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# Hong Kong Construction Newsletter

November 2017

# Introduction

Welcome to the November 2017 edition of Clyde & Co's Construction Newsletter. We hope you find this month's newsletter an informative and useful read.

Should you have feedback or suggestions for future topics, please contact us. Similarly, to hear more from our global projects & construction group, email us providing your area(s) and region(s) of interest.


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# Team highlights

## Outstanding Practitioner of the Year

The Construction Team is proud to look back on another eventful half year.

On 28 September 2017, our partner Ian Cocking was awarded **Outstanding Practitioner of the Year** at the *Asialaw Dispute Resolution Awards 2017.*

This Award is the highlight of the Asia Pacific Dispute Resolution Awards, and is based upon extensive research among private-practice lawyers and in-house Counsel across the region by Asialaw's editorial team between June and August 2017.

Congratulations Ian on this tremendous achievement and recognition among legal professionals across the Asia Pacific region.



## International Infrastructure Investment & Construction Forum

For the fourth year, we have sponsored the International Infrastructure Investment and Construction Forum, a leading global event for key players in the infrastructure industry and an indispensable platform for firms to connect and strategize for a stronger industrial future.

The forum, held in Macau, attracted more than 1,400 representatives from over 600 international institutions, including 46 distinguished ministerial guests from 36 countries. Topics included the impacts of the China-Australia FTA and the new Silk Road.

## Hong Kong In-House Congress 2017

We presented the arbitration section of the Hong Kong In-House congress for the fourth year, on the topic of Hong Kong's role as a dispute resolution centre for future Belt & Road Initiative disputes together with Wesley Pang, Managing Counsel from Hong Kong International Arbitration Centre.

The In-House Congress Hong Kong, is part of the highly successful In-House Community series, which brings together thought leaders from different industries to discuss the latest trends and issues within the legal field.

> "Clyde & Co has one of the best construction practices in the region.
>
> **Asia Pacific Legal 500**

# Third Party Funding ("TPF") is finally coming to Hong Kong

Singapore introduced TPF earlier this year. Now it is time for Hong Kong. Hong Kong is in the process of changing its law to allow TPF in the context of arbitration and mediation.

## Setting the scene for TPF

In Hong Kong, the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance ("the new law") was enacted on 23 June 2017. The new law has laid out the foundation for TPF of arbitration and mediation in Hong Kong. The new law will come into full force in the near future, once the regulatory framework is in place.

In respect of arbitration, the new law is designed to add Part 10A to the Arbitration Ordinance. Part 10A consists of the following six divisions:

- **Division 1** – Purposes
- **Division 2** – Interpretation
- **Division 3** – Third party funding of arbitration not prohibited by common law offences or torts
- **Division 4** – Code of practice
- **Division 5** – Other measures/safeguards
- **Division 6** – Miscellaneous

## Transitional arrangements

Some of the above divisions have been added to the Arbitration Ordinance, but divisions 3 and 5 are yet to be included and therefore will not be effective until further notice is published in the Gazette.

Division 3, once implemented, will operate to permit TPF in Hong Kong by dis-applying the common law offences of maintenance and champerty in the context of third party funded arbitration. In other words, without division 3 in effect, third party funded arbitration is still illegal in Hong Kong.

Similarly, division 5 will waive confidentiality restrictions and allow parties to communicate certain confidential information to third party funders in order to obtain funding. Without division 5 in operation, parties cannot disclose information about their cases to funders, making it practically impossible for TPF arrangement to take place.

## Upcoming regulatory framework - Code of Conduct

The expectation is that divisions 3 and 5 will be brought into effect, after finalisation of the code of practice, which will set out the expected standards and practices of third party funders. The Department of Justice has prepared and issued a preliminary draft code of practice in the Legislative Council Brief in 2016. Areas covered in the draft are: promotional materials, funders' minimum capital requirements, annual return requirements, procedure for conflicts of interest and protection of funded parties.

No concrete timeline has been set for finalisation of a code of practice, but an authorised body will be appointed and finalise the code of practice, subject to a public consultation process.

## Commercial point of view

From the commercial perspective, agreements between parties and funders will likely follow a format similar to those seen in other jurisdictions where TPF is available. In the U.K., for example, it is common for funders to take between 20% and 35% of proceeds recovered or three times the funder's investment, whichever is greater. In addition, for those who are considering obtaining TPF, it is worth noting that funders commonly aim to invest up to one-tenth of the claim value.

The exact mechanism of TPF in Hong Kong and its impact on the volume of the arbitral proceedings remain to be seen. Nonetheless, the development should be worthy of note to all legal practitioners in the city, including those not directly considering TPF of their proceedings. This is particularly so because they may be facing a third party funded opponent in arbitration.

In a recent High Court decision in the U.K. (*Essar Oilfields Services Ltd v Norscot Rig Management PVT Ltd* [2016] EWHC 2361), HHJ Waksman QC upheld the arbitrator's award that the losing party shall pay the costs of the winning party (which was funded by TPF) including the costs of obtaining the TPF. Although costs are normally at the discretion of the tribunal and the court, parties should be aware of the possible cost consequences as we proceed to the era of TPF.

**If you're interested in finding out more, please contact us.**

# From NEC3 to NEC4: 'evolution not revolution'?

The NEC suite of contracts, first published in 1993, marked a change from the industry standard. The underlying ethos of the NEC forms was to create a user-friendly, flexible contract that could be used for different types of construction activities, with different contracting strategies, anywhere in the world.

The goal was to produce a 'project management tool' for use throughout the project lifecycle and to assist parties in actually avoiding disputes. To provide more clarity and simplicity, the contracts are written in the present tense, using plain language, to avoid the 'legalese' used in more traditional construction contracts.

The other key feature of the NEC forms, introduced to encourage a collaborative approach to working on a project, is the overarching obligation for parties to act "in a spirit of mutual trust and co-operation". Added to reflect the outcome of the Latham Reports there has, and continues to be, much discussion regarding the meaning of this wording.

Nonetheless, the NEC forms are popular with government departments. The Hong Kong government has used the NEC3 suite of contracts since 2009 but decided to use them more widely on government projects tendered in 2015-16. Various NEC3 pilot projects were launched, including the HK$2 billion community hospital at Tin Shui Wai and the HK$678m Happy Valley underground stormwater storage scheme. Government issued the NEC Practice Notes for Engineering and Construction Contracts ("**ECC**") in March 2017, and for Term Service Contracts ("**TSC**") in July 2017 to provide guidance in preparing and administering public works projects using the NEC form.

In June 2017, NEC launched the NEC4 suite of contracts, which has introduced important changes into the NEC Suite, including:

1. Two new forms of contract are being published, i.e. the Alliance Contract and the Design Build Operate Contract
2. Changes in terminology within the Suite – e.g. "Employer" becomes "Client"
3. Key changes to the core clauses, particularly, to oblige a Contractor to submit applications for payment, or otherwise it will lose its rights to receive payment assessments from the PM and payments from the Employer (unless the assessments and payments are negative!)
4. New secondary options, notably, to allow the Contractor to propose changes in Scope or Working Areas, which could achieve cost savings to be shared between the Employer and Contractor; and the introduction of the Dispute Avoidance Board (DAB) option

According to NEC, "NEC4 is an evolution of the successful NEC3". The new features purport to address some of the concerns raised in response to NEC3 and to facilitate more proactive management of projects. It remains to be seen exactly how the changes would be when put into application, operation and interpretation.

# (a) Case law update on concurrent delay exclusion

Concurrent delay is the occurrence of two or more delay events at the same time, one an Employer Risk Event, another a Contractor Risk Event, and the effects of which are felt at the same time (see Society of Construction Law Delay and Disruption Protocol 2017).

Concurrent delay is a controversial topic. A recent English High Court case provides guidance on the effect of express provisions on concurrent delay as well as the application of the prevention principle in certain circumstances.

## Background

In *North Midland Building Ltd v Cyden Homes Ltd* [2017] EWHC 2414 (TCC), North Midland (the contractor) and Cyden (the employer) entered into a contract for the construction of a large house in the U.K. Both parties agreed to insert a bespoke concurrent delay exclusion provision into the contract, which read as follows:

"any delay caused by a Relevant Event which is concurrent with another delay for which the Contractor is responsible shall not be taken into account"

Subsequently, occurrence of multiple Relevant Events caused delay to the works, and the contractor requested an extension of time. The employer rejected most counts of the requested extension on the ground of the above concurrent delay exclusion term. The contractor sought declarations from the court on the effect of this provision.

## Court ruling

Mr. Justice Fraser found that the parties' concurrent delay exclusion provision was effective because the meaning of the provision in the parties' contract was clear. As a result, the contractor's entitlement to extension of time was excluded in respect of concurrent delay for which it was responsible. Further, the court agreed with Coulson J's reasoning in *Jerram Falkus Construction Ltd v Fenis Investments In (No. 4)* [2011] EWHC 1935 (TCC) that the prevention principle should not apply where the contractor could not show that the employer's acts had rendered it impossible for the contractor to complete its works on time.

## Conclusion

The judgment clarifies the English court's position on the effect of concurrent delay exclusions in construction contracts. We can anticipate that more employers will seek to include similar provisions in order to minimise contractors' claims for extensions of time. Also, parties using bespoke agreements should be aware of their potential consequences as to the express provision excluding concurrent delay. In practice, the application of concurrent delay is rare because, with experts' assistance, identifying the delay event is not very difficult. Nonetheless, parties should be aware of the effect of concurrent delay exclusions as it will have an impact on their future claims on extension of time.

# (b) Liquidated Damages ("LD"): recent legal developments

LD clauses typically stipulate a pre-determined sum to be paid if a party fails to perform certain contractual obligations. Commonly construction contracts contain such clauses, for example to deter late completion. The inclusion of LD clauses in contracts warrants special attention because LD clauses that are considered penal may become unenforceable.

The previous English authority on penalty clauses was *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79 ("Dunlop"). In Dunlop, Lord Dunedin held whether LD clauses are penal should be decided based on the following principles:

1. LD clauses would be penal if a stipulated sum is extravagant and unconscionable in comparison with the greatest loss that can arise from the breach;
2. LD clauses would be penal if the breach only concerns non-payment, and the stipulated sum is greater than the sum owed;
3. LD clauses would be penal when a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events that cause different levels of damage; and
4. LD clauses may not necessarily be penal even if the consequences of the breach make it almost impossible to pre-estimate damages because such impossibility is no obstacle to the sum stipulated being a genuine pre-estimate of damage.

After more than 100 years, the English Supreme Court has departed from the Dunlop test in *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Ltd v Beavis* [2015] 3 WLR. The court recognised that there may be a need for businesses to deter another party's breach of the contract and therefore, ruled that deterrence is not necessarily a penalty if (1) there is a legitimate business interest and (2) the stipulated sum is not out of all proportion to the interest to be protected.

In *ParkingEye*, the court was asked to consider whether an £85 charge for overstaying at the car park was a penalty, and provided helpful guidance in determining whether the sum is out of all proportion to the business interest of the car park business (ParkingEye Ltd). The court considered various factors including the level of charges imposed by local authorities, the appropriate display of the charge to inform users, and concluded that the £85 charge was not a penalty because it was not extravagant or unconscionable in any respect.

Whilst English courts have started applying this new test, Hong Kong High Courts have been slow in applying the new English authority. In 2016, Hong Kong's Court of First Instance and Court of Appeal handed down two judgments on LD clauses, both of which applied the old Dunlop test (see *Brio Electronic Commerce Ltd v Tradelink Electronic Commerce Ltd* [2016] 2 HKLRD 1449 and *Evergreen (FIC) Ltd v Golden Cup Industries Ltd* [2016] 5 HKLRD 636).

However, it is worth noting that judges from the District Court and Land Tribunal have applied the new test in their recent judgments. It is therefore likely that more Hong Kong judges will begin to adopt the new test in the near future.

In summary, the Dunlop test remains good law but this is likely to change in Hong Kong and such a change will affect how LD clauses can be drafted.

# Practical tips on handling industrial summonses

The happening of industrial incidents will very often be followed by the laying of industrial summonses by the Labour Department. As conviction records are likely to have an adverse impact on the prospects of contractors' tenders for projects, contractors would want to as far as possible minimize their conviction records. This article will give you some practical tips on handling industrial summonses.

It would be best if preparation can be done as soon as industrial incidents happen. If the contractor has staff members who are experienced in dealing with industrial incidents, do arrange them to attend the site immediately to take note of what had happened and to take photos of the scene. Start collecting relevant documents and arranging meetings with personnel involved to record their versions of the events as soon as possible. In case the industrial incidents lead to prosecution, such documents and meeting records will be helpful for the preparation of the defence.

After the commencement of investigation by the Labour Department, the Labour Department would usually require the contractor's staff to provide information and/or attend interviews with them. While contractors may not wish to give information which may be prejudicial to themselves, it should be noted that under the Factories and Industrial Undertakings Ordinance and the Occupational Safety and Health Ordinance, the Labour Department has wide investigations powers, including the requirement for provision of information by contractors. Failure to comply with Labour Department's requests may lead to prosecution. Having said that, skills may be exercised in responding to Labour Department's requests. Extent of details to be given to the Labour Department will need to be carefully considered before responding to their requests, as such details may be relied on by the prosecution in their case against the contractors. Contractors may, if possible, consider seeking lawyers' opinion before responding to them.

In the case where there is a prosecution, contractors may in appropriate cases rely on the notion of "reasonable practicability" as a defence. This is a statutory defence provided under s.18 of the Factories and Industrial Undertakings Ordinance. The burden is on the contractors to prove that it is not reasonably practicable to do more than what was in fact done. The court's approach to construing "reasonable practicability" has been clarified in the Court of Final Appeal case of ***HKSAR v Gammons Construction Ltd*** [2015] 4 HKC 28. It is held that in considering "reasonable practicability", a court may have regard to the need to balance the likelihood of risk against the cost, time and trouble necessary to avert the risk. In compiling documents in preparation of the defence, contractors may try to collect all relevant documents and evidence from its staff to show what precautions had been taken and why they had not been able to do more than what had been done.

It is important to make sure every step after the happening of industrial incidents is properly taken. Do consult lawyers immediately after the happening of industrial incidents to minimize the chance of getting convictions.

# Mediation – an introduction

The Courts are always encouraging parties to attempt to settle disputes instead of incurring costs by fighting their issues out in the Court. One of the most popular forms of ADR is mediation.

### Facilitative or evaluative?

There are generally two approaches that a mediator can adopt in order to find common ground between the parties, a facilitative approach or an evaluative one. In the UK, mediation is almost exclusively approached in a facilitative way, where the mediator will act as a communicator between the parties but won't express a strong view as to the prospects of each party's case. An evaluative approach sees the mediator offer an opinion as to the strengths or weaknesses of each party's case.

### When should a party mediate?

Mediation can be attempted at any time, and will often narrow the issues between the parties. However, it is likely to be a waste of money to mediate before both parties are genuinely willing to attempt a settlement. Often this will occur once parties have fully pleaded their cases or have become aware of the likely costs of litigation or arbitration.

### How does it work?

The process of mediation starts as soon as a mediation is proposed by one of the parties to the dispute (or a third party such as the Court) as this will often adapt the parties' mind sets towards settlement rather than arguing. The parties will then have to agree on the identity of the mediator.

Following this, the parties will often wish to present their positions using written statements before the mediation, submitting these to the mediator and the other side. It is important for each party to confirm that the attendees at the mediation will have the authority to agree a settlement of the matter. Mediating with a party that cannot settle without additional authority will often cause delays and can derail a settlement.

On the day of the mediation, the parties will sign a confidential mediation agreement, which makes it clear that anything said or handed over at the mediation will be considered confidential and on a without prejudice basis. This allows parties to discuss the dispute freely without being concerned about anything they say being used against them in formal proceedings.

The parties will initially meet the mediator separately, then ordinarily the mediator will hold a plenary session where all of the parties to the dispute sit around the same table with the mediator and summarise their positions. This often helps to identify the issues that are not agreed upon, in turn providing focus for further discussions throughout the day. Those further discussions will be decided on by the mediator based on how they think the time would best be spent. It is most common for a mediator to engage in "shuttle diplomacy", where the mediator moves back and forth between the parties and narrows differences.

### Costs

Mediations can be as cheap or as expensive as the parties are willing to accept, and the cost of a mediation will mostly be determined by the mediator that is chosen and their hourly rate.

Unless the parties decide to deal with their own costs of mediating as part of any settlement agreement, the parties would normally bear their own legal and other costs connected to mediation.

It is important to note that a party may suffer costs sanctions if it refuses to mediate and then goes on to fight litigation. In the case of Laporte and another v The Commissioner of Police of the Metropolis, a defendant to litigation refused to engage in ADR and went on to successfully defend the action against it. Despite its success, the Court decided not to award the defendant any of its costs due to its refusal to engage in discussions that had a reasonable prospect of success of concluding a settlement of the matter.

This case demonstrates that failing to engage in alternative dispute resolution can have negative costs consequences, even if you are successful in the ultimate litigation. Offers of ADR should always be considered, even if the other side is uncompromising, and any refusal to engage in ADR requires support of robust reasoning.

# Introduction of Clyde & Co's global construction practice

Under the international perspective of Clyde & Co LLP, the construction team deals with numerous legal issues, large and small scale, for its global clients.

Our team's expertise and experience spans across multiple construction and engineering projects, dispute resolution, PPP/PFI and project financing. Our team has particular expertise advising on projects in Greater China and our lawyers have advised on some of the most high-profile and complex infrastructure projects in the region such as casino resort developments in Macau, the Hong Kong airport, the West Kowloon Cultural District, major transport infrastructure in Hong Kong and energy and utilities projects in China.

We have the experience to advise across the entire lifecycle of all types of projects – from development and procurement through to contract drafting and tendering, risk management and dispute resolution.

On the transactional side, our work spans a wide variety of infrastructure, construction and engineering projects. We are familiar with all forms of procurement methods and standard form building contracts and regularly draft and advise on bespoke agreements that suit our client's needs.

On the contentious side, we assist our clients to resolve construction related disputes using all forms of dispute resolution including early settlement of claims, mediation, international arbitration, conciliation, adjudication and litigation.

The construction team remains highly praised in the legal markets and is described as: "Clients of Clyde & Co LLP *'would not take their work anywhere else'*; *'the service is excellent, very practical and appropriately priced'*. " (Legal 500 2017, Hong Kong).

## Partner profile – Dennis Wong

Dennis is a partner in Clyde & Co's Hong Kong and China Construction Group. He is a trusted advisor to governments, employers, contractors, engineers, and other clients, in handling various construction-related disputes, including mediation, litigation and arbitration. He has handled contentious matters across a wide range of construction issues, such as final accounts, delay, extension of time, liquidated damages, and variations.

He also has a vast amount of experience in non-contentious matters, advising on various infrastructure and construction projects across mainland China, Hong Kong, Macau, and other parts of the world such as Tajikistan, Indonesia, Philippines and Cambodia.

Dennis is dual-qualified in Hong Kong and New South Wales. Since qualified as a Hong Kong solicitor in 2005, he has taken substantive roles in complex arbitration proceedings involving stay-cable bridges, sub-sea cable installation, and site formation, among others.

Further to his role as a lawyer, he is also qualified as Hong Kong adjudicator under the HKIAC's first round of adjudicator training.

Dennis recently spoke at the 8th International Infrastructure and Construction Forum 2017 organised by the Chinese International Contractors Association regarding new trends in PPP contracts.

He was recognised by the Legal 500 Asia Pacific 2017 as a ***Next Generation Lawyer.***


## Key contacts


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"The service of Clyde & Co is excellent, very practical and appropriately priced"
**Asia Pacific Legal 500 2017**

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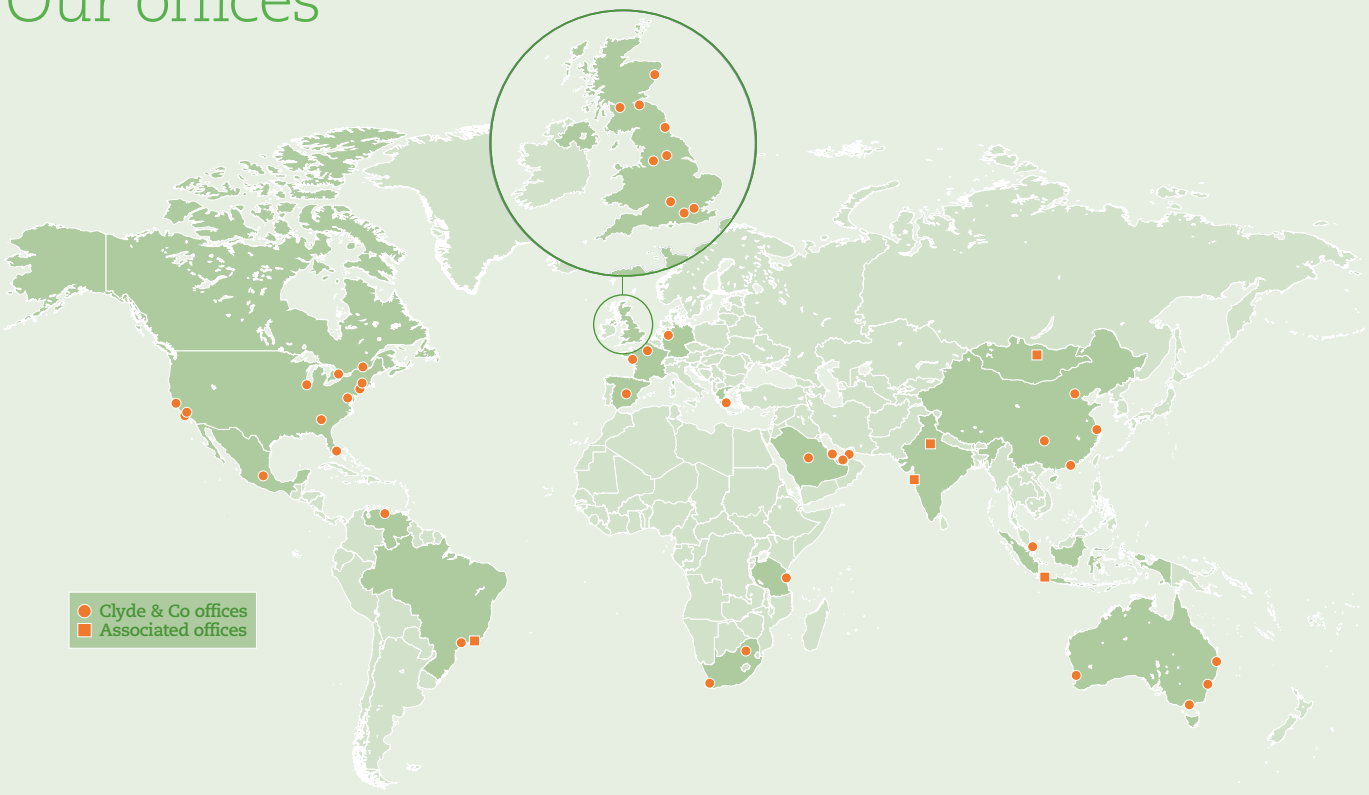


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Further advice should be taken before relying on the contents of this Newsletter.



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J403054 - November 2017