation. In the context of construction contracts, the successful application of the doctrine is unusual. This is because the risk of supervening events is normally expressly allocated, so that it cannot be described as unforeseen and performance (although more onerous and costly) has not become impossible.

The doctrine was however recently applied in a Singaporean construction case. In *Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd*[1] the appellant, Alliance, was a ready-mix concrete (RMC) supplier. The respondent, Sato, was a contractor. Alliance entered into three contracts with Sato for the supply of RMC for three Singaporean projects.

Shortly after entering the supply contracts, the Indonesian government implemented a ban on the export of sand to Singapore (the Sand Ban). To reduce the Sand Ban's impact, the Singaporean government agreed to provide sand from its own stockpile to contractors with ongoing Singaporean projects.

Sato initially drew sand from the stockpile, but a shortfall in the sand provided to Alliance soon developed. The parties disagreed over the cause. The underlying issue, however, was the increased cost of RMC production which Alliance was unwilling to bear.

The dispute came before the Singaporean courts. Sato said that the original RMC contract prices applied. Alliance, on the other hand, said that the contract had been frustrated and insisted on new prices.

The key issue for the court was whether the Sand Ban constituted a supervening event, such that the contracts had been frustrated. This depended on whether the parties had both contemplated that Indonesian sand would be used for the RMC.

The judge at first instance was not persuaded that the Sand Ban was a supervening event, and therefore found that the contracts had not been frustrated. This was because it was not a term of the contracts that sand had to come from Indonesia, Alliance could have sourced sand from other countries. He found that Alliance could have continued to supply RMC, but was unwilling to do so unless Sato agreed to the higher price for the RMC.

On appeal, the Court of Appeal held that the contracts had been frustrated. On the facts the court was persuaded that both parties contemplated Indonesian sand would be used, even though it wasn't stated in the contracts. The Sand Ban was a supervening event not within the parties' reasonable control.

It reached this decision even though technical performance of the contracts was possible. It reasoned that the "*contracts can no longer justly be said to be the same as that which was originally entered into by the parties*". The idea of justice and fairness as it relates to frustration is not a general concept. It only applies if an external event has rendered further performance so "*radically or fundamentally different*" from that originally contemplated.

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RICHARD BOOTH, SENIOR ASSOCIATE

The mere increase in cost will not constitute a frustrating event – even though a party may consider it unjust or unfair. An astronomical increase in cost might be sufficient, but such considerations are usually academic for construction contracts that usually allocate the risk of price fluctuations.

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1 [2014] SGCA 35

Conferences and events

IBC Construction Law Summer School
Variations under FIDIC Contracts
Cambridge, UK
9 September 2015
Presenting: Michael Sergeant

LEADR-IAMA Congress
Enforcement of Arbitration Awards in Asia
Adelaide: 15 September 2015
Perth: 18 September 2015
Melbourne 25 September 2015
Presenting: Nick Longley

MBL Construction Law Conference
London
1 October 2015
Presenting: Michael Sergeant

The Property Congress 2015
Property Council of Australia
Gold Coast, Australia
18-20 October 2015
Attending: Carolyn Chudleigh, Kendra McKay, Stephanie Lambert

Hong Kong Institute of Surveyors
Proposed Security of Payment Legislation
Hong Kong
31 October 2015
Presenting: Vincent Liu

Property Council Academy
Legal Framework – Transport Oriented Developments
Sydney, Australia
12 November 2015
Presenting: Carolyn Chudleigh

CIOB and Hill International Construction Master Class
Qatar
16 & 17 November 2015
Presenting: Michael Sergeant

Society of Construction Law
Variations & Claims
Reading, UK
24 November 2015
Presenting: Michael Sergeant

HFW Quarterly Seminar
Review of 2015 Construction Law Developments
HFW London office
24 & 26 November 2015
Presenting: Michael Sergeant, Richard Booth, Katherine Doran

FIDIC Users' Conference
London
1 & 2 December 2015
Presenting: Michael Sergeant and Max Wieliczko

HFW Annual Offshore Wind Conference
HFW London office
25 January 2016
Presenting: Max Wieliczko, Michael Sergeant, Robert Blundell

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