

Legal Update

Hong Kong Court Decision Is Reminder that Contractual Clarity Is Critical During Construction Tender Process

Large and complex construction projects frequently require careful and extensive preparation and evaluation to be undertaken during the tender stages. A recent case reminds participants in the tender process that they should, so far as possible, clearly set out what has and has not been agreed between them prior to formal award of contract to avoid the potential for costly disputes at a later stage.

Background

The Defendant (D) was employed as a sub-contractor for certain works (Sub-Contract Works) by the main contractor (MC) on a particularly large and complex cultural project in Hong Kong (Project). The Plaintiff (P) was a prospective specialist sub-contractor for particular works within the Sub-Contract Works, which included design, supply and delivery of precast concrete facades (Specialist Works). During the course of MC's tender for the Project, D evaluated, and negotiated with, P but eventually did not engage P as a specialist sub-contractor. P then took action against D, alleging that:

- During the tender period, P and D had entered into a pre-bid agreement (PBA) to the effect that, should D be awarded the Sub-Contract Works, D would sub-contract the Specialist Works to P.
- The PBA's existence could be inferred from four sets of documents (Four Documents) including (i) a confidentiality agreement entered into between P and D dated 10 June 2015 (Confidentiality Agreement); (ii) emails from D to P dated 23 and 25 June 2015 (June Emails); (iii) a letter from P to D dated 25 June 2015 (25/6 Letter); and (4) a pre-bid agreement made between the MC and D dated 31 August 2015 (MC/D PBA).
- The PBA resulted in a sub-contract (Specialist Sub-Contract) being created between P and D when D was awarded the Sub-Contract Works by the MC.
- Further or in the alternative, a Specialist Sub-Contract could be inferred from the elements of the Specialist Works that P had carried out after D was awarded the Sub-Contract Works. These included P's preparation and submission of mock-up samples and information (including plans and drawings), production of manufacturing quality plans, and attendance at meetings and workshops from December 2015 to June 2016.
- That P was entitled to recover damages for breach or wrongful termination of the Specialist Sub-Contract, or, alternatively, *quantum meruit* (i.e., a reasonable sum) for the work it had done for the Project.

D denied that any PBA or Specialist Sub-Contract ever existed, and that at the material time, P and D were only in preliminary discussions, with D still evaluating P as a specialist sub-contractor.

Inferring a Contract

P's argument was premised on either the PBA being "inferred" from the Four Documents, or the Specialist Sub-Contract being "inferred" from the parties' conduct after the award of the Sub-Contract Works to D. There was no dispute about the applicable principles for "inferring" a contract from the conduct of the parties:¹

- The test is an objective test, and the burden of establishing the existence of the contract is on the party asserting its existence.
- The Court will not infer a contract lightly:
 - » It must be shown, on the balance of probabilities, that the conduct relied upon is "unequivocally referable to the contract sought to be inferred".²
 - » What the parties have done must be "consistent only with there being a new contract implied, and inconsistent with there being no such contract".³
 - » It will be "fatal to the implication of a contract if the parties would or might have acted exactly as they did in the absence of a contract".⁴
 - » The law generally excludes as irrelevant the parties' actual intentions regarding the contract to be implied.⁵

Decision

Based upon P's pleaded case and the evidence before it, the Court found that it was insufficient to infer either the PBA or the Specialist Sub-Contract. The Court emphasised that the burden of establishing the existence of the PBA and Specialist Sub-Contract was on P, and that inferring a contract required "very convincing" and "unequivocal" evidence.

Although P argued in evidence that (i) there had been an oral PBA, and (ii) the PBA was back-to-back, and on identical terms, to the MC/D PBA, the Court declined to entertain these arguments as they had not been raised in the pleadings as required under Court rules. This provides a reminder of the importance of pleading a party's case properly before the Hong Kong Courts.

CONFIDENTIALITY AGREEMENT

In its decision, the Court was particularly guided by the terms of the Confidentiality Agreement, signed by both parties to govern the exchange of information between them during the tender process, as important evidence of the parties' intentions at the material times. The Confidentiality Agreement stated:

- In Recital C, that "[P and D] have commenced and **engaged in discussions and negotiations whereby the Parties shall mutually explore and evaluate the appropriateness and possibility of the involvement of [P] as a proposed specialist sub-contractor of [D] in the Main Contract Tender ... The assessment and evaluation of the appropriateness of the said proposed involvement of [P] remains to be the objective of the Parties in their said current discussions and negotiations (the "Objective")**" (emphasis added);

¹ *Shanghai Tongji Science & Technology Industrial Co Ltd v Casil Clearing Ltd* (2004) 7 HKCFAR 79

² *Brogden v Metropolitan Railway* (1877) 2 App Cas 666 at 693

³ *Mitsui & Co Ltd v Novorossiysk Shipping Co* [1993] 1 Lloyd's Rep 311 at 320

⁴ *The Aramis* [1989] 1 Lloyd's Rep 213 at 224

⁵ *Allied Marine Transport Ltd v Vale Do Rio Doce Navegacao SA ("The Leonidas D")* [1985] 1 WLR 925 at 936

- In Clause 8: “Both parties acknowledge and agree that the exchange and provision of information under this Agreement **shall not commit or bind either Party to any present or future contractual relationship** Nor shall the exchange and provision of information be construed as an inducement to act or not to act in any given manner. **Specifically, [D] has no obligation under this Agreement to enter into any contractual arrangement with [P] including but not limited to any pre-bid agreement for engaging [P] as [D’s] domestic specialist sub-contractor..**” (emphasis added)

Importantly, the Court held that, rather than supporting P’s argument that a PBA was in place, the Confidentiality Argument suggested otherwise.

The Court then interpreted the remainder of the Four Documents, and the conduct of the parties, in light of the Confidentiality Agreement, taking into account their existence in the context of a multi-tiered tender process for a highly complex project. Within this context, the Court held that the Four Documents, and the parties’ conduct, was just as consistent with there being no PBA or Specialist Sub-Contract existing. The more salient aspects of the Court’s analysis and findings are set out below.

JUNE EMAILS

In the June Emails, D forwarded P the MC/D PBA, stated that D was working on a pre-bid agreement to allow P to “team up” with D, and requested that P provide its “best offer” based on the MC/D PBA. A draft PBA was forwarded from D to P for its “consideration and acceptance”.

However, no PBA was ever signed, and the documents and information which passed between P and D in the June Emails were held to all be related to the strategy for tendering for the Project: they were all to facilitate D’s consideration of P as a suitable Specialist Sub-Contractor to be included in MC’s tender for the Project.

25/6 LETTER

The 25/6 Letter was issued by P, at D’s request, to confirm P’s willingness to act as the key domestic sub-contractor for MC, and as the key domestic supplier of D, for the provision of precast concrete panels for the Project.

However, this was not considered evidence that D would enter into a contract with P. The Court held that, on the evidence, P would have issued the 25/6 Letter on the basis of assurances from the MC that it would be engaged as the Specialist Sub-Contractor, without any direct agreement with D. It was also within P’s interests to provide the 25/6 Letter for inclusion in MC’s tender for the Project.

THE MC/D PBA

The Court held that the MC/D PBA added nothing to the evidence, because it was simply a separate agreement between MC and D.

CONDUCT OF P AND D AFTER THE AWARD OF THE SUB-CONTRACT WORKS TO D

P argued that the work that it did after the award of the Sub-Contract Works to D was within the scope of the alleged Specialist Sub-Contract, and that this either: (i) evidenced that the Specialist Sub-Contract existed, or (ii) constituted P or D’s acceptance by conduct of the Specialist Sub-Contract.

However, the Court held that D’s requests for, and P’s carrying out of, these works was equally consistent with there being no Specialist Sub-Contract. This was particularly so when viewed in light of the Confidentiality Agreement, which clearly evidenced an intention for the production and exchange of information to not create any contractual obligations, and in the context of collaboration between parties during the tender process for a large and complex project with a demanding specification:

- D’s inspection of P’s casting yard, preparation and submission of manufacturing quality plans, information, plans and drawings, attendance at meetings and workshops from December 2015 to June 2016, and the production and submission of a louver mock-up could all be seen as part of D’s reasonable

“*due diligence*” to determine whether P was a suitable specialist sub-contractor for the Specialist Works.

- This was especially so given the importance of the interface between the Specialist Works and D’s aluminium façade, and the fact that D had no prior experience working with P.
- All of the relevant works, except for the production and submission of the mock-up fell within the definition of “*Confidential Information*” in the Confidentiality Agreement, and therefore were expressly agreed by the parties not to give rise to contractual obligations.
- Given the time that P had invested familiarising itself with the tender documents and drawings, and that involvement as a specialist sub-contractor or supplier on the Project was a lucrative prospect, it would defy commercial and common sense to refuse D’s requests to carry out the works above unless a PBA or Specialist Sub-Contract existed. The direct costs P incurred in responding to D’s requests were modest.

The evidence shows that, at the material times, the parties were still negotiating key contractual terms including the price for carrying out the Specialist Works and the programme. No agreement was ever reached on these terms, as would be required for contract formation.

QUANTUM MERUIT

Based on the Court’s finding that the work done by P was to satisfy D’s “*due diligence*” in hopes of being awarded the Specialist Works:

- Such work was carried out as part of a tender exercise; and
- The situation could be distinguished from circumstances where there was an implied agreement to pay, or where work had been done in anticipation of the award of a contract,

and accordingly there was no basis for any claim in *quantum meruit* for the work done.

Comment

Although this decision shows a Court is willing to accept that parties to large or complex construction projects may carry out substantive preparatory work without remuneration, or a contract being in place, the outcome of each individual case will depend on its facts including the case pleaded and the evidence adduced, as demonstrated in this recent case.

Parties involved in the tender process should carefully review all the terms in any documents, including confidentiality agreements, that they issue or sign during the tender process to ensure that these reflect their intentions. This recent case reminds us that Courts will place substantial evidential weight on contemporaneous documents signed by the parties at the material time.

Parties involved in the tender process, particularly at the contractor/sub-contractor level should, so far as possible, make clear the basis upon which negotiations and work have been or would be undertaken and what has been agreed between them, particularly regarding any legally binding obligations pre- and post-tender, including the terms and conditions thereof, whether remuneration is to be paid and the terms and conditions of such payment (particularly in circumstances where negotiations are still ongoing). This should all be clearly and precisely formulated and recorded in writing, preferably with acknowledgement or agreement from the other parties involved.

Where negotiations are still underway, caveats such as “*subject to contract*” correspondence, term sheets or drafts, “*liberty to withdraw from negotiations at any time*”, “*no obligation to enter into any agreement*” are likely to assist in making clear that no binding contractual arrangement is in place. Conversely, a party should ensure that the other party agrees to pay for any work to be carried out in accordance with, say, a quotation, or other agreed forms of assessment, irrespective of whether or not formal contract documents are eventually or ultimately executed.

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