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Newsletter

Construction

15 December 2022

What's inside?

Contractor held liable for failing to complete works within a "reasonable time" under Supply of Goods and Services Act

Justin Yuen

In a recent judgment of England's Technology and Construction Court (Barkby Real Estate Developments Ltd v Cornerstone Telecommunications Infrastructure Ltd [2022] EWHC 1892 (TCC)), even though there was no formal contract between the parties stipulating time, the court held that the contractor had to complete works "within a reasonable time", pursuant to section 14 of the Supply of Goods and Services Act 1982. Section 14 of the Supply of Goods and Services Act 1982 is similar to section 6 of Hong Kong's Supply of Services (Implied Terms) Ordinance, Cap 457 and the judgment is therefore of note to the construction industry in Hong Kong.

Background

The project out of which the dispute arose was a development in Hastings. The Claimant, BREDL, a developer of trade parks in the United Kingdom, put the project site together, reached agreements with tenants for the site, and forward sold the project to Hastings Borough Council. BREDL engaged the Defendant (Cornerstone), a national infrastructure provider involved in the installation of electronic communications on land, to relocate a mobile telephone mast on the project site. Cornerstone produced a design for the foundations for the mast, which turned out to be inappropriate for the actual ground conditions and so it had to carry out a redesign, which resulted in a delay in the completion of Cornerstone's works.

The dispute

It was BREDL's case that when the main development was completed on 30 June 2020, it could not be handed over to Hastings Borough Council, because the sight lines were still obstructed by the old mast. Cornerstone's response was that the works for the main development were not then complete, so that the delay in the completion of its works caused BREDL no loss, which BREDL would not have suffered in any event.

What caused the delay in handover to the purchaser?

The court said that the resolution of this dispute turned upon the snagging lists produced by the Employer's Agent. The court was of the view that the fact that Practical Completion became dependent upon completion of Cornerstone's works may in itself be sufficient to resolve this issue in favour of BREDL. However, the court looked with care at the list of outstanding works as at 30 June 2020. The court accepted that these were of the nature of snagging works which would

not have prevented hand over to Hastings Borough Council and therefore accepted BREDL's case that the delay in handover after 30 June 2020 was as a result of the need for Cornerstone and its team to complete its works.

Who was responsible for the delay?

The court turned to the question of whether Cornerstone was contractually responsible for the delay. Although there was no formal written contract between BREDL and Cornerstone, the court held that a contract had been entered into by them when payment was accepted by Cornerstone as having been made for the works.

The parties agreed that the contract was subject to section 14 of the Supply of Goods and Services Act 1982, which provides that where, under a relevant contract for the supply of a service by a supplier acting in the course of a business, the time for the service to be carried out is not fixed by the contract, left to be fixed in a manner agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the supplier will carry out the service within a reasonable time and that what is a reasonable time is a question of fact.

Both parties referred the court to *Hick v Raymond & Reid* [1893] AC 22 in which the court said "*When the language of a contract does not expressly, or by necessary implication, fix any time for the performance of a contractual obligation, the law implies that it shall be performed within a reasonable time. The rule is of general application, and is not confined to contracts for the carriage of goods by sea. In the case of other contracts the condition has been frequently interpreted; and has invariably been held to mean that the party upon whom it is incumbent duly fulfils his obligation, notwithstanding protracted delay, so long as such delay is attributable to causes beyond his control, and he has neither acted negligently nor unreasonably*."

The court then went on to consider what was a reasonable time for completion of the works and to answer that question said it was entitled to and should take into account what actually happened. The crucial issue was who was to take responsibility for the five month delay attributable to the unsatisfactory ground conditions. The court was satisfied on the evidence that had it not been for that five month delay, Cornerstone would have completed its works by about the end of March 2020. Thus on the facts of this case, the answer to the question, what would be a reasonable time for completion, depended upon how responsibility for that five month delay was to be allocated.

Did Cornerstone fail to carry out and complete works within a reasonable time?

The court identified two sub-issues, namely (i) who bears responsibility for the fact that the original foundation design was inappropriate? (ii) once the foundation problem had been identified, did Cornerstone act with reasonable expedition to deal with the problem?

The court held that whatever the general practice of the telecommunications industry was, a competent designer would have called for a geotechnical survey before finalising the design. This was not done and as result, the original design was inappropriate. Cornerstone was responsible for design and there was a sufficient basis upon which to hold that it failed to carry out its works within a reasonable time. That conclusion was strengthened, the court said, by consideration of the second sub-issue: there was no explanation as to why it took five months to resolve the problem once identified. At most, the court said, a couple of months would be needed to find a solution and get the team back on site.

The court said that the overall impression it had, was that Cornerstone was very busy – it had about fifty contracts on the go, of which this was not a high priority contract. The court also found that Cornerstone was made aware that the execution of Cornerstone's works was necessary to enable BREDL to achieve its objectives – and that the "build contract" (i.e. the main development) was only eight months. In those circumstances, the court had no hesitation in holding that the Cornerstone works should have been completed well before 30 June 2020, and would have been, but for matters for which Cornerstone was contractually responsible.

If Cornerstone breached its obligation as to time, was BREDL entitled to damages, and, if so, in what amount? Were BREDL's losses too remote?

BDREDL claimed additional project finance costs and additional project management costs.

Additional project finance costs

The court was satisfied on the evidence that as a result of delay in the completion of BREDL's transaction with Hastings Borough Council, there was delay in redemption of the loan as a result of which the fees and interest were incurred. The calculation was premised upon the assumption that if Practical Completion had occurred on 30 June 2020 the fees and interest would have been avoided. However, the court did not accept that premise in its entirety. Once the Practical Completion Certificate was eventually issued in August, it still took about twenty one days for the transaction to complete and the court was not convinced that that particular delay would have been significantly less had Practical Completion occurred on 30 June 2020. But for Cornerstone's delays, the court said, the transaction with Hastings Borough Council

would have been completed on or about 21 July 2020. On that basis, BREDL would in any event have incurred the monthly fee for July 2020 and interest up to and including 21 July 2020. Conversely, but for Cornerstone's delays, BREDL would have avoided the monthly fee for August 2020 and interest after 21 July 2020.

The court then went on to consider Cornerstone's contention that this loss was too remote to be recoverable. It said that Cornerstone knew (i) from about 5 February 2019, that the build period for the main development was only eight months starting five weeks from that date; (ii) from at least 7 February 2019, that the project had been forward sold to Hastings Borough Council and (iii) from at least 12 February 2019, that BREDL needed the mast removed before it could complete its development. Accordingly, Cornerstone knew, or should have appreciated, that this was a main development where the build period was relatively short, needed the mast removed for its satisfactory completion and that it was being sold on to Hastings Borough Council.

The court said that there was no reason to suppose that Cornerstone knew in any detail of BREDL's precise arrangements with Hastings or with its financiers, but any intelligent consideration would have made them realise that there was a serious possibility that BREDL would have some sort of financing arrangement in place and that BREDL's final ability to pay off that financing would be tied to practical completion of the project, including its works. Accordingly, the court rejected the suggestion that the financing costs were too remote to be recoverable. Accordingly, under this head of claim, the court awarded the monthly fee for August and the interest incurred between 22 July 2020 and date of redemption of the loan (28 August 2020).

Additional project management costs

The court accepted that this additional fee may not have been a fee to which the project manager was strictly entitled under the terms of its engagement by BREDL, but it was the sort of additional fee very often paid to a professional adviser when the work involved in a project has been much delayed, as this was. Accordingly, it held that it was a payment reasonably associated with and caused by the delay to the main project and was the sort of payment which Cornerstone (which had been keen to charge extra for its additional expenditure in putting in the larger foundations) would or should have regarded as a serious possibility.

A more significant issue, the court said, was whether the payment was associated with general delay to the main project or to the effect of Cornerstone's delays upon the main project. As to that, the evidence was clear, that it was the additional time and work involved for the project manager because of Cornerstone's delays which was the reason for the payment. Accordingly BREDL was also entitled to recover the claimed sum.

Comments

Finance and management costs have long been recognised heads of delay claims in construction projects. This judgment serves to confirm that they are recoverable in law when the contractor can prove that they were caused by the delay for which the employer is responsible.

Court finds ADR clause too uncertain to be enforceable

KK Cheung

In Children's Ark Partnerships Ltd v (1) Kajima Construction Europe (UK) Ltd & (2) Kajima Europe Ltd [2022] EWHC 1595(TCC), the 1st and 2nd Defendants (Kajima) applied to strike out or set aside proceedings on the grounds of failure to comply with a contractual ADR provision, said by Kajima to be a condition precedent to the commencement of proceedings. The court dismissed the application. Although, it found that, properly interpreted, the ADR provision was a condition precedent to the commencement of court proceedings, it found it to be unenforceable, because it was not sufficiently clear and certain.

Background

Children's Ark Partnerships Ltd (CAP) and the 1st Defendant, Kajima Construction (Europe) UK Ltd, entered into a Construction Contract for the construction of a hospital. CAP and the 2nd Defendant (the parent company of the 1st Defendant) entered into a guarantee, under which the 2nd Defendant guaranteed the due and punctual performance by the 1st Defendant of its obligations to CAP under the Construction Contract. Disputes arose and CAP commenced court proceedings, which Kajima applied to strike out, on the basis that the court did not have jurisdiction because CAP had failed to comply with the Dispute Resolution Procedure (DRP) in the Construction Contract.

Dispute Resolution Procedure

The Construction Contract contained agreed contractual machinery for the resolution of disputes. Clause 56 provided that: "*Except where expressly provided otherwise in this Contract, any dispute arising out of or in connection with this Contract shall be resolved in accordance with the procedure set out in Schedule 26 (Dispute Resolution Procedure)".* It was Kajima's case that, properly interpreted, this machinery gave rise to a condition precedent to the right to bring an action; in other words, there could be no right to commence proceedings (and thus no jurisdiction to hear the proceedings) unless the parties to the Construction Contract had operated and concluded the DRP. The DRP provided that disputes were initially to be referred to a Liaison Committee for resolution and that any decision of the Liaison Committee shall be final and binding unless the parties otherwise agreed. Schedule 26 then provided that the parties "*may*" refer a dispute to mediation and adjudication before "*Court Proceedings*", providing that all disputes, to the extent not finally resolved pursuant to the procedures set out in the foregoing provisions of the Schedule, shall be referred to the High Court of Justice in England by either party for resolution.

Issues

The two main issues before the court were:

(1) The effect of the alleged failure to comply with the DRP and, in particular, whether such failure had the effect of ousting the court's jurisdiction;

(2) Whether, even if the court had jurisdiction, it should nevertheless decline to exercise it in the circumstances of this case.

The court said that these issues required consideration of the following questions:

(i) whether the DRP gave rise to a condition precedent, as Kajima contended, or whether it was a mandatory jurisdiction provision, as CAP contended;
(ii) whether the provisions of the DRP were enforceable;
(iii) whether, if enforceable, the provisions of the DRP were complied with by CAP in advance of the issue of proceedings;

Did the DRP give rise to a condition precedent?

The court held that the DRP, properly interpreted, was a condition precedent to the commencement of litigation. It said that when viewed together with the other provisions, the obvious purpose of the relevant provisions in the DRP (objectively construed) was to require the mandatory referral of disputes to the Liaison Committee for resolution before the parties became entitled to institute proceedings.

The court found that the key provisions supporting this interpretation and which evidenced a clear chronological sequence in the operation of the contractual machinery were: (i) paragraph 2 of Schedule 26, which appeared to anticipate the existence of pre-conditions to the commencement of proceedings by reason of the creation of express exceptions; (ii) paragraph 3.1 of Schedule 26, which expressly provided that "all Disputes **shall first** be referred to the Liaison Committee for resolution; (iii) paragraph 3.2 of Schedule 26, which envisaged that in the case of a Construction Dispute, the Liaison Committee would convene and seek to resolve the dispute within 10 days of referral; and (iv) paragraph 7.1 of Schedule 26, which expressly provided that all disputes shall be referred to the High Court "***to the extent not finally resolved*** *pursuant to the [DRP in Schedule 26*]".

The various clauses provided for disputes "first" to be referred to the Liaison Committee and then "to the extent not finally resolved" to the High Court. The clauses, the court said, provided for a sequence which must be followed before legal proceedings could be commenced.

Was the Dispute Resolution Procedure enforceable?

It was common ground that, if it was to be enforceable, the DRP must be sufficiently clear and certain by reference to objective criteria. The court held that the DRP was not sufficiently clear because, amongst other things, there was no meaningful description of the process to be followed and it was therefore unclear how the Liaison Committee would "*seek to resolve the Dispute*" and it was unclear when the condition precedent was satisfied. It seemed unlikely, the court said, that referral on its own could satisfy the condition precedent, but it was otherwise unclear whether a resolution or decision was required before litigation may ensue.

The court said that although it should be slow to deny enforceability, the test is not whether a clause is a valid provision for a recognised process of ADR: it is whether the obligations and/or negative instructions it imposes are sufficiently clear

and certain to be given legal effect. In all the circumstances, the relevant provisions in this case were not apt, it said, to create an enforceable obligation to commence or participate in a dispute resolution process designed amicably to resolve the dispute between the parties to the Construction Contract.

The court found that the DRP was neither clear nor certain. It did not include a sufficiently defined mutual obligation upon the parties in respect of the referral to the Liaison Committee and the process that would then ensue and it therefore created an obvious difficulty in determining whether either CAP or Kajima had acted in breach.

In the circumstances, the court found that, although expressed as a condition precedent, the obligation to refer disputes to the Liaison Committee was not defined with sufficient clarity and certainty. The court said there was no meaningful description of the process to be followed regarding the DRP and no unequivocal commitment to engage in any particular ADR procedure and it was unclear when the condition precedent was satisfied and when the process was intended to come to an end. It also said that the Liaison Committee was to comprise of only representatives from Brighton and Sussex University Trust (the Employer in the project) and from CAP and as there was no representation on the Committee from Kajima, the process would not have a final/binding effect. It was unclear what impact any decision of the Liaison Committee would have on Kajima. The Construction Contract provided that "*Any decision of the Liaison Committee shall be final and binding unless the parties agree otherwise agree*". If the reference here to "*parties*" meant the Trust and CAP, then the process had no final and binding effect on Kajima.

Accordingly, the DRP procedure could not constitute a legally effective precondition to the commencement of proceedings and the commencement by CAP of legal proceedings did not merit a stay of the proceedings.

Comment

The Court of Appeal has granted the Defendants leave to appeal the decision. The Defendants may probably argue that the details of the DRP can be left to the Liaison Committee to decide once it is constituted. We will report the Court of Appeal decision when it is published.

Use of NEC Contracts for public works – the results so far

Joseph Chung

On 23 November 2022, the Secretary for Development, Ms Bernadette Linn, answered a question in the Legislative Council regarding the New Engineering Contract (NEC). Her answers provide useful information about the use of NEC in public works projects so far, as follows:

- The Development Bureau (DEVB) introduced the NEC form in public works contracts with a view to advocating the spirit of collaborative partnering and bringing the project team together to tackle difficulties, which would be conducive to the smooth implementation of the project. The conventional form of the contract previously adopted in public works, focusing more on the obligations and responsibilities of the two contracting parties, often put them in adversarial positions. Once problems or foreseeable risks occurred during the construction period, both parties tended to focus on identifying the responsible party, and hence more disputes arose in the process. As a result, the problem was not dealt with promptly and it might take more time or even cost to complete the works, which was not conducive to the smooth implementation of the project. In contrast, the NEC embraces a collaborative culture and through contractual mechanisms fosters the building of a mutual assistance/trust partnering relationship between the contracting parties as well as joint risk management, thereby enhancing project management performance and cost-effectiveness.

- In 2009, the DEVB piloted the first public works contract in the NEC form. Since 2013, the application of the NEC has been extended in a progressive manner. In 2017, the DEVB issued guidelines requiring all large-scale public works contracts to adopt the NEC form. For public works contracts engaging Group C contractors (viz. contract value above $400 million), the NEC form shall be adopted unless there are justifications with prior endorsement.

- From 2009 to now, there have been over 400 public works contracts adopting the NEC form with a total value of over $250 billion, of which over 80 works contracts have been completed with the accounts finalised.

- Since the issue of the above guidelines, the ratio of the NEC contracts to all public works contracts has been increasing, from 22 % in 2017 to 47% in 2022. Over 90 % of the large-scale public works projects commenced this year have adopted the NEC form.

- The forecasted expenditure and actual expenditure of the completed NEC contracts and the forecasted expenditure for each ongoing NEC contract are given in the Annex. Since there are over 400 contracts involved in total, the Annex only provides the data on the capital works contracts in the past three years.

- Consolidating the DEVB's experience in managing the NEC works contracts and the feedback collected from the sector and various stakeholder groups through questionnaire surveys, focus group interviews and workshops, the NEC form in general has an advantage over the conventional contract form, in the following three aspects:

    - Enhancing risk management: With the introduction of an early warning mechanism in the NEC, both the client's representative and the contractor are encouraged to identify and raise potential risks that may affect the project as early as possible, and when construction difficulties and problems are encountered, to negotiate and formulate the optimal solution for the smooth implementation of the project according to the prescribed procedure framework and timeframes in the contract. In addition, the risk management system of the NEC has helped shorten the actual construction period of some construction projects. For example, the Drainage Services Department has been carrying out the construction of sewerage works in various rural areas in the New Territories. After adopting the NEC form, the actual construction period has been shortened by about 6% on average as compared with the conventional contract form.

    - Optimising claim management: The NEC has a mechanism to deal with compensation events, which serves to compensate the contractor resulting from unforeseeable or uncontrollable difficult situations, etc. that take place at the construction stage. Compared with the conventional contract form, the NEC expressly prescribes the timeframes for handling compensation events, thus making it possible for the majority of the compensation events to be properly dealt with in a timely manner during the course of the contract. This effectively reduces claim disputes and the need to refer such disputes to mediation, arbitration or even litigation, and in turn significantly shortens the time required for finalising the account. Based on statistical analysis, there is a time saving of over 30% on average to finalise the NEC contracts as compared with conventional contracts.

    - Enhancing cost effectiveness: The "Target Contract" option of the NEC form provides a mechanism for the contracting parties to share the difference between the actual construction cost and the Target Cost, which offers incentives for the client's representative and the contractor to work in collaboration and formulate the optimal construction method, rendering the smooth implementation of the project and avoiding budget overrun. The actual construction cost of a "Target Contract" is based on the actual expenses of the contractor which is to be calculated on a reimbursement basis. When the actual construction cost is lower than the Target Cost, both contracting parties will share the difference equally. On the contrary, the client has to bear half of the difference subject to a cap of 5% of the Target Cost. "Target Contract" is suitable for adoption in projects with higher complexity or risk level, or where the scope of works cannot be clearly defined.

- To sum up, under the NEC's collaborative partnering principle, the project team works together proactively to resolve construction problems and difficulties in a timely manner, thereby reducing the risk of time or cost overrun in works contracts.

- Upon review, the DEVB considers that the NEC form is suitable for application in the majority of public works contracts. The DEVB has issued guidelines requiring all large-scale public works contracts to adopt the NEC form, making it the dominant form of contract in large-scale public works. For small and medium-scale contracts, as the contractors are mainly small and medium-sized companies, the DEVB will consult them in due course for mapping out the timetable of full implementation of the NEC form, so as to allow sufficient time for them to get familiar with the contract form.

  Since 2018, the Hong Kong Government has also started to use NEC4. Over recent years, NEC have also been progressively introduced in the non-public works sector such as CLP, MTR and the Airport Authority related projects. With the wider use of NEC and its perceived benefits, it remains to be seen how the use of NEC contracts may develop in private development projects.

Arbitration (Outcome Related Fee Structures for Arbitration) Rules – effective 16 December 2022

Stanley Lo

In our previous articles dated 8 February 2021 and 7 February 2022, we reported on outcome related fee structures for arbitration. On 16 December 2022, the Arbitration (Outcome Related Fee Structures for Arbitration) Rules will come into

operation, permitting the use of certain outcome-related fee structures in arbitration proceedings (ORFSA) and setting out the regulatory framework on ORFSA.

ORFSA under the new Rules

The Rules allow 3 types of ORFSA, namely conditional fee arrangements (CFAs), damages-based agreements (DBAs) and hybrid damages-based agreements (Hybrid DBAs):

- CFA: An agreement under which the lawyer agrees with the client to be paid a success fee for the matter, only in the event of a successful outcome for the client i.e. a no win no fee arrangement.

- DBA: An agreement under which the lawyer agrees with the client to be paid for the matter only in the event the client obtains a financial benefit in the matter (DBA payment) and the DBA payment is calculated by reference to the financial benefit that is obtained by the client in the matter e.g. a percentage of the sum awarded or recovered.

- Hybrid DBA: An agreement under which the lawyer agrees with the client to be paid for the matter in the event that the client obtains a financial benefit in the matter – a payment calculated by reference to the financial benefit and, in any event, a fee which may or may not be calculated at a discount, for the legal services rendered by the lawyer for the client during the course of the matter.

All types of ORFSA must be in writing, signed by the lawyer and the client and state:

(i) the matter to which the agreement relates (that is the arbitration or any part of it);
(ii) in what circumstances the lawyer's fees and expenses, or any part of them, are payable;
(iii) that the lawyer has informed the client of the right to seek independent legal advice before entering into the agreement;
(iv) a cooling off period of at least 7 days, during which the client can terminate the agreement without incurring liability;
(v) whether disbursements, including barristers' fees are to be paid by the client irrespective of the outcome of the matter;
(vi) the grounds on which the agreement may be terminated before the conclusion of the matter; and
(vii) the alternative basis, on which the lawyer is to be paid by the client in the event of termination of the agreement under (vi) above.

Specific Conditions

There are specific conditions for each type of ORFSA, as follows:

CFA

- The success fee payable by the client to the lawyer must be expressed as a percentage of the benchmark fee.
- The uplift element must not exceed 100% of the benchmark fee. The uplift element means the portion of the total fee payable by the client to the lawyer in the event of a successful outcome that exceeds the benchmark fee for the matter to which the agreement relates.
- The agreement must state the circumstances that constitute a successful outcome of the matter, the basis for calculating the success fee and when the success fee becomes payable.

DBA:

- The DBA payment must be calculated by reference to the financial benefit obtained by the client, must not exceed 50% of the financial benefit obtained by the client and must be payable in addition to any recoverable lawyer's costs.
- The DBA must state the "financial benefit" to which the agreement relates, basis for calculating the DBA payment, when the DBA payment becomes payable by the client, and whether barrister's fees are to be regarded as part of the DBA payment or the client is liable to pay the barrister's fees in addition to the DBA payment.

Hybrid DBA:

In addition to the conditions for a DBA agreement above, a hybrid DBA agreement must also:

- State the fees applicable during the course of the matter and the benchmark fee.
- Provide that in the event that no financial benefit is obtained by the client, the client is not required to pay the lawyer more than 50% of the irrecoverable costs.
- Provide that in the event that the client obtains a financial benefit, but the DBA payment is less than the capped amount, the lawyer may elect to retain the capped amount instead of the DBA payment; and if the lawyer so elects, the capped amount instead of the DBA payment is to be payable by the client to the lawyer. The capped amount

means the amount of the irrecoverable costs that would have been payable to the lawyer by the client under the agreement in the event that no financial benefit is obtained by the client in the matter.

Comments

Singapore has permitted conditional fee agreements between lawyers and their clients for arbitration cases since May 2022. The ORSFA brings Hong Kong in line with Singapore and other top global dispute resolution centres. ORSFA, together with the third party funding law in Hong Kong, provides more funding options for clients. How it will change the way lawyers charge their clients is yet to be seen.

It should also be noted that the ORSFA is only applicable to lawyers. Some arbitrations, in particular construction arbitrations, may be conducted by claims consultants. Whether if they charge fees on a contingency basis will infringe the law against champerty and maintenance (which is a criminal offence) is unclear after Unruh v Seeberger (2007) 10 HKCFAR 31 (please see our previous article on this judgment), where the Hong Kong Court of Final Appeal expressly left open this question.

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