

Construction & Engineering



Legal Update Contents

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Preface

Welcome to Issue 57 of the Update.

Going boldly where no Update has gone before, we start with an overview of legal issues in contracting in the Middle East, written by Raid Abu-Manneh, who we are delighted to welcome to the Construction & Engineering Group. Raid will be bringing us more insight into Middle East construction law in future issues.

We visit Paris to learn from Patrick Teboul and Karen Sauvageot about builders' liabilities and insurance obligations under French law and we go to Germany for an introduction to German construction law by Dr Jürgen Streng and Andrea Stratmann from our Cologne office. We travel to Hong Kong for news from Menachem Hasofer of how their Civil Justice Reform affects construction and engineering disputes and to hear from David Boyle and David McKellar about the attitude taken by the Hong Kong Court of Appeal to the use of mediation.

We look at the latest headlines on European public procurement, in particular the news from Northern Ireland, by Kevin Owen, but saving the most dramatic development until last, and we then plunge into termination at will clauses in England and Australia and the not-so-obvious legal implications of tendering contract arrangements, notably in Canada.

And we think about good faith. Although English law has no general duty of good faith in contracts (yet) we do see that thread of good faith and fair dealing not only as a theme in other jurisdictions, for instance as an important part of *Shari'a* law and underpinning the EU procurement rules, but also in individual areas of English law, in the application of termination at will clauses, in the two contract analysis of tender arrangements and in the working out of the principles of natural justice and the effect of consumer protection regulations.

And to complete the picture we have an update on progress with the UK Construction Contracts Bill, more news on ADR, a report on a tussle between competing standard forms of appointment for architects and other news items, a note of what's been happening at Mayer Brown and the curious tale of the valuer who went to the wrong house.

We hope you enjoy the contents.

Contracting in the Middle East

The Middle East economies, particularly in the Gulf, are currently experiencing an unprecedented increase in the number of large and prestigious infrastructure projects. Contractors embarking on projects in the area often fail to appreciate, however, that there are significant differences between the laws in the Middle East and those in the West.

Local laws in the Middle East should be carefully considered as part of a proper evaluation of the risk by both contractors and employers. In many instances, local laws could provide significant help to contractors in advancing claims and recovering entitlements.

This article (the first of a series of articles on contracting in the Middle East) provides an overview of some of the key distinguishing features of Arab construction laws focusing primarily on the laws of Saudi Arabia and United Arab Emirates.

Introduction

There are substantial similarities between the laws of the various countries in the Middle East. The Egyptian Civil Code which came into force in October 1949 is the source of the vast majority of the laws in the Middle East (including UAE, Qatar, Kuwait, Jordan, Libya and Syria).

Although many parts of the Egyptian Civil Code are similar to the French and German Civil Codes, Al Sanhouri, the leading Egyptian scholar who drafted the Egyptian Civil Code, expressly recognised *Shari'a* as a source of law (Article 1(2)). The influence of *Shari'a* distinguishes the Arab civil codes from other civil codes in the West.

The exceptions to the above are Saudi Arabia and Yemen where the Egyptian Civil Code was not applied and where *Shari'a* in essence prevails. In Saudi Arabia, there is no Civil Code and, although many regulations have been enacted in areas such as agency, employment, investment and the judiciary, the courts will only apply these regulations to the extent that they do not contravene *Shari'a* law. Yemen adopted a Civil Code in 1992 but its provisions are not modern and are almost entirely taken from the *Shari'a* with some minor exceptions.

Accordingly, to varying degrees, *Shari'a* law is embedded in the laws of Arab countries and it is important to understand the basic principles of *Shari'a* law because, at the very least, *Shari'a* law forms an important background.

Shari'a law-Saudi law

The principles below are particularly important in Saudi Arabia where contract principles are mainly to be found in *Shari'a* law and not in a code, as is the case with other Arab countries.

In broad terms, *Shari'a* is a religious law consisting of principles revealed mainly in the *Qur'an* to which Muslim society is obliged to subscribe. *Shari'a* comprises two primary sources (the "Divine sources"): (a) *Qu'ran*; and (b) *Sunna* (the sayings and deeds of the Prophet according to his friends).

Unlike other laws, *Shari'a* is a comprehensive code of behaviour that embraces both ethical standards and legal laws. *Shari'a* strives to ensure justice and equity in respect of contracts and a proper balance of benefits between the parties.

Below are some principles of *Shari'a* law which are of particular relevance to contracting in Saudi Arabia.

Sanctity of contract

It is a fundamental principle of *Shari'a* law that contracting parties should abide and comply with their contractual obligations. Construction contracts are recognised by *Shari'a* law and enforceable in the usual way. Therefore the contract, if clearly drafted, will apply to define the rights of the parties. However, such rights are subject to important qualifications which are intended to achieve, in essence, a fair outcome. The principal qualifications are the duty of good faith and the prohibitions on *Riba* and *Gharar* (see below). This is different from the position in the West where the law is focused on the freedom of contracting and achieving legal certainty.

Good faith

Acting in good faith in commercial transactions is an important part of *Shari'a* law and therefore construction contracts are expected to be performed by both parties in accordance with good faith. Precisely how this impacts on a particular contract will be dependent on the facts and the specific terms of the contract. For example, a time bar provision may not be relied upon by an employer in circumstances where he is in breach and was fully aware that his breach would cause delay to the project.

Riba

Interest, or *Riba*, is prohibited, thereby restricting the recovery by a contractor of financing charges and interest. Provisions which provide for the recovery of interest in a contract will not be enforced and should not be included because they may taint the contract and make it unenforceable.

Gharar

The prohibition of unjust enrichment in *Shari'a* law precludes any element of uncertainty (*Gharar*) which could lead to one party to a contract taking advantage of the other. Parties should therefore be fully aware at the time when they enter into the contract of the extent of their obligations. For example, an obligation imposing on a contractor an unquantifiable or uncertain risk relating to the condition of the site may amount to *Gharar* and may not be enforceable.

UAE Civil Code

Expressly acknowledging *Shari'a* as a source of law and in many respects adopting principles from *Shari'a*, the Arab Civil Codes seek to a large degree to achieve fairness between the contracting parties. By reference to the UAE Civil Code, below are some important principles relevant to contracting in the UAE:

Upholding the contract

Article 267 of the UAE Civil Code confirms that contractual obligations must be honoured:

“If the contract is valid and binding, it shall not be permissible for either of the contracting parties to resile from it, nor to vary or rescind it, save by mutual consent or an order of the court, or under a provision of the law.”

The duty of good faith

Article 246 (1) of the UAE Civil Code provides:

“(1) The contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith.”

The duty of good faith applies to all contracts which, in a construction contract, is likely to impose an obligation to cooperate. A failure to comply with the duty of good faith amounts to a breach of contract. This duty is significant and provides practical implications for a project. For example, a party who adopts a certain position or gives certain undertakings in precontract negotiations, thereby inducing another party to enter into a contract, may not be entitled to rely on an ‘entire agreement’ clause since this would breach the obligation of good faith.

The doctrine of changed circumstances

The doctrine of changed circumstances was adopted by Al Sanhouri from the French legal principle of *imprévision* and the concept of *al-Udhr* under *Shari'a* law. Under French law, the legal principle of *imprévision* is applied only to administrative contracts but, due to the influence of *Shari'a*, Al Sanhouri applied it to all contracts including construction contracts. Article 249 of the UAE Civil Code provides:

“If exceptional circumstances of a general nature which could not have been foreseen occur as a result of which the performance of the contractual obligation, even if not impossible, becomes oppressive for the obligor so as to threaten him with grave loss, it shall be permissible for the judge, in accordance with the circumstances and after weighing up the interests of each party, to reduce the oppressive obligation to a reasonable level if justice so requires, and any agreement to the contrary shall be void.”

As would be expected, the doctrine of changed circumstances is increasingly being relied upon in the Middle East by contractors to deal with the prevailing market conditions arising from the dramatic increase in the price of raw materials and the severe shortage of skilled labour.

Decennial liability

Article 880 of the UAE Civil Code provides that the contractor and the engineer (if he produced the design and the works are to be carried under his supervision) will be jointly liable for a period of 10 years to compensate the employer for any total or partial collapse of the works and for any defect which threatens the stability or safety of the building. This period of time can be extended by contract but cannot be reduced. The ten year period commences as from the time of the delivery of the works.

Pursuant to Article 882, it is not permissible to exempt or limit the decennial liability provided by Article 880.

Liquidated damages

It is common in all construction contracts in the Middle East for the contractor to limit his liability for delay by reference to the period of delay and also to cap the total liquidated damages that can be recovered.

However, liquidated damages may be reduced to reflect actual losses. Article 390 provides:

“(1) The contracting parties may fix the amount of compensation in advance by making a provision therefor in the contract or in a subsequent agreement...”

“(2) The judge may in all cases, upon the application of either of the parties, vary such agreement so as to make the compensation equal to the loss, and any agreement to the contrary shall be void.”

Termination

Construction contracts generally cannot be terminated without an order of a court or from an arbitral tribunal unless specific machinery in the contract is provided (which should be carefully considered in light of UAE law). Article 892 provides:

“A contract of muqawala (construction contract) shall terminate upon the completion of the work agreed or upon the cancellation of the contract by consent or by order of the court.”

Conclusion

Successful construction contracts require a proper understanding of local laws in the Middle East. The above are some key distinguishing features of construction law in the Middle East. *Shari'a* law, which is preoccupied with achieving fairness and justice, is an important source of the law in the Middle East and is behind many of its distinguishing features. As a result of the influence of *Shari'a* law, an aggrieved contractor may find useful arguments to pursue his entitlements which may not be available in Western legal systems.

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What does ‘fair’ mean?

One of the few certainties of a legal dispute is that, following the outcome, one (and indeed sometimes both) of the parties involved will feel that they have been unfairly treated. It is therefore not surprising that the question of natural justice often arises in connection with construction disputes.

Three recent English cases have looked at different issues; one party communicating with a potential adjudicator and a nominating body; an adjudicator refusing to consider a late submission and an arbitration clause not explained to a consumer. Through them all, however, runs the thread of natural justice and the hard legal question “*Is it fair?*”

Hearing just one side of the pre-adjudication story

In ***Makers UK Limited v Camden London Borough Council*** the claimant in an adjudication had made unilateral contact with a potential adjudicator whom it considered had the relevant expertise to adjudicate the dispute. When this potential adjudicator confirmed his availability, the claimant contacted the RIBA (the nominating body under the contract), asking it to nominate the potential adjudicator to act. RIBA duly did so, and the adjudication proceeded.

In opposing enforcement of the adjudicator’s decision, the respondent contended that an implied term in the contract had been breached by the claimant. The implied term contended for was that “*neither party may seek to influence unilaterally the nominator’s determination regarding the identity of an adjudicator, by making unilateral representations...*”. It was also claimed that there was an appearance of (although not actual) bias.

In upholding the adjudicator's decision, the court said that there was no need for this term to be implied. It also decided that the claimant's unilateral communications did not give rise to any suspicion as to its conduct. Among the reasons cited for these conclusions was the fact that it was the RIBA, an independent and respected nominating institution, which actually made the decision to nominate, and that a nominating institution may, in many circumstances, be properly assisted by representations regarding an adjudicator's identity and/or suitability for the dispute in question.

The court also provided the following guidance on adjudicator nominations under the Housing Grants, Construction and Regeneration Act 1996:

- it is better for parties to limit all unilateral communications with the adjudicator, whether before, during or after the adjudication, since such conduct, even if entirely innocent, may be misconstrued;
- any contact made with the adjudicator is best made in writing, so that a clear record of the communications may be maintained;
- nominating bodies should consider their rules with regard to nominations – particularly as to whether notice of any suggestions for adjudicators should be given to the other party.

Refusing to consider a late submission

In *CJP Builders Limited v William Verry Limited* the respondent in an adjudication issued its response six hours beyond the subcontract deadline (which included an extension agreed by the claimant). The adjudicator decided that the subcontract prevented him from admitting the late response (although he stated that he would have admitted the response had he had a discretion to do so). The adjudicator duly awarded the redress sought by the claimant. The respondent opposed enforcement on the grounds that the adjudicator's refusal to allow service of the response out of time constituted a breach of natural justice.

The court decided that the adjudicator had indeed failed to apply the rule of natural justice that each party had the right to be heard and to have its arguments and evidence considered. The subcontract clause setting the date of the Response was not written in a prescriptive manner. It allowed the adjudicator to set his own procedure and gave him an absolute discretion in taking the initiative to ascertain the facts and law as he considered necessary. This included a discretion to grant reasonable and appropriate extensions of time, which he should have exercised in the circumstances. Failure to do so denied the respondent its basic right to be heard, and the adjudicator's award was therefore not upheld.

An arbitration clause for a consumer

In *Mylcrist Builders Limited v G Buck*, Mrs Buck had entered into a contract for works to her house on a building company's standard terms and conditions, which included an arbitration clause. When a dispute arose, the building company referred it to arbitration and the arbitrator found in the building company's favour. Mrs Buck challenged enforcement of the award on the grounds that the arbitrator had not been properly nominated and that the arbitration clause was an unfair term.

The Court found that the arbitration clause was indeed unfair because, since it prevented the right of a consumer to take legal action, the clause caused "*a significant imbalance in the parties' rights and obligations ... to the detriment of Mrs Buck*". The court judged the fairness of the arbitration clause according to the provisions of the Unfair Contract Terms Regulations 1999 and undertook a review of the cases which deal with fairness.

The court noted that terms restricting a consumer's right to take legal action by requiring that disputes be taken exclusively to arbitration are cited in Schedule 2 of the 1999 Regulations as an example of a potentially unfair term. The court also found that the detriment was compounded by the fact that the fees payable to the arbitrator (around £2,000) were considerable by comparison with the sum claimed (around £5,000). In addition, the impact of the arbitration clause within the contract in question would not have been apparent to a lay person and had not been apparent to Mrs Buck. The interests of fairness required that such a clause, and its effects, be more clearly, fully and prominently set out than was the case. The court concluded, therefore, that the builder did not deal fairly and equitably with Mrs Buck, that the arbitration clause fell foul of the 1999 Regulations and that it was not binding.

The moral

These three cases, though very different, all demonstrate that, while it takes more than one party simply concluding that "*it's not fair*", the courts are ready and willing to act, where necessary, to ensure that the requirements of natural justice are upheld in both adjudication and arbitration. The decisions also underline the importance for both parties and tribunals of making sure that the requirements of natural justice are recognised and observed at all stages of construction disputes.

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ADR – it’s good to talk

We can all do with encouragement. Depending, of course, on what encouragement means. Voltaire, in *Candide*, observed that in England “...it is good, from time to time, to kill an admiral, to encourage the others”, indirectly referring to the unfortunate fate of Admiral John Byng. Admiral Byng was executed by a firing squad for not doing his utmost to “take, seize and destroy the ships of the French King, which was his duty to have engaged” during the Seven Years’ War. Two hundred and fifty years later the Technology and Construction Court Guide says that the court will provide “encouragement” and, where appropriate, facilitation to the parties to use ADR. In these enlightened times, what does that mean?

The court’s approach has been captured not only in decisions of the TCC but also in the words of the TCC Court Guide. In addition, legal representatives are required to advise their clients of the merits of ADR and ensure that its use has been fully considered prior to the first case management conference.

The court’s “encouragement” can extend to making an ADR order at any stage in the proceedings, if it considers it appropriate, and includes an expectation that each party will co-operate fully with any such ADR. Failure to co-operate properly may lead to costs orders and/or “other sanctions” being ordered against the defaulting party. “Other sanctions” are not defined but presumably would not include the Byng remedy.

Even without such an order (which appear to be rare), if a court considers that a party’s refusal to take part in ADR was unreasonable, taking into account the factors identified in *Halsey v Milton Keynes General NHS Trust*, then that party may find itself on the receiving end of an adverse costs order.

And it does not stop there. When considering costs, the courts will not only have regard to any part 36 offers made but also to each party’s approach to negotiations (as far as admissible) and the general conduct of the litigation.

Parties should therefore be wary of any outright rejection of a part 36 offer (or other admissible offer) which might be considered to be nearly, but not quite, sufficient without any attempt to negotiate. Such conduct is unlikely to be looked upon favourably by the courts when it comes to considering costs. Such considerations may be the difference between winning or losing - in financial terms anyway. Sometimes there is no real winner at all.

Enter Multiplex and Cleveland Bridge

A dispute between the parties has now been raging for years. There have been some dramatic twists and turns along the way but on 29 September 2008 a step nearer closure was reached. The final result (of this chapter) was an order for CB to pay Multiplex £6,154,246.79 but Mr Justice Jackson noted that when the costs of the

litigation were taken into account (some £22 million) *“neither party has gained any significant financial benefit”*. He added that *“each party has thrown away golden opportunities to settle this litigation upon favourable terms”*.

One such opportunity was following the decision on preliminary issues 1 to 10 in June 2006. In his decision on these issues, Mr Justice Jackson had commended a course of action leading to a settlement between the parties through negotiation or else with the assistance of a mediator.

It was at this stage that the judge considered the dispute was ripe for settlement. The legal issues were out of the way, which left matters of valuation to be sorted out. In fact, he commented that the normal and sensible way of resolving such disputes is for the court to decide questions of principle and for the parties then to sort out the financial consequences.

“A resolution broadly along the lines of this judgment could have been arrived at by the parties at fractional cost, if both parties had instructed their advisers to go through the accounts together in a constructive spirit taking as their starting point the court’s decision on issues 1 to 10.”

The parties actually did attend mediation following judgment of the ten preliminary issues but *“...instead of reaching a sensible resolution at that mediation, the parties spent the next two years litigating”*.

In his judgment on costs, Mr Justice Jackson considered that both parties were open to criticism, CB for not having made an offer to settle the entire proceedings following the decision in June 2006 (despite having then conceded that some overall payment was due to Multiplex) and Multiplex for the way it approached part of its claim. But it was the failure by CB which the judge considered to be the overriding reason why the litigation was not settled.

There *“...is a heavier onus on the debtor to make a defendant’s offer than there is on the creditor to make a claimant’s offer. The manner in which Multiplex pursued schedule 4 is a matter for criticism, but it is less culpable than CB’s obstinate refusal to make any offer of settlement”*.

Mr Justice Jackson therefore increased the level of Multiplex’s costs (for the period from June 2006) payable by CB from 10 per cent to 20 per cent, but recorded that what had happened in the case was not representative of litigation in the TCC.

ADR in Hong Kong

The Hong Kong Court of Appeal has been thinking in similar terms to the TCC about “*encouragement*” of the parties towards ADR, in its recent decision in ***iRiver Hong Kong Limited v Thakral Corporation (HK) Limited*** (see the article by David Boyle and David McKellar at page 12). Again it was the court’s comments on ADR, rather than the issues in dispute, that were of interest and again it was a case where neither party gained any significant financial benefit when the costs incurred by the parties had been taken into account.

What about the parties’ conduct in the mediation itself?

Even going to mediation is not enough, as Mr Justice Jack’s recent decision in ***Earl of Malmesbury v Strutt & Parker*** makes clear. The parties had agreed to mediation but the judge considered the claimants’ position in the mediation to be plainly unrealistic and unreasonable. In his view, a party taking an unreasonable position in mediation was not dissimilar in effect to an unreasonable refusal to engage in mediation:

“For a party who agrees to mediation but then causes the mediation to fail by his reason of (sic) unreasonable position in the mediation is in reality in the same position as a party who unreasonably refuses to mediate. In my view it is something which the court can and should take account of in the costs order in accordance with the principles considered in Halsey”.

Pour encourager les autres?

In England, as well as Hong Kong, the writing is on the wall. Not to talk to the other party to try to settle claims will not be looked upon favourably by the courts when it comes to deciding who is to pay the costs. And a party that fails to take note of the warnings will need to be ready to explain itself. The consequences could be painful, even if mercifully less severe than the fate of Admiral Byng.

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The rapid rise of mediation in Hong Kong - ignore it at your peril!

The recent decision of the Hong Kong Court of Appeal in *iRiver Hong Kong Limited v Thakral Corporation (HK) Limited* has fired a warning shot across the bows of litigants with regard to the use of mediation.

The Court of Appeal has recently upheld a decision handed down by Deputy High Court Judge Gill. In the judgment of the court below, the Judge ordered the appellant, iRiver Hong Kong Limited to pay damages of slightly over HK\$1million plus interest to the respondent Thakral Corporation (HK) Limited regarding Thakral's claim that iRiver wrongfully terminated a distribution agreement under which iRiver supplied MP3 players to Thakral for onward sale to retailers at a profit. The Court of Appeal dismissed both iRiver's appeal against the Judge's decision on liability and quantum and Thakral's cross-appeal seeking to increase damages to about HK\$2.8 million.

Alternative Dispute Resolution

The interesting part of the Court of Appeal's decision lies less so in its findings in the appeal than its comments on the use of alternative dispute resolution (or ADR). The trial hearing lasted 8 days, legal expenses of the parties far exceeded the claim amount and, in the appeal, the parties were both represented by Senior Counsel. Unsurprisingly, Yeung JA said that it was "*regrettable that the parties in the present case have not had the good sense of trying to resolve their commercial dispute by a much more cost effective means*".

The Court of Appeal's observations

Yeung JA further commented at end of his judgment that this "*was a typical case where parties should have explored resolution of their disputes by mediation. The total damages are just over \$1 million. However, we are told that the total legal costs incurred by the parties, including costs of this appeal, run up to about \$4.7 million.*"

The Judge referred to several leading English cases which have commented on the benefits of mediation. The cases are summarised as follows:

- a mediator may achieve results and solutions beyond the power of lawyers and courts (*Dunnett v Railtrack*);
- mediation has "*established importance as a track to a just result running parallel with that of the court system*" (*Burchell v Bullard*, per Ward LJ);
- Hong Kong has a large number of skilled mediators whose cost is reasonable;
- mediation is a constructive process in which parties may narrow down their differences and achieve a full settlement at a later stage if not earlier (e.g. the Hong Kong case of *Chun Wo Const. v China Win Engineering*);

- lawyers should routinely consider with clients whether their disputes are suitable for ADR (*Halsey v Milton Keynes General NHS Trust*);.

Yeung JA also referred to the Civil Justice Reforms, which will come into force in April 2009 (see page 40) and emphasise the use of ADR (in particular, mediation) in dispute resolution, with the threat of costs sanctions hanging over the heads of litigants, and the likely requirement of formal Mediation Notices and Certificates.

Comments

Although earlier cases in Hong Kong have recognised mediation as a means to settle disputes, this appears to be the first time that the Court of Appeal has expressly acknowledged that “*both [mediation and the court system] have a proper part to play in the administration of justice*”. Administration of justice is traditionally taken as referring to litigation only.

Yeung JA's comments are a sign of things to come: the comments are an advance warning to litigants and solicitors that the Hong Kong Courts will actively promote mediation, and will most likely take a critical view of any litigant (or adviser) who does not take due account of mediation options in their case management.

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Builders' liabilities and insurance obligations under French law

Under French law, builders (see below for a brief description) are subject to three specific legal liabilities, and their related insurance obligations, with respect to the building work they carry out:

- the 10-year liability and the related insurance obligations (mandatory damage insurance and mandatory liability insurance);
- the good functioning guarantee (*garantie de bon fonctionnement*); and
- the perfect completion guarantee (*garantie de parfait achèvement*).

Scope of the liabilities

- **“Builders”**

According to French law, the notion of “builder” encompasses architects, engineers, technicians, technical controller, and more generally, any building contractor (*locateur d'ouvrage*). Other persons are deemed builders, such as a person who builds, or procures the building of, a construction which is sold after completion, or real estate developers (*promoteurs immobiliers*).

- **Beneficiaries of the builders' liabilities**

The beneficiaries of the builders' liability are the *maître de l'ouvrage*, i.e., the owner, in general, for whom the building work is carried out, along with all successive owners. The builders' liability is a guarantee, which, as such, follows the ownership of the construction.

10-year liability and related insurance obligations

French law provides for a 10-year liability which may be triggered in two types of damage: damage affecting the stability of a “construction” (*ouvrage*) or making it unsuitable for its purpose by affecting one of its constituent elements or one of its fixtures and fittings (Article 1792 of the French Civil Code); and damage impairing fixtures and fittings which cannot be separated from the construction (Article 1792-2 of the French Civil Code).

This liability is effective during a 10-year period as from the delivery of the construction work.

French law provides for two insurance obligations, whereby (i) the owner of the construction (*maître de l'ouvrage*) must take out “damage insurance” for said construction (Article L 242-1, paragraph 1 of the French Insurance Code), and (ii) the

contractor must take out “liability insurance” to cover his 10-year liability (Article L 241-1 of the French Insurance Code).

The mandatory damage insurance policy allows the owner of the building to be immediately financially indemnified by the insurer, without any prior liability search among the builders: it is the insurer who, after financially indemnifying the owner of the building, will deal with the identification of the builders’ liabilities. To cover their liabilities, the builder must take out mandatory liability insurance.

Both insurance policies must be taken out prior to the construction site’s opening (*ouverture de chantier*).

THE MANDATORY DAMAGE INSURANCE OF OWNER

Article L 242-1 of the French Insurance Code states that any natural person or legal entity who/which, acting as owner of a construction, seller or representative of the owner of said construction, has building work carried out for it, must, before the opening of the construction site, on its behalf or on behalf of successive owners, take out an insurance policy that covers, on a no-fault basis, payment of all the repair work necessary to remedy damage of the type that builders are liable for under the 10-year liability.

The insurance takes effect upon the delivery of the work (*réception*) and ends after a 10-year period as from the delivery of the work.

The insurance policy shall ensure the payment of all the repair work necessary to remedy the insured damage, VAT included, and is automatically transferred to successive owners of the construction.

The parties cannot contract out of this obligation.

THE MANDATORY LIABILITY INSURANCE OF BUILDER

Pursuant to Article L 241-1 of the French Insurance Code, any natural person or legal entity who/which may be liable under Articles 1792 *et seq.* of the French Civil code (see above) must be covered by an insurance policy.

The builder who has subscribed to such insurance will be covered by such insurance only if he has begun his work after the insurance policy has come into effect.

The guarantee starts upon the delivery of the construction, for a 10-year period, binding the insurer even during the year following such delivery, which is also covered by the perfect completion guarantee (see below).

The guarantee of good functioning (*garantie de bon fonctionnement*)

French law provides for a “guarantee of good functioning”, whereby all damages which are not subject to the above 10-year liability (i.e., damages affecting elements of equipment which are not separable from the construction and which affect neither the stability nor the purpose of the building) benefit from a guarantee of good functioning for a minimum two-year period as from the delivery of the construction (Article 1792-3 of the French Civil Code).

The guarantee of perfect completion (*garantie de parfait achèvement*)

Under French law, contractors are bound by a “guarantee of perfect completion” for a period of one year after the delivery of the work. This applies to the repairs of all apparent defects reported by the owner, either through a list of the defects (*réserves*) in the minutes of delivery of the work (*procès-verbal de réception*), or by way of a written notice of those defects which appeared after delivery of the construction (Article 1792-6, paragraph 2 of the French Civil Code).

Such guarantee covers all visible defects, whatever their seriousness, for a one-year period as from the delivery of the work, whereas the 10-year liability (which will coexist with the guarantee of perfect completion for a year as from the delivery of the work) covers only those defects which were not visible upon the delivery of the construction and which are likely to affect the construction’s stability or make such construction unsuitable for its purpose.

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Looking for the Higgs boson of tender contracts

In the world of contracting, you don't need a Large Hadron Collider to recreate the big bang – the moment when contractual life starts. In theory it's very simple; fusion of offer and acceptance is achieved when a tender is accepted. In practice, however, the legal reality can be rather more complicated, even if the evidence of contractual life is not strewn across the equivalent of a number of sub-atomic particles.

Public procurement

In the EU, the simple contractual model may be modified by the detailed regulations that govern public procurement. And they have teeth. Fail to comply and the consequences can be expensive in time and money. A town centre redevelopment scheme might have to be re-tendered (see page 29), a framework agreement might be set aside or a rejected tenderer might recover their loss of profit (see issue 56).

But even if we leave the EU regulatory framework on one side, in a typical tendering arrangement we may expect to find not one, but two contracts. This was the analysis the English Court of Appeal adopted in ***Blackpool and Fylde Aero Club Ltd v Blackpool BC*** in 1990. Blackpool Borough Council invited tenders for a concession to an air operator to operate pleasure flights from the local airport. The invitation to tender said that tenders received after 12 noon on a specified date would not be considered. The Aero Club put their tender in the Town Hall letterbox at about 11am but the letterbox was not cleared by the council staff at noon. The Aero Club tender was marked as received late and consequently not considered.

The Club brought proceedings against the Council claiming damages for breach of contract, contending that the Council had warranted that, if a tender was returned to the Town Hall before noon, it would be considered with all the other tenders duly returned when the decision to grant the concession was made.

The Court of Appeal agreed with this two contract analysis. Lord Justice Bingham said:

"I have no doubt that the parties did intend to create contractual relations to the limited extent contended for... I think it plain that the Council's invitation to tender was, to this limited extent, an offer, and the Club's submission of a timely and conforming tender an acceptance".

This contract was quite separate from the contract to be entered into by the Council with the successful tenderer.

Blackpool was soon considered by the Court of Appeal in ***Fairclough Building Ltd v Port Talbot BC*** where, although ***Blackpool*** was distinguished, the Court found

there was a contract to be implied from conduct that the Council would consider the aggrieved contractor's tender.

By the time that His Honour Judge Humphrey Lloyd QC decided the marathon case of *Harmon CFEM Facades (UK) Ltd v Corporate Officer of the House of Commons*, in 1999 the **Blackpool** principle appeared to be settled:

"I consider that it is now clear in English law that in the public sector where competitive tenders are sought and responded to, a contract comes into existence whereby the prospective employer impliedly agrees to consider all tenderers fairly (see the Blackpool and Fairclough cases)."

In 1981, the Supreme Court of Canada had established a two contract approach in *The Queen in Right of Ontario v Ron Engineering & Construction (Eastern) Limited*, where the lowest tenderer realised, after its bid had been opened and was found to be \$632,000 lower than the next lowest bidder, that it had made a mistake in its calculations, by failing to include a figure of approximately \$750,000. It did not withdraw its tender but said that, because notice of the error had been given to the owner before its tender was accepted, the tender could not be accepted. In the proceedings, it attempted to recover its tender deposit of \$150,000.

The Supreme Court said that a unilateral contract (contract A) arose automatically on the submission of a tender by the contractor and, under that contract, the tenderer could not withdraw the tender for a specified period of time, after which, if the tender had not been accepted, the deposit could be recovered by the tenderer.

The principal term of contract A was the irrevocability of the bid and the corollary term was the obligation on both parties to enter into a construction contract, contract B, upon the acceptance of the tender. The deposit was required to ensure the performance of the tenderer of its obligations under contract A. The contractor's claim failed because no mistake existed which impeded the coming into existence of contract A.

The case law has developed, notably in Canada as well as in Australia and New Zealand. More recently, in 2007, the issue appeared in the High Court of Northern Ireland in *Gerard Martyn Scott v Belfast Education & Library Board* (see issue 56). Weatherup J said that an implied contract with implied terms of fairness and good faith could arise from the issue of tender documents for a public works contract, both from the scheme of the tendering process and the presumed intention of the parties.

Another decision of the High Court of Northern Ireland in the previous year, in *J & A Developments Ltd v Edina Manufacturing Ltd*, also made the point that a party inviting tenders may expressly bind themselves to follow a particular procedure, in that case the 1996 Code of Procedure for single stage selective tendering. Ultimately, the legal effect of the chosen tendering arrangements in each case will depend on exactly what was said.

And is there a duty of care?

And now in 2008, and again in Canada, the debate has taken a different turn. ***Design Services Ltd v Canada*** asked the question: if there is no applicable contract A, does a prospective employer inviting tenders owe any duty of care in tort to subcontractors?

In ***Blackpool***, the Aero Club had made a second claim in negligence against the Council but the Court of Appeal had not needed to decide that because of its finding that the Council was in breach of the implied contract. In ***Design Services***, however, the Supreme Court of Canada did have to decide a claim in negligence by unsuccessful tendering parties.

Public Works and Government Services Canada (PW) launched a tendering process for a design and build project. Tenderers could bid alone or with others as a joint venture.

PW awarded the contract to a non-compliant bidder and one of the tenderers, Olympic Construction Limited, and certain subcontractors associated with its bid, sued PW. Olympic settled with PW but the subcontractors continued with the litigation. The Supreme Court had to decide whether an owner in a tendering process owed a duty of care in tort to subcontractors.

Olympic had not entered into a partnership or joint venture with the subcontractors and there was no contract between the subcontractors and PW. A contractual claim through the ***Ron Engineering/Blackpool*** route was not therefore open to the subcontractors. Which left the possibility of a duty in tort to be explored.

Using the ***Ron Engineering*** “contract A/contract B” analysis the Supreme Court noted that PW had been in breach of its contract A with Olympic by awarding contract B to a non-compliant bidder. That breach had affected the subcontractors since their opportunity to recover their tendering costs and the opportunity to earn a profit from participating in the project depended on Olympic being awarded contract B. The subcontractor’s losses were, however, pure economic losses, unconnected to any physical injury or physical damage to their property.

In Canadian law five different categories of negligence claims had been identified, where there was a duty of care in respect of pure economic losses, but no property of Olympic had been damaged and none of the five categories applied. So should a new duty of care be recognised? The test to be applied in Canada was that in ***Anns v Merton London Borough Council*** (overruled in English law by the House of Lords in ***Murphy v Brentwood District Council***.)

In ***Anns***, Lord Wilberforce proposed a two-part duty of care test. The first part asked whether the relationship between the claimant and the defendant is close or “proximate” enough to give rise to a duty of care.

The Supreme Court noted that several factors seem to have led the subcontractors to believe that their relationship with PW was closer than in the usual owner/subcontractor situation. The subcontractors had also expended considerable time and energy in preparing their bids but the Supreme Court (echoing the comments of Lord Goff in *Henderson v Merrett*, which was apparently not cited in *Design Services*, on contractual chains) concluded that the fact that the subcontractors had had the opportunity to form a joint venture, and to be parties to the “contract A” made between PW and Olympic, was:

“...an overriding policy reason that tort liability should not be recognised in these circumstances.....The appellants had the opportunity to arrange their affairs in such a way as to be in privity of contract with PW relative to “Contract A”, but they chose not to do so and they are now trying to claim through tort law for lack of a contractual relationship with PW. Tort law should not be used as an after-the-fact insurer.”

Indeterminate liability?

The second stage of the *Anns* test asked if there were countervailing policy considerations that negated the duty of care. Since the Supreme Court had found there was no duty of care at the first stage, they did not need to decide this second question but, as a postscript, they did comment on one residual policy concern – indeterminate liability, which is a greater risk in cases of pure economic loss.

The case had “indications” of indeterminate liability because the class of plaintiffs seemed to “seep into the lower levels of the corporate structure of the design-build team members”. Since the type of tendering process was not unique and there were many types of arrangements that could arise between owners and contractors and between contractors and subcontractors, recognition of an owner’s duty of care towards subcontractors in these circumstances could therefore lead to a multiplicity of proceedings in tort, which was an undesirable result. Even if a duty of care had been found in the *Anns* first stage test, the subcontractors would then have failed at the second stage because of this concern at indeterminate liability.

All of which must, no doubt, have left the unsuccessful subcontractors wishing they had tendered in a joint venture and secured the certainty of a contract A with PW. Duties of care in tort are a far more uncertain legal life form. Successfully predicting their existence would take more than a Large (or even Economy Size) Hadron Collider.

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Extras

(New contracts and the Bill)

FIDIC's Autumn Gold

On 10 September 2008, the first edition of the new FIDIC DBO (Design, Build & Operate) contract (the "Gold Book") was published at the DBO seminar at the FIDIC 2008 Quebec Conference. The Prepress Seminar edition of the DBO contract was originally published in September 2007 (see "*Has FIDIC got the Midas touch?*" in issue 55).

JCT pre-construction services agreements

In the UK, the JCT has just published a new contract for pre-construction services, with separate versions for a general contractor and specialist, which can be used whether or not they are responsible for design.

The general contractor version is for interim appointment of the contractor, after first stage tenders, to carry out pre-construction services under a two stage tendering procedure, covering the period leading up to the contractor's submission of a definitive second stage tender and entering into the main contract for the construction phase.

The specialist version is for interim appointment of a specialist to carry out pre-construction services for the employer or the actual or prospective main contractor. It is for use on substantial or complex projects.

Both versions are designed for use on projects where the JCT Standard Building Contract, Design and Build Contract, Major Project Construction Contract, Management Building Contract or either version of the Intermediate Building Contract are to be used.

Going public

Also just published is the JCT's new public sector consultancy agreement.

The Consultancy Agreement (Public Sector)(CA) is designed for use for by public sector employers engaging a consultant of any discipline in relation to construction works and:

- seeks to set reasonable limits to the 'pro-activity' that is sometimes implied as part of the consultant's obligations;
- contains a requirement for cooperative working with the consultant team, the wider project team, and the client, and a duty to warn them;
- has no net contribution provision; but
- has provisions for caps on liability; and
- is intended for use in projects based on any JCT main contract, other than the Constructing Excellence and Homeowner contracts.

Sustainability

Following an industry-wide consultation, the JCT has also decided to extend the 'green' provisions within its contracts. A JCT working group is now preparing a publication on how sustainability might be provided for within contract documentation, with publication anticipated early in the new year.

How long does it take to change a Construction Act?

The question may soon be answered. A draft Construction Contracts Bill was issued in July 2008, setting out proposed amendments to the relevant provisions of the original 1996 Act, for consultation on the drafting. The consultation period ended on 12 September and the Local Democracy, Economic Development and Construction Bill included in the legislative programme announced in the Queen's Speech on 3rd December contains, in Part 8, a revised set of proposed amendments to the 1996 Act.

A copy of the Bill can be found at

<http://www.publications.parliament.uk/pa/ld200809/ldbills/002/2009002.pdf>

More in the next issue.

New RICS forms

The RICS has published two new forms, a Standard Form of Consultant's Appointment and a Short Form of Consultant's Appointment, together with a set of explanatory notes.

The forms are written in plain English and include scopes of services for project managers, quantity surveyors, project monitors, building surveyors, CDM co-ordinators and employer's agents. The default positions in the forms are said to provide "*a practical balance of risk between the client and the consultant..*"

A notable feature of the Standard Form is a liberal use of tick boxes. Is this the way forward?

PPC2000 upgrade

In October 2008 the PPC, SPC and TPC forms of contract were relaunched. The structure and content are essentially the same but, in addition to drafting changes and amendments made in response to user feedback, there are key changes in respect of:

- KPIs, targets and incentives;
- partnering timetable and risk register;
- sustainability (with a full definition); and
- project bank accounts.

Construction law issues in Germany

Does Germany have standard forms of contract for construction contracts?

No. Construction contracts have to be agreed individually between the parties. Construction contracts may, however, include specific standard terms and conditions which are set out in the German Construction Contract Procedures (*VOB/B*) under federal law

Does federal or state law (or both) contain provisions that deal with construction contracts?

Generally, construction law is dealt with by the German Civil Code (*BGB*) which is federal law. However, as most of the statutory provisions are not compulsory, they can be modified by agreement or by predetermined general terms and conditions for construction contracts. Most of the common general terms and conditions for construction contracts are provisions contained in the German Construction Contract Procedures (*VOB/B*) under federal law.

In Germany what is the most popular contractual arrangement for procuring a construction project?

The contractor agrees to build the construction project in accordance with the design produced by the designers. This is the more common practice in Germany and is called a “general contractor agreement” (*Generalunternehmervertrag*), whereas the combination of the design and construction in one agreement (*Generalübernehmervertrag*) is not so common.

What is currently the most popular method of resolving construction disputes in Germany? Litigation in the courts or arbitration (if mediation or other forms of alternative dispute resolution are unsuccessful)?

Litigation in the courts or arbitration are the methods of resolving construction disputes in Germany, depending on the agreed contract dispute resolution process. Where the statutory provisions apply (for example the *VOB/B*, *BGB* or German Civil Procedure Act (*ZPO*)), generally litigation proceedings will apply.

On the whole, small construction projects rely on litigation in the courts, whereas large construction projects, especially with international aspects, will choose arbitration

If a party is considering taking a dispute to court, does it start legal proceedings in a state court and, if so, which one?

Under the German court system, no particular state court deals with disputes on construction law. In Germany, any and all disputes in connection with construction agreements need to be taken to the (general) state local courts (*Amtsgerichte*) or state district courts (*Landgerichte*) depending on the amount in dispute (local court: up to EUR 5,000; district court: more than EUR 5,000). State courts, however, have to apply federal laws.

If applicable, according to Section 18 VOB/B, the proceedings will take place at the competent court for the office of the owner's court representative (i.e. the competent court for where the owner's lawyer's office is).

Is there, in Germany, any equivalent of the UK construction dispute resolution process (DRP) of adjudication?

No, in Germany, there is no equivalent of the UK statutory construction dispute resolution process (DRP) of adjudication but the parties to an agreement may agree on a dispute resolution process alongside litigation or arbitration (for example, mediation or adjudication) according to Section 18 no. 3 VOB/B or under BGB.

In addition, according to section 15 lit a) of the Introductory Act to the German Civil Procedure Act (*EGZPO*), each state may enact an Act which provides for an arbitration before litigation is permitted, for disputes with an amount in dispute up to EUR 750. Further, pursuant to section 18 no. 2 VOB, any disputes in respect of agreements with public authorities (*Behörden*) need to be resolved first by such an arbitration dispute resolution process.

Under English law, purchasers, tenants, operators and funders of development ask for contractually binding “collateral warranties” or third party rights from the designers and contractor with whom, otherwise, they do not have a contract (and therefore no contractual remedy) or other right if the building works are defective. How does German construction law deal with this problem?

Under German law, if persons/entities have not agreed on contractually binding “collateral warranties” (which are not usual) where they are not party to the contract, their remedies are limited to statutory remedies as stipulated in the law of torts pursuant to Section 823 seq. *BGB*, i.e., German construction law does not have a general provision for collateral warranties.

Usually, the benefit of the construction agreement is assigned to purchasers, tenants, operators and funders of developments (i.e. to as many parties as necessary, which is permitted under German law) by the principal to provide for the equivalent of a warranty, but under the construction agreement. Although German law recognises contracts for the benefit of a third party (see Section 328 BGB), construction agreements generally do not provide for such wider liability of designers and contractors vis-à-vis third parties.

Is retention of a percentage from interim payment until final completion common practice in German construction contracts?

Yes, on average about 5 %.

What is the position in Germany generally between builders and employers - adversarial or collaborative?

In Germany there is no approach similar to partnering in England; the approach in Germany is more adversarial.

In England and Wales there is a specialist Technology and Construction Court. Does Germany have any specialist construction courts?

As noted, there are no specialist construction courts. However, each state court is divided into departments, each of which deals with specific questions of law. Therefore, the competent department of the court dealing with the dispute can be regarded as specialised in questions regarding construction law.

If a construction and engineering claimant is successful in its claim before a German court will the court order the unsuccessful party to pay the successful party costs of its lawyer?

Yes, pursuant to Section 91 paragraph 2 German Civil Procedure Act (*ZPO*), any legal costs shall be borne by the unsuccessful party as long as they are appropriate. This will, however, not cover lawyer's fees exceeding the statutory fees as stipulated in the German Lawyers' Fees Act (*RVG*). Thus, any lawyer's fee exceeding the predetermined statutory amount will have to be borne by the successful party even in a successful court dispute.

Is the cost position the same in arbitration?

As regards state arbitration proceedings for disputed amounts lower than EUR 750 pursuant to the EGZPO, the cost position is the same as for proceedings before the courts. Whether the cost position is the same in (contractually agreed) arbitration depends on the cost provisions in the relevant agreement.

Is there federal or state legislation (or both) on health and safety on construction and engineering projects?

The federal German labour protection laws (*Arbeitsschutzgesetz; ArbSchG*) which have been in place since June 1989 are designed to improve safety and health protection at work.

In addition, based on the *ArbSchG*, a federal ordinance on health and safety on construction and engineering projects came into force in June 1998 (*Baustellenverordnung*) and, as with the case of the German labour protection laws, implements a European directive on the matter.

After what period are claims under construction contracts time-barred?

Pursuant to statutory provisions, *i.e.*, Section 638 BGB, claims under construction contracts are time-barred within

- 5 years from final acceptance of the construction in relation to structure (Bauwerk); or
- 2 years from final acceptance of the construction if not in relation to structure.

Also, it is to be noted that the above periods may be reduced to under one year where the terms are individually agreed by the Parties, but not, however by way of predetermined general terms and conditions (for example the VOB/B). However, in cases where the VOB is applicable as general terms and conditions for the contract, the period may not be less than 4 years (Section 13 VOB).

Are time penalties for late completion permitted under German law?

German statutory law provides for time penalties where there is late completion: depending on the situation, the owner and/or the builder may be able to claim for damages, including additional costs for late completion, and/or terminate the contract.

What are the current headline issues in construction in Germany?

One important development is the change in legislation relating to planning laws which were amended on 1 January 2007 and facilitate proceedings for development plans in CBDs (town centre developments).

Another important topic is energy saving in buildings, which is to be proven by an energy performance certificate. This is to be provided by the property owners to purchasers or tenants.

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Surveyor's valuation takes a wrong turning

There is something reassuring about familiar things, whether it's office routine, the usual train or the Starbucks coffee on the way to work. Which means it can be a jolt to the system when something that seemed nicely settled is challenged. Take a professional's obligation to their client, for instance. Reasonable skill and care, of course, you might say. But is it?

Not necessarily, according to the Court of Appeal in *Platform Funding Limited v Bank of Scotland Plc*. Valuers were instructed to provide a mortgage valuation on 1 Bakers Yard, in Gosberton, in Lincolnshire. 1 Bakers Yard was on one of five plots, formerly in single ownership, and none of the plots had a house number. Access to the property was through the borrower who had to be contacted by phone.

The valuers contacted the borrower who showed their representative round a detached house. The valuer's report, which contained a certificate that the property offered as security had been inspected by him, valued the property inspected at £230,000. The catch was that the borrower had misled the valuer into inspecting 5 Bakers Yard, a house on another plot, which was almost completed. 1 Bakers Yard, however, was little more than a shell, with no roof or windows.

The rest of the story you can guess. The lender advanced the borrower £154,495; the borrower failed to maintain the payments under the loan agreement and the lender repossessed the property, at which point the mistake came to light. The property was sold, the lender was left with a shortfall of £30,444.69 and brought its claim against the valuers. The question for the Court of Appeal was whether the lender or the valuers, who had received the princely sum of £250 for a relatively superficial "Schedule 1" inspection, should bear the loss.

The lender claimed that the valuers were obliged to use the care and skill to be expected of a competent valuer but it did not allege any negligence. Its case was simply that:

- the valuers had accepted instructions to value 1 Bakers Yard; and
- had produced a report certifying that they had inspected the property;
- the lender had made an advance on the strength of the report; and
- was entitled to rely on the certificate as having contractual effect;
- the valuers had failed to inspect the property and were therefore in breach of contract.

If the valuers' obligation to value the correct property was, however, an obligation to use reasonable skill and care (and not to guarantee a result), in the absence of any allegation of negligence, the lender's claim would fail.

By a majority of 2 to 1, the Court of Appeal decided that the valuers had undertaken an unqualified obligation to inspect the property and were in breach of contract in failing to perform that task.

Lord Justice Rix said that it requires special facts or clear language to impose an obligation stricter than the default obligation of reasonable care; a professional will not readily be supposed to undertake to achieve a guaranteed result and if the professional is undertaking with care whatever they are retained or instructed to do, they will not readily be found to have warranted to be responsible for a misfortune caused by the fraud of another. It is not possible, however, to support a blanket approach whereby, even in the absence of an express warranty, a professional's responsibility is always limited to the taking of reasonable care.

The inspection of the wrong property, like the painting of the wrong portrait, or the photographing of the wrong wedding, was a straightforward breach of contract which did not depend on the taking or absence of reasonable care. The valuers had simply failed to carry out their instructions.

So, where does this leave surveyors and valuers and other professional people? The case could, of course, prove to be a one-off, because of the somewhat unusual facts and because of the Court of Appeal's requirement of "*...special facts or clear language....*" But, then again, it might not. Once you leave the safe harbour of treating all a professional's obligations as governed by reasonable skill and care, claimants in these days of the credit crunch may be encouraged to look for other obligations that guarantee a result.

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Procurement round-up

Rochdale, Alexandroupolis and Newham

If you thought public procurement was a little dull and lacked drama, think again. In these difficult times EU procurement regulations are being deployed to deadly effect against non-compliant tendering arrangements. Ask Rochdale Metropolitan Borough Council, for instance, who, when faced with a challenge to its appointment of a preferred bidder, decided to re-tender its town centre redevelopment scheme. Or ask the Northern Ireland Department of Finance and Personnel, whose £800 million framework agreement was set aside at the end of October by the Northern Ireland High Court. And don't forget that the European Commission estimates that public procurement accounts for approximately 16% of the EU's overall GDP.

We start with events in Rochdale and look at two key court decisions, one in the European Court of Justice and one in the High Court in London, that preceded those events. We go to Northern Ireland and are again indebted to Kevin Owen for his report and analysis of two cases where contractors tried to obtain injunctions to stop the award of framework agreements by public bodies. And then we return to the sequel of one of those Northern Ireland cases, where an £800 million framework agreement came (at least for the time being) to nothing.

ROCHDALE'S TOWN CENTRE

In August 2008, Rochdale Metropolitan Borough Council was forced to announce that it would have to re-tender a £250 million town centre redevelopment scheme. Wilson Bowden had been appointed as the preferred developer in May 2008 but the award process was challenged by a competing bidder, Sultan Properties, on the basis that the Council's decision was in breach of EU public procurement rules, following recent decisions of the ECJ and the High Court in London.

ALEXANDROUPOLIS

One of those decisions was that of the ECJ in January 2008, in *Lianakis v Dimos Alexandroupolis*, brought by two unsuccessful bidders who had challenged the award of a public contract to a third bidder by the Municipal Council of Alexandroupolis. They claimed that the winning bidder had only been awarded the contract on the basis of the weighting factors and sub-criteria subsequently applied by the Municipal Council.

The ECJ agreed that a contracting authority could not apply weightings and sub-criteria in respect of award criteria which it had not previously brought to the attention of the bidders. If a contracting authority does not, therefore, disclose the weightings and sub-criteria before the bidders prepare to submit their bids, then it cannot rely on them when evaluating competing bids.

The ECJ also reaffirmed that the award criteria should not include the bidders' ability to perform the contract and qualities such as experience, qualifications, manpower and equipment. The suitability of tenderers should be checked at the outset by reference to qualitative criteria of economic and financial standing and technical capability but, after that stage, public contracts must be awarded on the basis of the "*most economically advantageous*" tender or the lowest price bid. The qualitative criteria belong to the earlier stage of bidder qualification and not to the stage of awarding the contract.

NEWHAM

Six months later, in July 2008, in the High Court in London, Lettings International Limited, a property management company, successfully challenged the award of two framework contracts by the London Borough of Newham to another bidder. The court found that the Council had acted unfairly and without the requisite transparency when applying its award criteria.

In *Lettings* there were five award criteria broken down into 28 separate sub-criteria. These sub-criteria were relevant when assessing competing bids but the weighting given to each sub-criteria was not disclosed by the Council to prospective bidders. The court held that the Council was obliged to disclose the weightings given to each sub-criteria and the marks to be allocated to each criteria. It was not acceptable for the sub-criteria to be developed after bids had been received or without drawing the bidders' attention to them in the tender documents.

Lettings said that had the marking allocation and weighting in relation to the sub-criteria been disclosed with the tender documentation its tender would have been different but the court made it clear that, under the Regulations, it is irrelevant whether the outcome of the tender process would have been the same had the Council complied with them. Article 30(3) of the Regulations contains an express and unqualified obligation to disclose the weightings given by a contracting authority to the award criteria:

"Where a contracting authority intends to award a public contract on the basis of the offer which is the most economically advantageous it shall state the weighting which it gives to each of the criteria chosen in the contract notice or contract documents....."

Under Regulation 47(6) there is no minimum level of loss required for bringing a claim for breach of the Regulations. A claimant is not required to show that it has suffered actual loss; it is sufficient that there was a risk that the claimant would suffer a loss as a result of the breach. It is enough for the claimant to show that there has been a breach of the principles of transparency and equal treatment set out in the Regulations and that such a breach meant that there had been a loss of opportunity to take part in a competitive tender process. In order to claim damages, however, a claimant needs to provide evidence of having suffered a loss.

Lettings also claimed that the Council had failed to mark the tenders fairly and objectively. The court said that the Council would have been in breach of the Regulations if it had made any manifest error of assessment when marking the tenders and if these errors had led to a different result. When assessing tenders, however, the Council had a margin of appreciation and the Council would not be in breach of the Regulations if the Council's manifest error had made no difference to the result of the tender process (unlike the position in relation to disclosure of the award criteria weighting).

The court invited the parties to agree a remedy and suggested that the Council might add the name of the claimant as one of the successful tendering parties, which is what the Council appears to have done.

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Where is the balance of convenience for injunctive relief?

Two recent decisions of the High Court in Northern Ireland in *Henry Brothers (Magherafelt) Ltd. and others v Department for Education for Northern Ireland* and *McLaughlin & Harvey Ltd. v Department of Finance and Personnel* demonstrate that tenderers for public works contracts will face difficulties in obtaining injunctive relief against irregularities in tender procedures, even where there is a serious issue to be tried and damages may not be an adequate remedy.

Background

Both decisions of the High Court of Northern Ireland related to tenders by contractors for inclusion in "Framework Agreements" for the execution of major construction works for public projects in Northern Ireland. A "Framework Agreement" is an agreement by which a public body selects a limited number of contractors for the purpose of inviting tenders for individual projects in the future.

In *Henry Brothers*, the evaluation system for the Framework Agreement was to be 80% qualitative and 20% commercial. The commercial component was to be based on the fee percentages proposed by tendering companies.

Henry Brothers argued that reliance on the fee percentage as the sole commercial criterion, without reference to any other element of cost, was wrong and contrary to the procurement requirements of the European Union. Such reliance, it was argued, did not take into account differing levels of efficiency between contractors or the prices that contractors could negotiate for labour, materials and site establishment costs.

Henry Brothers sought injunctive relief to prevent the Northern Ireland Department for Education awarding the Framework Agreement based on the evaluation system.

In applying the guidelines set out by the Court of Appeal in *American Cyanamid Company v Ethicon Ltd* for exercising the court's discretion in granting injunctive relief, the High Court of Northern Ireland agreed that there was a serious issue to be tried. It held that the Department for Education's sole reliance on the fee percentage in evaluating the commercial component of tenders did not satisfy the EU requirement that the "most economically advantageous" or lowest priced tender should be accepted.

The court also agreed with the contractor that damages would not necessarily be an adequate remedy. While a claim for damages could be produced on the basis of a tenderer's loss of opportunity of securing work on a number of projects (with a total value in the region of £54 million), the court acknowledged that the calculation of damages would be difficult. It therefore found that damages would not be an adequate remedy.

Notwithstanding these findings, in considering the "balance of convenience" between the parties, the court held that it could take into account the public interest. It concluded that, if an injunction was granted to prevent the award of the Framework Agreement, there would be a substantial increase in the cost of public projects together with delay which, amongst other things, could result in loss of central government funding.

The court therefore refused injunctive relief on the basis that the balance of convenience was weighed heavily in favour of the public entity and that the increased cost of and delay to individual projects would not be in the public interest.

The second case of *McLaughlin & Harvey Ltd*, related to the establishment of a Framework Agreement for various construction projects with a combined capital value in the range of £500 million to £800 million.

The contractor's tender for the Framework Agreement was unsuccessful and they requested a debrief meeting with the Department of Finance and Personnel (DFP). At the debrief meeting, the contractor became aware that the DFP had marked their tender using a methodology which had not been disclosed prior to the submission of their tender. It was claimed that this was in breach of the EU requirement for transparency and that the basis on which their tender had been evaluated was unfair. The contractor therefore sought an injunction to prevent the award of the framework agreement.

Again, in considering the guidelines set out in *American Cyanamid*, the court had little difficulty in establishing that there was a serious issue to be tried. However, in this instance, the court held that although the assessment of damages would not be easy

to determine or calculate, damages would nevertheless be an adequate remedy. More importantly, however, in assessing the balance of convenience between the parties, the court held that it cannot be in the public interest for the public to be required to pay a contractor for the cost of executing public works and also to pay another contractor loss of profit on projects from which it had been excluded, even if unlawfully. The court therefore refused to grant the injunction sought.

Commentary

The decisions in *Henry Brothers* and *McLaughlin & Harvey* underline the difficulties faced by tenderers for public works contracts in obtaining injunctive relief from the courts to prevent unlawful action in procurement procedures. It appears that the balance of convenience will always be weighed in favour of the public procuring entity who will, in the majority of instances, be able to establish that an injunction would delay worthy public projects and result in increased costs to the taxpayer.

Even if it can be established under the *American Cyanamid* guidelines that there is a serious issue to be tried and that damages would not be an adequate remedy, the adverse consequences of granting injunctive relief are always likely to outweigh the rights of private tendering parties.

This will need to be recognised in considering the remedies available to tendering entities if procedural or substantive irregularities are encountered during a procurement exercise.

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Hong Kong

Court brings down framework agreement

The dust in *McLaughlin & Harvey Limited v Department of Finance & Personnel* hardly had time to settle between episodes before the parties returned for a sequel.

As reported by Kevin Owen, in the first episode the High Court in Northern Ireland refused to grant an injunction. In the next episode the judge decided that the Department of Finance & Personnel was in breach of its duty under Regulation 47.1 of the Public Contracts Regulations 2006 because it had not disclosed, to the contractors seeking to be included in a framework agreement, 39 elements or sub-criteria which its panel had subsequently taken into account when making their assessment. Nor had it disclosed the weightings which the panel attached to those elements or sub-criteria. As the parties could not agree on a remedy for McLaughlin, they had to ask the High Court to decide what that should be

The court took the view that the matters complained of entitled McLaughlin to some substantive remedy. McLaughlin had come sixth in the competition, within 1% of the contractors placed fourth and fifth, so that even a modest improvement in its marking could have materially affected the outcome of the tender process.

Under Regulation 47(9), however, the court cannot order a remedy, other than damages, in respect of certain breaches of duty if the “*contract*” in relation to which a breach has occurred has been entered into. The framework agreement in question had been entered into some months previously (although no contracts had been let under it), but did the reference to “*contract*” in the Regulations apply to the framework agreement?

After reviewing the relevant wording of Directive 2004/18/EC and the Public Contracts Regulations 2006 the judge said it seemed clear that the word “*contract*” meant a specific contract and was not intended to cover a framework agreement. The restriction in Regulation 47(9) would, however, extend to a specific contract *under* a framework agreement.

McLaughlin’s first preferred remedy was that it should be added as a sixth economic operator to the framework agreement. That was the course that the court in England had suggested as a possibility in the *Lettings* case but no authority was found in *McLaughlin* for that course. The judge in *McLaughlin* thought that adding McLaughlin as a sixth operator would dilute the work for all the five current parties under the framework agreement and that course would introduce some unfairness to the best of the tenderers.

The second remedy sought by McLaughlin was to set aside the decision to enter into the framework agreement with the original five parties, which is what the judge decided to do. That, he said, would, in all likelihood lead to a re-run of the framework agreement competition, in the more transparent way indicated by the court, and would be in the public interest to secure the tenderers who would be most economically advantageous to the public.

The Department had said that the appropriate remedy was damages but the court considered that assessment of the loss of profits due to the breach of duty might well have to wait for some time, perhaps years, to allow the Court to make a reasonable estimate of the profits which the successful economic operators would enjoy from the framework agreement. That approach would be necessary, said the judge, and it was clearly not ideal. The court would have to value the percentage of any profits which the plaintiff should recover (i.e the value of its loss of chance) but reliably fixing that would take time, face difficulties and be costly. In the judge’s view, damages were clearly an inferior remedy to that of setting aside the framework agreement.

There were also public policy reasons for his decision. There was a question over whether the best of five economic operators had been selected under the framework agreement:

“Given that some £800m of works are said by the Department to be at stake here it must be in the public interest to try and ensure that the best five, whether or not that includes the Plaintiff, are in fact selected. Secondly, it cannot be in the public interest for the public to pay for these new buildings and to pay the Plaintiff again a percentage of the profits of the contractor who actually builds the new buildings. That is in the most literal sense of the word a waste of money”.

The judge therefore ordered the Department’s decision to enter into the framework agreement, and the agreement of April 2008 acting on that decision, to be set aside. It was a matter for the Department as to whether it wished to persist with a framework agreement covering the works in the competition conducted by it in 2007 but, if it did, it should only be open to the original eleven tenderers and the process should be determined by a different panel.

It is, on any view, a dramatic decision that will only increase the considerable pressure on contracting authorities to check that their procedures are compliant in every detail.

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Could your contract have a happy ending?

Serious but not life-threatening perhaps; ‘termination at will’ or ‘termination for convenience’ that is. Interchangeable terms used to describe an employer’s entitlement to end a contractor’s appointment for reasons which are not conditional on the contractor being in default and which are additional to the employer’s usual entitlement to terminate when the contractor is in default. Commonly found in contracts used in the United States, in particular in federal government contracts.

The reason for including these clauses in a contract is that there is always a possibility that the entire project may be abandoned by the employer, a consideration that is all the more relevant in today’s economic climate and particularly in light of the recent research undertaken by Emap Glenigan which shows that 826 projects have been parked since January 2008. It is therefore a very useful weapon for the employer to have in its armoury since it allows the employer easily to determine the contractor’s contract where it might otherwise be in breach of contract (e.g. by reason of unlawful termination or repudiation). The clause may also provide more protection for the employer in terms of limiting his financial liability towards the contractor. The contractor should also have a similar clause in its subcontracts so that they can also be brought to an end if the contractor’s contract is determined for the employer’s convenience.

Although they are increasingly being used, termination for convenience clauses are not common in the UK but the more they are included in contracts, the more that employers, contractors and subcontractors need to know and understand their rights and obligations in respect of them. Key questions to be asked include:

- is the employer's clause an unfettered and absolute right or is it restricted to situations where the project is simply to be abandoned? For instance, can an employer use this clause to get rid of a poorly performing contractor and appoint someone else?
- is there a duty of good faith on the part of the employer when exercising this right?
- is the terminated party entitled to receive its costs? Do these include loss of profit?

England - *Abbey Developments v PP Brickwork*

Since there has been limited use of these clauses in the UK, there is limited judicial guidance on the parties' rights and obligations when it comes to termination for convenience. In 2003, however, in *Abbey Developments v PP Brickwork*, Judge Lloyd in the English Technology and Construction Court had to decide whether Abbey had the power to take away the balance of PP's contract work (and give it to another subcontractor) simply because the work that PP had carried out had not been carried out properly.

Although the case did not directly concern termination for convenience clauses, Judge Lloyd made some comments about them. He focused on the well established principle that the parties had struck a bargain and Abbey could therefore not use a variation procedure and/or the termination procedure to get out of that bargain, even if it was a bad bargain. In particular, the judge did not believe that, in the absence of express and clear words, Abbey would simply be able to take away PP's work and substitute another contractor. That is not the purpose of these clauses and was certainly not what the contract in this case stated.

Judge Lloyd also thought that, if the employer terminated the contractor's contract for convenience, then the contractor would be entitled to his loss of profit. Even if the contract expressly excluded loss of profit, he believed such clauses “...*risk being treated as leonine and unenforceable as unconscionable.*”

Australia - *Kellogg Brown & Root Pty Limited v Australian Aerospace Ltd*

More recently, in Australia, in *Kellogg Brown & Root Pty Limited v Australian Aerospace Ltd*, the Supreme Court of Victoria reviewed the law on termination for convenience clauses, and in particular whether an employer must operate the clause in good faith. The case involved a government contract between the Australian Government and AA for the supply of helicopters. KBR was subsequently engaged by AA to provide training and support in relation to one of the contracts between AA and the Australian Government, and, as is common in government related contracts, KBR's appointment included a termination for convenience provision.

AA made various allegations against KBR; in particular that KBR's performance was poor. There were several meetings between the two to try to resolve the disputes but these were unsuccessful. After KBR initiated the dispute resolution procedure, AA invoked its right to terminate the contract for convenience instead of terminating the contract for KBR's default. KBR consequently initiated proceedings in the Supreme Court and applied for an injunction to prevent the AA from proceeding with, and relying on, the notice of termination.

In deciding whether an injunction should be granted, the Court was therefore only asked to determine whether there was a serious issue to be tried - whether AA was under an obligation to exercise its right to terminate the contract for convenience in good faith. It was not, however, asked to provide a decision on whether there was such an obligation.

Ultimately AA did not dispute that there was a serious issue to be tried and Justice Hansen agreed with KBR that this was a case to be argued. Unfortunately, the case does not appear to have gone further and we have, therefore, no answer to the key question.

While it remains unanswered, the safe course for employers wishing to operate such a clause is to do so in good faith, especially as the courts are increasingly finding obligations in that vein in other areas of law. That in turn raises the next question as to what termination for convenience in good faith might mean in practice. Termination where a project is abandoned is an obvious example of such an entitlement; getting rid of a poorly-performing or too expensive contractor is not.

If an employer wishes to exclude loss of profit from the contractor's entitlement on termination then this must be expressly and clearly stated in the contract, although, in the light of Judge Lloyd's comments, that is no guarantee that the courts will treat the exclusion as enforceable.

The issues need some answers and, given the poor economic climate and the consequent attractiveness to employers of termination for convenience clauses, courts may be asked to provide the necessary guidance sooner rather than later.

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What's been happening at Mayer Brown?



Raid Abu-Manneh
Partner
Construction &
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Welcome to Raid Abu-Manneh

At the beginning of November we were delighted to welcome Raid Abu-Manneh to the Construction & Engineering Group as a Partner.

Raid has advised on numerous rail, power, process plant and infrastructure projects and has extensive experience of different forms of dispute resolution including international arbitrations under ICC, LCIA and UNCITRAL rules.

Disputes arising from large and complex projects in the Middle East have become an important part of Raid's work in recent years. He is a fluent Arabic speaker and has advised on projects in many countries in the region, including United Arab Emirates, Saudi Arabia and Qatar. Raid regularly speaks at seminars and international conferences on the resolution of project disputes in the Middle East and the issues which arise under local laws.

Raid's overview on contracting in the Middle East appears at page 2 of this Update.

Middle East Working Group

On 20 November Raid was a speaker on an expert panel drawn from the media, the construction sector, the risk consultancy industry and the Foreign & Commonwealth Office at a meeting of the British Expertise Middle East Working Group.

The meeting considered the impact of a world recession on the booming GCC economies and opportunities in the region. Raid's talk looked at increased disputes in the Middle East (particularly in the real estate sector) as a result of the credit crunch. Raid will be providing a full briefing in the next issue.

International Oil and Gas Conference

Mayer Brown Construction & Engineering partner Jonathan Hosie and Corporate partner Robert Hamill were speakers on 17 November at the IEL-SEERIL International Oil and Gas Conference in London.

Jonathan spoke on the topic: "*Does the EPC model work for energy projects?*" and explored issues relevant to the procurement and development of energy projects.

Welcome to Tamsin Travers and Sean Hardy

In September we congratulated Tamsin Travers and Sean Hardy on their qualification as solicitors and welcomed them to the London Construction & Engineering Group. Tamsin and Sean spent time with the Group during their training contracts with Mayer Brown and we were very pleased to see them return.

And congratulations to James Fielden

The good news continued with the appointment of James Fielden to Partner, with effect from 1 January 2009. James has been a key member of the London Construction & Engineering Group for some years and we were delighted that he has been promoted.

Architect's appointments – the ACA and RIBA go head to head

The RIBA's 2007 forms of appointment have another rival – their cousin. In September 2008 the ACA published a new Standard Form of Agreement for the Appointment of an Architect - SFA/08. The UK construction press has reported on the lively debate between supporters of the two forms as to their merits. So what are key features of the ACA form and what, if anything, sets it apart from its relations?

ACA o8 – the family connection

According to the preface to the ACA Appointment, it is “...a development of the SFA series of appointments for architects which was launched in 1992...The intention behind the ACA's decision to publish ACA SFA/08 is to ensure the availability of an SFA form of appointment... ACA SFA/08 is essentially based on the SFA/92 version, adding amendments to enhance its usefulness and updating in line with case law and legislation to 2008.”

Key features of ACA SFA/o8

Since ACA SFA/08 is the offspring of SFA/92, its contents come as no surprise but the family debate about the respective merits of the new form and its RIBA cousins has highlighted particular features:

- all rights of set off at common law or in equity are excluded;
- there is a net contribution clause;
- an adjudicator is given “...the discretion to direct the payment of legal costs and expenses of one party by another...”;

- either party may terminate the contract at will by giving reasonable notice in writing to the other;
- the interest rate for late payments is 8% over Bank of England base rate.

The RIBA 2007 Standard Agreement for the appointment of an Architect (S-Con-07) also excludes the client's right to set off and contains a net contribution clause, but both clauses are optional for consumer clients; unless the consumer client expressly decides to adopt these clauses, they are excluded. This option takes into account the requirements of the Unfair Terms in Consumer Contract Regulations 1999 (UCTRR), and the need to explain terms of this type to consumer clients before the appointment is concluded.

ACA SFA/08 takes a different approach, trusting architects to ensure they always explain the impact of these clauses.

S-Con-07-A does not include the ACA's power for an adjudicator to direct the payment of legal costs by another. Once again, the UCTRR are relevant. In *Picardi v Cuniberti* the court considered that denying a successful consumer client the right to recover their legal costs might hinder the consumer's right to take legal action and thus make adjudication unfair to consumer clients.

Again contrasting with ACA SFA/08, S-Con-07-A only allows for determination at will by the client, by giving the architect not less than 14 days' notice in writing.

Although not featuring in the family debate, ACA SFA/08 retains the SFA/99 clause requiring the client to pay the architect's legal costs (following a dispute) on an indemnity basis (which S-Con-07-A does not). It also incorporates provisions for third party rights, a form of collateral warranty, guidance notes and a model letter to a commercial client but no provision for novation.

In the end, the overall difference between the two forms is perhaps not as pronounced as the debate might initially have suggested. But then they do share similar genes.

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How will Hong Kong's Civil Justice Reforms affect construction and engineering disputes ?

11 years after the handover: A variation on England's Civil Justice Reform

In the Hong Kong Special Administrative Region (SAR) of the People's Republic of China, the English system of common law and court procedures which existed prior to Hong Kong's handover in 1997 remains in force under the Basic Law, subject to ongoing development by local case law and legislation.

Reform of Hong Kong's civil justice system has been the subject of debate and consultation for most of the past decade. The reforming legislation has now been passed and the changes will be implemented as from 2 April 2009, applying to the High Court, District Court and Lands Tribunal.

Many readers will be familiar with the Woolf Reforms which led to the introduction in 1999 of the Civil Procedure Rules (CPR) in England and Wales. The CPR replaced the previous court rules with a completely new rule book.

Hong Kong's Civil Justice Reform (CJR) will introduce fundamental changes familiar to those with experience of the English CPR, but with two major differences:

- unlike the English CPR, Hong Kong's CJR does not entirely replace the previous court rules, but amends the existing court rules with a view to improving the civil justice system;
- Hong Kong's CJR does not include 'pre-action protocols'.

Another key difference is that, in England, the CPR followed shortly after the introduction in 1996 of the Housing Grants Construction and Regeneration Act (HGCRA), which radically altered the dispute resolution landscape in the construction and engineering industries, via the introduction of statutory adjudication. In contrast, there is at present no system of statutory adjudication in Hong Kong such as the HGCRA.

Introduction of "Underlying Objectives" and Case Management Powers

The most significant component of Hong Kong's CJR is the introduction of "*underlying objectives*", very similar to the elements of the "*overriding objective*" which is the cornerstone of the English CPR. They are:

- increasing cost-effectiveness;
- ensuring that a case is dealt with as expeditiously as is reasonably practicable;
- promoting a sense of reasonable proportion and procedural economy in the conduct of proceedings;
- ensuring fairness between the parties;

- facilitating settlement of disputes; and
- ensuring that the resources of the court are distributed fairly.

The Hong Kong courts will be obliged to seek to give effect to these underlying objectives whenever exercising any powers or interpreting the court rules or a practice direction. Additionally, the courts will have a duty to actively manage cases, including:

- encouraging the parties to co-operate with each other;
- identifying the issues at an early stage, deciding promptly which issues require full investigation and trial, and the order in which the issues need to be resolved;
- assisting the parties to settle the case, and encouraging and facilitating the use of Alternative Dispute Resolution (ADR);
- fixing timetables and controlling the progress of the case;
- considering costs and benefits of steps in the proceedings;
- dealing with the case without the parties needing to attend court;
- making use of technology; and
- giving directions to ensure that the trial proceeds quickly and efficiently.

The introduction of the underlying objectives and case management powers means that, although a large portion of the text of the court rules in Hong Kong remains unchanged, the rules and procedures will be implemented from April 2009 in a dynamic and radically different manner.

Practical changes to Hong Kong Court procedure affecting construction and engineering disputes

Apart from the underlying objectives referred to above, and the increased emphasis on mediation (discussed separately below), a number of key changes will affect construction and engineering litigation.

Case management

After close of pleadings, both parties' solicitors will be required to complete a questionnaire and a paper-based procedure for directions by consent will be encouraged. If directions cannot be agreed, a "case management summons" will be issued and the parties will attend a "case management conference".

The court's directions will, in every case, include a timetable containing "milestone events", which cannot be varied by the parties' consent alone.

Discovery

Traditional “general discovery” in court actions, where all documents relevant to the matter in question or which may fairly lead to a train of inquiry must be disclosed, is of particular concern in construction and engineering litigation, which tends to be document-intensive. At the same time, discovery procedures are an important part of a fair and effective civil justice system.

The Hong Kong CJR has retained the previous rules for automatic “general discovery”, but this is now subject to the underlying objectives of promoting a sense of reasonable proportion and procedural economy in the conduct of the proceedings and ensuring fairness between the parties. New rules have been enacted to give the courts power to order limited discovery, having regard to the underlying objectives. These rules are likely to play a significant role in construction and engineering litigation before the Hong Kong courts. Details of the new discovery regime are not yet known, as the judiciary is yet to publish any draft Practice Direction concerning the new limited discovery regime.

Sanctioned payments and offers

The existing system contains only a mechanism for a defendant to make a payment into court. If not accepted, the payment-in provides protection against costs if it exceeds the sum of the final judgment.

The new rules provide for both plaintiffs and defendants to make “sanctioned offers” and “sanctioned payments”, with potential costs implications if the sanctioned offers or payments are not accepted. The consequences may now include orders to pay the other party’s costs on an indemnity basis, to pay higher interest on the judgment sum, or to pay interest on costs at up to 10% above the judgment rate (which may amount to 18% per annum!).

Expert evidence and statements of truth

The CJR formalises the requirements for impartiality of experts which were first set out in the *Ikarian Reefer* case. Experts will be required to comply with a Code of Conduct attached to the court rules and to sign a declaration acknowledging their overriding duty to the Court. Additionally, the courts will have an express power to limit the use of expert evidence in all cases and to appoint a single joint expert, where this would further the underlying objectives including cost-effectiveness, expedition and reasonable proportion.

A statement of truth will need to be signed by a senior person in the company which is a party or by a lawyer authorising a pleading, by the maker of a witness statement and by an expert providing a report.

Trial and interlocutory appeals

Amongst the measures introduced to promote cost-effectiveness, expedition, reasonable proportion and fair distribution of resources, are:

- powers to limit evidence and impose time limits on cross-examination and speeches at trials; and
- the requirement to obtain leave to appeal against most interlocutory orders.

Pre-action protocols

In England, the CPR's pre-action protocols outline the steps parties must take to seek information from, and to provide information to, each other about a prospective legal action.

Pre-action protocols will *not* be introduced in Hong Kong because of reservations over the “front-loading” of costs, and the automatic sanctions for non-compliance with such protocols. These concerns are particularly apposite in relation to construction and engineering disputes.

Costs

The usual rule that “costs follow the event”, i.e. the successful party is awarded its costs, will be subject to a number of qualifications. Under the new rules, judges will have a wide discretion to award and apportion costs, taking into account the “underlying objectives”, partial successes and the reasonableness of the parties’ cases, the issues, and the manner in which the parties have conducted themselves, including conduct prior to the commencement of the court action.

The Construction and Arbitration List of the High Court

Although Hong Kong does not have a specialist court like the Technology and Construction Court (TCC), a specialist List has been in place since 1986 to deal with High Court actions concerning civil or mechanical engineering, building or construction work, claims concerning professional persons or entities specialising in practice related to the construction industry, and applications under Hong Kong’s *Arbitration Ordinance*. There is a judge in charge of the Construction and Arbitration List.

The detailed Practice Direction regulating procedures for actions in this List is being revised to come into line with the new CJR provisions. Proposed changes include:

- a mandatory requirement for the plaintiff to take out a summons for a case management conference within 28 days after the close of pleadings;

- more detailed directions relating to expert witnesses may be given at the case management conference, including a more defined scope of the expert evidence and specific questions which experts should answer;
- the trial date is to be treated as a milestone date, which cannot easily be varied.

Mediation

A pilot scheme encouraging the use of mediation in the Construction and Arbitration List, which has been in place since September 2006, will become permanent under the new CJR regime. The scheme provides for one party to serve a Mediation Notice requesting the other(s) to mediate. Although participation in the scheme is voluntary and the mediation is conducted on a confidential and without prejudice basis, there are potential costs sanctions for unreasonable failure to respond to a request to mediate.

The encouragement of mediation in this way is consistent with the underlying objectives of the CJR, and also follows the trend in the English courts to award costs against a party who unreasonably refuses to mediate. The Hong Kong Court of Appeal has recently indicated its support for the English case law in this area (see page 12).

Conclusion - future directions for litigation, arbitration and adjudication in Hong Kong

The CJR reforms will undoubtedly change the way in which construction and engineering actions are litigated in the Hong Kong courts. As with the English CPR, the extent to which such reforms will produce tangible results in terms of the worthwhile objectives of cost-effectiveness, expedition and reasonable proportionality, is likely to be the subject of much discussion in future.

The vast majority of construction and engineering contracts in Hong Kong contain provisions which mandatorily refer disputes to arbitration and only a relatively small percentage of construction and engineering cases are litigated in the Hong Kong courts, such as claims involving professional negligence. There are no indications that this is likely to change in the short term.

Of greatest interest to participants in the construction and engineering industries is the question whether the Hong Kong legislature will consider the introduction of statutory adjudication, which has the potential to fundamentally change the way most construction disputes are handled, as has been shown by the introduction of the HGCRA in England and the Security of Payment legislation in Australia. Developments in this area will be closely monitored.

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