

# HFW



**CONSTRUCTION BULLETIN**  
**SEPTEMBER 2023**

### Welcome to the September 2023 edition of our Construction Bulletin.

In this edition we cover developments in international construction law that may be relevant to all parties in the industry, as follows:

- The enactment of the Civil Transactions Law in the Kingdom of Saudi Arabia which marks a significant milestone in providing transparency, efficiency and business stability in this jurisdiction and will preserve the application of Sharia principles.
- Consideration of the scope and requirements of the “best endeavours” obligations found in contracts;
- The continued impacts of COVID-19 in the context of material escalation clauses in construction contracts.
- A timely reminder as to application of and the differences between Security of Payment legislation in certain jurisdictions and the need to ensure compliance.

We also list upcoming events and webinars at which members of the construction team will be speaking over the next few months.

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## KSA CIVIL TRANSACTIONS LAW

The Kingdom of Saudi Arabia (KSA) has recently enacted the Civil Transactions Law (Law)<sup>1</sup> as a significant milestone towards KSA's "Vision 2030" to provide transparency, efficiency, and stability to business in KSA (including consistency of judicial rulings) and to develop the kingdom's profile as a safe place to invest and do business. Previously, the KSA derived its law principally from Shari'a (the Holy Qur'an and The Sunnah (the prophetic teachings of the Prophet Muhammad)).

The Law, which becomes effective on around 16 December 2023, will have retrospective effect on matters that are covered in its 726 Articles and applies to almost all KSA law governed contracts signed prior to December 2023. The Law does not apply to contracts where the parties have expressly chosen a different governing law.

The Law supports certain fundamental principles. In brief: (i) contracts have binding force and the parties must fulfil them; (ii) where a contract is clear, deviation is not permissible. However, if interpretable, the parties must interpret in good faith and according to their common will at the time of signature; and (iii) liquidated damages are permissible but may be reduced by a court if considered inequitable. Other damages must have been foreseeable at the time of signature. There is no specific reference to 'loss of profit' being recoverable.

To the extent that the Law's Articles are insufficient, the Law promulgates 41 Islamic law (Shari'a) principles in its final chapter to be used as a 'fallback position' and to fill any gaps in the law. The 41 principles include

important maxims for parties (and Courts) to follow when considering contracts, including: certainty is not removed by doubt; freedom from liability is presumed; customs are regarded as part of the contract; ignorance is not an excuse for non-performance; the rights of individuals are not removed by necessity; and priority is given to intention and meaning, as opposed to text and formation.

The Law draws on the Shari'a approach which involves widely interpreting a contract through the lens of good faith, equity, and to ensuring 'fair' outcomes. This is a contrast to a strict 'Black letter' law that is often confined to a strict interpretation of a contract often to the exclusion of extraneous considerations. This is particularly relevant to parties in the construction industry as the Law, which is similar to other civil code laws such as those found in the UAE law, will most likely be contractor friendly.

The only situation in which the Law should not be applied is where a party can show that its provisions contradict the original Shari'a text. The obligation to prove this rests with the party seeking to make that claim. The Law is superior to any other KSA law, and any contradictory laws are now void.

Once the Law becomes effective, it will be interesting to see how the Law will be applied by parties and the Courts of KSA and the interplay of its provisions with the 41 Sharia principles to achieve its objectives.

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<sup>1</sup> 19 June 2023 by Royal Decree M/191

## BEST ENDEAVOURS

**As in this World, nothing is certain but death and taxes, there are variable levels of certainty used in drafting, to accommodate circumstances beyond parties' control and to avoid uncertainty. During negotiations, absolute obligations are often diluted or qualified by terms like "best endeavours" or "commercially reasonable efforts". When including a "best endeavours" clause, it is advisable to specify what will be required to satisfy "best endeavours".**

There is a range of "efforts" clauses, with "best" being on the more stringent end of the spectrum. The efforts clause will be interpreted in light of the circumstances at time the contract was formed, taking into account the commercial situation in question. The satisfaction of an undertaking (of using the best endeavours) is assessed by reference to the circumstances at the time of performance.

According to *Sheffield District Railway*<sup>1</sup> best endeavours "means what the words say; they do not mean second-best endeavours". While the Sheffield Railway authority seems to indicate that best endeavours is an onerous obligation "not to leave a stone unturned", later authorities consistently apply a test of reasonableness.

Best endeavours<sup>2</sup> require the obligor to put himself in the shoes of reasonable obligee "to take all those steps in their power which are capable of producing the desired results ... being steps which a prudent, determined and reasonable [obligee] ... would take".

Best endeavours clause is onerous, but is not an absolute obligation, nor is it "the next best thing to an

absolute obligation or a guarantee"<sup>3</sup>. It "must at least be the doing of all that reasonable persons reasonably could do in the circumstances"<sup>4</sup>.

In practice, the principle of "reasonableness" means that best endeavours obligation may require expenditure on behalf of the obligor<sup>5</sup>, but the obligor would not need to take action resulting in "the certain ruin of the Company or ... the utter disregard for the interests of shareholders"<sup>6</sup>. It may impose an obligation to litigate or appeal against a decision, though this would not extend to action that was doomed to failure or would be unreasonable in all the circumstances<sup>7</sup>. It may be overridden by other duties (an obligation on the directors of a company to use best endeavours to pass a resolution did not require the directors to give bad advice to the shareholders and continue to recommend the resolution once it ceased to be in the company's interests)<sup>8</sup>.

The courts have suggested there are two ways in which a person could breach an obligation to use best endeavours. One is if the person has not been genuine in his efforts to achieve the required objective; the other is if the person, even if acting in good faith, has failed to do everything that he reasonably could<sup>9</sup>.

To avoid uncertainties that would make Heisenberg think twice, it is important to stay consistent and focused on the overall desired outcome, when negotiating contractual terms using the "efforts" clauses in the process.

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**"The efforts clause will be interpreted in light of the circumstances at time the contract was formed, taking into account the commercial situation in question."**

<sup>1</sup> *Sheffield District Railway*  
<sup>2</sup> *IBM United Kingdom Ltd*  
<sup>3</sup> *Midland Land Reclamation Ltd*  
<sup>4</sup> *Pips (Leisure Productions) Ltd*  
<sup>5</sup> *Jet2.com*  
<sup>6</sup> *Terrell*  
<sup>7</sup> *Malik Co*  
<sup>8</sup> *Rackham*  
<sup>9</sup> *Kea Investments Ltd*



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## RECOVERING FROM THE COVID HANGOVER

**Clouded by high levels of uncertainty, rising energy prices, lack of supply, increased interest rates and cost of materials, the once soaring progression of the global construction industry is slowing to a halt, and major infrastructure investment prospects are looking bleak.**

We take a look into the current issues the global construction industry is facing in 2023 and what this means for key construction players in the industry and how companies can alleviate the pressures they are facing.

### Construction Material Supply

The COVID-19 pandemic brought along with it unencountered issues that permeated every industry including, not the least, construction. In 2023, we are still experiencing the COVID-19 hangover with the resultant shortage of building materials and skilled trade.

In many ways, this has stunted the growth of the construction industry with:

- residential construction in Australia slowing to about 3%;
- residential construction in the United Kingdom contracting by 1.5%;
- uncertainty in investment prospects brewing; and
- the increased cost of materials resulting in a severe impact on profit margins.

With material escalation clauses being a thing of the past, the contracts entered into before COVID-19 meant that construction companies were not prepared or protected by the increase in the cost of materials and the associated delays.

Profit margins were severely impacted by the inability to pass on the additional costs to the client and meant that the construction sector suffered as a whole, with over 7,578 construction companies entering administration in the 2022-2023 financial year<sup>1</sup>.

### Labour Shortages

Material shortages coupled with the demand for tens of thousands of skilled workers has meant that the cost of labour is on the rise, and profitability within the industry is on the decline.

Globally, the construction workforce shortage reached half a million in 2023 with the Associated Builders and Contractors estimating that an additional 546,000 workers on top of the normal pace of hiring in 2023, was required to meet the demand for labour<sup>2</sup>.

The constriction of labour is a world-wide experience with:

- skilled labour shortage in Australia becoming one of the key challenges for the sector (tradespeople comprising 35% of that shortfall), resulting in soaring labour costs, placing further pressure on profit margins;
- 53% of surveyed home builders in the United Kingdom stating that they cannot find the workers they require to build their homes;
- 700,000 fewer workers than needed in Spain to execute EU-funded construction projects;
- an acute labour shortage in Singapore resulting in 1,538 construction firms entering into administration; and
- a 158.4% increase in job vacancies in the construction industry in the last two years.<sup>3</sup>

### Global Growth

The global construction industry's growth has generally faced growth challenges, with construction expanding by only 0.8% in 2023. The construction industry will contract by a further 0.1% (excluding China) as a result of the weak economic global situation and challenged the industry is currently facing, including the high material costs and labour shortages identified above.

Danny Richards, Construction Analyst at GlobalData, comments:

"The anticipated poor performance in 2023 reflects the downturns across advanced economies, with Europe as a whole expected to shrink by 2.8%, North America to fall by 0.9%, and Australasia to contract by 1.5%. Growth in emerging markets will be positive, but the pace of growth will slow to 2.4% from 4.6% in 2022. GlobalData forecasts that the global construction industry is expected to regain some growth momentum from 2024, assuming an improvement in global economic stability, with output expanding by 3.0% in 2024 and recording an annual average of 4.2% during 2025–2027."

The growth of the industry has also been impacted by the Ukraine war and the importance of commodity supplies from Russia and Ukraine. Richards concludes that the "macroeconomic instability has pushed down growth in North America, and in particular, the residential sector has suffered heavily as a result. Inflationary pressure is beginning to subside, and the Federal Reserve is beginning to wind down rate hikes, which bodes well for a recovery in growth. The outlook over the latter part of the forecast period has been bolstered by the stronger outlook for infrastructure construction in the US".

### Delayed Payments

Exacerbating the situation is the delay in payment and cashflow issues impacting the smooth progression of construction projects.

Within Australia, the average payment cycle is 60-90 days, and despite Australian legislation (and in particular Security of Payment Acts within the relevant jurisdictions) seeking to alleviate the issue and encourage cashflow, the issue is still at large. Similarly, payments in the United Kingdom construction industry can take between 75-90 days on average, with the number of outstanding payments and insolvencies increasing as a result.

Small to medium sized companies have less cash flow and greater difficulty in obtaining finance, placing them at a high risk of entering administration.

### Evolving Regulations

Finally, countries are seeing the introduction of evolving legislation and regulations which have added

an additional layer of complexity and cost.

In New South Wales, Australia, for example, the *Design and Building Practitioners Act 2020* has not only increased the risk carried by any person and/or entity conducting building works on residential and other sites, but it has also added another layer of strict regulations that all entities carrying out building work must adhere to. This includes the introduction of a Planning Portal which requires all proposed works to be submitted and approved before any building works can be undertaken or final occupation certificate being issued.

### Where to from here?

The key question from here is, what is the hangover remedy?

The answer is, there isn't one that will resolve the multitude of issues the industry is currently facing on a global scale. However, there are ways that you can assist in mitigating that risk. As a starting point, you can reinvigorate your boilerplate contracts and standard terms and conditions to introduce clauses that more appropriately share escalation risk.

Material escalation clauses should find their way into each contract to protect you from fluctuation in the cost of materials, and extension of time and liquidated damages clauses remain essential to protect you against unprecedented delays. Careful thought needs to be given how to capture EOT and delay cost entitlements. For example, traditional clauses do not always deal with delays and cost escalation in consequence of supply chain issue in other jurisdictions. Thoughtful contract inclusions can mitigate this risk.

You should be more selective in the jobs they bid for, conditions they are willing to accept, and the partners they work with. Construction companies ought to give careful consideration to risk allocation in all future projects. Whilst COVID-19 appeared to bring about the above highlighted issues in construction, the reality is these issues existed prior to COVID-19 and were simply accentuated by the global pandemic. It has long been a problem within construction that companies adopt a "pass-the-parcel" approach to risk by allocating the risk from client to

designers, designer to contractors and from contractor to various subcontractors. This often results in smaller, less resilient companies carrying a disproportionate amount of risk for a comparatively smaller profit margin, inevitably resulting in those smaller companies' demise.

Companies should also look to:

1. engage a limited number of well-established organisations with sufficient cashflow to enable projects to reach completion without any significant issues being encountered during the project;
2. prioritise appropriate delivery and procurement models;
3. focus on proper and accurate cost estimations to avoid losses on projects;
4. introduce achievable construction programmes and schedules to avoid experiencing significant delays which results in continued costs being incurred;
5. embed and integrate risk management practices within their company structure;
6. introduce and/or reinvigorate robust risk quantification for both schedule and cost;
7. introduce and/or reinvigorate an effective project management office that can manage and supervise the project to ensure matters are being conducted cost and time effectively;
8. introduce and/or reinvigorate appropriate governance and assurance practices;
9. integrate project controls; and
10. enable data analytics and technology applications that assesses the effectiveness of methodology used and identifies any areas of weakness within the company that could be improved.

What we do know is that we don't know what the future holds, but by introducing mechanisms and protective measures within your contracts, we can minimise the risk of lost profits and exposure to failure.

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1 Data released by Australian Securities and Investments Commission.

2 Construction workforce shortage reaches half a million in 2023 - International Construction (international-construction.com)

3 Can the Next Generation Solve the Construction Labor Crisis? (procore.com)



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**“Parties need to ensure that the terms of their contracts dealing with payment (payment claims, responses, and invoicing) are consistent with the SOP Legislation that applies to the work performed or goods supplied under that construction contract.”**

## “SECURING CASHFLOW – IT PAYS TO GET THINGS RIGHT!”

The paramountcy of “cash flow” security in the construction industry is recognized by many governments in the Asia Pacific region<sup>1</sup> that have enacted Security of Payment legislation (SOP Legislation) imposing statutory entitlements for contractors and suppliers in the construction industry to receive payment for “construction work” or goods supplied in connection with construction work. In many instances, this SOP Legislation has been in force for several decades and is similar to legislation found in other jurisdictions<sup>2</sup>.

However, it is apparent that many Employers/Principals and Contractors/Subcontractors or Suppliers are still not familiar with the scope of these statutory entitlements (for instance, they cannot be contracted out of), the streamlined and expedited process for adjudication of payment claims (which may be prosecuted concurrently and determined long before any formal determination of the substantive disputes in a Project) and financial consequences of any adverse adjudication (which in many jurisdictions becomes a debt due and payable and enforceable in the Courts).

To add to this, parties may not be aware of important differences between these jurisdictions in terms of the scope of substantive entitlements (or liabilities) and the codified procedures, in particular time frames, that the parties must strictly comply with. For instance, the UK Act allows a wide range of issues to be subject to adjudication including defects, loss and expense, delay and claims for extensions of time. In contrast, scope of the NSW Act is confined to disputes related

to progress payments/ claims to be subject of adjudication.

Critical considerations for all parties include:

1. what falls within the definition of “construction work” under the relevant SOP Legislation. In certain jurisdictions, work and goods relating to mining or oil gas activities are expressly excluded whilst other activities such as painting for a project or paint supplied will be caught. In a similar vein, work on railway infrastructure will be caught but not work on railcars<sup>3</sup>.
2. the jurisdiction in which the construction work will be performed or will be supplied. In most cases, the location where the construction work takes place, or the destination of the goods supplied will determine the SOP Legislation to be applied not the domicile of the parties<sup>4</sup>.
3. the formal criteria that the Contractor/Subcontractor must satisfy to validate its payment claim this includes (amongst other things) the payment claim bearing the correct endorsement and being lodged within time.

The consequences of not understanding or complying with these statutory rights and processes can be profound as the grounds for review or appeal of a determination under the legislation are generally very limited.

Accordingly, it “pays” (quite literally) to get these matters correct from the outset.

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<sup>1</sup> Each State and Territory in Australia has SOP Legislation, for instance in NSW the Building and Construction Industry Security of Payment Act 1999 (NSW) (NSW Act); Similar legislation can be found in New Zealand; Singapore, Malaysia and Hong Kong. .

<sup>2</sup> Housing Grants, Construction and Regeneration Act (UK Act) in 1996, Construction Contracts Act 2013 (Ireland).

<sup>3</sup> NSW Act, s5.

<sup>4</sup> Consider the Application of the SOP Legislation. For example, s7 of the NSW Act.



## UPCOMING EVENTS & WEBINARS

### Construction Law Summer School

Cambridge, UK

12 - 16 September 2022

**Speakers:** Michael Sergeant, Ben Mellors

### CI Arb's Time-bar clauses under FIDIC standards

21 September 2023

**Speakers:** Slava Kiryushin

### Design and Construction Contracts refresher

Late September 2023

**Speakers:** Alex McKellar, Mike Debney

### Korea Construction Seminar

Seoul, Republic of Korea

12 October 2023

**Speakers:** Sam Wakerley, James Plant and Helen Lee

### ME Construction Quarterly Briefing

Dubai, UAE

18 October 2023

**Speakers:** Slava Kiryushin and James Plant

### ME Contractors Seminar

Dubai, UAE

8 November 2023

**Speakers:** Sam Wakerley, James Plant and Helen Lee

### Contractors Offshore Wind Conference

Rotterdam, Netherlands

9 November 2023

**Speakers:** Max Wieliczko and Richard Booth

### Society of Construction Law

Singapore

9 November 2023

**Speaker:** Nick Longley

### Singapore Contractors Association

Singapore

16 November 2023

**Speaker:** Nick Longley, Helen Lee and Ken Hickman

### The Adjudication Society Annual Conference

30 November 2023

**Speakers:** Richard Booth

### UK Construction Seminars

London, UK

28 and 29 November 2023

**Speakers:** Michael Sergeant, Richard Booth and Tanya Chadha

### Offshore Wind Seminar

*In partnership with Korea Wind Energy Industry Association (KWEIA)*

Seoul, Republic of Korea

26 January 2024

### ME Construction Quarterly Briefing

Dubai, UAE

31 January 2024

**Speakers:** Slava Kiryushin and James Plant

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