

Hong Kong Institution of Engineers
Alternative Dispute Resolution Committee
jointly organised with HKIAC & HKU Dept of Real Estate and Construction

Law of Contract
for Resolving Construction Disputes

Presented By : Ir Teresa Cheng SC
Ir Gary Soo

30 July 2010

Rundown

0900 *Registration*

0910 *Welcome*

0915 **Fundamentals of Contract Law**

1030 *Break*

1045 **Payments, non-payment and late payment in Construction
Contracts**

1145 **Extension of Time and Liquidated Damages, Prolongation Costs
& Disruption Claims**

1300 *Lunch*

1400 **Variations and Changes**

1515 *Break*

1530 **Termination of Construction Contracts**

1630 **Dispute Resolution**

1730 *Closing Remarks*



Fundamentals of **Contract** Law

Fundamentals of Contract Law

- *‘A contract is a promise or set of promise that the law will enforce.’*
- *‘Disputes (and damage) are locked in once a contract is formed.’*
- *‘Getting the contract right and in writing is most fundamental!’*

Fundamentals of Contract Law

- Formation of contract is to be tested objectively.
- Interpretation of contract is to find out its meaning as conveyed to a *reasonable man*
- Elements:
 - A valid *Offer*
 - with effective *Acceptance*
 - supported by *Consideration*
 - with *Intention to create legal relationship*
 - by parties with *Capacity to contract*
 - in a legitimate context
- Types:
 - Oral, Written, Conduct...or just a Combination
 - Parol evidence rule - *Consort Engineering Co Ltd v. Leung Wai Ying alias Tommy Leung trading as Kin Ming Company*

Fundamentals of Contract Law

- **Ascertaining the express terms of the contract - *Grand Choice Construction Co Ltd v. Dillingham Construction (H.K.) Ltd & Man Keung Co Ltd v. Prosperity Machinery Manufacturers Ltd***
- **‘Whole Agreement Clauses’**
- **Implied Terms**
 - ◆ **By legislation (e.g. *Nippon Kanzai Centre Co Ltd v. Ho Biu Kee Construction Engineering Co Ltd*)**
 - ◆ **Implied in law (e.g. ‘business efficacy’ in *The Moorcock*)**
- **Duty to co-operate (*Luxor (Eastbourne) Ltd. v. Cooper* : “...where B is employed by A to do a piece of work which requires A’s co-operation...it is implied that the necessary co-operation will be forthcoming” - *Lee Chau Mou t/a Chau Mou Engineering & Co v. Kin Sing Engineering (HK) Co Ltd*)**
- **Factors - *BP Refinery (Westernport) v. Shire of Hastings***

Fundamentals of Contract Law

- *A breach of contract occurs where, **without lawful excuses**, a party either fails or refuses to perform its contractual obligation.*
- **Classically, a term can be a ‘*condition*’, a ‘*warranty*’ or an ‘*intermediate term*’.**
- **All breaches entitle the innocent party to damages, if any.**
- **Breach of ‘*condition*’ or ‘*intermediate term*’ may be a fundamental breach that goes to the root of the contract, i.e. a repudiatory breach that can immediately discharge the innocent party from further performing the contract (*Hong Kong Fir Shipping v. Kawasaki Kison Kaisha & Mersey Steel & Iron Co. Ltd. v. Naylor*).**
- **There can also be other remedies available, i.e. specific performance, injunction or by way of quantum meruit.**

Fundamentals of Contract Law

- **Aim : *so far as money can do as if the contract had been performed***
 - **Difference in value**
 - **Costs of cure/repair**
- **The 9 inches difference that worth £ 21,560 - *Ruxley Electronics and Construction Ltd. v. Forsyth***
- **Other consequential losses (e.g. other economic loss or interest etc. - *Hadley v. Baxendale*)**
- **Duty to mitigate**
 - **Duty to take all reasonable steps to minimize one's loss**
 - **The fundamental basis is thus compensation for pecuniary loss naturally flowing from the breach; but this first principle is qualified by a second, which imposes the loss consequent on the breach, and debars him from claiming any part of the damages which is due to his neglect to take such steps” - *British Westinghouse v. Underground Railways Co.***



Payments in Construction Contracts

Payments in Construction Contracts

● Right to Payments

- Doctrine of Entire Contract vs. Doctrine of Substantial Performance - *H. Dakin & Co., Ltd. v. Lee and Hoeing v. Isaacs*
- Progress or Staged or Interim Payments
- *Quantum Meruit*

Payments in Construction Contracts

● Non-payment at Common Law

➤ Non-payment as breach of contract - Interests

➤ Non-payment as repudiation of contract

➤ Right to suspend work?

● *Mersey Steel and Iron Co. v. Naylor, Benzon & Co.* - Contract for sale of 5,000 tons of steel delivered by 5 instalments, each to be separately paid for. **HELD:** Payment for previous delivery not condition precedent to right to claim next delivery

● BUT

➤ *Cretilles Building Materials Co. Ltd. v. To's Universe Construction Co. Ltd.*

➤ *Hongkong Underground Engineering Ltd. v. Welcome Construction Co. Ltd.*

Payments in Construction Contracts

- **Non-payment under the Contract**
 - ◆ **Contractual provisions for termination upon notice**
 - ◆ **HKIA/RICS(HK) standard form**
 - ◆ **“Pay-when-Paid” clause? - *Hong Kong Teakwood Works Ltd. v. Shui On Construction Co. Ltd. & Honeywell Ltd. v. Kin Ming E& M Works Ltd.***

Payments in Construction Contracts

● Certification

◆ General rule

- No certificate no payment

◆ Formality

- Certificate copied to sub-contract - *Pyrok Industries Ltd. v. Chee Tat Engineering Co. Ltd.*
- Certificate signed but not delivered - *London Borough of Camden v. Thomas McInerney*

◆ Payment without certificate

- Waiver
- Disqualified
- Prevention by employer
- Death or incapacity

Payments in Construction Contracts

● Interim Payments

➤ *“Certification may be a complex exercise involving an exercise of judgment and an investigation and assessment of potentially complex and voluminous material. An assessment by an engineer of the appropriate interim payment may have a margin of error either way...At the interim stage it cannot always be a wholly exact exercise. It must include an element of assessment and judgment. Its purpose is not to produce a final determination of the remuneration to which the contractor is entitled but is to provide a fair system of monthly progress payments to be made to the contractor.” - Secretary for State for Transport v. Birse-Farr Joint Venture*

● Problems of non-payment?



EOT & LD

EOT & LD

● **Contractual provisions as to time**

- *Exist parallel with common law rights (e.g. quantum meruit)*
- *Modify common law rights (e.g. liquidated damages)*
- *Add common law rights upon breach (e.g. termination)*

● **Commencement date**

● **Completion date**

● **LD & EOT clauses**

- *Wholly borne by employer (e.g. late drawings or 3rd parties)*
- *Wholly borne by contractor (e.g. shortage of plants)*
- *Shared between employer and contractor (e.g. inclement weather)*

● **Excusable vs. Non-excusable**

● **Compensable vs. Non-compensable**

EOT & LD

- **Example: “HK\$3,000.00 per day”**
- **Rationale:** *“The fact that in certain circumstances a party to a contract might derive a benefit in excess of his loss does not...outweigh the very definite practical advantages of the present rule of upholding a genuine estimate, formed at the time the contract was made of the probable loss ...Since it is to their (the parties) advantage that they should be able to know with a reasonable degree of certainty the extent of their liability and the risk which they run as a result of entering into the contract. This is particularly true in the case of building and engineering contracts. In the case of those contracts provision for liquidated damages should enable the Employer to know the extent to which he is protected in the event of the contractor failing to perform his obligations” - Philips Hong Kong Ltd. v. The Attorney-General of Hong Kong*

EOT & LD

● **Other Issues**

➤ **What if no loss at all?**

➤ **What if more loss?**

● **Deduction of liquidated damages**

➤ **Valid clause, i.e. not otherwise as a penalty**

➤ **Definite start date for deduction**

➤ **Definite end date for deduction**

➤ **No non-compliance nor other default on the part of employer**

● **Breach of condition precedent**

● **Date to run?**

EOT & LD

- **Delay of works vs. delay of completion**
- **Rationale for extension of time clauses**
- **Time at large**
 - where an act of prevention by the employer creates delay and that delay is not covered by an extension of time provision; and, to a lesser extent;
 - where the provisions for extension of time have not been properly administered or have been misapplied;
 - where there has been waiver of the original time requirements
 - where there has been interference by the employer in the certifying process. (*Wells v. Army & Navy Co-operative Society Ltd.*)
- ***Peak Construction (Liverpool) Ltd. v. McKinney Foundations Ltd***

EOT & LD

- **Proving Delay and Disruption**
 - **Demonstrating *nexus* between cause and effect**
- **Global claims - *John Doyle Construction Ltd. v. Laing Management (Scotland) Ltd.***
 - **Normally, individual causal links be demonstrated**
 - **Cumulative effect could be relied on where impossible to separate specific loss and expenses**
 - **Global claim failed if a (significant?) cause of loss and expenses not liable**

EOT & LD

● Proving Delay and Disruption

- ◆ *“... the purpose of the power to grant an extension of time ... was to fix the period of time by which the period of time available for completion ought to be extended having regard to the incidence of the relevant events, measured by the standard of what is fair and reasonable ”*
- ◆ *“... if there are two concurrent causes of delay, one of which is a relevant event, and the other is not, then the contractor is entitled to an extension of time for the period of delay caused by the relevant event notwithstanding the concurrent effect of the other event” BUT “...an architect is not precluded from considering the effect of other events when determining whether a relevant event is likely to cause delay to the works beyond completion”*
- ◆ *“...the approach must always be tested against an overall requirement that the results accords with common sense and fairness” - **Balfour Beatty Building Ltd. v. Chrestermount Properties***



Variations & Changes

Variation & Changes

- **General Principles**
 - *Scope of contracted work*
 - *Agreement to pay*
- **Implied obligations**
- **Written Requirement**
 - *Contractual condition for varied work*
 - *Contractual condition for payment*
- **Binding quotation?**
- **Time implication?**
- **Non-action of engineer?**
- **Waiver?**
- **Estoppel?**

Variation & Changes

- **The Unit Rate**
 - **Applicable rate**
 - **Item coverage**
 - **Rate built-up**
- **Reasonable sum: Market rate, At-costs & Costs plus?**
- **Quantum meruit claim**
 - **No agreement to pay**
 - **Incomplete contract**

Variation & Changes

- *Secretary for Justice v. Sun Fook Kong (Civil) Ltd.*
 - Rock excavation & removal measured as 7,048m³
 - Unit rates for 70m³, 20m³ & 100 m³ at \$5,000, \$8,000 & \$5,000 and others for 1m³ at \$3,000
 - Clause 59 giving difference of \$31M
- Nature and circumstances of work & Method of working ?

Variation & Changes

*‘Change in the delivered scope, or in the manner or sequence in which it is carried out, must to some degree be inevitable... The cumulative effect of such instructed changes can undermine the whole economy of a project. A weakness of the traditional JCT and ICE forms...is that these contracts provide for changes to be implemented **before their impacts in time and/or cost have been resolved.** Ex post facto claims, arguments, justifications and eventual disputes over what is an appropriate adjustment to the contract programme and contract price are hardly surprising results.’*

Professor Philip Capper



Termination of Contracts

Variation & Changes

- *Owt Asia Ltd. v. CPCNet Hong Kong Ltd.*
 - ◆ **Contract for the provision of telecommunication system for international telephone services involving prepaid calling cards**
 - ◆ **System installed and testing satisfactory in 1999**
 - ◆ **Discussion went on to fine tune the system**
 - ◆ **Payment of installment delayed**
 - ◆ **System crashed repeatedly for unclear reason**

Variation & Changes

● *Owt Asia Ltd. v. CPCNet Hong Kong Ltd. (Cont'd)*

- ◆ *“In this case, it seems to me that the persistent failure of the Defendant to pay, or even to respond at all to demands for payment which I am satisfied were made by Mr Lee to Mr Chang and the Defendant, does evince an intention on the part of the Defendants not to be bound by the contract between itself and the Third Party. Further, I am satisfied that the Third Party was thereby entitled to, and did, regard itself as released from further performance so that it was justified in refusing to carry on with the UATs from the end of September 1999. The consequence is that even though the Third Party might otherwise have been in breach of its obligations to the Defendant by failing to deliver the postpaid software, the Defendant not having terminated the contract on this ground, it remained open to the Third Party to perform that obligation later, until it became itself entitled to treat the contract as terminated so as to free itself from the obligation to do so.”*

Termination of Contracts

- Where one party so conducts or expresses itself as to show he does not mean to accept the obligations of a contract anymore
- **Effect:**
 - ◆ If accepted, discharge of innocent party from further performance and entitle it to immediately to sue for damages
 - ◆ If not accepted or affirmed, innocent party may insist of full performance on its side and sue for the whole price under the contract
- Labels: “*determination*”, “*rescission*”, “*treating the contract as repudiated*” or “*accepting the repudiation*”

Termination of Contracts

- Termination under the Contract
- Forfeiture Clause
 - ◆ Bringing the contract to an end in certain circumstances
 - ◆ *‘not proceeding with the works to the satisfaction of the Engineer’*
 - ◆ *‘not complying with the Engineer’s orders’*
 - ◆ *‘not proceeding with due diligence’*
 - ◆ Side Effect: **Licence to occupy the site revoked**
 - ◆ *London Borough of Hounslow v. Twickenham Garden Developments Ltd.*
 - ◆ *Mayfield Holdings Ltd. v. Moana Reef Ltd.*
 - ◆ Agreed consequences [e.g. Clause 81 of HKSAR Government CoC]

Termination of Contracts

- **Termination at Common Law**
- *Thomas Feather & Co. (Bradford) Ltd. v. Keighley Corporation*
 - ◆ Contract to erect houses with right to determine if sub-contracting without consent
 - ◆ Employer asked for extra costs to complete
 - ◆ Held: Not entitled to extra costs
- *Architectural Installation Services Ltd. v. James Gibbons Windows Ltd.*
 - ◆ Labour-only sub-contract to install window units
 - ◆ Held: Not able to rely on clause to terminate but still able to rely on common law



Dispute Resolution

Dispute Resolution

● Litigation

- ◆ Court System in Hong Kong – Small Claims, District Court, High Court (Court of First Instance & Court of Appeal) & Court of Final Appeal
- ◆ Pleadings
- ◆ Discovery of Documents
- ◆ Interlocutory Applications
- ◆ Exchange of Witness Statements
- ◆ Exchange of Expert Reports
- ◆ Trial
 - ◆ Submission
 - ◆ Evidence – Examination in Chief; Cross Examination & Re-Examination
 - ◆ Practice Direction on Mediation

Dispute Resolution

- **Worldwide Trend towards Alternative Dispute Resolution**
- **Types of ADR Processes**
 - ◆ **Facilitative**
 - ◆ **Advisory**
 - ◆ **Determinative**
- **Advantages of ADR**
 - ◆ **Party control**
 - ◆ **Flexibility**
 - ◆ **Speed**
 - ◆ **Cost**
 - ◆ **Hostility**
 - ◆ **Expertise**

Dispute Resolution

● **Mediation**

- ◆ **Mediator Assisting Negotiation**
- ◆ **Output – Voluntary Settlement Agreement**
- ◆ **Shuttling Diplomat at Impasses**
- ◆ **Process**
- ◆ **Pilot Schemes**

● **Arbitration**

- ◆ **Legal Process under Arbitration Ordinance**
- ◆ **Arbitrator**
- ◆ **Output – Award, enforceable easily as a judgment of the court**
- ◆ **Arbitration Agreement in Writing**
- ◆ **Stay of Proceedings/Enforcement of Award**

● **Dispute Resolution Advisor and Other ADRs**

Dispute Resolution

- **What is evidence?**
- **What is good evidence?**
- **Importance of documents**
 - ◆ **Persuasive force of written records**
 - ◆ **Persuasive force of absence of written records**
 - ◆ **Records at the time**
 - ◆ **Records passing between the parties**
 - ◆ **Gaps in records?**



Questions

&

Answers