Construction

March 2015

Welcome to the March edition of our Construction Bulletin.

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

Enforcement of FIDIC dispute board decisions: Richard Booth considers the impact of a recent Singaporean judgment on a party's ability to enforce a FIDIC dispute board decision.

The IBA country guides to ADR: The International Bar Association has published fourteen country-specific guides on ADR in construction disputes. Tim Atwood highlights some of the key issues arising from these guides.

Adjudication and insolvent contractors: Matthew Blycha discusses a recent judgment in Western Australia regarding an insolvent contractor's ability to enforce an adjudicator's determination and the parallels with the law in the UK and elsewhere.

HFW annual offshore wind seminar: Robert Blundell reports on HFW's 2014 seminar.

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

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

Michael Sergeant, Partner, michael.sergeant@hfw.com

Enforcement of FIDIC dispute board decisions

A recent decision of the Singapore High Court has considered how a party should enforce a FIDIC dispute board decision.

The FIDIC suite of international construction contracts provides for a tiered dispute resolution process. The Red, Silver and Yellow books contain broadly similar dispute clauses requiring parties to first refer a dispute to a dispute board before arbitration for final determination.

The referral of disputes to a dispute board is on the "pay now, argue later" principle familiar to participants of adjudication processes which now exist in many jurisdictions including the UK, Australia and Singapore. In other words, a process that provides a binding, but not a final decision. This facilitates a contractor's desire for cash flow, but without disturbing the employer's entitlement (and indeed also the contractor's entitlement) to argue later in arbitration or litigation about the underlying merits.

What happens, however, if an employer fails to honour a binding dispute board decision?

The Singapore High Court gave guidance on the approach to enforcement of dispute board decisions in *PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia)*[1] which concerned a project contracted under the FIDIC Red Book.

A variations dispute was referred to the dispute board which held that CRW was entitled to payment of US$17 million. Persero declined to pay the decision. It accepted that it was under a contractual obligation to give effect to the decision, even though the underlying dispute had not been finally resolved. However it said it did not need to comply because the contract did not permit CRW to do anything to enforce that decision.

CRW disagreed and made an attempt through arbitration to compel Persero to pay the sum awarded. It asked the arbitral tribunal to deal with both that failure and the underlying dispute.

CRW obtained two interim orders at an early stage in the arbitral proceedings. First, an "interim award" compelling Persero to give effect to the decision pending resolution of the underlying dispute. Second, an order to enforce the decision as though it were a court judgment.

In response, Persero applied to the Singapore High Court to set aside the interim award and the order. It argued that the award was a provisional award, binding only until the tribunal determined the underlying dispute, and as such it was prohibited by the International Arbitration Act in Singapore.

The judge found in favour of CRW and held that the award was entirely consistent with the parties' contract. The judge also held that the award was not prohibited by Singapore's International Arbitration Act. As part of its judgment the court considered how a party should enforce a FIDIC dispute board decision.

It considered whether a party should refer solely the issue of the non-compliance, i.e. as a separate dispute in its own right distinct from the underlying dispute (the two-dispute approach). Alternatively, whether both the other party's non-compliance as well as the merits underlying the dispute board decision should be referred (the one-dispute approach).

"...the non-compliance with the decision was an aspect of the primary underlying dispute, and not a separate dispute in itself..."

RICHARD BOOTH, ASSOCIATE

The judge rejected the two-dispute approach. He considered that such an approach would require the party seeking to enforce the decision to comply with the pre-conditions contained in clause 20 before it could resolve the dispute by arbitration – such an approach would be contrary to the security for payment regime intended by the dispute board process.

He held in favour of the one-dispute approach because this best supported the FIDIC payment security regime. It would mean that the non-compliance with the decision was an aspect of the primary underlying dispute, and not a separate dispute in itself, and for which the condition precedents to arbitration have already been satisfied.

Persero has appealed the court's judgment and the outcome of the appeal is awaited.

For more information please contact Richard Booth, Associate, on +44 (0)20 7264 8385, or richard.booth@hfw.com, or your usual contact at HFW.

1 [2014] SGHC 146

The IBA country guides to ADR

The International Bar Association's (IBA) International Construction Projects Committee has published country guides on alternative dispute resolution (ADR) in construction disputes. We consider the benefit of these guides to industry users.

The IBA's Country Guide project has published guides to ADR in construction projects across different jurisdictions.[1] It currently offers guides for fourteen different countries (Argentina, Australia, Chile, Germany, Hong Kong, India, Indonesia, Ireland, Malaysia, Russia, Scotland, Spain, Switzerland and the USA), with further countries to be added in time.

The guides are based on questionnaires completed by experienced practitioners in each jurisdiction. Whilst the IBA points out that they should not be construed as legal advice, they provide a useful reference for anyone working on projects in unfamiliar jurisdictions.

Each guide starts by providing some background information about which sorts of dispute resolution processes are commonly used on construction projects in that jurisdiction, be it litigation, arbitration, mediation or other forms of ADR such as adjudication or dispute adjudication boards (DABs). It also discusses whether certain processes are mandatory where they have been specified in the contract. It ends with an interesting section on current trends and developments.

It is a useful starting point for businesses to get an idea of how sophisticated a country's ADR regimes are and what approach the industry

"The guides will be of particular interest to FIDIC users as they focus on the use of DABs and the enforceability of DAB decisions."

TIM ATWOOD, ASSOCIATE

favours. For example, Argentina and Germany both prefer litigation, whereas in Indonesia the courts are perceived as not being transparent or expert enough and arbitration is favoured. India, in part due to the legacy of a number of World Bank funded contracts, favours arbitration but barely uses mediation. Whereas in countries like Spain, Hong Kong, Ireland and the USA mediation is a popular choice, and in some cases even legislated for. Ireland, Australia and Malaysia all have statutory adjudication procedures, and Germany is considering introducing such a process.

The guides will be of particular interest to FIDIC users as they focus on the use of DABs and the enforceability of DAB decisions. For example, they consider whether DAB awards are enforceable through the local courts without first having to obtain an arbitral award. Readers will also find Richard Booth's article on the Persero case in this Bulletin of interest, in which the Singapore High Court considered the enforcement of a DAB decision by arbitration.

Many contracts contain multi-tiered dispute resolution clauses which provide for progressive escalation of a dispute through different stages of ADR before final determination. The guides explain how these are treated in different jurisdictions and in particular whether the local courts insist on them being followed. In most jurisdictions, if the steps are stated to be conditions precedent to arbitration or litigation, then they are typically treated as being mandatory. This is not the case in all jurisdictions. For example, in the USA steps can be omitted if pursuing them would be futile. On the other hand, in Russia there are no consequences for skipping steps before arbitration, but if steps are ignored before litigation, the court will refuse to consider the claim.

The guides also give information on the regulations concerning how public bodies must act in a variety of jurisdictions. For example, whether public entities are barred from settling disputes using ADR, whether they enjoy immunity, and whether procurement disputes can be settled using ADR. In Spain, for example, public bodies are barred from using ADR, and in India it is very rare for them to compromise disputes due to watchdog bodies that will scrutinise their decisions. In Russia there is no formal immunity, but in reality public bodies may be protected by "budget immunity", where any compensation payable is limited by the funds allocated to that body by the Russian Federation for paying out damages.

The IBA's guides provide a good analysis of arbitration and other forms of ADR across various jurisdictions, flagging up important commercial and legal differences.

For more information please contact Tim Atwood, Associate, on +44 (0)20 7264 8286, or tim.atwood@hfw.com, or your usual contact at HFW.

1 www.ibanet.org

hfw Adjudication and insolvent contractors

A recent Western Australian decision has provided guidance on the limits of an insolvent contractor's ability to enforce an adjudication determination where the principal has an offsetting claim.

Security for payment legislation is a common feature in the construction industry in many jurisdictions, notably the UK, Singapore, New Zealand and Australia. In recent years the number of adjudications brought under such legislation, and the value of individual adjudications, has increased. Security for payment legislation came into force in Malaysia in 2012, and the legislation is currently being considered in Hong Kong. The continued growth of adjudication, both in established jurisdictions and into new jurisdictions, demonstrates that it is an effective means for resolving payment disputes.

In essence, adjudications initiated under security for payment legislation are aimed at ensuring contractors and subcontractors do not run into financial difficulty while waiting for payment from the principal down the contractual chain. With this principle in mind, a quick resolution of payment disputes, as facilitated through the adjudication process, is generally seen as a benefit to the industry as a whole.

Nonetheless, adjudications are often brought by cash-strapped contractors and by the liquidators of insolvent contractors. In these circumstances, the benefits of adjudication need to be balanced against the potential prejudice that can occur if, by awarding a payment to an insolvent contractor, an adjudicator's interim determination effectively becomes "final and binding".

Hamersley Iron Pty Ltd v James

In *Hamersley Iron Pty Ltd v James*[1], the Supreme Court of Western Australia for the first time considered whether to grant an insolvent company leave to enforce an adjudication determination under the Construction Contracts Act 2004 (WA) ("CCA"). The CCA is relevant security for payment legislation in Western Australia. The question arose following an application brought by the receivers and managers of Forge Group Constructions Pty Ltd (Forge), who sought leave to enforce an adjudication determination issued under the CCA made in Forge's favour.

Western Australia is unique in that determinations made by adjudicators require permission (referred to as "leave") from the court before a determination can be enforced. While applying to the court for leave is a requirement under the CCA, there is a predisposition in favour of granting leave.

Hamersley resisted Forge's application for leave on the basis that it had counterclaims against Forge. Ordinarily, the existence of counterclaims will not stop leave being given to enforce a CCA determination. However, Hamersley maintained that ordinary principles should not apply where the beneficiary of a CCA determination is insolvent. More particularly, Forge's insolvency, coupled with Hamersley's counterclaim for damages, meant that Section 553C of the Corporations Act 2001 (Cth) was engaged, and consequently, leave to enforce the determination should be refused (Section 553C of the Corporations Act mirrors Section 323 of the English Insolvency Act 1986).

Background and Forge's demise

Hamersley contracted with Forge to design and construct two fuel hubs in the Pilbara region in Western Australia. On 11 February 2014, before the contracted works were complete, Forge went into voluntary administration. Immediately following voluntary administration, receivers and managers (Receivers) were appointed by Forge's principal secured creditor. Shortly thereafter, Forge's creditors resolved to wind up the company.

In March 2014, Forge served an adjudication application under the CCA on Hamersley seeking AUS$14,335,778.07 plus GST. The adjudicator determined that Hamersley was liable to pay AUS$641,607.33 plus GST (Determined Amount). Hamersley did not pay the Determined Amount and Forge (through the Receivers) brought an application before the Supreme Court seeking leave to enforce the Determined Amount.

Issues considered by the court

In considering Forge's application, the court started by considering the objects, purpose and policy of the CCA. The court acknowledged that it is for the party resisting enforcement (in this case Hamersley) to demonstrate why leave should not be given. It also acknowledged that the CCA did not limit the reasons as to why leave may be refused, so all circumstances may be considered in deciding whether leave should be refused.

Hamersley presented evidence that demonstrated it had counterclaims that greatly exceeded the Determined Amount. These counterclaims consisted of costs that have been or will be incurred by Hamersley as a direct result of Forge's insolvency. Hamersley argued that these counterclaims needed to be offset against the Determined Amount by operation of Section 553C of the Corporations Act.

Section 553C states that where there have been mutual dealings between an insolvent company and a person who wants to have a claim admitted against the insolvent company, an account is to be taken between the parties. The account that is to be taken is deemed

1 [2015] WASC 10

to operate at the point the liquidation takes effect, and, from the time of liquidation, only the net balance remains between the parties.

If there have been mutual dealings, Section 553C will apply to liabilities which, at the date of insolvency, may or may not arise depending on whether future events occur (that is, contingent liabilities). Hamersley's position was that because Forge was in liquidation, and because its counterclaims exceeded the value of the Determined Amount, the operation of Section 553C of the Corporations Act meant that there was no net balance owing to Forge. In effect, leave to enforce the determination should not be granted because no amount remained of the Determined Amount.

The decision

The court accepted Hamersley's position and found that there was a serious question to be tried as to whether Hamersley's counterclaim exceeded the Determined Amount. It found that Hamersley's counterclaim constituted a "mutual dealing" for the purpose of Section 553C and that Section 553C operated as at the date Forge appointed voluntary administrators so that, from that time onwards, only the net balance remained between Forge and Hamersley.

The court found that the object and purpose of the CCA – to keep money flowing in the contracting chain by enforcing timely payment and sidelining protracted and complex disputes – does not apply in circumstances where the contractor is insolvent. Indeed, the court noted the object and purpose of Section 553C would be defeated if Forge were able to recover the Determined Amount and Hamersley was left having to prove its counterclaim in the liquidation of Forge. In this context, the court noted the purpose of Section 553C was *"to do substantial justice between the parties, where a debt is really due from the bankrupt to the debtor".*

"Where adjudications are brought by insolvent contractors, the interaction of insolvency legislation with the applicable security for payment legislation will need to be taken into account."

MATTHEW BLYCHA, PARTNER

The court accepted all of Hamersley's contentions with one exception. Rather than dismiss Forge's application for leave the court stayed the application (that is, the application was suspended) pending resolution of Hamersley's counterclaim. The court stated that while Hamersley had demonstrated there was a serious question to be tried in relation to its counterclaim, the counterclaim was not yet proven. If the application was dismissed, Hamersley could avoid paying the Determined Amount without ever pursuing or proving its counterclaim. In the interests of justice, the proceedings were stayed pending resolution, by further legal proceedings or agreement, of Hamersley's counterclaim.

Practical implications

When a contractor becomes insolvent it will be common for the contractor to have unpaid payment claims against one or more principals. In these circumstances, the contractor, or a liquidator or a receiver and manager appointed over the contractor, will commonly seek to recover the unpaid payment claims through one or more adjudications commenced under security for payment legislation, such as the CCA. In this situation it will be equally common for the principal, who is on the receiving end of an application for adjudication, to have competing claims against the contractor, such as claims for costs associated with completing the contractor's works.

The decision in *Hamersley Iron Pty Ltd v James* calls into question the utility of insolvent contractors commencing adjudications, at least where the principal may be able to demonstrate an off-setting claim. Importantly, any off-setting claim can include contingent and unliquidated claims that the principal may have against the contractor.
In particular, the decision will be of interest to insolvency professionals who may have otherwise used the CCA (and corresponding legislation in other jurisdictions) as a tool to assist in the recovery of payment claims on behalf of insolvent contractors.
Where adjudications are brought by insolvent contractors, the interaction of insolvency legislation with the applicable security for payment legislation will need to be taken into account. This principle applies equally in the UK, where the probable inability of a contractor to repay the judgment sum may render it appropriate to grant a stay of execution and where a contractor is in insolvent liquidation, a stay of execution will usually be granted.

HFW acted for Hamersley.

For more information please contact Matthew Blycha, Partner, on +61 (0)8 9422 4703, or matthew.blycha@hfw.com, or your usual contact at HFW.

HFW annual offshore wind seminar

For the second year running, Holman Fenwick Willan hosted leading industry companies at its offshore wind seminar held on 1 December 2014 at our offices in London. Attendees came from a wide spread of participants in the sector from suppliers and contractors to developers, insurers, and marine warranty surveyors.

The seminar continued from last year's analysis of the procurement challenges in advance of the UK Round Three developments. This time the topic concentrated instead on the thorny issues of performance of the works and liability for design.

In a lively discussion, the issue of design liability was well covered by using the recent case of *MT Højgaard A/S v E.ON Climate & Renewables UK Robin Rigg East Ltd*[1] as a practical example.

A gradual change has been seen in offshore wind contracts in recent years where design liabilities are progressively being passed to suppliers. These are causing issues in an industry which remains at the forefront of technical development with each new project presenting new, and sometimes unforeseeable, challenges.

In the MT Højgaard case this created problems where a failure in a specification led to a conflict in the applicable design terms that had been written into the contract. In particular, an obligation on a supplier to design in accordance with a third party's specification conflicted with another strict obligation to produce a design with a specific design life.

This raised further interesting points for discussion regarding the exact meaning of "design life" and whether works could truly be said to be defective and not compliant with a design life warranty until such time as they failed in practice.

Throughout the seminar it became apparent that new contracts being advanced in the market contain a proliferation of applicable standards for design liability: from statements of "design life", compliance with third party specifications and obligations to carry out design using "reasonable skill and care", to generic statements that works when completed should be "fit for purpose".

All of these terms were considered along with their potential pitfalls and conflicts. It was apparent around the room that there were differing opinions on the interpretation of what a simple phrase such as "20 year design life" actually means, which highlighted the need for clarity in this fundamental area. Delegates had the opportunity to discuss how design obligations should be defined for use in future projects to give greater certainty to all project participants.

The seminar finished up by considering what should or could be done in situations where a design defect is likely to cause a failure before the end of the design life is reached. Proposals covered the need to have certainty over the extent of liability, and comfort for all parties that the liabilities are shared proportionately amongst the various team members (consultants, subcontractors and suppliers). Should issues arise over the course of the works the parties would need to consider the role of insurance in managing design liabilities, whether through Contractors All Risks policies, professional indemnity insurance, or latent defects insurance.

The issues of design liability go right to the heart of a construction contract as they require clear identification of the scope of works that a contractor is expected to undertake. Perhaps the salutary lesson to be taken from this year's seminar was that just because a standard is impossible to achieve, it did not mean that a party wouldn't still be obliged to try to reach it.

HFW will be addressing some of these issues in greater detail in future Construction Bulletins.

The seminar proved again to be an ideal opportunity for thought leadership involving participants from across the industry. HFW will be holding further offshore wind seminars in future and we look forward to similar lively discussion.

For more information please contact Robert Blundell, Partner, on +44 (0)7912 741 593/ +971 (0) 4 423 0571, or robert.blundell@hfw.com, or your usual contact at HFW.

"Perhaps the salutary lesson to be taken from this year's seminar was that just because a standard is impossible to achieve, it did not mean that a party wouldn't still be obliged to try to reach it."

ROBERT BLUNDELL, PARTNER

1 [2014] EWHC 1088 (TCC)

Conferences and events

FIDIC 6th Middle East Contract Users' Conference
Abu Dhabi
3–4 March 2015
Presenting: Michael Sergeant and Robert Blundell

Property Council of Australia Property Industry Programme
Sydney
5 March 2015
Presenting: Carolyn Chudleigh

Construction Breakfast Seminar
Paris
5 March 2015
Presenting: Pierre-Olivier Leblanc and Pauline Arroyo

NSW Young Lawyers
Project Financing, Large Scale Vertical Villages
Sydney
7 March 2015
Presenting: Carolyn Chudleigh

EPC in Oil & Gas
Kuala Lumpur
9–12 March 2015
Presenting: Chanaka Kumarasinghe and Nick Watts

HFW Breakfast Seminar
London
10 March 2015
Presenting: Michael Sergeant and Richard Booth

Australasian Oil & Gas (AOG) Conference
Perth
11–13 March 2015
Presenting: Matthew Blycha

HFW Evening Seminar
London
12 March 2015
Presenting: Michael Sergeant and Richard Booth

Society of Construction Law
County Durham, UK
17 March 2015
Presenting: Michael Sergeant

Chartered Institute of Arbitrators – Centenary Conference
Hong Kong
19–21 March 2015
Presenting: Nick Longley

Subsea Power Cables Conference
London
23–24 March 2015
Presenting: Richard Booth

Negotiating offshore contracts in a challenging market
Singapore
Tuesday 24 March 2015
Presenting: Paul Aston, Chanaka Kumarasinghe, Gordon Inkson, Adam Richardson and Suzanne Meiklejohn

Hebei Chamber of Commerce
Doing Business in Australia
Sydney
29 March 2015
Presenting: Ian Taylor

Property Council of Australia NSW Division Lunch
Sydney
1 April 2015
Presenting: Carolyn Chudleigh

UK Trade & Investment Trade Mission
Urban Regeneration and Smart City Projects
Sydney
20 April 2015
Presenting: Carolyn Chudleigh

Variations Half Day Seminar
Dubai
21 April 2015
Presenting: Michael Sergeant, Robert Blundell

Chartered Institute of Arbitrators
Diploma for International Commercial Arbitration
Sydney
26 April 2015
Presenting: Amanda Davidson

Competition Issues in the Construction Industry
London
28 April 2015
Presenting: Anthony Woolich and Richard Booth

Society of Construction Law Australia
Perth
28 April 2015
Presenting: Michael Sergeant

Society of Construction Law Australia
Melbourne
30 April 2015
Presenting: Michael Sergeant

Variations Seminar
Seoul
6 May 2015
Presenting: Max Wieliczko and Robert Blundell

HFW Construction Breakfast Update
Dubai
18 May 2015
Presenting: Max Wieliczko and Robert Blundell

CWC Oil & Gas EPC Conference
Dubai
19–21 May 2015
Presenting: Max Wieliczko, Michael Sergeant and Robert Blundell

Griffith University Conference
Built Environment Challenges
Gold Coast
2 September 2015
Presenting: Carolyn Chudleigh

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

Lawyers for international commerce hfw.com

© 2015 Holman Fenwick Willan LLP. All rights reserved

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice.

Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please contact Craig Martin on +44 (0)20 7264 8109 or email craig.martin@hfw.com

São Paulo London Paris Brussels Geneva Piraeus Dubai Shanghai Hong Kong Singapore Melbourne Sydney Perth