The dispute resolution epicentre: is Med-Arb in Europe’s future?

Halliburton v Chubb: clarity or missed opportunity?

Jurisdiction and admissibility in dispute resolution clauses
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FROM THE EDITORS

Dear readers,

It is with great pleasure that we introduce to you the first edition of *Construction Law International* for 2021.

In this edition, we are excited to introduce a ‘diversity and inclusion’ questionnaire which will be a recurring feature of this magazine, along with our ‘FIDIC around the world’ series. This will feature in each edition and may include responses by way of invitation to individuals or submission should you be inclined to share your experiences. The questions are as follows:

1. What is your name and current job, role or title?
2. When starting out in your career, did you have any role models?
3. What advice did you receive which helped you progress in your career?
4. Do you think that diversity is improving in your particular professional area?
5. What positive steps have you seen organisations take to progress diversity and inclusion?
6. What aspects do you think are still ripe for improvement in organisations?
7. What are the indicators of when a reasonable diversity balance is reached?
8. What do diversity and inclusion mean to you and why are they important?
9. What impact has the Covid-19 pandemic had on diversity in your professional area?

For our updates sections, we are fortunate to have two contributions from Oksana Wright, Sarah Biser and Craig Tractenberg. The first article provides an overview of the notable and substantive revisions to the 2021 International Court of Arbitration Arbitration Rules. The second piece considers a recent United States Supreme Court case which ruled that state-law principles allow non-signatories to enforce arbitration provisions against signatories to arbitration agreements. From Australia, Michael Barnes and Kristy Eaton discuss incoming Western Australia legislation on statutory adjudication, the effect of which will be to close the divide between the western state’s approach and that taken on Australia’s east coast.

Moving to our feature articles, Andrew Tweeddale considers an issue that often arises in international arbitrations, which is the jurisdiction and admissibility of the tribunal. Matthew Finn queries whether Med-Arb is a cost effective and efficient form of dispute resolution which would be suited to Europe, having regard to its success as a means of resolving disputes in Asia.

Joshua Paffey, Rachael King and Rose Leonforte review a recent United Kingdom Supreme Court decision, *Halliburton v Chubb*, and ask whether the decision provides clarity around an arbitrator’s duty to disclose subsequent appointments.

We have a contribution from the Chair of the Editorial Board, Virginie Colaiuta, in which consideration is given to risks relating to ground conditions under French and English law.

J B Kim and Dukgeun Yun take a close look at back charges, or contra charges, in the common law jurisdictions of Canada, the UK and the US.

In our March 2020 edition we published an article from Yasha Sakhavi which investigated the enforceability of the American Institute of Architects (AIA) C195 indemnity provision under English law. In this edition, we publish part two of the paper, which investigates the enforceability of the AIA C195 indemnity provision under US law based on US anti-indemnity statutes and case law.

From Asia, Andreas Hyungrae Noh considers a subcontractor’s right to claim directly against the employer by reference to a comparison of South Korean law and rules and practices in the Middle East.

Lastly, we are delighted to publish an article from China; Nan Jinlin, Xin Zhifeng and Huang Rongcheng review China’s newly adopted Civil Code and contend that it is a better fit for the construction industry.

We thank our contributors for their insightful articles and we hope you will enjoy reading this edition.

From our diversity and inclusion series, FIDIC around the world, or country updates and feature articles, we invite you all to contribute your thoughts and insights to *CLInt* by submitting your articles to CLInt.submissions@int-bar.org.

Thomas Denehy
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Dear ICP Members,

We hope everyone had a joyful holiday season, and a good start to the year.

The year 2020 will, in all certainty, be remembered for the tragedy derived from the Covid-19 crisis. The pandemic struck our lives without warning, expanded at the speed of a globalised, hyper-connected world, and collected its heavy toll of human lives and economic loss. The first global and massive health crisis in more than 100 years reached virtually every country and put the world into quarantine. Lockdown, isolation, facemasks and social distancing became part of our daily vocabulary, and are very likely to shape the way we interact with others going forward.

However, as in every crisis, opportunities arose. The pandemic showed, perhaps in the worst possible way, the extent to which the world is rather a small place, and the concept of globalisation achieved its widest possible scope. But at the same time, this globalisation and connectivity produced an unprecedented new ground for global cooperation which was crystallised in the remarkable race to develop a vaccine against the virus, bringing together governments, non-governmental organisations and corporations in a joint, monumental and international scientific effort. The fruits of this endeavour can be seen today, bringing hope and relief everywhere.

The construction industry suffered the consequences of the pandemic as any other industry or sector across the world; legal issues of all sorts surfaced as contracts and projects were suspended or even cancelled, and owners, contractors, vendors, subcontractors, advisors, etc worked out how to sort the problems with the legal tools available, which did not seem to respond or adapt well to the new reality.

Negotiation and common sense achieved a whole new meaning as everyone understood that litigation or arbitration were not the immediate answers to tackling problems derived from the pandemic, and that rather, the solution lay in the hands of the parties. Collaborative approaches to contracting and dispute resolution appeared as a sensible path to follow and are likely to become a growing trend in the years ahead.

The dispute resolution sector also underwent a process of profound change. Digital and online proceedings became the norm, even in places where, only a year ago, the possibility to administer justice through a computer was unthinkable, or at least heavily underdeveloped. Online mediations, hearings, meetings and depositions became part of day-to-day practice, and lawyers, judges, arbitrators, mediators and experts quickly learnt the new rules of the game. Arbitration rules across the world have been amended to make proceedings more accessible and expeditious, and dispute boards and other alternative dispute resolution methods have increasingly captured the attention of governments and private companies as a more cost-effective and efficient way of settling disputes with a focus on the project.

At the ICP Committee we also encountered a quick learning curve and adaptation process. During 2020, we presented 12 fully online sessions, with more than 50 speakers and more than 2,000 registered participants. The ICP Committee officers met online ten times during the year, and there was an enormous amount of interaction, ideas and discussion. Last year also marked the launch of the ICP Committee initiative on Diversity and Inclusion in the construction industry, which had its kick-off event with a session addressing global diversity and inclusion policy with a focus on the infrastructure and construction industry.

CLInt, our exclusive magazine, also transformed itself from a paper publication to the current online, digital format, without losing a pinch of the quality content it is known for. In fact, more than 50 articles have been contributed by 69 members across the world, making CLInt a unique platform of construction law knowledge-sharing with a truly global reach.

All this would not have been possible without the hard work and dedication of all of our officers and the constant support of our members and IBA staff. To all of them, our sincere gratitude. We asked a lot of you over the year and we really appreciated your amazing response, which allowed the ICP Committee to be more connected than ever, despite no in-person events.

The second year of our tenure as Co-Chairs in 2021 poses new challenges before us. In the hope that the pandemic finally recedes, we are making plans to host our traditional working weekend in Vevey, Switzerland. This landmark event in the ICP Committee calendar had to be postponed in 2020 and more recently in early March 2021 because of Covid-19-related travel and events restrictions, but a new date has been set for May 2022, when we hope to meet in person again. Members interested in attending the working weekend, but not registered, please feel free to reach out to us as there may be opportunities to participate in lieu of registered delegates who will not be able to make it.

Our biennial conference, Projects from Inception to Completion, is also on the agenda, and we are also working with the IBA in the development of our programme for the IBA Annual Conference. We very much look forward to all of these in-person events, and to meeting old and new friends face-to-face again.

At the same time, we will continue to develop online working sessions and hope to achieve more cooperation with other committees within SEERIL and across the IBA, finding areas of mutual interest to develop joint
sessions and projects. This will provide ICP Committee members with greater opportunities to learn from, share knowledge and interact with members of related committees and practices.

The ICP Committee has always been open to attracting new members and providing tangible and immediate opportunities for involvement. We encourage members to stay alert for calls for expressions of interest to act as speakers or moderators in our functions, and to submit applications and contribute papers to these and articles to CLInt.

As Co-Chairs we welcome everyone to reach out to us and share views and ideas on how to make the ICP Committee a richer, more interactive, diverse, inclusive and global community.

We wish you and your families, friends and colleagues well and look forward to the year ahead.

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At CLInt, we are fortunate to have a diverse readership that spans continents, cultures, nationalities, genders and much more. Diversity and inclusion are of increasing importance for the legal profession.

To recognise and appreciate those in our industry, we would like to propose a series of questions to promote diversity and inclusion. Our aim is to print two or three responses per edition.

Please send any contributions to CLInt.submissions@int-bar.org.

1. What is your name and current job, role or title?
2. When starting out in your career, did you have any role models?
3. What advice did you receive which helped you progress in your career?
4. Do you think that diversity is improving in your particular professional area?
5. What positive steps have you seen organisations take to progress diversity and inclusion?
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8. What do diversity and inclusion mean to you and why are they important?
9. What impact has the Covid-19 pandemic had on diversity in your professional area?
2021 ICC rules update aims at greater efficiency, flexibility and transparency and addresses Covid-19 issues

Oksana Wright, New York City
Sarah Biser, New York City
Craig Tractenberg, New York City

The leading international arbitration institutions, including the London Court of International Arbitration (LCIA) and the International Court of Arbitration of the International Chamber of Commerce (ICC), are revising their arbitration rules to improve efficiency, flexibility and transparency, and address challenges and concerns relating to the Covid-19 pandemic.

The LCIA recently updated its arbitration and mediation rules, which came into effect on 1 October 2020. The ICC has issued similar updates to its 2017 Arbitration Rules, which will take effect on 1 January 2021 (the 2021 ICC Rules). The updates, according to the ICC Court President, Alexis Mourre: ‘[...] mark a further step towards greater efficiency, flexibility and transparency of the Rules, making ICC Arbitration even more attractive, both for large, complex arbitrations and for smaller cases.’

We provide an overview of the notable and substantive revisions to the 2021 ICC Rules below.

Virtual hearings

The ICC, like other international arbitration fora, has quickly adapted to the Covid-19 reality of remote hearings. Article 26(1) of the 2021 ICC Rules now provides that: ‘[t]he arbitral tribunal may decide, after consulting the parties, and on the basis of the relevant facts and circumstances of the case, that any hearing will be conducted by physical attendance or remotely by videoconference, telephone or other appropriate means of communication.’

Joiner

The ICC made important amendments to its joinder rules. Article 7(5) of the 2021 ICC Rules now allows, on request of one party, joinder of an additional consenting party after the tribunal has been confirmed or appointed. The amendment further provides that: ‘[i]n deciding on such a Request for Joinder, the arbitral tribunal shall take into account all relevant circumstances, which may include whether the arbitral tribunal has prima facie jurisdiction over the additional party, the timing of the Request for Joinder, possible conflicts of interests and the impact of the joinder on the arbitral procedure.’

The previous joinder rule did not allow the joinder of an additional party after confirmation of appointment of the tribunal unless all parties consented to such a joinder.

Avoidance of conflicts of interest

The amendments also aim to prevent potential conflicts of interest. Article 11(7) of the 2021 ICC rules grants the tribunal power to exclude new party representation when it causes a conflict of interest.

Constitution of the tribunal

Article 12(9) of the 2021 ICC Rules is another provision that expands the ICC powers with regard to the constitution of the arbitral tribunal. It provides that: ‘[n]otwithstanding any agreement by the parties on the method of constitution of the arbitral tribunal, in exceptional circumstances the Court may appoint each member of the arbitral tribunal to avoid a significant risk of unequal treatment and unfairness that may affect the validity of the award.’

Previously, Article 12(8) empowered the ICC Court to appoint each member of the arbitral tribunal (and designate one to act as president) in multiparty arbitrations ‘where all parties are unable to agree to a method for the constitution for the arbitral tribunal’.

On the one hand, the new rule ensures fairness in the arbitration process in cases when there are multiple parties involved or when the agreement unequally provides one party with the right to choose an arbitrator. On the other, it allows the ICC to interfere with the parties’ freedom of contract, although only in exceptional circumstances. Time will tell under which circumstances the ICC will actually employ this new rule.

Third-party funding disclosure

Article 11(7) of the 2021 ICC Rules requires that each party must inform the Secretarial, the arbitral tribunal and the other parties of the existence and the identity of any third-party funder. The new provision provides: ‘[i]n order to assist prospective arbitrators and arbitrators in...’
complying with their duties under Articles 11(2) and 11(30), each party must promptly inform the Secretariat, the arbitral tribunal and the other parties, of the existence and identity of any non-party which has entered into an arrangement for the funding of claims or defences and under which it has an economic interest in the outcome of the arbitration.’

The introduction of this section serves to avoid conflicts of interest that may arise by use of third-party funding arrangements and avoid objections to confirmation or a challenge of arbitrators.

**Investment arbitrations**

The 2021 ICC Rules introduced several amendments that concern the treaty-based investment arbitrations. Article 29(6) prevents emergency arbitrations in treaty-based investment arbitrations. Moreover, Article 13(6) precludes the appointment of an arbitrator who is of the same nationality as any party to the treaty-based dispute.

**Expedited proceedings**

The threshold for expedited procedures has been increased from $2m to $3m. See Article 30(2) and Article 1(2)(ii) of Appendix VI. The $3m threshold will apply to the arbitration agreements concluded on or after 1 January 2021.

**Other changes**

**Additional award**

Article 36(3) now allows a tribunal to issue an additional award to address claims that were not addressed in the original award.

‘[Any such] application of a party for an additional award as to claims made in the arbitral proceedings which the arbitral tribunal has omitted to decide must be made to the Secretariat within 30 days from receipt of the award by such party.’

**French law governs claims regarding administration of arbitration**

A new section, Article 43 (Governing Law and Settlement of Disputes), explicitly provides that

‘[a]ny claims arising out of or in connection with the administration of the arbitration proceedings by the Court under the Rules shall be governed by French law and settled by the Paris Judicial Tribunal (Tribunal Judiciaire de Paris) in France, which shall have exclusive jurisdiction.’

**Operations of the ICC**

Appendices I and II of the 2021 ICC Rules were likewise updated. Appendix I contains information concerning the operation of the ICC and provides for a two consecutive term limit for its members. Article 5 of Appendix II now allows a party to request the ICC to provide reasons for its decision regarding whether and to what extent the arbitration shall proceed; consolidation of arbitrations; appointment of tribunal in multi-party arbitrations and other circumstances. The amendments aim to provide more transparency regarding the ICC’s operations.

**Conclusion**

The 2021 ICC Rules introduce robust provisions that enhance the efficiency, flexibility and transparency of ICC-administered arbitrations. Notably, the 2021 ICC rules target potential conflicts of interest and expand the powers of the ICC Court and Tribunal to efficiently facilitate arbitrations. At the same time, the 2021 ICC Rules may cause some controversy by allowing the ICC Court to circumvent the parties’ agreement regarding the constitution of the arbitral tribunal.

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AUSTRALIA

Closing the divide between East and West: Building and Construction Industry (Security of Payment) Bill 2020 (WA)

Spencer Flay, Perth
Michael Barnes, Perth
Kristy Eaton, Perth

Each Australian state and territory has security of payment legislation (not unlike the statutory adjudication regime in Malaysia, New Zealand, Singapore and the United Kingdom) which seeks to ensure the flow of money in the contracting chain.

As the esteemed authors of Hudson’s Building and Engineering Contracts observe: ‘The Australian adjudication legislation, although based upon the process introduced by the UK legislation, is subject to a broad dichotomy of approach.’

Western Australia (WA) and the Northern Territory have, since 2004, championed the ‘West Coast Model’ of security of payment legislation. The balance of the states and territories (the Australian Capital Territory, New South Wales, Queensland, South Australia, Tasmania, and Victoria) have, on the other hand, each (at different times) enacted legislation that broadly subscribes to the ‘East Coast Model’ of security of payment legislation.

At a very high level, the West Coast Model legislation seeks to uphold contractual freedom by giving primacy to the terms of the contract, including any contractual payment regime. The East Coast Model legislation is far more prescriptive. It establishes a statutory payment regime which runs alongside any contractual payment regime and treats very harshly a payment respondent that fails either to issue a payment schedule or include in its payment schedule any reasons for withholding payment.

Again, to quote words from Hudson’s:

‘The lack of uniformity resulting from this dichotomy and the variation in the details of the legislation made under each model have obvious disadvantages for parties involved in interstate projects resulting from a lack of familiarity with the relevant procedure.’

Since at least 2003 (with the Cole Report) and particularly since 2017 (with the Murray Report and the Fiocco Report), there have been calls to harmonise Australia’s security of payment laws. It now seems extremely likely that the calls for national harmony will shortly result in the Northern Territory being the only Australian state or territory with West Coast Model security of payment legislation.

On 23 September 2020, the Government of WA introduced to Parliament the Building and Construction Industry (Security of Payment) Bill 2020 (WA) (Bill). The Bill passed the lower house (Legislative Assembly) on 10 November 2020. It now sits in the upper house (Legislative Council), where it will remain until after the WA state election on 13 March 2021. The Bill, which draws on many of the recommendations in the Murray and Fiocco reports, represents the most significant reform to WA’s security of payment laws in more than a decade. It seeks to replace WA’s current (2004) Construction Contracts Act with laws that better protect subcontractors and are generally more consistent with security of payment laws on the East Coast of Australia.

As currently drafted, the Bill proposes amendments in four key areas:

• regulating certain contract terms;
• reforming the payment dispute adjudication process;
• creating deemed trusts for retention money; and
• enhancing the powers of the Building Services Board to manage the commercial conduct and behaviour of registered building service providers under the Building Services Registration Act 2011 (WA).

Application of the Bill

The Bill proposes to apply to building and construction contracts entered into after its commencement. The substantive provisions are set to apply to construction contracts entered into after the date or dates on which they come into operation by proclamation. The Bill would not apply to some construction contracts, including:

• building contracts with homeowners worth less than AU$500,000;
• contracts between employers and employees for construction work or related goods and services;
• contracts relating to loan agreements with financial institutions;
• contracts for drilling for or extracting minerals, oil and gas-related works (this is a narrower exception than the current ‘mining exception’ in section 4(3) of the CCA);
• contracts to build watercraft; and
• contracts involving works where a party fails to hold a registration in contravention of the Building Services (Registration) Act 2011.

The narrowing of the so-called ‘mining exclusion’ is particularly significant and will likely expand significantly the ambit of security of payment laws in WA.

Contract terms

As with the existing legislation, the Bill contains a ‘no contracting out’ clause. Importantly, the Bill proposes to:
• give adjudicators, arbitrators and courts power to declare ‘unfair’ time-bar clauses void in prescribed circumstances;
• extend the prohibition in the current CCA of ‘paid-when-paid’ provisions; and
• create statutory rights (which may be inconsistent with the terms of a contract) to:
  – receive advance notice of an intention to call on a performance security;
  – substitute a performance bond for retention money;
  – make progress payment claims (and provide minimum requirements and procedure for making progress payment claims); and
  – require a principal to respond by way of a payment schedule.

**Time bars**

Notice-based time-bar provisions are common in construction contracts. The Bill proposes to regulate these provisions by giving an arbitrator, adjudicator or court the power to declare void any notice-based time-bar provision that it considers unfair in the particular circumstances of each case.

A declaration that a provision is unfair (and thus void) in respect of one payment claim would apply only to that claim, and would not void the provision otherwise. The provision would continue to operate with respect to other payment claims.

The proposed power to declare unfair (and, therefore, void) a notice-based time-bar provision is unique to the Bill. It would represent a significant departure from the current treatment of notice-based time-bar provisions in common law.⁴

The Bill considers the operation of a time-bar unfair where compliance with the provision ‘is not reasonably possible’ or ‘would be unreasonably onerous’. This is largely consistent with the recommendation in the Fiocco Report, which considered the Murray Report (Murray, J, Review of Security of Payment Laws, (December 2017), Recommendation 84) recommendation. The meaning of ‘is not reasonably possible’ and ‘would be unreasonably onerous’, however, is open to debate and will almost certainly consume pages of law reports, should the Bill become law in its current form.

A claimant seeking to argue that any notice-based time bar is unfair will bear the onus of proof.

**‘Pay when paid’ provisions**

As with the CCA, ‘pay when paid’ provisions will continue to be prohibited. The Bill proposes to extend the prohibition beyond contract terms that make payment dependent on payment from another party, to other provisions that are contingent or dependent on the operation of another contract such as the:
• due date for payment of an amount owing;
• making of a claim for an amount owing; or
• release of retention money or of a performance bond.

**Performance security**

A party seeking recourse to a performance security will be required to give a notice of intention to call to the party proving the security. The notice of intention must be given at least five business days before the party has recourse to the performance security (or any longer period provided for in the contract).

The notice of intention must:
• be in writing;
• identify the construction contract and the relevant provisions of the contract that the party relies on to have recourse to the performance security; and
• describe the circumstances that entitle the party to have recourse to the performance security.

The Bill proposes an entitlement to seek the release of retention money under a contract by substituting a performance bond for retention money in a payment claim. To do so, the payment claim will need to include a draft of the proposed performance bond (or multiple bonds) in a final form that meet minimum requirements prescribed in the Bill.

**Right to make payment claims and receive payment**

The Bill proposes that a party that carries out or undertakes to carry out construction work, or to supply related goods and services, has a statutory right to receive progress payments and to make a payment claim every month (or more often if provided for in the relevant contract). This is consistent with security of payment statutes in other states.

The Bill prescribes when and how payment claims may be made, and how a party receiving the claim must respond. They must do so in the form of a payment schedule to be provided within 15 days of receiving the payment claim. Any payment dispute may then be referred to adjudication.

**Adjudication procedures**

The Bill introduces an adjudication process that will be more consistent with those in most other Australian states and territories.

The adjudication procedures in Part 3 of the Bill remain broadly similar to those in the CCA. Their purpose is to determine payment disputes on an interim basis as quickly and inexpensively as possible, while ensuring the principles of natural justice are adhered to within the compressed timeframe. The key differences proposed by the Bill include:
• a requirement to provide notice of intention to apply for adjudication where a response to a payment claim is provided and the claimed amount is unpaid;
• shortening the time frame in which to bring an adjudication application to 20 business days.
following the payment claim and response procedure;
• penalising a party that does not provide a response to a payment claim in the form of a payment schedule or fails to provide reasons for rejecting the claimed amount by not allowing the responding party to submit an adjudication response where no payment schedule is issued, or restricting the adjudication response to only the reasons given in the payment schedule; and
• introducing a new review process, under which another (and, presumably, more senior) adjudicator may be appointed to review an adjudication determination. However, the parties still retain their full rights to litigate or refer the dispute to another form of dispute resolution in accordance with the construction contract.

Deemed retention trusts
The Bill introduces a retention money trust scheme to provide security for builders, contractors, subcontractors and suppliers if their immediate contractual counterpart becomes insolvent. The scheme grants a first priority to the retention money retained as security under a contract over other security interests, effectively ‘ring-fencing’ the money from being claimed by other creditors.

The Bill proposes requiring all construction contracts that exceed AU$20,000 to have retention money trust accounts established. A trust will not need to be established for construction contracts with government principals or home owners if the contract is for home building works worth more than AU$500,000 (with a few exceptions).

The retention money trust account works by having the party procuring the construction work or service (Principal or Trustee) retain money in a trust account in accordance with the construction contract. This is held as security for the other party’s (Contractor or Beneficiary) performance of works or services under the contract. The Bill contemplates allowing a Trustee to engage an agent to manage the trust account, at their own expense and at their own risk. A Trustee will be liable for an agent’s acts and defaults as if they were acts and defaults of the Principal themselves.

Enhanced powers of the Building Services Board
Finally, the Bill proposes to amend the Building Services (Registration) Act 2011 (WA) and the Building Services (Complaint Resolution and Administration) Act 2011 (WA) to give the Building Services Board enhanced powers to manage the commercial conduct and behaviour of registered building services providers.

The Building Services Board will be empowered to:
• declare an individual or non-corporate body an ‘excluded contractor’ where an event resulting in their insolvency has occurred;
• exclude people with a history of insolvency from registering as a building service contractor either temporarily (for a period of three years) or permanently in the case of repeated insolvency events; and
• discipline a building service provider for their failure to pay a ‘building service debt’ (a judgment debt or adjudication determination).

The Building Services Board’s powers to remove building contractors with a history of insolvency from the industry allows for the piercing of the ‘corporate veil’; the Building Services Board will have powers to exclude a corporation or non-corporate body in connection with an insolvency event which is tied to an officer of that body.

Notes
2 ibid.
6 See CMA Assets Pty Ltd v John Holland Pty Ltd [No 6] [2015] WASC 217 (Allanson J, upholding a strict time bar even where the contractor would otherwise have been entitled to an extension of time).

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**UNITED STATES**

**US Supreme Court rules that state-law principles allow non-signatory to enforce arbitration provision against signatory**

Sarah Biser, New York City
Craig Tractenberg, New York City
Oksana Wright, New York City

In cases involving contracts between US companies, courts frequently allow a non-signatory to a contract to enforce an arbitration provision in the contract against a signatory, when the signatory to the contract relies on the terms of that agreement in asserting its claims against the non-signatory. On 1 June 2020, the US Supreme Court ruled unanimously that this principle—known as ‘equitable estoppel’—may also be applied to international contracts governed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention. This is because nothing in that Convention conflicts with the enforcement of arbitration agreements by non-signatories under domestic-law equitable estoppel doctrines.

The Supreme Court’s decision in *GE Energy Power Conversion France SAS, Corp v Outokumpu Stainless USA, LLC*, overturned a ruling of the US Court of Appeals for the Eleventh Circuit, and resolves a split on this issue between the Eleventh and Ninth Circuits, on the one hand, and the First and Fourth Circuits, on the other.

*GE Energy* concerned a company that had entered into three contracts with F L Industries, Inc for the construction of cold rolling mills at a steel manufacturing plant in Alabama. Each of the contracts contained an identical arbitration clause, providing for arbitration of disputes to take place in German in accordance with the Rules of Arbitration of the International Chamber of Commerce. After executing these agreements, F L Industries entered into a subcontract agreement with GE Energy Power Conversion France SAS, Corp (GE Energy) for the design, manufacture and supply of motors for the cold rolling mills. The owner of the steel plant and its insurers filed suit against GE Energy in the Alabama State Court, alleging that the motors that it supplied failed, resulting in substantial damages.

GE Energy removed the action to federal court and then moved to dismiss and compel arbitration of the claims, relying on the arbitration clauses in the contracts between F L Industries and the original owner of the plant. The District Court ruled that GE Energy qualified as a party under the arbitration clauses because the contracts defined the terms ‘seller’ and ‘parties’ to include subcontractors and compelled arbitration.¹

The Eleventh Circuit reversed, ruling that the New York Convention includes a requirement that the parties actually sign an agreement to arbitrate their disputes in order to compel arbitration.² It then ruled that GE Energy could not rely on state-law equitable estoppel doctrines to enforce the arbitration agreement as a non-signatory because, in the Court’s view, equitable estoppel conflicts with the New York Convention’s signatory requirement. The Eleventh Circuit’s ruling on the equitable estoppel was consistent with an earlier Ninth Circuit decision,³ and inconsistent with decisions of the First and Fourth Circuits.⁴

The Supreme Court reversed. In a unanimous opinion written by Justice Thomas, the Court noted that it had previously ruled that the Federal Arbitration Act permits non-signatories to rely on state-law equitable estoppel doctrines to enforce an arbitration agreement. The Court ruled that nothing in the New York Convention prohibits the application of domestic equitable estoppel doctrines to international contracts providing for arbitration, and that the treaty’s silence on that issue was dispositive. The Court also found support for its interpretation by looking to decisions by courts of other New York Convention signatories, which it found also permitted enforcement of arbitration agreements by entities that did not sign the agreement.

Because the Eleventh Circuit concluded that the New York Convention prohibited enforcement by non-signatories, it did not determine whether GE Energy could enforce the arbitration clauses under principles of equitable estoppel or which body of law governed that determination. The Supreme Court remanded the case to the Eleventh Circuit to make those determinations.

The Supreme Court’s decision therefore resolved an issue on which the federal appeals courts were split. It also brings the enforcement of arbitration provisions in international contracts into conformity with the enforcement of such provision in domestic contracts in regard to the potential for non-signatories to compel a signatory to bring its claims in arbitration, rather than to litigate against the non-signatory in court. The decision provides

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¹ Noted that it had previously ruled on state-law equitable estoppel
² GE Energy could not rely on state-law equitable estoppel doctrines to enforce the arbitration agreement as a non-signatory because, in the Court’s view, equitable estoppel conflicts with the New York Convention’s signatory requirement.
³ Consistent with an earlier Ninth Circuit decision.
⁴ Inconsistent with decisions of the First and Fourth Circuits.
non-signatories with an option to compel arbitration when the conditions for equitable estoppel are met.

Notes
1 Case No 18-1048 (1 June 2020).
3 Outokumpu Stainless USA LLC v Converteam SAS, 902 F 3d 1316 (11th Cir 2021).
4 Yang v Majestic Blue Fisheries, LLC, 876 F 3d 996 (9th Cir 2017).

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The International Bar Association’s Human Rights Institute (IBAHRI), an autonomous and financially independent entity established in 1995, works to promote and protect human rights and the independence of the legal profession worldwide. The IBAHRI undertakes training for lawyers and judges, capacity-building programmes with bar associations and law societies, and conducts high-level fact-finding missions and trial observations. The IBAHRI liaises closely with international and regional human rights organisations, producing news releases and publications to highlight issues of concern to worldwide media.

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- 5 continents
- 46 grant-funded projects
- 6 trial hearings observed
- 12 CONSTRUCTION LAW INTERNATIONAL Volume 16 Issue 1 March 2021
In an arbitration context, jurisdiction refers to the authority of an arbitral tribunal to make a decision affecting the merits of the case. If an arbitrator decides it has no jurisdiction it cannot make an award on the merits. The word ‘admissibility’ is used in international commercial arbitration to refer
to the power of a tribunal to decide a case at a particular point in time, having regard to a possible temporary or permanent defect within the claim. If a tribunal concludes it has jurisdiction then it must proceed to rule on the merits of the claim, which may include considering questions of admissibility.

Some commentators have argued that the approach to determining whether there is a question of jurisdiction or admissibility is to examine whether the challenge is to the arbitral tribunal or the claim. Challenges to the arbitral tribunal give rise to questions of jurisdiction whereas challenges to the claim give rise to issues of admissibility.

"Jurisdiction is commonly defined to refer to "the power of the tribunal to hear a case", whereas admissibility refers to "whether it is appropriate for the tribunal to hear it."”

Jan Paulsson, a leading international arbitrator, acknowledged the difficulty of establishing a dividing line between admissibility and jurisdiction in his article on the subject:

"[I]t is perhaps not easy to define the exact dividing line, just as it is not easy in twilight to see the divide between night and day. Nonetheless, whilst the exact line may remain undrawn, it should still be possible to determine which side of the divide a particular claim must lie.”

The complexity with this distinction arises from the perspective of the person looking at the issue. A civil lawyer in France might draw the line differently to a lawyer from the United States, or England. Depending on where the arbitration is seated or the law governing the arbitration agreement, the line between admissibility and jurisdiction will often be different.

### Jurisdiction and admissibility – why is it important?

Where an arbitral tribunal rules that it has jurisdiction then that decision will invariably be reviewable by the courts. Where, however, the parties have consented to the jurisdiction of the arbitral tribunal to deal with the dispute, for example in the arbitration’s terms of reference, a decision as to the admissibility of a claim should be final and binding. It has also been argued that where an arbitral tribunal decides that is has no jurisdiction, a claimant will be prevented from re-referring the same dispute to the same arbitral tribunal at a later date. However, dismissing a claim because it is inadmissible will not in principle prevent the claimant from resubmitting its claim, providing that it has cured the flaw in the claim which caused it to be inadmissible.

### Case law on admissibility and jurisdiction

The FIDIC 1999 forms of contract (as well as the 2017 forms of contract) contain conditions precedent to the commencement of arbitration. There are compulsory time-bar clauses and a multi-tiered dispute resolution clause. There are similar clauses found in the NEC and IChemE suite of contracts and within many other forms. The view of some civil law arbitrators is that since these types of contracts contain a valid and binding arbitration clause that gives them jurisdiction, arguments about notices or whether one party has taken all the steps required by the dispute resolution provisions are questions of admissibility. However, not every arbitral tribunal will adopt this approach. The following cases, which mostly relate to the FIDIC forms of contract, illustrate the differences in approach.

### If a tribunal concludes it has jurisdiction then it must proceed to rule on the merits of the claim, which may include considering questions of admissibility

In *Interim Award in Case 16083*, the arbitral tribunal found that a failure to comply with the dispute resolution provisions in the contract gave rise to an issue of admissibility and not jurisdiction, although it accepted that there was some debate on this issue. The arbitral tribunal reasoned that it was bound to follow French law, as the arbitration had its seat in Paris, and that under French law the French Cour de cassation had termed this type of challenge one of admissibility (*recevabilité*). The arbitral tribunal also held that there was no evidence that the parties’ consent to arbitration was conditional on the pre-arbitral procedures being undertaken. It therefore did not affect the jurisdiction or authority of the arbitral tribunal.

An arbitral tribunal reached a similar conclusion in *Interim Award in Case 16135*, where, again, the seat of the arbitration was in Paris. In this arbitration both parties accepted that the requirement to refer a dispute to the Dispute Adjudication Board...
was a condition precedent to arbitration, except where there was no Dispute Adjudication Board in place.\textsuperscript{10} Both parties proceeded on a presumption that a failure by one party to refer a dispute to the engineer and then to the Dispute Adjudication Board was an issue of admissibility. Similarly, in \textit{Interim Award in Case 14431},\textsuperscript{11} in Zurich, the arbitral tribunal found that the requirement to refer a dispute to a FIDIC Dispute Adjudication Board was a mandatory requirement and that the arbitral tribunal had therefore the option to dismiss the claims or stay the arbitration so that the adjudication could take place. The arbitral tribunal decided to stay the arbitration. The case proceeded on the basis that this was a question of admissibility.

In contrast, the Swiss Federal Supreme Court in \textit{X Ltd v Y SpA}, 4A_628/2015\textsuperscript{12} inferred that the issue was one of jurisdiction but used its case management powers to suspend the proceedings so that the defect could be resolved. The case involved the failure by one party to operate the conciliation process under the ICC ADR Rules, prior to commencing arbitration. The Supreme Court used the words ‘admissible’ and ‘jurisdictional’ synonymously\textsuperscript{13} but was clear that an award as to whether the arbitral tribunal could proceed with the dispute in the absence of a failure to comply with the multi-tier dispute resolution clause was an award on jurisdiction. The court stated: ‘When an arbitral tribunal rejects a jurisdictional defence in a separate award, it issues a preliminary award (Art 186(3) PILA). This is the case here.’

Some arbitral tribunals have found that a final and binding decision of an engineer or dispute adjudication board gives rise to questions of jurisdiction and not admissibility.

A comparison between jurisdiction and admissibility was undertaken in \textit{Final Award in Case 19581}.\textsuperscript{14} The arbitral tribunal referred to the ICSID case of \textit{Abacalat and others v Argentine Republic}\textsuperscript{25} and stated that it had jurisdiction because there was a dispute and a valid arbitration agreement. The arbitral tribunal then considered the admissibility of the claims and concluded, based on the facts, that these were admissible. The seat of the arbitration in this case was an Eastern European country.\textsuperscript{16}

Arbitral tribunals sitting in London have traditionally taken very different approaches. In a case dealing with FIDIC’s 2nd edition,\textsuperscript{17} the arbitral tribunal found that it was a condition precedent to its jurisdiction that the claimant first submits a dispute to the engineer. In that case the arbitral tribunal concluded that it lacked jurisdiction because that process had not taken place. In \textit{Partial Award in Case 16262},\textsuperscript{18} which involved FIDIC’s \textit{Yellow Book}, the arbitral tribunal found:

> ‘that a reference to the DAB was a condition precedent to arbitration and that, since that condition precedent has not been satisfied, the Arbitral Tribunal has no jurisdiction. It follows from the Arbitral Tribunal’s opinion that a reference of a dispute to a DAB is mandatory and a condition precedent to arbitration […] that, absent such reference, there is no jurisdiction save only where Sub-Clause 20.8 applies. In the present case, Sub-Clause 20.8 does not apply.’

The English courts had historically proceeded on the basis that a failure to comply with a condition precedent would give rise to challenge as to the substantive jurisdiction of the arbitral tribunal. It was only in 2018 that the English courts recognised the distinction between admissibility and jurisdiction.\textsuperscript{19} In February 2021 the commercial court addressed the issue of whether a failure to comply with clause requiring good faith amicable settlement for a 3 month period gave rise to a question of admissibility or jurisdiction.\textsuperscript{20} Sir Michael Burton stated that “Jurisdiction ... is commonly defined to refer to ‘the power of the tribunal to hear a case’, whereas admissibility refers to ‘whether it is appropriate for the tribunal to hear it’.” The English commercial court found that the failure to attempt good faith amicable settlement gave rise to an issue of admissibility and therefore brought English law into line with Singapore law,\textsuperscript{21} the law of the United States\textsuperscript{22} and the views of Jan Paulsson.

The following cases illustrate that some arbitral tribunals have found that a final and binding decision of an engineer or dispute adjudication board gives rise to questions of jurisdiction and not admissibility. In \textit{Final Award in Case No 7910},\textsuperscript{23} the arbitral tribunal considered whether an engineer’s decision had become final and binding where no notice of dissatisfaction had been given. On the facts, the arbitral tribunal concluded it was both final and binding and stated: ‘the said decision has become final and binding...’
justifies inadmissibility of such claims for lack of jurisdiction of the Arbitral Tribunal’. While the arbitral tribunal used the words inadmissibility and jurisdiction synonymously it was clear that their decision involved a finding of no jurisdiction. A similar decision was reached in Final Award in Case No 16435,24 where the arbitral tribunal had to consider a contract that contained the following clause: ‘Either party may refer a decision of the Adjudicator to an Arbitrator within 28 days of the Adjudicator’s written decision. If neither party refers the dispute to arbitration within the above 28 days, the Adjudicator’s decision shall be final and binding.’ The seat of the arbitration was Mauritius and the case was influenced by English common law. The arbitral tribunal held that the claimant was not entitled to refer the dispute to arbitration as it had not made the referral within the specified 28-day period. Its conclusion was ‘that, therefore, it does not have the power or jurisdiction to decide the claims’.25

Which law applies?

Questions of jurisdiction and admissibility have often been considered by reference to the law of the seat of the arbitration.26 However, the recent UK Supreme Court decision of Enka Insaat Ve Sanayi A S v OOO Insurance Company Chubb27 has cast doubt over the correctness of that approach. Lord Hamblin and Lord Leggatt stated: ‘It has become increasingly common for commercial parties to include in their contracts provisions which require other forms of dispute resolution, such as good faith negotiation or mediation, to be undertaken without success before a dispute is referred to arbitration […] it is reasonable to expect that, where a multi-tiered procedure is chosen, the law which determines the validity and scope of the arbitration agreement will determine the validity and scope of the whole dispute resolution agreement.’28

The case of Enka v Chubb did not, however, consider the difference between admissibility, jurisdiction and arbitrability. The power to rule on substantive jurisdiction is a power usually given to the arbitrator by the relevant arbitration laws of the seat of the arbitration.29 Whether issues of admissibility will be covered by the law applicable to the arbitration agreement or the law of the seat remains unclear.

Conclusion

There are differences in the way that arbitral tribunals deal with the issues of jurisdiction and admissibility in multi-tiered dispute resolution clauses. Matters such as time-bar clauses; mandatory ADR clauses; claims for extinctive prescription; waiver of claims; or final and binding third-party decisions may be treated by some arbitrators as questions of admissibility. Other tribunals may differentiate between clauses that make a third-party decision final and binding and clauses that mandate an ADR process, such as clause 20.4 of the FIDIC 1999 forms. Once a third-party decision has become final and binding under such a clause, some arbitral tribunals may find the effect to be a bar on a remedy, which will affect its jurisdiction.30

Whether a particular issue is a matter of jurisdiction or admissibility is unclear. It will depend where the arbitration has its seat or the law applicable to the arbitration agreement and the background of the arbitral tribunal making the decision. However, recent jurisprudence shows that common law countries are now recognising the difference between admissibility and jurisdiction and the following the lead taken in many civil law countries. In the case of Republic of Sierra Leone v SL Mining Ltd,31 the court recognised international arbitration practice and adopted it. This approach is to be welcomed.

Notes

1 Waste Management Inc v United Mexican States ICSID Case No ARB(AF)/98/2; approved in Swisborough Diamond Mines (Pty) Ltd v Kingdom of Lesotho [2019] 1 SLR 263 and BBA and others v RAZ and another appeal [2020] SGCA 53.
3 Methanex Corporation v United States of America, Partial Award on Jurisdiction and Admissibility, 7 August 2002, 7 ICSID Reports 239 at 271 [139].
4 Absolut and others v Argentine Republic, Decision on Jurisdiction and Admissibility, ICSID Case No ARN/07/5, 4 August 2011 [287].
5 Interim Award in Case 16083, ICC Dispute Resolution Bulletin 2015, No 1, p 57.
6 In Medissimo v Logica, 29 April 2014, No 12:27.004 the Cour de cassation held that the dispute resolution clause had to be mandatory, a condition precedent and sufficiently detailed if a claim was to be considered inadmissible.
International p 363; see also Medissimo v Logica, 29 April 2014, No 12-27.004.
9 Interim Award in Case 16155, ICC Dispute Resolution Bulletin 2015, No 1, p 71.
10 Ibid, No 1, at [61] and [63]; see also Final Award in Case 18505, ICC Dispute Resolution Bulletin 2015, No 1, at p 137.
11 Interim Award in Case 14431, ICC Dispute Resolution Bulletin 2015, No 1, p 35; see also Final Award in Case 16765, ICC Dispute Resolution Bulletin 2015, No 1, p 101 at [127].
13 See also Swiss Federal Supreme Court, 4A_124/2014, 7 July 2014, where the Court was again unclear as to whether the failure to comply with FIDIC’s mandatory requirements for referring disputes to a DAB gave rise to a jurisdictional challenge or a challenge to the admissibility of the claim.
14 Final Award in Case 19581, ICC Dispute Resolution Bulletin 2015, No 1, p 147.
15 Abaclat and others v Argentine Republic, Decision on Jurisdiction and Admissibility, ICSID Case No ARN/07/5, 4 August 2011, [287]. See also the decision of the Philippines court in Hutama-Karya joint Operations, Inc v Citrus Metro Manila Tollways Corporation – G R No 180640 [2009] PHSC 435.
16 The country is unspecified in the report due to confidentiality reasons.
17 Final Award in Case 6555, ICC International Court of Arbitration Bulletin, Vol 9, No 2 at p 60.
18 ICC Dispute Resolution Bulletin 2015 No 1, p 75.
19 PAO Tatneft v Ukraine [2018] I WLR 5947; and Obrascon Huarte Lain S.A. v Qatar Foundation for Education [2020] EWHC 1643 (Comm).
20 Republic of Sierra Leone v SL Mining Ltd [2021] EWHC 286 (Comm) at [18].
23 Final Award in Case 7910, ICC International Court of Arbitration Bulletin, Vol 9, No 2, p 46.
24 Final Award in Case 19581, ICC Dispute Resolution Bulletin 2015, No 1, p 147.
25 Ibid at [161].
26 Interim Award in Case 16083, ICC Dispute Resolution Bulletin 2015, No 1, p 57.
28 Ibid at [168].
29 See, for example, s.30(1)(c) of the Arbitration Act 1996.
30 Ewelina Kajkowska, Enforceability of Multi-Tiered Dispute Resolution Clauses (Bloomsbury Publishing 2017) at 4.76.
31 [2021] EWHC 286 (Comm) at [18].
FEATURE ARTICLE

What is Med-Arb?

There are many hybrids of mediation and arbitral approaches. The ideology behind Med-Arb, specifically, is that the parties use the assistance of a mediator in an attempt to reach a settlement. If the mediation fails, the mediator switches roles and takes on the role of an arbitrator to render a binding arbitral award on the merits of the case. Usually, these hybrids are commenced at the early stages of the dispute by the parties or by the arbitral tribunal, although this is not restrictive and hybrids can be considered at any stage of the arbitration.

Remaining the dispute resolution epicentre: is Med-Arb in Europe’s future?

A hybrid of mediation and arbitration known as Med-Arb is a less formal, more expedient alternative dispute resolution (ADR) process which can be more flexible when resolving disputes. Although rare in Europe, it is widely used in Asian jurisdictions. In order to remain at the forefront of international dispute resolution, Europe could consider the benefits of Med-Arb: namely, a swift and cost-effective resolution, avoiding more traditional costly and time-consuming processes such as litigation and arbitration. As we enter a period of economic downturn in Europe due to the Covid-19 pandemic, are hybrids that combine arbitration with mediation a better form of ADR?

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Hybrids such as Med-Arb afford the flexibility of choosing from mediation or arbitration according to what best fits the parties’ interests.

There are many different forms of hybrid and they include:

- Med-Arb (single) – the same neutral party is both the mediator and the arbitrator;
- Med-Arb (duo) – two different neutral parties are the mediator and then arbitrator and appointed at different stages;
- Med-Arb-Opt-Out – either party can call for a separate arbitrator after the mediation stage;
- Arb-Med-Arb – initial arbitration proceedings, followed by mediation, and then the continuation of arbitration proceedings if the mediation was unsuccessful (very popular in the People’s Republic of China);
- Arb-Med – initial arbitration proceedings are halted before the decision is made followed by mediation regarding the narrowed issues;
- High-Low arbitration – parties arbitrate based on progress and/or parameters decided during the mediation stage;
- Co-Med-Arb – the separate mediator and the arbitrator are simultaneously provided the same submissions and information. The separately appointed mediator firstly attempts to settle the dispute and the arbitrator only gets called back if the mediation fails to arbitrate;
- Mediation and Last Offer Arbitration (MEDALOA) – known as the ‘baseball arbitration’ method and is a concept used in the US, whereby if the mediation fails, the mediator becomes the arbitrator and decides between a proposed ruling presented by each party.

What are the perceived advantages of Med-Arb?

Med-Arb is a flexible ADR mechanism as it allows parties to design a dispute resolution process to meet the needs of the dispute and the parties involved. Med-Arb not only allows for the prospect of early settlement in the mediation stage, it also provides finality – of a binding nature – in the later arbitration stage.

The Med-Arb approach can be cost-effective at resolving the dispute as it allows the arbitrator to investigate with the parties a pre-action settlement opportunity and, if successful, can save the parties from incurring the time and costs involved in proceeding to arbitration. There is also no duplication in time and cost in getting the arbitrator and parties to understand the dispute, because the mediation flows into the arbitration.

Furthermore, the mediation settlement agreement should be rendered as an arbitral award which gives the parties certain advantages under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention.

It could also be argued that Med-Arb increases the likelihood that parties will participate in good faith during the mediation stage, in knowing that should the mediation fail, the parties will lose control over the outcome of the dispute.

What are the perceived drawbacks and considerations of Med-Arb?

As advantageous as Med-Arb can be, there are some perceived drawbacks. Any mediation is confidential between the parties and the mediator. The parties must consent to the terms of any agreement, which only becomes binding when in writing. The mediator, therefore, is only to assist the parties in an impartial manner and is not there to render any decisions or determine the dispute. The mediation is completely voluntary, and the parties are free to walk away at any point.

Arbitration is a complex legal process and has many similarities to litigation, but one
which takes place in a private forum. While both mediation and arbitration are confidential between the parties, the arbitrator will be required to determine how the dispute and the award are legally binding on the parties. Therefore, the content of the arbitral awards are not controlled by the parties.

Although arbitration and mediation are different ADR processes with different purposes, the fundamental difference is who makes the final decision: a neutral party or the parties at dispute themselves. It cannot be ignored that the role of the mediator is inconsistent with that of the arbitrator.

Concerns over candour and confidential information

Prima facie, Med-Arb as a hybrid seems to be trying to fit a square peg in a round hole, and it has raised concerns with critics as to how it can work in practice. This is because mediation requires the parties to be candid with the mediator, which necessitates disclosing sensitive information such as their bottom-line negotiating position. Parties will often share more information in mediation than arbitration under the protection of the mediation being conducted strictly on a ‘without prejudice’ basis and completely confidential. If, however, the mediation fails and goes to arbitration then this can change the parties’ approach to be less open and honest, in fear that the arbitrator could later consider such shared information against them in the arbitral award.

There is also a fear among legal counsel that confidential information gained during mediation may taint the arbitrator’s final decision, where the mediator becomes the arbitrator. While a mediator and arbitrator are both completely independent and impartial, parties are concerned that even the most diligent neutrals could carry over unconscious bias from the mediation into the arbitration, as explored in Gao Haiyan v Keeneye Holdings Limited. This is especially concerning when a single neutral party is acting as both the arbitrator and mediator. Proponents of Med-Arb could counter-argue that similar situations often arise in litigation and other ADR processes with no ill effects. For example, a judge might be required to disregard evidence they have heard but have subsequently determined to be inadmissible or decide that it was privileged.

To counter this concern, as part of the opening proceedings in mediation the parties could agree on what evidence the neutral is to consider in arbitration, and that the arbitrator shall not base their decision on any information obtained at the mediation stage.

Med-Arb as a hybrid seems to be trying to fit a square peg in a round hole

Med-Arb in Asia

The future of Med-Arb is promising in Asia and is becoming increasingly common. Med-Arb procedures seem popular in China in particular, and in arbitrations that have Chinese involvement. In China, it appears the Med-Arb process involves the mediator evaluating each party’s case and directing them towards settlement, as opposed to mediating and facilitating the parties to a settlement with no evaluation. In an interview in 2011 with the Global Arbitration Review, the Secretary-General of the China International Economic and Trade Arbitration Commission (CIETAC), quoted that 20 to 30 per cent of CIETAC’s caseload is resolved by Med-Arb each year. This is even more impressive considering CIETAC is one of the world’s largest arbitration institutions by the number of arbitrations, with a 2019 market share of 46 per cent among the main international arbitration centres (see Figure 1).

Unlike the rules in China and Singapore, in Hong Kong, under Med-Arb the mediator has a duty to disclose to all parties any confidential information obtained during the mediation that they consider material to the arbitration. In Singapore, the Arb-Med-Arb protocol by the Singapore International Mediation Centre (SIMC) allows for the arbitrator and the mediator to be separately and independently appointed by the Singapore International Arbitration Centre and SIMC. It is considered that the arbitrator and mediator will generally be different neutrals; however, the parties may agree that the same neutral may be both the arbitrator and mediator.

Singapore has seen issues in the High Court on Med-Arb such as in Heartronics Corporation v EPI Life Pte Ltd & Ors, whereby the defendant refused to cooperate during the mediation stage and the claimant commenced
proceedings in litigation. The defendant subsequently applied for a stay of proceedings on the basis of the arbitration clause, but Singapore’s High Court dismissed the stay application as the agreement to arbitrate was discharged by the breach of the mediation agreement. If the parties had opted for an Arb-Med-Arb agreement there would probably have been a very different outcome. It is crucial that parties carefully consider their options should they agree to a Med-Arb or Arb-Med-Arb clause if the agreement should completely fail in the future.

**Beyond Asia**


In another common law jurisdiction, a recent case in Australia (*Ku-ring-gai Council v Ichor Constructions Pty Limited*) reviewed Med-Arb under the Australian Commercial Arbitration Act and provided guidance to parties. Despite this case, the use of Med-Arb in Australia remains relatively low. In other common law jurisdictions, Med-Arb does not seem popular with common law lawyers, particularly where arbitral tribunals of common law lawyers are unlikely to offer Med-Arb.

On 12 September 2020, we saw the Singapore Convention on Mediation, formerly the United Nations Convention on International Settlement Agreements Resulting from Mediation, become effective. This works on the same concept as the New York Convention, in that it enables international parties to enforce a settlement agreement arising out of a mediation in the court of any country that is a party to the Convention. As seen with the New York Convention, it provides a direct enforcement of a cross-border settlement agreement between parties resulting from mediation. There are 53 states currently signed up to the Convention, including some of the largest economies in the world such as the US, China, India, Saudi Arabia, and Turkey. The UK and the European Union states appear to be deliberating on whether to sign up to the Convention.

Following the success of the Singapore Convention on Mediation, the UN Commission
on International Trade Law is working on draft provisions on expedited arbitration. There is also the growing popularity in the UK of construction adjudication over the past 22 years, and the international use of FIDIC suite of Standard Forms which introduced dispute adjudication boards commonly referred to as ‘DABs’. These recognise that parties’ requirements for the future of international ADR are moving towards swifter and more cost-effective forms, rather than traditional, costly litigation and arbitration. As the Honourable Chief Justice of Singapore Sundaresh Menon recently said, ADR should, instead, stand for ‘appropriate dispute resolution’.

Conclusion

The growth of Med-Arb internationally, and particularly in Asia, cannot be ignored. In the UK and wider Europe, there appears to be limited use of Med-Arb and so its future in the European disputes market is unknown, with no signs of increased use any time soon.

While the UK and EU remain cynical, hybrids are certain to continue developing and adapting to the needs of the parties in dispute. For Med-Arb to flourish in Europe it will require parties to become more comfortable with such hybrids and mediation, and perhaps see how successful they are in Asia, before accepting whether it can be more widely used in Europe as a form of ADR. It is crucial that London and Paris do not wait too long, otherwise they risk being left behind as the world’s most popular arbitral seats and epicentres of the resolution of international disputes.

Notes

12 Introduced in the 1999 FIDIC suite of Standard Forms (under the red, yellow and silver books) under cl 20 of the 1999 FIDIC Conditions.
The Court dismissed Halliburton’s appeal from the Court of Appeal’s much-dissected 2018 decision to dismiss an application to remove an arbitrator on the basis of apparent bias. The inference of apparent bias was said to arise from the arbitrator’s failure to disclose to one party, Halliburton, his subsequent appointment to multiple overlapping cases. The case turned on its facts but the Court took the opportunity to provide clarity on the test for apparent bias.

Summary of decision

The final judgment in a line of authority described as the most important for the international arbitration community in a decade was handed down on 27 November 2020 by the UK Supreme Court ([2020] UKSC 48). The Court found that arbitrators have a duty to disclose appointments in overlapping arbitrations, that the arbitrator in the relevant arbitration breached this duty, and that an appearance of bias might well have existed at a point in time. The Court, however, unanimously dismissed Halliburton’s application. Did the Supreme Court provide much-needed clarity around an arbitrator’s duty to disclose subsequent appointments or did it inadvertently undermine confidence in the impartiality of international arbitral tribunals?
The decision will be successful in putting the brakes on parties mounting tactical challenges to arbitrators on the grounds of impartiality.

But the judgment will also give pause to parties that select arbitration as their method of dispute resolution because arbitration provides the opportunity to resolve disputes on terms of their own choosing.

That Halliburton did not want the arbitrator in question appointed, and Chubb did, was clear from the very outset of the substantive matter. On the other hand, Halliburton itself was a repeat appointer of Professor William W Park as arbitrator, whose participation in the arbitral award apparently was limited to expressing his profound disquiet about the arbitration’s fairness.

Given what later happened, it is a matter of some note that the pool of appointable arbitrators appeared so small that this situation could not be entirely avoided. This aspect is difficult to explain to international parties who are the end-users of the business of arbitration.

These international parties are willing to step outside the court system and pay directly for access to justice, through significant fees disbursed to arbitrators. As such, in return these parties are entitled to expect and demand parity of treatment before the arbitrator.

For immediate purposes, it will be vital to revisit agreements to arbitrate and test whether they provide sufficient protection to the parties to ensure that the contractual controls on the arbitral process are correctly calibrated, including the appointment of arbitrators and potentially the circumstances in which the parties agree those arbitrators may accept and disclose subsequent, overlapping appointments.

Key facts

The dispute concerned rejected insurance claims arising from the Deepwater Horizon oil spill in the Gulf of Mexico in 2010. Transocean and Halliburton were defendants in private claims for damages arising from the incident; both settled the action and subsequently claimed on their respective insurance policies held by Chubb. Chubb refused an indemnity and to pay out under the policies.

Consequently, Halliburton commenced an arbitration against Chubb in London. The parties each selected an arbitrator but failed to agree on the chairperson.

Following a contested hearing, the English Commercial Court appointed Chubb’s preferred chairperson, Mr Rokison QC. Prior to appointment, Mr Rokison disclosed to the parties that he had previously acted and was currently acting in a number of arbitrations that involved Chubb.

The basis for the proceedings before the Courts of England and Wales, ultimately heard by the Supreme Court, concerned Mr Rokison’s failure to disclose to Halliburton two subsequent appointments as an arbitrator in disputes arising out of the Deepwater Horizon oil spill, including one as Chubb’s appointee.

Halliburton discovered Mr Rokison’s subsequent appointments 18 months into its arbitration. Halliburton challenged the impartiality of Mr Rokison and sought to have him removed under section 24(1)(a) of the Arbitration Act 1996 (UK). This empowers the Court to remove an arbitrator on a party’s application if ‘circumstances exist that give rise to justifiable doubts as to his impartiality’.

Halliburton impugned the conduct of Mr Rokison on the basis that he accepted the subsequent appointments, failed to disclose them, and failed to resign from the first arbitration, which Halliburton alleged gave rise to an appearance of bias. The application was dismissed at first instance.¹

UK Court of Appeal

In February 2018, the UK Court of Appeal dismissed Halliburton’s appeal from the first instance decision.²

The Court of Appeal held that an arbitrator sitting in more than one arbitration arising out of the same facts could be a legitimate concern in overlapping arbitrations, but in itself this did not justify an inference of apparent bias: ‘something of substance’ is required to support such an inference.

Furthermore, the Court decided that, while the chairperson ought to have disclosed to Halliburton his proposed appointment in the subsequent references, the non-disclosure would not lead a fair-minded and informed observer to conclude that there was a real possibility that the chairperson was biased.
Appeal to the UK Supreme Court

Permission to appeal to the UK Supreme Court was granted to Halliburton on the following issues: whether and to what extent an arbitrator may accept appointments in multiple references concerning the same or overlapping subject matter with only one common party without thereby giving rise to an appearance of bias; and whether and to what extent he or she may do so without disclosure.

The appeal was considered critical to the integrity of the arbitral process and the appeal to the Supreme Court was decided on different grounds, at least to some extent, from those argued before the Court of Appeal.

Unanimous decision to dismiss

The Supreme Court clarified that arbitrators have a duty to disclose facts and circumstances that might reasonably give rise to the appearance of bias. The Court also determined that Mr Rokison had failed to comply with that duty because he failed to disclose a subsequent appointment in a related arbitration. Interestingly, the Court went on to state that, at the time of the subsequent appointment, a fair-minded and informed observer might well have concluded that Mr Rokison’s failure to disclose it created an appearance of bias.

Despite the findings, the Court relied on a sequence of facts (including the timing of Halliburton’s application and the measured manner of Mr Rokison’s response) unanimously to dismiss Halliburton’s application. Critically, the Court determined that the fair-minded and informed observer would not conclude that circumstances existed that gave rise to justifiable doubts as to the chairperson’s impartiality as at the date of the hearing.

Test for apparent bias

The Court restated the test for apparent bias, being whether a ‘fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased’.

Lord Hodge, writing the majority judgment, emphasised that the context forms an important part of the material to be considered, and adopted HHJ Kirby’s description of the objective observer as ‘neither complacent nor unduly sensitive or suspicious’ (Johnson v Johnson (2000) 201 CLR 488, 53).

Lord Hodge also noted that this test was similar to the test of ‘justifiable doubts’ adopted in the UNCITRAL Model Law and the IBA Guidelines on Conflicts of Interest in International Arbitration, without deciding whether the tests were one and the same.

While noting that the test applies equally to judges and arbitrators, the Court noted at some length the fundamental differences between judicial and arbitral determinations of disputes, including arbitrators’ financial interest in reappointment, which differences must be borne in mind in applying the test to arbitrators.

This test applies to the question of whether and to what extent an arbitrator may accept appointments in multiple references concerning the same or overlapping subject matter with only one common party without thereby giving rise to an appearance of bias.

The Court observed that the informed observer would have regard to the contractual and factual matrix, including custom and practice in the subject matter field of arbitration. The Court disagreed with the Court of Appeal’s decision that ‘something more’ was required to establish apparent bias; depending on custom and practice, mere acceptance of appointments in multiple references is capable of giving rise to an appearance of bias.

On this basis, arbitrators should proceed on the understanding that disclosure is required, unless the arbitration is one in which there is an accepted practice of multiple appointments.

Disclosure versus confidentiality

The Court affirmed that the appearance of bias is best avoided by prompt disclosure of matters that arguably could be said to give rise to a real possibility of bias.

The Court disagreed with the trial judge’s conclusion that disclosure is not a legal duty in English law and is merely good arbitral practice (unless the parties submit their dispute to arbitration under arbitral rules that impose a legal obligation). The Court decided that the statutory duties of an arbitrator (arising from section 33 of the

arbitrators should proceed on the understanding that disclosure is required, unless the arbitration is one in which there is an accepted practice of multiple appointments
the 1996 Act) give rise to an implied term in the contract between the arbitrator and the parties that the arbitrator will act fairly and impartially.

Furthermore, an arbitrator would not comply with that term if the arbitrator at and from the date of his or her appointment did not disclose matters that are relevant and material to an assessment of the arbitrator’s impartiality and might reasonably lead to an adverse conclusion. This aspect assisted Mr Rokison, because of the element of doubt over the legal duty to disclose at the time he failed to do so, but subsequent arbitrators will not escape this duty.

Whether disclosure of appointment to multiple references is required will depend on the customs and practices of the arbitrations in question. If the customs and practice of the type of arbitration have created expectations of multiple references, for example, this would agitate against the need for disclosure. This is an objective test; the Court recognised that parties to an arbitration (who may not have the same experience of the relevant arbitration field as the commonly appointed arbitrator) may have different expectations of disclosure and impartiality.

This legal duty to disclose does not, however, override the legal duty in England and Wales of privacy and confidentiality.

The Court noted that the relationship between the duty to uphold confidentiality and the duty to disclose is unclear, as the law in this area is developing, but did provide practical guidance to arbitrators. If an arbitrator in one arbitration seeks appointment in a second arbitration, and such appointment ought to be disclosed to one or more parties in the first arbitration, disclosure can be made only if the parties to the second arbitration give their consent. If consent is not given, the arbitrator must decline the second appointment. Such consent may explicitly be sought and given, or inferred from the underlying arbitration agreement in the context of the customs and practice of the arbitration field (for example, if the parties incorporate certain institutional rules into their agreement).

This approach appears to balance parties’ competing interests: disclosure of multiple appointments is important to avoid a potential ‘inequality of arms and material asymmetry of information’, but categories of exceptions to privacy and confidentiality must be limited to what is necessary in the interests of justice.

The decision was unanimous but some of the complex details of the case are reflected in the separate judgment of Lady Arden. In particular, Lady Arden found that confidentiality will not be breached if disclosure is made without giving the names of the other parties to the subsequent arbitration, other than that of the overlapping party (who may be taken to have consented to the disclosure), but that this disclosure alone would not necessarily of itself be enough to discharge the duty of disclosure.

where arbitrator appointment in overlapping cases has now been considered at every level of the UK judicial system, it appears the availability of tactical challenges is limited

Comment

In circumstances where arbitrator appointment in overlapping cases has now been considered at every level of the UK judicial system, it appears the availability of tactical challenges is limited. Most users of arbitration, who uniformly wish to have efficient proceedings with as few avenues for obstruction and obfuscation as possible, on this basis will welcome the Supreme Court’s decision. In particular, this decision highlights the difficulty in challenging an arbitrator on the basis of impartiality. This is valuable in light of the significant costs that parties may incur if they wish to challenge either the arbitrator or the award, where arbitrators fail to abide by requisite standards.

The Court emphasised the importance of maintaining party autonomy to appoint arbitrators from limited pools in particular industries, where it is the custom and practice to appoint arbitrators to multiple overlapping arbitrations. This aspect of the decision appears, however, to be slightly out of step with a trend towards encouraging greater diversity in appointment of arbitrators.

Whether London will become less appealing as a seat of arbitration in favour of emerging jurisdictions remains to be seen. While certainty as regards the test for apparent bias and protection of the duty of confidentiality is attractive to parties, continuing uncertainty about the ability to challenge an arbitrator or award for failure to disclose that which ought to have been disclosed may be an unacceptable
risk to some international parties. Despite placing ‘a premium on frank disclosure’ in arbitration, the Court leaves the extent of required disclosure to be determined in light of the custom and practice of each relevant field of arbitration, which is a standard that any one arbitrator or party may find difficult to identify.

Immediate practical concerns

The matters covered in this lengthy line of authority are of immediate practical concern to parties currently involved in arbitrations, as well as in future disputes. We agree with the Court that it falls to arbitral institutions to incorporate this guidance into the rules and for parties to consider amending the terms of existing or prospective arbitration agreements specifically to provide for:

• explicit consent to disclose to each party to the relevant arbitration agreement all appointments related to that arbitration agreement;
• a requirement to disclose, at any stage of proceedings, related arbitrator appointments (regardless of the extent of any overlap);
• liability for costs thrown away as a consequence of the arbitrator’s failure to disclose information that ought to have been disclosed (even if the disclosure is not sufficient to found an application for removal); and/or
• a ban on subsequent appointments in overlapping cases with a common party without the consent of all parties to the arbitration agreement (potentially even in circumstances in which not all of those parties are party to the arbitration).

Notes


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The UK Supreme Court. Credit: Victor Moussa/Shutterstock
Risk relating to ground conditions under French and English law*

The characteristics of the ground, including the rock nature and resistance, the existence of groundwater, mines, fractures and underground quarry and pollution, may lead to significant cost and time consequences affecting construction projects. The allocation of the costs and risks of ground conditions is often a source of tension between contractors and employers. This article aims to explore the legal principles governing the liability of contractors that may derive from ground conditions under French and English law.

Ground conditions under French Law

Contractor’s liability under Article 1792 of the French Civil Code

A mandatory principle defining the liability of a contractor derives from Article 1792 of the French Civil Code, which provides that:

‘Any builder of a construction is liable as of right, towards the building’s owner or purchaser, for damages, even resulting from a defect of the ground, which imperil the stability of the building or which, by affecting it in one of its constituent parts or one of its equipment items, render it unsuitable for its purposes.

Such liability does not take place where the builder proves that the damages were occasioned by an extraneous event.’

(emphasis added)

Accordingly, ground conditions do not constitute a basis for exonerating the contractor from liability within the circumstances
expressly defined in Article 1792 of the French Civil Code. Article 1792 indirectly implies that surveys and studies are done in relation to the ground conditions so that the construction is solid and fit for purpose. Even when the contractor is not responsible for the design of the construction, it must ensure that the stability of the construction is not imperilled by the ground conditions. Otherwise, the contractor may be held liable under Article 1792. However, the contractor will not be liable for defects resulting from ground conditions if the burden to conduct a ground survey was expressly allocated to the project owner.

The contractor’s obligation also applies in the event of works to a pre-existing construction, unless the renovation works are marginal and non-structural. Thus, the contractor will be liable under Article 1792 for substantial renovation works. Furthermore, under French law, the contractor has a duty to advise its client or employer: it will have the obligation to make all necessary enquiries, to express the relevant observations and to make the necessary reservations when performing its work. This duty applies to all contractors involved in a construction project, regardless of the nature of the contract. Consequently, even when the contractor is acting on the instructions of an expert, the contractor must conduct the minimal verifications to ensure the works are feasible and must advise the employer if necessary. Failure to do so may result in the contractor being held liable.

The contractor must go so far as to refuse to carry out the construction works if the ground conditions make it impossible to comply with the obligations assumed. Thus, in a decision rendered in 1976, the French Court of cassation ruled that a contractor that was aware of defects affecting the ground ‘Should have refused to perform the work’, even though it was acting in accordance with clear instructions from the employer, which knew that the ground was not suitable for the construction. Since the contractor did not refuse to perform the work, it was held liable.

Scope of contractors’ liability under French Law

In principle, the contractor has an obligation to a committed result (obligeobligation de résultat) as opposed to a general obligation to provide services and materials (obligeobligation de moyens). Thus, a contractor is expected not only to perform to the best of its abilities on the construction project, but also to actually deliver the result promised.

If the contractor has an obligation to a committed result, the risk for ground conditions is typically allocated to it. However, the contractor’s liability is not without limits. The contractor has limited liability in the event the employer is aware of the ground conditions and nonetheless accepts the risks affecting the construction. Indeed, if the employer is aware that the ground conditions may result in defects but refuses to pay for a survey, it may be considered partially liable and therefore excludes the full liability of the contractor.

In addition, contractors are not always solely liable for defects resulting from ground conditions under Article 1792. Indeed, liability is shared with other parties involved in the construction project. In particular, the architect of the project is also responsible for carrying out the appropriate ground survey and can be held liable if it fails to do so. The liability of the architect for defects resulting from ground conditions is, however, excluded when its contractual obligation is limited to the obtaining of a construction permit. According to Article 1792-1 of the French Civil Code: ‘Shall be considered as builders of the work: 1. Any architect, contractor, technician or other person bound to the building owner by a construction contract; 2. Any person who sells, after completion, a work which he built or had built; 3. Any person who, although acting as an agent for the building owner, performs duties similar to those of a construction contractor.’

Furthermore, parties can agree to limit or exclude their liability. A contractor can exclude its liability for indirect or consequential losses, including loss of business or profits. However, exclusion of liability will not be valid in several situations.

First, pursuant to Article 1231-3 of the French Civil Code, a party cannot limit its liability in a case of gross negligence (faute lourde) or willful misconduct (dol).
The contractor is expected to provide a minimum standard of performance and the limitation of liability is not accepted when this minimum standard is not met.

The exclusion of liability is not possible when it would be so broad that the obligation of a party becomes insignificant. This derives from the Chronopost case, where the Court of Cassation found that a party cannot include in the contract a clause limiting its liability to the extent that, even when it fails to perform the contract at all, that party is not or only minimally liable. This decision is now codified in Article 1170 of the French Civil Code.

Pursuant to Article 1792-5 of the French Civil Code, liability is established as per public policy (ordre public) in several situations.

First, with respect to the garantie de parfait achèvement. This is a one-year warranty that applies to all defects indicated by the employer within one year following the handover (Article 1792-6 of the Civil Code).

Second, under the garantie biennale, that is a two-year warranty applicable to all defects affecting separable equipment that can be detached from the main construction without damaging the latter or being damaged (Article 1792-3 of the Civil Code).

Third, pursuant to the garantie décennale, a ten-year warranty applicable to defects that compromise the stability of the construction or make it unfit for purpose (Article 1792-4-1 of the Civil Code).

Article 1792-5 implies that the above-mentioned warranties cannot be contractually limited or excluded.

As a result, French law seems to be particularly protective of the employer and makes contractors bear a high level of risk.

**Article 1218 of the French civil code on force majeure**

Although contractors are usually liable for defects resulting from ground conditions under Article 1792, this liability is not without limit. As explained above, contractors must carefully consider the nature of the ground and the feasibility of the project, but in some cases, they will not be liable even if the defects affecting the building are caused by ground conditions.

Under French law, a contractor is not responsible for any event considered force majeure, for instance, damages resulting from an earthquake, insofar as the contractor has respected any specific construction rules pertaining to earthquakes in that region.

Article 1218 of the French Civil Code provides that:

‘In contractual matters, there is force majeure where an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of the conclusion of the contract and whose effects cannot be avoided by appropriate measures, prevents performance of his obligation by the debtor.

If the prevention is temporary, performance of the obligation is suspended unless the delay which results justifies termination of the contract. If the prevention is permanent, the contract is terminated by operation of law and the parties are discharged from their obligations under the conditions provided by articles 1351 and 1351-1.’

A contractor is expected to provide a minimum standard of performance and the limitation of liability is not accepted when this minimum standard is not met.

There are three criteria to prove that a force majeure event occurred, exonerating a party to a contract from liability.

First, exteriority (extériorité): the event is beyond the affected party’s control. The event must not result from the affected party or from anything or anyone that would lead to the liability of the affected party (eg, its employees).

Then, unforeseeability (imprévisibilité): the event could not have been reasonably foreseen at the time of the conclusion of the contract.

Finally, irresistibility (irrésistibilité): the event could not be prevented through appropriate measures. This is determined in abstracto by French courts by referring to whether an average person in the same circumstances could have continued to perform their obligations. If performance were possible, even if costly, the event cannot qualify as force majeure.

However, the threshold for relying on force majeure under French law is high, and courts will carefully consider whether all criteria have been met and if a particular event prevented the Contractor from fulfilling its obligations.
For instance, in a decision dated 24 March 1993, the Court of cassation considered that since the construction in question was built on clay ground, formerly exploited as a quarry, the ground shift that occurred could not have been considered as unforeseeable. Therefore, force majeure was an ineffective defence.\(^\text{19}\)

On the other hand, in a decision dated 20 November 2013, the Court of cassation held that since a ground shift could not have been detected by a conventional ground survey, such a ground shift, by its magnitude, constituted force majeure, resulting in the contractor not being held liable for the defects.\(^\text{20}\)

In this respect, case law holds that contractors are only required to carry out appropriate surveys to the extent that there is reason to suspect that a defect in the ground is likely to damage the construction. Thus, the French Court of cassation held that a ground slide that caused significant damage to a building was an unforeseeable event of force majeure, even though no ground survey had been conducted.\(^\text{21}\)

Indeed, the Court of cassation held that ‘nothing could lead the architect or the contractor to anticipate the existence of such geological phenomena in the area in question’ and that, consequently, ‘the defect in the ground that caused the damage to the building’ was unforeseeable.

Most of the time, the qualification of force majeure results from a combination of factors. In a 2006 case,\(^\text{22}\) a mudslide penetrated an apartment, causing extensive damage and the death of a person. The liability of the city of Tulle, owner of the building, was sought, but the Court of cassation ruled that it was a force majeure event. Firstly, the mudslide was a consequence of exceptionally heavy rainfall that characterised an unforeseeable and irresistible event. Secondly, the ground upon which the building was constructed was by nature fragile and sloping, which had exacerbated the mudslide. As these ground features were not attributable to the building owner, the Court of cassation concluded that the exteriority test was also satisfied. Thus, all criteria of force majeure were met.

**Article 1195 of the French Civil Code on imprévision**

For a long time, imprévision (changes of circumstances) has been neglected by French law in private contracts.\(^\text{23}\) Following a reform of the French Civil Code in 2016, the new Article 1195 entitles parties to a contract to renegotiate the terms of the contract when an unforeseeable change of circumstances occurs. Article 1195 of the French Civil Code provides that:

‘If a change of circumstances that were unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party that had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The affected party must continue to perform its obligations during the period of renegotiation.

If the renegotiation is refused or fails, the parties may agree to terminate the contract or to turn to a court or arbitral tribunal to adapt the contract. In the absence of such an agreement in a reasonable time, upon the request of any party, a court or tribunal may amend or terminate the contract. In such circumstances, the court or tribunal would determine the date and conditions of the termination.’\(^\text{24}\)

When the negotiation fails, the parties may turn to a court or arbitral tribunal to seek a remedy. The court or arbitral tribunal will determine whether a major change of circumstances occurred, and if so, will amend or terminate the contract.

The relevant contract must have been concluded after 1 October 2016 in order for a party to rely on the doctrine of imprévision,\(^\text{25}\) and the contracting parties remain free to exclude or adjust the regime of imprévision.

A crucial requirement is to demonstrate that the economic imbalance between the parties is excessive as a consequence of the change of circumstances. Not every change of circumstances will qualify as imprévision; for example, a minor change that makes the performance of the contract more costly for a party is not sufficient. On the contrary, a change of circumstances that amounts to nullifying any benefit to a party will often be considered as imprévision.

So far, it is unclear to what extent the new Article 1195 will have an impact on construction contracts. Indeed, most construction contracts already provide that the contractor is responsible only for the work that was foreseeable at the time of the contract. As a result, contractors are usually entitled to an additional payment for works that are not predictable.\(^\text{26}\)
Ground conditions under English law

Contractors’ liability under English law

The English legal system is not generally prescriptive with respect to the obligations between contractual parties, which are in principle considered equal. That is why contracts governed by English law often include limitation of liability clauses, liquidation of anticipated damages and waivers of consequential loss.

Under English law, there is no specific statutory provision that prescribes the liability of contractors for defects resulting from ground conditions, as is the case in Article 1792 of the French Civil Code.

Nonetheless, contractors can, of course, be held liable for defects caused by ground conditions under English Law.

Where defects are not specifically defined in a contract, caselaw indicates that they must be considered as ‘anything which renders the [construction] […] unfit for the use for which it is intended, when used in a reasonable way and with reasonable care’.

Under English law, an important distinction must be made between a patent and a latent defect. A patent defect is a defect that is detectable either at practical completion or during a defect liability period, whereas a latent defect is a hidden defect, which may not become apparent for many years.

Latent defects, as opposed to patent defects, were defined in Baxall Securities Ltd & Anor v Sheard Walshaw Partnership & Ors as follows:

‘The concept of a latent defect is not a difficult one. It means a concealed flaw. What is a flaw? It is the actual defect in the workmanship or design, not the danger presented by the defect […] In my judgment, it must be a defect that would not be discovered following the nature of inspection that the defendant might reasonably anticipate the article would be subjected to.’

It is likely that ground conditions will result in latent defects rather than in patent defects.

Under English law, an important distinction must be made between a patent and a latent defect. It is likely that ground conditions will result in latent defects rather than in patent defects.

With respect to ground conditions, the position of English law dates to the end of the 19th century, in Bottoms v York Corporation. In this case, the contractor found that the ground that was excavated required unforeseen measures to complete construction. The contractor therefore requested an additional payment, but it was ruled that there was no representation or warranty as to the nature of the ground and that the contractor was not entitled to additional payment.

Thus, the risk of unforeseen ground conditions rests with the contractor and unless there are specific provisions in the contract regarding this matter, the contractor is not entitled to request additional payment and time.

In Bacal Construction (Midlands) Ltd v Northampton Development Corporation, it was held that where the contractor had prepared the design of a building relying on inaccurate data provided by the employer in the tender documents, the contractor was entitled to bring an action for breach of an implied term. In this case, the contractor discovered tufa (a low-density porous rock) in the ground that was not indicated in the data provided by the employer. In addition, the employer had indicated that the contractor’s design had to take into account the ground conditions as shown in the tender data, which did not include any warning about the presence of tufa.

However, contractors may also be responsible for conducting the appropriate ground study and survey when they are involved in a construction project.

In Obrascon Huarte Lain SA v Her Majesty’s Attorney General for Gibraltar, Obrascon Huarte, a Spanish contractor, filed a claim

The Latent Damage Act 1986, amending the Limitation Act 1980, introduced a statutory liability period with regard to negligence claims for latent defects. Where there is a latent defect, the time limit is six years from the date on which the cause of action accrued, which will be the date when the damage occurred. For a contract under seal, the period is 12 years.
against the Government of Gibraltar in relation to a contract for the design and construction of a road and tunnel under Gibraltar Airport. The contract incorporated the FIDIC Yellow Book Conditions.

A contaminated land desk study, which was provided to the contractor, outlined the history of the area and indicated that the ground was likely to be contaminated. While the work was in progress, the contractor eventually encountered contaminated soil and proposed to re-design the tunnel. However, a few months later, the Government of Gibraltar terminated the contract because of the contractor’s failure to progress the work.

The main issue was whether the amount of contaminated materials in the ground to be excavated was reasonably foreseeable by an experienced contractor at the time of tender: if not foreseeable, it would not have been the contractor’s risk. Akenhead J indicated that: ‘The real issue on analysis is whether [the contractor] judged by the standards of an experienced contractor would or should have limited itself to some analysis based only on the site investigation report and the Environmental Statement.’ (para 213)

Then, Akenhead J held that: ‘I am wholly satisfied that an experienced contractor at tender stage would not simply limit itself to an analysis of the geotechnical information contained in the pre-contract site investigation report and sampling exercise.’ (para 215)

Eventually, guidance was provided as to how the contractor should have conducted its work in order to comply with its obligations. In particular, the contractor should have:

‘(a) [made] a substantial financial allowance within the tendered price for actually encountering and dealing with a large quantity of such material’ and ‘(b) [planned and priced] for a post-contract site investigation to determine wherein the made ground particularly in the critical tunnel area the contaminants were going to be found.’ (para 223)

In *Van Oord UK Ltd & Anor v Allseas UK Ltd*, Allseas UK Ltd (AUK) was engaged as a contractor to carry out offshore and onshore works involved in the laying of gas pipelines. AUK subsequently engaged Van Oord UK Ltd and Sicim Roadbridge Ltd (together OSR) to carry out ‘the procurement, supply, construction, installation, flooding, cleaning, gauging and testing of pipelines, and certain on-shore works’.

OSR made three claims against AUK, one of them being ‘A claim for disruption and prolongation arising out of what is alleged to have been unforeseen ground conditions’. The court therefore attempted to determine whether the ground conditions were reasonably unforeseeable, which would have justified granting OSR a delay for completion.

In that context, Coulson J stated that: ‘Contractors are provided with all available information as to ground conditions, but ultimately it is a matter for their judgment as to the extent to which they rely upon that information. In my view, it is wrong in principle for a contractor to argue that, merely because, in some particular locations, the conditions were different to those set out in the pre-Contract information, those different conditions must somehow have been unforeseeable.’ (para 192)
He added that:

‘Every experienced contractor knows that ground investigations can only be 100% accurate in the precise locations in which they are carried out. It is for an experienced contractor to fill in the gaps and take an informed decision as to what the likely conditions would be overall.’ (para 193)

Finally, he concluded that:

‘Accordingly, by reference to the ground information available to OSR, I conclude that, if there were different conditions from those described in the Contract documents (which I do not accept), they were conditions which could reasonably have been expected to have been foreseen by an experienced contractor.’ (para 196)

Therefore, ground condition was not an acceptable basis for requesting an extension of time since the defects affecting the ground could have been foreseen.

A recent case, *PBS Energo AS v Bester Generacion UK Ltd and another*, upheld the above decisions. In this case, the court also had to consider a litigation in which the allocation of risk for ground conditions was in dispute. The facts were as follows: the employer hired a contractor to engineer, procure and construct a biomass power plant in Wales under a FIDIC 1999 Silver Book agreement. The contract provided that the employer would make available to the contractor all relevant data relating to, among other things, ground conditions. However, Clause 4.10 also provided that:

‘The condition of the Site (including Sub-Surface Conditions) shall be the sole responsibility of the Contractor and the Contractor is deemed to have obtained for itself all necessary information as to risks, contingencies and all other circumstances which may affect the Works, the remedying of Defects and the selection of technology and (save where otherwise set out in this Contract) the Contractor accepts entire responsibility for investigating and ascertaining the conditions of the Site’.

Clause 4.12 also provided that the contractor accepted responsibility for completing the project ‘except for Unforeseeable Difficulties’, that were defined as ‘any and all difficulties and cost, which the Contractor acting with Good Industry Practice could not reasonably foresee, especially events of Force Majeure’.

The data provided by the employer showed that asbestos was not only present on the construction site but was also found in the ground. The contractor sought to obtain an extension of time, but the employer refused.

The construction project was not completed and both parties sought to terminate the contract and claimed damages. The contractor argued that the employer failed to respond to several of its claims for an extension of time and additional payment, while the employer alleged that the contractor abandoned and failed to comply with a notice to correct.

**it is clear that English case law expects construction contractors to make reasonable inquiries to ensure that the ground is suitable for the project**

The court ruled in favour of the employer, stating that the contractor took the risk for ground conditions and that the discovery of additional asbestos on site was not an unforeseeable difficulty. The court held that the facts established that ‘the asbestos discovered was not a new discovery, or different from what had been indicated by the previous findings, but simply a more detailed manifestation of what was shown by the earlier materials’.

Eventually, the court relied on the *Obrascon Huarte Lain SA v Her Majesty’s Attorney General for Gibraltar and Van Oord UK Ltd & Anor v Allseas UK Ltd* cases to conclude that ‘reliance on ground investigations as being 100% accurate is not likely to be successful’. In addition, the court held that the burden of proving that the excessive asbestos contamination was unforeseeable lay with the contractor, stating that ‘It is not enough therefore for [the contractor] to point to the discovery of asbestos in more granular detail than previous reports had suggested. It must show that the asbestos discovered was unforeseeable.’ Thus, the contractor was not entitled to an extension of time or additional payment and was in breach of the contract.

In light of the *Obrascon Huarte Lain SA v Her Majesty’s Attorney General for Gibraltar and Van Oord UK Ltd & Anor v Allseas UK Ltd* cases, as upheld by the *PBS Energo AS v Bester Generacion UK Ltd and another* case, it is clear that English case law expects construction contractors to make reasonable enquiries to ensure that the ground is suitable for the project.

In particular, a contractor which does not undertake any ground studies or surveys, or that relies exclusively on a previous study or survey provided to it without any further verification, cannot invoke ground conditions to exclude its liability or to request an extension of time, unless otherwise agreed in the contract.
Scope of Contractors’ liability in English law

Construction law is generally based on two standards of performance. On the one hand, Section 13 of the Supply of Goods and Services Act 1982 provides that with regard to contract for the supply of services, and that unless otherwise agreed, a professional contractor will have a duty to act with reasonable skill and care. It is a rather low standard, given that ‘It is sufficient if [a contractor] exercises the ordinary skill of an ordinary competent man exercising that particular art’.34

On the other hand, the fitness for purpose obligation imposes a higher duty since it is an obligation to achieve a certain result, a breach of which does not require proof of negligence. In construction contracts, unless otherwise agreed, a fitness for purpose obligation will often be implied where a contractor is responsible for the design of a building. On the contrary, where the contractor is not responsible for the design, an implied term requiring fitness for purpose is less likely.35

In addition, it is generally accepted that under English law, the parties to a construction contract are entitled to shorten the statutory defects period, including the latent defects period.

However, pursuant to the Unfair Contract Terms Act 1977, a party cannot exclude or restrict its liability for death or personal injury resulting from negligence (section 2(1)). Furthermore, in the case of other loss or damage, a party may exclude or restrict its liability for negligence only if the term or notice satisfies the requirement of reasonableness (section 2(2)).

Case law confirms that a clause aimed at shortening the defects period can be enforceable. Accordingly, a clause providing that ‘No action or proceedings under or in respect of this Agreement shall be brought against the Contractor’ after one year from the date of practical completion was held to be enforceable and prevented the employer from bringing a claim against the contractor.36

Similarly, it was considered that a clause which provided that ‘All claims by the CLIENT shall be deemed relinquished unless filed within one (1) year after substantial completion of the Services’ was enforceable and did not fall within the scope of the Unfair Contract Terms Act 1977.37 It was pointed out that such a clause is acceptable since its purpose was to provide some form of certainty and not to prevent the client from making any claim.

However, this does not necessarily prevent the employer from filing a claim in the event of a major defect, such as defective workmanship, that is, when the completed work falls outside the building plans and specifications.38

It is also widely accepted that a party cannot exclude liability for its own dishonesty, which means that liability for fraud cannot be excluded.

With regard to ground conditions, the allocation of risk depends mainly on the contractual provisions. Some standard forms of contracts, including the JCT contracts, do not include specific provisions on ground conditions. Consequently, the contractors are likely to bear the risks of defects and damages resulting from ground conditions. On the other hand, some standard forms of contract contain specific provisions on allocation of risk related to ground conditions. For instance, the NEC3 Engineering and Construction Contract provides for a limitation of liability for the contractor in case of unforeseeable defects resulting from ground conditions.

In conclusion, and contrary to French law, a wide freedom of choice is given to the parties in the determination of liability under English law. Few statutory rules limit the contractual choice of the parties, although there are a limited number of situations in which the liability of a contractor cannot be limited or excluded.

Force majeure, frustration, and hardship under English law

Under English law, unlike French law, few statutory remedies are available to a contractor seeking to limit its liability for defects resulting from ground conditions, and the remedies must be found in the contract.

First, force majeure is not a standalone notion in English law. Performance of the contract will only be excused on account of unexpected circumstances, such as ground conditions, if they fall within the limited doctrine of frustration, which will apply unless otherwise agreed by the parties.
Under the doctrine of frustration, if performance of a contract becomes impossible, the parties may no longer be bound to perform their obligations and may be discharged.

The principle was clearly outlined in Taylor & Anor v Caldwell & Anor:39 ‘The principle seems to us to be that, in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance.’

It is now broadly accepted that a frustrating event is an event which (i) occurs after the conclusion of the contract; (ii) is so essential that it distorts the contract beyond what was contemplated by the parties at the time of the conclusion of the contract; (iii) is not due to the fault of either party; and (iv) makes the performance of the contract impossible, illegal or substantially different from what was contemplated by the parties.

As these criteria are very strict, it is in practice difficult to prove that an event amounted to frustration therefore discharging the parties.

Parties to a contract are in any event free to provide for a more protective standard in their contract, for example, by including a force majeure clause, thus avoiding problems due to the very narrow scope of frustration.

Finally, English law does not provide a right to renegotiate or terminate the contract in the event of a major change of circumstances. Indeed, there is no equivalent to the imprévision doctrine under English law.

Consequently, where parties to a contract want to provide for the discharge of performance when a change of circumstances occurs, they must include a hardship clause in the contract.

**Conclusion**

Dealing with defects resulting from ground conditions can be a real struggle for contractors involved in construction projects.

Under French law, contractors are less likely to limit or exclude their liability. Indeed, in numerous situations, contractors’ liability cannot be excluded or even limited. For instance, the garantie de parfait achèvement, the garantie biennale and the garantie décennale cannot be excluded.

In this respect, English law seems to be more permissive, as parties to a contract have a broad freedom to define the extent of their liability.

On the other hand, English Law does not provide statutory provisions on force majeure and imprévision, which can be a real loophole for contractors unable to cope with the consequences of ground conditions. In addition, the doctrine of frustration is very limited and, in many cases, unlikely to discharge the parties from performance of their obligations.

**Notes**

* Contracts: frustration, Practical Law Commercial
  1. *Tout constructeur d’un ouvrage est responsable de plein droit, envers le maître ou l’acquéreur de l’ouvrage, des dommages, même résultant d’un vice du sol, qui compromettent la solidité de l’ouvrage ou qui, l’affectant dans l’un de ses éléments constitutifs ou l’un de ses éléments d’équipement, le rendent impropre à sa destination.* Une telle responsabilité n’a point lieu si le constructeur prouve que les dommages proviennent d’une cause étrangère.
  2. Les risques tenant à la nature du sol, Jean-Pierre Karila, RDI 1997 p 545.
  7. Cass Civ 3, 26 octobre 1976, No. 75-10.407 ‘Mais attendu que la cour d’appel a relevé que l’entrepreneur, dont l’attention avait été attirée sur les difficultés pouvant résulter de la construction sans fondations sur terrain remblayé, aurait dû refuser l’extraction d’un tel travail ; Qu’elle a pas en déduire qu’une part de responsabilité incombait audit entrepreneur’.
  8. Cass Civ 3, 27 janvier 2010, 08-18.026 ‘Mais attendu que, quelle que soit la qualification du contrat, tout professionnel de construction étant tenu avant réception, d’une obligation de conseil et de résultat envers le maitre d’ouvrage ….’
  12. The French original version of Article 1792-1 states as follows:

    “Est réputé constructeur de l’ouvrage:
    1. Tout architecte, entrepreneur, technicien ou autre personne lié au maître de l’ouvrage par un contrat de louage d’ouvrage;
    2. Toute personne qui vend, après achèvement, un ouvrage qu’elle a construit ou fait construire;
    3. Toute personne qui, bien qu’ayant en qualité de mandataire du propriétaire de l’ouvrage, accompli une mission assimilable à celle d’un loueur d’ouvrage.”

13. ‘Le débiteur n’est tenu que des dommages et intérêts qui ont été prévus ou qui pourraient être prévus lors de la conclusion du contrat, sauf lorsque l’exécution est due à une faute lourde ou dolosive’. Pursuing to Ordonnance no 2016-131 of 10 February 2016 – Article 2, Article 1231-1 applied to contract concluded after 1 October 2016.
Si l’empêchement est temporaire, l’exécution de l’obligation est suspendue à moins que le retard qui en résulterait ne justifie de l'empêcher l'exécution de son obligation par le débiteur.

24 Si un changement de circonstances imprévisible lors de la conclusion du contrat rend l’exécution excessivement onéreuse pour une partie qui n’avait pas accepté d’en assumer le risque, celle-ci peut demander une renégociation du contrat à son cocontractant. Elle continue à exécuter ses obligations durant la renégociation.

25 Article 1995 of the French civil code was modified by Ordonnance no 2016-131 of 10 February 2016 – Article 2.


27 Yarmouth v France (1887) 19 QBD 647.


30 Bacal Construction (Midlands) Ltd v Northampton Development Corporation (1975) 8 BLR 88, CA.


33 PBS Energo AS v Bester Generation UK Ltd and another [2020] EWHC 223 (TCC).

34 Bolam v Friern Hospital Management Committee [1957] 2 All ER 118.


37 Elvanite Full Circle Ltd v AMEC Earth & Environmental (UK) Ltd [2013] EWHC 1191 (TCC) (24 May 2013).


Back charges in construction practice

In the construction industry, uncertain economic climates, such as that caused by the Covid-19 pandemic, can cause constraints on cash flow and potentially negatively affect liquidity across global supply chains. As such, employers have sought to rely on their contractual rights to avoid or delay payment. As a result, contractors and subcontractors are being faced with a lack of cash flow; it has regularly been stated that ‘cash is the lifeblood of the construction industry’\(^1\) resulting in problems with non-payment, late payment or underpayment.

In order to ensure cashflow, contractors may have a right to interim payments. Whereas employers may have a right to set-off or withhold sums due in the contractor’s interim payment applications to cover services performed by themselves, or costs incurred in relation to the contractor’s work a process is often referred to as back charge.

This article briefly introduces interim payments and set-off in the construction context it then details aspects of back charges in the common law jurisdictions of Canada, the UK and the US.
Introduction to the right to an interim payment and set-off

Under the general principle of contract law in the UK, a party does not have a right to claim interim or partial payments as part of the agreed sum of the contract, unless there is a contractual agreement or statutory right.2 In the context of construction contracts, the use of interim payments is a standard means of ensuring cash flow for contractors and subcontractors alike. The purpose of interim payments is to relieve the contractor/subcontractor of the burden of financing the whole of the works until completion – works that may take many months or years to complete. It is incorporated into all standard construction contracts (FIDIC, JCT, NEC, ICE and the like) and statutes in the UK (the Housing, Grant Construction and Regeneration Act (HGCRA) 1996 as amended by Part 8 of the Local Democracy, Economic Development and Construction Act (LDECA) 2009, section 109 ‘Entitlement to stage payment’).

According to RICS guidance notes,3 several methods and mechanisms are used for contractual agreements for interim payments. These include the use of the bill of quantities, priced activity schedules, milestone payments and contract sum analysis. The periodic intervals applicable to interim payments can also be contractually agreed, such as bi-weekly, monthly (the most common interval), every three months, quarterly and so on.

When an employer or contractor encourages the procurement of materials and equipment at the early construction stage, construction contracts allow the contractor or subcontractor to apply for payments for materials and equipment delivered at the construction site or some other agreed location before installation, which is often referred to as a payment for ‘material on site’. Generally, the employer or contractor is then entitled to inspect the stored materials and equipment to verify the quality and ensure that materials have been suitably stored and insured, before making payment.

The US appellate court held that ‘A set-off (sometimes called contra charging) is a counter demand which a defendant holds against a plaintiff, arising out of a transaction extrinsic of the plaintiff’s cause of action.’4 There is often confusion between abatement and set-off. Abatement is used as a means to reduce a contract price in circumstances where full payment may not necessarily be justified. For instance, if a subcontractor failed to carry out works to an acceptable standard and the value of the works was diminished, the contractor would have grounds to reduce the amount owed on the basis of the difference in value.5 The measure of abatement is ‘how much less the subject-matter is worth’, so the measure of the abatement cannot exceed the total of the sum to which it is applied.6 Since an abatement applies only to matters that go to reduce the value of the work performed, it cannot apply to a counter-claim for a delay in the execution of the works, which would be a matter of set-off.7 It is also well established that abatement cannot apply to a claim for professional services.8

Set-off has a wider application than abatement given that it could be a remedy for breach of contract, for example, applying to a counter-claim for recovering costs in relation to the costs of the delay that were incurred or rectifying defective works.9 From a quantum perspective, while the measure of abatement cannot exceed the contract sums, set-off, as a form of counter-claim for damages, may exceed an agreed sum.

In the UK, the right of set-off exists under common law. In Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd,10 the House of Lords held: ‘It has been a well-sealed principle of law since the middle of the last [19th] century that when a claim is made for the price of goods sold and delivered or work and labour done, the defendant is entitled to set-off or set up against the amount claimed any damages which he has suffered as a result of the plaintiff’s breach of the contract under which the goods were sold and delivered or the work and labour were done.’ The House of Lords11 held that the contractor was entitled to set-off unless there were clear terms excluding it. The House of Lords refused the subcontractor’s argument that set-off cannot be exercised to prevent cashflow from being impeded, which causes significant impacts in the construction industry. Therefore, this judgment allowed contractors to refuse the full payment to subcontractors by insisting set-off, which caused cashflow constraints in the construction industry. Thereafter, the UK construction industry experienced a substantial amount of bankruptcies among subcontractors in the 1980s and 1990s. The unregulated set-off was criticised, among others, by the Latham Report,
Constructing the Team (1994), which triggered the legislation of the HGCRA 1996 regulating the right to set-off under sections 110 ‘Dates for payment’ and 111 ‘Requirement to pay notified sum’. Later sections included 110A ‘Payment notices: contractual requirements’ and 110B ‘Payment notices: payee’s notice in default of payer’s notice’ and were inserted by the LDEDCA 2009.

Right to back charge

What is a back charge?

Construction projects are rarely completed without a contractor facing some issues with a subcontractor or vendor, such as poor quality of work, late delivery and abandonment of the project. The contractor may have a contractual or legal mechanism to resolve such issues themselves instead of the subcontractor, who should have fixed the issues first-hand, and charged the subcontractor for any direct and unanticipated costs incurred. In the construction industry this process is often called ‘back charging’.

A back charge, in which there is a deduction from a subcontractor’s payment for a contractor’s unexpected costs in relation to the subcontractor’s works, can be claimed as a form of set-off or counter-claim. A back charge is basically the claim for unexpected costs: ‘it is billings for work performed or costs incurred by one party that, in accordance with the agreement, should have been performed or incurred by the party to whom billed’.12

Under the law of contract in the UK, contracts provide the opportunity to recover damages when one party fails to perform. The starting point for the damages is: "[T]he rule of the common law is that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."13 This principle also applies to back charges.

Back charges can arise due to a variety of reasons, including:

- defective works or materials;
- delay to the works – a contractor might set-off the appropriate amount of liquidated damages in accordance with the contract;
- damage to a jobsite and cost of repair; and
- clean-up costs incurred to maintain worker safety or compliance with the regulations surrounding health, safety and the environment.

From the authors’ review, it appears that the most frequent reason for a back charge arises from defective works. Hudson defined that ‘defective work is work which fails to comply with the requirements of the contract and so is a breach of contract. For large construction or engineering contracts, this will mean work which does not conform to express descriptions or requirements, including any drawings or specifications, together with any implied terms as to its quality, workmanship, performance or design.’14 Many standard forms of contract do not provide the definition of defects (ie, FIDIC),15 so this will mean that whether or not work is defective can be influenced by local law and practice and will therefore vary in different jurisdictions.16

A back charge, in which there is a deduction from a subcontractor’s payment for a contractor’s unexpected costs in relation to the subcontractor’s works, can be claimed as a form of set-off or counter-claim.

Under UK law, there are quite significant legal issues relating to the contractor’s obligations as to the quality of materials, workmanship and design (generally fit for purpose obligations) and the construction professional’s liability (generally reasonable skill and care obligations). Further discussion is outside the scope of this article.

A back charge, in the context of this article, is money withheld by a contractor which relates to the payment to a subcontractor to cover services claimed to have been performed, or costs incurred by the contractor relating to the subcontractor’s work.

From the perspective of the contractor, it is necessary to recover the unexpected costs incurred due to the subcontractor’s defective and/or delayed works. From the perspective of the subcontractor, they may state that the back charges are unfair when there is no:

- prior notice of defective work;
- time to investigate whether the work is defective;
- time allowed to fix the work;
- documentation that the cost of the back charge is appropriate and due to the defective work; and/or
- payment of other money until back charges are accepted.
The Canadian judgment, *Impact Painting Ltd v Man-Shield (Alta) Construction Inc*, 2017 ABQB 743 (CanLII), provides substantial considerations for resolving differences and disputes between contractors and subcontractors related to the above issues.

*Impact Painting Ltd v Man-Shield (Alta) Construction Inc*

In the recent decision of the Court of Queen’s Bench of Alberta in Canada, *Impact Painting Ltd v Man-Shield (Alta) Construction Inc*, the Court dealt with disputes arising from back charges, and provided guidance in relation to them.

Man-Shield was the contractor on a retirement community construction project in Edmonton. Impact Painting was Man-Shield’s subcontractor for the painting and wallpaper installation.

Impact issued a number of invoices to Man-Shield for ‘extra works’, for which no written variation orders had been issued. Man-Shield rejected the majority of those invoices. Consequently, Impact commenced an action against Man-Shield to seek payment for the extra work and other unpaid amounts.

Man-Shield made a counter-claim against Impact in the sum of approximately CAD 209,000 for 12 heads of back charges for the expenses incurred which they had issued to Impact during the currency of the contract.

The Court held that a party claiming to be entitled to a back charge must meet a ‘four-stage test’:

1. The back charge is for an expense actually, necessarily and reasonably incurred by the party claiming the back charge.
2. By the terms of the subcontract, or by some other agreement between the parties, the charge is one, or is in relation to some task, for which the subcontractor undertook responsibility.
3. The general contractor incurred the expense because the subcontractor defaulted on the responsibility to which the charge relates.
4. Prior to incurring the charge, the general contractor gave notice to the subcontractor of its default and a reasonable opportunity to cure it.” (emphasis added)

It is submitted that the four-stage test appears to be very onerous, with hurdles to overcome in order for a contractor to exercise a back charge, details of which are set out below.

**Stage 1: “The back charge is for an expense actually, necessarily and reasonably incurred by the party claiming the back charge.”**

In the US, when the subcontractor performs defective work, the contractor is generally entitled to recover, as the principle of damages, the amount of money that will reasonably compensate the contractor for the harm resulting from the defective works.

Although loss and expense are deemed to be equivalent to damages for breach of contract, Stage 1 in the *Impact* case only “referred to expenses ‘which are actually, necessarily and reasonably incurred’. It is not clear why the judge referred only to an expense for the scope of back charges but it is submitted, given the facts of the case, that only expenses can be claimed by the defendant; the judge in the case does not need to refer to loss.

For the claiming party to seek to recover consequential damages in terms of loss, such as lost profits, lost use or lost rent, and in the US, in order to recover funds for these alleged, the employer must prove the following:

- it was foreseeable to the parties when they entered into the contract that these damages would probably result if the contract was breached;
- these damages were in fact caused by the contractor’s defective/incomplete construction; and
- the amount of damages.

The first two elements are related to stages 2 and 3, so will be discussed later. In relation to the amount of damages, the measure of damages will be either the cost of cure, or diminution in value as well as the availability of consequential damages for defective constructions.

**Cost of cure**

The general measure of damages for breach of contract when a contractor has provided less than full performance, or has provided defective work, is the cost of curing the defective condition.

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to the results to be obtained or would involve unreasonable economic waste, in which case the diminution in value rule applies.\textsuperscript{25}

**Diminution in value**

US law recognises that even though work can deviate from contract requirements, it would require great waste to remove and replace the work that has been performed.\textsuperscript{26} In such cases, ‘diminution in value’ is the appropriate measure of damages to compensate the client. A ‘diminution in value’ measure of damages is appropriate when the following occurs:\textsuperscript{27}

- the contractor failed to perform its works in strict compliance with the contract;
- the work performed by the contractor resulted in an unusable project; and
- the cost to remove and replace the work to the form required by the contract would result in unnecessary waste or very high cost.

The quantum calculation is the contract price minus the value of the work actually performed,\textsuperscript{28} which is a form of abatement.

In the UK, *Ruxley Electronics and Construction Ltd v Forsyth*\textsuperscript{29} was concerned with the choice between an award of damages being either the ‘cost of cure’ or ‘loss of amenity’.

Ruxley agreed to build a swimming pool in Forsyth’s garden. The contract specified that the pool would have a diving area of seven-foot six-inches deep. When constructed, the diving area was only six-feet deep, which was still a safe depth for diving. However, Forsyth brought an action for a breach of contract claiming the cost of having the pool demolished and rebuilt, being the ‘cost of cure’, at a sum of £21,540.

At first instance the judge rejected the claim for ‘cost of cure’ damages on the grounds that it was an unreasonable claim in the circumstances and awarded Forsyth ‘loss of amenity’ of £2,500. This award was reversed by the Court of Appeal, which held that damages should be awarded at the amount required to place Forsyth in the same position as he would have been had the contract been performed, which in the circumstances was the cost of demolition and rebuilding the pool as specified.

Ruxley appealed and the House of Lords allowed the appeal, upholding the judge’s award of £2,500 for ‘loss of amenity’. Lord Lloyd said:

‘Does Mr Forsyth’s undertaking to spend any damages which he may receive on rebuilding the pool make any difference? Clearly not. He cannot be allowed to create a loss which does not exist in order to punish the defendants for their breach of contract. The basic rule of damages, to which exemplary damages are the only exception, is that they are compensatory not punitive.’\textsuperscript{30}

Lord Mustill held that compensation should be reasonable, saying:

‘[t]he test of reasonableness plays a central part in determining the basis of recovery and will indeed be decisive in a case such as the present when the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered by the employer.’\textsuperscript{31}

The FIDIC Yellow Book 1999 edition clause 11.4 provides both remedies as employer’s options, as follows:

‘If the Contractor fails to remedy the defect or damage by this notified date and this remedial work was to be executed at the cost of the Contractor under Sub-Clause 11.2 [Cost of Remediating Defects], the Employer may (at his option):

(a) carry out the work himself or by others, in a reasonable manner and at the Contractor’s cost, but the Contractor shall have no responsibility for this work; and the Contractor shall subject to Sub-Clause 2.5 [Employer’s Claims] pay to the Employer the costs reasonably incurred by the Employer in remediating the defect or damage,

(b) require the Engineer to agree or determine a reasonable reduction in the Contract Price in accordance with Sub-Clause 3.5 [Determinations].’

( emphasis added)

**Stages 2 and 3**

In relation to Stage 2, the charge is one, or is in relation to some task, for which the subcontractor undertook responsibility. Stage 3 is where the general contractor incurred the expense because the subcontractor defaulted on the responsibility to which the charge relates.

In *Impact Painting Ltd v Man-Shield (Alta) Construction Inc*,\textsuperscript{32} stages 2 and 3 are related to the issues of causation.
As regards causation, under the principles in relation to causation in the UK, a claimant can recover damages only if a breach of contract has caused damages. It is not enough to argue that there is a breach of contract and the existence of damages: the damages must be a ‘consequence’ of the breach. In other words, in a civil case, the claimant must establish or prove them on the principle of the ‘balance of probabilities’, meaning there is a linkage between cause (breach) and effect (damages), which is referred to as ‘proof of causation’. Causation can be divided into two categories: ‘causation in fact’ and ‘causation in law’ (or remoteness).

Causation in fact
Under the law of contract in the UK, a ‘but for test’ normally has to be implemented to prove causation in fact. The question is ‘if there is no defendant fault, will the claimant still suffer the loss?’ When the answer is ‘no’, then the defendant will be liable.

However, a ‘but for test’ has its limits. In the UK, if a claimant and defendant are responsible for the competing causes (concurrent causes), the ‘but for’ test will not apply, and the ‘dominant cause test’ is not deemed to be applicable in this case.

Causation in law: remoteness
Under the rules of remoteness of damage in contract law, set out in Hadley v Baxendale, a claimant may only recover losses that may be reasonably considered as arising naturally from the breach (the first limb/leg). The first limb is sometimes referred to as an objective test, or those that may reasonably be in the contemplation of the parties when entering into a contract (the second limb/leg), which depends on additional special knowledge by the defendant; the second limb is sometimes referred to as a subjective test.

In the subsequent case of Victoria Laundry (Windsor) Ltd v Newman Industries Ltd, a normally expected loss of profit was deemed recoverable. However, exceptionally lucrative loss of profit recovery was not allowed since it was not in the reasonable contemplation of the parties.

If the type of loss caused by the breach of contract is within the reasonable contemplation of the parties, the magnitude/extent of the loss does not matter subject to a duty to mitigate. Hudson stated: ‘foreseeability is generally considered to be concerned with the type of loss, not its amount.’

Degree of certainty
It is a general principle that the claimant should prove the claim with sufficient certainty. In Lisbon v US, the US Federal Court of Claims stated the principle: ‘[C] bears the burden of proving the fact of loss with certainty, as well as the burden of proving the amount of loss with sufficient certainty so that the determination of the amount of damages will be more than speculation.’

In both the US and the UK, the courts have recognised the dangers of encouraging too detailed proof of causation with absolute certainty. On the other hand, the courts have also been careful to adopt a deliberately pragmatic and common-sense approach. The claimant must prove the extent of losses with reasonable certainty using civil law standards, examining a ‘preponderance of the evidence’ in the US and a ‘balance of probabilities’ in the UK, respectively. Whether or not the evidence advanced by the claimant meets the reasonable certainty rule is a matter of fact.

Bailey commented on the uncertainty issue, analysing a series of English and Australian case law stating that:

‘[i]t is difficult to calculate with any precision the extent of the innocent party’s loss or damage, the court will do its best to arrive at an appropriate award of damages, even if this involves elements of speculation or guesswork.’

By applying the general principles of UK law in conjunction with the stage 2 and 3 tests of the Impact case, it is submitted that it is crucial to prove with sufficient evidence that remedial works by the contractor were caused by the subcontractor in question, and back charge amounts were incurred directly by that specific subcontractor. The type of back charge should be foreseeable, and the claimant must prove the extent of back charge with reasonable certainty.

In the US case of Great Western v Role Construction, the Court ruled that it was the contractor’s responsibility to establish the fact that the subcontractor’s defective work was indeed tied to the back charge.

Meticulous documentation appears to be essential for both contractors and subcontractors. Keeping detailed records will help to support or contend any back charges.
Meticulous documentation appears to be essential for both contractors and subcontractors. Keeping detailed records will help to support or contend any back charges. For the contractor, it will be imperative to include as much detail as possible when sending a notice of defective work, such as a Non-Conformation Report, an Inspection Report, quality test results and the like. If the subcontractor decides to take remedial action, it will be important to take progress photos for the records. If the subcontractor does not cure the defects, it’s essential to keep the invoices and timesheets regarding the back charges separately to provide to the subcontractor/vendor on completion. It is also good practice to make a separate defect-related account for booking the costs incurred in the cost ledger. From the perspective of a subcontractor, the subcontractor should also document all phases of the work performed by themselves.

In the absence of evidence, the contractor may argue that it is impossible or impractical to trace back which subcontractor made a fault when many subcontractors are involved, which is highly likely in the construction industry. The contractor may attempt to allocate the overall incurred costs pro rata to each subcontractor. In the US case of Great Western Drywalls v Roel Construction, when the clean-up costs were the issue, the Court upheld the contractor’s right to assess clean-up costs against a particular subcontractor. However, the Court ruled the costs could not be calculated pro-rata back to each subcontractor but had to be specific to each contractor’s responsibility for clean-up costs.

Stage 4: Prior to incurring the charge, the general contractor gave notice to the subcontractor of its default and a reasonable opportunity to cure it

Stage 4 appears to be principally concerned with notice requirements to implement a right to back charge.

In relation to notice requirements between the employer and the contractor, the FIDIC Yellow Book 1999, clause 11.4 states:

‘If the Contractor fails to remedy any defect or damage within a reasonable time, a date may be fixed by (or on behalf of) the Employer, on or by which the defect or damage is to be remedied. The Contractor shall be given reasonable notice of this date.’

From the subcontractor’s perspective, like the FIDIC conditions, the subcontract shall provide reasonable notice provisions, meaning if and when the contractor finds the defective works, the subcontractor shall be notified and provided with a reasonable amount of time to correct, repair or clean up any issues caused by the subcontractor’s work. The reasonable amount of time will be a matter of fact. A best-recommended practice is to have any back charge-related notice requirements explicitly stated in the subcontract.

This research has found that in the US, an approach/guidance/standard subcontract form to construction back charges is provided by the Associated Schools of Construction, the Associated General Contractors, and the American Subcontractors Association (ASA).

The standard forms generally state that a contractor must first provide notice before any back charges are incurred. Secondly the subcontract requires another written notice to be sent seven days after the services or materials were provided. Finally, the contractor must provide a written compilation of the charges by the 15th day of the following calendar month.

The ASA recommendations are the most favourable to subcontractors:

‘No back charge or claim of customer for services shall be valid except by an agreement in writing by subcontractor before the work is executed, except in the case of subcontractor’s failure to meet any requirement of the subcontract. In such event, customer shall notify subcontractor of such default, in writing, and allow subcontractor reasonable time to correct any deficiency before incurring any costs chargeable to subcontractor. No back charge shall be valid unless billing is rendered no later than the 15th day of the month following the charge being incurred. Furthermore, any payments withheld under a claim of subcontractor default shall be reasonably calculated to recover the anticipated liability and all remaining payment amounts not in dispute shall be promptly paid.’

The effect of failure or noncompliance of the notice and providing the opportunity to cure is not clear in the judgment of Impact Painting Ltd v Man-Shield (Alta) Construction Inc. The effect can be either to disregard the whole entitlement of the back charge or deduct the quantum of back charges.

In the US, the Tennessee Court of Appeals has held that
'the common-law is that one should give notice designed to allow the defaulting party to repair the defective work, to reduce the damages, to avoid additional defective performance and to promote settlements of disputes.'

The Court of Appeals held that the defendant’s counter-claim was properly dismissed where a defendant ‘failed to give Plaintiff notice and an opportunity to cure the alleged construction defects pursuant to the common-law’. Many states in the US have enacted ‘right to cure’ statutes that require notice and an opportunity to cure prior to commencing litigation.31

Conclusion

In the construction industry, contractors may have a right for interim payments, which is against the common law principle in the UK prohibiting interim or partial payments.

Under the common law, employers have a right to set-off or withhold sums due in the contractor’s claim for interim payments or final payment in the UK. However, the HGCRA has regulated the employer’s action for set-off or withholding payments to secure cashflow in the industry.

Contractors may claim back charges to cover services performed by themselves or costs incurred in relation to the subcontractor’s work in the form of set-off or counter-claim against the subcontractor’s claim for interim payments or final payment.

The Canadian Court provides some considerations and guidance for back charges. A notice may be the first step and crucial requirement for a back charge; this is to ensure the subcontractor’s right to cure the defect. When the subcontractor resists the contractor’s request to cure the defect, then the contractor may cure the defect by themselves at the expense of the subcontractor. The remedy is generally based on ‘cost of cure’. The courts, however, may test the reasonableness of the cost and then apply ‘diminution in value’ principle. The contractor should prove that the type of back charge is tied to the subcontractor’s works and is foreseeable. The contractor should prove the causation with reasonable certainty.

Notes
1 As Denning LJ noted in Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd (1973) 71 LGR 162.
2 See Cutter v Powell (1795) 101 ER 573.
5 ‘Set off & Abatement – which is which?’ (Blake Newport, 22 June 2012), see https://blakenewport.wordpress.com/2012/06/22/set-off-abatement-which-is-which-2 accessed 27 January 2021.
6 S Furst, V Ramsey, and D Keating, Keating on construction contracts (10th edn, Sweet & Maxwell 2017) paras 19-111.
7 Ibid.
8 Ibid. paras 19–112.
9 Ibid. paras 19–113; see Set off & Abatement, n5, above.
10 Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd (1976) 1 BLR 73.
11 Ibid.
13 Robinson v Harman (1848) 1 Ex Rep 850 at 855; Ruxley Electronics and Construction Ltd v Forsyth [1995] UKHL 8; n 6 above paras 19–003.
15 In accordance with NEC 3rd edn Contract, a ‘defect’ is part of the works which is not in accordance with the Works Information or a part of the works designed by the Contractor which is not in accordance with the applicable law or the Contractor’s design which the project Manager has accepted.
16 See n 14 above, para 4–072.
18 Impact Painting Ltd v Man-Shield (Alta) Construction Inc 2017 ABQB 743 (CanLII).
19 Ibid, para 28.
20 See M Beutler, E Gentilcore, Model Jury Instructions: Construction Litigation, (2nd edn, ABA 2015) s 10.03.
21 Wraight Ltd v PH&G (Holdings) Ltd (1968) 13 BLR 29.
22 See n 20 above 10.06.
23 See n 20 above 10.03.
24 See n 20 above 10.04.
25 See n 20 above 10.05-10.05.
26 See n 20 above 10.05.
27 Ibid.
28 Ibid.
30 Ibid.
31 Ibid.
32 See n 18 above.
33 The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not, which is often said to be more than 50 per cent.
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36 Hadley v Baxendale (1854) 9 Ex Ch 341.
37 Victoria Laundry (Windsor) Ltd v Newman Industries Ltd [1949] 2 KB 528.
39 See n 14 above, para 7–003.
41 See n 14 above, para 7–002.
42 Ibid.
44 Walter Lilly v Mackay [2012] EWHC 1773 (TCC) at 486.
45 See Bailey, n 43 above, para 13.100.
46 Great Western Drywalls v Roel Construction 166 Cal App 4th 761 (2008).
47 Ibid.
48 FIDIC Yellow Book (1999 edition), clause 11.4 states: ‘If the Contractor fails to remedy any defect or damage within a reasonable time, a date may be fixed by (or on behalf of) the Employer, or on which the defect or damage is to be remedied. The Contractor shall be given reasonable notice of this date.’
49 See n 18 above.
51 See n 20 above, 10.02.

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Enforceability of the AIA C195 indemnity provision under US law

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The American Institute of Architects introduced document C195 as an integrated project delivery contract form in 2008. The document encompasses a broad indemnity provision which operates to indemnify a party in respect of the negligence of its members. US anti-indemnity statutes ban indemnification for an indemnitee’s own negligence. Nevertheless, the application of statutes is not absolute and the courts are permitted to interpret them by the US Constitution. Accordingly, US courts have developed three main statutory schools of interpretation by reference to the text, the intent of the statute and the purpose of the statute. Therefore, enforceability of the C195 indemnity provision for an indemnitee’s own negligence depends on a court’s approach to statutory interpretation. Courts applying a textualist interpretation would reject the enforceability of the indemnity provision to negligence of an indemnitee as there would be no justifiable grounds for deviation from the plain language of the statutes. On the other hand, consideration of the intention of the legislature and purpose of the anti-indemnity statutes with regard to the nature of the C195 indemnity provision would allow application of the provision to the negligence of an indemnitee, as indemnification of the company members for their own negligence by the company would not contradict the intention of the legislature and the purpose of the anti-indemnity statutes.

Introduction

The American Institute of Architects (AIA) introduced document C195 in 2008 as an internationally integrated project delivery contract form, which requires its members to create a limited liability company the sole purpose of which is to plan, design and construct the project. Sub-clause 12.3.1 of the document provides a broad indemnification obligation on the company which requires the company to indemnify its members for any loss and/or damage under
certain conditions. The plain language of the provision covers negligence of an indemnitee. The indemnification contradicts the anti-indemnity statutes operating in the majority of US states. This article investigates the enforceability of the C195 indemnity provision to negligence of an indemnitee by reference to US anti-indemnity statutes.

Contractual indemnification provisions

Indemnity clauses require that one party (the indemnitor) indemnify the other party (the indemnitee) against any losses the indemnitee may suffer. The main purpose of an indemnity clause is to shift the burden of liability onto the party whose ultimate malfeasance results in damages to the other party. For example, a contractor promises to indemnify the owner against claims brought by third parties for damages caused by its own deficient construction as the ultimate responsibility also rests on the contractor. The principle underpinning indemnity clauses is that the risk should be shifted to the party that is in the best position to deal with it and has the most control over it. For this reason indemnification clauses are also commonly used in commercial contracts as a risk allocation method. However, improper use of the clauses can result in unwanted situations and leave the party to which the risk is shifted liable for the risk in circumstances outside its control. Indemnification for an indemnitee’s own negligence is one of these.

The AIA C195 indemnity provision is drafted in broad language. Sub-clause 12.3.1 of the document imposes a broad indemnity obligation on the company in the following terms:

‘[...] the Company shall indemnify a Covered Person, to the fullest extent permitted by applicable law, for any loss, damage or claim the Covered Person incurs by reason of any act or omission performed or omitted by the Covered Person in good faith on behalf of the Company and in a manner reasonably believed to be within the scope of authority conferred on the Covered Person by this Agreement. However, no Covered Person shall be entitled to be indemnified for any loss, damage or claim the Covered Person incurs by reason of its willful misconduct with respect to the acts or omissions.’

As the provision requires the company to indemnify ‘any loss, damage or claim’, it can be considered to impose an obligation on the company to indemnify the covered person for negligent acts or omission of its members. Such an indemnification for an indemnitee’s own negligence, in general, is not accepted by US courts and legislature. The reason that there is a general tendency against enforceability of such indemnifications is that they are unlikely to be accepted by indemnifiers because agreement to such clauses would make them liable for risks outside of their control. Therefore, the majority of US states have enacted anti-indemnity statutes on the basis of public policy.

The principle underpinning indemnity clauses is that the risk should be shifted to the party who is in the best position to deal with it and has the most control over it.

Anti-indemnity statutes

The unfair use of indemnification clauses, most commonly in the construction industry between subcontractors and main contractors or main contractors and owners, has led most US states to legislate anti-indemnity statutes. The bans imposed by the statutes on the clauses vary by states; however, in general, they can be divided into three main categories. These are discussed below.

Statutes barring indemnification for indemnitee’s sole negligence

The first and most common type of anti-indemnity statute ban indemnification for the indemnitee’s own negligence. Alaska’s anti-indemnity statute, for example, is of this type. AK ST Code section 45.45.900 (1986) provides that:

‘A provision, clause, covenant, or agreement contained in, collateral to, or affecting a construction contract that purports to indemnify the promisee against liability for damages for […] other loss, damage or expense arising […] from the sole negligence or willful misconduct of the promisee […] is against public policy and is void and unenforceable’.

Statutes barring indemnification for indemnitee’s negligence

The second type of statute imposes more limitations on indemnification clauses by
banning the indemnitee to be indemnified for losses if the indemnitee partly or wholly contributes to the loss. In this regard, the anti-indemnity statute of New Mexico NM ST Code section 56-7-1 (1978) provides that: ‘A provision in a construction contract that requires one party to the contract to indemnify, […] the other party to the contract […] against liability, claims, damages, losses or expenses, including attorney fees, arising out of bodily injury to persons or damage to property caused by or resulting from, in whole or in part, the negligence, act or omission of the indemnitee […] is void, unenforceable and against the public policy of the state.’

Statutes barring indemnification of design professionals

The third type of statute targets the design professionals and bans them from indemnification for their negligence in providing their services. For instance, the Texas anti-indemnity statute, CIV PRAC & REM Code section 130.002 (2001), provides that: ‘(a) A […] promise in connection with, or collateral to a construction contract is void and unenforceable if the […] promise provides for a contractor who is to perform the work […] to indemnify or hold harmless a registered architect, licensed engineer […] from liability for damage that: (1) is caused by or results from: (A) defects in plans, designs, or specifications prepared, approved, or used by the architect or engineer; or (B) negligence of the architect or engineer in the rendition or conduct of professional duties called for or arising out of the construction contract and the plans, designs, or specifications that are a part of the construction contract.’

The prohibitions are generally justified on two grounds. Firstly, allowing a professional to be free of liability for its own negligence eliminates its incentive to operate or supervise a worksite properly, which results in a dangerous environment for the workers and the general public as a whole. The second justification is that the bans prevent inequity in the construction industry from an inequality of bargaining power and contributes to fair risk allocations among participants, particularly for those with less negotiating power such as small subcontractors and suppliers.

Enforceability of AIA C195 indemnity provision for indemnitee’s own negligence

The AIA C195 indemnity provision falls under each of the three main categories of US anti-indemnity statutes as the broad language of the provision can cover negligent acts or omission of an indemnitee. Since architects are parties to such agreements, the statutes which ban indemnification for a professionals’ negligence would also apply to the agreement.

However, it does not mean the C195 indemnification provision is entirely void. In fact, the provision in section 12.3.1 includes the saving clause, which qualifies the enforceability of the indemnification obligation of the company ‘to the fullest extent permitted by applicable law’. The effect of this qualification is to prevent the courts from holding the entire provision void. In other words, depending on the applicable law, each statute might ban the enforcement of the provision to the extent that it would be void under the relevant statute.

However, the application of the statutes is not absolute and, in some cases, they are subject to interpretation by the courts. The following section elaborates the application of the anti-indemnity statutes to the C195 indemnity provision with regard to the statutory interpretations.

Statutory interpretation

The judicial power to interpret statutes comes from the Constitution. The Constitution, however, does not contain guidance on how it is to be interpreted – that is the task of the judiciary. Jurisprudence has developed
by reference to three schools of statutory interpretation: textualism, intentionalism and purposivism.\(^\text{17}\)

**Textualism**

The textualists apply the most restrictive interpretation and contend that the meaning of a statute is only derived from its text and courts should not give effect to extrinsic evidence in order to find a meaning other than what the text itself implies. In fact, textualists consider that when the courts interpret the text of statutes, they have to achieve the objective meaning rather than the subjective intention of the legislature.\(^\text{18}\)

However, courts have shown flexibility in exceptional situations and allow evidence beyond the text if a result of a statute is absurd.\(^\text{19}\) In this regard, I refer to the statement of the US Supreme Court in *Caminetti v United States*,\(^\text{20}\) in which although the Court emphasised the importance of the words of statutes in interpretation, it conditioned the interpretation so as not to lead to absurd or impractical consequences. ‘When words are free from doubt they must be taken as the final expression of the legislative intent, and are not to be added to or subtracted from by considerations drawn from titles or designating names or reports accompanying their introduction, or from any extraneous source. In other words, the language being plain, and not leading to absurd or wholly impractical consequences, it is the sole evidence of the ultimate legislative intent.’

I refer to two further cases, *Greene’s Pressure Testing & Rentals Inc v Flournoy Drilling Company*,\(^\text{21}\) and *Weber Energy Corporation v Grey Wolf Drilling Company*,\(^\text{22}\) as examples of a textualist interpretation of the Texas anti-indemnity statute.\(^\text{23}\) The statute operates to void indemnification for an indemnitee’s sole or concurrent negligence in the oil and gas field. However, code section 127.005(b) allows unlimited mutual indemnification on the condition that the parties are required by their contract to provide an equal amount of insurance. Furthermore, the statute operates to void indemnification if there is unilateral indemnification up to $0.5m except in circumstances where there is a condition that the indemnitor provides insurance for that amount.\(^\text{24}\)

In the *Greene’s Pressure* case, the contract contained a mutual indemnification provision which required the subcontractor (Greene) to provide insurance cover of $0.5m. However, the contractor (Flournoy) as an indemnitor in the case had provided more insurance cover but voluntarily. The Fifth Circuit Court of Appeals held that the indemnity provision was void because the contract did not require an equal amount of insurance from both sides.\(^\text{25}\)

**Jurisprudence has developed by reference to three schools of statutory interpretation: textualism, intentionalism and purposivism.**

In a similar case, *Weber Energy*, although the contract involved a mutual indemnity provision, it required only Grey Wolf to purchase insurance. Weber Energy voluntarily provided the same amount of insurance. The Court of Appeals, following the reasoning of the court in *Greene’s Pressure*, held the indemnity agreement void under the Texas anti-indemnity statute.\(^\text{26}\)

Justice Murray Cohen, in pointing out the irrational results of both courts’ decisions, said that their decisions were contrary to the legislative intent. He continued that the statute was enacted to protect contractors from strong oil and gas operators taking advantage of their leverage by imposing oppressive indemnity obligations. In both cases, the operators provided equal and even higher amounts of insurance voluntarily to protect the contractors. By such insurances the purpose of the statute was met.\(^\text{27}\)

**Intentionalism**

Intentionalists believe that the intent of the legislature is paramount. In this regard, they refer to any evidence of intent such as legislative history to achieve the legislative intent. They also argue that the judiciary is the faithful fiduciary of the legislature and it is their duty to apply the legislature’s intent by determining the meaning of the legislation. In this way, judges have to look at each case from the legislature’s standpoint with regard to the words of the statute and interpret it as the legislature intended by reference to the relevant factual matrix.\(^\text{28}\)

Looking at the historical background of the US anti-indemnity statutes, it is said that the statutes are enacted ‘after pressure from the construction industry, who felt such
provisions were the result of inequality in bargaining power between subcontractors/general contractors or general contractors/owners. For example, although, in general, indemnification for an indemnitee’s own negligence is enforceable under Louisiana contract law, the legislature enacted Louisiana’s Oilfield Anti-Indemnity Act (LOIA) to ‘protect oilfield contractors and their employees from the large oil companies who used their leverage to force contractors to enter into MSAs requiring the latter to provide defense and indemnification, even for the oil companies’ own negligence’. In this regard, the view of the US courts regarding the legislature’s intention at the time of legislating anti-indemnity statutes is that ‘such an indemnity is, on principle alone, unfair, and is only agreed to at the insistence of the party with the “whip hand” in the negotiation’.

Applicability of the anti-indemnity statutes to the AIA C195 indemnity provision

The language of anti-indemnity statutes operates to make the indemnification provision of the C195 clearly void to the extent relevant to each statute. Although the language of the statutes prohibits the enforceability of the C195 indemnity provision, strict application of the statutes will create a result that might not be intended by the legislature or do not fit the purpose of the statutes. Therefore, the application of the statutes to the C195 indemnity provision is subject to interpretation. However, depending on each courts’ attitude towards interpretation, they may arrive at different conclusions.

With regard to the textualists, deviation from their strict approach requires proving that nullifying the indemnity provision is irrational and leads to a completely unreasonable or impractical result. As noted above, risk-sharing is an outstanding feature of IPD (Integrated Project Delivery) and the IPD contracts employ mutual exculpation provisions to achieve such a value. The indemnification provisions of the IPDs are also aimed at creating a further risk-sharing culture. A negligent C195 participant, seeing itself being indemnified by the company, is likely to be more open to sharing the relevant information, which is important for the overall project performance. Even in circumstances where the participant discloses its own negligence, with no fear of bearing the whole loss or damage individually, there are likely to be benefits to the overall project performance. However, the existence of other features of the C195 contract, such as its mutual exculpation provision and compensation scheme, will keep an indemnitee motivated to contribute to the sharing culture of the IPD even if it is held liable for its own negligence. Therefore, having regard to the anti-indemnity statutes which void the enforcement of the indemnification provision to the indemnitee’s own negligence, it is not likely to lead to an absurd result or make the contract impractical. Accordingly, it is likely that courts taking the textualism approach will not enforce the C195 indemnity provision.

Intentionalists and purposivists take a more flexible approach, as they consider evidence other than the words of the statutes in order to achieve the intention or purpose of the statutes. In this regard, it is believed that the general purpose of all the anti-indemnity

The application of the statutes to the C195 indemnity provision is subject to interpretation. However, depending on each courts’ attitude towards interpretation, they may arrive at different conclusions.

Purposivism

The proponents of the purposive approach are of the view that the purpose of a statute overrides its plain meaning. They believe that courts should first consider the stated purpose of legislation in order to solve uncertainty in the application of statutes in specific cases. They also consider that the courts in interpreting statutes should be guided by the best policy consequences under the circumstances and arrive at an appropriate meaning for each case in light of the practical effect on the case at issue. It is said that the society changes and the legislature does not have in mind new circumstances at the time the legislation is drafted, and therefore statutes have to be interpreted as though they had been enacted yesterday.
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statistics is twofold. Firstly, they aim to maintain an indemnitee’s incentive to operate or supervise the worksite with due care, which is crucial to the safety of the workers and the public as a whole. Secondly, the statutes are designed to protect small contractors and suppliers which have less bargaining power from unfair and burdensome indemnity obligations. Consideration of the background to the relevant anti-indemnity statute is also relevant for ascertaining the purpose and intent of the legislature at the time the legislation was drafted.

For example, the Arizona Supreme Court made the following comments with respect to the interpretation of the legislative intent of the anti-indemnity statutes:

‘Anti-indemnification statutes are primarily intended to prevent parties from eliminating their incentive to exercise due care. Because an indemnity provision eliminates all liability for damages, it also eliminates much of the incentive to exercise due care.’

However, regarding the formation of the company under C195, since an indemnitee itself has interest in the company (s 4.1.1), indemnification by the company would affect its own benefit. Therefore, the indemnitee’s incentive to perform with due care would not necessarily be eliminated entirely by the indemnity provision, even though it covers the indemnitee’s own negligence. Furthermore, provisions regarding Target Cost and Actual Cost (s 5), Mutual Management of the Company (s 8) and Incentive Compensation (s 10.1) still operate to keep an indemnitee motivated to perform with due care and skill, as any defect or problem in the construction would finally affect its own interest.

Moreover, although a small contractor or supplier with less bargaining power may enter into the IPD contract, it is not the indemnitor but the indemnitee whom the indemnification provision is designed. This is in order to protect and reduce their sole liability for their own negligence by sharing it among all the participants by way of creation of the single purpose entity.

In addition, joint control over the project (s 8) by the members reduces the unfairness of the indemnification for an indemnitee’s own negligence which originated from the understanding that ‘the indemnitor is usually in no position to prevent the risk by controlling the conduct of the indemnitee.’ In fact, the indemnification provision of the C195 can be an effective way of avoiding costly and time-consuming litigations as the projects subject to the C195 are normally high-risk and complicated, in which a large number of entities are involved and work side by side. In these circumstances, the agreement is based on efficiency and courts should give effect to the bargain of the commercial parties as a matter of commerce.

In this regard, I refer to the following statement of the Nevada Supreme Court in a case that involved an indemnity obligation which arose in an insurance context, despite the indemnity agreement being against the anti-indemnity statute:

‘As a matter of public policy, we conclude the indemnity contracts in these cases should be enforced because they allocate risk.’

Finally, the anti-indemnity statutes operate to make certain indemnity agreements void on the grounds of public policy. The New Mexico Court of Appeals in Holguin v FULCO OIL SERVS, in clarifying the public policy behind the statute, said:

‘The public policy embodied in both the oilfield and construction anti-indemnity statutes is to promote safety in uniquely hazardous work place environments.’

A public policy justification for the anti-indemnity statutes is endorsed by several other courts. Based on this argument, what clearly mattered for the legislature was the safety of the workers and the intention was to limit the parties’ contractual freedom right to protect the workers. Recently the US District Court, in United Rentals Northwest, Inc v Yearout Mechanical, Inc, stressed:

‘The purpose of the anti-indemnity statute is to protect construction workers and future occupants of a building by ensuring that all those involved in its construction know that they will be held financially responsible for their negligence.’

However, for the reasons mentioned previously, clauses 4.1.1, 5, 8 and 10.1 of the C195 operate to incentivise the project participants to take due care in performing the project. These clauses also provide a control mechanism for the contract involving all the participants in managing the matters related to the project which enable them to supervise the project as a whole. After all, the indemnity provision limits the indemnification to the company’s assets, which is ultimately the property of its members. Consequently, all the participants would be jointly liable for the safety of the project workers, and the quality of the project.
is a matter affecting the benefit of all the participants. Therefore, it is submitted that the indemnity provision of the C195 does not function against the public policy reasons underpinning the anti-indemnity statutes.

**Conclusion**

The US anti-indemnity statutes are the main barriers to enforceability of the C195 indemnity provision for an indemnitee’s own negligence either in the context of sole, concurrent or professionals’ negligence. However, statutory interpretations can lead to a flexible application of the statutes favourable to the C195 indemnity provision. Nevertheless, it depends on the courts’ approach to interpretation. The strict textualist interpretation of the statutes is likely to result in invalidation of an indemnification for negligence of any company member.

The case law considered shows that some courts, particularly the trial courts, are less willing to interpret the plain language of the anti-indemnity statutes. However, other courts, such as appellate and supreme courts, are more likely to interpret the statutes by reference to the intention of the legislature as a basis to protect the indemnifiers. Appellate and supreme courts are also more likely to interpret the statutes by reference to the purpose of the statutes as being mainly to protect the public. As discussed in this article, it is submitted that the C195 indemnity provision does not contradict the intention or purpose of the statutes.

Since the C195 indemnity provision is designed to share the final loss or damage among its participants, the legislature’s protective intent towards the weaker parties in construction contracts has no effect against the C195 indemnity provision as the entire risk does not rest on one party. The public protection purpose of the statutes is also achieved by the operation of the other provisions of the contract (s 4.1.1, s 5, s 8 and s 10.1) as they keep an indemnitee incentivised to perform with due care and skill, and also to provide a safe working environment for the good of the project as a whole, which is directly connected to its individual interest.

**Notes**

2. William Russell Allensworth and others (ABA, 2009), p 1361.
5. Ibid.
10. Ibid.
11. Ibid, at 27.
13. Podolak, see n 8 above, at 36.
17. See Healy, see n 14 above, at 234-35.
18. Cross, see n 15 above, at 134.
19. *Public Citizen v US DoJ*, 491 US 440, 470 (1989) (Kennedy J), concurring in the judgment, recognising that when clear language of a statute leads to an absurd result, the Court may look beyond the statutory text for meaning; *Green v Bock Laundry Machine Co*, 490 US 504, 527 (1989) (Scalia, J, concurring in the judgment, stating that the Court may ‘consult all public materials, including [...] legislative history’ when the plain meaning of a statutory text is absurd in order to ascertain whether Congress actually intended that meaning); Healy, see n 14 above.
20. 242 US 470, 490 (1917); Healy, see n 14, above, at 254.
21. 113 F 3d 47 (5th Cir, 1997).
27. Ibid, at 8.
28. Cross, see n 15, above, at 10.
29. L D Simmons, ‘Indemnities and Endorsements: Protecting the Owner and Developer’, Conference – Update on Indemnification, Anti-Indemnity Statutes and Additional Insured Endorsements, CoreNet Global Network, Charlotte, North Carolina, McGuire Woods LLP, 17 October 2015. Of the 44 US states that have anti-indemnity statutes, only six states permit a contractor to indemnify the owner where the owner is solely responsible for the loss; Wallace, see n 7, above.
30 Master Service Agreements.
32 R W Stone and J A Stone (2005) 54(125) ‘Indemnity in Iowa Construction Law’, Drake L Rev, at 32 (‘many states have recognized that contractors and subcontractors cannot effectively bargain over indemnity provisions and that they accept more risk than is economically prudent’); Wallace, see n 7, above.
34 Gross, see n 15 above, at 2–4.
36 Martin Fischer and others (John Wiley & Sons 2017) Integrating project delivery, p 47.
38 Stein, see n 12 above, at 1.
43 149 N M 98 (N M Ct App 2010).
45 Civ No 08-00050 RLP/CD (D N M 9 Sept 2008), at 4.

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Direct claim one link up in contracting chain: lawmakers know best, right?

National laws in effect in many countries grant an entitlement for subcontractors that allow direct claims against employers in exceptional cases (normally applicable to any level of the supply chain). However the language of these laws is drawn up, usually unequivocal and decisive, their application in reality seems larger-than-life, if not idealistic. This article illustrates and considers a typical case, followed by a discussion of the rules and practices of the Middle East and South Korea, as well as briefly considering some other jurisdictions. The article aims to answer the following question: are these laws emblematic of lawmakers’ intervention gone wrong?
Illustration

The following illustration is the bare bones of a real case. Communications are quoted *sic erat scriptum* to the extent possible, mainly to recreate the subtle nuances, while emphasis is added for the purposes of discussion with the use of italics.

A main contractor (‘M’) entered into a subcontract with a subcontractor (‘S’) for a specified scope of work, which in turn was partially carried out by a sub-subcontractor (‘S2’).

During the course of execution of the works, M and S agreed to an early termination of the subcontract and the final balance was calculated as $1m. At this juncture, the amount in arrears owed by S to S2 was in excess of $1m.

On 1 May 2020, S sent a letter to M instructing, ‘We request you to release our payment of $1m to S2, as we need to pay our S2 for design and materials. We are expecting your kind consideration in this regard and cooperation.’

On 1 June 2020, M replied to S2, ‘As we are aware, remaining payment to S from M is not covering the amount which S2 should receive from S. In case you confirm that S and S2 agreed payment for balance, we will release accordingly.’ The same day S2 answered M, ‘Regarding the remaining amount, we have not yet settled an agreement with S. We are in regular discussions with them. Could you please confirm we can submit our invoice for $1m to your department?’

On 2 June 2020, M responded, ‘Please note that “regular” discussion is not enough. We can release when you and S finally confirm payment of the remaining amount. This is in order to avoid any dispute between three parties. To avoid any confusion, M can pay $1m to S2 after receiving a letter saying that S2 shall settle the remaining with S, and S2 shall not request any further payment to M.’ S2 immediately sent a ‘discharge letter’ to M stating that ‘S2 is solely responsible for recovering the remaining amount in excess of $1m.’

On 10 June 2020, M responded ‘You will be paid the certified amount $1m.

From 10 June 2020 onward, actual payment was withheld because M and S2 conducted an inventory check of the items that were required to be handed over from S2 to a newly engaged supplier. But on numerous occasions M reaffirmed its intent to pay S2 the amount of $1m as soon as the outstanding issues were cleared.

On 1 October 2020, S notified M, ‘We hereby cancel our previous letter dated 1 May 2020. S and S2 have decided to settle our disputes in court. Sorry for the inconvenience caused.’

From 1 May 2020 to 1 October 2020, S was unreachable for reasons unknown to M. Subsequently, both S and S2 are demanding that the payment be made to them. Now, must M pay S2 at its peril?

Common features

Skirmishes on subcontracts are pushed back by triage. It is nonetheless important that subcontract disputes are considered. Disputes of this kind more often than not end in proverbial ‘global settlements’ after trench warfare, which, contrary to urban myth, usually extracts a heavier toll on M, who in turn pads his losses onto the employer.

There are several ways to frame how an obligation vis-à-vis another contracting party is somehow transferred, or duplicated to a non-contracting party.

The biggest problem is that these never slot themselves neatly into a single legal concept. S2s rarely invoke their statutory entitlements right out of the gate. Initial conversations are riddled with self-conflicting revocations and counter-offers, and even when there is an identifiable offer and acceptance, they are peppered with provisos, conditions and caveats. There are several ways to frame how an obligation vis-à-vis another contracting party is somehow transferred or duplicated to a non-contracting party. Is S’s benefit assigned to S2? Is M merely committing to perform vicariously? Is a tripartite settlement established? The discussions among the three parties will have ventured inadvertently in and around these legal concepts before they derail, although not in precise terms of art.

Lastly, my scope of interest, unlike most literature on this topic, leans more towards preserving M’s options than safeguarding cash flow for S2. Not one of the cases that sparked my enthusiasm to pen this article involved an insolvent or *mala fide* main contractor, but rather a confused one.

Qatar

The Qatari S2s that I have come across all invoked Article 702 of Law No 22/2004.
(the Civil Code), the relevant part of which translates as follows:

'The subcontractor and the workers working for the original contractor for carrying out the work shall have the right to claim directly from the employer the payment of not more than the amount for which he is indebted to the original contractor from the time of initiating the action.'

Understandably, M is considered an 'employer' within the meaning of Article 702, in relation to S and S2. Having said that, a few points stood out from the local counsel’s opinion.

Firstly, the timing when M’s direct liability is established. M’s outside counsel suggested that the date a lawsuit is filed is when M’s obligation to S2 is made due and payable. In effect, upon the complaint being filed M’s position would closely resemble that of an insurer or an issuer of an on-demand guarantee.

Secondly, there were no additional requirements for this liability. No pre-conditions, time-bars, thresholds or other eligibility standards existed.

However, these are not the crux of this article nor do I wish to delve into the academic limbo of searching for legal basis of these laws. I am willing to concede that this direct liability scheme is not supposed to be reconciled with the principles of contract law as we know it (brace yourself for the South Korean law below). The real question Article 702 leaves unanswered is, 'So, what happens next?'

The Qatari law firm with whom I consulted examined that M should ‘cease’ or ‘refrain from’ making payments to S, but only out of precaution, not by the operation of law. It mentioned that the court may order M to deposit the ‘ceased money’ into the court’s escrow account until judgment is made on the merits, as a way for S2 to enforce money judgment under Article 445 of Law No 13/1990 (Civil and Commercial Procedures). In a vacuum of clear authority, the law firm’s suggestion was to hold off any payment to either S or S2. Alternatively, it proposed that M pay S against an independent on-demand guarantee stating M as the beneficiary to cover any loss resulting from potential double payment. The primary approach of ‘wait-and-see’ did not seem to serve Article 702’s intended purpose, while seeking to obtain a new bond or extending an existing one seemed out of touch with the reality.

As of September 2015, I was told that there were no cases decided by the Qatari Court of Cassation, to be referred to on this matter, nor at Egyptian Court of cassation.

**Kuwait**

Under similar facts, a Kuwaiti S2 invoked paragraph 1 of Article 682 of Law No 67/1980 (Kuwaiti Civil Code), the unofficial English version of which reads:

‘The subcontractor and workmen working for the principal contractor in the execution of a contract have a direct right of action against the master, but only to an extent of such sums in portion to the amount of sums due by the master to the principal contractor on the date of filing such action.’

Another unofficial translation reads:

‘The subcontractor and labourers working for the original contractor in the execution of work, may directly request their dues vis-à-vis the original contractor from the employer within the amount due to the original contractor from the employer at the time of bringing the action.’

The Kuwaiti law firm’s interpretation as to when the direct liability becomes due and payable under Article 682 was in contrast to that of its Qatari counterpart. The entitlement under Article 682 is a right to initiate legal action, not a money debt per se. It opined that M would not be obliged to pay S2 unless and until an action is filed by them relying on Article 682 and a final/enforceable judgment is issued directing M to pay S2.

Both Qatari and Kuwaiti law firms were on the same wavelength, stating that M should ‘refrain from’ or ‘cease’ paying S, or ‘retain the amount demanded by S2 pending resolution of the matter irrespective of whether the [S2]'s claim is substantiated – even before a legal action has yet been filed and only a notice of intent has been communicated. Let me rephrase this proposition: ‘Stop performing your contractual obligation, when a non-contracting third party demands otherwise.’ In fact our Kuwaiti lawyers were fully aware that Article 682 was a gateway to nowhere. They suspected that multiple S2s would launch lawsuits against M like sharks in the water, which turned out to be only half-true. Things compound exponentially at level two. M did not have just ‘multiple’ S2s, it had spreadsheets of second tier specialists subbed out by that particular S. They also rightfully examined that M will
have difficulty substantiating any defence that was contractually available to S, obviously because M does not have specific details at its disposal. They drove a nail in the coffin by prognosticating an average of two to four years of proceeding at first instances.

None of the law firms framed these statutory regimes as effecting an assignment that transfers benefits from S to S2 by operation of law. Interestingly enough, one lawyer did mention that Article 682 of the Kuwaiti Civil Code ‘does not create any personal liability’. This description sounded very similar to ‘vicarious performance’, but whether or not such language was used as a term of art remains unclear.

A brief interlude, going back to the original question before hopping a continent. Should M pay S2? In both of these countries, supposedly the answer is ‘No. Wait until the lawsuits are over.’ By this point I was baffled, because in South Korea the position is comparatively clear.

**South Korea**

The 1999 amendment to the *Fair Transaction in Subcontracting Act* also resolved to pump cash directly to the subcontractors under duress. The provisions currently in effect reads at Article 14:

1. Where a ground falling under any of the following subparagraphs occurs, the person placing an order ['employer' or 'owner'] shall pay the subcontract consideration corresponding to the completed portion of manufacturing, repair, construction, or service performance **directly to the subcontractor**:
   1. When the subcontractor has **requested direct payment […] because the prime contractor’s payment has been suspended, the prime contractor is bankrupt, or other similar reasons exist**;
   2. When agreement has been made among the person placing an order, prime contractor, and subcontractor that the person placing an order shall pay the subcontract consideration **directly to the subcontractor**;
   3. When the subcontractor has **requested direct payment […] where the prime contractor has failed to pay […] two or more instalments […]**;

(2) Where a ground prescribed in paragraph (1) occurs, the obligation of the person placing an order to pay consideration to the prime contractor and the obligation of the prime contractor to pay the subcontract consideration to the subcontract shall be deemed to have extinguished within such limit.3

Here, a readily noticeable distinction is sub-article (2). Whether the lawmakers’ intention was to streamline the interlocked rights and obligations, or to throw a nugatory remedy out the window is unclear (the parliamentary minutes and records are silent on this issue), the courts have been consistent over the years: the existing chain of liabilities are discharged and substituted by a new one when any one of the listed events occur. The law was not designed to grant cumulative remedies for S2s. In effect, S2 is compelled to weigh the risks and elect quickly.

Another recognisable difference is that under South Korean law this protection is a self-help remedy. A simple notice of intent suffices as opposed to bringing actions in a court of law.

Does the South Korean regime provide a more expedient and accessible remedy for the subcontractors? Conversely, it would be surprising to see any level-headed M make payment to S2 even when Article 14 is clearly applicable. I certainly would advise against it, except for exceptionally *prima facie* cases. Let’s step one layer down to reality.

As a matter of practicality, for the purpose of this discussion Article 14 of the *Fair Transaction in Subcontracting Act* has to be read in conjunction with Article 487 of the *Civil Act*. Article 487 reads:

> ‘If the obligee refuses to accept performance or is unable to accept it, the person effecting performance may relieve himself of his obligation by depositing the subject matter of performance for the obligee. The same shall apply where the obligee cannot be ascertained without any negligence on the part of the person effecting performance.’

Under South Korean law, the debtor can easily be discharged of his obligation by
depositing in court the money or goods due. To some degree rooted in the Roman law concept of *mora creditoris*, and transposed also to Article 7:111 of the Principles of European Contract Law, this allows a debtor to deposit money as a general substitute of the original performance.

Having regard to the above, why would M say that the payee ‘cannot be ascertained’ when a mandatory provision in unequivocal terms has designated S2 as the lawful payee? There are two main reasons.

Firstly, the notion of channelling payments is rarely that easy. One distinguished commentator opined that the interests of M and S2 ‘in the making and receiving of direct payment most often coincide’, but with all due respect this statement is more complicated. In essence, there can never be an exact flow-down of monetary payments within a supply chain, even if the scopes of work are a gradual subset of one another. When toying with this idea, we are inclined to visualise this contractual structure as pneumatic cash tubes linked to one another.

It seems straightforward and sensible to simplify the payment process and deduct the same amount accordingly from a corresponding account. But it is not long before contract managers realise that this involves more than dollar-to-dollar comparisons. The amounts due to S from M may arise out of a single progress payment, while those due to S2 from S may be composed of differing causes: a progress payment that overlaps with the same activity, a progress payment that does not overlap but is long overdue, an uncontroverted indemnity claim for a different cause, an inflated overhead expense earmarked for a specific period of time, and so on.

To which of these sub-components is the direct payment appropriated to? Even if the basis of the claims are completely identical, the terms and conditions relating to those payments differ with each contract and those debts are thereby attached with different defences. S2 may have failed to maintain an agreed number of certified welders on site, a term not specified in a contract between M and S. A joint walk around the site may reveal a considerable discrepancy between the actual progress and the previous invoices. What if S2 is not releasing the goods at its prefabrication shop? Is any party willing to forego its defences? Was this interlocking ‘settlement and release’ ever communicated in any way? Soon enough companies realise that they are dealing with fluctuating numbers and incompatible sets of rights and obligations, but by then, in all likelihood, someone is bound to have made a legally binding promise that does not synchronise with Article 14. Therefore, on paper and in principle their interests should coincide – and if the stars align they would – but if there is one industry where we can ‘wish upon the stars’, it is not construction.

Secondly, as previously mentioned, these parties are not alone in a petri dish. By this time, a deluge of injunctions or preliminary injunctions may have been issued restraining S from liquidating, assigning or otherwise disposing of its assets, inter alia, the receivables against M (although the particular illustration above did not involve S’s insolvency). The same receivable that Article 14 ever so ambitiously threw out the window. The movants may include other second-tier subcontractors, lenders, or governments and local authorities enjoying priority over secured creditors.

Therefore what happens in reality is that M faces catch 22 where it either becomes reluctant to pay or cannot pay S2 directly, even in the face of the unambiguous language of Article 14. This is even so although Article 25.3 of the Act fines up to double the amount directly claimed if M breaches Article 14.

In South Korea, eventually M usually ends up depositing what is owed to S in court, designating the beneficiary as ‘S2 or others’. I prefaced this section partly in jest by saying that this matter is an open-and-shut case in South Korea. This was because depositing may not necessarily be the correct answer, but in most situations it is the least worst option. S2 will eventually have to go through a series of actions and motions, hampered by rounds of injunctive reliefs, around and over attempts lodged from a long queue of creditors piggybacking on proceedings.

In essence, there can never be an exact flow-down of monetary payments within a supply chain, even if the scopes of work are a gradual subset of one another.
commenced by S2 to set aside or vary distribution orders, before it can actually collect money from the fund deposited.

Remember how the Qatari and Kuwaiti lawyers advised me just to withhold payment until the dust settles in the courts? Same mess in the end, albeit different twist and turns in the middle.

Other countries

As for payer-oriented mechanisms, the rule of depositing money as a mode of discharging obligations never fused into the common law. Nonetheless, the need for a payer to have a proactive measure to avoid project disruptions is not unusual, as most recently discussed by the Commercial Court in England.6 Direct payment provisions in standard forms that allow employers to pay nominated subcontractors directly under certain circumstances7 are sometimes described as a protection for the subcontractors. But in reality this offers more protection for the employers than subcontractors, because by relying on these provisions the employers can keep the project afloat when the subcontractors threaten to suspend the works and withdraw from the site.

Lawyers from Maryland, New Jersey and the District of Columbia all suggested the creation of an escrow, without detailing how the fund could effectively be ring-fenced in relation to the rules against preference under insolvency laws.

As for payee-friendly mechanisms, France’s prototypical Law on Subcontracting, which embodies both ‘direct payment’ for public contracts and ‘direct action’ for private contracts, and is widely considered the benchmark.8 Payment guarantee is another way of securing cash flow for subcontractors and suppliers, and is compulsory in some sectors.9 In the UK, where the rule of privity stands firm, project bank accounts (PBAs) have been introduced and a Construction Supply Chain Payment Charter is being promoted as a commercial alternative. Builder’s lien or mechanic’s lien in the US or Canada appear to be more effective than the South Korean law analogues. Queensland has also recently enacted sweeping legislation that captures both PBAs and subcontractors’ charges, aka direct claims.10 Looking back at the Middle East, it is dangerous to lump Gulf countries altogether. It is reported that Bahrain, Kuwait and Qatar share a similar position, while UAE and Oman do not.11

Comparative analysis of these major regimes invoke intellectual fascination, but I will ultimately have to defer to other practitioners in these jurisdictions for in-depth observations on their actual applications.

Key takeaways

Countries are struggling to find a not-so-delicate balance between ‘robbing Peter to pay Paul’ on one hand, and ‘Mexican standoffs’ on the other. If a narrow interpretation of the national laws is maintained as a hyper-aggressive version of ‘pay now, argue later’, the payer will ultimately have to recover the overpaid amount from the payee or someone else.12 If not, these laws are limp solutions at best. At any rate, most of these systems are shoehorned somewhat awkwardly between the existing areas of substantive and procedural laws – contract laws, insolvency laws and freezing injunctions.

To revisit the illustration above, what is a practical guideline for contract managers in M’s situation?

Firstly, be careful not to make any commitment. Note how many times in the illustration above M inadvertently made misleading signals throughout the course of correspondence (vice versa, indeed). Paying directly seems innocuous because channelling monies makes commercial sense, but resist the natural impulse and your force of habit to cooperate with other parties. Remember that any request or attempt to change the identity of the payee is in principle a variation, and unless the contract specifically confers a party with a unilateral power of variation, you are not obliged to follow it. Barry J was brutally forthright in commenting:

’[t]he debtor is not bound to accept the transferor’s instructions, nor is he bound to make any promise of payment to the transferee. If he does promise, he has only himself to blame […] if he misapprehend his legal position, I am afraid he has again only himself to blame.’13

Secondly, do not engage in a tripartite discussion unless you are confident you have a firm grasp of the whole picture. This may be arguable and also counter-intuitive in a sense that we love to carbon copy any party remotely involved in the dispute, especially when the mood is amicable. However, you have more chance of interpreting your
way out of making binding commitments if conversations are sliced and diced. Plaster the usual tricks in the bag until the very end: ‘subject to formal contract’, ‘conditional upon’, ‘if and only if’, etc.

While one cannot override the mandatory provisions of governing laws, complying with these simple pointers will save you from another layer of complication being mapped onto already confusing national frameworks.

Notes
1 The law firms referenced are internationally recognised at least in the business circles active in the Middle East and North Africa, and their legal opinions were professionally drawn up under proper engagements.
7 Clause 35.13.5 of JCT Standard Form of Building Contract (1998 Edition); Subclause 4.5.3 of FIDIC Conditions of Contracts for EPC/Turnkey Projects (Silver) 2017.
8 Law No 75-1334, 31 December 1975 (Code du Travail).
9 For example, 40 U S C subsections 5131–4 (the ‘Miller Act’).
12 As observed in Nobiskrug GmbH v Valla Yachts Ltd.
13 Shamia v Joory [1958] 1 All ER 111, 115.

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Introduction

The Civil Code of the People’s Republic of China came into force at the start of 2021. This is a milestone for the development of the legal system in China. The Civil Code has been praised for its scientism and systematism in terms of legislative techniques and is expected to decrease disagreements among separate laws, regulations and judicial interpretations in the civil field and aims to meet the demands of a continually evolving society and economy.

When the Civil Code came into effect, it replaced nine previous separate laws. These included: the Marriage Law, the Succession Law, the General Principle of the Civil Law, the Adoption Law, the Guarantee Law, the Contract Law, the Real Right Law, the Tort Law and the General Provisions of the Civil Law.

This article introduces the major changes in the Civil Code compared with previous laws and analyses its effects on the construction industry.

Rules applied to the construction industry

Rule classifications

There are two types of rules that govern the construction industry: civil rules and administrative rules.
Civil rules

Parties involved in construction activities are the employer and the contractor together with the designer and the engineer. As parallel parities, their rights and obligations are regulated by civil laws such as the Contract Law and the Tort Law.

Consequently, the newly adopted Civil Code makes some changes to the construction industry.

Administrative rules

Due to the widely public consequences of construction activities, there are administrative rules governing entities in the construction industry and rules to prevent loss and damages arising from construction industry activities.

The Civil Code has replaced the Contract Law and Tort Law. The respective judicial interpretations of these former laws have consequently lost power. However, the administrative law that regulates the construction industry, appropriately the Construction Law, remains in effect.

Aspects of civil rules changed by the Civil Code

In the construction industry, prior to the introduction of the Civil Code, the relevant laws were: the Tort Law, General Provisions of Contract Law, the Particular Provisions for Construction Contracts of Contract Law, and two Interpretations of the Supreme People’s Court on Issues concerning the Application of Law in the Trial of Cases Regarding Disputes over Contracts of Construction Projects (‘Judicial Interpretation’).

Changes made to the general provisions of contract law

Two changes were introduced to the rules in the General Provisions of the previous Contract Law which will have an impact on the construction industry: the provisions about quality standards and the application of the principle known as ‘Change of Circumstance’. These are discussed below.

Quality requirement

Sub-clause 2 of Article 62 of the Contract Law stipulates that ‘when the contractual provisions about quality requirement are not clear, and the parties did not make any supplements to the agreement and the quality requirement cannot be determined according to the contractual provisions or trading customs, then the national standard or industry standard shall apply, and if there is no such national standard or industrial standard, then the normal standard or the specific standard consistent with the purpose of the contract shall apply.’ (emphasis added)

Although the above article provides some guidance when there is no clear standard in the contract for quality requirement, the standard reference is vague as it only gives the parties further options to choose from without providing a preferred approach. Disputes may arise when the parties are unable to agree on which standard to select.

In the newly adopted Civil Code

Article 511 of the Civil Code specifies the sequence of the application to different standards: first is the mandatory national standard, followed by the recommended national standards, then the industrial standards, while the normal standard and the standard consistent with the purpose of contract is last.

The new Civil Code narrows down the options to one and reduces the difficulties to the parties and judges in finding and applying the appropriate applicable standard.

The principle: Change of Circumstance

The Civil Code applies the Change of Circumstance principle (‘Qing Shi Bian Geng’). This principle is sourced from the case law Krell v Henry, and sets out the doctrine of frustration of purpose in contract law.

In the former rules

The Change of Circumstance principle was put into the draft version of the Contract Law in 1999 but removed from the final version due to concerns raised over the abuse of the principle by the breaching party.

Without this principle, the affected party may only resort to force majeure events to terminate or amend the contract to avoid unfair consequences. By comparison to the Change of Circumstance principle, force majeure has a clearly narrower scope and therefore cannot provide enough relief to the affected party in an adverse situation.
After having accumulated enough experience and having seen the insufficiency of reliance on force majeure to provide relief, the Supreme People’s Court adopted this principle in the form of judicial interpretation to the Contract Law in 2009 as follows:

‘Article 26. Where any major change which is unforeseeable, is not a commercial risk and is not caused by a force majeure event after the establishment of a contract, if the performance continues it is obviously unfair to the other party or cannot realize the purposes of the contract and the party files a request for the modification or rescission of the contract with the People’s Court, the People’s Court shall decide whether to modify or rescind the contract under the principle of fairness and in light of the actual causes of the case.’

In the newly adopted Civil Code
In the Civil Code, it is written as:

‘Article 533. Where the basic conditions of a contract undergo a material change unforeseeable by the parties at the time of contracting which is not a commercial risk after the formation of the contract, rendering the continuation of the performance of the contract unconscionable for either party, the adversely affected party may renegotiate with the other party; and if the renegotiation fails within a reasonable time limit, the party may request the People’s Court or an arbitration institution to modify or rescind the contract.’

Firstly, in the previous rules, the Change of Circumstance principle can be applied only when it cannot fall within a force majeure. But in the newly adopted Civil Code, the precondition ‘not caused by a force majeure’ is removed.

The removal of the ‘force majeure versus change of circumstance’ dichotomy gives the affected party one more option to remedy itself in circumstances where it is difficult to prove the material change as a force majeure.

Secondly, a mandatory pre-suit discussion or renegotiation process is added in the Change of Circumstance principle.

The renegotiation requirement echoes the most fundamental principle of contract law – the principle of freedom of contract – as it creates an opportunity for the parties to negotiate and amend the contract so that the contract can continue to be duly performed rather than terminated.

Therefore, there is one more option beyond force majeure which is of great importance to both the employers and contractors. Together with the mandatory pre-renegotiation process, the newly adopted Civil Code responds to the call for a flexible and clear definition for the Change of Circumstance principle.

Changes made to the particular provisions of contract law

Settlement rule when construction contract is invalid

Contracts may be invalid by reason of violating compulsory provisions of laws or administrative regulations.

In the construction industry, subcontracting the entire contract or affiliation (‘Guo Kao’ means an entity without the qualifications performing the contract under the name of another entity with the qualifications), which would significantly affect the quality of works, often renders the construction contracts invalid.

In the former rules
The previous Contract Law did not contemplate this problem and therefore provided no answer. To settle disputes of this nature, the Supreme People’s Court provided guidance in the Judicial Interpretation:

‘Article 2. Where a construction contract is invalid, but the construction project passes the inspection upon completion, the contractor’s request for payment of the construction cost by considering the contact for reference shall be sustained.

‘Article 3. Where a construction contract is invalid, and the construction project does not pass the inspection upon completion, the matter shall be handled separately according to the following circumstances:

• If the restored construction project passes the inspection upon completion, and the employer requests the contractor to bear the restoration expense, such request shall be sustained;

• If the restored construction project does not pass the inspection upon completion, and the contractor requests payment of construction costs, such request shall not be sustained.

‘With respect to the losses arising from the fact that the construction project does not pass the inspection upon completion, the
employer shall, if it has any fault, also bear its civil liabilities, accordingly.’

**IN THE NEWLY ADOPTED CIVIL CODE**

The Civil Code pulled this rule from the Judicial Interpretation into ‘law’, and refined it as follows:

‘Article 793. Where a contract for construction project is void, and the construction project passes the acceptance inspection, the contractor may be compensated by liquidation with reference to the stipulation about the project price in the contract.

‘If a contract for construction project is void, and the construction project fails the acceptance inspection, action shall be taken according to the following circumstances:

(1) If the construction project as repaired passes the acceptance inspection, the employer may request the contractor to bear the repair costs.

(2) If the construction project as repaired fails the acceptance inspection, the contractor has no right to request equivalent-value compensation with reference to the stipulation about the project price in the contract.

‘If the employer is at fault for the loss caused by the nonconformity of the construction project, the employer shall be correspondingly liable.’

Firstly, the modification from ‘inspected at the time of completion to be qualified’ to ‘passes the acceptance inspection’ removed the requirement of ‘completion’, allowing progressed works, works completed in stages and uncompleted works to be compensated as well as completed works. The contractors would no longer need to continue incurring costs and providing labour to complete the non-existing contract in order to be compensated.

Secondly, the inclusion of the words ‘compensated/compensation’ instead of ‘payment of construction cost’ is consistent with the logic that payment of the contract price only happens under a valid contract.

Thirdly, the modification from ‘shall’ to ‘may’ also grants the judge discretion holistically to decide whether or not to support the claim for compensation. This contrasts with the previous position which rigidly asked judges to support the contractors’ request unconditionally, which to a certain extent encourages the acts banned by law and is not conducive to cultivating positive competition within the construction industry.

**Right to terminate a construction contract**

Another rule that was promoted from the Judicial Interpretation to a provision in the Civil Code is the right to terminate a construction contract.

**IN THE FORMER RULES**

Previously, other than the provisions about rights to terminate a contract in the General Provisions of Contract Law, the parties to a construction contract might invoke the clauses in Judicial Interpretation to terminate the contract.

For example, Article 9 of Judicial Interpretation provides that:

‘Where an employer is under any of the following circumstances, thus causing the contractor to be unable to carry out the construction work, and the employer still does not perform its obligations within a reasonable period after being notified, the contractor’s request for rescinding the contract on construction project shall be sustained: [...] (3) It does not perform the assistance obligations as stipulated in the contract.’

**IN THE NEWLY ADOPTED CIVIL CODE**

The above rule is retained in Article 806 of Civil Code, amended by deleting the words ‘as stipulated in the contract’. This amendment enlarges the scope of ‘assistance obligations’ beyond contractual stipulation when the contractor finds it impossible or unreasonably difficult to continue the contract without assistance from the employer. The effect of this is to close the door on employers and force contractors to devote unreasonable efforts that may result in an unfair contract.

From the perspective of fairness, a businessperson should not be forced to win a contract while suffering loss. The removal of the words ‘as stipulated in the contract’ fills the gap between the Judicial Interpretation and principles of fairness.

**Results when the employer refuses to pay properly**

**IN THE FORMER RULES**

Article 264 of the replaced Contract Law provides as follows:

‘Where the ordering party fails to pay the remuneration or cost for the materials, etc to the contractor, the contractor is entitled
to lien upon the work results, except as otherwise agreed upon by the parties.’

Under contracts of works (’cheng lan’) and provisions for contracts of works, this may apply to construction contracts when there is no relevant or applicable rule in the construction contract.

However, there was only a right to a ‘lien’ on the work, which may not apply to construction contracts as construction works are not movable properties and cannot be subject to a lien. Therefore, contractors cannot invoke the ‘right to lien’ to hold the construction works as leverage to negotiate with the employer for full and timely payment.

In the newly adopted Civil Code

Article 783 of the contracts for works in the Civil Code provides that:

‘Where the ordering party fails to pay the remuneration or cost for the materials, etc. to the contractor, the contractor is entitled to lien upon the work results or refuse to make delivery, except as otherwise agreed upon by the parties.’ (emphasis added)

There are two different understandings in respect of the above clause:

1. The contractor may not be entitled to refuse delivery

Article 807 of the Civil Code provides that:

‘If the employer failed to pay the price in accordance with the contract, the contractor may demand payment from the employer within a reasonable period.

‘Where the employer fails to pay the price at the end of such period, the contractor may enter into an agreement with the employer to liquidate the project, and may also petition the People’s Court to auction the project in accordance with the law, unless such project is not fit for liquidation or auction in light of its nature. The construction project price shall be paid in priority out of proceeds from the liquidation or auction of the project.’

Based on above clause, when the employer fails to pay the contractor appropriately, this clause provides that the contractor has a right to be paid in priority out of proceeds from the liquidation or auction of the project. In such circumstances, Article 807 will prevail over Article 783 of the Civil Code.

2. The contractor may refuse to deliver

Provisions in the chapter of Contracts of Works may apply to construction contracts when there is no relevant applicable rule in the chapter of construction contracts.

As there is no specific stipulation for refusing to make delivery, when the employer fails to pay the remuneration or cost of the materials to the contractor, the contractor can refuse to deliver the project per Article 783 of Civil Code.

Article 785 (in the chapter of Contracts of Works) and Article 807 (in the chapter of Construction Contracts) shall be applied at different stages. The right to refuse to make delivery under Article 783 can be used in negotiation to improve the prospect of the contractor being compensated. Article 807 may only be used when there is an extreme settlement such as where liquidation or auction cannot be avoided.

Therefore, in this context, Articles 783 and 807 are complementary and both can be applied at different stages.

Changes made to the provisions on building liability of Tort Law

One key feature of construction contracts is that the works, though belonging to the employer after completion and handover, will to an extent be public, as the buildings and premises will be used by people. This may cause harm to third parties when quality issues occur.

The Civil Code made two major changes in this regard.

Tort liability for building collapse

In the former rules

To compel contractors to be responsible and improve the quality of construction, and to ensure the wronged parties obtain remedy rapidly, the Tort Law of China (2010) placed strict liability on the employer and contractor in respect of occasions where a building collapses and causes harm to third parties.

This strict liability is powerful as it – regardless of the actual situation or later evidence – directly identifies the employer and contractor as the tortfeasor who should pay damages to the infringed party.

However, construction has never been a simple process as various parties, designers, engineers, supervisors and suppliers of
equipment are all involved, of which any one could have caused the defect and should be responsible for the harm. Therefore, strict liability on the employer and contractor is too rigid to be fair.

**In the newly adopted Civil Code**

To relieve contractors of unreasonable responsibilities, the Civil Code resumes the fault presumption rule instituted by the previous General Principles of Civil Law (1987) through Article 1252:

‘Where any building, structure or facility collapses or subsides, causing any harm to another person, the construction employer and contractor shall be liable jointly and severally, unless the construction employer and contractor can prove the non-existence of quality defect. After making compensation, the construction employer or contractor shall be entitled to be reimbursed by other liable persons if any.’ (emphasis added)

With this ‘unless the construction employer and contractor can prove the non-existence of quality defect’, the employer and contractor have a chance to provide themselves a ‘safe harbour’. In order to benefit effectively from this ‘safe harbour’, contractors should be advised to collect and keep the documents produced in the process of construction, in case of presumed liability for building collapse.

**Tort liability for damages caused by ground/underground construction**

Another change is with respect to the words regarding tort liability for damages caused by ground or underground construction.

**In the former rules**

Article 91 of Tort Law is as follows:

‘Where anyone digs a pit, repairs or installs any underground facility, etc. at a public venue or on a public road but fails to set up any obvious warning sign or take any safety measure, and causes any harm to another person, the person shall assume the tort liability.’ (emphasis added)

**In the newly adopted Civil Code**

Article 1256 of Civil Code is as follows:

‘Where anyone digs, repairs or installs any underground facility, among others, at a public venue or on a public road and causes any harm to another person, if the person cannot prove that it has set up any obvious warning sign or taken any safety measure, the person shall assume the tort liability.’ (emphasis added)

The amendments from ‘fails to’ to ‘cannot prove that it has’ provides clarification that the liability is presumed and can be overturned by contrary evidence.

This change of wording reduces the previous ambiguity of law in confirming whether it is strict liability or presumed liability, and it reflects the legislators’ clear attitude towards placing the blame on the appropriate party.

As the liability can be overturned, contractors do not need to bear unreasonable liabilities that should be attributed to the real tortfeasor. Again, this reminds contractors to reasonably manage the construction activities and be aware of the importance of collecting evidence during construction.

**Conclusion**

The Civil Code is not an entirely new code, more a modification and perfection of existing rules. The rules of the Civil Code remain stable while there are some partial changes made to suit realities. This description is also true for the rules of construction contracts. Below is an overview of the key changes.

The Civil Code has determined the sequence of applying a quality standard when there is no clear contractual agreement about quality standards for works. A clear path to find the applicable quality standard will not only help the disputing parties to mitigate differences, but will also create new behaviour of consciously applying quality standards within the construction industry.

The adoption of the principle of Change of Circumstance provides the affected parties with the flexibility to amend or terminate contracts and highlights the importance of renegotiation before commencing an action.

The settlement rule for invalid construction contracts allows judges holistically to consider all factors when deciding fair compensation to parties. The enlarged scope of assistance obligations gives contractors more opportunities to defend themselves.

The arguable right to refuse delivery also provides more possibilities to protect contractors from delayed payment from the employer.
The restoration and clarification of the fault presumption principle in the Tort Law section also demonstrates the legislators’ determination to apply fair treatment in tort cases.

From the amendment to the wording of the Civil Code it can be seen that past experiences accumulated through litigation, research and discussions in the legal community of China have influenced the legislators into incorporating relevant developments to provide fairer market competition for all participants in the construction industry.

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Note
2 Translations in this article are unofficial translations provided by the authors.

The eyeWitness mobile app; seeking justice for the worst international crimes

eyeWitness to Atrocities begins with a simple vision: a world where the perpetrators of the worst international crimes are held accountable for their actions. As an initiative of the International Bar Association (IBA), with the support from LexisNexis Legal & Professional, the eyeWitness to Atrocities app provides a means of documenting human rights atrocities in a secure and verifiable way so that the material can be used as evidence in a court of law.

Every day, around the world, human rights defenders, investigators, journalists and ordinary citizens capture photos and video of atrocities committed by violent and oppressive states and groups. eyeWitness provides these individuals with a tool to increase the impact of the footage they collect by ensuring the images can be authenticated and, therefore, used in investigations or trials.

With the eyeWitness mobile app, users capture photos or videos with embedded metadata that shows where and when the image was taken and confirms that it has not been altered. The images and accompanying verification data are encrypted and stored in a secure gallery within the app. Users then submit this information directly to a storage database maintained by the eyeWitness organisation, creating a trusted chain of custody. Users retain the ability to share and upload copies of their now verifiable footage to social media or other outlets.

The eyeWitness to Atrocities app is available to download for free on Android smartphones. For more information, visit www.eyewitnessproject.org, follow @eyewitnessorg on Twitter or Facebook, or watch the eyeWitness YouTube channel.
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### EVENTS 2021

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