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CONSTRUCTION BULLETIN SEPTEMBER 2018



Welcome to the September edition of our Construction Bulletin.

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

- China's International Commercial Courts
- The new UAE Arbitration Law
- Smart Contracts in the Construction Industry
- 'No Oral Modification' Clauses in Construction Contracts

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

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REGISTERED FOREIGN LAWYER

“ICCs have one significant advantage over arbitration, which is that their judgments will have the status of judgments of the Supreme People’s Court. Successful parties will therefore have recourse to the court’s armoury of enforcement measures, whereas successful parties in arbitrations must obtain court orders in respect of awards before they can be enforced.”

CHINA’S INTERNATIONAL COMMERCIAL COURTS

On 29 June 2018, China launched two International Commercial Courts. One International Commercial Court (ICC) is in Shenzhen and the other is in Xi’an. The ICCs will handle disputes concerning the Belt and Road Initiative (BRI).

Why have the courts been established?

The BRI is an ambitious project to connect China with 65 countries across several land and maritime “roads”. The establishment of these ICCs is one of a series of measures to encourage foreign investors to participate in the BRI. The Xi’an ICC will handle disputes concerning the “Land Silk Road”, and the Shenzhen ICC will handle disputes concerning the “Maritime Silk Road”. An international commercial tribunal will be established in Beijing to coordinate between the two ICCs.

When might the ICCs be used?

In order for a dispute to be referred to one of the ICCs, it must be considered “international”, which requires it to (i) involve one or more foreign parties that reside outside China, (ii) concern a subject outside of China, and (iii) involve legal facts, which occurred outside China, creating, changing or eliminating relations.

The dispute must also be one that either:

- the parties have agreed to refer to the Supreme People’s Court and the disputed amount exceeds RMB 300 million;
- the parties have agreed to refer to the Higher People’s Court, and that court transfers it to the Supreme People’s Court;
- the Supreme People’s Court has decided it should be heard by one of the ICCs; or
- concerns interim measures in support of domestic arbitration or the enforcement or setting aside of a domestic or foreign arbitral award.

Procedural rules

The procedural rules of the ICCs share similarities with procedural rules

of other international commercial courts. For example, there will be no requirement for English documents to be translated into Chinese if all parties agree, and the judges will apply the law agreed by the parties. “Expert Committees” of foreign nationals will be established to assist the judges to apply foreign laws. The first committee was appointed in August 2018, and consists of leading arbitration specialists from Europe, Asia and America, and former judges from Hong Kong, Australia, the UK, and South Africa.

There are, however, significant differences between the procedural rules of the ICCs and other international commercial courts. In particular, the proceedings must be conducted in Chinese and parties must be represented by Chinese lawyers. The judges who will sit in the ICCs are all existing judges in the Supreme People’s Court, and whilst foreign judges might feature in the “expert committees”, they will not be invited to sit as judges in the ICCs.

Analysis

The establishment of the ICCs is a step towards improving access to justice in China. However, it is unclear how widely used they will be. Only permitting limited involvement by foreign professionals may lead to questions over the discernible differences between the ICCs and domestic courts. For these reasons, International businesses may be more attracted to arbitration, where they may appoint foreign arbitrators, engage foreign counsel and conduct proceedings in English.

However, ICCs have one significant advantage over arbitration, which is that their judgments will have the status of judgments of the Supreme People’s Court. Successful parties will therefore have recourse to the court’s armoury of enforcement measures, whereas successful parties in arbitrations must obtain court orders in respect of awards before they can be enforced. Whether this will be enough to sway international businesses remains to be seen.

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THE NEW UAE ARBITRATION LAW

Eleven years in the planning, the new UAE Arbitration Law has finally been rolled out – but has it modernised the UAE’s arbitral framework?

In June 2018, Federal Law No 6 of 2018 on Arbitration (the New Law) came into force in the UAE. It repealed and replaced Articles 203 to 218 of Federal Law No 11 of 1992 (the Old Law).

The Old Law was perceived by some to be outdated and not reflective of best practices in commercial arbitration. Its provisions – only 16 in total – left considerable scope for recalcitrant debtors to delay proceedings and frustrate enforcement of awards, as evidenced by numerous successful nullification challenges to awards in recent years.

In contrast, the New Law is based on the UNCITRAL Model Law. It is comprehensive, comprising 61 articles, and seeks both to remedy these issues and to bring the UAE in line with international best practice.

The New Law applies to both current and future arbitrations. Highlights include:

- the law will apply to local and international arbitrations (though treaty provisions may take precedence);
- the principles of separability and competence will apply, allowing the tribunal to rule on its own jurisdiction;
- electronic communications will satisfy the requirement for an arbitration clause to be in writing;
- interim and partial awards will be enforceable;
- awards will no longer need to be physically signed by the arbitral tribunal in the seat, potentially saving travel and administration costs.

Further, to reduce challenges to enforcement, applications for total or partial annulment must now be initiated within 30 days of the award being notified to the parties. Additionally, clarification has been given that an application for annulment will not automatically stay enforcement proceedings.

The New Law makes clear that both arbitral tribunals and courts have the power to order interim and conservatory measures in ongoing or potential arbitrations. It is not yet known how the tribunals and the courts will interact on this issue, as interim measures have not, traditionally, been available in the local courts. What is clear is that an application to court does not mean the parties have waived their right to arbitrate.

There are also limited restrictions on arbitrators’ qualifications, addressing previous uncertainty about the ability of non-UAE lawyers to sit on tribunals. At the same time, the UAE Ministry of Economy will co-ordinate with local arbitration institutions to develop a code of conduct for arbitrators.

The New Law is a welcome development, particularly in construction claims where arbitration remains the most popular method of dispute resolution. However, its true impact will ultimately be determined by the manner in which the UAE Courts interpret and apply its articles and address challenges to enforcement. It is nevertheless clear that the New Law represents a bold step to modernise the practice of arbitration in the UAE, with the ultimate goal of maintaining the UAE’s position as a regional hub of arbitration and making arbitrations more streamlined and cost-effective.

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“the New Law represents a bold step to modernise the practice of arbitration in the UAE”

SMART CONTRACTS IN THE CONSTRUCTION INDUSTRY

From certain corners, we hear that smart contracts will serve to make transactions ‘frictionless’: they will result in contracts being enforced automatically without the need to resort to a court or arbitration. There are even suggestions that they will, ultimately, remove or greatly reduce the need for the personnel involved in contract formation and administration, such as contract managers, commercial teams and even lawyers. This article looks at smart contracts in the context of the construction industry.

Terminology – what is a ‘smart’ contract?

First, it is necessary to clarify what the term means. A contract is an agreement between two or more parties which binds them to something in the future. The key feature of a ‘smart’ contract is that it can be enforced automatically. This concept of automatic enforcement is used (somewhat confusingly) to refer to ‘trustless execution’. It has led to the term ‘smart’ contract being understood by some to mean a computerised protocol that executes a contract.

This issue of terminology is not trivial: when a smart contract is understood (merely) as the protocol that executes a contract, it is easy to see why commentators have said that the legal status of smart contracts as legally binding agreements is uncertain. As any first year contract administrator will know, something that simply executes the terms of a contract does not meet the legal requirements of a contract (i.e. offer, consideration, acceptance).

A better definition for the term, and the one we will use in this article, is that a smart contract is a contract which includes *“promises, specified in digital form, including protocols within which the parties perform on these promises”*. This quoted phrase first originated in the mid 1990’s by Nick Szabo, a computer scientist and legal scholar. Viewed in this way, a smart contract is a contract which contains certain ‘smart’ contractual clauses. These smart clauses are embedded in hardware and software

in such a way that the clauses can ‘self execute’.

In this sense, a smart contract has all the hallmarks of a standard legally enforceable agreement, but some of the contractual provisions are backed-up by computer code. Importantly, this code operates in such a way as to give effect to those contractual provisions without the contracting parties having to take any other steps. For example, smart contractual clauses operate so that on the occurrence of a particular event, such as goods being delivered to site, certain contractual provisions take effect. For instance, legal title to goods transferring to a purchaser, or a payment being made to one contracting party.

The process of implementing smart contracts

As will be seen, a very large part of smart contracting requires digital and physical assets to be structured in such a way as to make the contracts ‘alive’ and responsive to events as they happen. This reconfiguration of digital and physical assets will happen, but will require substantial investment for all involved.

The following provides a (very) brief overview of the elements involved in implementing smart contracting.

Drafting the smart contract: The easy part, at least the conceptually easiest step, is drafting the smart contract. This first involves identifying contractual provisions that can be sensibly translated into computer code. Secondly, the contractual language of these provisions must be translated into a script that can be understood computationally (i.e. if this happens, then that happens). Finally, these contractual clauses, in the form of computer code, are uploaded so that they can interface with the world.

Linking code to the real world:

The smart contractual coding then interfaces with other digital infrastructure. An example might be the code interfacing with a sensor which is attached to a piece of equipment and the sensor is connected to the internet (i.e. the internet of things). The data from the code and the sensor interact and, if certain pre-requisites are met,

the combined information is sent to a ‘blockchain’ for validation. The information might be, for example, that equipment to be delivered under a contract is recorded as having arrived at site.

Blockchain: As the smart contract clauses are, effectively, a piece of software, that software needs somewhere to operate. This is provided by blockchains which provide the backbone of the digital infrastructure needed to run smart contracts. For present purposes we will describe a blockchain as a simply collaborative way of recording data.

Central to the concept of a blockchain is that this data, which maintains a record of transactions, is held on decentralised ledgers which are maintained by all the blockchain users. A disparate group of users on a blockchain is essential to the integrity and independence of a blockchain. A blockchain which had only two users – say, the employer and contractor, for example – would fail to achieve the central premise of a blockchain, which is to validate the authenticity of data in circumstances where the parties who are reliant on the data do not (and need not) trust one another.

A transaction occurs on a blockchain when a package of data is split into a time-stamped, encrypted ‘block’ and this block is distributed to all users on the blockchain who are responsible for validating the authenticity of the block. When the block is validated by the users (or in blockchain terminology, they reach ‘consensus’), it is added to the chain of earlier blocks, thus making the blockchain an immutable record of all previous transactions.

In our example above, the ‘package of information’ that is transmitted to the blockchain contains the contractual term regarding delivery of equipment to site and the record of actual physical delivery of that material to site. The information is then validated and, on confirmation, the corresponding contractual event that is linked to the validation occurs (for instance, payment is made to the contractor).

Case examples of use of smart contracts in the construction industry

In addition to a smart clause automatically triggering payment on delivery of materials mentioned above, another obvious example of a potential smart clause in a construction contract is in relation to contractual communications. In the smart contracting world we can imagine that notices are issued during a morning site walk by a project manager with her tablet.

However, smart contract clauses need not be limited to procedural matters. An EPC contract for the construction of a power station will typically include different liquidated damages regimes, both for delay to completion and also for meeting specified performance criteria.

With a smart EPC contract, we can imagine that delay liquidated damages might be linked to the need for the power station to distribute electricity into a grid by a set date. If a sensor placed on the grid does not record electricity distribution by the required date, liquidated damages could be automatically levied by deducting funds from the contractor's bank account. Similarly, conducting performance tests for the power station, which may be relevant to the achievement of performance guarantees and avoiding performance liquidated damages, might be determined based on a digital record of things that actually occur at the power station, such as the quantity of feedstock used to generate electricity, the level of noise and air pollution produced by the station and the amount of power fed into the grid. Whether contracting parties would agree to hand over control of these often contentious matters to automatic procedures is, however, another question.

In each instance, smart contractual coding interacts with digital infrastructure that records events in the real world. This information is then validated on a blockchain which then automatically trigger ("enforce") the operation of certain contractual rights (payment, transfer of title, etc).

Conclusion

Turning standard contractual provisions into smart contractual provisions will serve to automate a large part of parties' contractual relationships and will have many benefits. However, the effort required to turn all contracts into smart contracts should not be underestimated.

The potential benefits of smart contracts suggest it is inevitable that smart contracts will be widely adopted, though it is likely that transaction-based industries such as finance and commodities will see more immediate acceptance and use than the construction industry. While smart contracts will be implemented in time, there are many steps between having a written contract and having a smart contract that serve the needs of those in the construction industry.

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“The potential benefits of smart contracts suggest it is inevitable that smart contracts will be widely adopted, though it is likely that transaction-based industries such as finance and commodities will see more immediate acceptance and use than the construction industry.”



DANIEL JOHNSON
ASSOCIATE

“if a contract contains a NOM clause and the parties want to agree changes, be sure that any changes are made in writing.”

‘NO ORAL MODIFICATION’ CLAUSES IN CONSTRUCTION CONTRACTS

Earlier this year, in *Rock Advertising Limited v MWB Business Exchange Centres Limited*¹ the United Kingdom Supreme Court upheld a no oral modification (NOM) clause as effective. NOM clauses usually say that changes to a contract are only effective if in writing. We provided a briefing² on that decision. In this article we consider the approach to NOM clauses in standard form construction contracts and in civil law jurisdictions.

Rock decision – recap

Under English law, as with many common law jurisdictions, there are very few formalities for making a contract (except for certain special contracts, such as those relating to transfers of land). Parties can agree what they like, how they like.

In *Rock*, the court considered whether an oral agreement made between the parties to vary a contract was valid when the contract contained a NOM clause. The court found that the oral agreement was invalid as it was precluded by the NOM clause, which was effective.

The decision is significant, as previously there was uncertainty under English Law as to whether NOM clauses were effective. The perceived wisdom being that if parties to a contract later reached an oral agreement, the new agreement varied the old contract (including the NOM clause) and the variation was therefore valid. The Supreme Court has found this to be incorrect³.

NOM clauses and construction contracts

NOM clauses are commonly found in construction contracts.

The NEC4 suite contains a core clause in these terms:

“No change to the contract, unless provided for by these conditions of contract, has effect unless it has been agreed, confirmed in writing and signed by the parties.”

Following *Rock*, under English Law, this clause is effective and will restrict the parties’ ability to orally agree changes to the contract.

In the new FIDIC suite of contracts there is no NOM clause. While FIDIC contracts provide that communications regarding contract mechanisms, including notices and claims, must be in writing, such provisions relate to how the parties agree to operate the contract, rather than changes to the contract itself. A common amendment to FIDIC is to add a NOM clause.

NOM clauses in civil law jurisdictions

The requirements of contract formation vary between civil law jurisdictions, but in many cases oral changes to contracts are permitted. While it is not possible to say generally whether NOM clauses are effective in civil jurisdictions, there is likely an added difficulty to relying on them, as the civil law doctrine of good faith may in certain circumstances prevent a party from relying on a NOM clause where an oral agreement has been made.

Comment

The different approaches to NOM clauses under NEC and FIDIC show there can be no substitute to knowing what is agreed in the contract. Under English Law at least, NOM clauses are effective. So, if a contract contains a NOM clause and the parties want to agree changes, be sure that any changes are made in writing.

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¹ [2018] UKSC 24.

² <http://www.hfw.com/A-truly-fundamental-issue-of-contract-law-does-a-no-oral-modifications-clause-work>

³ Unless there is evidence of estoppel. See our previous briefing at: <http://www.hfw.com/A-truly-fundamental-issue-of-contract-law-does-a-no-oral-modifications-clause-work>.

CONFERENCES AND EVENTS

Leaders In Construction Summit

Dubai
12 September 2018
Speakers: Beau McLaren,
James Harbridge

HFW Construction Insurance Seminar

Melbourne
13 September 2018
Presenting: Nick Longley,
Richard Jowett

HFW Construction Seminar

Seoul
20 September 2018
Presenting: Nick Longley, Kijong Nam,
Alistair Feeney

HFW-HKA Construction Seminar

Dubai
24 September 2018
Presenting: Beau McLaren,
James Plant

HFW-Driver Trett Construction Seminar

Riyadh
15 October
Presenting: Humayun Ahmad

Subsea Cable Conference

London
16 October 2018
Presenting: Richard Booth

HFW-Driver Trett Construction Seminar

Kuwait
16 October 2018
Presenting: Michael Sergeant,
James Plant

HFW Seminar for the Resolution Institute

Melbourne
16 October 2018
Presenting: Nick Longley

Leaders In Construction Summit

Kuwait
17 October 2018
Speakers: Michael Sergeant,
Beau McLaren

6th International Arbitration Conference

Melbourne
17 October 2018
Presenting: Nick Longley

The Lighthouse Club Seminar

Melbourne
18 October 2018
Presenting: Nick Longley

Construction Week Dispute Resolution Conference

Abu Dhabi
24 October
Speakers: Beau McLaren,
James Harbridge

HFW Construction Insolvency Seminar

Melbourne
30 October 2018
Presenting: Brian Rom, Alex McKellar

Offshore Decommissioning Contracts & Operations Seminar

London
31 October - 1 November 2018
Presenting: Richard Booth,
Ben Mellors

Construction Disputes Conference

London
7 November 2018
Presenting: Richard Booth

The Adjudication Society's 7th Annual Conference

London
8 November 2018
Presenting: Richard Booth

FIDIC Construction Quarterly Seminar

London, HFW Office
13 November 2018
Presenting: Ben Mellors,
Michael Sergeant, Huw Wilkins,
Richard Booth

HFW-HKA Construction Seminar

Doha
14 November 2018
Presenting: Beau McLaren,
Gerard Moore

Property Council of Australia: Diploma Course

Sydney
22 November 2018
Lecturer: Carolyn Chudleigh

FIDIC International Contract Users' Conference 2018

London
4 - 5 December 2018
Presenting: Michael Sergeant,
Ben Mellors

MBL Construction Law Conference 2018

London
12 December 2018
Presenting: Michael Sergeant

HFW-Driver Trett Construction Seminar

Oman
13 December 2018
Presenting: James Harbridge,
Humayun Ahmad

Offshore Wind Conference

London, HFW Office
23 January 2019
Presenting: Max Wieliczko,
Michael Sergeant, Ben Mellors,
Richard Booth

Construction Quarterly Seminar

London, HFW Office
26 - 27 February 2019
Presenting: Max Wieliczko,
Huw Wilkins

11th IBA's Real Estate Investments Conference

Dubai
27 - 29 March 2019
Presenting: Carolyn Chudleigh,
Sydene Helwick, Richard Abbott

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