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CONSTRUCTION BULLETIN
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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, including:

- NEC aims global with new NEC4 contract
- Landmark UK court decision on design liability
- How to successfully limit your contractual liability
- FIDIC's Sub-Clause 20.1 under common and civil law

The inside back page of this bulletin contains a listing of the events at which the members of the construction team will be speaking over the upcoming months.

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DANIEL JOHNSON
ASSOCIATE

"The common law concept of "indemnity" has been removed from the risk and insurance section because it has a specific meaning under English law. It is replaced with references to "recovery of costs" from the party "liable". Other provisions commonly found in international contracts have been added such as one that deals with bribery and corruption."

NEC aims global with NEC4

The NEC4 suite of contracts was revealed earlier this summer amid much fanfare, with NEC making its global ambitions clear. We consider how NEC is targeting international projects and regions where FIDIC has traditionally been widely used.

Building on UK success

NEC says the NEC4 update is "evolution and not revolution". This is perhaps no surprise given the success of NEC3 in the UK. It has been widely adopted as the UK public sector contract of choice, boasting use on the largest UK infrastructure projects of recent times, including London Crossrail and the 2012 Olympics.

Building on NEC3's success in the UK, NEC4 retains the key principles of previous editions. The ethos is one of partnering, risk sharing and pro-active project management by the client (via the project manager) embodied by the NEC philosophy of "mutual trust and co-operation".

Further, as the NEC are keen to point out, its approach of using plain English and the present tense, makes NEC contracts both easy to translate and easy to understand by those who speak English as a second language.[1] This feature is retained for NEC4.

NEC4 changes targeting international use

So, if the underlying principles are the same, and NEC has always been suitable for international use, what has changed?

While there are new additions to the suite including a Design Build and Operate (DBO) form and an alliance contract, there is no major overhaul.

Instead, there is an active shift to make NEC4 more user-friendly internationally. Terms have been updated to provide familiarity for new users. Gone is some of the old terminology. "Employer" is replaced with "Client". "Works Information", "Service Information" and "Goods Information" are replaced and "Scope" is used throughout.

The common law concept of "indemnity" has been removed from the risk and insurance section because it has a specific meaning under English law. It is replaced with references to "recovery of costs" from the party "liable". Other provisions commonly found in international contracts have been added such as one that deals with bribery and corruption.

There is a new dispute avoidance option W3, to be used where the UK mandatory adjudication legislation does not apply. It involves the formation of a dispute avoidance board (DAB) with the power to make non-binding recommendations. Again, this is consistent with an appeal to international clients, who may be more familiar with DAB processes such as those under FIDIC.

Is NEC4 destined for world domination?

In many regions, such as the Middle East, FIDIC has long been the go to contract. While NEC4 is no major overhaul, NEC is using its latest update as a platform to focus its marketing internationally and to challenge the FIDIC strongholds.

Will this marketing strategy reap success? A browse of the NEC website reveals NEC already has impressive endorsements from the governments of Hong Kong and South Africa. Further, NEC cites increasing use of its contracts in public projects in jurisdictions including Australia and New Zealand. Yet, it is noticeable that these are all English-speaking and largely common law countries.

World domination may still be some way off, but we will watch with interest to see if with its savvy marketing and renewed emphasis on international projects the NEC is able to make ground on FIDIC on the global stage.

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1. NEC Whitepaper, *"NEC4: The next generation. An explanation of changes and benefits."*

Landmark UK court decision on design liability

The Supreme Court in Højgaard would not dilute a fitness-for-purpose warranty, but it did say that a 20-year warranty might be significantly less valuable.

Højgaard[1] was about defective foundations for off-shore wind-farms where the contract contained two competing standards. One required the works to be carried out with reasonable skill and care and in accordance with international standards and the other provided that *"the Works as a whole shall be fit for purpose as determined in accordance with the Specification using Good Industry Practice"*. Good Industry Practice itself was defined as reasonable skill and care, with reference to international standards.

The Contractor complied with J101, an international design standard, which was specified in the Technical Requirements (TR) but was flawed, resulting in the failure of the grouted connections to the monopiles. Was the Contractor in breach, notwithstanding that it used Good Industry Practice and followed J101?

At first instance, it was held that the Contractor breached the fitness for purpose standard, as set out in the TR notwithstanding its compliance with J101. However, the Court of Appeal held that the fitness for purpose requirement, when defined by reference to an industry standard, did not create an absolute warranty of suitability. Ultimately, the Supreme Court found that J101 was actually only a *"minimum requirement"* as stated elsewhere in the TR, and so there was no inconsistency with it and the fitness for purpose requirement. The Supreme Court also observed that, in design-build type scenarios, if there are two competing standards, the more onerous fitness for purpose requirement is likely to prevail. On this basis, an express obligation to construct work to a specified performance criteria would override an inconsistent obligation to comply with a specification.

The TR stated that the design was to *"ensure a lifetime of 20 years in every respect without planned replacement"*. On the face of the wording, this warranted that the foundations would have a lifespan of 20 years – something that might be considered to be an operational life warranty. The Supreme Court noted that the requirement that this 20 year requirement was either a warranty that the foundations would have a 20 year lifetime or that the foundations would be designed to have a lifetime of 20 years. There is a subtle but important difference between the two.

Although it did not need to decide in *Højgaard* which was correct because *"it was breached whatever meaning it has"*, the Supreme Court indicated its preference for interpreting the 20 year requirement as a contractual term that the foundations will be designed to have a 20 year lifetime. Crucially, this was based, not only on the wording of the specific 20 year requirement, but on the interpretation of the contract as a whole. This interpretation was consistent with the exclusive remedies provision: *"EON's ability to invoke its right ... would not depend on EON appreciating that the foundations were failing (within 24 months of handover) but on EON appreciating (within 24 months of handover) that the design of the foundations was such that they would not last for 20 years"*.

Therefore, in this case, what might have seemed to be a 20-year lifetime warranty was construed by the Supreme Court as more likely to be of more limited effect.

For a more detailed commentary of the Supreme Court decision, and practical guidance, please refer to our earlier briefing A Supreme Judgment that's Fit for Purpose[2].

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"At first instance, it was held that the Contractor breached the fitness for purpose standard, as set out in the TR notwithstanding its compliance with J101. However, the Court of Appeal held that the fitness for purpose requirement, when defined by reference to an industry standard, did not create an absolute warranty of suitability."

1. *MT Højgaard A/S (Respondent) v EON Climate & Renewables UK Robin Rigg East Limited and another (Appellants)* [2017] UKSC 59
2. http://www.hfw.com/A-Supreme-judgment-thats-fit-for-purpose-August-2017

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"Employers might think this is a bonus – the higher the liability cap, the more they can hope to recover. But if a contractor cannot afford to bear that level of uninsured loss, thereby leading to insolvency, the employer's recovery will be limited anyway, as a matter of fact, and the project will be riskier for everyone."

How to successfully limit your contractual liability

Limiting your contractual liability enables you to manage risk, keep prices competitive, and limit financial exposure in the event of a claim. It also means adequate insurance or other security is in place if things go wrong.

This article covers ways in which contracting parties can limit exposure, as well as some common pitfalls, which mean that certain liability caps might not be worth the paper they are written on. I have used the NEC4 ECC, FIDIC White Book and IChemE Silver Book, all published in 2017, to illustrate where the market is today[1].

Liability Caps

The most obvious way to limit financial liability is to include an express liability cap in your contract. Liability may be capped at a specified figure, as a percentage or multiple percentages of the contract price. See, for example, the FIDIC White Book:

"The maximum amount of damages payable by either Party to the other in respect of any and all liability, including liability arising from negligence, under or in connection with the Agreement shall not exceed the amount stated in the Particular Conditions."[2]

The NEC4 ECC adopts a similar approach at Option X18.5, limiting liability to an amount specified in the Contract Data. Another approach is to cap liability at the level of PI cover, as with the RIBA Standard Form of Appointment used for Architects in the UK.

When negotiating liability caps there are various factors to consider. Firstly, is it a 'per claim' cap, or aggregate? To ensure certainty, this needs to be expressly set out. For example *"The total aggregate liability of the Consultant to the Purchaser... shall not exceed [£££]"*[3]

Secondly, are there separate caps for different types of losses? And are these included in the general cap or not? NEC4 ECC for example separately caps consequential loss, damage to property and latent defects.

Does the cap apply only to loss or damage under or in connection with the contract? Or, as with NEC4, does it apply to all loss or damage *"whether in contract, tort or delict and otherwise"*?

In the UK, you cannot exclude or restrict liability for death or personal injury resulting from negligence.[4] Other liabilities resulting from negligence can only be capped or excluded if the contractual clause passes the 'reasonableness test'.[5] If you are dealing on standard terms of business (which may, in certain circumstances, include standard form contracts[6]) liability for breach cannot be excluded unless it is reasonable to do so. What is reasonable will depend on the facts. Factors may include bargaining positions of the parties, alternative options available, and whether an inducement was given to agree to a particular term.[7] Also in the UK, liability for fraud cannot be limited.[8]

Middle Eastern Civil Codes allow contracting parties to fix or limit compensation for breach. However, the courts retain a supervisory power. In the UAE, courts can 'vary' contracts to the effect that compensation payable mirrors the loss which was actually suffered. In theory, this would enable courts to set aside liability caps if a much greater loss was actually suffered.[9]

Carve Outs: Traps for the Unwary

When fixing the level of a liability cap, you must carefully consider anything which is excluded from that cap. For example, the FIDIC White Book carves out financing charges, and says that *"manifest and reckless default, fraud, fraudulent misrepresentation or reckless misconduct by the defaulting Party"* will not be included in the cap.

Costs and losses flowing from breach of anti-bribery or corruption provisions might be excluded from a cap, including sums payable on termination (possibly including the costs to complete the works).

1. For an overview of the NEC4 suite of contracts, see Daniel Johnson's article, "NEC aims global with NEC4"
2. Clause 8.3
3. IChemE Silver Book Clause 26.1
4. Unfair Contract Terms Act 1997 ("UCTA"), s. 2(1)
5. UCTA, s. 2(2)
6. *British Fermentation Products v Compare Reavell* [1999] EWHC Technology 227.
7. UCTA, s. 11 and Schedule 2
8. *HIH Casualty and General Insurance v Chase Manhattan Bank* [2003] UKHL 6.
9. In practice, however, the UAE and Qatari courts follow a similar approach where compensation is almost always only reduced, rather than increased.

Another example is indemnities, which are often carved out from limits of liability and can be a trap for the unwary. The IChemE Silver Book, for example, excludes indemnities against third party claims for infringement of IP rights, death, personal injury or property damage[10]. The 2nd edition of the FIDIC Yellow Book, currently in pre-release version, carves out an indemnity from the contractor in relation to *"any errors in the design of the works and other professional services which results in the works not being fit for purpose"*[11], meaning contractors could have unlimited liability for fitness for purpose.

In EPC Contracts, employers often seek to exclude insured losses from liability caps. This means money paid out by Project or CAR insurance will not count towards the liability cap. The rationale is that if the employer pays for the CAR policy, they still want the full benefit of the liability cap. If that is to be the case, it must be reflected in the level of the cap, otherwise contractors might find themselves facing uninsured losses of 100% (or more) of the contract price.

Employers might think this is a bonus – the higher the liability cap, the more they can hope to recover. But if a contractor cannot afford to bear that level of uninsured loss, thereby leading to insolvency, the employer's recovery will be limited anyway, as a matter of fact, and the project will be riskier for everyone.

Exclusion Clauses

In addition to capping liability, you can choose to exclude certain categories of liability altogether. The most common example is consequential losses, such as loss of profit, revenue, business, which are capped in NEC4 ECC, and excluded altogether in the FIDIC White Book and IChemE Silver Book. Particular care is however needed in the drafting of these provisions, especially in light of a recent shift in the judicial interpretation of the term 'consequential losses' in contracts to give it the more natural meaning, as opposed to a restrictive, specific legal meaning which had been the traditional view for many years.[12]

You may wish to exclude categories of loss or damage which are remote, or where the extent of the potential loss or damage is too nebulous to price. Commonly, loss or damage not covered by PI Insurance will also be excluded: asbestos, pollution, contamination and terrorism.

More generally, an exclusive remedies clause in a contract will exclude parties' rights to common law damages, meaning exposure is limited to compensation payable under the terms of the contract.[13]

Other Ways To Limit Liability

While liability caps and exclusion clauses will provide maximum certainty, there are other steps you can take to limit your exposure.

Liquidated damages pre-determine the compensation payable in the event of certain breaches of contract – usually failure to complete on time, or failure to achieve performance or output criteria. Of course, while LDs effectively cap liability, the flip side is that they are payable even if the actual loss suffered is less than the agreed rate – even if the loss is zero.

Where additional costs are claimed under a construction contract, pre-agreeing to fixed rates in BOQs will provide some degree of certainty. Conversely, requiring a claimant to prove the actual cost it has incurred will place a brake on potential exposure. More so if a party is only entitled to recover costs which are *"reasonably incurred and properly vouched"*. Such wording would mean that the party would not only have to prove that the costs were actually incurred, but also that it was reasonable to do so. The FIDIC Red Book achieves this by defining the *"Costs"* which a contractor can claim as: *"all expenditure reasonably incurred (or to be incurred by the Contractor), whether on or off the Site, including overhead and similar charges, but does not include profit."*

Liability can also be limited by restricting the obligations you undertake to deliver. For example, an obligation to use *"reasonable skill and care"* will usually be less onerous than guaranteeing *"fitness for purpose"* or output or performance criteria. Likewise, an obligation to use *"reasonable endeavours"* in order to achieve something is more limited than undertaking to use *"best endeavours"*. Best endeavours require you to incur cost or act in a way which might be contrary to your commercial interests. Reasonable endeavours are more limited, allowing you to balance your contractual obligations against other commercial considerations.

Conclusion

Limits on liability are commonplace in international contracting. However, in the 10 years since the global financial crash, the levels at which these limits are pegged have gradually increased. While employers might be tempted to push for higher caps, this might be false economy if the contractor can't absorb that risk. Similarly, contractors might agree to a high financial cap, only to aggressively restrict their obligations elsewhere in the contract, such that there is little prospect of the cap ever being reached.

When you are negotiating limits on liability, you should consider the value of the contract, your role in the project, and the potential risk if things go awry. Caps fixed at a specific figure will provide greater certainty, but might not be appropriate if a contract will run for a prolonged period, or if the scope of work is likely to change significantly.

You should always take legal advice to ensure limits on liability are properly drafted and enforceable under the law of the contract. It is important to understand the extent of your exposure, and how any limits will interplay with other provisions in the contract.

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10. Clause 26.1
11. Clause 17.6
12. See *Transocean Drilling UK Ltd v Providence Resources plc* [2016] EWCA Civ 372; *Star Polaris LLC v HHIC-PHIL Inc.* [2016] EWHC 2941 (Comm).
13. Sarah Mather's article, "Is your warranty fit for purpose?" discusses how the warranty in *MT Højgaard v EON* [2017] UKSC 59 was interpreted in light of the contract's exclusive remedies provision.

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"[In civil law jurisdiction] Faced with an alleged failure to adhere to Sub-Clause 20.1, a contractor could raise arguments based on a breach by the employer of the principle of good faith[3] or that an employer's reliance on a contractor's failure to give notice in time amounts to an unlawful exercise of a right because the consequences are disproportionate to the harm that will be suffered."

FIDIC's Sub-Clause 20.1 under common and civil law

Contractor's claim notice provisions in Sub-Clause 20.1 are one of the most delicate provisions of the FIDIC contracts to navigate.[1] Their purpose is to require the contractor to submit claims within a specified period so that they can be dealt with efficiently. However, the effectiveness and enforceability of such provisions can be affected by the law the parties have chosen to govern the contract.

Key features of Sub-Clause 20.1 of the FIDIC contract

Sub-Clause 20.1 provides that the contractor must give notice to the engineer for any claim that is related to any extension of the time for completion and/or any additional payment, *"as soon as practicable"*, and within a time limit of 28 days after the date on which the contractor *"became aware, or should have became aware, of the relevant event or circumstances"*. If he fails to give notice within this period, the FIDIC contracts state that the contractor will not be entitled to any extension of time or additional payment. Furthermore, the employer will be discharged from any liability in relation with the said claim.

Common law approach

English law has historically taken a strict approach to time-bar clauses such as these and considers compliance with Sub-Clause 20.1 to be a condition precedent to the contractor's claim for an extension of time and additional payment. This interpretation has recently been confirmed by the High Court in *Obrascon Huarte Lain SA v Attorney General for Gibraltar.*[2] This means that should the Contractor fail to provide the required notice, the contractor will lose its contractual rights and will become barred from claiming any extension of time or additional payment. This potentially provides the employer with a complete defence in case of any claim by the contractor. It can reasonably be expected that this interpretation will be followed in other common law jurisdictions.

Civil law approach

Civil law jurisdictions generally take a more lenient approach. Although the starting point is that the parties are bound by the terms of the contract, a failure to adhere strictly to Sub-Clause 20.1 may not necessarily restrict the contractor's claims from being pursued based on arguments under the governing civil law. The contractor will carry the burden of proof that his claims are valid and are not affected by his failure to meet his notice obligation on time. Faced with an alleged failure to adhere to Sub-Clause 20.1, a contractor could raise arguments based on a breach by the employer of the principle of good faith[3] or that an employer's reliance on a contractor's failure to give notice in time amounts to an unlawful exercise of a right because the consequences are disproportionate to the harm that will be suffered.[4] Finally, most civil codes strictly govern limitation or prescription periods[5] and it may be possible for a contractor to argue that a time-bar provision that contravenes the civil code is unenforceable. Whether these arguments are available, and ultimately successful, will depend on the particular facts and governing law, as well as their acceptance by the relevant court or arbitral tribunal.

Conclusion – the future?

The future second editions of the FIDIC contracts to be published shortly are expected to water down the strict provisions of the current contracts by giving the DAB an element of discretion to override the 28-day notice period where late submission was "acceptable" in the circumstances. If adopted, this might provide some comfort to contractors but is not without its own uncertainty as to when such relief may be available.

Irrespective of jurisdiction, contractors should ensure that they comply with the contractual requirements of Sub-Clause 20.1 to give timely notice on claims in order to avoid any uncertainty.

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1. Red, Yellow and Silver Books published in 1999.
2. [2014] EWHC 1028 (TCC). To alleviate the severe consequences of non-compliance with the time-bar provisions, the judge in this case interestingly adopted a less strict interpretation of the words *"became aware ... of the relevant event or circumstance"*.
3. For example, under Article 246(1) of the UAE Civil Code; Article 172 (1) of the Qatari Civil Code.
4. For example, under Article 106 of the UAE Civil Code; Article 63 of the Qatari Civil Code.
5. For example, Article 487(1) of the UAE Civil Code; Article 418 of the Qatari Civil Code.

Conferences and events

Construction Law Summer School
EPC Contracts and Variations under FIDIC
Cambridge, UK
4 – 7 September 2017
Presenting: Ben Mellors, Michael Sergeant, Richard Booth

UK SCL Seminar
NEC Contract, 'fit for purpose'?
Manchester, UK
18 September 2017
Presenting: Max Wieliczko

HFW Quarterly Seminar
Design Liability
HFW London office
3 & 5 October 2017
Presenting: Michael Sergeant, Richard Booth, Katherine Doran

Adjudication Society Seminar
Multiple Variations in Adjudication
Bristol, UK
4 October 2017
Presenting: Richard Booth

FIDIC Africa Users' Conference
Variations under FIDIC
Livingstone, Zambia
11 – 12 October 2017
Presenting: Ben Mellors, Beau McLaren

CWC Advanced Oil and Gas Contract Negotiations
London
12 October 2017
Presenting: Richard Booth

HFW & Driver-Trett Seminar
Kuwait
17 October 2017
Presenting: Michael Sergeant, James Plant

Subsea Power Cables Seminar
Managing Defects under Cable Lay Contracts
London
18 – 19 October 2017
Presenting: Richard Booth

Property Council Annual Congress
Metro Rails and New Cities
Cairns, Australia
18 – 20 October 2017
Attending: Richard Abbott, Carolyn Chudleigh, Kendra McKay, Stephanie Lambert, Chris Allen, Thomas Wait

Property Council's Property Development Diploma
Legal Framework and Dispute Resolution
Sydney, Australia
9 November 2017
Presenting: Carolyn Chudleigh

CIArb Event for Dubai Arbitration Week
Dubai
12 – 16 November 2017
Presenting: Beau McLaren, Jane Miles

HFW & HKA Seminar
Dubai
27 November 2017
Presenting: Beau McLaren, Jane Miles, James Plant

MIPIM Asia Summit
Hong Kong
28 – 29 November 2017
Attending: Richard Abbott, Carolyn Chudleigh, Kendra McKay, Thomas Wait

FIDIC International Users' Conference
Variations under FIDIC
London
5 – 6 December 2017
Presenting: Michael Sergeant, Max Wieliczko

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