CONSTRUCTION BULLETIN
SEPTEMBER 2022

Welcome to the September 2022 edition of our Construction Bulletin.

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

- Boilerplates – Their Importance and the Risks of Getting Them Wrong
- Dispute resolution clauses: Fiona Trust Principle
- Mitigating the Impacts of Cost Escalation
- Should Professional Consultants Provide Certificates?

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

Michael Sergeant, Partner
michael.sergeant@hfw.com

Anna Fazzini, Associate
anna.fazzini@hfw.com

ROXANNE LANGFORD
ASSOCIATE, LONDON

"Boilerplates provide parties with important contractual protections, and the risk of poorly drafted boilerplates is that these safeties are not properly conferred."

BOILERPLATES – THEIR IMPORTANCE AND THE RISKS OF GETTING THEM WRONG

Boilerplate clauses are often seen as 'routine' or 'standard' and are therefore regularly overlooked during contract negotiation and drafting. Yet, boilerplates provide important contractual protections for parties. By highlighting just three commonly mishandled boilerplate clauses, it is hoped that you will pay closer attention to these often-forgotten provisions next time you see them.

Entire Agreement

Typically, an entire agreement clause will state that the written contract contains the "complete agreement", and that it "supersedes any prior agreement" between the parties. Parties often assume that an entire agreement clause excludes liability for non-fraudulent misrepresentation; however, many entire agreement clauses (including some seen in standard form contracts), do not effectively operate as a bar to a claim for negligent misrepresentation.[1]

Risks of getting it wrong

The risk of not properly excluding liability for negligent misrepresentation is that a claim for damages on tortious recovery principles, as opposed to contractual ones, may materially increase the value of a party's claim. Generally, recovery of loss in a claim for negligent misrepresentation is determined on the same basis as fraudulent misrepresentation; but negligent misrepresentation, is considered easier to demonstrate than fraud.

Assignment on Termination Clause

It is common to see termination provisions requiring a contractor to assign all of its subcontracts to the employer upon termination. This is normally considered a practical way of allowing a project to carry on where the employer has a right to terminate the contractor.

Risks of getting it wrong

Consider a situation where (i) a contractor's subcontractor has caused delay to the contractor's works under its main contract, (ii) this delay gives the employer a right to terminate the main contract, and (iii) the contractor is then forced to assign its subcontract to the employer.

In this scenario, unless the assignment clause provides that only future benefits may be assigned, the contractor is at risk of losing any opportunity to claim against its subcontractor for breach of contract. The contractor may then be faced with a claim from the employer, without the right to bring a contract claim against its subcontractor. To make matters worse, it is not possible to assign the burdens of a contract, so the contractor may also face a claim from the subcontractor for payment under the subcontract.

Third Party Rights

The Contracts (Rights of Third Parties) Act 1999 creates a potential pitfall in contract drafting, where a non-party is given a right to enforce a contract term. Most main contracts include clauses excluding the rights of third parties under the Act. However, consideration should be given to include the same exclusions in all project contracts.

Risks of getting it wrong

Proper exclusion can often be forgotten in ancillary and smaller side-contracts that are negotiated and agreed as a project progresses. Without suitable exclusion clauses, a party can face a claim from a non-party seeking to enforce a contract term, and the English Courts often apply a broad interpretation when deciding whether a non-party is so entitled.

Conclusion

Boilerplates provide parties with important contractual protections, and the risk of poorly drafted boilerplates is that these safeties are not properly conferred - ignore boilerplates at your peril!

ROXANNE LANGFORD
Associate
D +44 (0)20 7264 8475
E roxanne.langford@hfw.com

1 BSkyB Ltd v HP Enterprise Services [2010] EWHC 86 (TCC) and Mears v Shoreline Housing [2013] EWCA Civ 639

DISPUTE RESOLUTION CLAUSES: FIONA TRUST PRINCIPLE

We explore how courts in Hong Kong and the United Kingdom have approached the "Extended *Fiona Trust* Principle" when construing conflicting dispute resolution clauses in multiple related agreements. Recent decisions have considered limitations to this principle, and concluded that the parties did not intend to submit all disputes to arbitration.

The Fiona Trust principle presumes that parties, as rational businesspeople, should be assumed to have intended any dispute arising out of their relationship to be decided by the same tribunal.[1] The principle is relied upon most commonly where a party wishes to have a single arbitral tribunal determine multiple disputes arising out of one contract. In comparison, the "Extended *Fiona Trust* Principle" is applied where multiple disputes arise under multiple related agreements (where such agreements are sufficiently related/interdependent or concluded at the same time) and between the same parties.[2]

Hong Kong

In *H v G*[3], the High Court set aside the arbitral tribunal's decision and held that the tribunal did not have jurisdiction over claims made under a warranty containing a non-exclusive court jurisdiction clause, where an associated building contract contained an arbitration clause.

The "Extended *Fiona Trust* Principle" was held to be displaced by clear language which showed the parties had intended to "carve out" disputes arising under the warranty from the arbitration agreement.[4] The "Extended *Fiona Trust* Principle" was found to have "*limited application*" in a case where the overall contractual arrangements between the parties gave rise to agreements with different dispute resolution provisions.

The Court may also have had in mind that the "Extended *Fiona Trust* Principle" normally applies only where the parties to Contract A and Contract B are the same. In this case a third party, H's subcontractor, was a party to the warranty, but not the building contract.

United Kingdom

In *Albion Energy Ltd v Energy Investments Global BRL*[5], the High Court refused to stay court proceedings concerning a sale and purchase agreement ("SPA"), containing an exclusive court jurisdiction clause, where an escrow agreement contained an arbitration clause.

The Court considered that there is nothing surprising in parties stipulating different dispute resolution provisions in principal and security agreements forming part of the same transaction; the arbitration clause in the escrow agreement did not displace the court jurisdiction clause in the SPA.

Lessons Learned

- The "Extended *Fiona Trust* Principle" can be displaced by clear language.
- Courts will consider the wording of clauses to ascertain the parties' intentions. Did the parties intend to carve out disputes arising under Contract B from the arbitration agreement in Contract A?
- Proper consideration should be given when drafting dispute resolution clauses in multiple related agreements to avoid inconsistency and ambiguity.

STEPHANIE YU
Senior Associate, Hong Kong
D +852 3983 7658
E stephanie.yu@hfw.com

STEPHANIE YU
SENIOR ASSOCIATE, HONG KONG

"The "Extended Fiona Trust Principle" can be displaced by clear language."

1 Fiona Trust v Privalov [2007] UKHL 40 (Comm), as per Lord Hoffman at [13].

2 Terre Neuve Sarl v Yewdale Ltd [2020] EWHC 772 (Comm), as per Bryan J at [30] and [31].

3 [2022] HKCFI 1327. This is the latest in a string of cases in Hong Kong in which parties have tried (and mostly failed) to apply the "Extended Fiona Trust Principle". So far, the court has applied the principle in only one case: Mak v. La [2022] HKCFI 285.

4 A similar decision was reached by the Singapore High Court in Silverlink Resorts Ltd v MS First Capital Insurance Ltd [2020] SGHC 251 where the Court held that the "carve-out approach" should be applied.

5 [2020] EWHC 301.

MITIGATING THE IMPACTS OF COST ESCALATION

MARIA DEUS
LEGAL DIRECTOR, ABU DHABI

MICHAEL DEBNEY
PARTNER, MELBOURNE

"Lack of specificity in the methodology is likely to result in the parties generating different pricing adjustment outcomes."

In this article we look at contract negotiation strategies and contract drafting to protect contractors against the impacts of cost increases arising under future contracts.

The Contract Model

There are a range of contractual and commercial models for project development. These include different regimes for the allocation of risk, including in respect of changes in the price of various project inputs.

At one end of the spectrum, there are lump sum fixed priced contracts which predominately allocate construction risk to the contractor. These risks not only include the cost of required materials and labour, but also the risks associated with construction itself, including site, industrial and political risks (often with limited exceptions). At the other end of the spectrum are approaches that adopt schedule of rates or cost-plus models. While the latter provides more protection for the contractor against exposure to cost variability, they do little to incentivise the contractor to prevent cost overruns and are, consequently, not often favoured by employers.

Even before the current market conditions, employers were considering other contracting models to share construction risks, including "alliance" or "collaborative" contracting, under which a greater proportion of construction risk is carried by the employer, but which still incentivise the contractor by placing some (or all) of the contractor's profit at risk through various methods, including KPIs, target cost and painshare / gainshare mechanisms.

In most cases, contractors are not able to influence the commercial model for a project and, particularly across the Middle East, Africa and Asia, that model remains the lump sum fixed price contract model.

Even where the delivery model is lump sum, there remains an opportunity for contractors to protect against price escalation by negotiating provisions that address the impacts of price escalation.

Negotiating Relief in Lump Sum Fixed Price Contracts

To successfully negotiate a price escalation clause, it is important to illustrate to the employer that there are commercial interests and objectives beyond pure project cost, e.g. safety, timely completion, quality, stakeholder satisfaction, environmental considerations and local content engagement. Where the contractor is able to shift the focus to optimising these objectives there is an increased prospect of obtaining a more balanced outcome.

In negotiating price escalation relief, there are a number of topical points that can be raised, including:

- the current economic climate:
  - *Positive outcomes:* the inclusion of cost escalation relief increases the prospect of positive project outcomes as all contractors and suppliers are under financial pressure;
  - *Inflation:* long lead items are at significant risk of price variability, particularly on projects with extended programmes;
  - *Interruption:* COVID and the war in Ukraine have resulted in material interruptions in supply, causing increasingly unstable and variable prices.
- clarifying that increases under a price escalation clause only arise when the costs actually rise, and are not simply ratchet price increases.
- proposing safeguards for the employer which balance out the allocation of the risk of the price increase to the employer, e.g.:
  - notification of the cost increase within a certain time period; and/or
  - provision of specified information, as conditions precedent to the contractor's entitlement to an adjustment justifying the price increase.
- proposing to cap the amount of any price increase, or that the contractor will bear the risk of the

first [x]% of any price increase (a materiality threshold).

Contractors should be prepared for the employer to insist on risk being shared, i.e. if prices decrease, the employer is entitled to a corresponding decrease in the contract sum.

Types of Clauses

Where parties agree that the contractor is entitled to relief for cost escalation there are many methods of addressing it, including:

- specific – dealing with materials and other inputs on a "type" basis; or
- general – dealing with escalation using baskets of goods and published indices to generate adjustments to the contract price (or its milestones).

The more effort that goes into considering these issues, the less chance there is of disputes arising. Lack of specificity in the methodology is likely to result in the parties generating different pricing adjustment outcomes as they are commercially motivated to choose inputs that suit their own interests.

Best Practice – the Detailed Approach

The more reliance there is on reputable third party generated data in any escalation provision, the better it will be.

Adopting the specific approach, Clause 13.8 of the FIDIC 1999 Red and Yellow Books relies on formulae to adjust the contract values to reflect cost escalation. Adjustment data included in the Appendix to Tender prior to execution of the contract, defines the coefficients (proportions) and the cost indices (reference prices) to adjust amounts in each interim payment certificate.

A more general approach would be to include a formula that uses a reasonable basket of indices that addresses (possibly on a weighted average basis) for each milestone each of the major price risk factors (foreign currency, labour cost, material costs, such as steel). Even on small projects this approach will provide an outcome that is less likely to be subject to dispute.

Alternative Approaches

In less complex projects or where the value at risk is lower, a simpler approach may be suitable. A few examples of such approaches are:

- a provision where the price is adjusted based upon the difference in cost between base prices and the current price of local labour and specified materials, such as:

  If the cost of any specified building materials escalates by more than [x] percent when compared to the pricing provided by Contractor in its proposed schedule of rates due to tariffs, material shortages, labour unavailability, or any other event beyond Contractor's control, Contractor shall notify the Employer in writing of the percentage of the increase and the source of supply supported by invoices, receipts, payroll reports, pricing sheets, work orders, etc. to substantiate such notice. Upon receipt of notice, the difference between the price as adjusted and the base-price plus the referenced percent increase the Employer shall make an adjustment reflecting the increase in the cost of the specified building materials to the [Contract Price/schedule of rates].

- a provision for the parties to review pricing at agreed times (includes reversion to original pricing in the event of the cost increase ceasing):

  *The parties hereto agree to, from time-to-time, but in no event more than once per [insert time period – monthly, quarterly, yearly, etc.], adjust upward the price to Employer of the specified [Materials/Equipment] in the event of a Significant Cost Increase, as defined below, in an equitable amount to such increase, for so long as such Significant Cost Increase is occurring. A "**Significant Cost Increase**" for purposes of this Contract shall be an increase of [__]% or more of the then-prevailing cost to Contractor of the specified [Materials/Equipment]. In the event a Significant Cost Increase is no longer occurring, the price of the specified [Materials/Equipment] hereunder shall revert back to that stated within the Contract.*

- a provision for an equitable adjustment to the contract sum as a variation:

In the event of significant delay or price increase of material, equipment, or energy occurring during the performance of the contract through no fault of the Contractor, the Contract Sum, time of completion or contract requirements shall be equitably adjusted by Variation Order in accordance with the procedures of the Contract Documents. A change in price of an item of material, equipment, or energy will be considered significant when the price of an item increases [ ]% between the date of this Contract and the date of installation.

Balanced pricing relief will only benefit successful project outcomes. Effective tender processes can still ensure that pricing is competitive and not inflated at the outset. Better still are more balanced commercial models, including the reformed alliance and balanced target cost delivery partner models that are gaining international recognition.

MARIA DEUS
Legal Director, Abu Dhabi
D +971 2 235 4907
E maria.deus@hfw.com

MICHAEL DEBNEY
Partner, Melbourne
D +61 (0)3 8601 4507
E michael.debney@hfw.com

SHOULD PROFESSIONAL CONSULTANTS PROVIDE CERTIFICATES?

KELVIN LO
REGISTERED FOREIGN LAWYER (NEW SOUTH WALES, AUSTRALIA), HONG KONG

"The decision in *Multiplex* puts significant weight on the direct contractual nexus between the consultant and the third-party."

New technologies enable contractors to overcome limits in conventional building work. In doing so, professional consultants including architects and engineers are engaged to provide specialist design or advice and are often required to provide certificates as formal record of their assessment. In some circumstances, the professional consultant does not have a direct contractual relationship with the employer or even with the main contractor, which raises the issue of whether the consultant owes a duty of care to those third-party stakeholders.

In *Multiplex Construction Europe Ltd v Bathgate Realisations Civil Engineering Ltd*[1], the Technology and Construction Court in England and Wales concluded that the independent design checker (i.e. the professional consultant), engaged by the sub-contractor, did not owe a duty of care towards the main contractor when issuing a certificate on the temporary works, which was subsequently found to be defective. Whilst the outcome was nothing out of the ordinary, it is one of the few judgments in which the English Courts have comprehensively considered the historical authorities in relation to the establishment of a duty of care.

Lessons learned

Although the facts are specific to each case, the following questions in light of *Multiplex* may provide some factors that are likely to be considered by tribunals when determining whether the professional consultant has assumed responsibility towards a third-party through the provision of a certificate.

1. Does another party have a contractual obligation to produce the design?
2. Is there a direct contractual relationship between the consultant and the third-party?
3. Is the consultant's role limited to verifying a design prepared by others?
4. Is the third-party involved in selecting the consultant?
5. Is the third-party aware of the documents used for the consultant's review?
6. Is there direct contact between the consultant and the third-party?
7. Does the consultant directly provide service to the third-party?
8. Does the project have a carefully crafted contractual structure that excludes the consultant from the main contract and sub-contract?
9. Is there a voluntary assumption of obligation by the consultant to the third party?
10. Is the consultant aware of the third party's other obligations in the project?
11. Is the consultant taking on responsibility for the accuracy of information in the certificate?

Applicability of *Multiplex* in Hong Kong

The decision in *Multiplex* puts significant weight on the direct contractual nexus between the consultant and the third-party. The leading case in Hong Kong relating to the assumption of responsibility is *Yiu Chown Leung v Chow Wai Lam*[2] where the Court of Final Appeal held that a duty of care arising out of the assumption of responsibility can be accepted by conduct or otherwise, in the absence of a contract. However, the decision in *Yiu* was confined to the voluntary assumption of responsibility in a loan transaction and it will be of interest to see whether *Multiplex* will be adopted by the Hong Kong Courts for construction disputes.

KELVIN LO
Registered Foreign Lawyer (New South Wales, Australia), Hong Kong
D +852 3983 7687
M +852 6627 4249
E kelvin.lo@hfw.com

1 [2021] EWHC 590.
2 [2005] 4 HKLRD 246.

UPCOMING EVENTS & WEBINARS

Construction Law Summer School

Cambridge, UK

12 – 16 September 2022

Speakers: Michael Sergeant, Ben Mellors

Webinar: Painting the Future of Arbitration in Asia Pacific

The Midnight Clause: managing risks relating to the dispute resolution clause

13 September, 4pm HK time

Speakers: Jo Delaney, Ben Bury, Ben Mellors, Adam Richardson and Peter Sadler

Construction Week: Leaders in Construction UAE Summit

Dubai, UAE

14 September 2022

Speakers: James Plant

Webinar: Sustainability Series Part Three: Disputes in Energy Transition Projects in Australia

Australia

14 September

Speakers: Jo Delaney, Nick Longley, Dan Perera, Jo Garland, Kate Fisher

Construction Week: Leaders in Construction KSA Summit

Riyadh, KSA

28 September 2022

Speakers: Maria Deus, James Plant

UK Adjudicators' London 2022 Adjudication & Arbitration Conference

London, UK

27 October 2022

Speaker: Richard Booth

Adjudication Society Annual Conference

Edinburgh, UK

3 November 2022

Speaker: Richard Booth

Renewable UK Legal & Commercial Conference 2022

Net Zero UK - The Decade of Delivery

The Risk and Opportunity of FIDIC 2017 for the Offshore Wind Sector

London, UK

15 November 2022

Speakers: Richard Booth

2nd Annual Submarine Power Cable and Interconnection 2022

Are cable lay contractors expected to sign unreasonable contracts?

Berlin, Germany

15 – 16 November 2022

Speakers: Richard Booth

HFW/HKA Offshore Wind Conference

Rotterdam, The Netherlands

6 December 2022

Speakers: Michael Sergeant, Max Wieliczko, Richard Booth

HFW has over 600 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our construction capabilities, please visit hfw.com/Construction

hfw.com

Americas | Europe | Middle East | Asia Pacific