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Contract Corner:

A review of typical contracts and clauses

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FIDIC Dispute Adjudication Boards

By **Jeremy Glover**
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Of all the provisions to be found in the FIDIC form, those of clause 20 have attracted by far the most comment. One of the potential hurdles that need to be overcome with clause 20 is the appointment of the Dispute Adjudication Board or DAB itself. This is dealt with in sub-clause 20.2 of the standard Red and Yellow FIDIC forms and sub-clause 20.3 of the Gold Book. One particular feature of the FIDIC form of contract is that obtaining a decision from a DAB is generally a precondition to a party being entitled to commence arbitration. This can often result in two conflicting questions:

- (i) What can I do if the other party to the contract refuses to assist in the appointment of the DAB? How do I resolve my dispute if there is no DAB and no DAB decision? Can I go straight to arbitration?
- (ii) Do I have to go through the DAB process? The contract is at an end. Obtaining a decision of the DAB is just an unnecessary duplication of costs.

Interestingly there have been two recent decisions which address these issues, one from England and one from Switzerland. It is therefore possible to compare and contrast the approach of the Civil Codes and Common Law.

Switzerland: Decision 4A_124/2014

This was a decision of the Swiss Supreme Court.

The attempts to set up a DAB

On 6 June 2006, the parties entered into a contract based on the FIDIC Red Book.

In March 2011, the Contractor notified the

Owner of its intention to refer to a Dispute Adjudication Board (DAB) a claim for €21 million.

It was not until 2 May 2011 that both parties had appointed their respective adjudicators.

In October 2011, the prospective chair of the DAB was provisionally agreed. However, no formal appointment was made because the DAB Agreement was not itself agreed.

In March 2012, the prospective chairman disclosed a conflict of interest.

A further chairman was not agreed until 14 June 2012. That second prospective chair requested that the parties produce a draft agreement by letter dated 2 July 2012.

On 27 July, the Contractor filed a request for arbitration with the ICC and a three-member Tribunal was appointed, the seat of the arbitration being in Geneva.

On 13 September 2012, the prospective chair of the DAB circulated a draft Dispute Adjudication Agreement (DAA). On 18 October 2012, the Owner suggested some changes and invited the Contractor to sign the Dispute Adjudication Agreement.

The Contractor replied the following day, noting that as the DAB was still not in place some 18 months after it had first tried to initiate proceedings, it had initiated the arbitration procedure to protect its rights.

The Owner challenged the jurisdiction of the Arbitration Tribunal on the failure of the Contractor to follow the DAB procedure required by the contract.

The Decision of the Arbitral Tribunal

On 21 January 2014, the Arbitration Tribunal made an award, by a majority, holding that the DAB procedure contemplated by clause 20 of

the FIDIC form was:

“not mandatory in that it would be a precondition to the right to initiate arbitration or that failure to observe it would lead to inadmissibility”.

The majority of the Tribunal noted that in the FIDIC Contracts Guide the commentary on sub-clause 20.8 states that one of the reasons that there may not be a DAB in place is because of a “party’s intransigence”, and pointed out that the FIDIC General Conditions do not set a time limit to constitute a DAB, which they said would argue against the mandatory nature of the prior procedure of dispute settlement established by FIDIC. The approximately 15 months (March 2011 to July 2012) it took for the parties to succeed in constituting such a body in the case at hand, without either party being entirely responsible for the delay, was said to be irrefutable evidence of that.

On 26 February 2014, the Owner filed a request to set aside the interim award for lack of the Tribunal’s jurisdiction.

The Decision of the Swiss Supreme Court

First of all, the court considered whether the pre-arbitration procedure was mandatory. The court was of the view that it was. The word “shall” was an obligation or duty and means that the action to which the verb applies must be undertaken. FIDIC itself made this clear in the definitions section of the Gold Book where it states at sub-clauses 1.2(e) and (f):

“‘shall’ means that the Party or person referred to has an obligation under the Contract to perform the duty referred to ... whilst ‘may’ means that the Party or person referred to has the choice of whether to act or not in the matter”.

In the view of the court, the DAB dispute



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resolution proceeding foreseen by clause 20 of the General Conditions is mandatory insofar as it must be finished for an arbitration procedure to begin. However, the court also looked at the approach of the Employer or Appellant, noting that:

“The DAB contemplated was more similar to an arbitral tribunal of first instance rather than an actual DAB, considering that it would intervene so late in the development of the contractual relationships and even after they were extinguished, when the respective positions of the parties were already fixed and the opponents doubtlessly irreconcilable. Therefore, even though it was proscribed by the General Conditions in principle, its implementation may no longer have been absolutely necessary in view of the economy of the system because it was unlikely that it would avoid the initiation of the arbitral procedure reserved by Sub-Clause 20.6 of the General Conditions. Seen in this perspective, the Appellant’s will to obtain a DAB decision no matter what appears questionable at the very least.”

Further, the court noted that the procedure to constitute the DAB had started 15 months before the Respondent filed its request for arbitration (10 March 2011 to 27 July 2012), which is a long time “in the context of a dispute resolution mechanism supposed to be expeditious”: five times longer than the 84 days within which the DAB procedure must normally be conducted. The court noted that, after initiating the process, the Contractor tried several times to restart the process despite the Employer’s “passivity”, a role it shook off only after the filing of the arbitration notice.

Swiss Court Conclusion

Accordingly, the court concluded that:

“In this respect, considering the circumstances germane to the case at hand ... they cannot be criticized for failing to denounce the Respondent’s failure to sign the DAA from the point of view of the rules of good faith. Pursuant to these rules and considering the process of constitution of the DAB, it is indeed



impossible to blame the Respondent for losing patience and finally skipping the DAB phase despite its mandatory nature in order to submit the matter to arbitration.”

Thus, although the court agreed that the DAB procedure was mandatory, it also took into account the reasons why there had been no DAB. Here it would be a breach of good faith for the Owner to insist on the mandatory nature of the DAB procedure, given the substantial delay in constituting the DAB for which it was primarily responsible. In addition, the court did question whether in circumstances where the project was over, the ad hoc DAB would in reality be similar to an arbitral tribunal at first instance. Would holding a DAB “have been absolutely necessary in view

of the economy of the system”?

England: Peterborough City Council v Enterprise Managed Services Ltd¹

Here, following completion of a project, Peterborough alleged that the plant had failed to achieve the required power output and claimed the Price Reduction. On 6 January 2014 Peterborough issued a letter of claim under the Pre-action Protocol. EMS responded that in accordance with the Contract terms the dispute ought to be referred to a DAB. Mr Justice Edwards-Stuart was therefore asked to consider whether or not the terms of the Contract required a dispute to be referred to adjudication by a DAB first as a pre-condition to any court proceedings. If that was correct,



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should the court exercise its discretion and order that the Council's proceedings be stayed?

On the first issue the Judge decided that upon a proper interpretation of the Contract, sub-clause 20.8 would only apply to give Peterborough a unilateral right to opt out of DAB adjudication if the parties had agreed to appoint a standing DAB at the outset. Accordingly, given that sub-clause 20.2 provided for ad hoc DAB appointments, the Judge accepted EMS's argument that the Contract required the determination of the dispute through DAB adjudication prior to any litigation. The right to refer a dispute to adjudication arises under sub-clause 20.4 as soon as a DAB has been appointed, whether under sub-clause 20.2 or 20.3.

Peterborough then argued that sub-clause 20.8 provided an opt-out from DAB adjudication but that if reference of a dispute to a DAB was mandatory, the court proceedings should be allowed to continue on the grounds that:

- (i) what was a complex dispute was unsuitable for a "rough and ready" DAB adjudication procedure; and
- (ii) any DAB adjudication would be an expensive waste of time as it was inevitable that the losing party would go to court.

Peterborough submitted that any decision by the DAB would almost inevitably provoke a notice of dissatisfaction from one or other party. Accordingly, to embark on the fairly lengthy (and therefore expensive) adjudication procedure under the contract would be a wholly or at least largely unproductive exercise. The dispute raised complex questions of construction and application of legislation, mandatory codes and standard industry practice and would require extensive disclosure. Therefore the "rough and ready" process of adjudication was entirely inappropriate to resolve this dispute.

However, the Judge noted that this was nothing new: the complexity of a potential dispute about when the required power

output was achieved was foreseeable from the outset, yet nevertheless the parties chose to incorporate the adjudication machinery in the FIDIC form of contract. Both parties therefore agreed to the "rough and ready" adjudication procedure.

That said, in circumstances where the parties had not yet invested time or money in the DAB adjudication, the Judge was sympathetic to Peterborough's case that the court proceedings should not be supplanted by adjudication.

However, the overriding principle, as illustrated by the English legal authorities, clearly showed a presumption in favour of leaving parties to resolve their disputes in the manner they had agreed to in their contract. Accordingly, the Judge ordered that the court proceedings were to be stayed.

The Swiss and English decisions compared

Although the circumstances of the cases were very different, both the English and the Swiss courts emphasised that DAB procedures must be treated as mandatory.

One of the main differences between the two decisions was the attitudes of the parties. In the Swiss case, the Employer was essentially trying to frustrate the entire dispute resolution process, first by moving very slowly when it came to the appointment of the DAB and then using the lack of a DAB to allege that the arbitration tribunal did not have jurisdiction. In the English case, the Employer did not really want to have a DAB, preferring to go straight to a final resolution of the case. This may, to a limited degree, have had an influence on the decision.

Thus whilst both courts did agree that the DAB was a condition precedent to arbitration, in England this meant that the parties had to submit to the DAB, even though the Judge recognised that there was a real risk of duplication of costs. This was not a case where either party had invested any time or money on the preparation for or conduct of an adjudication, and so it can fairly be said that it was better to have one dispute resolution

procedure, even if more expensive and extensive, than to take the real risk that this will be required in any event in addition to an adjudication.

However in the Swiss case, the Supreme Court, perhaps because the Swiss Civil Code, like that of Romania, makes provision for the parties to act in accordance with the principles of good faith, looked at the whole circumstances of the disputes between the parties. Here the Contractor spent some 18 months trying to bring about the appointment of a DAB before resorting to arbitration. An Employer could not then in good faith insist on the mandatory nature of the DAB procedure it had done so much to frustrate in the first place. This is rather helpful for contractors who are faced with an employer who is apparently trying to prevent what is seen as a legitimate dispute from being resolved through the DAB process.

Footnotes

1. [2014] EWHC 3193 (TCC)



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Ebola & ISIS: Force Majeure under the FIDIC form and civil codes

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The recent incursion of ISIS forces into Iraq is a matter of considerable concern to many who are involved in projects in Baghdad and Syria, who need to ensure the wellbeing of their staff and security of the works in difficult and often unpredictable circumstances. Ebola is equally problematic in West Africa and beyond, where there are concerns about workforces falling ill, travel being restricted or delayed both domestically and internationally, and the impact of government quarantine measures.

This article aims to consider (i) what events might constitute a force majeure in the international context; (ii) force majeure under the FIDIC form and civil codes; (iii) how to establish force majeure; and (iv) practical tips on how to deal with a potential or actual force majeure event.

What is force majeure?

In general terms, a force majeure event is an event that relieves the parties from performing their obligations under the contract. Such events are usually exceptional events that are deemed to be beyond the control of the parties, and which make performance of the contract physically or legally impossible, as opposed to merely more difficult, time-consuming or expensive.

There is no generally recognised doctrine of force majeure at common law, where force majeure exists as a concept with an unclear meaning. Force majeure will only apply at common law if there is a specific contractual provision which defines the type of occurrence(s) that might constitute a force majeure event. Often, the procedures that need to be followed when a party seeks to declare force majeure, and the consequences

of force majeure events are also set out (as is the case in the FIDIC form).

The civil law jurisdictions on the other hand define what is meant by force majeure, and in some cases, have a requirement for force majeure events to be unforeseeable. This raises the force majeure threshold considerably above that which is seen at common law.¹

Force majeure under the FIDIC form

Force majeure is widely drawn under the FIDIC form to reflect the greater risk that is inherent in international projects, where parties often contract in jurisdictions that are outside their own. Sub-clause 19.1 of the 1999 Red Book ("the Red Book") defines force majeure as an exceptional event or circumstance:

- (a) which is beyond a Party's control,
- (b) which such Party could not have reasonably provided against before entering into the Contract,
- (c) which, having arisen, such Party could not reasonably have avoided or overcome, and
- (d) which is not substantially attributable to the other Party.

Sub-clause 19.1 then goes on to provide a non-exhaustive list of the kind of events or circumstances that might amount to force majeure. These include:

- (i) war, hostilities (whether war be declared or not), invasion, act of foreign enemies,
- (ii) rebellion, terrorism, revolution, insurrection, military or usurped power, or civil war,
- (iii) Riot, commotion, disorder, strike or lockout by persons other than the

Contractor's Personnel and other employees of the Contractor and Sub-contractors

- (iv) munitions of war, explosive materials, ionising radiation or contamination by radio-activity, except as may be attributable to the Contractor's use of such munitions, explosives, radiation or radio-activity, and
- (v) natural catastrophes such as earthquake, hurricane, typhoon or volcanic activity.

Sub-clause 19.2 deals with notice, and provides a time bar in terms that:

"if a party is or will be prevented from performing any of its obligations under the Contract by Force Majeure, then it shall give notice to the other Party of the event or circumstances constituting the Force Majeure and shall specify the obligations, the performance of which is or will be prevented. The notice shall be given within 14 days after the Party became aware, or should have become aware, of the relevant event or circumstance constituting Force Majeure.

The Party shall, having given notice, be excused performance of such obligations for so long as such Force Majeure prevents it from performing them".

The consequences of force majeure appear at Sub-clause 19.4, namely:

"If the Contractor is prevented from performing any of his obligations under the Contract by Force Majeure of which notice as been given under Sub-clause 19.2, and suffers delay and/or incurs Cost by reason of such Force Majeure, the Contractor shall be entitled subject to Sub-clause 20.1 to:

- (a) an extension of time for any such delay,



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if completion is or will be delayed, under Sub-clause 8.4, and

- (b) *if the event or circumstance is of the kind described in sub-paragraphs (i) to (iv) of Sub-clause 19.1 and, in the case of subparagraphs (ii) to (iv), occurs in the Country, payment of any such Cost...."*

Notice of Force Majeure is given under Sub-clause 19.2 and the notice is to be delivered in accordance with Sub-clause 1.3.

Under Sub-clause 19.6, if the execution of substantially all of the works is prevented for a continuous period of 84 days (or for multiple periods that total more than 140 days) by reason of Force Majeure, then either Party can issue a notice of termination, which will take effect seven days later. The Engineer will then determine the value of the work that has been done, and other costs such as demobilisation costs.

The 2008 Gold Book ("the Gold Book") is also important in the context of force majeure as it represents a more collaborative, risk sharing approach than that which is seen in the 1999 suite of contracts: indeed, FIDIC is likely to follow the Gold Book approach at such time as the 1999 suite is revised.

The Gold Book does not contain the usual 1999 suite Clause 19 force majeure provisions. Instead, it drops Clause 19 completely in favour of a new Clause 18 that is headed "exceptional risks", and Clause 17 (which was formerly risk and responsibility) has been re-named "risk allocation". The definition of exceptional risks is very similar to the force majeure definition at Clause 19, but it is Clause 17 that makes the Gold Book stand out from the 1999 suite. Clause 17 sets out the risks that the Employer and Contractor are to bear in a very detailed manner, having separate regard to the Design-Build Period and the Operation Service Period of the contract. The Contractor is entitled to an extension of time and its costs if there are any exceptional risks or Employer risks during the Design-Build Period, but to its costs only if those same risks occur during the Operation

Service Period of the contract (to reflect the fact that the Operation Service Period cannot be extended). It is anticipated that FIDIC will follow the form adopted in the Gold Book when it releases its updated version of the 1999 Form.

Establishing force majeure

Is it a true force majeure event?

In order to establish Force Majeure, the Contractor will have to establish that the force majeure event is included within one of the definitions in Sub-clause 19.1 (or is similar in nature), and that he has been prevented from performing his contractual obligations in that performance has become physically or legally impossible, as opposed to more difficult or unprofitable.

Taking this and applying it to the ISIS insurgency, it should be possible to establish that the actions of ISIS in trying to establish an Islamic State within Iraq constitutes war, hostilities, terrorism, and invasion and so the existence of a Force Majeure event ought to be able to be satisfied. Epidemics are not explicitly covered under Sub-clause 19.1, but it must at least be arguable that the Ebola outbreak is exceptional in its extent and nature, in which case it might be regarded as being a natural catastrophe.

Could the Party have reasonably provided against the Force Majeure before entering into the Contract / is the Force Majeure beyond the Party's control or attributable to the other Party / could the Party have avoided or overcome the Force Majeure event once it had arisen?

These issues are relatively straightforward and the ISIS insurgency and Ebola threat provide some good examples. ISIS taking control of Bagdad is arguably an event that could not be prevented or avoided despite the exercise of reasonable diligence by either Party; indeed neither the current Iraqi government or the international community has been able to effectively challenge the advance of ISIS. However, if parties were affected by what is happening in Bagdad, then there are probably

some reasonable precautions and reasonable alternative measures that could be taken to avoid the ISIS threat.

As far as Ebola is concerned, because it is not an airborne disease, again, there are likely to be various measures that contractors could take to protect against the risks the disease poses. For example, medical checks could be imposed and employees could be excluded from site if necessary. Or materials could be sourced from alternative locations and/or suppliers in the event that the supply chain was affected (the same would apply to any logistical issues arising out of the ISIS threat).

Is the Contractor being prevented from performing any of his obligations under the Contract by reason of the Force Majeure?

Causation issues may arise in circumstances where a Party is concerned that conditions at or outside the site are too dangerous to allow its staff or sub-contractors to continue working. The issue here is that if the Contractor's response was to evacuate the site, a situation would not be created whereby work would be prevented from taking place. The Contractor's actions in evacuating the site would stop work, not the ISIS threat, regardless of how strong that threat is, or is perceived to be.

An alternative scenario may arise in relation to causation whereby the Contractor is unable to carry out work that is on the critical path, but he can carry out non-critical path work. Whilst this may cause substantial problems, it would probably not be prohibitive in terms of performance of the Contractor's obligations.

Foreseeability (under the civil codes)

If foreseeability is an issue under any applicable civil code (foreseeability does not feature in the FIDIC form), then the question that has to be asked is if the force majeure event would have been foreseeable to the hypothetical reasonable party at the time the contract was entered into. This question is likely to create substantial difficulties.

The current security situation in Iraq is seen



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by some as being entirely different from the problems that have been faced by Iraq in previous years and it is probably arguable that no reasonable party could have foreseen the rapid rise of ISIS in the manner in which it has occurred: ISIS taking control of Bagdad would probably also be unforeseeable. Contractors who have entered into contracts which were connected with areas that were previously secure, but that have subsequently fallen into turmoil should have less difficulty in establishing the foreseeability element of force majeure.

That said, given the very turbulent history of Iraq which includes the Iran-Iraq war, and the deposing of Saddam Hussein and the turbulence that followed, the contrary argument is that it was foreseeable that an insurgency such as ISIS might gain ascendancy in Iraq and that Baghdad might fall into the control of the insurgency and/or occupy sites in the region.

Much would depend on the site, the precise situation that was on foot around the time the contract was entered into, and the extent to which the parties recognised the force majeure event as being a likely risk. If, for example, the site was associated with a strategic energy asset in an isolated location, then it would be more realistic for it to be considered a likely target.

Ultimately, whether the force majeure event is foreseeable to the reasonable party at the time the contract was entered into would be a matter for expert evidence. The political stability of Iraq and the surrounding area, the general security position in Iraq and the surrounding area, and the strength and capability of insurgency groups such as ISIS at the time the contract was entered into would all have to be considered. Whilst the history of Iraq may suggest that it was foreseeable that an insurgency may gain ascendancy, whether that insurgency would have been expected to come from ISIS is a much more difficult issue and the arguments for and against are therefore reasonably well balanced.



If any applicable civil code requires force majeure events to be unforeseeable, then it would probably make it much more difficult for the Contractor to establish force majeure. On a similar note, if the event is foreseeable, then it will be more difficult for Contractors to argue that the impact of the force majeure event could not be mitigated, or alternative arrangements put in place in order to honour their contractual obligations.

Entitlement to additional time and cost

Additional time

Under the Red Book, the contractor would be entitled to an extension of time in circumstances where delay affects completion, subject to the time bar provision at Sub-clause 19.2 in relation to the giving of notice. The entitlement to any additional cost however is slightly more complex.

Additional cost

The entitlement to additional cost relates only to those force majeure events listed in Sub-clause 19.1(ii) – (iv). Therefore, taking the ISIS example again, if the site is located near borders with countries that are affected by the ISIS threat, there would be no entitlement to additional costs as ISIS would not physically be in the same country.

The key point to note about claims for additional time and cost is that they are subject to the time bar at Sub-clause 20.1. Under Sub-clause 20.1, claims for additional time or payment need to be made:

“...not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstance”.

Any claim for time or money will therefore be lost if it is not made within 28 days after the Contractor became aware of the force majeure event or circumstance, or should have been aware of it. The Contractor should keep such contemporary records as may be necessary to substantiate its claim.

A fully detailed claim needs to be provided within 42 days of the date on which the contractor became aware, or should have become aware, of the event or circumstance, and fully supporting particulars of the basis of the claim, and of the extension of time and/or additional payment claimed must be included. Sub-clause 20.1 goes on to make further provision for a Force Majeure that has a continuing effect.

Practical tips when dealing with a potential or actual force majeure event

- Employers sometimes amend the



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definition of force majeure at the drafting stage. They may, for example, narrow the definition of force majeure, exclude the right that otherwise exists to payment of costs, or limit the termination provisions. It is always worth checking your contract to see if any bespoke amendments have been made which alter the usual force majeure provisions in order to avoid being caught out.

- As soon as you become aware of a potential force majeure event that may potentially impact the performance of your contractual obligations or the works, serve notice under Sub-clause 19.2. It is better to err on the side of caution and serve a notice that transpires not to be necessary, than to serve a notice too late and lose your entitlement to make a claim. Sub-clause 19.2 is rather draconian in that the time bar starts to run from 14 days from when the Contractor should have become aware of the Force Majeure event, and common and civil law jurisdictions will generally uphold time bar provisions.
- If you find yourself in a potential force majeure situation, you need to reduce the risk surrounding whether an event is a true force majeure event by entering into without prejudice discussions with the other party. Try and agree what will constitute a force majeure event before the event actually arises, and / or agree legitimate steps you can take to mitigate the risk in a given set of circumstances. If all else fails, speak to the other party to see if you can suspend or terminate the works rather than declaring force majeure to avoid any liability that might otherwise arise from a false declaration of force majeure.
- Before making any firm decisions about whether to cease work, obtain as much information as you can about the force majeure event. In the case of ISIS, try and get reports from security advisers and any information that might be published by government agencies to support the existence of your force majeure event.
- If you do have to make a formal declaration of Force Majeure, once you have served notice of Force Majeure under Sub-clause 19.2, you need to present your claim for additional time and/or cost under Sub-clause 20.1 within 28 days of the date on which you became aware of the Force Majeure event or circumstance, or should have been aware of it, and your fully particularised claim should follow 14 days later. Your claim may be subject to a decision of the arbitral tribunal in due course so provide as much documentary evidence as you can.
- If your claim for relief for Force Majeure looks doubtful under the FIDIC form, consider whether any provisions of the relevant civil code might offer you assistance. Most civil codes provide relief for true force majeure events, but a word of warning. Not all provide a clear right to compensation², and some require the force majeure event to be unforeseeable at the time the contract was entered into, which can create considerable difficulties in countries such as Iraq that are mired by security and political conflict, as noted above.
- If you do need to demobilise and/or evacuate, prepare an inventory of all equipment and materials on site and secure photographic, video and/or documentary evidence of the physical condition of the site and works, as well as the progress of the works. Be sure to copy any paperwork in relation to progress payments, variations, or any pending claims before you leave. If you are unable to take soft copies, endeavour to transport hard copies to a safe and secure location. This documentation will be invaluable in substantiating future claims or defences that you might bring in due course relating to the Force Majeure, or in circumstances where theft or damage occurs due to the actions of a third party. Most claims and defences fail due to a lack of supporting evidence.

Conclusion

Force majeure can be a mine field, not least because the definition of force majeure can prove to be problematic and difficult issues of causation and foreseeability can arise.

A possible solution may be found in the advance warning procedure that appears in Sub-clause 8.4 of the FIDIC Gold Book which may assist to better manage difficult events. Sub-clause 8.4 provides that each Party shall endeavour to advise the other Party in advance of any known or probable future events or circumstances which may adversely affect the work, increase the Contract Price or delay the execution of the Works or the Operation Service. The Employer's Representative may require the Contractor to submit an estimate of the anticipated effect of the future events or circumstances, and/or a proposal under Sub-Clause 13.3 [Variation Procedure].

If parties incorporate the provisions of Sub-clause 8.4 of the Gold Book into their contracts, then it is to be hoped that the parties would be able to better manage force majeure type events, and that the formal declaration of force majeure would be the very last resort.

Footnotes

1. See, for example, Article 1148 of the French Civil Code which provides that a force majeure event must be unforeseeable, and render performance both impossible and outside the control of the party who seeks to invoke suspension of the relevant contractual obligation.
2. See, for example, Articles 168 and 425 of the Iraqi civil code which make no mention of compensation

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Does the UK late payment legislation apply to international contracts?

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In England and Wales, the Late Payment of Commercial Debts (Interest) Act 1998 applies to the vast majority of contracts for the supply of goods and services. It operates by implying a term into those contracts whereby, unless the contract itself provides a substantial remedy for late payment, debts are to carry statutory interest at a rate of 8% above base rate. It can be seen that the interest rate is not intended to be compensatory. It clearly exceeds the interest rates which most parties would be charged if they had to borrow money to cover the shortfall of not being paid. The Late Payment Act, as a matter of general policy, is intended to promote prompt payment of all commercial debts and discourage the use of delay in payment as a business tool for commercial advantage.

One question that has arisen is whether or not this legislation might apply to international contracts, where the parties have chosen English law. And this was the issue that came before Mr Justice Popplewell in the case of *Martrade Shipping v United Enterprises* [2014] EWHC 1884 (Comm).

Here, the Judge explained that section 12 of the Late Payment Act provides that where parties to a contract with an international dimension have chosen English law to govern the contract, the choice of English law is not of itself sufficient to ensure that the Act applies. The Act will only apply if there is a significant connection between the contract and England or if the contract would be governed by English law, leaving aside the choice of law clause.

The Judge also reminded everyone of the twin purposes of the Act: namely, to protect commercial suppliers whose financial position

makes them particularly vulnerable if their debts are paid late, and the general deterrence of late payment of commercial debts. This does not explain why section 12 provides that where parties to a contract with an international dimension have chosen English law to govern the contract, the choice of English law is not of itself sufficient to attract the application of the Act.

Mr Justice Popplewell explained. First, it reflected domestic policy considerations which are not necessarily the same as for contracts with an international dimension. Second, it is of considerable economic value that international parties regularly choose English law and jurisdiction to govern their contracts. Section 12 recognises that subjecting parties to a penal rate of interest on debts might be a discouragement to those who would otherwise choose English law to govern contracts arising in the course of international trade, and accordingly does not make such consequences automatic.

The Judge identified the following factors which might justify the application of a domestic policy of imposing penal rates of interest on a party to an international commercial contract. They must provide a real connection between the contract and the effect of prompt payment of debts on the economic life of the UK:

- (i) Where the place of performance of obligations under the contract is in England;
- (ii) Where the nationality of the parties or of one of them is English. Here, if the paying party was a UK national then the Act may well be engaged;
- (iii) Where the parties are carrying on some relevant part of their business in England;

- (iv) Where the economic consequences of a delay in payment of debts may be felt in the UK, something which may engage consideration of related contracts, related parties, insurance arrangements or the tax consequences of transactions.

Finally, the Judge was of the view that when it came to the performance of the contract, what mattered, at least for a contract for the supply of services, was the performance of the supplier, not that of the person who is paying for the services.

Accordingly, the late payment legislation will only apply where there is a "substantial connection" between the parties or their transaction and the UK. That is the case, even if the parties have chosen English law to govern their contract.



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Commentary:

International dispute resolution & adjudication

Issue 12, 2014

Good Faith: English Law v the UAE Civil Code

By Claire King¹
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Introduction

The reluctance of English common law to imply a term of good faith into agreements negotiated between two commercial parties at arm's length is well known and is based on the long-established doctrine of freedom of contract. In stark contrast in civil law countries such as the United Arab Emirates, performing obligations in a manner consistent with good faith is a fundamental part of the contract.

A series of English cases on good faith in early 2013 had raised the prospect that the English courts may be on their way to recognising an overarching duty of good faith but this prospect now seems to have receded. This article provides an update on the latest position under English law whilst highlighting the contrasting position under the UAE Civil Code. Those working with construction standard forms internationally need to keep these very real differences in mind as they can have a significant impact on how some provisions operate in practice.

English case law on good faith: the latest position

The early 2013 case of *Yam Seng Pte Ltd v International Trade Corporation Limited* ("ITC")² involved a long-term distribution agreement for fragrances produced by ITC bearing the name "*Manchester United*". The court adopted a fairly broad and purposive approach regarding the circumstances in which good faith obligations might be implied, raising expectations that the courts were open to an overarching duty of good faith being implied more widely.

In that case Yam Seng (the distributor) argued there was an implied term that the parties would deal with each other in good faith

and, specifically, that ITC had: (i) failed to act with an implied obligation of good faith and prejudiced Yam Seng's sales by offering the same products for domestic sale below the duty free prices that Yam Seng was permitted to offer; (ii) instructed or encouraged Yam Seng to incur marketing expenses for products that ITC was unable or unwilling to supply; and (iii) offered false information upon which Yam Seng relied to its detriment. There were no express terms of the contract covering any of these points.

Leggatt J noted: "*The content of the duty of good faith is established by a process of construction which in English law is based upon an objective principle. The Court is concerned not with the subjective intentions of the parties ...*"

On the facts, only two obligations were implied. First, the court found there was an obligation not to undercut duty free prices, and secondly, there was an obligation not to knowingly provide false information; a duty of good faith was implied in both these respects. The first obligation was contrary to usual standards of commercial dealing and the second was implied into the agreement between the parties as a matter of fact.

The fact that the contract was a long-term distributorship agreement which, the court noted, required the parties to communicate effectively and cooperate with each other in its performance, appears to have influenced the result. The state of the contract, which had not been drafted by lawyers also appears to have swayed the Court.

In stark contrast, the Court of Appeal took a much narrower and restrictive approach in *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust*.³ This also involved a long-term contract for catering services.

The issue was whether the Trust was entitled to terminate the contract on the basis that

Compass had exceeded the number of Service Failure Points allowed in any given six-month rolling period.

This contract contained an express duty to cooperate in good faith "*as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract*".⁴

The question before the court was whether this clause provided an overarching obligation on the parties to operate with each other in good faith. The Court of Appeal held that whilst there was an obligation to act in good faith it was specifically focused on the obligation to take all reasonable action as was necessary for the efficient communication of information and instructions. There was nothing that required the parties to act in good faith in relation to anything else.

Overturning the first instance decision,⁵ the court held that commercial common sense did not favour the addition of an overarching duty to cooperate in good faith in circumstances where good faith had been provided for in the contract in such a precise manner already.

Applying this reasoning to the facts of the case, the Court of Appeal considered that the Trust was not prevented from awarding service failure points for failures in performance. The contract expressly contained precise rules for these matters and the ability of the Trust to impose service failure points for poor performance was an absolute contractual right: "*if the parties want to impose such a duty they must do so expressly*".

The issue of good faith was further considered in *TSG Building Services plc v South Anglia Housing Ltd* ("SAH")⁶ in May 2013 in relation to an ACA Standard Form of Contract for Term Partnering.⁷



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Clause 1.1 of the contract provided:

"The Partnering Team members shall work together and individually in the spirit of trust, fairness and mutual cooperation for the benefit of the Term Programme... and in all matters governed by the Partnering Contract they shall act reasonably and without delay."

The contract contained an "unqualified and unconditional right to terminate" at any time (i.e. termination for convenience).

SAH terminated the contract and TSG argued that the termination was wrongful and in breach of clause 1.1. The issue the court had to decide was whether the good faith clause was pervasive such that it applied to the whole contract and therefore to the termination provisions.

The court accepted that, in principle, an express obligation to act in good faith could be pervasive and, depending on the nature and drafting of the clause, it may be possible for it to affect all aspects of the contract.

However, the court held that this was not the case here. The contract contained an unqualified right to terminate for convenience, to which the obligation to act in good faith could not possibly extend. The entitlement to terminate the contract was absolute. Each party was entitled to terminate at any time. Further, clause 1.1 primarily related to the assumption, deployment and performance of roles, expertise and responsibilities set out in the Partnering Documents.

In the later 2014 case of *Bluewater Energy Services BV v (1) Mercon Steel Structures BV and others*,⁸ Ramsey J examined again the impact of a good faith provision in the context of termination.

That contract provided for a notice of default to be issued to the subcontractor requiring them to "immediately commence and thereafter continuously proceed with action satisfactory to Bluewater to remedy such default". If they did not do so, a notice of termination could then be issued.

The subcontract also provided that the parties "shall uphold the highest standards of business ethics in the performance of the contract. Honesty, fairness and integrity shall be paramount principles in the dealings between the parties."

Ramsey J referred to the Court of Appeal decision in *Socimer International Bank Ltd (in liquidation) v Standard Bank London Ltd*,⁹ which related to the standard to be applied in circumstances where the valuation of assets was left entirely in one party's hands. In that case it was held that a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honest good faith and genuineness and the need for the absence of arbitrariness, capriciousness, perverseness and irrationality. However, the decision remained with the decision-maker and was therefore subjective.

Ramsey J decided that the same standard applied in these circumstances and was not impacted by the express clause in the contract although that clause was consistent with it. He went on to find that termination had been justified on four of the five main grounds alleged in the contractor's notice of default.¹⁰

Summary

It seems then that the English courts are not ready to imply a general doctrine of good faith. The judgment of the High Court in *Yam Seng* appears to have been sidelined (if not directly overruled) by the Court of Appeal and subsequent cases.

If the parties want to have an express duty of good faith they need to create one and they should think very carefully about its scope. The English courts will not allow good faith-type wording to overrule an absolute contractual right such as the right to terminate for convenience. The parties will need to expressly provide that a good faith obligation operates in relation to such a provision.

The situation might, however, be different if there was evidence to suggest a breach of an express good faith obligation in circumstances

where there was a discretionary right (for example awarding a discretionary bonus to an employee). In those circumstances a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honest good faith and genuineness and the need for the absence of arbitrariness, capriciousness, perverseness and irrationality.

Good faith in UAE contracts

In stark contrast, a duty to act in good faith is implied into all contracts that are subject to UAE law. This is underscored by principles of fairness developed under Sharia law.

Article 246 of the UAE Civil Code provides that:

"a contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith."

This in effect is a requirement not to use the terms of a contract to abuse the rights of the other contracting party, not to cause unjustified damage to the other party and to act reasonably and moderately.

Decisions of the Dubai Court of Cassation have ruled that an act of bad faith by one contracting party may provide a cause of action for the other and the duty of good faith is therefore overarching, unlike at English law. In deciding whether an act constitutes bad faith the court may also look at Article 106 of the UAE Civil Code which provides that a party is prohibited from exercising its rights if:

- it is intended to infringe the rights of another party;
- the outcome is contrary to the rules of Islamic Sharia, the law, public order, or morals;
- the desired gain is disproportionate to the harm that will be suffered by the other party; or
- it exceeds the bounds of custom or practice.



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There are some potentially wide-ranging ramifications of this including:

- Good faith is most likely to be applied to evidence for, or to support, an allegation of breach. Where, for example, building materials are found to be defective a breach will be easier to establish if there has been some attempt to conceal this or cover up the materials once incorporated into the works.
- Reliance on a time bar notice (e.g. FIDIC's clause 20.1) is likely to be restricted where a party seeking to rely on it knew about that breach previously (for example, if notification of the claim was made informally and is recorded in meeting minutes or similar but was never formally made). In other words, denying a claim due to the time bar when it had already been communicated, albeit informally, would be an act of bad faith.
- Avoiding liability for a very substantial claim due to a time bar may also be unlawful where the losses were serious and unequal with the employer's contractual claim to be notified in a required time period (for example 28 days under clause 20.1 of FIDIC). Article 106 (1) of the UAE Civil Code provides that "*a person shall be held liable for an unlawful exercise of his rights*" and this, together with the good faith obligation, may be used to challenge the effectiveness of a time bar in such circumstances.
- Whilst the UAE Civil Code does provide that parties may fix a pre-agreed compensation mechanism or amount in their contract, the court may also vary the pre-agreed amount of compensation or damages to equal the actual loss in any event, regardless of whether there was any "*act of prevention*" on the part of the employer.¹¹
- Good faith is also applicable in relation to termination for convenience clauses although it is worth noting that the duty

of good faith is not applicable to the obligation itself but to the performance of the obligation. Accordingly the parties' agreement that the employer may terminate the contract for convenience is a valid agreement and the UAE courts will normally uphold this. Although this employer's right might be looked at as contradicting the good faith principle, it would be an enforceable contract term as it was freely entered into. However, if the employer relies on this contract provision to terminate the contract in circumstances that give rise to performing the contract in a manner that is inconsistent with good faith, then the court might have a different view. For example, if the contract provides for termination for convenience and limits the liability of the employer to compensate the contractor for the work done until the date of termination, but excluding mobilisation cost, the employer who terminates the contract for convenience immediately after mobilisation and before the contractor has done any work is performing the contract in bad faith. In this case, the contractor might rely on Articles 246 (good faith), 106 (abuse of right) and 390(2) (claiming actual loss) of the UAE Civil Code to recoup its losses.

Overview

The stark contrast between the position regarding good faith under English law and that under the UAE Civil Code remains in place. This may make a real difference with regard to how some standard provisions in construction contracts are interpreted. As outlined above, the same time bar and termination for convenience provisions may result in very different outcomes on similar facts, depending on how the governing law approaches the issue of good faith.

Footnotes

1. With thanks to Lisa Kingston of Fenwick Elliott for her great assistance in preparing this paper and Ahmed Ibrahim of Ahmed Ibrahim Advocates and Legal Consultants for his assistance in relation to the position under UAE Law.
2. [2013] EWHC 111 (QB) (February 2013)
3. [2013] EWCA Civ 200 (March 2013).
4. Clause 3.5 of the contract.
5. At first instance the High Court ruled that the Trust had abused its contractual powers in relation to the service credits and breached the express provision of Clause 3.5. It further held that the Trust had acted capriciously and irrationally in the way in which it deducted out the credits (e.g. deducting £84,540 for one day out of date chocolate mousse).
6. [2013] EWHC 1151 (TCC).
7. TPC 2005 as amended in 2008.
8. (2) Mercon Holding BV; (3) Mercon Groep BV [2014] EWHC 2132 (TCC).
9. [2008] EWCA Civ 116
10. In the Compass case, Jackson LJ had rejected such an implied term on the grounds that the term in question was an absolute contractual right and not one which could be exercised with discretion



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Universal view:

International issues around the globe

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Enforcement in Saudi Arabia and the UAE

By **Nicholas Gould**
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In March 2013 a new Enforcement Law came into effect in Saudi Arabia, replacing the relevant provisions of the 1989 Rules of Civil Procedure before the Board of Grievances. With a particular impact on the enforcement of arbitral awards, whether domestic or international, this new Enforcement Law also contains provisions that affect aspects of domestic and foreign judgments and is a welcome change.

Saudi Arabia: before the new Enforcement Law

Prior to the new Enforcement Law, parties

were required to bring applications for the enforcement of foreign judgments and arbitration awards before the Board of Grievances. This was a lengthy and rigid procedure as the Board of Grievances would undertake a full review of the merits of each award, ensuring that the award was compliant with shariah law. It also required all relevant documents from the arbitration to be submitted to the Board in Arabic to allow for the review.

An illustration of the old system is seen in an ICC case, *Jadawel International (Saudi Arabia) v Emaar Property PJSC (UAE)*. In 2006 *Jadawel* commenced arbitration before a three-member tribunal seated in Saudi Arabia,

claiming damages of US\$1.2 billion based on a breach of contract by Emaar on a construction project. The lengthy arbitration took two years but was finally dismissed, with *Jadawel* being ordered to pay legal costs. The award was then submitted to the Board of Grievances for enforcement. In its review, the Board proceeded to re-examine the merits and not only did it decline to enforce the award, but it reversed the award and ordered Emaar to pay damages to *Jadawel*.

The new Enforcement Law

Abandoning the old system of enforcement proceedings before the Board of Grievances, the new Enforcement Law introduces an Enforcement Judge to deal with all





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enforcement issues.

The Enforcement Judge is required to follow shariah principles, unless the law stipulates otherwise, and Article 9 of the new Enforcement Law provides for compulsory enforcement upon the presentation of an executive deed, including a final arbitral award.

Also, notably, appeals of the Enforcement Judge's decisions suspend enforcement. This goes against domestic law trends seen in other parts of the world such as France.

The Enforcement Judge may enforce foreign arbitral awards only on the basis of the principles of reciprocity, refusing to enforce arbitral awards from jurisdictions that would not enforce Saudi judgments or awards, and if the party seeking enforcement can ensure that:

- Saudi courts do not have jurisdiction with regard to the dispute;
- the award was rendered in compliance with due process requirements;
- the award is in final form in the law of the seat of the arbitration;
- the award does not contradict a judgment or order issued on the same subject by a judicial authority in the Kingdom of Saudi Arabia; and
- the award does not contain anything contradictory to Saudi public policy.
- The new Enforcement Judge will be specialised in the enforcement of awards, and judgments should be more expedient.

Courts of the UAE

A similar situation can be seen in the courts of the UAE, as there are a number of technicalities which are peculiar to UAE law. Such technicalities include requirements that:

- a UAE award must be physically signed within the UAE;
- the legal representative of each party possesses a valid power of attorney to act in the proceedings; and
- witnesses should not be present in the evidentiary hearing except when they are giving evidence (however, it is worth noting that this is often relaxed by the agreement of the parties).

In the past, awards have been overturned by the courts for apparently insignificant errors such as the tribunal's failure to sign each page of the award in full, instead simply initialling each page. The Bechtel case is an example of this, where the Dubai Court of Cassation overturned an arbitration award because the oath used to swear in witnesses during the arbitration did not follow the formula prescribed for UAE court hearings.

Notably, the Paris Court of Appeal upheld the award in favour of Bechtel, setting aside the Dubai Court of Cassation's decision. The Paris Court of Appeal ruled that the arbitral award satisfied the requirement.

Positive trends in UAE courts

However, despite the history of technicalities, there are also positive developments in the UAE courts. There appears to be a general

trend by the UAE courts away from overturning arbitration awards on purely technical reasons.

Although there are still exceptions to this trend, there seems to be a more arbitration-friendly climate in the UAE and the developments are positive.

Conclusion

The new Enforcement Law in Saudi Arabia is a positive step in the right direction. It should guarantee that the merit of the dispute is no longer revisited; however, it is yet to be determined what effect the provisions will have in practice. The new Enforcement Law does not protect parties or foreign awards that are unfamiliar to Saudi law or shariah law concepts.

Similarly, the positive advances in the UAE are encouraging, but while fewer technicalities are being flagged by the courts, it is still important to know the pitfalls that can arise.



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News and events

Trends, topics and news from Fenwick Elliott

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This edition

Seminars and conferences

Fenwick Elliott once again supported the FIDIC International Contract Users' Conference 2014 which took place on 2-3 December 2014 in London.

Nicholas Gould, Partner, Jeremy Glover, Partner and Vincent LeLoup, EC Harris discussed "Time Bar Application under a Civil Law and a Common Law Perspective" in the morning of the second day.

Fenwick Elliott are also supporting the FIDIC Middle East Contract Users 2015 Conference in March next year. Both Nicholas and Jeremy will be speaking on the first day providing practical insights as to the reasons behind the application of time bars, their operation under different Governing Laws (civil law vs. common law jurisdictions), ways around it and recent jurisprudence on this matter. As a

sponsor of this event we are able to offer a 30% discount using the VIP code FKW82533FEE. Guests can register online, via email to professionalcustserv@informa.com or by calling +44 (0) 20 7017 5503.

2014

2014 has been a busy year for the firm and one in which the team has grown. During the past twelve months we have had two new partners in the firm, David Bebb and Thomas Young were promoted internally from senior associates to partners and we have also had one new senior associate (Marc Wilkins) and three new associates (Martin Ewen, Robbie McCrea and Suryen Nullatamby) join the firm. This further strengthens our team of construction law specialists.

This publication

We aim to provide you with articles that are informative and useful to your daily role. We are

always interested to hear your feedback and would welcome suggestions regarding any aspects of construction, energy or engineering sector that you would like us to cover. Please contact Jeremy Glover with any suggestions jglover@fenwickelliott.com.

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A very merry Christmas
and a happy 2015

from all the team at Fenwick Elliott



Fenwick Elliott

The construction & energy law specialists

