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Annual review of English Construction law developments

An international perspective

May 2015

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Introduction

Welcome to the 2015 edition of our internationally focused Annual Review of English Construction Law Developments.

2014 has been a year of strategic growth for us beginning with our merger with Dundas & Wilson, Scotland's leading construction practice, and continuing with the establishment of a permanent construction team in Dubai. The firm's English law construction practice last year operated in more jurisdictions internationally than ever before and the projects we are involved with are more exciting than ever.

2014 year has been also been a year of considerable development for English construction law. Unusually the FIDIC terms were before the English courts more than once last year and we report on important developments in this regard with three articles in this edition. Good faith remains a topical area of law and one important case last year marks the first time an English court has upheld the validity of an agreement to negotiate in good faith, (albeit within narrow confines). On-demand securities also remain very topical with a decision from England's highest court on the issue as well as a very recent case (too late to include in this year's edition) expressly criticising the controversial *Doosan* decision.

In other developments, termination for convenience clauses, the effect of amendments on liquidated damages provisions and the valuation of omitted works have also received attention in the English cases over the last year. Finally, we conclude this year's bulletin with an international construction orientated review of recent amendments to the LCIA arbitration rules effective from October 2014 last year.

We hope you enjoy our analysis of the law and recent cases on the above topics. If you have any queries on the topics covered please do not hesitate to contact either me or one of my fellow partners.

In the meantime, we look forward to working with you and wish you a prosperous continuance of 2015.

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Agreements to negotiate in good faith and to use reasonable endeavours to agree

Agreements to agree have long been held to be unenforceable under English law for the reason that they lack sufficient certainty. Two cases in 2014 have tested the boundaries of this rule and have considered the extent to which the requirements of good faith and reasonable endeavours can be used to support an enforceable obligation to negotiate. These decisions may suggest an increased willingness on the part of the English courts to uphold such agreements and follow developments to this effect in Singapore and Australia.

Dany Lions v Bristol Cars

We have considered the use of reasonable and best endeavours clauses in previous editions of this publication. Our 2011 edition commented on an important Court of Appeal decision in *Jet2.com v Blackpool Airport* where such clauses were held to be sufficiently certain to be enforceable if the object of the endeavours could be ascertained with sufficient certainty and there were sufficient objective criteria by which performance of the obligation could be ascertained (a two tier test). A subsequent decision last year in *Dany Lions v Bristol Cars* has considered whether an obligation to use reasonable endeavours to enter an agreement with a third party would be enforceable in circumstances where the third party had been identified in advance and the scope of works defined.

Dany Lions entered into a contract with Bristol Cars, a mechanic, for the restoration of a classic car. Bristol Cars entered administration during the contract and Dany Lions became concerned about the lack of progress. Bristol Cars suggested that Jim Stokes Workshops ('JSW') be appointed to undertake the restoration works and this led to a Settlement Agreement being entered into on 4 May 2012 between Bristol Cars and Dany Lions. It was this Settlement Agreement that formed the basis of the dispute before the High Court.

The Settlement Agreement was subject to a condition precedent that Dany Lions would enter an agreement with JSW, on or before 30 May 2012, to carry out restoration work to the car. Specifically, it stated:

'1.5 'Condition Precedent' means Dany Lions entering into an agreement with JSW on or before 30 May to carry out the works

2 Dany Lions will use its reasonable endeavours to fulfil the Condition Precedent.'

Annexed to the Settlement Agreement was an email setting out the scope of the Works to be undertaken by JSW. The date for the Condition Precedent was extended to 19 January 2013 by agreement of the parties.

Dany Lions and JSW could not reach an agreement on the price of the restoration works. JSW proposed a figure of £195,000 but this was considered to be unaffordable by Dany Lions (the original contract with Bristol Cars was a fixed price agreement for £127,500).

A meeting was fixed for 17 January 2013 between Dany Lions, Bristol Cars and JSW. At this point JSW advised they were not willing to enter any fixed price contract as there were too

many unknowns and they were concerned the true costs might be significantly higher than £195,000. At this point, Dany Lions decided that it had used *'reasonable endeavours'* to fulfil the condition precedent and stopped negotiations with JSW (2 days before expiry of the date for the condition precedent).

Dany Lions proceeded to sue Bristol Cars for damages for non-performance of its obligations and claimed the difference between the fixed price under the original agreement and the actual cost of having the work carried out (which Dany Lions had now agreed directly with JSW under a new contract based on hourly rates). The key issue was therefore whether Clause 2 was enforceable.

Reasonable endeavours to agree

The court referred back to the *Jet2.com* case and noted there was a distinction to be drawn between a clause whose content was so uncertain that it was incapable of giving rise to a binding obligation, and a clause which gave rise to a binding obligation, the precise limits of which would be difficult to define in advance. In determining whether a contractual obligation to use best or reasonable endeavours is enforceable the initial focus is to be on the object of the endeavours clause. If the object of the clause is sufficiently certain, a court is able to know what it is that the party concerned must use his reasonable endeavours to achieve. However, even in a case where there is certainty as to the object there is still potentially a problem as to whether there are sufficient objective criteria by which to evaluate the reasonableness of the endeavours (i.e. the 'yardstick' by which to measure the endeavours).

The court noted that the second problem of an appropriate 'yardstick' was more likely to arise where the best endeavours obligations is directed at a future agreement between the parties. Even if the proposed agreement has clearly been set out in draft, so that the object of the endeavours obligation is clear, the court would lack any objective criteria against which to judge either party's refusal to agree. The position was said to be different if the same endeavours clause was directed at reaching an agreement with a third party on terms which had already been identified. In such a case, the court would only be required to judge whether the endeavours made by one of the parties to procure the third party's agreement were sufficient.

On the facts, however, the court found that although the condition precedent required agreement with a third party (JSW), the object of the clause was too uncertain to be enforced. In particular, whilst the scope of work was adequately defined, no reference was made to the cost of the work or the timing of payments. These were matters which the condition precedent envisaged being open to future negotiation between Dany Lions and JSW, and there were no objective criteria by which the court could evaluate whether it was reasonable or unreasonable for Dany Lions to refuse to agree to any particular terms on offer.

The court reached this conclusion with some regret noting that the condition precedent was clearly intended by the parties to form a binding and enforceable obligation. However, despite the parties' intentions, they had not provided a sufficient degree of certainty. In the absence of something said expressly as to the terms of payment, the court was unable to imply an obligation on Dany Lions to contract with JSW on reasonable market rates or anything similar.

Good faith negotiations

The decision in *Dany Lions v Bristol Cars* provides an interesting comparison with another case decided last year where an obligation to negotiate was upheld. In *Emirates Trading Agency v Prime Mineral Private* the High Court was asked to consider whether a dispute resolution clause was a mere agreement to agree (and therefore unenforceable) or whether the parties had sufficiently defined the object to be achieved, thereby allowing the court to enforce the clause.

The clause in question (clause 11.1) stated:

> 'Parties shall first seek to resolve the dispute or claim by friendly discussion. Any party may notify the other Party of its desire to enter into consultation to resolve a dispute or claim. If no solution can be arrived at between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the dispute to arbitration'

Prime Mineral submitted that the obligation to resolve the dispute by 'friendly discussions' was a mere agreement to negotiate and therefore unenforceable. It argued that notwithstanding the commercial purpose of the clause, the parties were free to commence arbitration without having sought to resolve the claim by friendly discussions.

Prime Mineral relied on previous English case authorities which had found that a duty to negotiate in good faith was insufficiently certain to be enforced and inherently inconsistent with the ability of parties to negotiate in their own interests.

The court rejected these arguments making a number of significant findings:

1. Adopting the controversial decision in *Yam Seng Pte v International Trade Corporation* (reported in the 2012 edition of this Brochure), the court found that the obligation to engage in friendly discussions carried with it an implied term to negotiate in good faith.

2. There was a difference between time-limited obligations to negotiate existing disputes in good faith against the backdrop of an existing agreement and obligations to negotiate a fresh agreement in good faith. In the former case, the boundaries of the dispute and the existing contract were able to provide greater certainty to the obligation and the time-limit enabled any deadlock to be resolved.

3. There were good policy reasons for encouraging parties to negotiate existing disputes in good faith.

4. In the context of negotiations over an existing dispute, good faith was not an insufficiently certain criteria for a court to apply to negotiations and was not inherently inconsistent with the position of a negotiating party. Rather, the obligation would require an honest and genuine approach to settling a dispute and the observance of reasonable commercial standards of fair dealing.

The court reached its conclusion largely by adopting Singaporean and Australian authorities in preference to first instance decisions in England, whilst seeking to distinguish carefully those English authorities which were binding on it. It remains to be seen to what extent the decision will be followed in the future, in preference to the other English decisions which were not followed by the court. Nevertheless, the decision may give encouragement to parties wishing to rely on obligations to negotiate in good faith.

Conclusions and implications

The above cases suggest a potential softening of the English law approach to agreements to negotiate. Agreements to agree or to use reasonable endeavours to agree remain subject to strict requirements of certainty, however the decision in *Emirates Trading* may suggest that the English courts are now willing to imply obligations of good faith into agreements to negotiate and to enforce such obligations by reference to standards of honesty and fairness. One may expect these findings to be subject to challenge in future decisions and for present purposes it seems unlikely that the findings in *Emirates Trading* will extend beyond dispute resolution clauses or to obligations which are not limited in time. Nevertheless, the decision represents an incursion into what had hitherto been an entirely unfruitful area of English law.

These developments are likely to provide comfort to parties operating under the FIDIC suite of contracts where tiered dispute resolution clauses are common. For example, clause 20.5 of FIDIC Conditions of Contract for Construction (Red Book) states that:

> 'Where notice of dissatisfaction has been given under Sub-Clause 20.4 above [in respect of a DAB decision], both Parties shall attempt to settle the dispute amicably before the commencement of arbitration. However, unless both Parties agree otherwise, arbitration may be commenced on or after the fifty-sixth day after the day on which notice of dissatisfaction was given, even if no attempt at amicable settlement has been made.'

The *Emirates Trading* decision suggests that clauses along these lines will be enforceable. This is a positive development in ensuring that parties are held to their agreement and ought to encourage genuine attempts at settlement before the commencement of arbitration proceedings. Such clauses are not without their risks, however. They can have the effect of abridging slightly the period of any applicable limitation period. The running of time for the purpose of limitation periods will typically stop with the commencement of arbitration proceedings, meaning that parties should factor in any binding preliminary steps which are required before arbitration (such as a period of amicable negotiations). Failure to do so may result in the arbitration proceedings being invalid and limitation periods being missed.

Such clauses can also cause difficulties where new disputes have emerged during the course of amicable negotiations or where the scope of the dispute has significantly broadened. Claimants must then decide whether to issue fresh dispute notices and trigger a further period of amicable negotiations or to proceed straight to arbitration with the risk that jurisdictional objections may be made.

References: *Jet2.com Ltd v Blackpool Airport Ltd* [2012] EWCA Civ 417; *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB); *Dany Lions Ltd v Bristol Cars Ltd* [2014] EWHC 817 (QB); *Emirates Trading Agency Llc v Prime Mineral Exports Private Ltd* [2014] EWHC 2104 (Comm).

On-demand securities and the fraud exception

The enforcement of on-demand securities remains an area of continuing interest for English lawyers. In last year's edition of this publication, we reported on an English High Court decision which significantly widened the grounds on which challenges could be made to calls on such securities under English law (*Doosan Babcock v Comercializadora De Equipos Y Materiales Mabe*). This issue was back before the English courts again this year with a decision from England's highest court (the Privy Council). Although this decision concerns significantly different factual circumstances to the *Doosan* decision, it confirms English law's traditionally very strict approach to the application of the fraud exception for challenges to calls on on-demand securities. The decision lends support to existing criticism of the *Doosan* decision and goes some way to restoring the robust approach to on-demand securities traditionally adopted under English law.

The *Doosan* decision: a recap

Doosan concerned the construction of two power plants in Brazil. Doosan was subcontracted to the main contractor for the project, MABE, for the provision of two boilers and associated equipment, together with technical advisory services. Two on-demand performance bonds were provided by Doosan and these were expressed to expire on the earlier of Taking-Over under the subcontract or a certain long-stop date.

The parties fell into dispute over whether Taking Over had occurred. Doosan contended that Taking-Over had occurred when the boilers had been put to use by MABE. This was said to have occurred during the commissioning process for the power plants, when power was first exported to the grid. MABE argued that this was an essential part of the overall commissioning process for the boilers and that Taking-Over could only occur once the power-plants had been fully commissioned and there had been an opportunity to carry out the performance tests set out in the subcontract for each of the boilers.

Prior to the performance tests being carried out, but after Doosan had requested the issuance of the Taking Over Certificates, MABE had notified a claim for defects in relation to the boilers. Doosan feared that MABE might make calls under the performance bonds and brought pre-emptive proceedings in England for an order preventing such calls. Doosan argued that it had been entitled to Taking Over Certificates for some time and that, as these certificates would bring about the expiry of the performance bonds, MABE should be restrained from making any call under the bonds.

The court upheld Doosan's challenge on three separate grounds:

1. The court noted that, generally speaking, the same test applied to applications to prevent a beneficiary calling on an on-demand security as for those to prevent payment by a bank under an on-demand security. This is known as the "fraud exception" and requires the party seeking the order (usually the contractor) to show that a demand under the security has been (or would be) fraudulent. The court usually requires

particularly strong evidence to meet this criterion. In *Doosan* the court found that this test had been satisfied on the basis that there was a '*realistic prospect of success*' for showing that MABE's rejection of Doosan's request for the Taking Over Certificates had not been made in good faith. The court based its finding in this regard solely on what it perceived to be the implausibility of MABE's position in relation to the Taking Over Certificates i.e. there was no specific evidence that MABE did not in fact believe its position to be true. As noted in last year's edition of this brochure, this appears to be a considerable weakening of the usual application of the fraud exception in these cases: both because a lack of good faith is not usually sufficient of itself to support an allegation of fraud and because of the low standard of proof accepted by the court (a '*realistic prospect of success*').

2. The court extended another English decision (in itself controversial) which held that fraud was not needed where it could be shown that a call under an on-demand security would be in breach of a 'clear and express' stipulation in the underlying contract (such as clause 4.2 of the standard FIDIC terms). In such cases, an order could be granted if there was shown to be a 'strong case' that a call under an on-demand security would breach such a stipulation (this being a higher standard than a 'realistic prospect of a success'). The court found that this rule also applied to situations in which the underlying contract provided for the expiry of the on-demand security. It was sufficient therefore that Doosan had shown a strong case that the Taking Over Certificate ought to have been issued which would in turn have triggered the expiry of the on-demand security.

3. The court found that the order could be separately justified by an independent principle under English law that no party should benefit from its own wrong (derived from the House of Lords decision in *Alghussein Establishment v Eton College*). The principle was said to be applicable because it was only by virtue of MABE's breach of contract in refusing to issue the Taking Over Certificates that it could preserve its ability to call under the performance bonds. The court left open whether a breach of this principle would need to be proved to the standard of a 'strong case' or the lesser 'realistic prospect of success' to justify the making of an order.

Although not dealing with the second and third grounds set out above, the Privy Council decision we report on below appears to confirm that the weakening of the fraud exception adopted by the judge in Doosan is not to be followed.

Alternative Power Solution Ltd v Central Electricity Board

Alternative Power Solution ('APS') contracted with the Mauritian Central Electricity Board ('CEB') for the supply of 660,000 fluorescent lamps to be manufactured in China and shipped to Mauritius. Payment was to be by way of an on-demand letter of credit provided by the CEB. The contract between the parties provided for an inspection by CEB's representative prior to shipment of the lamps, but the letter of credit

did not require a certificate of inspection or any similar document to be presented to the bank. The goods were shipped to Mauritius without an inspection having taken place and APS proceeded to call on the letter of credit.

At the time the goods were shipped, the parties had been attempting to arrange an inspection. The CEB had felt that matters were not being handled satisfactorily and applied to court for orders preventing the bank paying out under the letter of credit. APS was self-represented at the hearing and stated that no shipment would take place until an inspection was carried out to the satisfaction of the CEB and likewise the bank advised that it would not make payment until the goods were shipped. The application was withdrawn on this basis, however, it later transpired that the goods had already been shipped two days prior to the hearing.

APS subsequently called on the letter of credit and the matter came back before the Mauritian courts. There was a dispute as to what was said at this hearing. APS's representative indicated that he had been unaware at the previous hearing that the goods had already shipped. According to the court's order, APS's representative also said that he had asked for the goods to be turned back and that APS had no objection to payment being withheld until an inspection had taken place. APS disputed the accuracy of the order, however, and alleged that it had only said that the goods could be turned back and payment made only after an inspection at the factory.

The CEB's application was again withdrawn at this hearing and (on APS's version of events) the offer to turn back the shipment was not subsequently taken up by the CEB (which would have required shipping documents and the letter of credit to be amended). The shipment continued toward Mauritius and APS wrote to the CEB noting that as no steps had been taken to arrange an inspection, it would now continue with its claim for payment under the letter of credit.

The CEB made a third application to court and this time obtained orders preventing the bank from paying out under the letter of credit. These orders were upheld in the Mauritius Court of Appeal. Both of these decisions found that APS had acted fraudulently in persisting with a call under the letter of credit without an inspection having taken place and in light of its untruthful statements to the court at the previous hearings.

APS appealed to the UK's Privy Council, which is the final court of appeal for UK overseas territories and Crown dependencies and some Commonwealth nations. The Privy Council is comprised of members of the Supreme Court, the UK's highest court (formerly known as the House of Lords). The Privy Council upheld the appeal in the present case finding that the Mauritian courts had not taken a sufficiently robust approach to the fraud exception. In reaching its decision the court reviewed the English authorities as to calls on on-demand securities and authoritatively stated the following test for applications to prevent payment by a bank under such an instrument:

— It must be *'clearly established at the [initial hearing] that the only realistic inference is (a) that the beneficiary could not honestly have believed in the validity of its demands under the letter of credit and (b) that the bank was aware of the fraud'.*

— The ‘balance of convenience’ must favour granting an order preventing payment by the bank (with the consequential impacts on the bank’s business and reputation that may entail) as opposed to leaving the bank to reimburse its client for any damage which will be wrongfully caused by allowing payment under the letter of credit.

The court held that both of these requirements had not been fulfilled in this case by some distance. The Mauritian courts’ conclusions as to the fraud test had not sought to address APS’s evidence that it had made attempts to arrange an inspection and its explanations in relation to the two initial court hearings.

The court also noted that, even if APS’s evidence was to be ignored, the position would still not have been sufficient to satisfy the fraud exception. Although the bank was present at the initial two hearings, it had not agreed to amend the letter of credit and the any undertakings given and breached by APS would not automatically invalidate a call under the letter of credit:

> ‘Whatever [the APS representative] said to the judge, even if he promised to do something outside the terms of the contract, there is no evidence that Standard Bank agreed to any amendment of the letter of credit as a result. This is important because it appears to the Board that, in the case of both the judge and the Court of Appeal, the underlying basis for their conclusions was, not so much that APS was in breach of contract, but that it dishonestly gave undertakings to the court which it had no intention of honouring. … Even if there were some force in this case as against APS, it is of no assistance to the CEB in this appeal unless Standard Bank either agreed a relevant variation of the letter of credit or knew that APS was acting fraudulently. There is no evidence of any such agreement and, in the opinion of the Board, notwithstanding the views expressed by the judge and the Court of Appeal, there is no evidence that Standard Bank knew that APS was acting fraudulently.’

This passage shows how difficult and precise the fraud exception is under English law. It is not fraud in general which is required, but fraud specifically in relation to the demands under the letter of credit which is known to the bank.

The court also emphasised the inherent unlikelihood of parties being able to satisfy the “balance of convenience” test in the circumstances of on-demand securities. The difficulty is that the bank will usually be able to compensate its client for any damage suffered as a result of any wrongful payment under the security (i.e. because the bank was aware of a fraudulent call). On the other hand, the bank may suffer much greater financial and reputational damage than its client is able to compensate it for.

The court noted that the stringency of these two tests account for why examples of successful challenges under English law are so rare, *‘(a) because it is almost never possible to establish the test for fraud as opposed to a mere possibility of fraud, but also (b) because the balance of convenience will almost always militate against the grant of an injunction.’*

Implications

The APS decision provides a striking contrast to the comparatively generous approach taken by the judge in the *Doosan* case. The judge’s approach to the fraud exception in *Doosan* was to find that there was a *‘realistic prospect of success’* for showing that the Taking Over Certificates had not been refused in good faith due to what the judge considered to be the implausibility of the employer, MABE’s, explanation in that case. This is a very long way from a finding now required by the *APS* decision that it was clearly established that the only inference available was that MABE could not have honestly held that view. Like the Mauritian judges in the *APS* case, there appears to have been no consideration given in *Doosan* as to whether MABE might have honestly held its views in relation to the Taking Over Certificate (particularly given that they related to matters of contractual interpretation).

The *APS* decision is likely to lend considerable support to the existing criticisms made of the *Doosan* decision. The Privy Council’s decision represents a very robust approach to the fraud exception in circumstances where calls have already been made under on-demand securities and judges in future cases may feel themselves considerably more constrained in seeking to widen the grounds of challenge by reference to the underlying contract in the manner proposed in the *Doosan* decision.

References: *Alternative Power Solution Ltd v Central Electricity Board & Anor (Mauritius)* [2014] UKPC 31.

Rights of termination for 'any breach'

Two cases in 2014 have considered clauses in construction contracts which permit an Owner to terminate for 'any breach' of contract by its Contractor. One of these cases concerns the standard termination clause under the FIDIC Yellow and Red Books and will be of interest to those negotiating or operating under the FIDIC form. This is an area of law where the literal words are likely to give way to broader commercial considerations and we consider the issue in detail below.

Introduction

Clauses permitting Owners or Employers to terminate in the event of breaches of contract by a Contractor are commonplace in the construction industry. In the absence of such clauses, or other contractual rights of termination, the parties will be left with general rights of termination under English common law. These general rights set a high bar for an Owner to achieve before being entitled to terminate in the event of a Contractor breach. The Owner will need to show that the contract has been 'repudiated', which means that the Contractor has either *'evinced an intention no longer to be bound by the Contract'* or has breached the contract in such a way as to *'go to the root of the contract'* or to have deprived the Owner of '*substantially the whole benefit*' of the contract (the *Hong Kong Fir Shipping* case).

The burden of proving that such standards have been met falls on the Owner and will usually depend heavily on the circumstances surrounding the breach in question. Moreover, if the Owner is mistaken and these requirements have not been met, its attempted termination will often amount itself to a repudiation providing the Contractor with its own right of termination. These considerations make reliance on common law rights of termination a risky venture, and so it is no surprise that construction contracts provide express rights for termination.

The FIDIC Yellow and Red books contain at clauses 15.1 and 15.2(a) an example of a reasonably Owner-friendly clause purporting to allow for termination due to 'any' contractual breach by the Contractor:

'[15.1] If the Contractor fails to carry out any obligation under the Contract, the Engineer may by notice require the Contractor to make good the failure and to remedy it within a specified reasonable time.

[15.2(a)] The Employer shall be entitled to terminate the Contract if the Contractor fails to comply with … a notice under Sub-Clause 15.1 …'

Termination for 'any breach'

Fortunately for Contractors, the English courts have found that an Owner cannot rely on the literal interpretation of the word 'any' in an 'any breach' clause to terminate a contract for any breach, no matter how trivial.

In the 2000 case of *Rice v Great Yarmouth Borough Council* the Court of Appeal considered a termination clause in a maintenance contract, which allowed a Contractor's appointment to be terminated in the event that it committed *'a breach of any of its obligations under the contract'*. The Council argued that the phrase should be applied literally, to allow termination for any event of default, however trivial.

The Court of Appeal considered that there were two opposing methods of interpretation which could be applied. On the one hand they could follow the comments of Lord Wilberforce in *Bunge Corporation v Tradax Export SA*, who stated that *'it is open to the parties to agree that*

… any breach shall entitle the party not in default to treat the contract as repudiated'. This would support the literal interpretation of 'any' breach, as both parties were businesses who entered the contract with their eyes open, and the Contractor could have sought an amendment to narrow the grounds for termination. On the other hand, the court contrasted the comments of Lord Diplock in *Antaios Compania SA v Salen Rederiern*, who required the interpretation of words outside of their literal form to *'yield to business commonsense'.*

The Court followed the rule in *Antaios* and decided that the implications of allowing termination for 'any' breach, however trivial, was contrary commercial sense. Relying on the English common law position, the Court concluded that the clause gave the Council the right to terminate the contract only on the occurrence of a repudiatory breach, i.e. one which deprived the Employer of *'substantially the whole benefit'* of the contract.

The decision in *Rice* had the effect of significantly restricting the ability of Employers to rely on a broadly drafted term to terminate for any breach of contract. The decision illustrates the importance of clear drafting where such broad rights of termination are desired.

Termination for "any breach" under FIDIC

In 2014 the effect of the *Rice* decision on clauses 15 of the FIDIC Yellow Book (the relevant parts of which are quoted above) was considered by the English Technology and Construction Court in *Obrascon Huarte lain SA v Attorney General for Gibraltar.*

Considering the FIDIC terms as a whole, Mr Justice Akenhead decided that the position in *Rice* was too restrictive to be applied directly to clause 15. The failure referred to in clause 15.1 was not required to amount to a repudiation and the clause would apply to all breaches which were *'more than insignificant contractual failures'*. This was said to include *'a health and safety failure, bad work, serious delay on aspects of work or the like'.* This is a considerably lower standard than upheld in Rice, and meant that a breach which was less than repudiatory but greater than trivial could be used as a reason to terminate the contract.

The court relied on two factors in particular to distinguish the FIDIC clause from the position in *Rice*:

1. Clause 15 also contained a separate ground of termination very similar to the common law test for repudiation. Clause 15.2(b) applied where the Contractor "plainly demonstrates the intention not to continue performance of his obligations under the Contract". This suggested that a broader interpretation was intended when clause 15.1 referred to failures to carry out "any obligation" (i.e. otherwise the two clauses would significantly overlap).

2. Clause 15 first required notice to be given allowing the Contractor to correct its failure and was therefore less severe than the clause in *Rice* which did not have such a provision. The court noted that: "In that sense, the Contractor is given the chance to avoid termination whilst the simple termination for any breach can come out of the blue. Commercial parties would sensibly understand that this contractual chance is a

> warning as well to the Contractor and the remedy is in its hands in that sense."

Despite differing from the outcome in Rice, the court adopted the same approach to interpretation, requiring that literal words yield to business common sense. Accordingly, the court noted that:

> 'The parties can not sensibly have thought (objectively) that a trivial contractual failure in itself could lead to contractual termination. Thus, there being one day's culpable delay on a 730 day contract or 1m² of defective paintwork out of 10,000m² good paintwork would not, if reasonable and sensible commercial persons had anything to do with it, justify termination even if the Contractor does not comply with a Clause 15.1 notice. What is trivial and what is significant or serious will depend on the facts.'

Variation on a theme

Two months after the *Obrascon* decision, the Technology and Construction Court considered a similar termination clause in *Bluewater Energy Services v Mercon Steel Structures*.

The clause in *Bluewater*, similar to the FIDIC clause 15.1 referred to above, provided a right to serve a notice to remedy *'in the event of any default'* by the Contractor. The contract then provided that:

'If the CONTRACTOR upon receipt of such notice does not immediately commence and thereafter continuously proceed with action satisfactory to BLUEWATER to remedy such default BLUEWATER may issue a notice of termination in accordance with the provisions of Clause 30.1.'

The court concluded that the word *'satisfactory'* did not imply an objective standard. The court should consider the specific facts of the case and the position of the parties rather than what a 'reasonable' person would have done in the same situation. Bluewater was therefore free to form its own view as to whether or not the Contractor's actions in response to its initial notice had been satisfactory. This was however subject to an implied limitation on the exercise of a contractual discretion affecting another party. The court applied the Court of Appeal's decision in *Socimer International Bank v Standard Bank London*, to find that Bluewater was required to abide by 'concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality' when making its decision to terminate. Bluewater's decision to terminate was not therefore subject to review by the Court as to whether it was right, correct or reasonable, but only as to whether Bluewater had honestly and genuinely satisfied itself as to the Contractor's failure to remedy the breach concerned.

Conclusions and implications

In light of the *Obrascon* and *Bluewater* cases, Owners and Contractors alike should pay close attention to the drafting of termination for breach clauses in their construction contracts. Owners should be aware that clauses purportedly allowing for termination for 'any' breach are likely to be read down by applying 'business common sense', either to allow only for repudiatory breaches (applying *Rice*) or the lesser standard of non-trivial or significant breaches (applying *Obrascon*). Whether a contract falls into one or the other category is likely to depend on the broader context of the termination clause, including whether it makes provision for a remedy period and whether other particularly serious breaches of contract are separately identified as grounds for termination.

Owners wishing to secure a broad right of termination applying literally to 'any breach' will need to use clear language by adding words such as 'however insignificant'. Owners should also be aware that any discretion given by the contract to assess whether or not a given breach has been remedied in accordance with a termination clause is likely to carry with it, as a minimum, a requirement to act honestly and genuinely. Clear words will again be needed if a broader discretion is required: such as 'in the Owner's absolute and unfettered discretion'.

References: *Hong Kong Fir Shipping* [1962] 2 QB 26; *Bunge Corporation v Tradax Export SA* [1981] 1 WLR 711; *Antaios Compania SA v Salen Rederiern* [1985] A.C. 191; *Rice v Great Yarmouth Borough Council* [2003] TCLR 1; *Socimer International Bank Ltd (in liquidation) v Standard Bank London Ltd* [2008] EWCA Civ 116; *Bluewater Energy Services BV v Mercon Steel Structures* BV [2014] EWHC 2132 (TCC); *Obrascon Huarte lain SA v Attorney General for Gibraltar* [2014] EWHC 1028 (TCC).

Claims for extension of time and unforeseeable physical conditions under the FIDIC form

An important decision of the Technology and Construction Court in 2014 has provided valuable guidance as to how the English courts will interpret certain standard provisions of the FIDIC suite of contracts. The decision also provides a helpful example of the court's approach to extensions of time and claims for unforeseeable physical conditions under the FIDIC form. The decision is likely to be an essential reference case for FIDIC based disputes, whether governed by English law or not.

Obrascon, a Spanish engineering firm, contracted with the Government of Gibraltar for the design and construction of a road and tunnel under the eastern end of the runway of Gibraltar Airport. Subject to relatively minor amendments, the contract between the parties was in the form of the FIDIC Conditions of Contract for Plant and Design-Build, also known as 'the Yellow Book'. The project was initially anticipated to take 2 years to complete, however Obrascon discovered considerably more contaminated material than expected at the Site. The extent of this material required the works to be re-designed. After 2 and a half years, only 25% of the works had been completed and Gibraltar sought to terminate due to a lack of progress.

In order to consider the legitimacy of Gibraltar's termination, the court first considered Obrascon's entitlement to an extension of time in relation to the contamination issue. This included consideration as to whether the contamination had met the test for "Unforeseeability" under the relevant FIDIC clause as well as the evidential and process requirements for establishing an extension of time under the FIDIC terms. We consider each of these requirements further below.

Unforeseeable physical conditions – Clause 4.12

Clause 4.12 of the FIDIC Yellow Book provided Obrascon with the following entitlement in relation to unexpected physical conditions:

'If and to the extent that the Contractor encounters physical conditions which are Unforeseeable, gives such a notice and suffers delay and/or incurs Cost due to these conditions, the Contractor shall be entitled subject to Sub-Clause 20.1 [Contractor's Claims] to … an extension of time … under Sub clause 8.4 and … payment of any such Cost …'

The term 'Unforeseeable' was defined by clause 1.1.6.8 of the Yellow Book to mean *'not reasonably foreseeable by an experienced contractor by the date of submission of the Tender.'*

At tender stage Obrascon had been provided with an Environmental Statement which had been prepared for the purpose of obtaining planning approval for the works. This document referred to an allowance of 10,000m^3 in respect of contaminated material. The tender documentation also included a site investigation report detailing sampling and testing across 28 boreholes. Taken on their own, an analysis of these site investigations yielded estimates of contaminated materials of between 3,000m^3 and 8,000m^3 depending on the relative optimism or pessimism applied. Estimates of the actual figure encountered by Obrascon submitted by the court experts ranged from 15,000m^3 to 39,000m^3.

Despite these tender documents, the court found that Obrascon ought to have foreseen an amount of contaminated material '*very substantially above 10,000m^3*' by reference to the known previous uses of the area as a military rifle range and an airport fuel farm. As noted by the court:

'The real issue … is whether [Obrascon] judged by the standards of an experienced contractor would or should have limited itself to some

analysis based only on the site investigation report and the Environmental Statement. … I accept [Gibralter's expert evidence] that experienced contractors at tender stage would not limit themselves to a study of the ES, which is primarily directed towards planning matters, albeit that it provided useful technical information. What was needed and could have been expected from experienced contractors was some intelligent assessment and analysis of why there was contamination there (namely the recent and less recent history) and therefore what the prospects of encountering more than had been unsurprisingly revealed by the pre-contract site investigation, even if it would be difficult to quantify. The very obvious questions which any experienced contractor asks and would have asked, in relation to what was in effect a brown-field site is: what was this site used for before? The answer broadly was and always would have been that the key part of the site (the tunnel area) was at the end of a runway and near a fuel farm on what had for many years been an extensive rifle range and therefore there would be an expectation of a very real risk that there could be extensive lead and hydrocarbon residues from these activities in the made ground.'

The court also emphasized the inadequacy of Obrascon's reliance on the site investigation report in circumstances where any contamination was likely to be distributed randomly across the site and therefore not readily susceptible to a representative sampling exercise:

'I am wholly satisfied that an experienced contractor at tender stage would not simply limit itself to an analysis of the geotechnical information contained in the pre-contract site investigation report and sampling exercise. In so doing … I adopt what seems to me to be simple common sense by any contractor in this field. Contaminants of the type with which this case are concerned will have been present as a result of human intervention over many years; they will have been deposited and spread either deliberately, accidentally or carelessly and possibly at times when the human agencies involved did not know or appreciate that they might be dangerous if left in the ground. They will therefore primarily have been in the made ground overlying the undisturbed strata underneath. Boreholes and sampling pits will only disclose what is in the samples, which in the case of contaminants will be randomly located and the contaminants may or may not show up in the relatively small number of samples taken; put another way, the contaminated materials will only show up in the samples by chance.'

As a result, Obrascon failed to show that the amount of contaminated material encountered by it was Unforeseeable within the meaning of the FIDIC terms.

Entitlements to extension of time – Clause 8.4

The court also analysed the extension of time provisions of the FIDIC Yellow Book in respect of other subsidiary claims for extension of time. The applicable provision of the Yellow Book in relation to extension of time is clause 8.4 which reads as follows:

'The Contractor shall be entitled subject to Sub-Clause 20.1…to an extension of the Time for Completion if and to the extent that completion for the purposes of Sub-Clause 10.1…is or will be delayed by any of the following causes …'

The court found that the '*is or will be delayed*' wording in this clause gives rise to an entitlement to claim at two distinct points in time. The entitlement will first arise when it becomes clear that there will be a delay (termed by the court as 'prospective delay') but a second entitlement to claim will arise when the delay begins to be incurred (termed by the court as "retrospective delay"). For example, if a variation is instructed which will cause critical delay in the future, an entitlement will arise when the variation is first instructed (i.e. prospective delay) and also when works the subject of the variation begin to impact upon the programme (i.e. retrospective delay).

The court also touched upon the approach to be adopted when analsing the causes of delay under the Yellow Book and the role of programming experts:

'The onus of proof is on [Obrascon] to prove that it was delayed by the matters now relied upon by it as critically causing it delay up until the time of termination. … The exercise … for the Court is, in circumstances where there is little material dispute as to what in terms of design or work was done and when, primarily one of logic, albeit based on the evidence. Programming experts, at least the good ones, help the Court to concentrate on the logic not only of the original (baseline) programme to which the contractor in question was working but also what was driving progress or a lack of it on key parts of the work at key times.'

In applying this approach to the facts of the case, the court referred in a number of places to what it considered to be the '*dominant*' cause of delay at any one time. The application of such a *'dominant cause'* test for delay analysis is, however, controversial under English law (prompting one construction law barrister to publish a paper in November 2014 entitled *'Causation in construction law: the demise of the 'dominant cause' test?'*). Given the controversy over this issue, it is unfortunate that the court did not articulate the justification for its references to dominant causes.

Generally speaking, the approach adopted by the court resulted in a retrospective as-built analysis of delays to the project with the elimination of delaying events which, whilst sufficient on their own to have caused critical delay to the project as originally planned, did not ultimately impact on the critical path of the works on an "as-built" basis.

Notifying claims for an extension of time – clause 20.1

The court also considered the application of the time bar provision in clause 20.1 of the Yellow Book to claims for extension of time. The clause provided that:

'If the Contractor considers himself to be entitled to any extension of the Time for Completion and/or any additional payment under any Clause of these Conditions or otherwise in connection with the Contract, the Contractor shall give notice to the Engineer, describing the event or circumstance giving rise to the claim. The notice shall be given as soon as practicable, and no later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance.

If the Contractor fails to give notice of a claim within such period of 28 days, the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and the Employer shall be discharged from all liability in connection with the claim. Otherwise, the following provisions of this Sub-Clause shall apply…'

The court carried through its interpretation of clause 8.4 to find that, in relation to extensions of time, Obrascon was entitled to notify a claim within 28 days from the occurrence of either of the two trigger points mentioned above (i.e. prospective delay or retrospective delay). This finding significantly relaxes the requirements of clause 20.1 which was thought by some prior to this decision to require notification within 28 days of the event grounding the claim to an extension of time. As such, claims for extensions of time will not now need to be submitted within 28 days of the Contractor first becoming aware of the need for an extension. Contractors will in many cases now be able to wait until the impacts of any given event upon the programme are known before serving notice under clause 20.1.

Although clause 20.1 does not call for any particular formality in the giving of a notice, the court observed that the notice must still be recognisable as a 'claim'. Accordingly, a simple statement made in a progress report from Obrascon that adverse weather had *'affected the works'* was not sufficient. On the other hand, letters stating that certain events would *'entitle us to an extension of time'* were found to be sufficient. The failure of Obrascon's progress report to amount to a 'claim' under clause 20.1 had the result of debarring Obrascon's claim for the item in question. Whilst overall the court's decision therefore represents a liberal approach to the notice requirements of clauses 8.4 and 20.1 of the FIDIC form, a failure to abide by those requirements will still have serious consequences.

Conclusion

This decision provides invaluable guidance as to a number of key provisions in the standard FIDIC suite of contracts. Owners and Employers who are negotiating contracts based on the FIDIC terms should pay careful attention to the decision to make sure that the interpretation of the various standard clauses set out above meets their expectations.

Contractors should also pay close attention to the court's views in relation to the definition of 'Unforeseeable' under the FIDIC terms. The decision shows that foreseeability is unlikely to be constrained by documents provided by the Owner during the tender stage. Contractors are likely to be expected to make their own investigations. Where the nature of the risks are intrinsically random, contractors might prudently assume that they will be taken to have allowed for worst case scenarios within the given risk profile. Contractors being asked to accept such risks may wish to negotiate limitations on the standard FIDIC wording, for example by limiting the definition of 'Unforeseeable' to certain sets of technical documentation or by imposing financial or quantities-based limits on the level of risk accepted.

References: *Obrascon Huarte Lain SA v Attorney General for Gibraltar* [2014] EWHC 1028 (TCC).

Liquidated damages update: damages for changes in personnel and the effect of contract amendments

Liquidated damages clauses are commonplace in the construction industry and are often linked to breaches of time obligations and performance requirements. Under English law, such clauses can be struck down if they are held to constitute a "penalty" aimed at deterring a breach of contract rather than providing compensation for loss. Two cases in 2014 have considered how this rule applies in the context of international construction projects. The first concerned the ability of parties to levy liquidated damages for changes made to key personnel in relation to an oil and gas project in Russia. The second concerned the impact of contract amendments on liquidated damages provisions in relation to a project in Iraq.

Bluewater Energy Services BV v Mercon Steel Structures BV

A sub-contract was entered into between Bluewater Energy Services and Mercon Steel Structures for the construction of a soft yoke mooring system for works at the Yuri Korchagin Oil Field in Russia. The sub-contract contained a list of Mercon's key personnel and prohibited Mercon from changing them without Bluewater's prior approval. Mercon agreed to pay liquidated damages to Bluewater for each change in key personnel made in breach of the contract. The liquidated damages applied to seven key personnel and ranged from €20,000 to €50,000.

A number of replacements occurred and Bluewater claimed liquidated damages. Mercon, however, argued the liquidated damages were a penalty and the clause was unenforceable. Mercon referred an earlier case in which an employer had claimed for fraudulent misrepresentation against its architect (*Fitzroy Robinson v Mentmore Towers Limited*). The architect had represented that a key staff member would be available for a contract, whereas in truth they had already handed in their notice. The architect was found liable for fraudulent misrepresentation, but the court held the employer had not suffered any loss as a result of the change in personnel. Any element of duplication or disruption was shouldered by the architect and was not passed on to the employer. The employer's claim therefore failed.

Mercon used this case to argue that any actual loss suffered by Bluewater would be minimal and, in comparison, the €20,000 to €50,000 amounts agreed were clearly intended to be a penalty to deter breach. Under English law, in order to show that a liquidated damages clause is not a penalty, it will usually be necessary to show that the amounts stipulated were a genuine pre-estimate of loss for the particular breach in question or that the amounts are not otherwise unconscionably extravagant.

The court disagreed with Mercon's approach. It emphasised English law's general reluctance to interfere with an agreed contractual term and noted that the parties had freely negotiated the liquidated damages amounts. Although it was impossible to put a precise figure on any loss suffered by Bluewater, the figure had been assessed by people who were experienced in such projects. In the context of the project, €50,000 was not unconscionably extravagant. The court also remind itself that the difficulty of putting a precise figure on any loss likely to be suffered was just the sort of situation where the level of pre-estimated damages respresented the true bargain between parties.

Unaoil Ltd v Leighton Offshore Pte Ltd

Unaoil and Leighton Offshore agreed to jointly tender to the South Oil Company ('SOC') in respect of the Iraq Crude Oil Expansion Project. Unaoil and Leighton Offshore entered into a Memorandum of Agreement in respect of project ('MOA') whereby Leighton Offshore agreed to appoint Unaoil as its sub-contractor for onshore construction works in the event that Leighton Offshore was appointed as main contractor by SOC. Leighton Offshore agreed to pay liquidated damages in the event that it failed to comply with its obligations under the MOA.

Leighton Offshore was subsequently appointed by SOC as main contractor but refused to appoint Unaoil as its sub-contractor, claiming that Unaoil was no longer approved by SOC. Unaoil disputed this and raised proceedings to recover liquidated damages (among other things).

Unaoil's claim for liquidated damages relied on Article 8 of the MOA which stated that if Leighton Offshore was awarded the contract by SOC and did not then adhere to the terms of the MOA, it would pay liquidated damages to Unaoil in the amount of $40 million. Article 8 also provided that: *'After careful consideration by the Parties, the Parties agree such amount is proportionate in all respects and is a genuine pre-estimate of the loss that UNAOIL would incur as a result of LEIGHTON OFFSHORE's failure to honour the terms of the MOA.'*

The original contract price under the MOA was $75 million, however the parties later amended the MOA to reduce the contract price to $55 million. No amendment was made to the liquidated damages clause to reflect this reduction and the liquidated damages remained at $40 million.

In these circumstances, Leighton Offshore was successful in having the liquidated damages clause struck down as a penalty. The court was prepared to assume that the liquidated damages clause at the time of the original MOA was a genuine pre-estimate of loss and not therefore a penalty. However, the amendment to the MOA had reduced the contract price to $55 million and at that time the court found that $40 million *'could no longer be a genuine pre-estimate of likely loss by a very significant margin.'* Although there was no previous case law on the topic, the court held that, *'where … the contract is amended in a relevant respect, the relevant date [for determining whether the clause is a penalty] is … the date of such amended contract'.* On this basis, the court struck down the liquidated damages clause noting that once the contract price had been reduced, the clause was:

'on any objective view, extravagant and unconscionable with a predominant function of deterrence without any other commercial justification for the clause.'

Conclusions and implications

These two cases appear to be the first English law decisions to consider penalties for changes in personnel and the impact of contract amendments. The *Bluewater* decision reminds us that liquidated damages provisions can be enforced despite underlying uncertainty as to the likely damages for breach of the clause in question. The court's emphasis on the parties' negotiations in *Bluewater* as justifying its conclusions is also notable. English law does not usually allow evidence of negotiations to be used in interpreting a contract. Liquidated damages clauses are an exception to this rule, however, and parties are permitted to refer to negotiations to show that the amounts of liquidated damages specified were intended to be compensatory rather than a deterrent for breaches of contract.

Parties would be well advised to be aware of these principles when negotiating liquidated damages provisions. Employers should ensure that negotiations stay focused on the types and amount of losses that liquidated damages are intended to compensate for. Contemporaneous calculations can be helpful in this regard. Contractors who are facing difficult negotiations and who are presented with unreasonable liquidated damages proposals might attempt to provoke discussion as to the reasons for the amounts proposed in the hope that they are shown to be proposed for their deterrent value rather than on the basis of compensatory principles.

The *Unaoil* decision raises a number of difficult issues in relation to the effect of amendments to liquidated damages clauses. This is an area of English law which is largely unexplored. Although the drastic reduction in contract price considered by the court provides a helpfully clear example of when a liquidated damages provision may be undermined by contract amendments, the implications of the decision may extend more broadly:

1. Many construction contracts contain powers to omit works, yet few allow for liquidated damages to be adjusted based on the value of any omissions made. It is unclear whether

or how the *Unaoil* decision might apply in circumstances where a large reduction in the contract price is effected through such an omissions clause rather than by way of a contract amendment.

2. The decision may well apply to other contract amendments which leave the contract price unaffected but alter other commercially relevant aspects of the agreement. For example, a Deed of Variation which adjusts an agreed date for completion may make original calculations as to liquidated damages for delay no longer applicable. Delay will now occur over a different period of time and may therefore have different financial consequences.

3. It is less clear how amendments which have no direct relevance to any liquidated damages provisions are to be treated. Do such amendments require liquidated damages clauses to effectively be re-assessed at the date of the amendment? For example, if the factual basis for an original pre-estimate of loss has changed so that losses are now much less than expected, will a minor unrelated amendment to the contract require the liquidated damages clause to be reformulated on the basis of the new state of affairs?

4. A similar issue arises where the parties' own understanding of the likely losses has developed since the time the contract was originally entered into. What is to happen, for example, if a contract amendment is agreed at a time when one or both of the parties has learned that the original pre-estimate of loss was mistaken? The commercial aspects of the parties' agreement may be left unchanged by the contract amendment, but must the parties still revise the liquidated damages clause to refresh the genuineness of the original estimate?

These are issues which appear likely to be explored further in light of the *Unaoil* decision in the coming years. Another notable aspect of the decision is a lack of emphasis on the fact that, pursuant to Articles of their contract, the parties had expressly agreed that the liquidated damages clause was proportionate and a genuine pre-estimate of loss. There is very little law on the extent to which such agreements are effective to displace the penalties doctrine. Many English lawyers think they are not effective and the *Unaoil* decision may well reflect this. Nevertheless, the question is not straightforward as English law permits parties to agree upon a factual state of affairs which is to bind them in the future. For example, a party will be bound by a clause which states that he did not rely on any representations in entering into a contract, even though that may not reflect the truth. Whether or not this principle can apply to penalty clauses remains to be seen.

References: *Fitzroy Robinson v Mentmore Towers Limited* [2009] EWHC 1552 (TCC); *Fitzroy Robinson v Mentmore Towers Limited* [2009] EWHC 3365 (TCC); *Bluewater Energy Services BV v (1) Mercon Steel Structures BV (2) Mercon Holding BV (3) Mercon Group BV* [2014] EWHC 2132 (TCC); *Unaoil Ltd v Leighton Offshore Pte Ltd* [2014] EWHC 2965 (Comm).

Limitations of liability implied by termination for convenience clauses

Two English High Court decisions in 2014 have considered the extent to which termination for convenience clauses provide an inherent limitation on the loss of profit which can be claimed by a contractor in the event of a breach or repudiation of its contract by the employer. The limitation said to arise from these clauses is based on the fact that in the absence of any breach or repudiation, the employer could have legitimately deprived the contractor of any entitlement to further profits through use of the termination for convenience clause.

Comau v Lotus Lightweight

This decision concerned a contract for the supply of goods and services by Comau (part of the Fiat group) relating to the installation of a new production line at a factory owned by the Lotus group. Lotus delayed in making certain payments under the contract and Comau sought to terminate under the contract and at common law for repudiatory breach. Comau brought proceedings to recover the profit it would have earned had the contract been performed by Lotus.

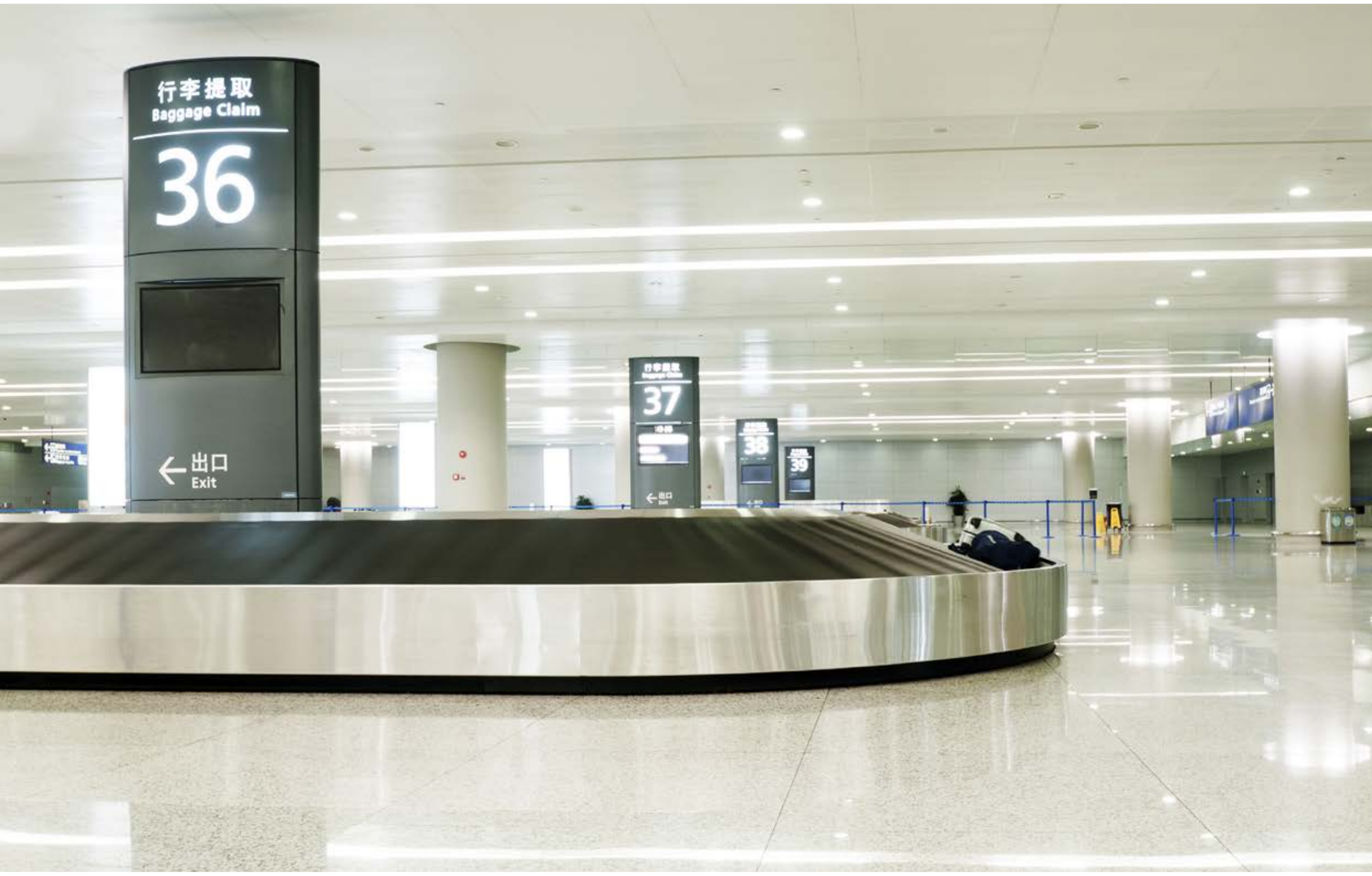
Lotus argued that Comau's claim for loss of profit ought to fail due to a termination for convenience clause included in the contract (which provided no entitlement to recover loss of profit). Lotus argued that it could have terminated the contract at any time and Comau therefore had no right to earn a profit for the full duration of the contract (Comau therefore had an insufficient "expectation interest" to sustain a claim for loss of profit).

The English Commercial Court agreed with Lotus and applied a line of English cases which require a court, when assessing damages for breach of contract, to assume that a contract-breaker will perform a contract in the least onerous way possible. The court therefore proceeded on the assumption that Lotus would have exercised its right to terminate for convenience. The court noted that, *'any other assumption ignores the limited nature of Comau's 'expectation interest' – that Comau was never entitled to profits on the whole of the goods and services to be supplied pursuant to the Agreement but was only ever entitled to such profit as it might have gained prior to any 'termination for convenience'.'*

One notable aspect of the court's reasoning is the apparent absence of any need by Lotus to show that it would have exercised its right to terminate for convenience had Comau not terminated the contract. The mere existence of the termination for convenience clause appears to have been sufficient without evidence as to whether or not the clause would – as a matter of fact – have impacted upon the profits which Comau would have derived from the contract.

Willmott Dixon v Hammersmith and Fulham BC

Shortly after the Comau decision, the English Technology and Construction Court reached a different conclusion on this issue in a procurement claim brought by Willmott Dixon against Hammersmith and Fulham Borough Council. Willmott Dixon was the incumbent provider of repairs and maintenance services to the Council and lost out on the award of a new contract for the same services to a competitor. Willmott Dixon challenged the probity of the procurement process and sought to recover the profit it would have expected to earn had it been awarded the new contract.



The proposed contract was for a 10 year initial term but permitted the Council to terminate for convenience on six month's notice after the first year of the contract (i.e. 18 months after commencement at the earliest). The Council argued that any claim to damages ought to be limited to this 18 month period as Willmott Dixon would not have had any guaranteed entitlement to work beyond that period.

The court rejected Willmott Dixon's claim on the merits, but found in its favour on this specific point. The court held that it was open for Willmott Dixon to make factual arguments, by reference to political, budgetary or economic considerations, to show that the Council would not have terminated for convenience and would have operated the contract for its full 10 year term (assuming of course that Willmott Dixon had been successfully awarded the contract in the first place). Unlike in *Comau*, the termination for convenience clause was not in itself sufficient to limit the Council's liability. The Council was required to prove that it would have exercised the termination for convenience clause in order to limit its exposure for loss of profit.

The correct approach?

The different outcomes reached in these two decisions reflect an underlying difference in approach to the assessment of damages. In one instance, the court permits the contract breaker to rely on the *theoretical minimum* level of performance the contract allows and in the other the court requires a factual investigation into the likely level of performance which would have been achieved.

The authority for the proposition that a court, when assessing 'damages claims', must assume that the contract breaker will perform the contract in the least onerous way possible is derived from a line of cases starting with the English Court of Appeal's decision in *Abrahams v Herbert Reiach Ltd* [1922]. In that case, the contract was one to publish a book and pay royalties to the author on the number of books published. The contract did not specify the number of copies that were to be published or the price of the book. The publisher repudiated the contract and the author sued for loss of royalties. The court found that the agreement was an enforceable contract which required the publication of at least one book. That left a question as to whether the author was entitled to royalties only on one book or something greater. Lord Justice Atkin held as follows:

> 'If a merchant makes a contract to deliver goods to a shipowner to be carried by him for reward, and the merchant fails to provide the goods, the Court must first find what is the contract which has been broken; and if it was to carry the goods to one of two alternative ports at different distances from the port of loading at rates of freight differing according to the distance, the only contract on which the shipowner can sue is a contract for carriage to the nearer port. The plaintiff cannot prove a contract for performance of the more onerous obligation. This explains why in cases of this kind the Court regards only the lesser of two alternative obligations. But in the present case there are no alternatives, and to adjust the rights of the parties the only method is to form a reasonable estimate of the amount the respondents would be in pocket if the appellant had kept his promise. Everything likely to affect the amount of the profit must be considered; the nature and popularity of the subject matter, the reputation of the authors, the cost of producing a book on that subject, the price at which it would command a sale, the business capacity of the publishers and the chances of earning a profit by the sale of the book. On the other hand the publishers are not bound to run risks contrary to their judgment; they would naturally and properly allow for fluctuation in the public taste for literature of this kind.

This passage has been applied in subsequent cases and is said to require the court to first ascertain whether the repudiated obligations are one which allow for true alternatives in performance or whether they are a single obligation with a discretion as to the level of performance.

In this respect, a construction contract with a termination for convenience clause poses some difficulties of categorisation. The clause neither gives rise to an alternative mode of performance nor does it turn the performance required of the employer into one with a discretion as to the level of performance. A termination for convenience clause simply provides a means by which the employer may be relieved of performance altogether. This difficulty of categorisation would appear to account for the different conclusions reached in the *Comau* and *Wilmott Dixon* decisions.

Implications

The *Comau* decision was not referred to by the court in the *Wilmott Dixon* case and different authorities were cited by the court in each case to justify these opposing conclusions (with the Commercial Court in *Comau* expressly declining to apply the line of authorities relied on by the *Wilmott Dixon* court). The law on this topic would therefore appear to be in an uncertain state and parties will need to await further decisions and possibly authoritative guidance from the English Court of Appeal to understand the full effect of termination for convenience clauses on claims for loss of profit.

In the meantime, parties should be aware that such clauses may in certain circumstances result in an exclusion or limitation of liability for future loss of profit in the event of breaches or a repudiation of the contract. To the extent that this is thought to be an unwelcome result, parties should seek to clarify their intentions in the termination for convenience clause itself, addressing specifically the extent to which the clause may be relied upon to reduce damages which might otherwise be recoverable for loss of profit.

Reference: *Abrahams v Herbert Reiach Ltd* [1922] 1 KB 477; *Comau UK Limited v Lotus Lightweight Structures Limited* [2014] EWHC 2122 (Comm); *Willmott Dixon Partnership Ltd v London Borough of Hammersmith and Fulham* [2014] EWHC 3191 (TCC).

The interpretation of exclusion and limitation clauses

In last year's edition of this publication we indicated that there were signs that the English courts were beginning to return to their traditionally stricter approach to time bar and exclusions clauses. This trend has continued in 2014, with three cases on the topic, all relevant to construction contracts.

Exclusions for 'loss of use'

The first case concerned the interpretation of an exclusion clause for 'loss of use' by the English Commercial Court in *Transocean Drilling v Providence Resources*.

Transocean hired a drilling rig to Providence and claimed payment at the daily rates of hire specified in the contract. In defence of that claim Providence claimed that the hire period was prolonged due to problems with the rig in breach of Transocean's obligations under the contract and that it should not be liable for the daily rates of hire during these periods of delay. Providence also counterclaimed for the costs of its personnel, equipment and third party services ('spread costs') wasted as a result of the delay.

Transocean argued that spread costs were excluded losses under clause 20 of the contract. The clause excluded (among other things):

> '… loss or deferment of production, loss of product, loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties), loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to [Transocean] by way of remuneration under this CONTRACT), loss of profit or anticipated profit, …'

Transocean argued that the spread costs were 'loss of use' because they were claims for loss of use (or the cost of use) of the property, equipment, materials and services provided by contractors, subcontractors and third parties.

The court interpreted the clause *contra proferentem* (whereby if the contractual interpretation is not clear, the provision is construed against the person seeking to rely on it), even though the clause was bilateral with mutual exclusions[1]. The court acknowledged that parties to commercial contracts are entitled to apportion the risk of loss as they see fit and any provisions excluding or limiting liability are to be construed according to the same principles as other terms. Nonetheless, it held that the correct approach was to begin with a presumption that neither party intended to abandon remedies for breach of contract by the other and that clear words were needed to rebut that presumption (known as the *Gilbert Ash* line of authority from the English House of Lords decision in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd)*.

Adopting this approach, each type of loss in clause 20 was construed narrowly to limit the parameters of excluded loss. In the context of the other exclusions for losses of income or benefit, referred to in the clause 'loss of use' was read as the loss of expected profit or benefit to be derived from the use of property or equipment. It was held that spread costs did not fall into this definition as the costs were for equipment and services which were in fact provided provided. The use of the equipment and services were not lost by Providence. They remained available at all times, even though they could not be used productively by Providence the claimed loss was therefore more properly characterised as wasted expenditure and therefore not caught by the terms of clause 20.

The court also cited in support of its conclusion the fact that a broader interpretation of clause 20

[1] It should be noted that there are different approaches to the contra proferentem rule. In the *Transocean* and *Heathy Buildings* decision reported in this article, the courts have focused on the party seeking to rely on the clause in question. However, the rule is sometimes said to be restricted to the party who drafted or 'profferred' the clause.

was likely to cover all losses which Providence could conceivably suffer as a result of breaches by Transocean. The court was reluctant to allow such an interpretation in the absence of clear language and relied on the so called 'declaration of intent' principle described as follows by Lord Wilberforce in *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale:*

> 'One may safely say that the parties cannot, in a contract, have contemplated that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force; to do so would be to reduce the contract to a mere declaration of intent.'

The decision provides a good example of the traditional approach to exclusion clauses adopted by English law. The natural reading of the words used by the parties, as matter of ordinary language, could have extended to the spread costs claimed by Providence, but traditional principles suggested that a narrow interpretation was to be preferred.

The decision also provides a useful illustration of the proper scope of 'loss of use' exclusions and suggests that such words on their own are unlikely to be sufficient to exclude claims for prolongation, non-productive overtime or other categories of costs arising from delay. The standard exclusion clause within the FIDIC suite refers to '*loss of use of any Works*' and would therefore appear to make this conclusion even clearer.

Loss of profit clause as alternative approach

As noted above, the court in the *Transocean* decision sought to limit the exclusion clause in that case to avoid the contract becoming a mere declaration of intent and depriving the parties of any right to claim financial remedies for breaches of contract. A similar argument was raised in a separate case before the Technology and Construction Court last year (*Fujitsu Services v IBM United Kingdom*), with results significantly different to *Transocean*.

The *Fujitsu* case concerned an exclusion clause in favour of both parties under an IT services sub-contract excluding liability for: '*loss of profits, revenue, business, goodwill, indirect or consequential loss or damage*'. The court's statement of the relevant principles was similar to that described above in relation to the *Transocean* case, noting in particular that the *Gilbert Ash* line of authority required clear words to exclude liability.

Fujitsu claimed that IBM had breached the contract by not allocating or causing sufficient work to not be allocated to it under the sub-contract. Fujitsu argued that if the exclusion clause were to remove any liability for loss of profit, IBM's obligations to allocate work would be meaningless and a mere declaration of intent. The court rejected this argument and found that the exclusion clause was sufficiently clear to apply to claims for loss of profit such as those made by Fujitsu. The court rejected the declaration of intent argument, primarily on two grounds:

- The exclusion applied only to breaches of contract and would not prevent Fujitsu claiming amounts due for work actually allocated to it and performed under the sub-contract.

- In any event, Fujitsu would still be able to bring non-monetary claims against IBM in respect of breaches of contract, such as for a declaration or for injunctive relief or orders for specific performance. The sub-contract would not therefore be deprived of all contractual force.

These grounds suggest a much narrower approach to the "declaration of intent" rule than that applied in the *Transocean* case. Both of the above considerations also applied in *Transocean*, however, the court in that case proceeded on the basis that the parties were not – without clear words – to be taken to have intended to exclude all financial remedies for breach of contract. The logic in *Transocean* could well have been applied in *Fujitsu* to say that, whilst limited contractual remedies would still remain, the parties should not, without clear words, be taken to have intended that IBM be able to breach its obligations to allocate work to Fujitsu with impunity save only for the prospect of declaratory and mandatory orders from a court.

The narrow approach for time-bar clauses

Another construction decision in 2014 which appears to signal a return to the traditional approach is *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd.* This case concerned a time-bar provision requiring the notification of claims within an eight week period. Such clauses have in the past been distinguished from exclusion clauses and employers have had greater success in persuading courts to give them an ordinary interpretation as opposed to a strict interpretation. For example, one judge in *Waterfront Shipping Co v Trafigura* noted:

'… the especially exacting principles of construction that apply to exemption clauses probably do not apply to time-bar provisions.'

This approach was not followed in this decision, however, with the Northern Irish Court of Appeal concluding that: '*[the] time bar provision in Clause 61.3 is an exclusion clause in favour of the Executive and falls to be construed contra proferentem*'. The Court also sought to apply the following passage from an earlier English authority supporting the traditional approach *(Dairy Containers Limited v Tasman Orient Limited):*

'The general rule should be applied that if a party, otherwise liable, is to exclude or limit his liability or to rely on an exception, he must do so in clear words: unclear words do not suffice. Any ambiguity or lack of clarity must be resolved against that party.'

The facts of this case provide a helpful illustration of the difference in the two approaches. The case concerned the Professional Services Contract (PSC) from the NEC suite of construction contracts, popular in the UK and growing in popularity internationally (particularly in Australasia, Africa and Hong Kong). Clause 61.3 of the PSC provided that the Consultant under the contract was to notify the Employer of claims for additional time or money (known as Compensation Events under the NEC suite). The clause went on to state that:

'If the Consultant does not notify a compensation event within eight weeks of becoming aware of the event, he is not entitled to a change in Prices, the Completion Date or a Key Date unless the Employer should have notified the event to the Consultant but did not.'

The case concerned a disputed instruction given by the Employer. The Consultant argued that the instruction had changed the scope of works and sought to claim a Compensation Event as a result. The Employer disagreed that the instruction amounted to a change, but in the alternative argued that the Contractor had not notified its claim within eight weeks of the instruction. Clause 61.1 of the contract required the Employer to notify the Contractor of a Compensation Event at the time of giving an instruction, but the Employer claimed that this requirement did not apply where the Employer was of the view that the instruction did not amount to a Compensation Event. The Consultant disagreed and relied on the final words of clause 61.3 quoted above to excuse the absence of any notification within the required eight week period.

The Employer's submissions sought to highlight the absurdity of requiring the Employer to notify a Compensation Event in circumstances where it did not believe that its instruction had resulted in a change in scope and did not therefore constitute a Compensation Event. This absurdity suggested, so it was argued, that the final words to clause 61.3 were ambiguous and should be interpreted to support the commercial purpose of the clause, which was to allow for claims to be notified and dealt with as they arose during the course of the works. Although the court rejected the argument as to ambiguity, it noted that it would in any event have applied the *contra proferentem* rule to arrive at a narrow reading of the time-bar. Such an approach is to be contrasted with that taken to ordinary clauses under English law (i.e. those not having the effect of excluding rights or liabilities). In those circumstances, a court would typically look to resolve ambiguity in accordance with the commercial purpose of the given clause or contract. The Employer in this case had sought to have this wider, ordinary approach applied to the time-bar provision under the NEC, but the court felt constrained to apply the more narrow approach traditionally give to exclusion clauses.

Conclusion

All of the above three cases suggest a return to the traditional approach to the interpretation of exclusion and time-bar clauses. This approach requires clear words for the parties to exclude or limit liability and any ambiguity will be interpreted *contra proferentem* against the party seeking to rely on the clause.

Despite the general application of the traditional approach, tensions with a more liberal approach can still be observed in the differences of approach adopted to the 'declaration of intent' principle as described above. Parties may also be expected to continue to argue for a more liberal approach overall based on earlier authorities which had suggested that, for time-bar clauses in particular, the strictness of the traditional approach may not be appropriate.

Reference: *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361; *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689; *Dairy Containers Limited v Tasman Orient Limited* [2005] 1 WLR 215; *Waterfront Shipping Company Ltd v Trafigura AG* [2007] EWHC 2482 (Comm); *Transocean Drilling U.K. Limited v Providence Resources plc the Arctic III* [2014] EWHC 4260 (Comm); *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd* [2014] NICA 27; *Fujitsu Services Limited v IBM United Kingdom Limited* [2014] EWHC 752 (TCC).

The application of the English legislation to international construction projects

A decision of the English Commercial Court last year has considered the circumstances in which the UK's late payment legislation will apply to international contracts. We consider the implications of this decision for international construction projects below, together with an overview of other UK legislation potentially applicable to such projects.

The Late Payment of Commercial Debts Act (Interest) 1998

The Late Payment of Commercial Debts Act (Interest) 1998 requires parties to specify a 'substantial remedy' for late payment and if no such remedy is specified, a penal interest rate will apply (presently 8% above the Bank of England Base Rate), together with an entitlement to the reasonable costs of recovering payment (which may include legal costs). The late payment legislation also imposes limits on the length of payment terms which may be agreed (with a fairness test applying in cases above 60 days).

This piece of legislation reflects the UK's implementation of European directives on combatting late payment in commercial transactions. Section 12 of the Act concerns international contracts and prescribes that a choice of English law alone is not sufficient to attract the applicability of the Act. In such cases, the Act will only apply where (i) there is a 'sufficient connection' between the contract and the UK; or (ii) the contract would be governed by UK law apart from the parties' choice.

In *Martrade Shipping v United Enterprises* the Commercial Court overturned an arbitral finding that a 'significant connection' to the UK had been established by the presence of an English arbitration clause and the use of the English language in the contract and contract documents. These were rejected by the court as providing any evidence of a significant connection to the UK for the purpose of the Act. However, the court also commented on four matters which might provide such a connection:

1. Where the place of performance of obligations under the contract is in the UK.

2. Where the parties or one of them is of UK nationality. The court noted that the policy behind the Act was likely to be engaged where a paying party was a UK national and fairness may then require that both parties should be placed on an equal footing, even if the other party was not a UK national.

3. Where the parties are carrying on some relevant part of their business in the UK.

4. Where the economic consequences of a delay in payment might be felt in the UK. The court noted that this could involve the consideration of related contracts, related parties, insurance arrangements or the tax consequences of transactions.

The above criteria have the potential to apply to international construction projects located outside the UK where the parties have chosen English law to govern the contract. The incorporation of one of the parties in the UK is an obvious example. Others could be the granting of performance securities by a UK bank or the existence of a UK parent company with or without a parent company guarantee.

As noted above, the Act applies where the parties fail to provide a 'substantial remedy' for late payment. An example where there may be such a failure is the FIDIC Conditions of Contract for Construction (the Red Book). Whilst clause 14.8 specifies a remedy for late payment for payments to the Contractor (financing charges,

References: *Martrade Shipping & Transport GmbH v United Enterprises Corporation* [2014] EWHC 1884 (Comm) compounded monthly) nothing is provided for payments due to the Employer. Were the Contractor to delay in the payment of liquidated damages, for example, the Act would impose its penal rate of interest (assuming a sufficient connection is shown between the contract and the UK as discussed above).

Other UK legislation applicable to international construction projects

Aside from the Late Payment Act, other UK legislation may also apply to construction contracts outside the UK if those contracts incorporate English law. Such legislation can operate to imply terms into the contract and, in some circumstances, restrict the parties' ability to exclude liability.

We have set out a table below showing which UK legislation will apply to an international project where the parties have chosen (i) English law to govern their contractual obligations; and (ii) English law also to govern their non-contractual obligations (i.e. claims in tort or delict).

Legislation	Brief summary of the legislation	Applies to contracts performed outside UK where the governing law of the contract is English law	Applies to contracts performed outside UK where the governing law of the contract and the parties' non-contractual obligations is English law
Bribery Act	The Bribery Act criminalises various corruption offences. Its reforms include: — Criminalising business to business bribery; — Seeking to prevent bribery by the use of third parties; and — Extending to bribery outside the UK.	Y (provided, for the Corporate Offence, that company or partnership is incorporated, or "carries on a business, or part of a business" in any part of the UK)	
Housing grants, Construction and Regeneration Act 1996 ('Construction Act')	The Construction Act incorporates two important features into all construction contracts, which cannot be excluded: — The structure of payment provisions; and — Adjudication. The Act defines construction contracts as those involving construction operations (which cover all areas of construction commonly encountered) subject to certain exclusions.	N	
Sale of Goods Act 1979	The Sale of Goods Act implies a number of terms into contracts for the sale of goods including: — Good title; — No encumbrance and quiet possession; — Satisfactory quality; and — Fitness for purpose.	Y	Y
Supply of Goods and Services Act 1982	The Supply of Goods and Services Act implies similar terms as the Sale of Goods Act, but also implies terms that services will be carried out: — With reasonable skill and care; — Within a reasonable time; and — For a reasonable price.	Y	Y
Unfair Contract Terms Act 1977	The Unfair Contract Terms Act imposes limits on the extent to which liability for breach of contract, negligence or other breaches of duty can be avoided by means of contractual provisions such as exclusion clauses.	N	N

Legislation	Brief summary of the legislation	Applies to contracts performed outside UK where the governing law of the contract is English law	Applies to contracts performed outside UK where the governing law of the contract and the parties' non-contractual obligations is English law
Law Reform (Contributory Negligence) Act 1945	The Law Reform (Contributory Negligence) Act provides that the damages recoverable by a claimant whose negligence has contributed to the damage can be reduced in accordance with what is just and equitable in the view of the court.	Y	Y
Civil Liability (Contribution) Act 1978	The Civil Liability (Contribution) Act provides that any person liable for damage suffered by another person may recover a contribution from any other person liable in respect of the same damage.	N (The same result can be achieved through contractual indemnity provisions, however)	
Misrepresentation Act 1967	The Misrepresentation Act allows a party to claim damages in respect of misrepresentations which have induced one party to enter into a contract. The Act also limits the parties' ability to exclude liability for such misrepresentations.	Y	Y
Late Payment of Commercial Debts (Interest) Act 1998	The Late Payment of Commercial Debts Act requires parties to specify a "substantial remedy" for late payment and if no such remedy is specified, a penal interest rate will apply (presently 8.5%), together with an entitlement to the reasonable costs of recovering payment (which may include legal costs).	Y (if there is also a sufficient connection with the UK)	Y (if there is also a sufficient connection with the UK)

Dispute resolution under the FIDIC form

Key aspects of the FIDIC dispute resolution provisions were considered in three important decisions last year emanating from England, Switzerland and Singapore. These decisions have confirmed the pivotal role played by DABs in the FIDIC dispute resolution process by confirming their status as a pre-condition to arbitration and clarifying their enforceability ahead of a final arbitral award.

DABs as a pre-condition to arbitration

Regular users of the FIDIC suite of contracts will be aware of the multi-tiered dispute resolution process, which requires a Dispute Adjudication Board (DAB) to make a binding decision on a dispute before it can be referred to arbitration. One question that often arises is what the parties should do where a DAB has not been constituted, especially in circumstances where one of the parties is attempting to delay and disrupt the constitution of an *ad hoc* DAB that has to be put in place to resolve a particular dispute (as opposed to a standing DAB that is appointed at the outset of a project). If there is no DAB, how can a dispute be referred to it? Can the dispute be referred straight to arbitration instead?

The standard FIDIC terms do not provide a clear answer to these questions. However, it has been suggested by some that an answer could be found in clause 20.8. Despite being entitled '*Expiry of Dispute Board's Appointment*', which could be interpreted as applying only where a DAB was already implemented, the clause says that the provisions relating to the DAB do not apply and a dispute may be referred directly to arbitration in circumstances where '*there is no [DAB] in place, whether by reason of the expiry of the [DAB's] appointment or otherwise*' It is the '*or otherwise*' part of this clause that offers a potential answer to the question, although it is by no means a clear-cut one.

One effect of this uncertain situation is that a party on the receiving end of a notice of arbitration will often challenge the arbitral tribunal's jurisdiction, if only as a tactical point to be taken in settlement discussions or to buy them more time to prepare their defence in the arbitration.

Two decisions last year from the Swiss Supreme Court and English Technology and Construction Court have provided some further guidance about how this clause will be interpreted. The Swiss case, known simply as Case 4A_124/2014, concerned two contracts governed by Romanian law between a French company and a Romanian state company for the restoration work on a Romanian highway. The parties had attempted to constitute a DAB, but the process had been delayed by over a year and the DAB was not operative by the time the claimant had lost patience and decided instead to file a request for arbitration under the ICC Rules. The respondent challenged the tribunal's jurisdiction on the basis that complying with the DAB procedure under the FIDIC contract was a condition precedent to the issue of a valid request for arbitration.

Following a decision by the arbitral tribunal that it did have jurisdiction, a challenge was made to the Swiss Supreme Court. It had therefore to consider the issue of whether the DAB procedure in the FIDIC contract was mandatory and, if so, what were the consequences of a failure to comply with the requirement.

The Swiss Supreme Court's decision contains helpful analysis of the relevant FIDIC provisions, which could be applied equally in other jurisdictions. As part of this analysis, the Swiss Supreme Court considered the wording of clause 20.8. The words '*or otherwise*' were described by the Swiss Supreme Court as a '*very vague expression*' but it said '*interpreting it literally and extensively would short-cut the multi-tiered alternative dispute resolution system imagined by FIDIC when it came to a DAB ad hoc procedure*

because, by definition, a dispute always arises before the ad hoc DAB has been set up, in other words, at a time when 'there is no DAB in place', however such interpretation would clearly be contrary to the goal the drafters of the system had in mind.'

The conclusion of the Swiss Supreme Court was therefore that, at least for international arbitrators sitting in Switzerland, the DAB procedures under the FIDIC contract must be treated as mandatory. An arbitration may not be initiated without going first to the DAB if the contract provides for this. However, in the particular circumstances of this case, where an *ad hoc* DAB had not been constituted 18 months after it was requested, the respondent was ultimately found to be unable to continue to rely on the mandatory nature of the DAB procedure to prevent the resolution of the dispute by arbitration.

A similar result was reached in the English case of *Peterborough City Council v Enterprise Managed Services Ltd*. In this case, the claimant commenced court proceedings in the TCC arguing that it was entitled to in effect opt-out of the requirement in clause 20.2 of the FIDIC Silver Book where it did not wish to have a dispute resolved by the DAB and to refer the dispute directly to court (which had been chosen by the parties as the final determination procedure, rather than arbitration).

The claimant again relied on clause 20.8 and in particular the '*or otherwise*' wording. The claimant's position was that the parties could not be under a mandatory obligation to achieve the appointment of a DAB and that the phrase '*or otherwise*' was wide enough to include a state of affairs where a DAB was not in place because the Dispute Adjudication Agreement had not been concluded between the parties and the DAB.

Mr Justice Edwards-Stewart considered how the clause should be interpreted and concluded that the words '*or otherwise*' should be viewed narrowly with the effect that clause 20.8 did not give either party '*a unilateral right to opt out of the [DAB] process, save in a case where at the outset the parties have agreed to appoint a standing DAB and that, by the time when the dispute arose, that DAB had ceased to be in place, for whatever reason.*'

The court proceedings commenced by the claimant were therefore stayed to enable the parties to '*resolve their dispute in accordance with the contractual machinery …*' i.e. by the DAB.

Enforcement of DAB decisions pending arbitration

In another part of his judgment in the *Peterborough City Council* decision, Edwards-Stewart J rejected the proposition that clauses 20.4 to 20.7 of the FIDIC dispute resolution procedure were unenforceable for lack of certainty. A number of commentators have commented on a potential 'gap' in these provisions, summarised by the judge as follows:

'… what has been described as "the gap" in those sub-clauses … arises when the DAB has made a decision and one party has given a notice of dissatisfaction - with the result that the DAB's decision, whilst binding, is not final. The problem then is that if the unsuccessful party refuses to comply with the decision of the DAB, as it is

required to do by sub-clause 20.4.4, the only remedy (it is said) available to the other party is to refer the dispute occasioned by the refusal to comply to yet another adjudication. This can have the effect, Ms. Sinclair submitted, that the party in default can embark on a course of persistent non-compliance with DAB decisions and thereby deprive the other of any effective remedy.'

Mr Justice Edwards Stewart was able to side-step this difficult issue because the contract before him provided for court proceedings rather than arbitration. He noted that whilst the point '*may be arguable in the context of the standard FIDIC Books which include an arbitration clause*', an English court was not subject to the same jurisdictional limitations as an arbitrator. It could, for example, simply order specific performance of the DABs decision pending final determination of the court proceedings.

The difficulties which arise in an arbitration context were, however, addressed head-on by a Singaporean court last year in *PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia).* This litigation has a long history which we have reported on previously in the 2012 edition of this publication. The first round of the litigation involved a contractor obtaining a DAB decision for the payment of $17 million against an owner. The owner gave a 'notice of dissatisfaction' and the contractor commenced an arbitration to enforce the DAB's decision. The arbitral tribunal gave a final award enforcing the DAB's decision and declined the owner's request to consider the underlying merits of the contractor's claim. The tribunal ruled that the proper course for the owner was to seek such a review by a separate arbitration.

This final award was struck down by the Singaporean Court of Appeal as being without jurisdiction and in breach of the rules of natural justice. The arbitral tribunal was required to determine the full dispute between the parties and had been wrong to decline the owner's request to consider the underlying merits of the claim. The Court noted that a better approach for the contractor would have been to have sought an interim or partial award pending the making of a final award.

The contractor took account of the Court's comments and commenced a further arbitration, this time seeking an interim award to enforce the amount of the DAB's decision. The interim award was granted and the owner then brought proceedings before a Singaporean court to challenge its validity. The owner contended that the applicable arbitration rules prevented any provisional award being made which might be varied in the tribunal's final award and also offended against a provision in the rules which prevented the tribunal from varying, amending or revoking an award.

The Singaporean court rejected the owner's challenge and found that the tribunal's award, although expressed as being "interim" was final and binding in relation to its subject matter, that being the owner's compliance with the DAB decision. If the DAB decision was reversed in the final award that would not be an amendment or revocation of the interim award, as such, but merely an accounting exercise given effect to by the final award.

As noted in our 2012 edition, it is anticipated that this issue will be resolved expressly in the revised suite of FIDIC contracts which are now expected imminently (beginning with the Yellow Book). For the time being, however, this case provides welcome confirmation that DAB decisions will be capable of enforcement by some means despite the drafting deficiencies in the FIDIC form.

References: Case 4A_124/2014 (Swiss Federal Tribunal); *Peterborough City Council v Enterprise Managed Services Ltd* [2014] EWHC 3193 (TCC); *PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation (Indonesia*) [2014] SGHC146

The omission of works under international construction contracts

The English Court of Appeal has recently upheld a TCC decision concerning the valuation principles to be applied when ordering omissions under a variation clause. The case provides helpful guidance as to how such omissions are to be valued and provides a good illustration of the risks and limitations which can apply when using a right to omit works as a tool for managing Contractor delays.

In 2006, E.ON appointed Højgaard as the main contractor for the design, fabrication and installation of the foundations for 60 wind turbine generators and 2 substations for the Robin Rigg offshore windfarm in the Solway Firth. The total contract value was around €100m and of this around a quarter related to the installation of the 60 wind turbine generator foundations.

To install the foundations, Højgaard agreed to provide a jack-up barge called the 'LISA'. Unfortunately, the LISA proved inadequate to carry out the works. She arrived on site 3 months late and less than 2 weeks into the works two of her legs settled into the sea bed causing her to tilt dangerously. She was abandoned and upon refloating it was discovered that significant repairs were required. It soon became obvious that use of the LISA would mean a significant increase in the time required to complete the project.

To mitigate delays to the works, E.ON commissioned the (perhaps appropriately named) 'Resolution' to carry out the LISA's duties. The project Engineer issued 3 variation orders for this substitution but did not consent to or instruct Højgaard to demobilise the LISA - though Højgaard eventually did so after several failed attempts to return to site.

In the end, the Resolution installed all but 2 of the 62 foundations. A dispute arose as to how to value the effective omission of the LISA from the contract. Variations were to be valued under clause 31.3 of the contract, which did not expressly deal with the valuation of omissions, but provided for a tiered valuation procedure as follows:

> 'If the Contractor and the Employer are unable to agree on the adjustment of the Contract Price, the adjustment shall be determined in accordance with the rates specified in Part L, Schedule L1.3 Schedule of Rates.
>
> If the rates contained in the Schedule of Rates (Schedule L1.3) are not directly applicable to the specific work in question, suitable rates shall be established by the Engineer reflecting the level of pricing in the Schedule of Rates (Schedule L1.3).
>
> Where rates are not contained in the said Schedule, the amount shall be such as is in all the circumstances reasonable. Due account shall be taken of any over- or under-recovery of overheads by the Contractor in consequence of the Variation.'

The valuation of omissions

It was accepted by both parties that the second paragraph of the above clause should apply. The parties differed, however, as to whether in the case of omissions the valuation was to be linked to the Contract Price or carried out simply by reference to the suitable rates established by the Engineer.

E.ON argued that the correct manner in which to value the variations was to look at how long it would have taken Højgaard to carry out the works had they used the LISA. Just as where for additional work the Engineer would formulate an appropriate rate and multiply that rate by the number of days or hours required, E.ON argued that the relevant daily rate for the LISA should be multipled by the estimated number of days that it would have taken Højgaard to complete

the works using the LISA. Due to the problems encountered with the LISA this period would be considerably more than that allowed for in the Contract Price. In support of this, E.ON referred to the fact that the breakdown of the Contract Price (contained in a Schedule L1.1) was not referred to in clause 31.3. E.ON also sought to argue that the reason behind the variation orders (Højgaard's failure in breach of contract to progress the works) was relevant to determining the value of the omission.

Højgaard argued that the valuation of omitted work should be based on the original contribution of the omitted work to the contract sum. Accordingly, the omission of the LISA should not result in a deduction more than the amount of the contract sum relating to the foundations and the barge. In rebuttal, E.ON argued that this interpretation involved a transfer of the pricing risk away from Højgaard.

The difference between the parties' valuations was significant; Højgaard sought a reduction of €12,900,000 whilst E.ON claimed €57,250,000.

The Court of Appeal

In affirming the first instance decision, the Court of Appeal accepted Højgaard's position and found that the parties must have intended a distinction between the valuation of omissions and additions. The court noted:

> '… there is a missing element in Clause 31 in the sense that it does not, in terms, tell you how to deal with omissions. For that purpose it is necessary to consider the contract as a whole, the price risk for MTH inherent in it, and the fact, as it seems to me, that the parties must have intended that an omission would result in a reduction in price commensurate with the work omitted, whilst ensuring that MTH continued to be paid (for work which it in fact carried out) the proportion of the Contract Price attributable to that work.'

The court rejected E.ON's 'hypothetical' method of valuing the variation and found that it was neither *'necessary nor appropriate to work out how many days it would, in fact, have taken to complete the installation with the LISA and apply a rate to those days'*. The court emphasised Højgaard's right to be paid for work actually carried out by it under the contract and noted that E.ON's interpretation could result in Højgaard being required to work for free. For example, if 50% of the work was omitted and it was proved that this work would have cost twice the amount originally expected, then the omission argued for by E.ON would be 100% of the Contract Price, leaving Højgaard to complete the remaining 50% of the work for free.

The Court of Appeal therefore agreed with the judge at first instance that E.ON was essentially attempting to achieve additional contractual remedies for breach of contract under the guise of an adjustment to the Contract Price, whereas under clause 31.3 the Engineer should be seeking to achieve an approximation to the Contract Price made by those parts of the Works which were omitted by the Variation Orders.

The limitations of omissions clauses

E.ON took the unusual approach of hiring the Resolution itself and then seeking to recover its costs through the variation clause. This is interesting given the other potential remedies that would have been open to E.ON under the contract. For instance, it could have sought liquidated damages for the delay caused by Højgaard up to 20% of the contract price. Alternatively, as Højgaard was responsible for providing all the necessary equipment under the contract, E.ON could have required Højgaard to instruct another barge. Both of these options would have left the responsibility of the barge to Højgaard.

Instead, E.ON tried to take the initiative to avoid further delays. It seems possible that E.ON may have been concerned that the delay in using LISA was likely to have led to the liquidated damages cap being exceeded and the erosion of any financial incentive for Højgaard to proceed diligently with the works. It seems that in these circumstances, Højgaard may have viewed the omissions clause as a route to take control of the delays being caused by LISA whilst at the same time preserving its right to damages on account of those problems. That view was ultimately held to be unfounded and demonstrates the limitations that can apply when attempting to deal with breaches of contract through a variations clause.

Another more common misuse of variation clauses concerns the taking up of omitted work by a third party. In long term contracts and in large scale complex projects running for several years, personnel are likely to change and a contractor's performance could alter. There may be a temptation to deal with poor performance (that may otherwise amount to a breach of contract) through an omissions clause to avoid arguments over liability and the best approach for remedying any breach. However, Owners should be aware that there are significant risks in using omissions clauses in this way if omitted works are to be given to a third party. In *Carr v J A Berriman Pty Ltd*, although the variation clause allowed for the omission of works, the court found that this did not allow the employer to hand these to another contractor - such a power would require 'very clear words' in the contract.

Conclusions and implications

The decision in this case highlights a number of important considerations for the drafting and use of variation clauses in relation to omissions:

— The valuation rules included within variation clauses can often overlook the peculiar difficulties which arise in relation to omissions. Had the clause in the present case made clear that its rules applied both to omissions and additions, E.ON would have been much better placed to argue for its interpretation.

— In the absence of any specific treatment of omissions within a variation clause, the present decision shows that the court is likely to adopt an interpretation which values omissions by reference to the Contract Price.

— Owners should consider all contractual options before omitting works. There may be other contractual remedies such as LADs which may provide more adequate compensation.

— Contractors should be aware of their general right to complete the works within the original contract scope. Most of the time, a variation clause will not be wide enough to allow an employer to omit works within the original scope to be give to someone else. Indeed the FIDIC suite of contracts expressly state that variations cannot comprise the omission of any work to be carried out by others.

— Parties should carefully consider their rights and obligations when negotiating long term contracts and ensure that there are adequate remedies to deal with poor performance.

References: *Carr v J A Berriman Pty Ltd* (1953) 89 CLR 348; *MT Hojgaard v E.ON* [2014] EWCA Civ 710.

Arbitration update: an international construction law perspective on the new LCIA rules

The London Court of International Arbitration ('LCIA') released updated rules (the '2014 Rules') on 1 October 2014. While the general framework remains the same, a number of procedural changes have been introduced. The changes cover a range of issues including choice of law, duties of arbitrators, conduct of arbitrations, multiparty proceedings and the conduct of legal advisors.

Certain updates to the LCIA Rules are of particular interest for the international construction industry, including the addition of emergency arbitrator provisions and the extension of rules relating to multi-party proceedings. This article examines these two areas in further detail and seeks to highlight issues that construction contract drafters should bear in mind during the contract formation stage.

Emergency Arbitrators

The ability to seek interim legal measures on an urgent basis during the course of a project or dispute is sometimes necessary to protect a parties' position, for example, by preventing the dissipation of assets or unreasonable calls on on-demand securities, requiring specific performance (e.g. timely completion), preserving evidence and addressing other urgent issues. Prior to the advent of an emergency arbitrator and expedited arbitration rules, the only avenue by which a party to a dispute bound by an arbitration clause could seek interim measures was through a local court, or in certain cases, through a pre-referral procedure available under certain rules (for example, under the ICC Rules). This caused difficulties for parties domiciled outside of the relevant jurisdiction of the project or the location of the other party's assets, particularly if unfamiliarity or lack of faith in the local jurisdiction was the reason arbitration was agreed to in the first place. In many situations, difficulty in obtaining such interim measures could potentially render any eventual arbitration award ineffective.

The LCIA rules have sought to address these problems by the inclusion of Emergency Arbitrator ("EA") provisions in a new Article 9B. The key features of Article 9B are:

- An EA may only determine a dispute prior to the formation of the arbitral tribunal and must do so within 14 days of the appointment by the LCIA, absent agreement by the parties or exceptional circumstances.

- An EA may issue an order or an award. An order must be in writing with reasons. The Rules provide that an award will be final and binding in accordance with Article 26.8 of the Rules, but do not to extend the same status to an order.

- Both orders and awards may be confirmed, varied, discharged or revoked, in whole or in part, by the arbitral tribunal.

- The parties' right to apply to a state court or other legal authority for interim or conservatory measures is preserved (prior to formation of the arbitral tribunal).

— Parties whose arbitration agreement was concluded prior to 1 October 2014 must 'opt in' before the emergency arbitrator provisions will apply. Conversely, parties must 'opt out' if they do not wish the provisions to apply to agreements concluded after 1 October 2014.

The 2014 emergency arbitrator provisions align the LCIA Rules with the rules of the International Chamber of Commerce (ICC), the International Centre for Dispute Resolution (ICDR), the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), the Stockholm Chamber of Commerce (SCC) and the Swiss Chambers Arbitration Institution (SCA), all of which allow for the appointment of emergency arbitrators. Statistics released by the ICC and SIAC provide insight into the popularity of the provisions. In 2013, of the 767 requests for arbitration received by the ICC, 6 were referred to an emergency arbitrator. Since the SIAC introduced emergency arbitrator[1] provisions in 2010, as at March 2014 it had received 34 applications for emergency relief (11 of which were rejected).[2] It will be interesting to review the LCIA EA related statistics (if made available) over the course of the coming year, to monitor the frequency of their uptake.

While Article 9B confers some obvious benefits for parties bound by the 2014 Rules, the EA provisions are not without their limitations. One such limitation is the unsuitability of the EA procedures in circumstances where a party considers it necessary to seek relief *ex parte* (i.e. without notice to the other party). Another relates to the question of enforceability of an EA's award or order under domestic legislation. These issues are discussed in further detail below.

Applications for interim measures are often sought *ex parte* to stop the responding party from taking steps that would cause serious harm to the applicant's interests, in circumstances where there is extreme urgency. The EA provisions under the 2014 Rules require copies of an application for interim measures to be served upon each party, thereby excluding the option for a party to submit an *ex parte* application. This requirement could effectively render an EA's decision redundant, as the very act of putting the responding party on notice of an application for interim measures may trigger the action that the application intends to prevent. For example, asset freezing orders will almost always be sought *ex parte*, as any party given notice that its assets will potentially be frozen will have the opportunity to immediately dissipate those assets outside of the relevant jurisdiction.

In situations where one party intends to seek an urgent interim measure such as an asset freezing order or an order to prevent a call on a performance bond, EA proceedings could potentially still have some utility. For example, an

[1] ICC website; http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Introduction-to-ICC-Arbitration/Statistics/.

[2] SIAC website; http://www.siac.org.sg/2014-11-03-13-33-43/facts-figures/statistics.

EA could order that the dissipated assets be paid back into a holding account, or could make some other order that would have a negative effect on the non-compliant party when a final award is issued. Ultimately, however, this is unlikely to provide the parties with sufficient protection in all situations. It would certainly have little utility if potential destruction of evidence was at issue.

The *ex parte* limitation appears to have been considered by the drafters of the 2014 Rules, given that the Rules expressly allow the parties to seek urgent interim measures from a competent judicial authority at any stage prior to the formation of the arbitral tribunal, regardless of whether an EA has been appointed. However, the English Arbitration Act 1996 limits the scope for court intervention in arbitral proceedings. In particular, section 44 (5) provides that

> 'the court shall act only if or to the extent that the arbitral tribunal, and any arbitral or other institution or person vested by the parties with power in that regard, has no power or is unable for the time being to act effectively'.

Section 44(5) may therefore suggest that an English court would only intervene where EA provisions have not been agreed to. This issue was touched upon by the Technology and Construction Court this year in *Seele Middle East v Drake & Scull Inernational* in relation to an application for interim measures by a party involved in an ICC arbitration, in circumstances where arbitration proceedings had commenced, the arbitral tribunal had not yet been formed, and no EA provisions applied. The lack of EA provisions was relevant because in their absence, there was no method by which an interim application could be dealt with, and therefore the Court agreed that it had the requisite jurisdiction to deal with the application. The inference might be drawn from this judgment that in circumstances where EA provisions do apply, the Court will be reluctant to intervene.

However, the wording of section 44(5) is important. It states that the arbitral tribunal, or EA, must be *'unable for the time being to act effectively'*. It is certainly arguable that an EA cannot act effectively in situations where an application must be made *ex parte* in order to have proper effect. In light of this, and given that the 2014 Rules expressly state that recourse to the courts is preserved under the 2014 Rules, it seems unlikely that an English court would decline jurisdiction over an *ex parte* application if the subject matter warranted urgent action.

As noted above, an EA's decision may take the form of an award or an order, but only an award is stated to be binding and final until revisited by the arbitral tribunal. By comparison, the ICC rules provide that an EA's decision must take the form of an order, which the parties must comply with. The HKAIC and SIAC Rules refer to an EA's decision as capable of being both an order and an award, and emphasise that an EA's decision has the same effect as an interim measure, being a temporary measure which is only binding on the parties until the arbitral tribunal decides otherwise. The distinction between orders and awards may reflect a difference between procedural and substantive remedies. A tribunal would, for example, make an 'order' rather than an 'award' in relation to the preservation of evidence or the freezing of assets (those not being based on substantive rights). It might, however, make an 'award' declaring a certain state of affairs under the construction contract, for example that a certain proposed course of action would be in breach of contract, and also an 'award' seeking to prevent that course of action being implemented (i.e. final awards are not restricted to monetary sums and can include injunctive relief).

The distinction between orders and awards may be significant for enforcement purposes. The usual means of enforcing foreign arbitral awards through the New York Convention or local recognition / *exequatur* proceedings is likely to apply only to awards in the sense described above and not orders.[3] In this respect there would appear to be two ways to enforce an 'order':

- The curial law of the arbitration will usually provide a means for converting such orders into orders of the local supervisory court. For example, section 42 of the English Arbitration Act 1996 permits the English courts to make orders enforcing orders made by an arbitral tribunal which have not been complied with (although the arbitral tribunal is required to make a second, 'peremptory', order before this section can be used). This would typically apply to procedural orders during the conduct of an arbitration, such as for the disclosure of documents, but there is no reason why it might not also apply to orders made by an EA.

- Breach of an order will amount to a breach of the arbitration agreement (the parties having implicitly agreed to abide by the orders of an EA if the EA procedure is adopted) regardless of the ultimate outcome of the dispute. A failure to comply with the order may therefore allow additional claims for damages to be made and may allow the innocent party a right to terminate the arbitration agreement (under English law, a failure to comply with an order of the EA might be characterised as a 'repudiation' of the arbitration agreement if it indicates an intention not to be bound by, orders of the arbitral tribunal).

Where the EA makes an 'award' rather than an "order" the potential for enforcement via foreign courts may also apply. The New York Convention provides for the enforcement of arbitral awards in more than 150 countries and may provide a convenient means for the enforcement of EA 'awards'. One potential difficulty may arise, however, as to the finality of the award. Once an EA's decision has been issued, an arbitral tribunal must be formed to resolve the wider dispute (or same dispute if there is no wider dispute). The consequent effect is that the EA's decision *will* be subject to review at some point, absent the parties' agreement as to the outcome of the EA's decision.

The New York Convention contains limited grounds for refusing to enforce or recognise an arbitral award. If the award is not yet binding or has been set aside in the jurisdiction of the seat, then this is a proper ground upon which a foreign court may refuse recognition. A lack of finality in itself is not however a ground for refusing enforcement. As the EA's decision, if made as an 'award' rather than an 'order', is expressed to be binding pending later review by an arbitral tribunal, the New York Convention should in principle permit enforcement.

Local differences may well be encountered in relation to this question, however. The US courts, for example, have gone in different directions as to whether to permit local enforcement of EA decisions given in US arbitrations due to arguments as to their finality.[4]

Multiparty proceedings

Although the power to join consenting non-parties existed previously under the LCIA Rules, a new power to consolidate arbitrations has been introduced by the 2014 Rules. Provisions for joinder of non-parties and consolidation of arbitrations are important, as they allow for the co-ordinated and consistent resolution of multi-party disputes. This is particularly so for large construction projects, where multiple parties (employers, contractors, architects, designers, subcontractors, suppliers etc.) may have different levels of culpability in relation the dispute and are not party to the same agreements.

[3] Although courts are likely to look to the substance of the order made rather than its formal description as an "order" or "award". For example, the description of an interim measures decision as an "order" did not prevent a US Court of Appeal from treating the decision as sufficiently final for enforcement purposes in *Publicis Communication v True North Communications Inc.*

[4] Enforcement granted in *Yahoo! Inc. v Microsoft Corporation* (2013) but not in *Chinmax Medical Systems v Alere San Diego* (2011).

Key features of the joinder and consolidation provisions under the 2014 Rules are:

- An arbitral tribunal may join one or more third persons to the arbitration provided the applicant and the third person(s) agree in writing following the commencement date of the arbitration agreement (Article 22.1(viii)).

- An arbitral tribunal may consolidate two or more arbitrations if the parties agree in writing and the LCIA Court approves the joinder (Article 22.1(ix)).

- An arbitral tribunal may order consolidation of multiple arbitrations under the same arbitration agreement or compatible arbitration agreements if the parties are the same and the arbitral tribunal has not been formed for the other arbitration(s), or alternatively, the arbitral tribunal is composed of the same members (Article 22.1(x)) and a similar power exists under Article 22.6.

- With the approval of the Tribunal, respondents may issue cross-claims against one another (Article 22.1(i)).

Powers to join third parties to an arbitrated dispute and to issue cross-claims against one another should be considered when the arbitration agreement is drafted. Compatibility and consistency with respect to arbitration agreements and dispute resolution clauses will go a long way to avoiding difficulties with joinder and consolidation, which are pivotal to avoiding parallel proceedings in circumstances where third parties do not agree to being joined, or where consolidation is not provided for. Ensuring consistency may be difficult where the parties do not have aligned interests, which gives further cause to address these issues before contacts are executed.

Some standard construction forms, such as the FIDIC 1999 suite, require amendment to allow for multi-party arbitration, although some more recent editions do provide alternative methods for dealing with related claims and related disputes.[5] Any amendments will of course need to take full account of the rules of the external institution which apply to the contract (whether it be the ICC, LCIA or some other institution) and consider the problems that might arise where different contracts contain different dispute resolution provisions.

Parties should also consider whether a single multi-party arbitration agreement or several bilateral arbitration agreements in identical terms are more appropriate. Single multi-party agreements are common where a number of consortiums are involved in a joint venture. More common on construction projects are bilateral agreements, otherwise known as 'back-to-back' agreements, binding all of the parties to identical dispute resolution procedures and mandating each to consent to joinder of related arbitrations. If this option is elected, it is important that the arbitration agreements refer to one another and are clear in wording and intention, emphasising the consent and agreement of the parties.

Conclusion

The 2014 Rules will help to consolidate the LCIA's reputation as a premier dispute resolution institution. The Rules align the LCIA with other international institutions while still retaining the LCIA's unique features and preserving the parties' flexibility with respect to the arbitration process. The changes relating to multiparty proceedings are not by any means a detailed overhaul, however, they are useful for discussion so as to remind those drafting construction contracts to be aware of the rules by which their arbitrations will be bound. Ultimately, due attention to these issues during the drafting stage and ensuring consistency across project arbitration agreements will facilitate greater certainty during the dispute resolution process.

[5] For example, see the FIDIC Conditions of Subcontract for Construction and Engineering Works designed by the Employer (First Edition, 2011).

References: *Middle East FZE v Drake & Scull International SA Co* [2014] EWHC 435 (TCC); *Publicis Communication v True North Communications Inc.* 2006 F. 3d 725 (14 March 2000); *Chinmax Medical Systems v Alere San Diego* Case No. 3:10 CV 02467 (USDC S.D. Cal. May 27, 2011); *Yahoo! Inc. v Microsoft Corporation* No. 13 CV 7237, 2013 U.S. Dist. LEXIS 151175 (S.D.N.Y. October 21, 2013).

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