Fenwick Elliott

The construction & energy law specialists

International Quarterly

Issue 16, 2015

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

Inside this issue:

Follow us on and for the latest construction and energy legal updates

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16, 2015

If a contractor is in delay, when can you terminate?

By Simon Tolson, Partner, Fenwick Elliott

In our last edition of IQ,[1] Simon Tolson wrote about when you can terminate a contract for a failure to proceed regularly and diligently. But if your contract makes no provision that a contractor must proceed regularly and diligently, can you still terminate if the contractor falls into delay?

Does delay on the part of a contractor amount to a repudiation of the contract?

Delay is, of course, one of the areas that arise most frequently in practice. It can be particularly prevalent during a recession as the reason for the main contractor's lack of progress is invariably due to his subcontractors' cash-flow problems and a lack of materials being ordered as credit limits with suppliers are reached. Delay on the part of the contractor can be one of the main signs that all is not well with his supply chain. In most instances, of course, delay is expressly dealt with in the contract and the issue that usually arises is whether the contractor is proceeding regularly and diligently. But what if you cannot go down that route?

So does delay on the part of the contractor amount to a repudiation of the contract? As a rule of thumb, and where time is not of the essence (discussed below), delay does not amount to a repudiation. As ever, though, it depends on the circumstances. If the contractor's delay means that he cannot or will not carry out the contract, then it may amount to a repudiatory breach if the delay deprives the innocent party of substantially the whole benefit of the contract.[2]

Even if the employer is on reasonably certain grounds that the delay amounts to a repudiation of the contract then it is almost always necessary to notify the contractor of this before accepting that repudiation.

In F*elton v Wharrie*[3] the plaintiff had agreed to demolish some houses for the defendant within 42 days. This date was missed and when asked by the employer whether it would take one, two or three months to complete, the contractor said that he could not say. The contractor carried on with the work and two weeks later the employer ejected the contractor from the site. It was held that the employer had no right to do so because he had failed to inform the contractor that he treated such a response as a refusal to carry out the work and he should not have waited two weeks. Essentially, the employer must act quickly and communicate any dissatisfaction with the contractor's performance.

Time of the essence

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

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

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

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

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

In construction contracts points (1) and (2) are rarely an issue. Construction contracts do not tend to make the timing for the performance of any obligations of the essence. Similarly, the subject matter of the contract is not such that completion should be considered of the essence. Instead, it is point (3) which is relevant. Despite the comprehensive provisions in standard contracts dealing with time, there are circumstances where the employer is entitled to make time of the essence.

The effect of making the contractor's obligation to complete the works of the essence is essentially to put the contractor on notice that unless he completes by a specified date the employer will treat this as a repudiation of the contract. Unsurprisingly, getting this process right is not without its pitfalls for the employer.

This has been considered recently in *HDK Limited v Sunshine Ventures & Others*[4] and includes a useful overview of the law in this area. The case concerned three separate building contracts. HDK (the contractor) sought payment of outstanding sums and Sunshine (the employer) was claiming damages for non-completion and defects in the works. In a nutshell, the contractor was late in completing his works. The employer was becoming increasingly frustrated with progress, and on 26 September 2006 wrote to the contractor requiring him to "*complete the work … as soon as possible*". He then wrote again on 30 September 2006 requiring the

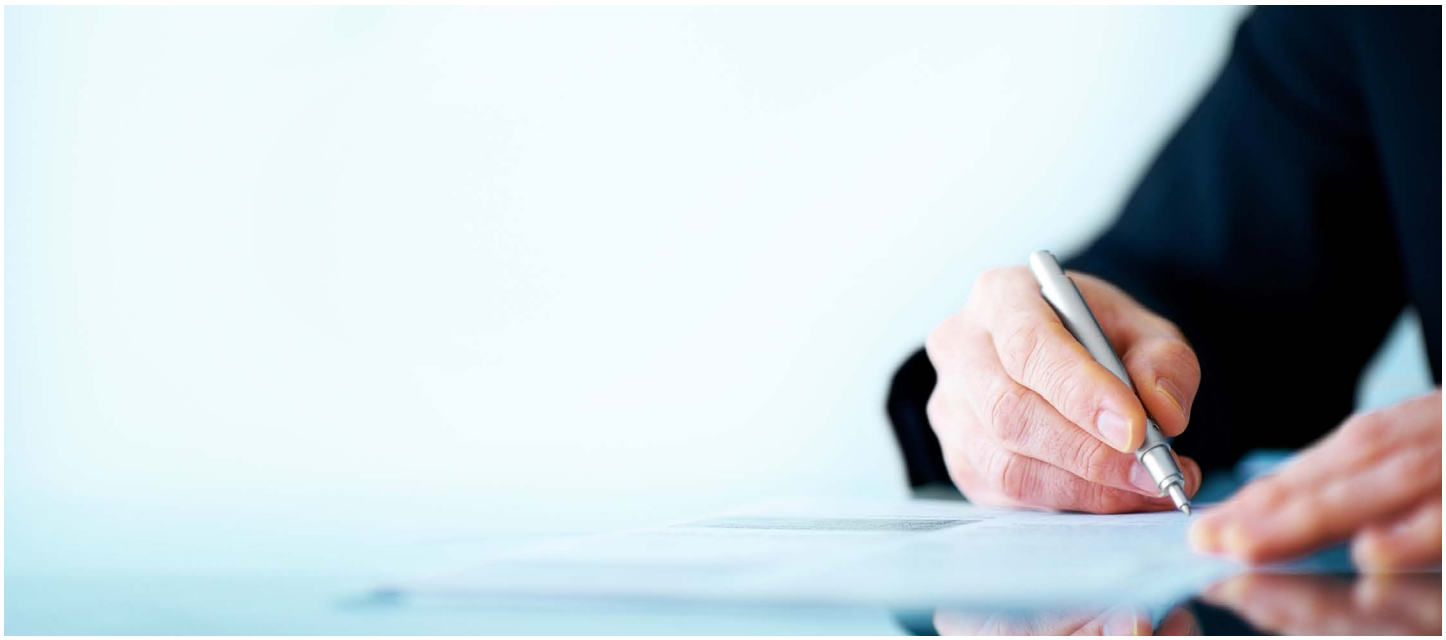
Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16 2015



contractor to "*complete the outstanding works as a matter of urgency*". On 24 November 2006 a letter was issued to the contractor terminating the contract. The issue was whether the September letters had the effect of making time of the essence and essentially setting up the ground for the termination in November. It was held that they were not. They failed on two grounds. First, they did not convey in clear terms that unless the notice was complied with the employer would treat the contract as at an end. Second, they did not specify a date by which the contractor was to complete. The result of the failure to properly make time of the essence meant that the termination letter of 24 November was effectively a repudiation of the contract on the part of the employer.

Conclusions

In summary, the points the employer needs to bear in mind when wishing to make time of the essence as a result of delay on the part of the contractor are:

(1) a reasonable time for performance must have elapsed;

(2) the notice to the contractor must set out a requirement for completion by a specified date;

(3) the specified date for completion must not be unreasonably soon in the circumstances judged at the time the notice is given;

(4) the notice must make clear that the employer will treat the failure to complete by the specified date as a repudiation by the contractor (i.e. the contractor must be in no doubt as to the consequences of failing to complete by the date specified); and

(5) the employer himself must not be committing a breach of contract which is affecting the contractor's ability to complete.

What amounts to a reasonable time for performance to have elapsed will, of course, depend on the circumstances. A court will take into account the original agreed date for completion, the effect of any variations and the conduct of the parties.

Footnotes

1. http://www.fenwickelliott.com/research-insight/newsletters/international-quarterly/terminate-failure-proceed-regularly-diligently
2. *Shawton Engineering Ltd v DGP International Limited and DGP Ltd* [2006] BLR 1, CA
3. See *Hudson's Building and Engineering Contracts*, eleventh edition at para 4.214
4. [2009] EWHC 2866 (QB)

Simon Tolson, Partner
Fenwick Elliott
stolson@fenwickelliott.com

Fenwick Elliott
The construction & energy law specialists

International Quarterly

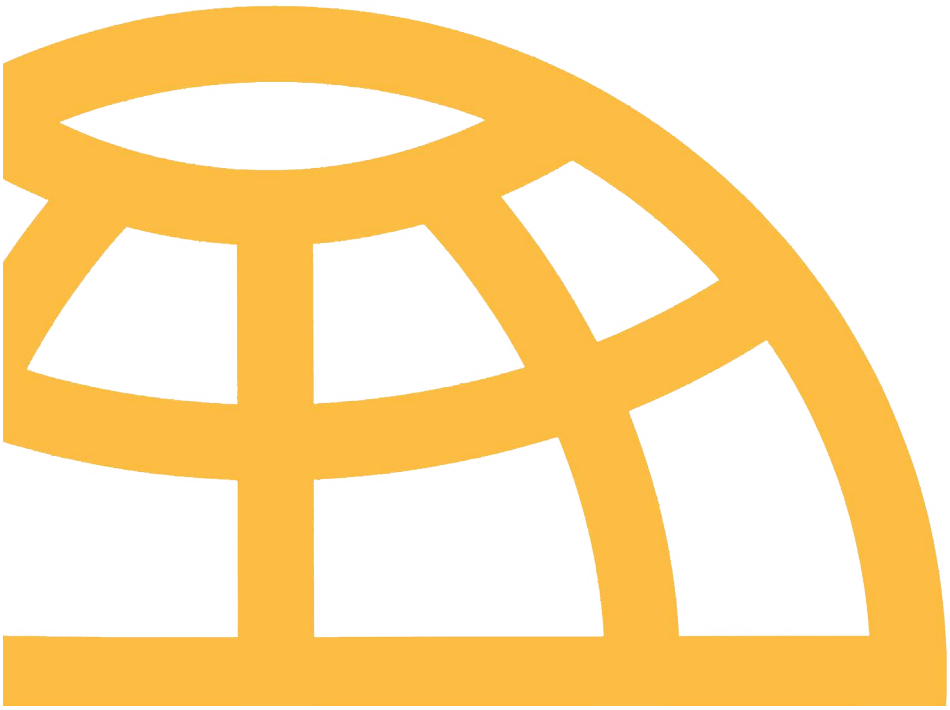
Universal view:

International issues around the globe

Issue 16, 2015

Liquidated damages: the differing approaches in the UAE and the UK

By Jeremy Glover, Partner
Fenwick Elliott



Liquidated damages tend to be a fairly standard part of most construction and engineering projects. Subject to express agreement, there is normally to be implied into a building contract a term that the contractor will complete the works within a reasonable time. If, without sufficient excuse, the contractor is late in completing the works then under the common law principles he is liable to pay damages at common law. Formal building contracts not only usually quantify precisely the completion date, but also fix the amount recoverable by an employer for delay in completion of the works by a liquidated damages clause.

The FIDIC Form of Contract

By way of example, sub-clause 8.7 of the FIDIC Yellow Book says this:

> *"If the Contractor fails to comply with Sub-Clause 8.2 [Time for Completion], the Contractor shall subject to Sub-Clause 2.5 [Employer's Claims] pay delay damages to the Employer for this default. These delay damages shall be the sum stated in the Appendix to Tender, which shall be paid for every day which shall elapse between the relevant Time for Completion and the date stated in the Taking-Over Certificate. However, the total amount due under this Sub-Clause shall not exceed the maximum amount of delay damages (if any) stated in the Appendix to Tender.*
>
> *These delay damages shall be the only damages due from the Contractor for such default, other than in the event of termination under Sub-Clause 15.2 [Termination by Employer] prior to completion of the works. These damages shall not relieve the contractor from his obligation to complete the works, or from any other duties, obligations or responsibilities which he may have under the Contract."*

The FIDIC Guide notes that the purpose of delay damages is to compensate the Employer for losses he will suffer as a consequence of delayed completion. Where the amount of delay damages is pre-agreed, the intention is that the Employer does not have to prove actual loss and damage. Whether that is entirely correct may depend on the applicable law.

The position in the UAE

For example, in the UAE, Article 390 of the Civil Transactions law (Civil Code) states:

> *"1- The contracting parties may fix the amount of compensation in advance by making a provision therefor in the contract or in a subsequent agreement, subject to the provisions of the law.*

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Universal view:

International issues around the globe

Issue 16, 2015

> *2- The court may, on the application of either party, vary such agreement so as to make the compensation equal to the loss and any agreement to the contrary shall be void."*

Therefore in the UAE, a contractor may challenge the element of "loss". Article 390(2) entitles the judge to vary the parties' agreement to reflect the actual loss. For example, the UAE High Federal Court in Abu Dhabi[1] stated that:

> *"delay fines clauses contained in construction contracts are, in substance, no more than an agreed estimate of compensation that would become due in case of the contractor's failure or delay to perform its contractual obligations. According to Article 390 of the Civil Code, it is not sufficient — for the agreed compensation to become due — to establish the element of fault alone. In addition, the element of loss which is suffered by the other party should be established'. If the contractor succeeds in establishing the absence of loss, the agreed compensation should be repudiated."*[2]

In other words, a court may set aside entirely the liquidated damage, in the unlikely event of the employer suffering no loss from the delay. Further, the court may also award less damages reflecting the actual loss. In both scenarios, the burden of proof is placed squarely on the contractor. Similar standards will be applied to the employer who is trying to argue that his actual loss exceeds the liquidated damages. However, parties should be aware that as a starting point, the court will attempt to respect the parties' agreement and so in practice is reluctant to vary the liquidated damages clause unless it is evident that the liquidated damages considerably exceed the actual loss.

The traditional position in England and Wales

Under English law, the traditional starting point has always been that a liquidated damages clause will not be enforceable where it constitutes a "*penalty*". In England and other common law jurisdictions, the approach is based on the House of Lords' decision just over 100 years ago in *Dunlop v Matthew Tyre Co Ltd v New Garage Motor Co Ltd*.[2]

The approach that the courts followed was set out by Mr Justice Jackson in his review of the position in *Alfred McAlpine Capital Projects Ltd v Tilebox*.[3] He made four general observations:

> *"1. There seem to be two strands in the authorities. In some cases judges consider whether there is an unconscionable or extravagant disproportion between the damages stipulated in the contract and the true amount of damages likely to be suffered. In other cases the courts consider whether the level of damages stipulated was reasonable. Mr Darling submits, and I accept, that these two strands can be reconciled. In my view, a pre-estimate of damages does not have to be right in order to be reasonable. There must be a substantial discrepancy between the level of damages stipulated in the contract and the level of damages which is likely to be suffered before it can be said that the agreed pre-estimate is unreasonable.*
>
> *2. Although many authorities use or echo the phrase 'genuine pre-estimate', the test does not turn upon the genuineness or honesty of the party or parties who made the pre-estimate. The test is primarily an objective one, even though the court has some regard to the thought processes of the parties at the time of contracting.*
>
> *3. Because the rule about penalties is an anomaly within the law of contract, the courts are predisposed, where possible, to uphold contractual terms which fix the level of damages for breach. This predisposition is even stronger in the case of commercial contracts freely entered into between parties of comparable bargaining power.*
>
> *4. Looking at the bundle of authorities provided in this case, I note only four cases where the relevant clause has been struck down as a penalty. These are Commissioner of Public Works v Hills [1906] A.C. 368, Bridge v Campbell Discount Co Ltd [1962] A.C. 600, Workers Trust and Merchant Bank Limited v Dojap Investments Limited [1993] A.C. 573, and Ariston SRL v Charly Records (Court of Appeal, March 13, 1990). In each of these four cases there was, in fact, a very wide gulf between (a) the level of damages likely to be suffered, and (b) the level of damages stipulated in the contract."*

Mr Justice Jackson's judgment provides a reminder that, as in the UAE, cases where liquidated damages were overturned are rare. However, in summary, the predetermined level of liquidated damages had to represent a genuine pre-estimate of the employer's likely loss should the specified breach occur. There was no requirement for the employer to prove that it had actually suffered the loss provided for by the liquidated damages provision, and the employer would still be entitled to the amount of liquidated damages stipulated by the contract even if its actual loss was lower.

The new test in England and Wales

In England and Wales at least, that position and traditional test have now changed following the decision handed down on 4 November 2015, of a seven-strong bench of the Supreme Court in the case of *Cavendish Square Holdings BV (Appellant) v Tatal El Makdessi (Respondent)*.[4] The Supreme Court held that the correct approach in commercial cases was to have regard to the nature and extent of the

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Universal view:

International issues around the globe

Issue 16, 2015

innocent party's (e.g. the employer's) interest in the performance of the obligation that was breached as a matter of construction of the contract. In doing so, the Supreme Court formulated a new test, namely whether or not the clause which provides for liquidated damages:

> *"imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity. But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations."*

The basic principle that a penalty is unenforceable remains unchanged. The real question when a contractual provision is challenged as a penalty is whether it is penal and not any longer whether it is a genuine pre-estimate of loss. The fact that a clause is not a genuine pre-estimate of loss does not necessarily mean that it is penal. What this means is that a penalty clause whose purpose is to punish the contract-breaker is likely to be an unenforceable penalty clause, whereas a clause that is intended to deter a breach of contract is less likely to be a penalty clause, even if it does not represent a genuine pre-estimate of loss. It is important to remember both that the principle behind the new rule is intended to deter a breach of contract and also that this means that the rate of liquidated damages does not necessarily have to be representative of any actual financial loss the employer may have suffered.

Can the liquidated damages clause be commercially justified? For example, this might mean that commercial interests such as reputational issues, goodwill, the interests of third parties and other losses that cannot be easily quantified can now be taken into account in determining the level of liquidated damages. Further, if a liquidated damages clause has been negotiated in a commercial contract made between two parties of comparable bargaining power then there will be a strong initial presumption that the clause is not out of all proportion to the employer's legitimate interests in timely completion. In other words, this new test requires a consideration of the commercial justification for the liquidated damages clause at the time the contract was entered into, and whether it is out of all proportion to the employer's legitimate commercial interest in the works completing on time.

One thing that remains unchanged is the recommendation that it is always sensible to keep a record and explanation of the reasons (perhaps including details of any negotiations) why the amount of the liquidated damages was set at the level it was, and why it represents a reasonable and proportionate protection of a legitimate commercial interest.

Footnotes

1. High Federal Court, case 25/24 – 1 June 2004 (Civil)
2. [1915] AC 79
3. [2005] EWHC 281
4. [2015] UKSC 67. For further details about the Supreme Court's decision see Insight No.53 dated November 2015: http://www.fenwickelliott.com/research-insight/newsletters/insight/53

Jeremy Glover, Partner
Fenwick Elliott
jglover@fenwickelliott.com

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Commentary:

International dispute resolution & adjudication

Issue 16, 2015

English Court of Appeal allows enforcement of an arbitration award on the ground of excessive delay in the court proceedings challenging the award at the seat of arbitration

By Martin Ewen,
Senior Associate, Fenwick Elliott

In its judgment in the case of *IPCO (Nigeria) Limited v Nigerian National Petroleum Corporation* [2015] EWHC Civ 1144 and *IPCO (Nigeria) Limited v Nigerian National Petroleum Corporation* [2015] EWCA Civ 1145, handed down on 10 November 2015, the Court of Appeal ordered that IPCO (Nigeria) Limited ("*IPCO*") should be entitled to enforce an arbitration award made against Nigerian National Petroleum Corporation ("*NNPC*") in Nigeria (the seat of arbitration) in October 2004, notwithstanding the fact that there still remained challenges from NNPC to that award in the Nigerian courts.

The Court of Appeal decided that the lengthy delays (which it was estimated could run into decades) in the proceedings challenging the award in Nigeria were such that it would be inconsistent with the principles of the New York Convention if IPCO had to wait until the outcome of those challenges in the Nigerian courts before being able to enforce the award.

The facts

IPCO is a Nigerian corporation carrying on business as a turnkey contractor specialising in the construction of onshore and offshore oil and gas facilities. NNPC is a state-owned corporation. On 14 March 1994 IPCO entered into a contract with NNPC for the design and construction of a petroleum export terminal in Nigeria.

In October 2004, in arbitration proceedings in Nigeria, IPCO was awarded US$152 million plus interest at 14% per annum ("*the Award*"). The value of the Award at the time of the Court of Appeal proceedings was over US$340 million.

NNPC commenced proceedings in Nigeria to have the Award set aside on the grounds that there was an error of law and an inadequacy of reasoning ("*the non-fraud challenge*").

In November 2004 IPCO attempted to enforce the Award in England. In April 2005 Gross J gave judgment for the uncontested sum of US$13.1 million and ordered adjournment of enforcement of the Award pending determination of the challenge in Nigeria on the provision of US$50 million security.

The non-fraud challenge proceeded very slowly in the Nigerian courts and in 2007 IPCO applied to the English courts for reconsideration of the adjournment, arguing that the Nigerian proceedings were taking much longer than had been expected when Gross J made his order, and that this change in circumstances entitled the court to revisit the order. Tomlinson J held that the delays in Nigeria were now "*catastrophic*" and varied the order of Gross J. He granted partial enforcement in respect of over US$75 million, but stayed the order, pending appeal, upon the provision of further security. NNPC's appeal was dismissed in October 2008.

In December 2008, and for the very first time, NNPC argued that the Award had been procured by fraud ("*the fraud challenge*") and applied to set aside or adjourn enforcement

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Commentary:

International dispute resolution & adjudication

Issue 16, 2015

of Tomlinson J's order. NNPC also filed an application to vary the order of Tomlinson J so as to provide that the enforcement be set aside on grounds of public policy. The parties then agreed to adjourn the decision on enforcement under section 103(5) of the Arbitration Act 1996. In March 2009 criminal proceedings against IPCO staff were instituted in Nigeria.

Matters again proceeded slowly in Nigeria and in July 2012 IPCO applied to enforce the Award. It argued that the ongoing delays amounted to a change in circumstances and that the court should therefore enforce the Award. Field J dismissed the application. He found that IPCO had failed to establish that there had been a sufficient change of circumstances since the Tomlinson order to justify a further application to enforce the Award. In any event, he found that he would have exercised his discretion to continue the adjournment because NNPC had a good prima facie case that the Award had been obtained by fraud. IPCO appealed.

The Court of Appeal's decision

The question at issue in the appeal was whether Field J was right to decline to enforce the Award made in Nigeria in October 2004 and, instead, to continue an adjournment of the enforcement proceedings begun in this jurisdiction.

The Court of Appeal held that "*insofar as the judge decided that the court should only consider the re-opening of the exercise of its discretion if IPCO showed that the fraud case was hopeless or not made bona fide, he applied, in my view, too strict a test*".

The court decided that the change in circumstances required it to exercise a consideration of the exercise of the court's discretion to adjourn. Field J had given insufficient weight to the character and extent of delay.

The court said that it was faced with a "*stark choice*". It could order enforcement of the Award. That may mean that IPCO receives payment under an Award which it obtained by fraud. The prospect of NNPC recovering the amount paid if the Award was set aside in Nigeria would be almost non-existent. Another choice was to permit enforcement conditional upon the provision of security by IPCO for return of the monies if the Award was set aside by NNPC. This would be difficult and expensive for IPCO and even if security was provided the final resolution of the validity of the Award would probably not take place for decades.

If, on the other hand, the court declined to order enforcement the result is likely to be that IPCO, if the Award is upheld, will not "*receive the fruits of it for a generation*". It went on to say that this was "*inconsistent with the principles that underpin the New York Convention*".

The court ordered that IPCO's application to enforce should be permitted subject to determination by the Commercial Court pursuant to section 103(3) of the Arbitration Act 1996 as to whether the Award should not be enforced in whole or in part because it would be against English public policy to do so. If it is determined that the Award is not contrary to the public policy of England and Wales, IPCO may enforce it.

The court felt that this was consistent with the underlying purpose of the Convention. The court considered that if the Award is not inconsistent with English public policy, it will be enforceable in England, notwithstanding the challenges to it in Nigeria. However, it said that it was not bound to defer enforcement until the court of the seat of arbitration has ruled on a challenge, however long that may take. The position had now been reached when the Award should (unless the fraud challenge succeeds) be enforced, notwithstanding the existence of a non-fraud challenge which will only finally be determined in Nigeria in a far too distant future.

Comment

This is the first reported English appeal court decision where delay alone has been held to entitle the holder of an award to enforce a New York Convention award, notwithstanding a challenge at the arbitral seat.

The Court of Appeal acknowledged that issues as to the validity of an arbitration award were matters for the courts of the seat of arbitration to consider, but it was also necessary to give due consideration to the principles of the New York Convention. The Court of Appeal formed the view that the New York Convention "*was intended to foster international trade by ensuring a relatively swift enforcement of awards and a degree of insulation from the vagaries of local legal systems*".

The Court of Appeal noted the importance of comity and respect for other courts, but nevertheless decided that the time had come when the Award should be enforced (subject to the determination of the fraud defence in the Commercial Court).

Martin Ewen, Senior Associate
Fenwick Elliott
mewen@fenwickelliott.com

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16, 2015

ISIS update: Force Majeure and Frustration

By Jonathan More,
Senior Associate, Fenwick Elliott

We wrote on this topic at this time last year. Unfortunately whilst it appears that West Africa is finally (almost) Ebola-free, the threat posed by ISIS (or "*Daesh*"), far from easing off, remains not only current but at risk of escalating. What was originally an insurgency into Iraq has spread into Syria and become what appears to be a longer-term claim to permanent territory as the so-called Islamic State.

The recent attacks in North Africa, Paris and on the Russian passenger jet have only served to intensify the geopolitical situation and places another risk on this area: the escalation of military action by countries from outside the region.

All of this makes the construction of projects in the region increasingly difficult and fraught, especially where the delivery of projects needs to be balanced with ensuring the well-being of staff and security of the works.

It is therefore timely to revisit the relevant legal implications that may arise in affected areas, covering both a reminder of how force majeure will operate, and also when the principle of frustration might apply.

What is force majeure?

In general terms, a force majeure event is one that relieves the parties from performing their obligations under the contract. Such events are usually exceptional occurrences 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."*

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

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16, 2015

> *(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 sub-paragraphs (ii) to (iv), occurs in the Country, payment of any such Cost…."*

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 for demobilisation.

Establishing force majeure

Is it a true force majeure event?

An event within one of the definitions in Sub-clause 19.1 (or which is similar in nature) must have occurred, and the contractor must have been prevented from performing his contractual obligations because that performance has become physically or legally impossible, as opposed to more difficult or unprofitable.

It is possible that the Daesh situation has become clearer over the past year or so. Many might argue that Daesh is no longer simply an insurgency. It controls large areas of Iraq and Syria which are now under continual military attack from a variety of sources. This should assist in establishing that the continued actions of Daesh, and the military action of others against it, constitute war, hostilities, terrorism and invasion, and so the existence of a force majeure event ought to be able to be satisfied.

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?

There are two issues here. First the extent to which it can be said that the party entering into the contract ought to have been aware of the potential threat posed by Daesh. However, the longer Daesh retain a foothold in the region, and with "*territory*" under its control, there is an argument that each Party to the contract in question will have had more time and more knowledge with which to take appropriate measures to prevent events happening in and around relevant project sites. This fact will also impact upon matters of foreseeability as discussed below.

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 subcontractors 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 Daesh 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 whether 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.

Contractors who have entered into contracts which were connected with areas that were previously secure, but which have subsequently fallen into turmoil, should have less difficulty in establishing the foreseeability element of force majeure.

That said, for contracts entered into since the original Daesh insurgency, against the backdrop of the very turbulent history of Iraq, the contrary argument is that it was foreseeable that once Daesh gained ascendancy in Iraq and encroached into Syria, the region would remain, and probably become increasingly, unstable.

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.

Frustration under the FIDIC form

Immediately after those clauses referred to above that deal with force majeure, sub-clause 19.7 provides that the parties will be released from performance if required by governing law, or if any event beyond the control of the parties (including but not limited to force majeure) renders it impossible or unlawful for the parties to fulfil their contractual obligations.

In effect, Sub-clause 19.7 acts as a fall-back provision for events which render performance impossible or illegal, but do not fall within the definition of force majeure. In addition, Sub-

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16, 2015

clause 19.7 entitles the party seeking relief to rely on any applicable principle prescribed by the law governing the contract.

Accordingly, in relation to contracts governed by English law, the affected party will be able to invoke the concept of frustration, which:[2]

> *"occurs whenever the law recognises that without the default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract".*

It can be seen, therefore, how this may be a very relevant consideration for projects affected by Daesh. There is clearly increasing risk that relief from time-related damages provisions becomes secondary to issues such as the viability of projects themselves.

Whilst frustration is a difficult test to fulfil, it is not as difficult as the concept of impossibility (or illegality) referred to in Sub-clause 19.4 and the first limb of Sub-clause 19.7.

Another difference between force majeure and frustration is that notice of force majeure, for example under Sub-clause 19.2, can be given if a party is prevented (or will be prevented) from performing any of its obligations under the contract, and not just where a party is prevented from performing the entire contract as would be the case under the common law doctrine of frustration.

Labour shortages and bad weather were not sufficient in the case quoted above (*Davis Contractors v Fareham*). Similarly, changes in economic conditions, for example a sharp or sustained recession, will not frustrate a contract.[3] Where the parties have made provision for the event within the contract, frustration will not apply,[7] and similarly where an alternative method of performance is possible.[8]

For frustration to apply, what is required is a radical turn of events completely changing the nature of the contractual obligations.

An example of a contract that was frustrated is found in *Atwal & Anr v Rochester*[4] where a building contractor suffered a heart attack and was unable to complete the building work. The judge held that the contract was a personal contract which had been frustrated by the builder's illness. The consequences of that illness were such that it significantly changed the nature of the obligations between the

Fenwick Elliott
The construction & energy law specialists

International Quarterly

Contract Corner:

A review of typical contracts and clauses

Issue 16, 2015

parties such that it would be unjust to hold them to the contract. Other examples where it has been found include destruction of the subject matter of the contract by fire[5] and landslip.[6]

Destruction due to some act of war or military action is the most likely relevant event in the circumstances we are considering. However, it may be that the "*destruction*" will have to be more fundamental than simply some or all of the civil works being destroyed, as these can be rebuilt. Destruction of all required infrastructure supporting the project might be one such case, as might destruction of the ability to extract oil from an oil field being constructed.

It is likely, however, that the option of frustration will be explored increasingly as the situation in Iraq and Syria intensifies.

Conclusion

Despite the recognised and known difficulties associated with Daesh in Iraq and Syria, two of the key principles that, in theory, might need to be utilised by contractors working in the region are inherently difficult to successfully pursue.

Force majeure can prove to be problematic, and difficult issues of causation and foreseeability can arise. Frustration is only slightly less difficult to establish.

As suggested last year, a possible solution in respect of force majeure 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 Lord Radcliffe in *Davis Contractors v Fareham UDC* [1956] 2 All ER 145 at p. 160.
3. See *Gold Group Properties Ltd v BDW Trading Ltd* [2010] EWHC 323. A drop in the anticipated proceeds of sale did not frustrate the contract.
4. [2010] EWHC 2338.
5. *Appleby v Myers* [1867] LR 2 CP.
6. *Wong Lei Ying v Chinachen Investments Ltd* (1979) 13 BLR 86.
7. *Jackson v Union Marine Insurance Co Limited* [1874] LR 10 CP 125.
8. *The Furnace Bridge [1977]* 2 Lloyds Rep 367.

Jonathan More, Senior Associate
Fenwick Elliott
+44(0)207 421 1986
jmore@fenwickelliott.com

Fenwick Elliott
The construction & energy law specialists

International Quarterly

News and events

Trends, topics and news from Fenwick Elliott

Issue 16, 2015

This edition

2015 has been a busy year for those involved in construction law. During the year in our editions of IQ we have kept you updated with latest developments and we featured articles on the launch of the ICC's Expert Rules; The Insurance Act 2015; the Persero II case reaching the Singapore Court of Appeal; and the Obrascon case in the English Court of Appeal to name a few. It was also an active year for us at Fenwick Elliott, we opened an office in Dubai and we made up two partners this year from within the firm, Andrew Davies and Jatinder Garcha, and welcomed our two new partners, Ahmed Ibrahim and Heba Osman in the Dubai office. We now have 17 partners, the most we have ever had. We also promoted six other team members during the year and welcomed seven new team members.

We hope to continue to bring you the latest construction law updates in 2016 and if there are any specific areas of construction law that you would like us to feature in future editions please let us know. We would like to take this opportunity to thank you for your continued interest in IQ and we wish you the very best for 2016.

***International Quarterly* is produced quarterly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.**

International Quarterly is a newsletter and does not provide legal advice.

Edited by Jeremy Glover, Partner, Fenwick Elliott LLP
jglover@fenwickelliott.com Tel: + 44 (0) 207 421 1986
Fenwick Elliott LLP
Aldwych House, 71-91 Aldwych
London , WC2B 4HN
www.fenwickelliott.com