HFW

CONSTRUCTION BULLETIN
SEPTEMBER 2019

Welcome to the September 2019 edition of our Construction Bulletin.

In this edition we cover a broad range of recent developments in international construction law, as follows:

- FIDIC's New Emerald Book for Underground Works
- Construction Industry Reforms in Australia and the United Kingdom
- Notices and Valuation of Variations
- Conspiracies and Contract Administrators

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.

Michael Sergeant, Partner michael.sergeant@hfw.com

JULIE-ANNE PEMBERTON
REGISTERED FOREIGN LAWYER

"The Emerald Book has the potential to be used for subsurface and tunneling works in projects in various sectors including energy, transport, and urban infrastructure, particularly where such works involve significant geotechnical uncertainty."

WE'RE NOT IN KANSAS ANYMORE – FIDIC BREAKING NEW GROUND WITH THE INTRODUCTION OF THE EMERALD BOOK FOR UNDERGROUND WORKS

In May 2019 the Fédération Internationale des Ingénieurs-Conseils (FIDIC), together with the International Tunnelling and Underground Space Association (ITA), launched the "Conditions for Contract for Underground Works" (Emerald Book) as part of its Rainbow Suite of standard form contracts.

The first of its kind, the dedicated standard form contract aims to address the unique risks and challenges peculiar to tunnelling and underground works.

In the past, parties carrying out underground works often modified other standard form contracts to take into account various reports, recommendations, guidelines and checklists published by the ITA, as well as national codes and laws.

Key Concepts

While predominantly based on the 2017 FIDIC Yellow Book Edition, the Emerald Book introduces a number of new concepts particular to subsurface construction projects including:

- an elaborated demarcation of risk allocation; and
- flexible time and remuneration mechanisms.

Balanced risk allocation

Introducing a new model for risk allocation relating to ground conditions, the Emerald Book provides for the use of a Geotechnical Baseline Report (GBR). The GBR (which is provided by the employer at the tender stage, and later incorporated into the contract) describes the anticipated ground conditions and reaction(s) of the ground to excavation and lining works under the contractually agreed construction methodology. The risk of anticipated ground conditions or adverse reactions are assigned to the contractor. Equally, any ground condition or adverse reaction that is not identified in the GBR will be considered 'unforeseeable', with the risk borne by the employer.

The employer is also required to disclose all available geological and geotechnical information.

Flexible time and remuneration mechanisms

Recognising that the time for completion of underground works is often affected by unforeseen ground conditions, the Emerald Book incorporates contractual mechanisms which allow for the time for completion to be adjusted if the ground conditions encountered on a project are more or less onerous (as the case may be) than those contemplated in the GBR.

The Emerald Book also provides that the costs of excavation and lining works (which are often dependent on the subsurface physical conditions and adverse reaction(s) to such works) are to be measured and paid using rates and prices set out in the bill of quantities, whereas other works are priced on a lump sum basis. The effect of this is that the employer assumes more of the risk in relation to excavation and lining works than other works.

What to expect?

The Emerald Book has the potential to be used for subsurface and tunneling works in projects in various sectors including energy, transport, and urban infrastructure, particularly where such works involve significant geotechnical uncertainty.

While the new Emerald Book is a welcome development, given the inherent complexities with tunneling and underground works, parties who wish to use the Emerald Book should obtain appropriate advice to ensure that it is suitable and – if it requires amendment – what amendments are needed.

JULIE-ANNE PEMBERTON
Registered Foreign Lawyer,
Hong Kong
T +852 3983 7695
E julie-anne.pemberton@hfw.com

ANNA FAZZINI
ASSOCIATE

"Parties must understand the scope of their potential liability having now been placed on notice as to the defective nature of certain types of cladding and to potential claims for breach of any relevant duty of care."

CONSTRUCTION INDUSTRY REFORMS IN AUSTRALIA AND THE UNITED KINGDOM

Builders, developers and consultants may all be at risk of legal action commenced as a result of the impending changes to building regulations. This article comments on the status of the Australian and United Kingdom building industries and considers the impact for parties involved in the industry.

Australia

In Australia, significant issues associated with combustible cladding products became apparent in 2014 after the Lacrosse Tower fire in Victoria. It was not until the Grenfell Tower fire in 2017 however, that state and territory governments in Australia took more immediate action and established taskforces to investigate the impact of those issues on the Australian building industry.

Calls for building reforms were recently brought to a head with the evacuation of two residential apartment buildings in New South Wales when structural defects became apparent (Opal Tower in December 2018 and Mascot Towers in June 2019). The Australian government has now committed to a national approach to building regulation, with NSW outlining additional regulations to be introduced later this year requiring building practitioners to be registered, a new duty of care to make it easier for home owners to seek compensation against negligent building practitioners and ensuring all buildings are designed and constructed to plans that comply with the National Construction Code.

United Kingdom

In 2009, six people died in a fire at Lakanal House in South London, partly due to combustible cladding products. In 2013, the jury and coroner advised the UK government to review the building regulations with particular regard to fire safety; there were also calls from the construction industry for clarity and minimum standards. However, by the summer of 2017 the building regulations were yet to be amended. Following the Grenfell Tower fire, an independent expert advisory panel was established to advise the UK government on the steps required to be taken immediately to achieve fire safety.

It has taken almost two years to publish proposals for consultation, with amended building regulations remaining some time away. Whilst the UK government moved quickly to strip the combustible cladding from public housing towers, many private apartments still use the same type of cladding that resulted in the ferocity of the Grenfell Tower fire. Many of the developer-friendly regulations that allowed Grenfell Tower to be built on the cheap remain in place.

Commentary

The response to the tragic incidents in England and Australia has been similar - with the reform process being reactive to dangerous building failures. The Australian reforms to its construction industry appear to be gaining momentum and it is expected the UK reforms will catch up.

In light of these impending changes, builders and developers as well as project consultants must undertake a detailed review of any projects which may have used non-compliant building products or methods to ensure that potential liabilities are identified and actioned accordingly – including the replacement of any non-compliant products. Parties must understand the scope of their potential liability, having now been placed on notice as to the defective nature of certain types of cladding and to potential claims for breach of any relevant duty of care.

It is imperative that builders, developers and consultants take a proactive stance to identify potential risks related to the projects with which they have been involved as the reforms and recent case law make it clear there will be a heavier burden on these parties in the very near future.

ANNA FAZZINI
Associate, Sydney
T +61 (0)2 9320 4625
E anna.fazzini@hfw.com

MICHAEL SERGEANT
PARTNER

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"It is essential that a contractor gives notice in accordance with the terms of the contract, no matter how stringent these terms may be."

NOTICES AND VALUATION OF VARIATIONS

The Hong Kong case of *Maeda v Bauer* deals with the validity of claims notices and the valuation of variations. This judgment contains a valuable insight into how the issues of notices and *"fair valuation"* of variations are treated.

The recent Hong Kong case of *Maeda Corporation and China State Construction Engineering (Hong Kong) Ltd v Bauer Hong Kong Ltd [2019] HKCFI 916*, addresses two thorny issues that often arise in construction projects:

The Notice Issue: will a contractual notice given under one ground of dispute be valid if the resulting claim succeeds on different grounds?

The Valuation Issue: does the term *"fair and reasonable rates"* refer to *the actual cost of the work* (i.e. the cost that the party undertaking the works incurs in completing the works), or the *market rate* (i.e. the rate that the party could charge on the open market for doing the work)?

Background to the dispute

The Employer, MTRC, awarded a contract for the tunnelling works of a rail link between Guangzhou and Hong Kong to the Contractor, a joint venture of Maeda Corporation and China State Construction. The Contractor sub-contracted the diaphragm wall works to a Sub-contractor, Bauer Hong Kong Ltd.

Various disputes arose which were submitted to arbitration. Of the various awards made by the arbitrator, one was the subject of an appeal by the Sub-contractor to the Hong Kong Court of First Instance. The Contractor appealed the Arbitrator's decision on the Notice Issue and the Valuation Issue as questions of law. The task of the Hong Kong Court was to consider whether the Arbitrator's decision was misdirected in law or whether the decision was one that no reasonable arbitrator could reach.

The appeal judgment for this award provides a useful analysis of how common law courts may treat notice and valuation issues in practice.

The Notice Issue

The Sub-contractor encountered unforeseen ground conditions during the project that required it to excavate more rock that it had initially anticipated. The Sub-contractor based its case for payment of additional monies on a variation of its scope of work due to these unforeseen ground conditions. However, it undertook the additional work without complying with the contractual mechanism for variations, which required a formal instruction from the engineer. The Arbitrator found that the Sub-contractor therefore had no right to be paid for the extra work on the basis of a variation mechanism.

However, the Arbitrator found that the Sub-contractor's performance of the extra work gave rise to a valid claim under clause 21 of the sub-contract. This clause contemplated the Sub-contractor recovering its loss and expense for claims, subject to compliance with the notice requirements under sub-clause 21.1:

"... as a condition precedent to the Sub-Contractor's entitlement to any such claim, the Sub-Contractor shall give notice of its intention to the Contractor within fourteen (14) days after the event...".

Further, Sub-clause 21.2 provided that if the Sub-contractor gave notice under sub-clause 21.1, it must submit the *"contractual basis"*, the *"full and detailed particulars"*, and *"the evaluation of the claim"* in writing and within 28 days of the notice date.

Even though the Sub-contractor gave notice on the basis of a *variation*, rather than a *claim*, the Arbitrator found the basis of this notification was not a relevant factor. In the Arbitrator's opinion, the key issue was that the Sub-contractor gave the Contractor notice of the *factual basis* of the claim:

"I consider that both as a matter of sympathy and as a matter of construction, the contractual basis of the claim stated in the Clause 21.2 notice does not have to be the contractual basis on which the party in the end succeeds in an arbitration … It therefore follows that the fact that Bauer have made its claims on the basis of the relevant claim being a Variation or Sub-Contract Variation does not preclude Bauer from making the claim on a new legal basis based on notices given by reference to a different legal basis."

When the case was referred to the Hong Kong Court, the Judge did not agree that interpreting clause 21 should be a *"matter of sympathy"*; it was purely a *"matter of construction"*:

"… however much sympathy the contractor may deserve, Clause 21 employs clear and mandatory language for the service and contents of the notices to be served …".

The judge applied the full force of the stringent notice provisions because this was the *"proper construction"* of clause 21. She found that the Arbitrator's decision to allow the Sub-contractor's claim was *"wrong in law"*.

The Valuation Issue

The Valuation issue emerged from a separate element of the works regarding panels for the diaphragm wall, which the Arbitrator had found to be a variation. The contract included a provision that variations must be valued on a *"fair and reasonable rate or price"*. The Arbitrator valued the works under the variation on a 'cost plus overhead and profit basis'. In doing so, he accepted the Sub-contractor's evidence that the valuation should include an amount for plant and equipment that was in storage, and therefore not in use, during the relevant period of the diaphragm wall works.

The Contractor's position was that the sub-contract did not contemplate the Sub-contractor receiving a windfall for idle plant and equipment. In essence, the question was whether a *"fair valuation"* could include sums for the use (or non-use) of plant and equipment that the Sub-contractor did not own, and for which it did not actually incur any cost.

The Arbitrator found that a 'market rate' analysis was the most suitable:

"Whilst it seems that Bauer [Sub-contractor] *did not have to pay for the items of plant during the period, I am concerned with valuation of a variation and the issue of whether a party has or has not paid for a piece of plant does not determine the issue of the value of the piece of plant. I consider that in valuing the variation it is the "cost" in terms of what it would cost which is the relevant information and that the issue does not depend on questions of payment."*

The Court's task was to decide whether the Arbitrator was wrong in law, or if not, whether his decision was outside the permissible range of solutions open to him. To grapple with this question, the judge considered a number of commentaries on this subject including Sergeant and Wieliczko's *Construction Contract Variations book*. She concluded that *"it appears … that there is no fixed rule as to how variations should be valued"*. Many of the authorities in question acknowledged that the terms *"fair and reasonable"* are not instructive, and that either a 'cost-based or 'market rate analysis' may be employed to value a variation.

The Court also considered the Sub-contractor's submission that the valuation of a variation does not require proof of actual loss, because it operates as a contractual entitlement rather than an assessment of damages for loss.

The Arbitrator's decision therefore stood. The Court concluded that the Arbitrator had not misdirected himself in law in electing to use a 'market-rate' analysis; nor was his decision outside the permissible range of solutions open to him.

Key Takeaways

- It is essential that a contractor gives notice in accordance with the terms of the contract, no matter how stringent these terms may be.
- Where the contract specifies that a contractor's notice must set out the legal basis of the claim, outlining the factual basis is not enough.
- The concept of a *"fair and reasonable price"* is not set in stone. Both a 'cost-based' and 'market-based' analysis may be within the permissible range of methodologies.

MICHAEL SERGEANT
Partner, London
T +44 (0)20 7264 8034
E michael.sergeant@hfw.com

MATHEA McCUBBING
ASSOCIATE

"Contractors may have another string to their bow when dealing with unruly contract administrators!"

CONSPIRACIES AND CONTRACT ADMINISTRATORS

There is a recent trend of contractors seeking to rein in, or seeking relief against, contract administrators – typically where their certifications are considered unfair, incorrect or where the contract administrator is thought to have been unduly influenced by the employer.

Popular thought has long suggested contractors have limited options when dealing with unfair or unreasonable contract administrators. This follows the decision in *Pacific Associates v Baxter*[1], where the Court of Appeal held that the contract administrator in question did not owe a duty of care to the contractor, meaning that a claim in negligence was not possible.[2] Since then, in the absence of a contractual relationship with contract administrators, contractors have been left to rely on employers – either to ensure the contract administrator acts fairly or for relief when they do not.

A line of recent cases, including Palmer Birch[3], suggests contractors could alternatively seek relief by bringing claims in the tort of conspiracy. Palmer Birch concerned two brothers – M and C – who were accused of engaging in a conspiracy to avoid paying a contractor engaged to renovate a house.

M owned the house via a company – SHL – and M set up another company to fund the works – HHL (whose sole shareholder and director was C). A few months into the works, M encountered funding issues and HHL failed to pay two interim certificates. HHL also became engaged in a dispute with the contractor regarding various delays.

Shortly after that, HHL's lawyers wrote to the contractor advising it that HHL had been put into liquidation and purporting to terminate the contract between HHL and the contractor[4]. A new company – solely owned by M – then stepped into HHL's shoes and completed the works. The contractor, unable to pursue HHL, commenced proceedings against the brothers.

The Court held that the brothers had colluded to put HHL into liquidation in order to avoid the contract and having to meet the contractor's claims. M and C were both held personally liable in tort for conspiring to carry out unlawful acts (the repudiation of the contract) with the intention of causing the contractor loss.

Palmer Birch was an extreme case, but it does illustrate that contractors may be able to use the tort of conspiracy to seek relief against third parties – such as contract administrators. To do so, they will need to demonstrate there was a "combination"[5], an intent to harm the contractor, that the parties acted in accordance with the combination and that the acts caused loss and damage. At the very least, contractors may be able to refer to the possible cause of action so as to encourage wayward contract administrators to perform their duties fairly and impartially. Contractors may have another string to their bow when dealing with unruly contract administrators!

MATHEA McCUBBING
Associate, London
T +44 (0)20 7264 8340
E mathea.mccubbing@hfw.com

1 *Pacific Associates Inc and Another v Baxter and Others* [1990] 1 Q.B. 993.

2 In Pacific Associates, the Court of Appeal held that an engineer did not owe a duty of care to a contractor, but acknowledged that whether a duty is owed will turn on "the factual matrix [of the case] including especially the contractual structure against which such duty is said to arise".

3 *Palmer Birch (A Partnership) v Lloyd* [2018] EWHC 2316.

4 The purported termination was held to be invalid, as HHL had no right to terminate the contract at will.

5 An understanding, agreement or combination of two or more people.

LIST OF EVENTS – 2019

BCC: Perspectives on Construction and Infrastructure in the Greater Bay Area
28 August 2019
Hong Kong
Presenting: Carolyn Chudleigh (moderator)

Construction Law Summer School
2 - 6 September 2019
Cambridge
Presenting: Michael Sergeant, Ben Mellors

Belt and Road Summit – Resolving construction disputes on the Belt and Road
12 September 2019
Hong Kong
Presenting: Ben Bury

HFW - Adjudication Society Event
17 September 2019
London
Presenting: Richard Booth

Leaders in Construction UAE
17 September 2019
Dubai
Presenting: Beau McLaren

Global EPC Contract and Risk Management Conference
3 - 4 October 2019
London
Presenting: Richard Booth

HFW Construction Seminar
14 October 2019
Kuwait
Presenting: Michael Sergeant, Kijong Nam, James Plant

CDR Autumn Arbitration Symposium
15 October 2019
London
Presenting: Ben Mellors, Damian Honey

Leaders in Construction Kuwait
16 October 2019
Kuwait
Presenting: Michael Sergeant

Abu Dhabi Dispute Resolution Question Time
22 October 2019
Abu Dhabi
Presenting: James Harbridge

The Chartered Institute of Building – Mitigating Commercial Risk through the Lifespan of a Project
29 October 2019
Abu Dhabi
Presenting: James Harbridge

Leaders in Construction Saudi Arabia
October 2019
Riyadh
Presenting: Beau McLaren

White Paper Construction Contracts Conference
12 November 2019
London
Presenting: Richard Booth

Subsea Power Cables Conference
13 - 14 November 2019
London
Presenting: Richard Booth

HFW Construction Seminar
14 November 2019
Seoul
Presenting: Max Wieliczko, Nick Longley, Kijong Nam

HFW – HKA Offshore Construction Seminar
20 November 2019
Rotterdam
Presenting: Richard Booth, Michael Sergeant, Max Wieliczko, Ben Bury, Ben Mellors, Matthew Blycha, Nick Longley

Property Council of Australia: Legal Framework and Dispute Resolution – Property Development and Construction
21 November 2019
Sydney
Presenting: Carolyn Chudleigh

MBL Construction Law Conference 2019
2 December 2019
London
Presenting: Michael Sergeant

FIDIC International Contract Users' Conference 2019
3 – 4 December 2019
London
Presenting: Michael Sergeant, Max Wieliczko, Ben Mellors

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