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The construction & energy law specialists

International Quarterly

Issue 03, 2012

Our newsletter provides informative and practical information regarding legal and commercial developments in construction and energy sectors around the world.

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Global claims

This issue's contract corner looks at the question of global or total-cost claims.

By Jeremy Glover
Partner, Fenwick Elliott

This month's contract corner looks at the question of global or total-cost claims.

Global claims were defined by Byrne J in the Australian case *John Holland Construction v Kvaerner RJ Brown* as being a claim where:

"the claimant does not seek to attribute any specific loss to a specific breach of contract, but is content to allege a composite loss as a result of all the breaches alleged, or presumably as a result of such breaches as are ultimately proved".

This has lead to tension with those who say that the loss attributable to each cause should be separately identified and particularised,[1] but as everyone will recognise, that separation is not always a simple task. In a judgment recently released in the UK,[2] Mr Justice Akenhead set out a number of principles which apply to global claims. Although the case revolved around clause 26.1 of the JCT Standard Form of Building Contract 1998 Edition Private Without Quantities, the general principles set out by the judge will apply to many other projects. Clause 26.1 states that:

"If the Contractor makes written application to the Architect that he has incurred or is likely to incur direct loss and/or expense (of which the Contractor may give his quantification) in the execution of this Contract for which he would not be reimbursed by a payment under any other provision in this Contract … because the regular progress of the Works or of any part thereof has been or is likely to be materially affected by any one or more of the matters referred to in clause 26.2; and if and as soon as the Architect is of the opinion that … the regular progress of the Works or of any part thereof has been or is likely to be so materially affected as set out in the application of the Contractor then the Architect from time to time thereafter shall ascertain, or shall instruct the Quantity Surveyor to ascertain, the amount of such loss and/or expense which has been or is being incurred by the Contractor."

Mr Justice Akenhead concluded that there is nothing "wrong" in principle with a "total" or "global" cost claim and set out the following propositions:

(i) Claims by contractors for delay- or disruption-related loss and expense must be proved as a matter of fact. The Contractor has to demonstrate on a balance of probabilities that, first, events occurred which entitle it to loss and expense, secondly, that those events caused delay and/or disruption and thirdly that such delay or disruption caused it to incur loss and/or expense (or loss and damage as the case may be).

(ii) It does not, as a matter of principle, have to be shown by a claimant contractor that it is impossible to plead and prove cause and effect in the normal way or that such impossibility is not the fault of the party seeking to advance the global claim. In the absence of any contractual restrictions, the claimant contractor simply has to prove its case on a balance of probabilities.

(iii) There is no set way for contractors to prove their claim. It can be done with whatever evidence will satisfy the tribunal and the requisite standard of proof. The Judge noted that a claim may be supported or even established by detailed factual evidence which precisely links reimbursable events with individual days or weeks of delay or with individual instances of disruption, which then demonstrates with precision to the nearest penny what that delay or disruption actually cost.

(iv) A global claim may have added evidential difficulties which a claimant contractor has to overcome. For example:

1. The late Iain Duncan Wallace, (*Hudson's Building and Engineering Contract*, 11th Edition, page 1090) went so far as to say that "claims on a total cost basis, will *prima facie*, be embarrassing and an abuse of the process of the court, justifying their being struck out and the action dismissed at the interlocutory stage".
2. *Walter Lilly v Giles Patrick MacKay*, [2012] EWHC 1773 (TCC)

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(a) It will generally have to establish (on a balance of probabilities) that the loss which it has incurred (namely the difference between what it has cost the contractor and what it has been paid) would not have been incurred in any event.[3]

(b) It will need to demonstrate in effect that there are no other matters which actually occurred (other than those relied upon in its pleaded case and which it has proved are likely to have caused the loss).[4]

(v) The fact that one or a series of events or factors (unpleaded or which are the risk or fault of the claimant contractor) caused or contributed (or cannot be proved not to have caused or contributed) to the total or global loss does not necessarily mean that the claimant contractor can recover nothing.[5]

(vi) If there are events during the course of the contract which are the fault or risk of the claimant contractor which caused or cannot be demonstrated not to have caused some loss, the overall claim will not be rejected save to the extent that those events caused some loss. [6]

(vii) There is no need for the court to go down the global or total cost route if the actual cost attributable to individual loss-causing events can be readily or practicably determined. However, the suggestion that a global award should not be allowed where the contractor has himself created the impossibility of disentanglement was, in the view of the Judge, wrong.[7]

This all led Mr Justice Akenhead to conclude that:

"In principle, unless the contract dictates that a global cost claim is not permissible if certain hurdles are not overcome, such a claim may be permissible on the facts and subject to proof."

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3. This means it will need to demonstrate that its accepted tender was sufficiently well priced that it would have made some net return.
4. However, it was wrong to suggest that the burden of proof transfers to the defending party. That said, the defending party can raise issues or adduce evidence that suggest or even show that the accepted tender was so low that the loss would always have occurred irrespective of the events relied upon by the claimant contractor or that other events (which are not relied upon by the claimant as causing or contributing to the loss or which are the "fault" or "risk" of the claimant contractor) occurred that may have caused or did cause all or part of the loss.
5. The Judge gave as an example the situation where a contractor's global loss is £1 million and it can prove that but for one overlooked and un-priced £50,000 item in its accepted tender it would probably have made a net return; the global loss claim does not fail simply because the tender was underpriced by £50,000; the consequence would simply be that the global loss is reduced by £50,000 because the claimant contractor has not been able to prove that £50,000 of the global loss would not have been incurred in any event.
6. Here the Judge gave an example of time spent by management in dealing with lift problems (in particular the over-cladding). Assuming that this time can be quantified either precisely or at least by way of assessment, that amount would be deducted from the global loss. Mr Justice Akenhead noted that this was not inconsistent with the Judge's reasoning in the *Merton* case that *"a rolled up award can only be made in the case where the loss or expense attributable to each head of claim cannot in reality be separated"*, because, *"where the tribunal can take out of the 'rolled up award' or 'total' or 'global' loss elements for which the contractor cannot recover loss in the proceedings, it will generally be left with the loss attributable to the events which the contractor is entitled to recover loss".*
7. Indeed, in *John Holland*, Byrne J noted that a global claim "*has been held to be permissible in the case where it is impractical to disentangle that part of the loss which is attributable to each head of claim, and this situation has not been brought about by delay or other conduct of the claimant*".

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Impact of the new ICC Rules (2012) on the management of construction arbitration cases

By Frederic Gillion
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Most European international contractors will no doubt have noticed a significant increase in the number of arbitrations that they have had to commence or defend over the past 10 years. In fact, over that period, the workload of the Court of the International Chamber of Commerce (ICC) has grown by at least 40%, and between 2007 and 2010 the number of arbitration cases handled by the ICC has grown by 15%. Approximately 1,500 arbitration cases are currently being administered by the ICC. According to the latest statistics from the ICC (2010 Statistical Report), 17% of the cases filed in 2010 (796 new cases) related to construction and engineering disputes, i.e. 135 new cases. Fifty per cent of the parties involved in the cases filed that year were from Europe.

Is this trend symptomatic of a (new) belief that arbitration is an efficient way of resolving disputes for international construction projects? Probably not. This increase in the number of arbitration proceedings is most likely simply the result of an increase in the number of construction disputes, which in turn is a direct consequence of the severe financial difficulties experienced by both contractors and employers in recent years. Parties still rightly attempt to stay away from arbitration proceedings by seeking an amicable resolution of their disputes during the course of their projects. However, the current uncertain times sometimes make a settlement difficult to achieve, especially for public works projects where an additional layer of bureaucracy makes settlement discussions problematic.

It is still with a lot of reluctance (often to avoid limitation issues) that parties eventually start arbitration proceedings following the completion of a project, knowing that it will be a lengthy and costly process. Conscious of those concerns amongst users of international arbitration, the ICC has sought to promote in its new arbitration rules ("the 2012 ICC Rules") a more cost-effective, expeditious and efficient procedure for the resolution of disputes. This article highlights the new procedural mechanisms and principles introduced by the 2012 ICC Rules to improve case management, and considers the impact (if any) these changes may have on the conduct of construction arbitration proceedings under the ICC Rules.

Main concerns for parties involved in construction arbitrations: time and cost

Time and costs are beyond any doubt the two major concerns of parties involved in construction arbitrations.

A recent survey conducted by the Chartered Institute of Arbitrators showed that the average costs for a UK claimant are £1.54m (£1,685,000 for claimants in the rest of Europe), with proceedings lasting on average between 17 and 20 months.

This survey was based on 254 arbitrations that took place between 1991 and 2010, of which a quarter related to construction/engineering disputes. Although the survey does not specify the average costs and time for construction arbitration proceedings, my experience is that any construction disputes of real significance commonly take anything between 2 and 4 years from the commencement of the arbitration to the final award, and that assumes that the arbitral tribunal has been diligent enough to render its final award fairly swiftly after the closing of the proceedings. A further year is also usually required to enforce that award.

In these difficult economic times, changes are undoubtedly needed to enable those disputes to be resolved in a much shorter time frame and in doing so to reduce the costs of the arbitration.

Who is to blame for this situation?

In the spirit of openness, I should probably start with the parties' legal advisors who should accept some

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responsibility for the management of a case by assessing at an early stage the chance of success of some of their clients' claims so that no time is wasted arguing weak claims. Legal counsel should also identify from the outset the main issues of a case so that, if possible, a partial award may be made by the arbitral tribunal at an early stage of the proceedings. This can make a significant difference in the conduct of the case by increasing the pressure on one party and the chance of an early settlement as well as limiting the scope of the dispute. Finally, the parties' legal advisors should also ensure that any work given to experts is properly managed so that their scope of work is clearly defined.

Arbitrators are also partly to blame for the current situation. They can delay arbitrations in two ways: (1) their lack of availability for meetings and hearings, which is made worse in the case of a three-member arbitral tribunal; and (2) when drafting the award. A usual complaint with regard to arbitrators is that they take on too many cases at the same time (in the hope that some of them will settle early), making the management of each case a real challenge. I have been the unfortunate witness of a case where it took 18 months for the sole arbitrator to render his award. I have also been involved in some cases where it was clear that the arbitrators were not fully aware of the key issues of the case at the beginning of the proceedings, when it is often at this stage that they can assist the parties the most in fixing procedures that are swift and appropriate to the case.

Finally, arbitration institutions such as the ICC have a role to play in ensuring that the arbitration process is run in an efficient and cost-effective manner. This can be done through the clarification of the arbitration rules, but also by making sure that arbitrators, who genuinely have enough capacity to take on new cases, are appointed promptly. This is what the ICC has sought to achieve with its new rules of arbitration.

The ICC's response to these concerns in the 2012 ICC Rules

The 2012 ICC Rules came into force on 1 January 2012 and will apply to all ICC arbitrations that commenced on or after that date, unless the parties have agreed that the previous version (1998) of the Rules will apply. The FIDIC forms of contract anticipate in their arbitration clause that all disputes shall be finally settled under the Rules of Arbitration of the ICC without specifying a particular version of the Rules. Construction disputes that arose under an unamended FIDIC contract will therefore be subject to the 2012 ICC Rules if the arbitration was commenced on or after 1 January 2012.

By and large, the 2012 ICC Rules maintain the main characteristics of ICC arbitration such as the terms of reference, the scrutiny of draft awards by the International Court of Arbitration (the ICC Court), and the involvement of national committees involved in the appointment of arbitrators. It is important to bear in mind that the ICC Court does not resolve disputes, but rather administers the resolution of disputes by arbitral tribunals and oversees the arbitration process.

Many of the changes introduced by the 2012 ICC Rules in fact amount to a codification of current practice of the ICC Court and Secretariat since 1998. However, they also seek to address some of the concerns mentioned above by bringing in new procedural mechanisms and principles, including case management techniques focused on time and costs. I will not deal in this article with all the changes introduced by the 2012 ICC Rules. I will simply highlight below some of those changes that may improve the way ICC arbitration cases are managed. They include:

- New provisions regarding the appointment and availability of arbitrators;
- Several updates and additions relating to the conduct of the proceedings to make them more efficient and cost-effective, including provisions on which arbitrators will be able to rely to sanction a party's delaying tactics when allocating costs between the parties; and
- Indication of the timescale for the issuance of the award.

Appointment and availability of arbitrators

The ICC Court's power to speed up the appointment of arbitrators

In order to address one of the traditional complaints made against the appointment of arbitrators by national committees (in particular the length

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of time it sometimes takes for those committees to appoint arbitrators and also the limited pool of arbitrators who are, as a result, very busy), the 2012 ICC Rules (Article 13) empowers the ICC Court to appoint arbitrators directly if it does not accept the proposal made by the national committee or no proposal is made within the time limit fixed by the ICC Court. The ICC Court may also appoint arbitrators directly in certain circumstances, including arbitrations involving a State entity.

Requirement for arbitrators to sign a statement of availability

Article 11(2) of the 2012 ICC Rules requires any prospective arbitrator to sign before his appointment a statement confirming his availability for the case. In reality, this requirement simply confirms the ICC's practice to distribute to prospective arbitrators a form that requires them to disclose information not only about their independence, but also their availability to arbitrate a particular case. This new requirement in itself is therefore unlikely to avoid delays attributable to arbitrators. The ICC is, however, conscious that this is a serious issue and both the ICC Court and its Secretariat will no doubt continue to place pressure on slow arbitrators when it comes to the drafting of awards, especially now that the 2012 ICC Rules have also introduced a requirement for arbitrators to inform the ICC Secretariat and the parties of the date when they anticipate their draft award being ready (see below).

Conduct of the proceedings under the 2012 ICC Rules

Mandatory case management conference

A case management conference must now form part of the arbitral process under Article 24 of the 2012 ICC Rules in order to consult the parties on the appropriate procedural measures at the outset of the proceedings. Article 24 further calls on the arbitral tribunal to hold subsequent case management conferences "to ensure continued effective case management", and under Article 24(4) the arbitral tribunal is specifically empowered to request the attendance of a party representative at a case management conference, the intention being to ensure the parties "buy in" to these procedural measures.

Appropriate procedural measures may include one or more of the case management techniques described in new Appendix IV which incorporates the ICC's publication *Techniques for Controlling Time and Costs in Arbitration*. None of these case management techniques are terribly new, but this Appendix IV does provide a useful reminder for the arbitral tribunal, and also for the parties and their legal advisors, of the procedural measures that can be used to control time and cost. They include the following measures:

(a) Bifurcating the proceedings or rendering one of more partial awards on key issues, when doing so may genuinely be expected to result in a more efficient resolution of the case. A usual bifurcation observed in construction cases is between issues of principle and quantum. Although this split is sometimes appropriate, it can however lead in some cases to a significant lengthening of the proceedings and therefore an increase of the overall costs;

(b) Identifying issues that can be resolved by agreement between the parties or their experts, typically issues of quantum in construction cases;

(c) Identifying issues to be decided solely on the basis of documents rather than through oral evidence or legal arguments at a hearing;

(d) Limiting disclosure of documents. This is particularly relevant to construction cases which tend to involve a considerable amount of documents;

(e) Limiting the length and scope of written submission and evidence so as to avoid repetition and maintain a focus on key issues;

(f) Encouraging the parties to consider settlement.

New duty of the parties and arbitrators to conduct the arbitration in an expeditious and cost-effective manner

Article 22(1) of the 2012 ICC Rules imposes on the arbitral tribunal and the parties a new duty to "make every effort to conduct the arbitration in an expeditious and cost-effective manner, having regard to the complexity and

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value of the dispute". The duty on the parties is confirmed by Article 37(5) which specifically authorises the arbitral tribunal to consider in its cost decision the extent to which each party complied with its general duty.

Timescale for the issuance of the award under the 2012 ICC Rules

Finally, as mentioned above, the 2012 ICC Rules seek to address the issue of delays in the drafting of awards. At the close of the proceedings the arbitral tribunal must now inform the ICC Secretariat, as well as the parties, of the date by which the tribunal expects to submit its draft award to the Court for approval. To reinforce that duty, a new Appendix III to the 2012 ICC Rules (on Costs and Fees) provides that in setting the arbitrators' fees, the ICC Court will take into account their "diligence and efficiency", "the time spent", the "rapidity of the proceedings", but also "the timeliness of the submission of the draft award". This may well work as an incentive for arbitrators to render their award within the anticipated timescale.

Conclusion

Although not radical, the procedural mechanisms and principles introduced by the 2012 ICC Rules to improve case management may contribute to giving the parties more faith in the arbitration process by allowing them to have more certainty over the likely time and cost involved in pursuing a claim in arbitration.

However, this will be so only if these mechanisms are implemented properly by the arbitrators and the parties, and also providing that the parties do buy in.

In principle, the parties should not have any difficulties in agreeing on a swift procedural timetable given that their common interest should be a speedy and efficient resolution of their dispute. However, the reality is that there will be cases where only one party may have interest in pushing for a resolution of the dispute (typically the claimant), while the other will do everything to delay the proceedings and the outcome of the case, and will ask for more time for more time to present its case.

In that situation, the arbitral tribunal's main objective will be not to give priority to one argument over the other but rather to balance the parties' interests in the light of the particular dispute that it has to arbitrate. Providing the opportunities given to the parties are equal, there should, however, be nothing stopping an arbitral tribunal from setting precise and narrow limits on matters such as the length of submissions or whether certain issues should be decided on the basis of documents only. In addition, tribunals can take advantage of the new rules relating to costs to sanction a party's wasteful tactics such as unmeritorious applications by making a partial award on costs against that party.

It is obviously too early to predict the impact of the 2012 ICC Rules on how arbitral tribunals will conduct arbitration proceedings. However, judging from the cases brought to ICC arbitration this year by clients of this firm, it would seem that arbitrators may well have embraced the ICC's new emphasis on case management and appear ready to stand up to the parties when determining the procedure of the arbitration by insisting in particular on shorter timetables.

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Saudi Arbitration Law

By David Toscano
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Overview

A new Arbitration Law in Saudi Arabia came into effect on 9 July 2012, replacing the 1983 Arbitration Law and solving some of the particular difficulties that Law posed to local and international businesses trading in the Kingdom. It is a marked improvement on the 1983 Law with a closer alignment to international principles. It is hoped parties will begin to have greater confidence in Saudi arbitration as a viable means of dispute resolution.

Dispute resolution in Saudi Arabia

For businesses trading in Saudi Arabia, commercial disputes could be referred to:

1. Local courts, including the Board of Grievances (a specialised commercial court);

2. Domestic arbitration, previously under the 1983 Arbitration Law but now subject to the new Arbitration Law; or

3. International arbitration, to which parties may also agree to apply the new Arbitration Law.

The 1983 Law

Domestic arbitration in Saudi Arabia under the 1983 Arbitration Law posed a number of particularities, including:

• Government bodies were not permitted to refer disputes to arbitration without specific permission.

• Arbitrators were required to be 'experienced' and 'of good conduct and reputation' and 'full legal capacity' (which, under the 1983 Law, meant that arbitrators had to be male and of the Islamic faith).

• Arbitration agreements were to be filed with the court or Board of Grievances who would then supervise the conduct of the arbitration, including appointing the Arbitral Tribunal where the parties failed to agree on the identity of the arbitrator(s) and hearing applications to replace an arbitrator.

• Arbitral awards were required to be issued within 90 days or an agreed extended period, and once that period expired, either party could commence separate proceedings in the supervising court, avoiding the effect of the arbitration agreement.

• The award needed to be ratified by the supervising court in order to be enforceable. Before ratifying any award, the court heard objections from either party and also determined whether the award contravened shariah law. If so, it was rendered unenforceable and when considering an objection, the court could reopen the merits of the dispute at this final stage.

Features of the new Arbitration Law

The new Arbitration Law replaces the 1983 Arbitration Law in its entirety. It was approved by the Saudi Arabian Council of Ministers in April 2012, published in the Official Gazette on 8 June 2012 and came into effect as of 9 July 2012.

The key changes are in the following areas:

• *Arbitration agreements*

- Parties will no longer have to file their agreements with courts for supervision and the new Law codifies that an arbitration agreement will not be rendered invalid by the termination or invalidity of the substantive contract between the parties. This brings Saudi Arabia in line with many jurisdictions on this issue.

- Parties may now also be sure that incorporating standard form conditions into their agreements and referring to the

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rules issued by arbitration institutions will comply with the new Law.

• *Arbitrators*

- In addition to the requirements set out in the 1983 Law, the new Law requires that arbitrators be holders of at least a university degree in shariah science. This is an important practical consideration when appointing an arbitrator given that the award cannot contravene shariah law.

- Arbitrators now have a positive obligation to keep parties informed of circumstances that may give rise to conflicts of interest or apparent bias. This will improve transparency and trust in the process.

- The new Law also provides for two nominated arbitrators to choose the third arbitrator. This procedure is familiar to international practice and reduces the intervention of the supervising court.

- Challenges to the arbitral tribunal for bias or conflict of interest will now have to comply with time limits, which should avoid such issues being raised at the enforcement stage.

• *Procedure*

- Arbitrators will be able to request assistance from a relevant authority for procedural steps such as summoning a witness or expert and ordering the production of documents.

- Where the parties have not agreed on the applicable arbitration rules, the new Law sets out a detailed default procedure that is similar to the UNCITRAL Model Law.

- Arbitrations are no longer required to be conducted in Arabic and the parties may agree to apply a substantive law other than that of Saudi Arabia (although the award must still comply with shariah law to be enforceable).

• *Awards*

- Arbitrators now have 12 months from the commencement of the arbitration to issue their awards, with the power to extend this by a further 6 months and the parties able to agree to longer extensions. This is a more realistic time frame than the 90 days that applied in the 1983 Law.

• *Enforcement*

- Any application seeking to invalidate an award must be made within 60 days and can only be made on the limited grounds identified in the New York Convention.

- Further, it is only the relevant court that can, of its own initiative, raise arguments that the award violates shariah law. In doing so, the court cannot reopen the substantive issues of the dispute, which is a significant improvement on the 1983 Law.

- Awards made under the new Law will be res judicata however; in order to the enforce that award, the successful party will need to obtain an enforcement order from the courts.

Summary

The new Arbitration Law is a refined improvement on the 1983 Law which brings Saudi Arabia closer to international best practice. For an award to be enforceable, it must still comply with shariah law.

However, the new Arbitration Law is a modern approach to this important area for businesses trading in the Kingdom. With greater clarity on the appointment and independence of arbitrators and with a narrowing of the grounds for challenges to awards, it is likely that Saudi Arabia will see an increase in arbitration being used as an option for resolution of commercial disputes.

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Contract interpretation: commercial intent takes centre stage

By Richard Smellie
Partner, Fenwick Elliott

Throughout the commercial world, on a daily basis, contracts drawn up to regulate the commercial activities of parties to a business enterprise are subjected to close scrutiny for the purpose of ascertaining legal rights and obligations. Where the language is clear, the rights and obligations will be clear, but language is often susceptible to more than one possible meaning, particularly when arguments arise or the unexpected occurs.

The commercial world of international construction contracts is no exception. These contracts are often complex, and ascertaining the true nature of the parties' agreement on a particular point can be challenging. The starting point is, of course, the words on the page, but where there is conflict or ambiguity — as there often is when a dispute arises — they must be interpreted. It is at this point that the law of the contract steps in, with rules on how the contact is to be interpreted.

In English law, for many years now, there has been a steady move away from the application of individual, strict rules of interpretation, particularly for commercial contracts, with the primary touchstones being that the relevant provision in the contract must be interpreted in the context of the document as a whole, and that what the parties meant by the language used involves ascertaining what a reasonable person would have understood the parties to have meant. To that end, the "reasonable person" is a person with the background knowledge that would have reasonably been available to the parties at the time they entered into the contract (but excludes the subjective knowledge and intentions of the parties, and so excludes the detail of contract negotiations).

Recently, English law took a further, important step along the road of contract interpretation, in the decision of the Supreme Court in *Rainy Sky S.A. and others v Kookmin Bank* [2011] UKSC 50. In short, the Supreme Court (which since October 2009 has been the highest court in the United Kingdom, taking over the judicial functions of the House of Lords) confirmed the particular importance of giving weight to "business common sense" in ascertaining what the parties meant by the language they used, when ambiguity arises.

The *Rainy Sky* decision concerned the insolvency of a shipbuilder, and whether the purchasers of vessels not completed at the time of the shipbuilder's insolvency could claim back monies paid to the shipbuilder against refund guarantees issued by the Kookmin Bank. The problem was that the wording of the guarantees was open to two possible interpretations. The bank contended for a literal interpretation, which, whilst making the guarantees available for many types of default by the shipbuilder, meant that the guarantees were not available as security in the event of the shipbuilder's insolvency.

The bank succeeded on its interpretation before the Court of Appeal. In particular the Court of Appeal said as follows:

"Unless the most natural meaning of the words produces a result which is so extreme as to suggest that it was unintended, the court has no alternative but to give effect to its terms. To do otherwise would be to risk imposing obligations on one or other party which they were never willing to assume and in circumstances which amount to no more than guesswork on the part of the court."

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The Supreme Court, however, disagreed. In so doing, it placed considerable importance on the fact that the literal interpretation contended for by the Bank meant that the security was not available on the shipbuilder's insolvency, saying that it *"defies commercial common sense to think that this, among all other such obligations, was the only one which the parties intended should not be secured"*.

Consequently, whilst the Supreme Court reaffirmed that where the language in the contract is unambiguous, then the court must apply it, it went on to say that where there is ambiguity, generally the interpretation that is consistent with business common sense should be taken to be the interpretation intended by the parties. The Supreme Court put it as follows:

"The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other" and

"where a term of a contract is open to more than one interpretation it is generally appropriate to adopt the interpretation which is most consistent with business common sense."

This decision, arguably, reflects an emphasis on the perceived commercial realities that many Dispute Adjudication Boards and arbitrators have been quietly giving precedence to for many years. It does, however, place business common sense at the heart of contract interpretation when ambiguity arises, and so has important ramifications for all commercial contracts, not least construction contracts.

The language of complex construction contracts, including the layering of obligations through appendices, is often capable of more than one meaning. It remains the case that the aim of interpreting the relevant term is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person with the background knowledge reasonably available to the parties at the time of the contract, would have understood the words used to mean. But English law now calls for more weight to be given to "business/commercial common sense" and the commercial purpose of that which is being considered, and does not require a particular interpretation to give rise to an absurd or irrational result before having regard to that commercial purpose.

Parties — and their advisors — must therefore give much more consideration to the possible commercial purpose and business common sense of a provision when disagreements arise and the provision is open to more than one interpretation, and place less emphasis on a literal interpretation that might not sit with business common sense.

Further, in the drafting of commercial contracts, the parties — and their advisors — must now give greater thought to the inclusion of provisions that expressly confirm the commercial purpose of the agreement, and in particular the commercial purpose of any provision which might be said to be contrary to business common sense. The facts in *Rainy Sky* provide a simple example: if it had been intended that the guarantees should not secure the insolvency of the shipbuilder, the recitals should have confirmed this to be the commercial intention of the parties, and included some explanation as to the reason for this unusual allocation of risk.

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News and Events

Trends, topics and news from Fenwick Elliott

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This edition

We hope that you have found this edition of International Quarterly informative and useful. We aim to keep you updated regarding legal and commercial developments in construction and energy sectors around the world. Fenwick Elliott's team of specialist lawyers have advised on numerous major construction and energy projects worldwide, nurturing schemes to completion with a combination of careful planning, project support and risk assessment. From document preparation to dispute resolution, our services span every stage of the development process.

We also offer bespoke training to our clients on various legal topics affecting their business. If you are interested in receiving bespoke in-house training please contact Susan Kirby *skirby@fenwickelliott.com* for a list of topics.

Annual Review

Our 16th Review will be available on our website www.fenwickelliott.com in November. This annual review will contain a round up of the key developments in the construction and energy arena over the past year and will include a look at key developments in International Arbitration over the past 12 months. We will also feature articles on procurement, bonds and guarantees, Building Information Modelling (BIM) and the latest developments with the FIDIC form of contract.

The arrival of Lyndon Smith strengthens our team

Fenwick Elliott is very pleased to welcome Lyndon Smith to our team. Lyndon has extensive experience throughout the construction industry advising on a wide range of disputes for construction professionals, their indemnity insurers, contractors and employers.

Follow us on Twitter and LinkedIn

Keep up to date with latest legal developments and Fenwick Elliott news by following Fenwick Elliott on Twitter (@FenwickElliott) and LinkedIn. We regularly update these accounts with articles and newsletters regarding construction and energy law and Fenwick Elliott news and events.

Fenwick Elliott to support the FIDIC International Contract Users' Conference 2012

We are proud to support the FIDIC International Contract Users' Conference taking place in London on 5 & 6 December. Nicholas Gould will chair a panel of speakers including Fenwick Elliott's Jeremy Glover in a session entitled "Dispute Boards in practice – overcoming the hurdles". To find out more about our participation at this conference please contact Susan Kirby *skirby@fenwickelliott.com*

Fenwick Elliott lawyers nominated as leaders in the their field

Simon Tolson, Tony Francis, Julian Critchlow and Nicholas Gould are listed as leaders in the field of construction in the 2012 edition of The International Who's Who of Construction Lawyers. Nominees have been selected based upon comprehensive, independent survey work with both general counsel and private practice lawyers worldwide. Only specialists who have met independent international research criteria are listed.

About the editor, Jeremy Glover

Jeremy has specialised in construction energy and engineering law and related matters for most of his career. He advises on all aspects of projects both in the UK and abroad, from initial procurement to where necessary dispute avoidance and resolution. Typical issues dealt with include EU public procurement rules, contract formation, defects, certification and payment issues, disruption, loss and/or expense, prolongation, determination or repudiation and insolvency.

Jeremy organises and regularly addresses Fenwick Elliott hosted seminars and provides bespoke in-house training to clients. He also edits Fenwick Elliott's monthly legal bulletin, *Dispatch*.

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