



Construction Law: Contracts & Dispute Management Successful contract drafting and management techniques

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1 Introduction

1.1 The purpose of this seminar is to cover:

- 1.1.1 Choice of law and forum;
- 1.1.2 Key practical differences between common and civil law;
- 1.1.3 Good Faith obligation in common and civil law;
- 1.1.4 Drafting tricky clauses: delay and extension of time, caps & limitation of liability, termination, liquidated damages;
- 1.1.5 Ensuring that dispute avoidance and resolution clauses are effective;
- 1.1.6 How to successfully draft contracts which represent good value for money;

2 Choice of law and forum

- 2.1 The interpretation and effect of contractual terms can vary significantly depending on the law that governs them. It is therefore important that the choice of which law should govern the contract is clearly stated.
- 2.2 Commercial relationships increasingly have an international flavour. Parties are often based in different countries or their activities take place abroad. Consequently, questions of jurisdiction and governing law have an increasing prominence during contractual negotiations and in subsequent disputes.
- 2.3 The Rome I Regulation, which came into force on 17 December 2009, applies to all contracts which were concluded on or after that date in all EU Member States, except Denmark¹. In particular, the Rome I Regulation provides that where there is an express agreement as to the choice of law, the courts of all EU states (except Denmark) will uphold and apply that choice.
- 2.4 Criteria for selecting the applicable law would be:
 - 2.4.1 With which law are the parties most familiar?
 - 2.4.2 Which law offers the parties the most certainty in relation to key aspects of the contract?
 - 2.4.3 Where will the contract be performed, if different from the location of the parties?
 - 2.4.4 Which law will give the most beneficial outcome? Obviously, this may be different for each of the parties.
 - 2.4.5 Which jurisdiction and dispute forum have the parties selected for dispute resolution?

1. Prior to the 17th December 2009, the Rome Convention applied and had broadly the same principles as the Rome I Regulation.

Governing Law

2.5 It is eminently sensible for parties to select the law which will apply to their contractual obligations. Otherwise, it will be difficult for them to determine what their rights and obligations are, both when drafting and complying with the contract. Those rights and obligations will depend on the governing law which, in the absence of an express choice, may not be clear.

2.6 It is rare for commercial parties not to agree a governing law clause. Where they omit to do so complex rules exist to determine what the governing law of the contract should be. Where parties are located, or obligations are to be performed, in different jurisdictions, determining the governing law of the contract may be difficult. This may lead not only to uncertainty but also to time and cost being spent arguing at the outset of any dispute over what law should be applied.

2.7 The problems which can arise in this regard are highlighted by the comments of Mr Justice Mann in the case of *Apple Corps Ltd v Apple Computer Inc*². In that case a dispute arose in relation to an agreement which did not contain either a governing law or jurisdiction clause. Mr Justice Mann noted that:

"The evidence before me showed that each of the parties was overtly adamant that it did not wish to accept the other's jurisdiction or governing law, and could reach no agreement on any other jurisdiction or governing law. As a result, [the relevant agreement] contains no governing law clause and no jurisdiction clause. In addition, neither party wanted to give the other an advantage in terms of where the agreement was finalised. If their intention in doing so was to create obscurity and difficulty for lawyers to debate in future years, they have succeeded handsomely."

2.8 A choice of law governing a contract must be made expressly or must be clearly demonstrated by the terms of the contract or the circumstances of the case.³

2.9 The parties can choose the law applicable to the whole or to part only of the contract. The parties are also free at any time to change their choice of law governing the contract. Any such change will not prejudice the formal validity of the contract or adversely affect the rights of third parties.⁴

2.10 The parties can choose the law of a particular country as the governing law of the contract even if all elements relevant to the situation at the time of choice are located in a different country. Nevertheless, there are certain limitations in such instances.

2.11 Firstly, the choice made by the parties will not exclude the application of provisions of the law of the relevant country which cannot be derogated from by agreement⁵ and, secondly, where the relevant country is a Member State of the European Union, the parties' choice of applicable law other than that of a Member State cannot prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement.⁶

2.12 In situations where the parties do not choose the law applicable to their contract, for whatever reason, the law which will apply will be determined in accordance with rules set out in Article 4 of the Rome I Regulation. The law governing the most common contracts will be determined as follows:

2. [2004] EWHC 768 (Ch).
 3. Article 3 (1) of the Rome I Regulation
 4. Article 3 (1) and 3 (2) of the Rome I Regulation
 5. Article 3 (3) of the Rome I Regulation
 6. Article 3 (4) of the Rome I Regulation

- 2.12.1 a contract for the sale of goods will be governed by the law of the country where the seller is habitually resident;
 - 2.12.2 a contract for the provision of services will be governed by the law of the country where the service provider is habitually resident;
 - 2.12.3 a contract relating to a right in rem in immovable property or to a tenancy of immovable property will be governed by the law of the country where the property is situated (with the exception of a tenancy concluded for temporary private use for a period of no more than six consecutive months which will be governed by the law of the country where the landlord is habitually resident, provided that the tenant is a natural person who is habitually resident in the same country);
 - 2.12.4 a franchise contract will be governed by the law of the country where the franchisee is habitually resident and, similarly, a distribution contract by the law of the country where the distributor is habitually resident;
 - 2.12.5 a contract for the sale of goods by auction will be governed by the law of the country where the auction takes place, if such a place can be determined; and
 - 2.12.6 a contract concluded within a multilateral system facilitating multiple third-party buying and selling interests in financial instruments in accordance with non-discretionary rules and governed by a single law will be governed by that law.
- 2.13 Contracts not falling into these categories and contracts which contain elements which would be covered by more than one category will be governed by the law of the country where the party required to effect the characteristic performance of the contract lives. However, there is an exception in Article 4(5) that states that the presumptions of Article 4(1)-(4):
- “shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country.”*
- 2.14 In the case of a contract consisting of a bundle of rights and obligations capable of being categorised as falling within more than one of these specified types of contracts, the characteristic performance of the contract should be determined having regard to its “centre of gravity”.⁷
- 2.15 It is important to note that there is an overriding principle of the closest connection. Pursuant to this principle, in situations where it is clear from all the circumstances of the case that the contract is manifestly most closely connected with a different country from that indicated by applying the rules set out above, then the law of that country will apply.⁸ Similarly, in all residual cases which do not fall within the ambit of the rules, the contract will be governed by the law of the country with which it is most closely connected.⁹
- 2.16 Rome II applies to situations involving a conflict of laws regarding civil and commercial matters. Special rules are laid down for non-contractual obligations in the event of damage caused by defective products, damage arising from an unfair commercial practice, violation of the environment and infringement of intellectual property rights.

7. Recital 19 of the Rome I Regulation

8. Article 4 (3) of the Rome I Regulation

9. Article 4 (4) of the Rome I Regulation

- 2.17 The Regulation does provide for some freedom of choice: the parties are free to choose the law applicable to a non-contractual obligation either by common agreement after the event giving rise to the damage or, between business people, by an agreement freely negotiated before the event giving rise to the damage. The choice must be explicit or evident from the circumstances, and must not prejudice the rights of any third party. This freedom of choice does not apply to infringements of intellectual property, and cannot be invoked when all the elements relevant to the situation relate to a country other than the one chosen. Similarly, Community law overrides the law of a non-EU country, chosen by the parties, when all the elements of the situation are located in one or more EU Member States.
- 2.18 Therefore, when drafting the governing law clause, thought should be given to whether to limit it to the agreement itself or to extend it so that any other non-contractual obligations related to the contract are also covered. There is currently no clear authority as to whether, under English law, such a clause would be effective to determine the law governing the parties' non-contractual obligations. In light of Rome II that position has now changed.
- 2.19 Rome II also applies to pre-emptive actions. These are defined in the regulation as:
- 2.19.1 non-contractual obligations that are likely to arise;
 - 2.19.2 events giving rise to damage that are likely to occur;
 - 2.19.3 damage that is likely to occur.
- 2.20 Certain matters are excluded, including:
- 2.20.1 revenue, customs and administrative matters;
 - 2.20.2 obligations arising out of family relationships and matrimonial property issues;
 - 2.20.3 negotiable instruments;
 - 2.20.4 company law issues;
 - 2.20.5 voluntary trusts;
 - 2.20.6 nuclear damages;
 - 2.20.7 defamation and privacy;
 - 2.20.8 evidence and procedure.
- 2.21 The applicable law for the resolution of non-contractual disputes is determined on the basis of where the damage occurs, regardless of the country or countries in which the act giving rise to the damage occurs. This is subject to certain exceptions where that would be inappropriate, for example if the situation only has a tenuous connection with the country where the damage has occurred.
- 2.22 It will not always be obvious where the place the damage occurred is, particularly in claims for financial loss caused by certain commercial torts. For example, in a claim for negligent representation this could be the place where an investor received and decided to act on the representation, or the place where the resulting investment was made or the loss discovered.

- 2.23 The place of damage rule is subject to two exceptions:
- 2.23.1 if the parties have the same habitual residence at the time of damage, the law of that country shall apply to the exclusion of the law of the place of damage. There need be no further meaningful connection between the place of mutual habitual residence and the damage in question.
 - 2.23.2 if the tort is manifestly more closely connected with another country. This exception will allow for displacement of either the law of the place of damage or the law of the place of mutual habitual residence, and in the case of the latter may mean reinstating the law of the place of damage. The requirement of a “manifestly” closer connection is intended to convey the exceptional nature of this rule – it cannot be lightly invoked to displace the law otherwise applicable.

Choice of Forum

- 2.24 Following the introduction of Rome I and II, the question of which court hears a dispute, and thus forum selection clauses, might appear unimportant, since all EU courts must apply the same applicable law rules in any event. However, forum selection can still significantly affect the outcome of a dispute for a number of reasons:
- 2.24.1 Non-EU countries are not bound by Rome I and II. If non-EU courts hear the dispute, their governing law rules may result in the application of different countries’ laws.
 - 2.24.2 Rome I and II envisage the application of substantive laws of the forum (including overriding mandatory and public policy rules) even when the applicable law is that of another country. Consequently, whether such rules are applied depends on where in the EU proceedings are commenced.
 - 2.24.3 The law of the forum generally governs procedural and evidential issues (Article 1(3), Rome I and II). Rules differ considerably between countries, including the judicial process (adversarial or inquisitorial), disclosure obligations, presentation of evidence, and the availability and suitability of remedies.
- 2.25 Commercial and practical considerations must also be borne in mind when selecting a forum. These include: familiarity with procedures, publicity, language, geographical convenience and recoverability of costs. Further, judgments in some EU member states are more widely or easily enforceable than those in countries outside the EU, where judgment debtors and their assets may be located.
- 2.26 Some account can be taken of these issues when drafting forum selection clauses. Such clauses might limit where in the EU parties may commence proceedings and/or seek to prevent proceedings outside the EU. Alternatively, they might provide parties with additional options.
- 2.27 Parties will usually want consistency between their governing law clause and jurisdiction clause. So, for example, if disputes are to be resolved in the English courts, it makes sense to choose English law. Where they are not consistent so,

for example, the parties agree that their contract is to be governed by French law but, if a dispute arises, it will be resolved by the English courts, the parties will have to adduce expert evidence as to the foreign law before the English courts. In the example given, the parties will need to produce expert evidence on French law in order for the English Court to determine the relevant issues. This increases the cost of litigation and there is a risk that the court will incorrectly apply the foreign law. Another thing to consider is that where English law is chosen but the jurisdiction of a different court selected for dispute resolution, if outside the EU, there is no guarantee that the particular court chosen will recognise an express choice of law clause.

- 2.28 It remains crucial to include appropriate provisions on both forum selection and governing law in contractual documents. It is remarkable how many contracts (often erroneously) contain one and not the other. Further, when drafting suites of related documents, parties should ensure that differing clauses do not conflict and are workable.
- 2.29 Parties often feel uncomfortable negotiating such clauses because they do not wish to be seen to be considering the prospect of litigation at that stage. However, the clauses' importance should not be underestimated; something illustrated by the volume of reported cases on these issues last year. They are not mere boilerplate clauses which can be cut and pasted from other documents without due consideration. They are key terms going to the heart of the parties' fundamental rights and obligations, and should be treated as such.

3 Key practical differences between common and civil law

- 3.1 The terms common law system and civil law system are used to distinguish two distinct legal systems and approaches to law. The use of the term 'common law' in this context refers to all those legal systems which have adopted the historic English legal system. Foremost amongst these is, of course, the United States, but many other Commonwealth and former Commonwealth countries retain a common law system. The term 'civil law' refers to those other jurisdictions which have adopted the European continental system of law derived essentially from ancient Roman law, but owing much to the Germanic tradition.
- 3.2 The usual distinction to be made between the two systems is that the common law system tends to be case-centred and hence judge-centred, allowing scope for a discretionary, pragmatic approach to the particular problems that appear before the courts. The law can be developed on a case-by-case basis. On the other hand, the civil law system tends to be a codified body of general abstract principles which control the exercise of judicial discretion. In reality, both these views are extremes, with the former overemphasising the extent to which the common law judges can impose their discretion and the latter underestimating the extent to which civil law judges have the power to exercise judicial discretion. It is perhaps worth mentioning at this point that the European Court of Justice, established, in theory, on civil law principles, is, in practice, increasingly recognising the benefits of establishing a body of case law. Although the European Court of Justice is not bound by the operation of the doctrine of stare decisis, it still does not decide individual cases on an individual basis without reference to its previous decisions.

- 3.3 Common law is a peculiarly English development. Before the Norman conquest, different rules and customs applied in different regions of the country. But after 1066 monarchs began to unite both the country and its laws using the king's court. Justices created a common law by drawing on customs across the country and rulings by monarchs. These rules developed organically and were rarely written down. By contrast, European rulers drew on Roman law, and in particular a compilation of rules issued by the emperor Justinian in the 6th century that was rediscovered in 11th-century Italy. With the Enlightenment of the 18th century, rulers in various continental countries sought to produce comprehensive legal codes.
- 3.4 To ensure consistency, courts abide by precedents set by higher courts examining the same issue. In civil-law systems, by contrast, codes and statutes are designed to cover all eventualities and judges have a more limited role of applying the law to the case in hand. Past judgments are no more than loose guides. When it comes to court cases, judges in civil-law systems tend towards being investigators, while their peers in common-law systems act as arbiters between parties that present their arguments.
- 3.5 Civil-law systems are more widespread than common-law systems: the CIA World Fact book puts the numbers at 150 and 80 countries respectively. Common-law systems are found only in countries that are former English colonies or have been influenced by the Anglo-Saxon tradition, such as Australia, India, Canada and the United States.
- 3.6 The claim that common law is created by the case law is only partly true, as the common law is based in large part on statutes, which the judges are supposed to apply and interpret in much the same way as the judges in civil law.
- 3.7 The common law and civil law systems are the products of two fundamentally different approaches to the legal process. In civil law, the main principles and rules are contained in codes and statutes, which are applied by the courts codes. Hence, codes and statutes prevail, while case law constitutes only a secondary source of law. On the other hand, in the common law system, the law has been dominantly created by judicial decisions, while a conceptual structure is often lacking. This difference is the result of different role of legislator in civil law and common law. The civil law is based on the theory of separation of powers, whereby the role of legislator is to legislate, while the courts should apply the law. On the other hand, in common law the courts are given the main task in creating the law.
- 3.8 The civil law is based on codes which contain logically connected concepts and rules, starting with general principles and moving on to specific rules. A civil lawyer usually starts from a legal norm contained in legislation, and by means of deduction makes conclusions regarding the actual case. On the other hand, a lawyer in common law starts with the actual case and compares it with the same or similar legal issues that have been dealt with by courts in previously decided cases, and from these relevant precedents the binding legal rule is determined by means of induction. A consequence of this fundamental difference between the two systems is that lawyers from the civil law countries tend to be more conceptual, while lawyers from the common law countries are considered to be more pragmatic.

- 3.9 One of the main differences between the civil law and common law systems is the binding force of precedents. While the courts in the civil law system have as their main task deciding particular cases by applying and interpreting legal norms, in the common law the courts are supposed not only to decide disputes between particular parties but also to provide guidance as to how similar disputes should be settled in the future. The interpretation of a legislation given by a court in specific case is binding on lower courts, so that under common law the court decisions still make the basis for interpretation of legislation.
- 3.10 On the other hand, in contrast to common law, the case law in civil law systems does not have binding force. The doctrine of stare decisis does not apply to civil law courts, so that court decisions are not binding on lower courts in subsequent cases, nor are they binding on the same courts, and it is not uncommon for courts to reach opposite conclusions in similar cases.
- 3.11 In practice, however, the higher court decisions certainly have a certain influence on lower courts, since judges of lower courts will usually take into account the risk that their decisions would probably be reversed by the higher court if they contradict the higher court decisions.
- 3.12 Hence, even though in civil law systems the case law formally has no binding force, it is generally recognised that courts should take into account prior decisions, especially when the settled case law shows that a line of cases has developed.
- 3.13 Key features of a common law system include:
- 3.13.1 There is not always a written constitution or codified laws;
 - 3.13.2 Judicial decisions are binding – decisions of the highest court can generally only be overturned by that same court or through legislation;
 - 3.13.3 Extensive freedom of contract - few provisions are implied into the contract by law (although provisions seeking to protect private consumers may be implied);
 - 3.13.4 Generally, everything is permitted that is not expressly prohibited by law.
- 3.14 Features of a civil law system include:
- 3.14.1 There is generally a written constitution based on specific codes (e.g., civil code, codes covering corporate law, administrative law, tax law and constitutional law) enshrining basic rights and duties; administrative law is however usually less codified and administrative court judges tend to behave more like common law judges;
 - 3.14.2 Only legislative enactments are considered binding for all. There is little scope for judge-made law in civil, criminal and commercial courts, although in practice judges tend to follow previous judicial decisions; constitutional and administrative courts can nullify laws and regulations and their decisions in such cases are binding for all.
 - 3.14.3 In some civil law systems, e.g., Germany, writings of legal scholars have significant influence on the courts;

- 3.14.4 Courts specific to the underlying codes – there are therefore usually separate constitutional court, administrative court and civil court systems that opine on consistency of legislation and administrative acts with and interpret that specific code.
- 3.14.5 Less freedom of contract - many provisions are implied into the contract by law and parties cannot contract out of certain provisions.

Practical Differences

- 3.15 In common law, a contract has no binding effect unless supported by consideration. On the other hand, in civil law a contract cannot exist without a lawful cause (causa). Cause is the reason why a party enters a contract and undertakes to perform contractual obligations. Cause is different from consideration as the reason why a party binds himself need not be to obtain something in return. For example, a party may enter a gratuitous contract which may bind him to perform an obligation for the benefit of the other party without obtaining any benefit in return. One of the major practical consequences of the difference between consideration and cause is that common law does not recognise the contracts in the favour of third party beneficiary as only a person who has given consideration may enforce a contract.
- 3.16 Another difference between the two systems is that in civil law, the parties to a contract may agree that contractual rights can be transferred to a third party (stipulatio alteri). For example, article 328 of the German Civil Code provides that “*a contract may stipulate performance for the benefit of a third party, so that the third party acquires the right directly to demand performance.*” Under common law the doctrine of privity of contract applies, which effectively prevents stipulations in favour of third parties. According to this doctrine, a contract can not impose obligations on, or give rights to, anyone other than contracting parties: “*only a person who is a party to a contract can sue on it.*”¹⁰
- 3.17 The doctrine of privity of contract was developed by the common law because common law focuses more on the issue who is entitled to sue for damages, rather than who derives rights under the contract. In the last several decades this doctrine has caused numerous problems and has proved inconvenient to commercial practice. As result, legislation accepting contracts for the benefit of third parties has been adopted in several common law countries. On 11 November 1999, the Contracts (Rights of Third Parties) Act received the Royal Assent thereby removing the doctrine of the privity. The Act sets out the circumstances in which a third party on whom benefits are conferred may enforce his rights against the party conferring the benefit.
- 3.18 In the common law, an offer may always be revoked or varied, in principle, until the moment when it was accepted. This applies even to firm offers which expressly state that they are irrevocable. This is because before acceptance no consideration is given for these undertakings.
- 3.19 In Civil law, in principle, an offer has binding character and can't be revoked after being given. Depending on the offer's content, the offeree is bound by the offer for the period specified therein, or if this period is not specified, then for a reasonable period. The offer will be considered as revoked if it was not accepted, or it was not accepted within specified period.

10. Dunlop Pneumatic Tyre Co v Selfridge & Co [1915] AC 847, 853.

- 3.20 In civil law systems, *force majeure* operates independently of any agreement, which means that it will protect a party even if the contract does not contain a force majeure clause. Since in civil law the liability is based on fault, the party will not be liable in case of *force majeure*. On the other hand, in common law *force majeure* leads to the termination of the contract and not to exoneration of a party from liability. In other words, in civil law *force majeure* is related to the obligation of one party, whereas in common law it affects the whole contract.
- 3.21 The general principles on liability for breach of contract are based on similar principles in both common law and civil law, but there are some important differences related to damages. A fundamental difference between the common law and civil law concepts related to the recovery of damages for breach of contract is the requirement of fault in the civil law, whereas this requirement is absent in the common law.
- 3.22 In common law, fault is not a requirement for breach of contract, and damages can be awarded without fault. On the other hand, in civil law countries, existence of fault is the basis for awarding damages to the innocent party; the recovery of damages can be awarded only if the breach of contract is caused at least by negligence. Hence, the debtor is responsible for damages he caused intentionally or negligently, but he will not be responsible for damages that are purely accidental or are caused by *force majeure*.
- 3.23 The common law terms “liquidated damages” and “penalties” may cause confusion in civil law, especially in French law, because the French term “*clause penale*” and the English term “penalty clause” seem to be similar, but they have very different meanings.
- 3.24 *Clause penale* specifies the sum of money which is recoverable by the creditor if the debtor fails to perform his obligations. The amount specified by *clause penale* should correspond to the estimated loss suffered by the innocent party. Hence, the correct English translation of *clause penale* is “liquidated damages clause” and not “penalty clause”. While under common law the courts do not enforce penalty clauses which provide for excessive amount of damages, under civil law the courts may reduce the agreed amount of damages if that amount is found to be excessive because it contravenes the principle of good faith, or even increase them, if the amount of liquidated damages is considered to be too low.
- 3.25 Differences in procedural law between the civil law and common law are even more obvious than those in substantive law. Common law procedure is usually called “adversarial”, which means that the judge acts as neutral arbiter between the parties in dispute as they each put forward their case. The parties in a dispute lead the proceedings, while the position of judge is rather passive as he or she does not undertake any independent investigation into the subject matter of the dispute. The role of judge is not to find the ultimate truth. The judge’s main task is to oversee the proceedings and to ensure that all aspects of the procedure are respected. The judge does not himself interrogate the witnesses, but his task is to ensure that the questions the parties put to the witnesses are relevant to the case. At the end, the judge should decide the case according to the more convincing of the competing presentations.

- 3.26 Civil law procedure is usually called “inquisitorial”, because the judge examines the witnesses, and the parties in dispute practically have no right of cross-examination. Compared to common law, the judge in civil law plays a more active role in the proceedings, e.g. by questioning witnesses and formulating issues. This is because the court has the task to clarify the issues and help the parties to make their arguments. The judge plays the main role in establishing the material truth on the basis of available evidence. The judge does not have to wait for the counsels to present evidence, but he or she can actively initiate introducing of relevant evidence and may order one of the parties to disclose evidence in its possession. The judge has a task not merely to decide the case according to the stronger of the competing presentations, but to ascertain the definite truth and then to make a just decision.
- 3.27 With respect to the resolution of legal issues, the civil law system is based on the principle “*jura novit curia*” (“the Court is supposed to know the law”), which means that there is no need for parties to plead the law. On the other hand, in common law the law has to be pleaded and the precedents for or against have to be submitted and distinguished.
- 3.28 The use of the terms “adversarial” and “inquisitorial” can be misleading, as these two terms could be used for both procedures. In order to find out those differences the more appropriate way is to compare certain aspects of common law and civil law procedures, such as the way of determination of facts, service of documents, rules on admission and weight of evidence, witness statements, position of court experts, standard of proof in civil and criminal cases.
- 3.29 While in common law system the parties and the court first investigate the facts in order to establish the truth, in civil law system the court is mainly concerned with the claims of the parties as they are expressed in the pleadings. In common law a complaint is merely a formality which starts a procedure of investigation aimed at establishing the truth. On the other hand, in civil law the complaint actually determines the parameters of the case. Consequently, the judges in civil law countries will concentrate on the facts which are submitted by the parties and if the facts as presented by the parties differ, the judge will make a decision on the basis of the available evidence as presented by the parties.
- 3.30 The parties, of course, are also active in a civil law trial. The parties are entitled to introduce evidence and propose motions. The parties are allowed to introduce evidence after providing the other side with an opportunity to inspect. While the judge makes the initial interrogation of witnesses, the counsels have the right to make additional questions.
- 3.31 Also, there are important differences between civil law and common law in the way a trial is conducted. A civil law trial is consisted of a number of hearings, and written communications between the parties, their attorneys and the judge during which an eventual dispute on court’s jurisdiction is resolved, evidence is presented, and motions are made. Compared to the common law system, there is less emphasis on oral arguments and examination. Instead, written communication is prevailing, and if during the trial a new point is raised by one of the attorneys, the other may ask the court for a certain period of time to answer that issue in writing.

- 3.32 Another important difference between common law and civil law exists in the methods of gathering evidence in the pre-trial stage.
- 3.33 In common law, the pre-trial search for evidence is dominated by the process of discovery. The parties are obliged to produce for inspection by the other party all documents or information which are relevant to the matters in dispute and which are in their possession without the intervention of the court, whether or not the documents favour their claim or defence. Through discovery of documents, the parties to a dispute can obtain access to facts and information the adverse party intends to rely on at trial. Thus, discovery enables the parties to obtain facts and information about the case from the other party, which assists them in preparing for trial.
- 3.34 On the other hand, in civil law civil there is no pre-trial discovery. The main purpose of evidence presented by a party is to prove his or her legal or factual arguments. Consequently, a party is obliged to produce only those documents which are referred to in its pleadings. Under civil law, the parties are not obliged to produce documents voluntarily to the other party during the course of civil litigation. While in the common law system the parties should collect and introduce evidence, in the civil law system the judge plays the main role in collecting evidence. If one party wishes to obtain access to documents held by another party, it will have to ask the court to order the other party to disclose the document in question. So, while the common law process of discovery is, generally speaking, a private matter, performed by lawyers in accordance with prescribed procedure, the civil law process of collecting evidence is a public function conducted by the court. This is in accordance with the general principle in the civil law system that the court rather than the parties is in the charge of the process of the development of evidence.
- 3.35 There are significant differences between common law and civil law in relation to witness evidence. One of the basic principles of common law is the cross-examination of witnesses, which allows a thorough examination of the case. Oral evidence is given considerable weight and will usually prevail over written evidence. At a common law trial witnesses are examined and cross-examined in the presence of the judge and jury. Motions and objections are often made orally by counsel, and the judge rules on orally on them.
- 3.36 In the civil law, on the contrary, written evidence prevails over oral evidence. If a claim is supported by a document, the judge will usually not go further. If a document is contradicted by oral statement of a witness the document will normally prevail. In commercial cases, the use of witness evidence is very unusual. In some civil law countries, the court may even exclude the evidence given by a party witness in his or her own case. In criminal cases, most civil law countries recognise testimonial privilege for potential witnesses drawn from the family.
- 3.37 Cross-examination of witnesses is virtually unknown in civil law. However, in some civil law countries counsel is allowed to question the witness directly, while in some other civil law countries counsel can only formulate questions and ask the judge to put them to the witness. The judge has a discretionary right to decide whether to ask the proposed.

- 3.38 In common law, the experts are appointed and paid by the parties. Therefore, the experts are usually partial and their task is to support the position of the party who appointed them. Like other witnesses, they are examined and cross-examined by attorneys.
- 3.39 On the other hand, the experts in a civil law trial are not considered as witnesses and they are usually called “court’s experts”. The court experts are appointed by the court, not by the parties, and they are expected to be impartial. The courts often rely on expert opinion, and many cases are decided mainly on the basis of expert evidence. The expert is usually instructed by the court to prepare a written opinion, which is then circulated to the attorneys. The attorneys may interrogate the expert at a hearing. If one of the parties objects to the expert opinion, or the court finds the expert’s report unsatisfactory, the court may appoint another expert. A party may propose a particular expert but the court may reject this proposal and select another expert.
- 3.40 To conclude, the examination of common law and civil law reveals that there are more similarities than differences between these two legal systems. Despite very different legal cultures, processes, and institutions, common law and civil law have displayed a remarkable convergence in their treatment of most legal issues.
- 3.41 Under the contemporary pressure of globalisation, modern civil law and common law systems show several signs of convergence. Many of the differences that used to exist between the civil law and common law systems are now much less visible due to the changes which have occurred both in common law and civil law. In the common law, regulatory law has achieved a greater importance leaving less room for the courts, while in the civil law the role of the courts in the creation of law has greatly increased. As a result of these processes going to opposite directions, many of the differences between common law and civil law look now more like nuances rather than major differences.
- 3.42 The differences which exist between civil law and common law should not be exaggerated. It is also important to note that differences on many issues exist both among civil law and among common law countries. The differences between civil law and common law systems are more in styles of argumentation and methodology than in the content of legal norms. By using different means, both civil law and common law are aimed at the same goal and similar results are often obtained by different reasoning. The fact that common law and civil law, despite the use of different means arrive at the same or similar solutions is not surprising, as the subject-matter of the legal regulation and the basic values in both legal systems are more or less the same.
- 3.43 While a certain rapprochement between civil law and common law systems is evident and this tendency will continue, there are still important differences which will continue to exist for an indefinite period. The differences in some areas are substantial and the parties contemplating starting proceedings in another legal system are advised to check those differences before taking action.

4 Good faith obligation in common and civil law

4.1 One of the potential difficulties with international projects is that the contracts entered into are governed by laws which may be unfamiliar to one or other of the contracting parties. Therefore it is important that you do not make assumptions on either what particular clauses mean or as to which legal principles you can imply into that contract, as sometimes particular jurisdictions take an entirely different approach to that which you might have been expecting. This is particularly the case if you are familiar with English or Common Law jurisdictions and you are faced with a civil code, or vice versa.

4.2 The commission on European contract law is trying to establish principles of European contract law. Article 1.106 of (1) of the principles reads:

"In exercising his rights and performing his duties each party must act in accordance with good faith and fair dealing."

4.3 The intention is that this rule runs through the entire contract, from negotiation to final ultimate completion. However, that does not actually assist in establishing what good faith actually is. And this uncertainty is one of the main reasons why the English courts are reluctant to deal with the concept.

4.4 Under English law, the insurance policy is one of the small number of types of contract which are subject to the duty of utmost good faith. Under an insurance contract this means that each party is under an obligation:

4.4.1 Not to misrepresent material facts; and

4.4.2 To disclose material facts even if no question has been raised about them.

4.5 The reason why insurance contracts require parties to act with the utmost good faith is because the contracts are based on knowledge solely in the sphere of the proposer or the insured. Thus, section 17 of the Marine Insurance Act 1906 confirms that the duty of utmost good faith applies to both parties, and sets out the consequences of any breach of that duty as follows:

"A contract of machine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party."

4.6 The duty of good faith has actually been around for over 200 years. In 1776, Lord Mansfield in the case of *Carter v Boehm*¹¹ said:

"Good faith forbids either party, by concealing what he privately knows to draw the other into a bargain from his ignorance of the fact, and his believing the contrary."

4.7 However, this apparent policy statement was not followed by others. One reason for this might be the basic, and to many fundamental, issue of freedom of contract and the extent to which, if at all, the court should interfere in the bargains made by the parties to the contract. For example, the courts will be most unlikely to interfere with a contract because a party discovers he has made a bad bargain.¹² Thus Jessel MR said:

11. (1766) 97 ER 1162

12. *C.P Haulage v Middleton* [1983] 3 All ER.

"...if there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice. Therefore you have this paramount public policy to consider - that you are not lightly to interfere with freedom of contract".¹³

- 4.8 Accordingly the English courts, from a construction context (and indeed largely from a contractual context), do not recognise any separate duty of good faith. Vinelott J said:

"Although the courts will imply a duty to do whatever was necessary in order to enable a contract to be carried out, the requirement of good faith has not been incorporated into English law."¹⁴

- 4.9 To imply such a term at English law, the principles from the Australian case of *BP Refinery (Western Port) PTY Ltd v Hasting Shire Council*¹⁵ must be followed:

- 4.9.1 The term must be reasonable and efficacy;
- 4.9.2 The term must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
- 4.9.3 The term must be so obvious that "it goes without saying";
- 4.9.4 The term must be capable of clearing expressions;
- 4.9.5 The term must not contradict any expressed term of the contract.

- 4.10 To Vinelott J, the concept of good faith in English law was restricted, in construction contracts, to the duty not to act fraudulently. Devlin J in the case of *Mona Oil Equipment Company v Rhodesia Railways*¹⁶ was only prepared to go as far as co-operation and that co-operation was limited or restricted to doing what is required under the contract:

"I can think of no terms that can properly be implied other than one based on the necessity of co-operation. It is, no doubt, true that every business contract depends for its smooth working on co-operation, but in the ordinary business contract and apart, of course, from express terms, the law can enforce co-operation only in a limited degree to the extent that it is necessary to make the contract workable. For any higher degree of co-operation the parties must rely on the desire that both of them usually have that the business should get done."

- 4.11 The requirement to act in good faith is often seen as amounting to no more than an "agreement to agree" which is unenforceable. Reference is often made to the House of Lords' decision in *Walford and Others v Miles and Another*.¹⁷ That case considered in the context of lock-out agreements whether the obligation to negotiate an agreement in good faith could be implied. The House of Lords decided not only that an obligation to negotiate an agreement was unenforceable, but also that an obligation to negotiate such an agreement in good faith was similarly unenforceable.

13. *Printing and Numerical Registering v Sampson* (1875 LR 19 Eq

14. *London Borough of Merton v Leach* (1986) 32 BLR 51

15. (1997) 52ALJR20

16. (1949) 1014

17. [1992] 1 All ER 453

- 4.12 In relation to the first issue, Lord Ackner stated that

"The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty."

4.13 In relation to the second issue, according to Lord Ackner:

"A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party ... In my judgment, while negotiations are in existence either party is entitled to withdraw from these negotiations, at any time and for any reason."

4.14 However, even co-operation can only go so far. Thus, the case of *Ultraframe (UK) Limited v Taylor Roofing Systems Limited*,¹⁸ provides a good example of the approach of the English courts. Here, TRS fabricated conservatory roofs and sold them on to installers. Ultraframe supplied the roof components. The parties entered into an exclusivity agreement. However, after a few months, Ultraframe began a campaign to induce customers of TRS to deal direct with them. Ultraframe offered price inducements to those customers. There was no express term which would make it a breach of contract for Ultraframe to make a deliberate concerted effort to persuade TRS's customers to switch business. TRS sought to imply a term that Ultraframe should act at all time in good faith towards them.

4.15 LJ Waller understandably noted that, at first sight, the conduct of Ultraframe appeared to be unmeritorious. However, the court had to look at the actual contract, and the problem for the courts was that Ultraframe were considered to be indulging in a form of competition which fell outside normal healthy competition but was short of unlawful competition. If the court was to imply a term into the contract, it would be dealing with matters for which the parties themselves made no provision. LJ Waller said:

"I would suspect that the lack of particularity of precisely what TRS would seek to impose on Ultraframe and the need to use words such as "deliberate" or "intentional" or "good faith", all of which would in any event give rise to serious problems when considering what was or was not a breach, demonstrate that the framing of the term devoid was itself so difficult but as to make implication impossible."

4.16 Although, good faith will not be implied by the courts, it is being found (and considered by the Courts) in an increasing number of contracts. For example, in the case of *Petromec Inc and Others v Petrobras and Others*,¹⁹ the Court of Appeal had to consider the following contractual term:

"B agreed to negotiate in good faith with P the extra cost referred to in [the Contract]."

4.17 The term was drafted by solicitors and expressly agreed by the parties. LJ Mance said:

"The traditional objections to enforcing an obligation to negotiate in good faith are (1) that the obligation is an agreement to agree and thus too uncertain to enforce, (2) that it is difficult, but not impossible, to say whether, if negotiations are brought to an end, the termination is brought about in good or in bad faith, and (3) that, since it can never be known if good faith negotiations would have produced an agreement at all or what the terms of any agreement would have been if it would have been reached, it is impossible to assess any loss caused by breach of the obligation. I doubt, however, if any of these objectives would be good reasons for saying that the obligation in negotiating good faith contained in clause 12.4 is unenforceable in this particular case."

18. [2004] EWCA Civ 585

19. [2005] EWCA Civ 891

4.18 There were two reasons for this. First the requirement was expressly agreed by the parties as part of a contract drawn up by lawyers. Second, the Court recognised that it would be able to calculate the cost referred to and so would be able to establish whether there was a lack of good faith on the part of anyone.

4.19 In the case of *ABB Ag v Hochtief Airport GmbH and Another*,²⁰ Mr Justice Tomlinson had to consider a challenge to an arbitrator's decision pursuant to section 68 of the 1996 Arbitration Act on the grounds of serious irregularity. This was an arbitration conducted under the LCIA rules. The seat of the arbitration was London. The arbitration was governed by Greek law. The dispute related to the transfer of shares and the ownership of Athens International Airport. One of the issues was whether during the course of the negotiations leading up to the consortium agreement, the parties were under an obligation to act towards one another in accordance with the obligations of good faith and loyalty. Article 207 of the Greek Civil Code provided that:

"A condition shall be deemed fulfilled if its fulfilment was impeded contrary to the requirements of good faith by the person who would have suffered a prejudice from its fulfilment."

"A condition shall be deemed not having been fulfilled if its fulfilment was brought about contrary to the requirements of good faith by the person who would have benefited by its fulfilment."

4.20 What mattered to the Court of Appeal was whether ABB had had the opportunity fairly to address whether *Hochtief* either did act or could be said by ABB to have acted contrary to good faith in its actions. It was clear that ABB did have a fair opportunity. The tribunal considered the case and rejected it. Therefore the case failed. However, it is clear that the Judge had no difficulty in considering the "good faith" argument made during the arbitration hearing.

4.21 There are an increasing number of construction contracts which now impose a duty of good faith. For example, the concept of good faith does sit quite easily with a number of the new arrangements in procurement, such as partnering or alliance relationships and for longer-term relationships based on undertakings to act in good faith. With these long-term supply contracts, distribution systems based upon franchises, employment relationships and term contracts there is a need to evolve mechanisms for recognising and supporting expectations for flexibility, co-operation and to support the development of such long-term relationships.

4.22 Clause 10.1 of the NEC Third Edition states:

"The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and cooperation."

4.23 This comes close to a requirement to act in good faith. It should be noted that the first part of clause 10.1 requires the parties to act in accordance with the provisions of the contract. Thus, the requirement for the parties that act in a partnering context does nothing to change their respective responsibilities under the contract as a whole.

4.24 In addition, the NEC does not actually define what it means by "mutual trust and cooperation".²¹ Thus there may be a question mark over the enforceability of

20. [2006] EWHC 388

21. In fact, the explanatory guidance notes merely state that the requirement was added on the recommendation of the 1994 Latham report entitled "Constructing the Team".

this clause. For example in the case of *Bedfordshire County Council v Fitzpatrick Contractors Limited*²² Dyson J would not imply a term into a road maintenance contract that neither party should conduct itself in such a way that would “damage the relationship of confidence and trust” between them. One reason for this was the care taken by the parties to detail out the terms which were to govern their contract. Thus there was no scope to imply this further relationship.

4.25 Of course, as will be clear from the above, there is a difference between implying a term and enforcing a term which the parties have agreed upon. Therefore, it is likely that the courts will consider the term, although they may well be met by doubts that the clause is too uncertain to be enforceable.

4.26 And in so considering, it does appear that the English courts will pay attention to the intentions of the parties. Thus, in *Birse Construction v St David Ltd*²³ HHJ Lloyd QC held that the terms of a Partnering Charter which was not and was never intended to be a binding contract, even though it had been signed by the parties:

“Though clearly not legally binding, are important for they were clearly intended to provide the standard by which the parties were to conduct themselves and against which their conduct and attitudes were to be measured.”

4.27 The Judge accordingly considered the conduct of the parties in the context of the Partnering Charter in deciding when and whether a contract had been concluded.²⁴

4.28 Indeed, Lord Hobhouse in *Manifest Shipping v Polaris*²⁵ said:

“Having a contractual obligation of good faith in the performance of a contract presents no conceptual difficulty in itself. Such an obligation can arise from an implied or inferred contractual term. It is commonly the subject of an express term in certain types of contract such as partnership contracts.”

4.29 So what if you have a long-term arrangement or contract which requires that you negotiate in good faith or using reasonable endeavours in order to extend that relationship? Negotiations, whether conducted in good faith or conducted using reasonable endeavours, mean more and involve more than an invitation to take part in a tender process. A typical definition of negotiations can be found in *Capital Court Health Limited v New Zealand Medical Laboratory Workers Union Inc*,²⁶ where Hardie Boys J stated:

“Negotiations are as I have said a process of mutual discussion and bargaining, involving putting forward and debating proposal and counter-proposal, persisting, conceding, persuading, threatening, all with the objective of reaching what will probably be a compromise that the parties are able to accept and live with.”

4.30 The area of tender negotiation is obviously important. In the case of *Fairclough Building v Borough Council of Port Talbot*,²⁷ the Court of Appeal held that:

“It was the duty, in my judgment, of the Defendants honestly to consider the tenders of those whom they had placed on the short-list, unless there were reasonable grounds for not doing so.”

4.31 The New Zealand case of *Pratt Contractors Limited v Transit New Zealand*²⁸ arose from a dispute over a claim for damages by Pratt in relation to competitive tendering

22. (1998) CILL 1440

23. [1999] BLR 194

24. This first instance decision was overturned on appeal, although the Court of Appeal did not deal with the comments made by the Judge on the charter itself.

25. [2001] 1 All ER 743

26. 1 NZLR 7 at 19

27. [1992] 62 BLR 86

28. [2003] UKPC 83

procedures adopted for a state highway contract in New Zealand. Having failed with its tender, Pratt alleged that the terms of the request for tenders gave rise to a preliminary contract which laid out certain expressed and implied terms in relation to the selection of the successful tenderer. Pratt said that Transit had been in breach of those terms. Pratt found out that its bid had been scored by the tender valuation team on a similar footing to that of the successful party. Pratt was also thought by some parties to practise low-balling, which is tendering a low price to obtain the contract in the expectation of being able to make a profit by making aggressive claims for all additional payment. Indeed, the decisive factor against Pratt had been the perception that they were more litigious and aggressive than the successful party. Pratt duly lived up to its reputation taking the case through every stage of appeal.

4.32 The Privy Council did not have to consider whether the tender proposal did give rise to a preliminary contract as the parties agreed that it did and that implied within that contract were the duties to act fairly and in good faith. This disagreement was over what acting fairly and in good faith was.

4.33 In his judgment, Lord Hoffman considered the implied duty to act fairly and in good faith which had been the subject of discussion in a number of Commonwealth authorities. Slightly unhelpfully in *Pratt Contractors Limited v Palmerston North City Council*,²⁹ Gallen J had said that fairness was “a rather indefinable term”. In the Australian case of *Hughes Aircraft Systems International v Air Services Australia*³⁰ Finn J had said that the duty in cases of preliminary procedural contract of dealing with tenders was a manifestation of a more general obligation to perform any contract fairly and in good faith. However, in the Pratt case it was accepted in general terms that such a duty did exist.

4.34 Lord Hoffman held:

“The duty of good faith and fair dealing as supplied to that particular function [evaluating the tender] required that the evaluation ought to express the views honestly held by the members of the TET. The duty to act fairly meant that all the tenderers had to be treated equally. One tenderer could not be given a higher mark than another if their attributes were the same. But Transit was not obliged to give tenderers the same mark if they honestly thought that their attributes were different. Nor did the duty of fairness mean that Transit were obliged to appoint people who came to the task without any views about the tenderers, whether favourable or adverse. It would have been impossible to have a TET, to perform its function unless it consisted of people with enough experience to have already formed opinions about the merits and de-merits of ... contractors. The obligation of good faith and fair dealing also did not mean that the TET had to act judicially. It did not have to accord Mr Pratt a hearing or enter into a debate with him about the rights and wrongs of, for example, the Pipiriki contract. It would no doubt have been bad faith for each member of the TET to take steps to avoid receiving information because he strongly suspected that it might show his opinion on some point that was wrong. But that is all.”

4.35 With good faith it is therefore apparent that the courts are comfortable in addressing the concept when it forms part of the contract agreed by the parties. The question is whether (in time) such an approach will lead to the English courts following the lead of the courts elsewhere.

29. [1995] 1NXLR 469

30. [1997] 146ALR1

5 Drafting tricky clauses

Delay and Extension of Time

- 5.1.1 The obligation to commence the works and to complete the works on specific dates. This is in reality a benefit to the contractor rather than just an obligation (see *Wells v Army & Navy Cooperative Society* (1902) 86 LT 764, where Vaughan Williams LJ stated “to my mind that limitation of time is clearly intended, not only as an obligation, but as a benefit to the builder ...”).
- 5.1.2 Business efficacy may require an implied term to the effect that the contractor is to proceed with “reasonable diligence” and also with momentum and reasonable progress during the contract period. How the contractor organises himself is however a matter for him.
- 5.1.3 There is no general implication to execute the works to an absolute standard simply to expedite and with a reasonable diligence. Neither is there a requirement to complete by key dates, unless those dates are expressly contractual (*GLC v Cleveland Bridge and Engineering* (1984) 34 BLR 50).
- 5.1.4 Temporary non-conformity. In other words, slowness that does not result in a delay to complete the work on time is unlikely to be a breach of contract.
- 5.1.5 The employer has a duty not to prevent the contractor completing the work (see *London Borough of Merton v Leach (Stanley Hugh) Ltd* 1985 32 BLR 51) but this obligation does not go as far as requiring the employer to support early completion by the contractor (see *Glenlion Construction v The Guinness Trust* (1987) 39 BLR 89). *Glenlion* supports the argument that under English law the employer owns the float rather than the contractor.
- 5.1.6 The advantages of extension of time provisions are that:
- 5.1.6.1 Employer preserves right to liquidated damages;
 - 5.1.6.2 Contractor is relieved of liquidated damages, but can claim additional costs associated with delays; and
 - 5.1.6.3 Neither party is in breach of contract.
- 5.1.7 Extension of time provisions are construed strictly contra proferentem. Contractual logic of such a provision was considered in the House of Lords case of *Percy Bilton Limited v Greater London Council* [1982] WLR 794 HL as follows:
- 5.1.7.1 The general rule is that the main contractor must complete the work by the date for completion. If not he is liable for liquidated damages;
 - 5.1.7.2 The exception to the payment of liquidating damages is if the employer prevents the main contractor from completing his work (see *Holme v Guppy* (1838) 2 N&W 387; *Wells v Army & Navy Cooperative Society Limited* (1902) 86 LT 764); and
 - 5.1.7.3 The general rules may be amended by the express terms of the contract.
- 5.1.8 The risks are therefore allocated between the parties by the particular express terms of the contract.

- 5.1.9 If completion takes place after the agreed date for completion then the contractor is liable for liquidated damages unless:
- 5.1.9.1 Time is “at large” because of a delay caused by the employer and there remains some period of culpable delay; or
 - 5.1.9.2 The delay is caused by some event for which an extension of time is available (regardless of whether that event could amount to an act of prevention or a breach by the employer).
- 5.1.10 Clear drafting is required. General wording will not be sufficient. For example, “other special circumstances” is insufficient (*Peak Construction (Liverpool) v McKinney Foundations*) and the extension of time might need to be awarded before the completion date, unless the contract provides otherwise (*Amalgamated Building Contractors v Waltham Holy Cross UDC* [1952] 2 All ER 452 CA).
- 5.1.11 The role of the contract administrator is dependent upon the drafting of the contract, but generally to consider and make decisions upon the extensions of time.
- 5.1.12 The obligation is to consider the extension of time within a reasonable time. What is a reasonable time depends on the circumstances (*Neodox Limited v Borough of Swinton and Pendlebury* (1985) 5 BLR 38). Failure to do that can amount to a breach in itself, although what damages flow from this breach?
- 5.1.13 If the contractor does not accept that the extension of time is correct then his remedy is against the employer. Most standard forms state that an arbitrator has the ability to “open up, review and revise” decisions or certificates. *North Regional Health Authority v Derek Crouch* [1984] QB 644 concluded that the Court did not have the power to open up, review and revise. Section 43a of the Supreme Court Act 1981 inserted by Section 100 of the Courts and Legal Services Act 1990 partially addressed this issue. The point was then reversed by the *House of Lords in Beaufort Developments (NI) Limited v Gilbert Ash (NI) Limited* [1999] 1 AC 266.
- 5.1.14 An arbitrator (and no doubt the Court) could therefore open up, review and revise downwards an extension of time granted by the Contract Administrator if it were excessive.
- 5.1.15 When considering an extension of time request reference must be made to the contract, and the precise terms of the contract.
- 5.1.16 Generally, a contractor would need to demonstrate:
- 5.1.16.1 There was an event recognised under the contract; and
 - 5.1.16.2 That event has delayed or is likely to delay the works beyond the planned completion date.
- 5.1.17 Roger Toulson QC in *John Barker Construction Limited v London Portman Hotel Limited* (1996) 83 BLR 31 set out the following criteria which should be considered in order to calculate a “fair and reasonable” extension of time:
- 5.1.17.1 Apply the rules of the contract;
 - 5.1.17.2 Recognise the effects of constructive change;

- 5.1.17.3 Make a logical analysis, in a methodical way, of the effect of relevant events on the contractor's programme; and
- 5.1.17.4 Calculate objectively, rather than make an impressionist assessment of the time taken up by the relevant events.
- 5.1.18 FIDIC Red Book 1999 edition requires the engineers to make a "fair determination" (Clause 3.5) and NEC3 tries to remove discretion where possible (see the calculation for an extension of time in respect of weather in Clause 60.1(13)).
- 5.1.19 In assessing an extension of time entitlement the preference is to grant a provisional extension of time and then revisit after completion.
- 5.1.20 An objective approach is required and there are various methods which exist to aid in the assessment including:
 - 5.1.20.1 Bar chart analysis;
 - 5.1.20.2 Retrospective critical path analysis (CPM). As planned impacted adds employer cause delays to the planned programme, while as built but for analysis subtracts employer caused delay from the as built programme;
 - 5.1.20.3 Windows analysis. The construction period is broken down into multiple windows, so that each segment of the contract period can be considered; and
 - 5.1.20.4 Snapshot analysis.
- 5.1.21 Concurrent delay is conceptually challenging. It is important to distinguish true concurrency as distinct from the wider view that concurrency exists wherever the effects of two causes of delay are having an effect on the project at the same time.
- 5.1.22 It is really an issue as to causation. It is easy to define legally (what in fact caused the loss), but in practice it can be difficult to unravel.
- 5.1.23 There are competing House of Lords decisions:

Leyland Shipping Company Limited v Norwich Union Fire Insurance Society Ltd [1918] AC 350; (1981) 2 All ER 752. The torpedoed ship subsequently sank in the bay during a storm. The "proximate" cause approach.

Baker v Willoughby [1969] 3 All ER 1528. Personal injury case. "First cause" approach; and *Jobling v Associated Dairies*. (1981) 2 All ER 752. Personal injury again, this time "ultimately critical", "dominant" approach adopted.
- 5.1.24 See John Marrion QC's paper to the Society of Construction Law (February 2002). He identifies the two most widely accepted competing approaches:
 - 5.1.24.1 Dominant cause (where there are two competing causes, the Plaintiff needs to establish that the Defendant is responsible for the dominant cause. This is a question of fact; and
 - 5.1.24.2 Dyson J's (as he was) approach in *Henry Boot Construction (UK) Limited v Malmaison Hotel (Manhattan) Limited* (1999) All ER 118 where he said (note that the parties had agreed to this approach):

"Second, it is agreed that if there are two concurrent causes of delay, one of which is a relevant event, and the other is not, then the contractor is entitled

to an extension of time for the period of delay caused by the relevant event notwithstanding the concurrent effect of the other event."

5.1.25 The application of *Malmaison* and to some extent *Doyle* can be seen in *City Inn Limited v Shepherd Construction Limited* [2007] ScotCS CSOH 190 (30 Nov 2007).

5.1.26 In the final judgment of *City Inn v Shepherd Construction Limited* [2007] ScotCS CSOH 190 Lord Drummond Young had to consider the approach to be taken to delay analysis when the causes were concurrent. The approach of the judge was:

5.1.26.1 Consider the dominant cause first;

5.1.26.2 If it is not possible to identify a dominant cause then all concurrent causes of delay must be considered.

5.1.27 The judge said that :

"Where there is true concurrency between a relevant event and a contractor default, in the sense that both existed simultaneously, regardless of which started first, it may be appropriate to apportion responsibility for the delay between the two causes; obviously, however, the basis for such apportionment must be fair and reasonable"

5.1.28 The judge took the view that the apportionment would be similar to the apportionment of liability resulting from contributory negligence or contribution between joint wrongdoers. This required consideration of;

5.1.28.1 The period of delay; and

5.1.28.2 The causative significance of each event on the works as a whole.

5.1.29 In *City Inns* the judge concluded that a claim for an 11 week extension of time should be reduced by 2 weeks. He apportioned prolongation cost in exactly the same manner.

Caps & Limitation of Liability

5.2.1 A limitation of liability clause describes contractual clauses relied upon by a party who wishes to limit or cap its liability and should be distinguished from clauses which define the parties' rights and duties, such as LDs. The key point to note about limitation of liability clauses is that they are construed against the party who is seeking to rely on them.

5.2.2 The leading case on the construction of limitation of liability clauses is *Photo Production v Securicor Transport*.³¹ For a very modest charge, Securicor agreed to provide a night patrol service for four visits per night and their contract incorporated printed standard conditions which exempted them from any loss "except in so far as such loss is solely attributable to the negligence of the company's employees acting within the course of their employment"

5.2.3 On a Sunday night, the duty employee of Securicor deliberately started a fire which got out of control and a large part of the premises were burned down causing losses of £615,000. Although the fire was started deliberately, it was not established that the duty employee intended to destroy the factory. The House of Lords held that upon the construction of the clause, and having regard to the surrounding circumstances (which included the very modest charge for the services that were provided by Securicor), the clause exempted Securicor from liability.

31. [1980] A.C. 827, HL 348.

- 5.2.4 In *Photo Production*³², Lord Salmon emphasised³³ that contracting parties are free to enter into any contract they may choose and providing the contract is not void due to illegality or voidable (for example, due to coercion, undue influence, misrepresentation or fraud) it will be binding upon them. Ultimately though, everything depends upon the true construction and interpretation of the clause in dispute.
- 5.2.5 In any consideration of limitation of liability clauses, reference must not only be made to the construction of the clause but also the Unfair Contract Terms Act 1977 (“UCTA”), section 11(1) of which will only permit a limitation of liability clause to be effective if it is fair and reasonable to be included having regard to the circumstances which were, or ought reasonably to have been known to, or were in the contemplation of the parties at the time the contract was entered into.
- 5.2.6 In considering whether a limitation of liability clause is reasonable, section 11(4) of UCTA requires that regard shall be had in particular to (a) the resources the party could expect to be available to him for the purpose of meeting the liability should it arise; and (b) how far it was open to him to cover himself by insurance. Section 11(5) of UCTA confirms that it is for the party claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.
- 5.2.7 With regards to FIDIC, Clause 17 of FIDIC Silverbook Conditions of Contract for EPC/ Turnkey Projects First Edition 1999 details the risks and responsibilities for which one party must indemnify the other.
- 5.2.8 The parties’ respective liabilities are limited by Sub-Clause 17.6, which provides:
- “Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract, other than under Sub-Clause 16.4 [Payment on Termination] and Sub-Clause 17.1 [Indemnities].*
- The total liability of the Contractor to the Employer, under or in connection with the Contract other than under Sub-Clause 4.19 [Electricity, Water and Gas], Sub-Clause 4.20 [Employer’s Equipment and Free-Issue Material], Sub-Clause 17.1 [Indemnities] and Sub-Clause 17.5 [Intellectual and Industrial Property Rights], shall not exceed the sum stated in the Particular Conditions or (if a sum is not so stated) the Accepted Contract Amount.*
- This Sub-Clause shall not limit liability in any case of fraud, deliberate default or reckless misconduct by the defaulting Party.”*
- 5.2.9 The key features of this limitation of liability may therefore be summarised as follows:
- 5.2.9.1 claims for indirect or consequential losses, loss of use of the works, loss of any contract, or loss of profit can only be made in respect of Sub-Clause 16.4 and Sub-Clause 17.1;
- 5.2.9.2 the Contractor’s total liability is limited to either the sum stated in the contract or the Accepted Contract Amount; and
- 5.2.9.3 in cases of fraud, deliberate default or reckless misconduct liability is unlimited.

32. *Supra*

33. *At para 853.*

5.2.10 It is worth noting that the first paragraph of Sub-Clause 17.6 limits liability not only in relation to direct losses, but also indirect or consequential losses. In this respect, the aim is to exclude the type of losses fall within the second limb of *Hadley v Baxendale*³⁴. In that case, the *Court of Exchequer Chamber* (the Appellate Court as it then was) held that³⁵:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it.”

5.2.11 In addition, the first paragraph of Sub-Clause 17.6 excludes liability for loss of profits. In the past, there have been many disputes as to whether loss of profit fell within the meaning of indirect or consequential losses. As a result, Clause 17.6 expressly excludes claims for loss of profit to resolve this ambiguity.

5.2.12 The second paragraph of Sub-Clause 17.6 places a cap on the liability of the Contractor to the Employer. The limit may be set out either in the Particular Conditions or in the Accepted Contract Amount. Sub-Clause 1.1.4.1 defines the Accepted Contract Amount as the original contract sum, as agreed in the Letter of Acceptance. It is not, however, the ultimate contract price, which may vary depending on any variations or omissions made. Liability caps are used because the potential losses from a project may well exceed the contract price as well as the Contractor’s profit on that project. In addition, the Contractor might be concerned to ensure that the level of its professional indemnity insurance cover is not exceeded by the extent of liability under the contract.

5.2.13 It should also be noted that the cap on liability is subject to a number of exclusions, namely, the potential costs of power, water and any equipment provided under Sub-Clauses 4.20 and 4.21, and the indemnities under Sub-Clause 17.1. This is because the costs covered by Sub-Clauses 4.20 and 4.21 are likely to be minor, while the indemnities in Sub-Clause 17.1 are likely to be covered by insurance.

5.2.14 Finally, Sub-Clause 17.6 provides that liability will be unlimited in instances of fraud, deliberate default or reckless misconduct on the part of the defaulting party. In this respect, it is worth noting that insurance cover will almost certainly be declined in such circumstances.

5.2.15 The position under both English law and FIDIC is therefore:

5.2.15.1 Parties are free to contract on whatever terms they wish, provided they are sufficiently clear to be capable of being enforced by a court or tribunal.

5.2.15.2 Any limitation of liability clause will be valid provided that it is reasonable (under English law), and provided that the contract was not entered into for reasons of fraud, deliberate default or reckless misconduct (under FIDIC), or due to coercion, undue influence, misrepresentation, fraud or illegality (under English law).

34. [1843-60] All ER Rep 461

35. see *Alderson J in Hadley v Baxendale* [1843-60] All ER Rep 461 at p. 465

- 5.2.15.3 Under both English law and FIDIC, parties can only recover damages which arise naturally from the breach of contract, or that were reasonably within the contemplation of the parties at the time the contract was entered into.

Termination

- 5.3.1 The law surrounding termination can be confusing and is littered with legal terminology (much of which is frequently used incorrectly). Terms such as 'forfeiture', 'fundamental breach', 'determination' (and 'termination'), 'rescission', 'conditions', 'warranties' and 'repudiation' are regularly used by lawyers.
- 5.3.2 Where there is a contract between two (or more) parties, a breach of the terms of that contract will give the injured party the right to bring an action for damages and/or (depending on the seriousness of the breach and the term of the contract that has been breached) to terminate the contract.
- 5.3.3 Whether a party is entitled to damages only or is entitled to damages and to terminate the contract depends on the status of the terms of the contract in question.
- 5.3.4 Traditionally, in English Law, the terms of a contract have been classified as being either 'conditions' or 'warranties', the difference being that any breach of a condition entitles the innocent party, if he so chooses, to treat himself as discharged from further performance under the contract, and in any event to claim damages for loss sustained by the breach. A breach of warranty, on the other hand, does not entitle the innocent party to treat himself as discharged but to claim damages only.³⁶
- 5.3.5 In practice, the distinction between conditions and warranties is not often relied upon, but as will be seen below, there will be an important distinction between breaches of contract which give rise to a right to terminate and those which simply entitle the innocent party to claim damages.
- 5.3.6 The right of an innocent party to bring to an end or terminate a contract because of breach by the other can arise both at 'common law' and also by virtue of express terms of the contract in question.³⁷ By 'common law' we mean English law as developed through the decisions of the Courts, rather than law recorded in legislation.
- 5.3.7 Common law termination occurs where the guilty party has committed a 'repudiatory' breach of contract. A repudiatory breach is a breach of a term of the contract which is so serious in itself that it would be unreasonable to expect the other party to continue with the contract.
- 5.3.8 Such a breach is usually called a "*repudiatory breach of contract*". When it is accepted by the innocent party it is called the "*acceptance of repudiatory breach of contract*" or simply "*repudiation*."
- 5.3.9 By accepting a repudiatory breach, the innocent party brings the contract to an end. Importantly, until the innocent party does accept the repudiation, the contract continues to exist. Conversely, if the innocent party fails to accept the repudiation, that party will be taken to have affirmed the contract and it will remain

36. See Chitty on Contracts, Volume I, General Principles, (London: Sweet & Maxwell, Thirtieth Edition) ("Chitty"), Section 12-019.

37. See Hudson's Building and Engineering Contracts by Atkin Chambers (London: Sweet & Maxwell, Twelfth Edition), ("Hudson"), Section 8-004.

valid. There is some Court of Appeal authority that the innocent party can spend some time making up their minds before accepting a repudiation, but exactly how long it is entitled to do this for depends on the facts.³⁸

5.3.10 A repudiatory breach may also occur where there is a breach of a term which, while not by itself sufficiently serious, may be so protracted or repeated, despite protest or notice by the innocent party, that it either demonstrates an intention not to be bound by the contract, as in the case of deliberate and continued breaches (however minor), or simply an involuntary inability to perform the contract properly.³⁹

5.3.11 Other situations in which a repudiatory breach might arise include where one party actually informs the other of their intention not to perform the contract as a whole, or any part of it, either presently or in the future, or where a party acts in a way as to render their own future performance impossible.⁴⁰

5.3.12 Because the right to terminate (by accepting a repudiation) arises at common law, the innocent (or terminating) party will have that right regardless of whether there is a detailed termination clause in the contract. Although it should be noted that where the parties have expressly agreed to rules which will apply in the circumstances of a termination, such contractual terms may modify the right to terminate at common law.

5.3.13 For example, if the contract were to provide that a 30-day cure period must be given to allow a defaulting party to remedy a specific breach, the innocent party could not rely on that same breach as providing grounds to accept a repudiation.

5.3.14 Whether or not a breach of contract will constitute a repudiatory breach of contract will depend on the facts of each case and the terms of the contract in question.

5.3.15 Examples of what is likely to, and what is not likely to, constitute a repudiatory breach of contract by a contractor include:

Abandonment

5.3.16 Refusing to carry out the works is often an act of repudiation;

Defects

5.3.17 The existence of defects is not usually an act of repudiation. As a rule of thumb defective work will not be treated as repudiatory if it will not prevent substantial completion taking place. However, if the seriousness of the breaches is such that it becomes clear the contractor does not intend to, or cannot, perform its obligations, then this may amount to a repudiation by the contractor. This, of course, will depend on the facts of the case but *Sutcliffe v Chippendale & Edmonson*⁴¹ sheds some light on the situation.

5.3.18 The case involved an allegation that the defendants (a firm of architects) had over-certified the contractor's work owing to the number of defects. The employer had ordered the contractor off-site and others were engaged to complete the work. The contractor then became insolvent and so the employer sought to recover the cost of the remedial works from the defendants. The issue as to whether the employer had grounds to terminate the building contract was considered. The Judge agreed

38. *Allen v Robles* [1969] 1 WLR 1193.

39. example, an employer's failure to prepare the site and decision to give large parts of the works to another party in *Carr v AJ Berriman* (1953) 27 ALJR, High Court of Australia.

40. See *King v Allen (David) Bill Posting Ltd* [1916] 2 AC 554 where a billposting site was alienated after the grant of a licence to post bills thereon.

41. (1971) 18 BLR 157.

with the employer's argument that an accumulation of defects, which on their own would not amount to a repudiation, could be regarded as such. The Judge also relied on the fact that the quality of work was generally deteriorating as the works progressed, and the number of defects were multiplying (many of which the contractor had tried unsuccessfully to put right). This, coupled with delay on the part of the contractor, entitled the employer to order the contractor off site.

Delay

5.3.19 Delay by the contractor is usually not an act of repudiation unless the time is of the essence. This is one of the areas which arises most frequently in practice. So does delay on the part of the contractor amount to a repudiation of the contract? As a rule of thumb, and where time is not of the essence (discussed below), delay does not amount to a repudiation. As ever, though, it depends on the circumstances. If the contractor's delay means that he cannot or will not carry out the contract, then it may amount to a repudiatory breach if the delay deprives the innocent party of substantially the whole benefit of the contract.⁴²

5.3.20 Even if the employer is on reasonably certain grounds that the delay amounts to a repudiation of the contract, then it is almost always necessary to give notice to the contractor notifying him of it before accepting that repudiation. In *Felton v Wharrie*⁴³ the plaintiff had agreed to demolish some houses for the defendant within 42 days. This date was missed and when asked by the employer whether it would take one, two or three months to complete the contractor said that he could not say. The contractor carried on with the work and two weeks later the employer ejected the contractor from the site. It was held that the employer had no right to do so because he had failed to inform the contractor that he treated the contractor's response in failing to confirm how long the works would take as a refusal to carry out the work and should not have waited two weeks. Essentially, the employer must act quickly and communicate any dissatisfaction with the contractor's performance.

5.3.21 What is the effect of making time of the essence and how can it be done?

5.3.22 The first point note is that time is not of the essence in relation to the whole contract. The issue is whether time is of the essence in relation to a particular obligation. Time is not considered of the essence unless:

5.3.22.1 the parties state that a term relating to time must be strictly complied with; or

5.3.22.2 the nature of the subject matter of the contract or the surrounding circumstances show that time should be considered of the essence; or

5.3.22.3 a party who has been subjected to unreasonable delay gives notice to the other party and makes time of the essence.

5.3.23 In construction contracts points (i) and (ii) are rarely an issue. Construction contracts do not tend to make the timing for the performance of any obligations of the essence. Similarly, the subject matter of the contract is not such that completion should be considered of the essence. Instead, it is point (iii) which is relevant. Despite the comprehensive provisions in standard contracts dealing with time, there are circumstances where the employer is entitled to make time of the essence.

42. *Shawton Engineering Ltd v DGP International Limited and DGP Ltd* [2006] BLR 1, CA.

43. See Hudson's Building and Engineering Contracts, Eleventh Edition at Section 4.214.

- 5.3.24 The effect of making the contractor's obligation to complete the works 'of the essence' is essentially to put the contractor on notice that unless he completes by a specified date, then the employer will treat this as a repudiation of the contract. Unsurprisingly, getting this process right is not without its pitfalls for the employer.
- 5.3.25 This has been considered recently in *HDK Limited v Sunshine Ventures & Others*⁴⁴ and includes a useful overview of the law in this area. The case concerned three separate building contracts. HDK (the contractor) sought payment of outstanding sums and Sunshine (the employer) was claiming damages for non-completion and defects in the works. In a nutshell, the contractor was late in completing his works. The employer was becoming increasingly frustrated with progress, and on 26 September 2006 wrote to the contractor requiring him to "complete the work... as soon as possible". He then wrote again on 30 September 2006 requiring him to "complete the outstanding works as a matter of urgency". On 24 November 2006 a letter was issued to the contractor terminating the contract. The issue was whether the September letters had the effect of making time of the essence and essentially setting up the termination in November. It was held that they were not. They failed on two grounds. First, they did not convey in clear terms that unless the notice was complied with then the employer would treat the contract as at an end. Second, they did not specify a date by which the contractor was to complete. The result of the failure to properly make time of the essence meant that the termination letter of 24 November was effectively a repudiation of the contract on the part of the employer.
- 5.3.26 In summary, the points the employer needs to bear in mind when wishing to make time of the essence as a result of delay on the part of the contractor are:
- 5.3.26.1 a reasonable time for performance must have elapsed;
 - 5.3.26.2 the notice to the contractor must set out a requirement for completion by a specified date;
 - 5.3.26.3 the specified date for completion must not be unreasonably soon in the circumstances judged at the time the notice is given;
 - 5.3.26.4 the notice must make clear that the employer will treat the failure to complete by the specified date as a repudiation by the contractor (i.e. the contractor must be in no doubt as to the consequences of failing to complete by the date specified); and
 - 5.3.26.5 the employer himself must not be committing a breach of contract which is affecting the contractor's ability to complete.
- 5.3.27 What amounts to a reasonable time for performance to have elapsed will, of course, depend on the circumstances. A court will take into account the original agreed date for completion, the effect of any variations and the conduct of the parties.

Other breaches

- 5.3.28 The key question to ask is whether the breach goes to the "root of the contract".
- 5.3.29 Examples of what is likely to, and what is not likely to, constitute a repudiatory breach of contract by an employer include:

44. [2009] EWHC 2866 (QB).

Refusal

5.3.30 An absolute refusal by the employer to carry out his part such that the contractor cannot carry on with his works is a repudiation of contract.

Rendering completion impossible

5.3.31 If the contractor cannot get possession of the site because the employer refuses to give it then the employer is very likely to be in repudiatory breach of contract.

Ordering the contractor to stop work

5.3.32 This can be a repudiation of the contract by the employer in certain circumstances.

Failure to pay instalments

5.3.33 A failure to pay instalments cannot amount to a repudiation if there is no contractual duty to pay them in the first place.

5.3.34 In practice, of course, most building contracts will have some mechanism for interim payment. Whether or not non-payment amounts to repudiation depends on the circumstances. If just one instalment out of many is unpaid then it is unlikely to amount to a repudiation.

5.3.35 However, the issue to consider in relation to non-payment is not so much the non-payment itself but whether, in the circumstances, that amounts to a refusal or inability to pay (which will amount to a repudiation by the paying party). Hudson (a leading English construction law text book) also suggests that repeated failure to pay on time, despite warnings from the contractor, may amount to a repudiation on the part of the employer if it is done so to derive financial advantage.⁴⁵

5.3.36 So what the courts are looking for is evidence of foul-play or bad faith. This, of course, will be a question to be considered by looking at all the circumstances at the time.

5.3.37 However, a word of warning to the contractor who considers that the employer's poor payment habits amount to a repudiation of the contract. The contractor needs to bear in mind possible set-offs which the employer may have (these set-off rights are most unlikely to have been excluded in the contract and so remain available to the employer). If the employer can establish a set-off against sums due, then the contractor's course of action in treating non-payment as a repudiation may back-fire. The comfort for the contractor in this situation lies in the fact that the set-off must be for genuine loss, and be known to the employer at the time. The employer will not be able to raise a set-off if the grounds for that set-off only come to light at a much later date.

5.3.38 For example, the employer will not be able to set-off in respect of defective work if that defective work was not known to him at the time the contractor alleged that the employer's non-payment amounted to a repudiation of the contract.

Under certification

5.3.39 Under certification will not usually amount to a repudiation.

45. See Hudson, Section 4.222.

Suspending the works

5.3.40 Whether this would constitute a repudiatory breach of contract will depend upon whether there is a contractual right to suspend the works for the employer and whether that right has been properly exercised.

Contractual termination

5.3.41 In addition to a common law right to terminate by accepting a repudiation, parties to a contract can, and very frequently do, agree upon express termination provisions for the benefit of a party where certain defined events occur.

5.3.42 We will consider below the defined events included within FIDIC for this purpose.

5.3.43 Similarly, the parties may indicate expressly by the contractual agreement that a single breach of a particular contractual obligation is to have the same consequences as a fundamental breach entitling the innocent party to rescind the contract, even though otherwise (without that agreement) it would not have amounted to a fundamental breach justifying immediate termination.

5.3.44 It is worth emphasising at the outset that any termination, whether it arises at common law, or by virtue of the termination provisions within the relevant construction contract, is fraught with risk.

5.3.45 This is because a decision to bring a contract to an end, if not justifiable either under the contractual termination clauses or at common law, will itself be a repudiatory breach of contract which the other party can accept.

5.3.46 Whilst there is normally little doubt as to whether the contract has actually ended in these circumstances, issues as to which party terminated, and how the termination was carried out, will have a very significant impact on which party has liability for the costs of completion and for the terminated party's lost profits. (Please see Section 5 below for more information in relation to this).

5.3.47 Some points to note arising out of a termination which you should be aware of, and which are often forgotten, are as follows:

No reason given or bad reason given

5.3.48 Where a party refuses to perform a contract giving as its reason a wrong or inadequate reason, or no reason at all, he may later justify his refusal if there were at the time facts in existence which would have provided a good reason, even if he did not know of them at the time of his refusal.⁴⁶ For example, where an employee brings an action against his employer alleging that he has been wrongfully dismissed, the employer can rely on information acquired after the dismissal when seeking to justify the dismissal.

5.3.49 This general rule is subject to a number of exceptions. First, a party cannot rely on a ground which he did not specify at the time of his refusal to perform "*if the point which was not taken could have been put right*":⁴⁷ Second, a party may be precluded by the operation of the doctrines of waiver or estoppel from relying on a ground which he did not specify at the time of his refusal to perform.⁴⁸

46. See Chitty, Section 24-014.

47. *Helisler v Anglo-Dal Ltd* [1954] 1 WLR 1273.

48. In order to invoke this it is necessary to show that there was an unequivocal representation made by one party or otherwise which was acted upon by the other. It may not be easy to establish the existence of such an unequivocal representation in practice.

Arbitration Agreements are separate contracts

5.3.50 Arbitration agreements are considered to be separate contracts and so are not generally repudiated or terminated even when the agreement which contains them is repudiated.⁴⁹ As a result an arbitrator appointed under an arbitration clause will have jurisdiction to decide whether a contract has been repudiated by one of the parties.⁵⁰

Contractual Termination Clauses – some basic principles

5.3.51 We will consider at Section 4 below the termination provisions in the FIDIC forms of contract. However, it is perhaps worth noting at this stage some of the basic principles underlying contractual termination clauses. These are as follows:

- 5.3.51.1 contractual termination clauses must be followed absolutely and entirely in accordance with their drafting. A failure to do this may result in the party attempting to terminate committing a repudiatory breach of contract itself;
- 5.3.51.2 a party which believes that it is operating the contractual provisions, but is subsequently found to have not been entitled to do so, is likely to have repudiated the contract;
- 5.3.51.3 contractual termination provisions do not usually exclude local law remedies;
- 5.3.51.4 the grounds for operating the termination provisions must exist;
- 5.3.51.5 the notices must be served in accordance with the contract, which means identifying the ground or grounds and complying strictly with the timetable; and
- 5.3.51.6 most termination provisions require the issue of a second notice of termination, which must be issued in accordance with the contract, by the correct party, and in accordance with the timetable of the contract.

5.3.52 If there is any doubt as to how the termination provisions should be implemented and/or interpreted, advice should be sought. It is very important not to apply the provisions incorrectly!

Liquidated Damages

5.4.1 Most construction contracts contain a provision for the payment of liquidated damages (“LDs”) in the event of certain specified breaches by a contractor. Those within the construction industry in the UK will no doubt be familiar with LDs although it is useful to remind ourselves of a few basic principles, especially in comparison with the civil law approach.

5.4.2 LDs are a predetermined level of damages agreed between the parties which the employer will be entitled to deduct from the contractor in the event of certain specified breaches occurring. LDs benefit both parties to the contract. They offer certainty, limit the contractor’s liability, can save costs in circumstances where proving actual damage can be complex, expensive and time consuming, and they act as a deterrent to breaching the contract.

5.4.3 The parties agree the level of LDs when negotiating their contract. Although not

49. Heyman v Darwins Ltd [1942] AC 356.

50. See Keating, Section 16-012.

always straightforward, the predetermined level of LDs should represent a genuine pre-estimate of the employer's likely loss that it will suffer should the specified breach occur. When claiming LDs, the employer does not have to prove that it has actually suffered the loss in the amount stipulated or at all. Further, the employer will be entitled to the amount of LDs stipulated, even if its actual loss is lower. If the level of LDs does not represent a genuine pre-estimate, it may be open to challenge by the contractor later down the line on the grounds that it constitutes a penalty (see below).

- 5.4.4 Care needs to be taken by the employer when completing the LDs provisions in the contract. Most standard form contracts such as the JCT have an Appendix which includes a section allowing the parties to simply fill in the level of LDs. However, in the past the courts have held that where the parties have completed such a provision by entering "£nil", they have agreed that there should be no damages for delayed completion, that it constitutes an exhaustive remedy entitling the employer to nil damages and that it is not open to the employer to claim general damages as an alternative.³
- 5.4.5 The most common specified breach in construction contracts for which LDs will be payable is the contractor's failure to complete its works on time. The fact that an employer may not suffer any actual loss from the delay does not relieve the contractor from its obligation to complete on time or pay LDs in the event of a delay. However, LDs do not relate exclusively to delay issues and the parties may decide at the contract negotiation stage to apply them to other events of default.
- 5.4.6 Whilst LDs will usually be an exhaustive remedy for a specified breach such as the failure to complete on time, an interesting question arises as to whether LDs also constitute a remedy where the breach is not the failure to complete on time but some other breach which gives rise to the delay. For example, if the contractor's work is defective and needs to be remedied, which in turn causes delay, does the LDs provision constitute a remedy for that breach? If, as a matter of construction, the provision appears to be a complete remedy for delayed completion then it does not matter why the contractor failed to complete on time (providing of course that the cause of delay does not give rise to an entitlement to an extension of time or was due to the employer's default).
- 5.4.7 Another interesting question is whether a contractor's liability for LDs continues after the termination of the parties' contract. The orthodox view by most legal commentators is that LDs will remain recoverable up to the date of termination and general damages for delay will apply thereafter.
- 5.4.8 Where there are delays on a project, a contractor may find itself faced with a significant amount of LDs levied against it. In such circumstances it is likely that the contractor will want to challenge the LDs provision in the contract. In reality, given that the parties negotiated and agreed the terms of their contract, the courts are usually reluctant to go against the parties' agreement. However, there are grounds for the contractor to challenge the LDs being levied by the employer and one of the most common of these is an argument that the amount of LDs constitutes a penalty rather than a genuine pre-estimate of loss and therefore is unenforceable.
- 5.4.9 Nearly a hundred years ago, the House of Lords in *Dunlop v Matthew Tyre Co Limited v New Garage Motor Co Limited*⁵ established a number of principles to help

distinguish LDs and penalties. Although these principles have inevitably been refined over the years by the courts, the law on LDs has not been the subject of drastic change and evolution and the basic principles are well established.

- 5.4.10 If the employer had made a genuine attempt to pre-estimate its loss, the courts are unlikely to judge it to be a penalty. That said, it should be noted that a genuine pre-estimate does not mean an honest pre-estimate. However, where the amount of LDs bears no relation to a loss that could conceivably result from that breach, the courts will not enforce it against the contractor on the basis that it constitutes a penalty. In *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd*⁶ the court held that the sum must not be extravagant and unconscionable; although this does not mean that it has to be very similar in amount to the actual losses. The point in time for the assessment of whether a stipulated figure is a genuine pre-estimate or a penalty is when the contract is entered into, not when the delay occurs.
- 5.4.11 It is always a sensible precaution for an Employer to consider keeping records to show the reasonableness of the final figure agreed for LDs. In *Tullett Prebon Group Ltd v Ghaleb El-Hajjali*⁷, Nelson J. noted that an express contractual statement that there is a pre-estimate or that the sum stipulated is not a penalty is persuasive but not conclusive. In *Azimut-Benetti SpA v Healey*⁸ the trial judge concluded that both parties had the benefit of expert representation in the conclusion of the contract. The terms, including the liquidated damages clause, were freely entered into:
- 5.4.12 “As the authorities referred to. . . show, in a commercial contract of this kind, what the parties have agreed should normally be upheld.”
- 5.4.13 Difficulties can also arise where the contract provides for a single sum of LDs but the works are in fact completed in sections or the employer takes partial possession of the works before completion. Unless the contract provides for the division of the single sum between sections or a proportionate reduction for partial possession, it is likely that an employer’s claim for LDs will fail.
- 5.4.14 In reality, the argument that LDs in fact constitute a penalty is a difficult one to run and where the contractor is challenging the LDs provision, the burden is on it to demonstrate that it constitutes a penalty.
- 5.4.15 In addition to the penalty argument, other defences available to a contractor to challenge LDs include (but are not limited to): the employer is responsible for the delays, there has been a breach of condition precedents by the employer (for example, a failure to comply with the contract’s certification or notification provisions) and the contractor is entitled to an extension of time.
- 5.4.16 Challenging LDs can be difficult. However, if a contractor does successfully defend a claim for LDs, the employer is not left without a remedy and it can still pursue a claim for general damages in the usual way. Alternatively, if it is determined that the agreed sum is in fact a penalty, the employer can rely on its claim for the penalty but recover no more than the actual loss which it proves up to the amount of the penalty.
- 5.4.17 Should a contractor fall into delay, in order to try and protect itself from LDs it should assess whether it has any notification obligations under the contract, whether it may be entitled to an extension of time and the procedure that needs

to be followed in relation to this. However, whilst perhaps stating the obvious, the best way for a contractor to protect itself against LDs is to ensure that it manages its works diligently and effectively and that progress is closely monitored.

6 Ensuring that dispute avoidance and resolution clauses are effective

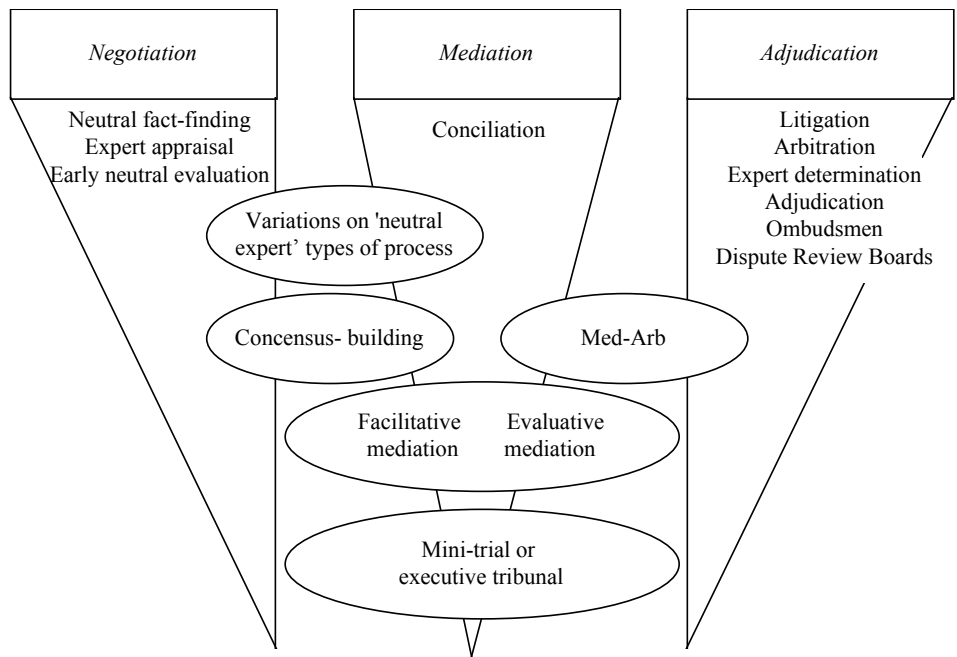
6.1 The development of ADR, the rejuvenation of the Civil Procedure Rules, the developments in the Technology and Construction Court (TCC), and especially the introduction of adjudication, as well as hybrid multistage dispute resolution procedures has changed the landscape of construction dispute resolution.

6.2 In order to deal with ensuring that dispute avoidance and resolution clauses are effective, it is necessary to consider the range of dispute resolution techniques that are available in the construction industry including:

- 6.2.1 Negotiation;
- 6.2.2 Mediation and conciliation;
- 6.2.3 Adjudication;
- 6.2.4 Arbitration; and
- 6.2.5 Litigation.

6.3 The discrete techniques may be introduced under one of the three pillars, depending upon the main characteristics of the particular technique; see diagram below:

Figure 1: 'The Dispute Resolution Landscape'



Source: Mackie, K. Miles, D. and Marsh, W. (1995) **Commercial Dispute Resolution: An ADR Practice Guide**, Butterworths, London, p. 50. The chart was derived from a chart by Professor Green of Boston University (1993).

Negotiation

- 6.4.1 According to the Concise Oxford Dictionary,⁵¹ "to negotiate" means to "confer with others in order to reach a compromise or agreement." Negotiation is merely the name given to that process. Goldberg et al described negotiation as "communication for the purpose of persuasion; the pre-eminent mode of dispute resolution."⁵² Nonetheless negotiation should not be considered as merely a dispute resolution process. Negotiation in its broadest form may be considered as the process by which individuals communicate in order to arrange their business affairs and private lives by establishing agreement and reconciling areas of disagreement.
- 6.4.2 In its most basic form direct negotiation provides a simple party based problem solving technique. A further dimension is added when either party introduces advisers. Nonetheless, the essential feature of this process is that control of the outcome remains with the parties. Litigation and arbitration require the parties to submit their dispute to another who will impose a legally binding decision. Negotiation is a "process of working out an agreement by direct communication. It is voluntary and non-binding." The process may be bilateral (between two parties) or it could be multi-lateral (many parties). Each party may utilise any form of external expertise it considers necessary, and this is often described as "supported negotiating".
- 6.4.3 Negotiation clearly involves some form of communication leading to joint decisions. Do these negotiations always maintain a processual shape with identifiable features regardless of the individuals involved or the conditions under which the negotiation takes place? Gulliver maintains that negotiation is essentially a developmental process with eight distinct but often overlapping phases.⁵³

Phase 1: The Search for an Arena

Phase 2: Agenda and Definition

Phase 3: Exploring the Field (emphasis on differences)

Phase 4: Narrowing the differences

Phase 5: Preliminaries to final bargain

Phase 6: Final bargain

Phase 7: Ritualising the outcome

Phase 8: Execution of outcome

Mediation and Conciliation

- 6.5.1 To mediate means to act as a peacemaker between disputants. It is essentially an informal process in which the parties are assisted by one or more neutral third parties in their efforts towards settlement. Mediators do not judge or arbitrate the dispute. They advise and consult impartially with the parties to assist in bringing about a mutually agreeable solution to the problem. Some definitions in circulation include:

51. Concise Oxford Dictionary (1995)

52. Goldberg S. B. (1992) *Dispute Resolution: Negotiation and Mediation and Other Processes*, 2nd edn Little Brown, Boston

53. Gulliver, P H. (1979) *Dispute and Negotiations: A cross Cultural Perspective*, Academic Press, London

- 6.5.1.1 “Mediation is negotiation carried out with the assistance of a third party. The mediator, in contrast to the arbitrator or judge, has no power to impose an outcome on disputing parties.”⁵⁴
 - 6.5.1.2 “Mediation is a facilitative process in which disputing parties engage the assistance of a neutral third party who acts as a mediator in their dispute.”⁵⁵
 - 6.5.1.3 “Where two or more people or companies are unable to resolve a particular problem they invite a neutral person to help them arrive at a solution. The neutral person, or Mediator, will work hard with each side and help them to understand better their own and the other person’s position, and explore alternative solutions.”⁵⁶
 - 6.5.1.4 “Mediation consists of the effort of an individual, or several individuals, to assist the parties in reaching the settlement of a controversy or claim by direct negotiations between or among themselves. The mediator participates impartially in the negotiations, advising and consulting the various parties involved.”⁵⁷
- 6.5.2 There are two common threads. Firstly, the form of the third party intervention. The primary role of the third party is to facilitate other people’s decision making. The process builds on negotiation, and the mediator fundamentally sustains and reviews the situation with the parties. Secondly, the third party should be independent of the parties in dispute. The essence of mediation that the mediator is impartial. The trust which develops during the process allows the mediator to perform “a bridging role” between the parties.
- 6.5.3 Confusingly, the term ‘conciliation’ is often used interchangeably with mediation. In the UK conciliation is usually taken to mean a more interventionist or evaluative style of mediation. However, there is no internationally agreed norm. The conciliation of labour disputes by ACAS is generally considered to be more evaluative, as is ICE conciliation. If the parties fail to settle under the ICE procedure, the conciliator will make a recommendation. However, the terms mediation and conciliation are often used interchangeably.
- 6.5.4 During a facilitative mediation, the mediator is trying to re-open communication between the parties and explore the options for settlement. The mediator does not openly express his/or her opinions on the issues. If, on the other hand, the mediator is called upon to state his opinion on any particular issue then he/she is clearly making an evaluation of that issue.

Table 1: facilitative and evaluative processes

Mediation or Conciliation	
Facilitative	Evaluative
The mediator/conciliator aids the negotiation process, but does not make recommendations	The mediator/conciliator makes a recommendation to the outcome

54. Goldberg, S. B. et al, (1992). p103
 55. Brown, H. and Mariott, A. (1992) ADR Principles and Practice, Sweet and Maxwell, London. p108
 56. British Academy of Experts (1992)
 57. American Arbitration Association, (1992)

6.5.5 In practice a mediation that starts off in a purely facilitative way may become evaluative in order to try and reach a settlement. This may occur intentionally, at the request of the parties or with forethought on the part of the mediator, or unintentionally by the words or actions of the mediator. The boundary is clear in theory, but not necessarily in practice. Nonetheless, at a basic level a distinction can be made between "settlement" processes and "decision" imposing processes. Control of the outcome, or the power to settle rest with the parties during negotiation, mediation and conciliation. By contrast, "adjudicative" or "umpiring" processes, such as litigation, arbitration and adjudication, rely on the judge, arbitrator or adjudicator having the power to impose a decision.

Table 2: Settlements and decisions

Control of the outcome rests with the parties	Decisions are imposed
Negotiation	Litigation
Mediation	Arbitration
Conciliation	Adjudication
	Expert determination

6.5.6 In summary, the main elements of mediation and conciliation are:

- 6.5.6.1 That it is voluntary in the sense that the parties participate of their own free will;
- 6.5.6.2 A neutral third party assists the parties towards a settlement;
- 6.5.6.3 The process is non-binding unless an agreement is reached; and
- 6.5.6.4 The process is private, confidential and conducted without prejudice to any legal proceedings.

6.5.7 Many consider that mediation and conciliation offer a range of benefits when compared to the traditional formal adjudicative processes such as litigation and arbitration. These benefits include:

- 6.5.7.1 Reductions in the time taken to resolve disputes;
- 6.5.7.2 Reductions in the costs of resolving disputes;
- 6.5.7.3 Providing a more satisfactory outcome to the dispute;
- 6.5.7.4 Minimizing further disputes;
- 6.5.7.5 Opening channels of communication;
- 6.5.7.6 Preserving or enhancing relationships;
- 6.5.7.7 Savings in time and money; and
- 6.5.7.8 Empowering the parties.

Adjudication

6.6.1 The term adjudication can be misleading. In its general sense it refers to the process by which the judge decides the case before him/her or the manner in which a referee should decide issues before him or her. More specifically, adjudication may be defined as a process where a neutral third party gives a decision, which is

binding on the parties in dispute unless or until revised in arbitration or litigation. This narrow interpretation may refer to the commercial use of an adjudicator to decide issues between parties to a contract. The use of an adjudicator is found in a variety of standard forms of contract used in the construction industry.⁵⁸

- 6.6.2 Until recently, adjudication in the construction industry has displayed certain characteristics. First, the adjudicator is a neutral individual who is not involved in the day to day running of the contract. He or she is neither an arbitrator, nor a State appointed Judge. Second, the adjudicator enjoys his or her powers by virtue of the agreement between the parties. In other words the parties have agreed by contract that the decision of the adjudicator shall decide the matter for them. Third, the adjudicator's decision is binding on the parties, and therefore, unlike mediation, the process does not require the co-operation of both parties. Fourth, adjudicators decisions are usually expressed as being binding until the end of the contract when either party may seek a review of the decision, most commonly by arbitration. Finally, adjudication is not arbitration and is therefore not subject to the Arbitration Act 1996.
- 6.6.3 It follows therefore that an adjudicator's powers are limited to those which are contained in the contract. For example, the DOM/1 (a widely used standard form of sub-contract) made use of an adjudication provision in relation to payment and set-off. However, the position has recently changed with the introduction of statutory adjudication under the Housing Grants, Construction and Regeneration Act 1996.
- 6.6.4 The Housing Grants Construction and Regeneration Act received Royal Assent on 24th July 1996. However, those parts relating to construction (Part II of the Act) were not brought into force until the Scheme for Construction Contracts had been affirmed by Parliament. The Scheme and that part of the Act relating to construction commenced on 1 May 1998. At the same time an exclusion order reduced the scope of adjudication in relation to certain statutory provisions, contracts relating to private finance initiative finance agreements, and development agreements.
- 6.6.5 The Act sets out a framework for a system of adjudication. All construction contracts must meet this minimum criterion. Should a contract fail to meet these minimum requirements then the Scheme for Construction Contracts will apply. A consultation document was issued by the then Department of the Environment in November 1996. This document indicated the likely content of such a scheme. However, this document received widespread attention and criticism.⁵⁹
- 6.6.6 Section 108 sets out the minimum requirements for an adjudication procedure. These may be summarised as follows:
- 6.6.6.1 **Notices:** A party to a construction contract must have the right to give a notice at any time of his intention to refer a particular dispute to the adjudicator;
- 6.6.6.2 **Appointment:** A method of securing the appointment of an adjudicator and furnishing him with details of the dispute within seven days of the notice is mandatory;
- 6.6.6.3 **Time scales:** The adjudicator is then required to reach a decision within 28 days of this referral. It will not be possible to agree in advance of any

58. McGaw, M, (1992) "Adjudicators, experts and keeping out of court" Legal Obligations in Construction; Revised Conference Proceedings, Construction Law Press, p 605

59. Enderson G. (1996)

dispute that additional time may be taken for the adjudication. There are only two exceptions to this rule. First the adjudicator may extend the period of 28 days by a further 14 days if the party refereeing the dispute consents. Second, a longer period can be agreed by consent of all the parties. Such agreement can only be reached after the dispute has been referred;

- 6.6.6.4 **Act impartially:** The adjudicator is required to act impartially;
 - 6.6.6.5 **Act inquisitorially:** The Act requires that the adjudicator "takes the initiative in ascertaining facts and the law". This gives the adjudicator power to investigate the issue in whatever manner he or she deems appropriate given the short time scale available;
 - 6.6.6.6 **Binding nature:** The decision of the adjudicator is binding until the dispute is finally determined by legal proceedings, by arbitration or by agreement. Phillip Capper (1997) suggests that "the 'until' formulation gives an unfortunate interim air to the decision almost inviting the view that it ought to be reopened at a later stage". The Act does, however, go on to say that the parties may agree to accept the decision of the adjudicator as finally determining the dispute; and
 - 6.6.6.7 **Immunity:** The adjudicator cannot be held liable for anything done or omitted in the discharge of his function as an adjudicator unless acting in bad faith. This protection is extended to any employee or agent of the adjudicator.
- 6.6.7 In addition to this basic procedural framework the Act further requires that any construction contract complies with the provisions of the scheme for construction contracts.
- 6.6.8 If the construction contract does not comply with the above eight requirements then the Scheme for Construction Contracts will be implied into the contract. Alternatively, if the construction contract does comply with the above provisions then the parties may include further more detailed provisions and perhaps a procedure for enforcement. Essentially then the parties can achieve compliance with the Act in one of four ways:
- 6.6.8.1 the parties could adopt the Scheme;
 - 6.6.8.2 adopt one a standard forms contract which sets out a series of adjudication rules;
 - 6.6.8.3 adopt one of the alternative sets of rules, for example, the Institution of Civil Engineers Adjudication Procedure, the Construction Industry Council Model Adjudication Procedure or the Centre for Dispute Resolution Rules for Adjudication, the Institution of Chemical Engineers Adjudication Rules, the Technology Court Solicitor's Association Rules; and
 - 6.6.8.4 draw up their own set of bespoke rules.
- 6.6.9 Section 114(1) provides that the Secretary of State for England and Wales and the Lord Advocate for Scotland "shall by regulation make a Scheme ("the Scheme for Construction Contracts") containing provisions about the matters referred to" in the Act. The Scheme for England and Wales was introduced by a statutory instrument

which commenced on 1 May 1998.⁶⁰ In its consultation paper, the Department of the Environment (as it was) stated that:

"The Scheme may be used to remedy deficiencies in contractual adjudication agreements ... and also to provide payment terms".

- 6.6.10 The Scheme detailed in the statutory instrument is divided into two parts; the first dealing with adjudication, and the second with payment. If a construction contract does not contain adjudication provisions which satisfy the eight key requirements of the Act then the Scheme applies in its entirety. The aim of the Scheme is to provide a series of workable arrangements which detail the mechanics of adjudication in the event that either no provision is made in the contract or an inadequate provision is included in the contract.
- 6.6.11 The Scheme is therefore an attempt to provide a workable adjudication procedure which supplements the skeletal regime in the Act. For example the Scheme states that the written notice must briefly set out the nature and description of the dispute, the parties involved, details of where and when the dispute arose, the remedy sought and the names and addresses of the parties to the contract. Further, the Scheme contemplates that there may be more than two parties to the contract and requires the notice of referral to be given to "every other party". In addition, an attempt is made at joinder of related disputes and different contracts and the adjudication at the same time of more than one dispute, but only with the consent of all parties.
- 6.6.12 Adjudication is extremely successful and will continue to be widely used within the construction industry. Not just in the UK. Adjudication has now been introduced into the domestic laws of Australia, New Zealand, Singapore and Malaysia. Other countries are currently in the process of debating and introducing adjudication. Further, the international FIDIC suite of contracts introduced, in 1999, a dispute adjudication board that is now becoming widely used throughout the world. That procedure is an 84-day, rather than a 28-day process in order to deal with the fact that international projects are often larger and the dispute board will need to travel to the project.
- 6.6.13 Clearly, adjudication is no longer a new phenomenon in the construction industry but one that is now widely used, in an increasingly tactical manner.

Arbitration

- 6.7.1 Arbitration is a process, subject to statutory controls, whereby formal disputes are determined by a private tribunal of the parties' choosing. According to Stephenson, Lord Justice Sir Robert Raymond provided a definition some 250 years ago which is still considered valid today:⁶¹

"An arbitrator is a private extraordinary judge between party and party, chosen by their mutual consent to determine controversies between them, and arbitrators are so called because they have an arbitrary power; for if they observe the submission and keep within due bounds, their sentences are definite from which there lies no appeal!"

- 6.7.2 Arbitration is essentially a process which is available as an alternative to litigation. The parties must agree to submit their dispute to arbitration and a distinction is often drawn between existing and future disputes. The distinction is of

60. Statutory Instrument 1998 number 649

61. Stephenson D. A. (1998)

historical importance because some jurisdictions, notably France, would not until comparatively recently recognise agreements to refer future disputes to arbitration. Providing arbitrators stay within the law, there is generally no appeal from the arbitrator's award, and the award may be enforced by the courts if necessary.

6.7.3 The advantages of arbitration are well rehearsed and include; flexibility, economy, expedition, privacy, freedom of choice of Arbitrator, and finality. Five main objectives underlie the Arbitration Act 1996:

6.7.3.1 To ensure that arbitration is fair, cost-effective and rapid.

6.7.3.2 To promote party autonomy, in other words to respect the parties choice.

6.7.3.3 To ensure that the courts' supportive powers are available at the appropriate times.

6.7.3.4 To ensure that the language used is user friendly and clearly accessible.

6.7.3.5 To follow the model law wherever possible.

6.7.4 Arbitration commences when one party sends the other a notice stating that a dispute has arisen between them and refers it to arbitration. If an arbitrator has not been named in the contract, then party will also send a "notice to concur" in the appointment of an arbitrator. If the parties are unable to agree on a arbitrator then it is common for the professional institutions to appoint one, although this can only be done if the parties have agreed that this mechanism is appropriate. Most commonly, a procedure for default appointment is included within their contract.

6.7.5 Arbitration rules may adopt one or more of the following three possibilities:

6.7.5.1 procedure without a hearing (documents only);

6.7.5.2 full procedure with a hearing; and

6.7.5.3 short procedure with a hearing.

6.7.6 The procedure without a hearing anticipates that the arbitrator will make an award based on documentary evidence only. The parties support their statements with a list of relevant documents together with a copy of any documents upon which they rely. The short procedure may be appropriate for disputes which are simple in nature. The time scales are short, allowing only 28 days for the entire process. This procedure is not frequently used. However, when it is used it is not uncommon for the parties to agree to extend the time scale. Finally, the full procedure with a hearing provides that the parties will serve their statements of case and that the arbitrator will conduct a full oral hearing. Often the parties will be legally represented, expert witnesses are appointed and evidence is given under oath.

6.7.7 The Arbitrator's award is final and binding on the parties unless they agreed to the contrary (Section 58). Section 66 of the Act provides that the award may, with leave of the court, be enforced as if it were a judgement of the court. The ability for a party to challenge the award is extremely limited. On issuing the award the arbitrator becomes "functus officio". This means that the arbitrator's duty and powers are at an end and save for minor corrections the arbitrator is relieved of his task.

- 6.7.8 Frequently, the arbitrator may make more than one award, each award dealing with different issues. These “partial awards” or “interim awards” could relate to a part of the claim or an issue which affects the whole of the claim (Section 47). An interim award is not provisional in nature but is final and binding with respect to the issues with which it deals. The benefit of interim awards is that a major issue can be dealt with by the arbitrator as a preliminary point which dispenses with the need to spend time and money on related issues. The resolution of an important issue early in the proceedings may lead the parties to settle the whole of the dispute.
- 6.7.9 Should the parties settle the dispute, then the arbitrator may issue a consent award which records the parties agreement. Such an award is capable of enforcement in the Courts. Unless the parties have agreed otherwise then the arbitrator has the power to award a wide range of remedies:
- 6.7.9.1 order payment of money;
 - 6.7.9.2 make a declaration of the rights between the parties;
 - 6.7.9.3 order a party to do or refrain from doing something;
 - 6.7.9.4 order specific performance; and/or
 - 6.7.9.5 order the rectification, setting aside or cancellation of a deed or document.
- 6.7.10 In addition, Section 49 of the Act provides that the arbitrator can unless otherwise agreed by the parties award simple or compound interests. This is an interesting provision as in most instances the court can only award simple interests. Rarely does the court have the power to award compound interest.

Litigation

- 6.8.1 The Courts provide the setting for the traditional mode of dispute resolution; namely, litigation. The Law Courts themselves are often considered the most visible feature of the English legal system, and their main function is the adjudication of disputes. Nonetheless, the number of disputes determined by the Court is negligible, compared to the number of disputes settled by other means. Furthermore, very few proceedings which are commenced result in a trial and subsequent judgement. In fact, in excess of 90% of the actions commenced in the High Court are disposed of before reaching trial, and only a few percent result in a judgement (Judicial Statistics).
- 6.8.2 The Civil Procedure Rules were implemented on 26 April 1996 and apply to all new actions commenced from that date. Part 1 of the CPR establishes the overriding objective upon which all rules must be interpreted. Essentially, the overriding objective is that cases should be dealt with justly and in accordance with 5 basic principles that the court will adopt:
- 6.8.2.1 to ensure that the parties are on an equal footing;
 - 6.8.2.2 save expense;
 - 6.8.2.3 deal with the case in ways which are proportionate to:
 - 6.8.2.3.1 the amount of money involved;

- 6.8.2.3.2 the importance of the case; the complexity of the issue; and
 - 6.8.2.3.3 the parties financial position.
 - 6.8.2.4 deal with case expeditiously and fairly; and
 - 6.8.2.5 allocate an appropriate share of the Court's resources to the case whilst taking into account the needs of other cases.
- 6.8.3 In addition, the Courts are undertaking a new proactive role in managing the cases in order to ensure that the overriding objective is complied with. The management process of the Courts will include encouraging the parties to use ADR, identify the main issues at an early stage, make appropriate use of IT, attempt to deal with the case without requiring the parties to attend Court if possible and ensure the matter proceeds as fast as is sensibly possible. More importantly, a party who engages in gamesmanship which the Court considers is other than in accordance with the overriding objective risks incurring sever cost penalties.
- 6.8.4 The Court's general management powers are set out in part 3 and are wide ranging. Unlike the old rules the Court is now expected to be proactive and may therefore exercise any of its powers on his own initiative.
- 6.9 There are a wide range of dispute resolution techniques that are available in the construction industry. It is clear that the TCC is now able to rapidly deal with cases that come before it. Adjudication has substantially reduced the workload in the court, with the benefit that the court is available to deal with adjudication enforcement and also to deal with its primary workload in an efficient and rapid manner. In the past, it would have taken at least three years from the service of a writ to the issuing of a judgment for a relatively substantial construction case. Now, even complex construction cases can be dealt with within a year.
- 6.10 It is no longer the judge or the court's ability to deal with matters that are the delaying factor. It is simply a case of whether the parties can keep up with the judge. There is therefore much to commend the adjudication process in terms of its contribution to judicial efficiency and it seems likely that statutory-backed adjudication procedures will be seen in many other common law jurisdictions. It may even be the case that the process of rapid binding dispute resolution is introduced into other commercial areas in order to reduce the burden on the court.

7 How to successfully draft contracts which represent good value for money?

- 7.1 A review of the standard forms cannot be divorced from the procurement pathways that are used in the construction industry. The development of the standard forms that are used in the construction industry is historic in that the mostly widely recognised standard forms were developed by construction professions, principally the Royal Institution of British Architects and the Institution of Civil Engineers. However, with the commercialisation of standard forms and the diversity within the construction industry, not to mention the global international nature of the industry, there are now a wide variety of standard forms and a large number of organisations producing standard forms. The forms have become more diversified dealing not only with employer contractor relationships, but also at the same time more specific, dealing with for example, sub-contractors, suppliers, facilities managers, works contractors, the professions and more recently PFI.
- 7.2 Nonetheless, the most easily identifiable benchmark is the simple distinction between the traditional procurement route and the design and build route. Essentially, standard forms could be divided into those where the contractor simply constructs the design of another (employer led design), and those where the contractor is responsible for design. This simple distinction is not as helpful as it once was, given the development of new procurement techniques such as Prime Contracting and management contracting, however, it stills serves as a very useful categorisation technique for standard forms.
- 7.3 Probably the most widely recognised, and certainly the most widely used in the UK is the JCT 2005 family of contracts (predominantly the With Contractor's Design 1988 edition being now the most widely used) and the ICE Standard Form of Contract (now in its 7th edition, although the 5th and 6th editions are more widely used in practice). JCT have developed a range of standard forms for a variety of procurement processes. The traditional JCT Private With Quantities (also available without quantities, i.e. for use with the specification, and local authorities version) have developed from the RIBA Standard Form of Building Contracts. Under these forms the employer is responsible for producing the design and providing it to the contractor in the traditional way.
- 7.4 The design and build version (JCT 1998 Edition With Contractor's Design) is merely an update of the original 1981 JCT Design and Build Contract, which was simply developed from the traditional JCT Form. It is therefore a lengthy contract, adopting almost all of the clauses wholesale from the traditional JCT Form. The risk allocation is therefore much the same in terms of payment, variation and time. The design obligation placed upon the contractor is not the common law fitness for purpose obligation that would be expected of a person that designs and manufactures an article, but one of reasonable skill and care in respect of the design as if the contractor were an architect. The JCT 2005 Design and Build Contract is an updated rationalised version of the 1998 Edition, but much of the philosophy remains the same.
- 7.5 While the contracting market was ready to accept this obligation it must be said that it defeats the fitness for purpose single point responsibility that an employer might expect from a main contractor that holds itself out to design and construct

- a building to meet the needs of a particular employer. On the other hand, the frequent practice of novating the design team from the employer (having done the initial design work) to the contractor for the purposes of completing the design or carrying out design development in reality means that the contractor has little control over the initial and often very important design decisions that are taken in respect of the project.
- 7.6 The construction industry can be neatly divided into the building sector and the engineering sector. The former dealing with the construction of buildings such as residential houses, flats, apartments, as well as offices, commercial and industrial units. The engineering industry deals predominantly with often large scale infrastructure projects such as roads, bridges, tunnels and rail. The JCT Forms have confined themselves to the building industry, while the ICE Forms have been for use within the engineering industry.
- 7.7 The predominant difference between the forms is that the JCT Forms in the main are lump sum contracts. In other words, the contract sum is fixed, subject to the correction of any errors and adjustment to the scope of the works by way of a change order (usually referred to as a variation in a JCT Contract). On the other hand, the ICE Standard Forms are re-measurement contracts. They are still lump sum contracts in that the rates for the work are fixed. While then the JCT Forms are lump sum contracts, it may be possible to consider that the individual rates for each element in the bill of quantities attached to the ICE Form are also individual lump sums in their own rights. In other words, while the contractor is to be paid for the items as eventually carried out and measured, the contractor will be paid the rate upon which his original tender was based. If the quantities change substantially, then arguments might be raised that the rate should be varied because of the substantial change in the quantities, resulting in a change to the nature of the works.
- 7.8 It is in the nature of engineering work that the scope of the work is not entirely known until the work has been completed. This is because the majority of the work involves dealing with unknown ground conditions, whereas building work is mostly carried out above ground usually on comparatively simple foundations.
- 7.9 In terms of risk, most of the risks are encountered in the initial stages of a building project during the ground works, many of those risks have been eliminated when the foundations are complete. However, civil engineering work by comparison, most frequently involves ongoing risks until the project is nearing substantial completion.
- 7.10 A further aspect of the development of the most widely used standard forms is the competitive tendering procedure used in the industry. Projects are and have been most frequently let to the contractor who produces the cheapest tender. Profit margins have been low within the industry for many years, and it is not unusual for contractors to produce claims in order to protect or ensure their profit margin on any particular project. At the same time this factor highlights an inherent risk not just in the standard forms, but also in the procurement pathways and the practice of selecting the lowest tenderer within the construction industry.
- 7.11 Construction projects take time on site to complete. It is, therefore not unusual for projects to be delayed because of a variety of influences, many of which are

external to the parties, but also as a result of changes to the scope of work to occur. Some have argued that changes to the work can be avoided by simply completing the design before issuing the tender. A frequent practice within the construction industry, at least in the UK, appears to be issuing an incomplete design at tender stage which is then supplemented by changes to the design and further variations as the work proceeds.

- 7.12 This in part might be due to a particular employer's inability to precisely define his or her brief, and also because of the employer's perceived urgency to commence work of site as early as possible, in perhaps the erroneous belief that the project will be completed at the earliest possible time. Could it be the case that a later start on site, but with a totally completed design might in fact lead to a project that, with minimal extensions of time, is completed earlier and with greater cost certainty?
- 7.13 It has been the drive towards greater certainty as to outturn cost and a need to meet a planned completion date that more novel approaches to procurement have developed. The result, of course, is that standard forms have developed in order to meet these procurement pathways. Initially, JCT produced prime cost contracts for cost plus work, as well as management contracting forms and standard forms for works package contractors. The ICE has stuck with its traditional approach, albeit with the development of the design and build version, but other new standard form providers have entered the arena.
- 7.14 The NEC (now the Engineering and Construction Contract, Third Edition) has been produced by a private publisher, Thomas Telford (owned by the ICE) in order to provide a suite of contracts for a variety of different procurement pathways. The NEC approach must be the most novel mainly because the NEC has adopted a less is best approach to the drafting, resulting in very short clauses.
- 7.15 The NEC Form comprises a front end "black book" which includes all of the core clauses that might be used to produce a contract to meet the procurement pathway adopted by the employer. These further breakdown into the rainbow coloured suite of contractual variations which comprise:
- 7.15.1 priced contract with activity schedule "purple book"
 - 7.15.2 priced contract with bill of quantities "blue book"
 - 7.15.3 target contract with activity schedule "yellow book"
 - 7.15.4 target contract with bill of quantities "red book"
 - 7.15.5 costs reimbursable contract "light green book"
 - 7.15.6 management contract "green book"
- 7.16 In addition, there is the engineering and construction sub-contract, the guidance notes and flow charts which identify the procedures that should be followed when using the NEC. The flowcharts are expressed not to be a part of any contract, but they clearly depict how the authors consider how the NEC contract is to be used in practice.
- 7.17 Despite the ongoing development of apparently new procurement pathways and the proliferation of standards forms, the selection of a particular standard form for any particular project is often based on familiarity. In other words, the construction

professional, perhaps the quantity surveyor or engineer that is carrying out the tendering procedure and thus needs to identify the form of contract, will adopt a standard form which the professional is most familiar with. This might mean that the procurement pathway remains relatively traditional, albeit with some consultant specific “tweaks”, or it might be that the standard form is inappropriate for the procurement pathway or the project.

7.18 Another aspect of the adoption of a standard form based on familiarity is the use of the particular form in question. It is not uncommon for the contract administrator to administer the contract in a particular way that bears little or no relationship to the contractual terms. The contract administrator progressing on the basis that he or she has always done it in a particular way for many years or decades in a mistaken understanding of the contractual terms of any particular form. This is perhaps not the reason why old versions of contracts are more frequently encountered. For example, while the more recent JCT 1998 versions are frequently encountered, one is more likely to encounter the 6th, or even the 5th edition of the ICE Form rather than the 7th edition.

7.19 Amending standard form contracts

7.19.1 The guidance notes to most of the standard forms state that the forms have been drafted to carefully balance the rights and obligations of the employer and contractor or other participants as the case maybe. On this basis users are warned not to upset this balance by amending the standard form. In many cases un-amended forms are used. However, it is rarely the case that the standard form balances the risk of the parties in a manner which is applicable to the particular parties.

7.19.2 More importantly, the level of security that can be obtained if an external funding institution is providing capital for the project is rarely adequate. A bank will require the ability to step-into the contractual arrangements and complete the project or sell on the development if the employer or developer defaults or becomes insolvent. This will require warranties to the bank with step-in rights, or the ability to assign the contract (most funders require both). Most standard forms are expressed to be non-assignable. In addition, a bond might be required as a measure of security. Bonds are rarely required by the standard forms of building contract and so would need to be introduced by amendment.

7.19.3 Relevant events for the awarding of an extension of time might be upon reflection unacceptable to an employer. For example, clause 25 of the old JCT forms anticipated that a contractor would receive an extension of time if the contractor suffered a labour or materials shortage. Most employers rely on the contractor to obtain adequate labour and materials for the works. This relevant event has been removed from the JCT 2005 suite of contracts.

7.19.4 Certificates expressed to be final and conclusive might be inappropriate for certain parties. The use of nominated sub-contractors, or a price adjustment formulae might also be inapplicable.

7.19.5 Proactive measures for the management of change might be incorporated by amendment. The NEC has gone some way to requiring

such an approach with an early warning system and compensation events. However, the privately drafted PFE Change Management Supplements for use with JCT contracts introduce by amendment a change management process. Guidance Notes exist for each of the supplements. It should therefore be possible for a construction professional to follow the guidance notes and insert the amendment in the usual way.

7.19.6 The Supplements are intended to provide the parties with specific binding obligations in respect of the management of change. The contractor is required to produce information including the programme and if he does not produce that information then he will be liable for liquidated damages. The benefit is that if the parties are pro-active then the contractor and the employer (or employer's representatives) will have a detailed plan of how the contractor proposed to build the project, together with resource related records in order to assist in the more objective termination of extensions of time and compensation as the work proceeds.

7.19.7 Further, the parties will also be working towards a planned actual completion date rather than a contractual but incorrect Completion Date. In order to assist this process the Supplements introduce the new concept of a risk manager, who is retained by the employer in order to check the programmes produced by the contractor. The purpose of the Supplements is to allow the employer to become more closely involved with the change process and therefore to manage it more effectively rather than leaving it to the contractor in the hope that all will be well.

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