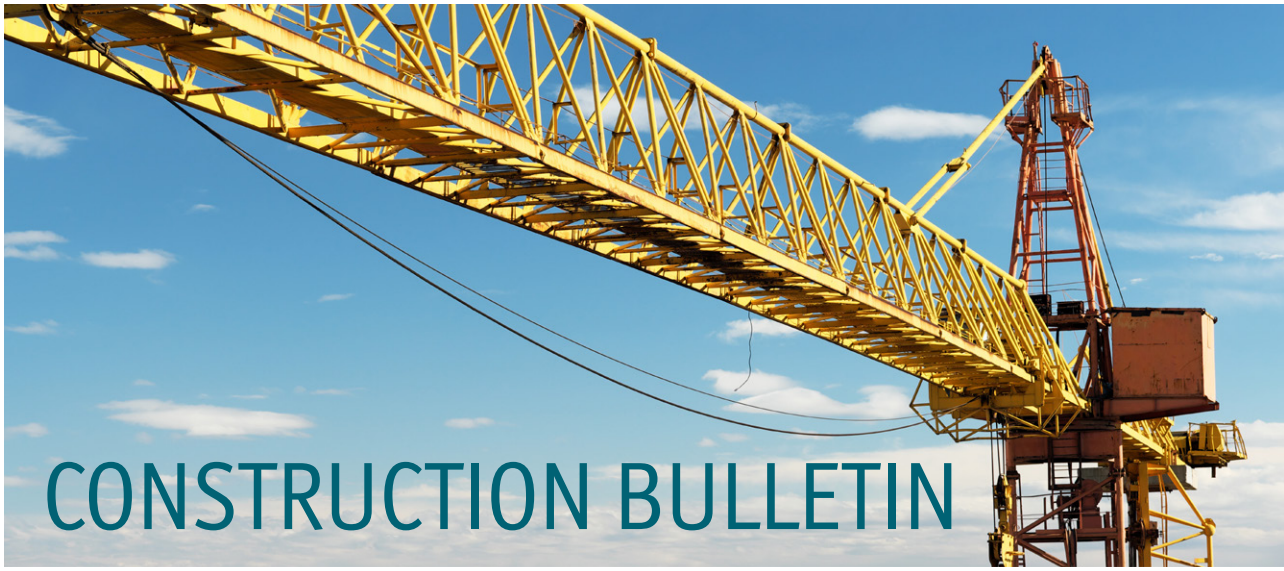
Construction

September 2016



CONSTRUCTION BULLETIN

Welcome to the September edition of our Construction Bulletin

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

- **Pay-when-paid clauses:** Pay-when-paid clauses are outlawed in the UK and many other jurisdictions. Robert Blundell considers their enforceability in the Middle East.
- **The cost of hot tubbing:** Adam Wortman contrasts the increasingly popular practice of experts giving oral evidence by 'hot tubbing' to the more traditional methods in both adversarial and inquisitorial legal systems.
- **Striking out unfair contract terms in civil law jurisdictions:** Soraya Salem considers amendments to the French civil code and compares these with similar provisions in the UAE and Qatari civil codes.
- **Getting on with the job:** Matthew Blycha gives some practical advice on how to manage an ongoing project which is in dispute.

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.

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Pay-when-paid clauses

Contract clauses permitting a contractor to pay a subcontractor only when payment has already been received from the employer are very divisive in an industry dependent on cashflow. Whilst prohibited in some jurisdictions such provisions are not only permitted, but almost encouraged in others.

Pay-when-paid clauses give greater power to the contractor in paying subcontractors and managing their own cashflow. However, a lack of certainty for parties further down the supply chain causes great financial pressure and results in higher rates of subcontractor insolvency.

As a result of years of lobbying by specialist subcontractors, pay-when-paid clauses have been outlawed in many jurisdictions such as the UK, Singapore and Australia. However, many subcontractors moving from these jurisdictions to work around the world are surprised to find that "pay-when-paid" is alive and well elsewhere.

Whilst onerous, clear wording placing the contractor and subcontractor on a back-to-back basis will be regarded as enforceable in most of the Middle East. The legal systems of the Gulf states will look primarily to the principles of freedom of contract to conclude that terms signed up to by commercial parties should be upheld. This will only be prevented where the terms agreed to are either unlawful or in contravention of public morals[1].

It is unlikely that an aggrieved unpaid subcontractor would be able to claim that such provisions fail under local laws for a lack of good faith where they are both express in the contract and common in the industry.

It is also not certain that the failure of a contractor to make payment would give rise to an entitlement to suspend

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ROBERT BLUNDELL, PARTNER

performance by the subcontractor under local laws. Article 247 of the UAE Civil Code will only give such a right where the obligation to perform is regarded as reciprocal to the obligation to pay and the suspension is regarded by the courts as proportionate. A pay-when-paid clause would almost certainly render statutory suspension impossible, since as an expressly agreed term any attempt to exclude it would be regarded as disproportionate.

Similarly, termination is also not commonly available in the Gulf states without court consent and it is unlikely that unilateral termination provisions would be made available to the subcontractor in the event of non-payment, let alone where a pay-when-paid provision had been inserted.

Where a subcontractor is forced to accept a pay-when-paid clause in a subcontract, the manner in which the contractor applies such a clause may still give some chance for relief to the subcontractor.

It is very common for contractors to bundle together claims prior to their submission upstream to an employer. Even more prejudicial to a subcontractor would be the situation where a claim is effectively blocked upstream due to some default of the contractor or other subcontractors. This means that the contractor will never be able to recover the sums due in respect of the innocent subcontractor's work.

In either of these situations the contractor may arrange for a commercial settlement of his upstream claims which the contractor will then wish to apportion onto various subcontractors. Such an approach by a contractor is likely to fall foul of middle eastern Civil Codes which state that a party shall not do harm to another. As a result of the contractor entering into a global settlement upstream in respect of works which have been fully and adequately performed, the subcontractor would otherwise be placed in an onerous position.

Where a subcontractor has fully completed and handed over his works without complaint or dispute, the contractor will no longer be entitled to rely on the pay-when-paid clause to continue to withhold. To get around this principle it is not uncommon for an impoverished contractor to try and withhold completion of the subcontractor's part of the works for as long as possible.

When faced with a pay-when-paid clause a subcontractor would always be well advised to push for obligations on the contractor to pursue prompt payment upstream.

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1 See Qatar Civil Code Article 154.

The cost of hot tubbing

Hot tubbing (known formally as concurrent evidence) is a different approach to testing expert evidence. This article explains what it is, compares it to traditional methods, and discusses its benefits and pitfalls.

What is hot tubbing?

In common law jurisdictions such as England, Singapore and Australia, expert evidence is traditionally tested in an adversarial context. The expert is cross-examined by the opposing party's lawyers who decide the scope and tone of the questioning. Experts are examined individually with the decision-maker listening to and evaluating the evidence. Although the decision-maker can intervene to clarify matters, such interventions are limited. The decision-maker's role is to decide the dispute based on the information as presented.

Hot tubbing breaks from that traditional approach. First, the expert no longer gives evidence alone. Instead, experts from like disciplines give their evidence together. Second, it is the decision-maker that takes the lead in questioning – similar to the inquisitorial approach adopted in civil jurisdictions, such as France. Whilst the lawyers may also ask questions, that opportunity is more limited than would normally be the case.

Does hot tubbing save costs?

Hot tubbing is commonly associated with cost saving, the theory being that by limiting the parties' ability to cross-examine, the length of the hearing will reduce, and so too the cost. In reality however, significant cost savings are unlikely to result. In most cases the costs associated with cross-examining experts will represent only a small portion of the total cost. More significantly, parties are often reluctant to adopt a pure hot tubbing process, instead opting for a hybrid approach where hot tubbing is used in addition to normal cross-examination.

Allowing inter-expert discussion is likely to expose weak arguments and elicit concessions which might otherwise not occur.

ADAM WORTMAN, ASSOCIATE

Keeping control

Adopting a hybrid approach to hot tubbing eliminates a major risk – loss of control. Handing control of expert questioning to a decision-maker makes little sense when it is the parties who are more familiar with the issues being addressed. The adversarial system gives the parties full control over their fates – they can question an expert on technical details and background facts that a decision-maker coming fresh to a dispute may not fully appreciate. Whilst hot tubbing questions are often agreed in advance, those questions are more high level and are unlikely to delve into the detail as would normally be the case.

The true benefit – expert debate

The opportunity for the experts to discuss and question each other is where hot tubbing distinguishes itself. This interactive process is simply not provided for in either the traditional adversarial or inquisitorial approaches. While an expert may find it easy to criticise his opponent's views in a report, it is another thing to have to justify a position when sat face to face and being questioned by a peer. Allowing inter-expert discussion is likely to expose weak arguments and elicit concessions which might otherwise not occur.

In some cases this benefit might be lost. In a recent Scottish case[1] the hot tub contained seven experts. Whilst order was maintained by providing only one microphone, and allocating each expert a portion of the time available to speak, the number of experts did not allow a proper exchange of views to take place. In that same case two experts speaking to a separate issue later sat together in the hot tub. That discussion was free flowing, concessions were more forthcoming, and the issues were narrowed as a result.

Conclusion

Hot tubbing is a useful addition to the expert examination process. Although unlikely to save significant costs, having experts give evidence together is likely to lead to more reasonable positions being advanced. Whether this is in a party's interest will very much depend on the case being advanced and the strength of the expert.

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1 *SSE Generation Limited v HOCHTIEF Solutions AG and Ors*, CA162/12 (decision pending)

Striking out unfair contract terms in civil law jurisdictions

This article considers certain aspects of the recent reform of the French Civil Code which have relevance to construction and infrastructure contracts, and compares them to similar provisions existing in UAE and Qatari law.

The reform of French law introduced by Ordinance No. 2016-131 dated 10 February 2016 applies to private construction contracts entered after 1 October 2016, although a number of procedural provisions will apply to contracts concluded before that date.

The reform is intended to modernise French contract law. It covers many aspects of contract law including the introduction of a requirement of good faith during pre-contract discussions and negotiations, as well as new provisions permitting the renegotiation or annulment of a contract in certain circumstances.

This article considers two aspects of the new law and their anticipated impact on construction and infrastructure contracts. First, the regulation of contractual imbalance and, second, the impact of the new hardship provisions. These new rights are compared in this article to similar provisions which exist in UAE and Qatari law.

They are rights which unlock remedies of interest to parties engaged in long term contracts where changes in economic conditions mean that disputes have arisen as the parties seek to adjust their contracts to reflect the changed circumstances.

Regulation of contractual imbalance

Whilst the general rule is that a court will not interfere with the contractual bargain reached by parties, there are two important exceptions to this rule that have now been codified. Although these two exceptions are not mandatory rights,

Whilst the introduction of codified hardship provisions under article 1195 is likely to be welcomed by commercial parties, it is unlikely to have a major impact in the construction industry given that similar provisions can generally be found in the sophisticated contracts parties already in use.

SORAYA SALEM, ASSOCIATE

and could be excluded by the parties by an express provision in their contract, such exclusion is in practice difficult to imagine except in cases of imbalanced bargaining positions of the parties.

The first exception, previously based on the controversial concept of 'cause', established in case law by the Cour de Cassation in 1996, has now been codified by Article 1170 which provides: *"any contract terms which deprive a debtor's essential obligation of its substance is deemed not written"*.

This exception permits, in certain circumstances, the striking out of contractual provisions found to deny a party's essential entitlement under a contract. The extent of the application of this remedy to construction contracts is yet to be seen, but it could theoretically extend to judicial interference with agreed contractual caps on liability and/or performance obligations that are held to be out of sync with the principal obligation under the contract in question.

The second exception, in Article 1171, provides that *"any term of a standard form contract which creates a significant imbalance in the rights and obligations of the parties to the contract is deemed not written"*. This exception only concerns parties contracting on one or other's standard terms and conditions (Article 1110 defines "standard form contract" as a contract *"whose general conditions are determined in advance by one of the parties without negotiation"*) and gives the French courts the power to nullify offending terms which are found to have created a significant imbalance in the parties' rights and obligations.

In the construction industry, this second exception is likely to be most relevant to small businesses that have terms and conditions imposed on them by a larger business such that a contractual imbalance has arisen. It is possible that the effect of this Article may also extend to some private works contracts which are often marginally negotiated by the contractor - but it is not expected to affect larger or freely negotiated contracts.

UAE law takes a similar approach to these two new exceptions. The general rule is that the UAE courts will not interfere with parties' contractual agreements, but Article 248 of the UAE Civil Code does provide some protection to parties who contract on the other party's standard terms, referred to as a contract of adhesion.

In this connection Article 248 states: *"if the contract is made by way of adhesion and contains unfair provisions, it shall be permissible for the judge to vary those provisions or to exempt the adhering party therefrom in accordance with the requirements of justice, and any agreement to the contrary shall be void"*.



Article 248 accordingly allows a judge to vary or remove terms of the contract considered unfair to a party contracting on the other party's standard terms. Parties cannot, for public policy reasons, exclude the effect of Article 248 from their contracts.

Hardship provisions

The second remedy considered by this article and brought into French law by the new Ordinance is the possibility for a party to seek the renegotiation or termination of a contract *"where a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance exceedingly onerous for a party who had not accepted the risk of such a change"* (Article 1195).

This is generally known as a "hardship provision" and is a remedy which applies where the party claiming hardship has not expressly taken the contractual risk of the event that leads to the changed circumstances. It is also non-mandatory and can therefore be excluded in full or part by clear contractual terms.

The remedy entitles an aggrieved party, for whom performance of a contract has been rendered excessively onerous by an unforeseeable change of circumstance, to seek the renegotiation of the contract with its counterpart. Both parties are required to continue to perform their contractual obligations during the renegotiation to provide certainty that the parties will continue to abide by their contractual obligations.

If the parties are unable to agree new terms, they may agree to terminate the contract on mutually acceptable terms. If the parties have been unable to agree terms, but do not wish to terminate the contract, then they can jointly ask the court to determine revised terms to reflect the changed circumstances.

Alternatively, if the parties do not agree to approach the court jointly, then a party acting within a reasonable time period, may itself request the court to revise the contract in light of the change of circumstance, or direct that the contract be terminated. It permits the court discretion to intervene in the parties' contractual bargain and to ultimately impose a solution that had not been requested by the parties. This is a right of last resort and is expected to be exercised with caution by the courts.

The new Article 1195 has left it up to the French courts to determine what constitutes an "unforeseeable change" that can be said to have rendered the contract performance "excessively onerous".

The impact of this remedy on construction and infrastructure contracts will have to be monitored once the Ordinance comes into force. Indeed, it is quite possible that it will have little discernible impact on contracts which typically contain agreed contractual mechanisms catering for unforeseeable events, such as force majeure provisions. Similarly the courts have shown a historical reluctance to order a higher price/additional costs in lump sum contracts on the ground of unforeseeable or disrupted market conditions. It seems more likely that the remedy will be used more often as an avenue to seek termination of the contract on the basis of an unforeseeable event.

In any event, we expect the construction industry to routinely exclude this remedy from construction contracts to limit judicial interference with the parties' contractual agreement. Not least, as mentioned above, because construction contracts generally already include adequate mechanisms for responding to unforeseeable events. But also due to uncertainty as to the approach and interpretation likely to be taken and applied by the courts to the remedy.

Both UAE and Qatari law contain similar hardship provisions. However, unlike the new hardship provision introduced into the French Civil Code, the rights are mandatory and cannot be contracted out of by parties.

Article 171 Qatari Code, and Article 273 of UAE Code, both permit relief for financial hardship. The operation of this relief is, however, different between the two jurisdictions.

In terms of the applicable tests in relation to the notion of unforeseeability, Qatari law refers to "exceptional and unforeseen events" whereas UAE law determines the rights based on force majeure principles. The nature of the hardship is also determined by different tests – in Qatar it is required to be "excessively onerous" and under UAE law "impossible".

The remedy available to the parties also differs. In Qatar, there is a focus on reasonable resolution by renegotiation, whilst under UAE law the remedy is rescission of the contract, either in whole or in part.

Conclusion

Whilst the introduction of codified hardship provisions under Article 1195 is likely to be welcomed by commercial parties, it is unlikely to have a major impact in the construction industry given that similar provisions can generally be found in the sophisticated contracts parties already in use. We therefore expect to see these provisions routinely expressly excluded from contracts subject to French law, whereas the equivalent rights cannot be contracted out of under UAE or Qatari law.

Similarly the new remedies introduced by Articles 1170 and 1171 to rectify contractual imbalance are also to be welcomed, and parties should be aware of these new codified remedies when negotiating terms which are out of sync with the primary obligations and/or if contracting on standard terms of business.

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Getting on with the job

The first thing that first aiders are taught is the "Three P's of First Aid" which are "preserve life", "prevent further harm" and "promote healing". Similar thinking can be applied to an incomplete construction project which is in dispute or heading towards a formal dispute process. Project managers and contract administrators involved in disputed projects are something like a paramedic to the lawyer's doctor[1].

In the construction context the "Three P's" translate to three instructions:

- Do not make it worse.
- Do not compromise your position.
- Do try to make it better.

By adhering to these simple guidelines even the most challenged project can make it to completion.

Do not make it worse

It is a truism that people build projects. It is critical not to lose sight of this when a dispute is underway.

Regardless of the status of the dispute, while there are works to be completed, representatives of the contractor and employer have to interact, both in person and via correspondence. This can present a challenge where the parties are engaged in a dispute in another forum.

One way to take pressure out of the relationship is to move management of the dispute to an entirely separate team and let the project staff focus on the day-to-day tasks associated with completing the job. There are collateral benefits to this approach in terms of maintenance of privilege and, importantly, in getting the separate claims team to provide an impartial view of the merits of the dispute.

In such a situation the claims team should adhere to a communications protocol. Such a protocol would limit the number of people who communicate directly with the project team, the other side and any lawyers. Adherence to the protocol means that communications about the dispute can be easily corralled and managed so as not to lose legal privilege.

Of course, the project teams will still need to talk to each other. In such situations there usually are handover inspections, punchlist works to be completed and as-built documentation to be exchanged. Without communication, the job would never get finished. But, when corresponding across the contractual divide, it is important not to add fuel to the fire. So, prepare your correspondence carefully and treat meetings with caution but, most of all, be polite. It sounds simple, but being polite in all of your dealings with the other party can go a long way to taking the heat out of the relationship. It can help parties focus on getting on with the job rather than putting energy into making or defending personal attacks.

Do not compromise your position

Of course, being polite doesn't mean giving up your position. It is perfectly fine to say "I disagree" and move on. However, contractors should be mindful that there is usually a clause in the contract which mandates performance even in the face of a dispute. Failing to perform in those circumstances might amount to a repudiation which, in turn, might expose the contractor to a damages claim.

Of course, there might be a power, whether in the contract or in statute, for a contractor to suspend work in some circumstances. If this power is engaged correctly it can create leverage in negotiations which might be useful in bringing the dispute to a mutually beneficial conclusion.

People build projects. It is critical not to lose sight of this when a dispute is underway

MATTHEW BLYCHA, PARTNER

Do try and make it better

Similarly, the project team can't just adopt the "ostrich approach" and ignore the existence of the dispute. They should work to help the personnel involved in managing the dispute.

At the individual level this might include: responding promptly to requests for information; drafting a preliminary witness statement; not talking to other project team members about evidence; or filing correspondence in a way that will make it easy for the disputes team to find important information – for example, if a particular variation is in dispute then make sure all of your emails and diary notes related to that variation are in one spot.

At the project level "trying to make it better" means adhering to the dispute resolution procedure set out in the contract[2]. However, never lose sight of the fact that there is nothing immutable about the dispute resolution process. If it doesn't suit the particular dispute there is nothing to stop the parties from agreeing to adopt a different, customised, procedure.

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1 See also, Paula Gerber, 'How to Stop Engineers from Becoming "Bush Lawyers": The Art of Teaching Law to Engineering and Construction Students' (2009) 1 *Journal of Legal Affairs and Dispute Resolution in Engineering and Construction* 179, 179.

2 See for example, *Santos Ltd v Fluor Australia Pty Ltd* [2016] QSC 129 (13 June 2016)

hfw Conferences and events

HFW Seminar
Construction Industry Seminar
Perth, Australia
1 September 2016
Presenting: Matthew Blycha

IBC Construction Law Summer School
Workshop on variations under FIDIC
London, UK
5-8 September 2016
Presenting: Michael Sergeant and Richard Booth

Television Education Network Property and Construction Law
Seminar on current legal issues facing Property and Construction Lawyers in Australia
Sydney, Australia
8 September 2016
Chair: Carolyn Chudleigh

HFW Seminar
Getting to "Yes" in EPC Contracting
Seoul, Korea
21 September 2016
Presenting: Max Wieliczko and Nick Longley

IBC International Construction Disputes Conference
International Arbitration
London, UK
4-5 October 2016
Presenting: Michael Sergeant and Max Wieliczko

Variations in Adjudication
London, UK
5 October 2016
Presenting: Michael Sergeant and Richard Booth

HFW/BK Surco seminar on insurance law
Hong Kong
12 October 2016
Presenting: Nick Longley

CWC Negotiating Oil & Gas Contracts Conference
EPC Contracts
London, UK
17-21 October 2016
Presenting: Michael Sergeant

Insolvency in the Construction Industry
Melbourne, Australia
20 October 2016
Presenting: Brian Rom

Property Council of Australia 2016 Congress
Hamilton Island, Queensland, Australia
20-22 October 2016
Presenting/attending:
Carolyn Chudleigh, Richard Abbott, Kendra McKay, Stephanie Lambert, Chris Allen

Hill International Master Class
Changes and Variations
Dubai, UAE
25 – 26 October 2016
Presenting: Michael Sergeant

Society of Construction Law Australia Conference
Canberra, Australia
4 November 2016
Presenting: Nick Longley

Adjudication Society Annual Conference
Birmingham, UK
10 November 2016
Presenting: Richard Booth

Property Development Academy of Australia
Property Development Industry Diploma
Legal Framework and Dispute Resolution
Sydney, Australia
10 November 2016
Presenting: Carolyn Chudleigh

HFW Quarterly Construction Seminar
The SCL Delay and Disruption Protocol
HFW London office
16-17 November 2016
HFW speakers: Max Wieliczko, Richard Booth and Katherine Doran
Guest speaker: David Barry

Construction Insurance Claims
Melbourne, Australia
17 November 2016
Presenting: Nick Longley and Richard Jowett

Asia Institutional Investment Summit 2016
Current Market Status and Strategies for Off-Shore Real Estate Investments
Outward bound Chinese investment
Beijing, China
17-18 November 2016
Presenting: Richard Abbott and Carolyn Chudleigh

HFW Seminar
Construction Law – 2016 in review
Perth, Australia
24 November 2016
Presenting: Matthew Blycha and David Ulbrick

FIDIC Users Conference
Variations under FIDIC forms
London, UK
6-7 December 2016
Presenting: Michael Sergeant and Max Wieliczko

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