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International Quarterly

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The Court of Appeal in Persero II: how to enforce "binding but non-final" Dispute Board Decisions under the FIDIC Form of Contract

By Robbie McCrea, Associate
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PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation [2015] SGCA 30

This article is a follow-up to two International Quarterly ("IQ") articles on the Persero series of cases, the first of which followed the Persero I Court of Appeal decision in Issue 01, 2011, and the second followed the Persero II High Court decision in Issue 12, 2014[1]. As promised we have continued to monitor the progress of this influential series of cases, and we set out below our conclusions on the enforcement of non-final DAB decisions following the latest (and final) decision by the Court of Appeal in Persero II.

Introduction

The 1999 FIDIC Suite of Contracts[2] includes a dispute resolution mechanism that was designed to give the parties quick, cost-effective and immediately binding awards through the Dispute Adjudication Board ("DAB") mechanism at Clause 20 of the Conditions of Contract.

However, an apparent oversight in the drafting of Clause 20 has left many parties with an entirely different experience from that intended by the FIDIC drafters, and even today there is no settled pathway to enforce a DAB decision where the non-complying party has prevented the decision from becoming "final".[3]

A DAB decision will become final if neither party provides written notification of their dissatisfaction with the decision within 28 days of receiving it (pursuant to Sub-clause 20.4). It is therefore a straightforward matter for either party to ensure a DAB decision remains "non-final".

Both final and non-final DAB decisions are immediately binding on the parties. However, final decisions cannot be appealed, and if a party fails to comply with a final decision Sub-clause 20.7 expressly allows the other party to refer to arbitration the discrete issue of non-compliance in order to enable the DAB decision to be enforced as an arbitral award.

Although the FIDIC drafters have stated that their intention was that non-compliance with "non-final" DAB decisions be enforceable in the same manner as "final" decisions,[4] there is no express provision in the Conditions of Contract to allow it. This has led to debate as to how to enforce a binding but non-final DAB decision.

The issue has been dealt with in a multitude of ways by DABs, arbitral tribunals and legal commentators. However, because DABs and arbitration are private, there has been very little guidance from the courts.

For this reason there has been widespread interest in a series of cases involving this issue in Singapore, the "Persero" series, which culminated in the decision of the Singapore Court of Appeal in *PT Perusahaan Gas Negara (Persero) TBK v CRW Joint Operation* [2015] SGCA 30, the reserved judgment being issued on 27 May 2015.

In a split decision, the Majority of the Court of Appeal found that binding but non-final DAB decisions could be submitted directly to arbitration on the discrete question of non-compliance.

While the Majority's decision is on face value a victory for contractors seeking the protection of a security of payment regime, the result is bittersweet. Interim enforcement of the DAB decision was obtained only after going through two sets of arbitration, High Court and Court of Appeal proceedings, and over a period of six years. A decision on the merits of the underlying dispute is still to be decided.

Furthermore, the pathway to interim relief laid down by the Majority differs from all previous judgments in the *Persero* series, whereas the Minority judgment held that the Conditions of Contract provide no scope whatsoever for expedited relief by enforcing non-final DAB decisions.

Parties would therefore be well advised to proceed carefully when pursuing the enforcement of non-final DAB decisions under the FIDIC Conditions of Contract.

Background

The *Persero* series involves a dispute between parties to a contract based on the FIDIC Red Book, and which is governed by the law of Indonesia. A DAB was established and subsequently ordered that the employer ("PGN") pay the contractor ("CRW") in excess of US$17 million (the "DAB Decision"). PGN accordingly issued a Notice of Dissatisfaction ("NOD") pursuant to Sub-clause 20.4 and refused to comply with the DAB Decision. The *Persero* series is based upon CRW seeking expedited enforcement of the DAB Decision.

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CRW first attempted to enforce the DAB Decision by proceeding to arbitration in 2009 under Sub-clause 20.6 on the discrete question of whether CRW was required to comply with the DAB Decision. The arbitral tribunal found in CRW's favour and held in a final award that PGN had an obligation to make immediate payment of the sum awarded in the DAB Decision. This is consistent with the stated intention of the contract drafters.

The 2009 tribunal's award was subsequently set aside by the High Court of Singapore. The High Court reasoned that the tribunal could not convert the non-final DAB Decision into a final award without determining the merits of the underlying dispute. However, the Court opined that if CRW were to obtain a second DAB decision on the discrete question of non-compliance with the first DAB Decision, it could then submit the second DAB Decision to arbitration where the tribunal could decide the issue as it would be hearing the issue referred on its merits. This is known as the "two-dispute" approach.

The High Court decision was appealed to the Court of Appeal which confirmed that the 2009 Arbitral Award should be set aside. However, the Court of Appeal did not endorse the two-dispute approach. Instead, the Court considered that the tribunal would have been able to enforce the DAB Decision by way of interim relief, if CRW had also submitted the underlying dispute to the tribunal as part of the same referral. Under this approach the tribunal could first give an interim award on the issue of non-compliance with the DAB Decision, and then go on to hear the substantive dispute on its merits. This is known as the "one-dispute" approach.

CRW subsequently commenced a new arbitration under the one-dispute approach. By majority, the 2011 tribunal issued an interim award compelling PGN to give prompt effect to the DAB Decision (the "Interim Award") pending the tribunal's final determination of the underlying dispute.

The Interim Award and the one-dispute approach were upheld by the High Court in *Persero* II[5] in its decision of July 2014, which found that Clause 20 of the Conditions of Contract establishes a "security of payment regime", the principal purpose of which is to facilitate the cash flow of contractors by requiring the employer to pay immediately, while preserving its right to argue later the substantive merits of the dispute in arbitration (i.e. "pay now, argue later"). Accordingly, the arbitral tribunal was entitled to grant a final and binding award that the DAB Decision be complied with immediately, albeit as the first step of the primary dispute being finally decided in due course.

PGN appealed *Persero* II to the Court of Appeal.

The Court of Appeal in Persero II

The 2015 Court of Appeal by majority ruled in favour of CRW and upheld the Interim Award. However, the Court found that neither the one-dispute approach nor the two dispute approach was strictly correct. Instead, it considered that binding but non-final DAB decisions should be enforceable by way of interim awards in and of themselves, that is, without referring the secondary dispute back to the DAB and without the need to also submit the underlying dispute to arbitration.

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The Majority judgment

As a preliminary matter the Majority considered the DAB's powers under Sub-clause 20.4 and set out the following three propositions:[6]

> *(a) "A DAB decision is immediately binding once it is made. …*
>
> *(b) The corollary of a DAB decision being immediately binding once it is made is that the parties are obliged to promptly give effect to it until such time as it is overtaken or revised by either an amicable settlement or a subsequent arbitral award.*
>
> *(c) The fact that a DAB decision is immediately binding once it is made and unless it is revised by either an amicable settlement or arbitral award is significant … the issuance of an NOD [notice of dissatisfaction] self-evidently does not and cannot displace the binding nature of a DAB decision or the parties' concomitant obligation to promptly give effect to and implement it."*

The Majority then considered the two-dispute approach that was preferred by the High Court in *Persero* I and rejected it on the basis that, in light of the above three propositions, "any requirement to refer a question as to the immediate binding effect of a binding but non-final DAB decision back to the DAB seems to us not only wholly superfluous, but also contrary to the express words of cl 20.4[4]".[7]

In respect of the one-dispute approach that was preferred by the Court of Appeal in *Persero* I and the High Court in *Persero* II, the Majority rejected the notion that all differences between the parties would need to be settled in a single arbitration. The Majority instead found that a "paying party's failure to comply with a binding but not final DAB decision is itself capable of being directly referred to a separate arbitration under cl 20.6".[8]

In practice, however, the Majority's decision may be less of a departure from the one-dispute approach than a first glance would suggest. This is because the Majority also found that the non-complying party could, by filing a counterclaim, require that the underlying dispute also be heard as part of the same arbitration, albeit after the tribunal had first made a final award in respect of non-compliance with the DAB decision.[9]

The Minority judgment

In a 95-page dissenting judgment, Senior Judge Chan Sek Keong found the opposite. His Honour's opinion was that, unlike final decisions under Sub-clause 20.7, there is no scope in Sub-clause 20.6 or elsewhere in the Conditions of Contract for interim enforcement of non-final DAB decisions.

His Honour considered that the Interim Award should be set aside on one or more of the

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following three grounds:

1. Failure to comply with the non-final DAB Decision did not fall within the scope of "dispute" in Sub-clause 20.4, or anywhere in the arbitration agreement, and therefore it could not be the subject of an arbitral award.

2. The 2011 Majority Arbitrators had no mandate under Sub-clause 20.6 to issue the Interim Award pending the final adjudication of the Underlying Dispute.

3. Even if the 2011 Majority Arbitrators did have the mandate under Sub-clause 20.6 to issue the Interim Award, the Interim Award was, and was intended to be, in substance a provisional award outside the ambit of "award" in s.2 of the Singapore International Arbitration Act ("IAA") and was not enforceable under s.19 of the IAA as a judgment.

Accordingly, His Honour considered that in order to enforce the DAB Decision CRW would need to go outside the contractual machinery, for instance by seeking summary judgment in a court of competent jurisdiction.

Conclusion

Far from providing the much needed clarity that was hoped for (by contractors at least), the *Persero* series has concluded by adding yet more interpretations of the disputes mechanism at Clause 20. Prospective claimants must now consider the four potential approaches endorsed in the *Persero* series when considering enforcement of a non-final DAB decision, namely:

1. Submit the issue of non-compliance with the DAB decision directly to arbitration.

2. Obtain a second DAB decision in relation to non-compliance and refer that second DAB decision to arbitration (the two-dispute approach).

3. Submit the entire substantive dispute to arbitration, seeking in the first instance an interim award that the DAB decision be complied with immediately, on the basis that the substantive dispute will be heard on its merits in due course as part of the same referral (the one-dispute approach).

4. Seek to enforce the DAB decision outside the contractual machinery, for instance by seeking summary judgment in a court of competent jurisdiction.

It should be noted that the *Persero* series were decided in Singapore under Indonesian law, and the judgments included consideration of a number of factual and jurisdiction-specific matters. These should be considered carefully before placing reliance on the *Persero* decisions in relation to other jurisdictions and cases.

Footnotes

1. These articles are both available in the IQ archive on the Fenwick Elliott website www.fenwickelliott.com.
2. The Red Book, the Yellow Book and the Silver Book.
3. Either party can prevent a DAB decision from becoming final by giving written notification of their dissatisfaction with the decision within 28 days of receiving it (pursuant to Sub-clause 20.4).
4. The FIDIC Contracts Committee issued a Guidance Memorandum on 1 April 2013 in which they sought to clarify that in the event of non-compliance with non-final DAB decisions, "the failure itself should be capable of being referred to arbitration under Sub-clause 20.6".
5. *PT Perusahaan Gas Negara (Persero) TBK ("PGN") v CRW Joint Operation (Indonesia) ("CRW")* [2014] SGHC 146.
6. At paragraph 57.
7. At paragraph 66. The Majority's principal rationale behind this finding was that while PGN's NOD only *expressly* covered its dissatisfaction with the DAB Decision, by PGN choosing not to comply with the DAB Decision its NOD also *implicitly* expressed dissatisfaction with the requirement that the DAB Decision be complied with, and therefore the dispute over non-compliance was already encompassed in the NOD. With respect, this reasoning is questionable.
8. At paragraph 83.
9. The Court's position was summarised at paragraph 88.

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Unforeseeable ground conditions: the *Obrascon* case reaches the Court of Appeal

By Jeremy Glover, Partner
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The decision of Mr Justice Akenhead in the Obrascon case featured in Issue 10 of IQ last year, where we reviewed the implications of the judgment in relation to termination by the Employer and serving contractual notices. The case has now reached the Court of Appeal[1], where Lord Justice Jackson considered certain discrete elements of the original judgment.

To recap, Obrascon ("OHL"), a Spanish civil engineering contractor, was engaged, under an amended FIDIC Yellow Book, to construct a road around Gibraltar Airport. Mr Justice Akenhead held that, amongst other things, the Employer had effectively terminated the contract under clause 15 of the contract. The issues on appeal primarily related to the following conclusions of Mr Justice Akenhead:

(i) The amount of contaminated soil which OHL encountered was not more than an experienced contractor should have foreseen. Therefore OHL was not entitled to an extension of time or additional payment under clause 4.12 of the Conditions in respect of contamination.

(ii) OHL, in breach of clause 8.1, failed to proceed with due expedition and without delay.

(iii) The Employer validly terminated the contract pursuant to clause 15.2.

Unforeseeable ground conditions

Under the basic scheme of clause 4.12, if a contractor encounters adverse physical conditions which he considers to have been unforeseeable, then the contractor must give notice to the engineer as soon as practicable.

Physical conditions are defined as meaning:

> *"natural physical conditions and man-made other physical obstructions and pollutants, which the Contractor encounters at the Site when executing the Works, including sub-surface and hydrological conditions but excluding climatic conditions".*

By clause 1.1.6.8, "unforeseeable" means:

> *"not reasonably foreseeable by an experienced contractor by the date for submission of the Tender".*

Here, there was ground contamination which arose from the military activities on the site over previous centuries and from the use of the site as an airfield in the twentieth century. Airfield activities generated further contamination, for example aircraft fuel and substances used for de-icing runways. All these matters were clearly spelt out in the desk study provided to tenderers in 2008. The study included a plan showing a rifle range at the north-east corner of the isthmus, where the tunnel was due to be built. Most of the contamination was confined to the made ground, although some of the hydrocarbons penetrated deeper. In the tunnel area (where the most significant excavation was required) the depth of made ground varied between 1 metre and 5.4 metres, with an average depth of 2.5 metres.

The borehole logs showed that the made ground was not uniformly contaminated. Some areas were free from contamination, while other areas were contaminated at a high level.

The depth to which OHL initially stripped the site was a matter for their choice. They chose to strip the top layer of the whole site to a depth of 2 metres. After that the principal area of excavation was the tunnel and the ramps leading down to the tunnel at both ends. OHL prepared a Construction Environmental Management Plan (CEMP), which stated that there would be "correct separation of wastes" and that contaminated materials would be "removed off site, stored and dispersed to a licensed site". However, OHL did not adhere to the CEMP and they stockpiled all excavated materials indiscriminately, without any attempt to differentiate between contaminated and inert materials. Inevitably there was cross-contamination. The result was that all the stockpiled excavation materials were progressively being exported to landfill sites in Spain.

This made it difficult for the experts instructed by the parties to estimate the actual quantity of contamination on the site. The preferred report calculated the total volume of contaminated soils to be 15,243m³; this was higher than the figure of 10,000m³ shown in the Environmental Statement.

What contamination would therefore be "reasonably foreseeable by an experienced contractor" at the date of tender (the test under clauses 1.1.6.8 and 4.12 of the Conditions)? The approach of the expert accepted by Mr Justice Akenhead lead was to suggest a figure of 15,000m3. The basic reasoning was that an experienced contractor would not "slavishly" accept the figure. Instead an experienced contractor would make its own assessment of all available data. Lord Justice Jackson in the Court of Appeal agreed. The FIDIC conditions require the contractor at tender stage to make its own independent assessment of the

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available information:

> *"The contractor must draw upon its own expertise and its experience of previous civil engineering projects. The contractor must make a reasonable assessment of the physical conditions which it may encounter. The contractor cannot simply accept someone else's interpretation of the data and say that is all that was foreseeable."*

The Court of Appeal also noted that Mr Justice Akenhead had approached the expert evidence critically. He also made his own assessment of all the information that was available. The Court of Appeal said that this was:

> *"entirely appropriate. The Technology and Construction Court is a specialist court with long experience of cases such as this one. The judges are not prisoners of the expert evidence."*

The Court of Appeal also noted that the historical material provided to the contractor made it clear that very extensive contamination was foreseeable across the site. The contractor needed to make provision for a possible worst case scenario; the contractor should have made allowance for a proper investigation and removal of all contaminated material. The estimate of 10,000m3 of contaminated materials contained in the Environmental Statement was one person's interpretation of the data. Tenderers were bound to take that assessment into account, but they remained under a duty to make their own independent assessment of the physical conditions likely to be encountered.

Accordingly, OHL's claim for unforeseeable ground conditions under clause 4.12 of the FIDIC conditions failed.

Termination

Under clause 8.1 of the FIDIC Conditions the contractor is obliged to: "proceed with the Works with due expedition and without delay". However, as the Court of Appeal noted, this clause is not directed at every task on the contractor's to-do list. It is principally directed at activities which are or may become critical. Here Lord Justice Jackson referred to the reasoning of Stuart-Smith J in *Sabic UK Petrochemicals Ltd (formerly Huntsman Petrochemicals (UK) Ltd) v Punj Lloyd Ltd (a company incorporated in India)* [2013] EWHC 2916 (TCC) where he said this:

> *"However, when looking at the other individual elements, two points should be made. First, it is in my judgment most important to look at how SCL reacted to those elements that were thought to be critical during the Warning Period since those were, or should have been, the ones to which SCL should have been giving primacy at the time.* ***A failure to exercise due diligence in relation to the works that were perceived to be critical would tend to support a conclusion that SCL was not exercising due diligence overall. Second, the mere fact that an element was not critical (or not thought to be critical) at a particular moment does not render SCL's performance on that element uninformative when assessing its attempts to comply with its contractual obligation of due diligence. This is because there were a number of elements at any given time which could have become critical if they had slipped into delay. It is to be remembered that SCL's obligation to secure EID covered the whole of the works (apart, of course, from category 3 defects, which were those that could be left until after EID)."*** [emphasis added]

Here, OHL submitted that the critical activity in the period May to July 2011 was obtaining the category 3 check certificate and final approval of the re-design from the Engineer. Therefore other delays, in particular delays on tunnel works, were immaterial. The Court of Appeal did not agree. The tunnel was on the critical path of the whole project. The next stage of work on the tunnel was the PEE excavation, together with cropping and repairing of the diaphragm walls. These tasks were very much on the critical path.

In the view of the Court of Appeal, OHL's lack of significant activity on site between 21 January and 28 July 2011 was a failure "to proceed with the works with due expedition and without delay". It was a serious breach of clause 8.1 of the Conditions. That was not the end of the matter as the Court of Appeal went on to consider whether there was "reasonable excuse" for OHL's failure to proceed with the works. This was a question of fact and having gone through the six issues put forward by OHL in their defence, the Court of Appeal concluded that OHL's failure over many months to proceed with the works (a failure which continued in defiance of a notice to correct dated 16 May 2011) did "plainly demonstrate" an intention not to continue performance of their contractual obligations. This meant that the Employer was entitled to terminate the contract as it did under clause 15.2.

Footnotes

1. *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar* [2015] EWCA Civ 712.

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Subcontracting under UAE Law

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Subcontracting is common in the modern construction industry. It would almost certainly be unmanageable for one contractor to deliver a construction project, especially if the project involves a certain level of complexity, without contracting third parties having various expertise and capabilities to carry out specific portions of the works. On the other hand, from the project owner's perspective, it does seem more desirable to engage one main contractor who remains responsible for all other subcontractors. That being said, it is not surprising that the main players in most construction projects are the project owner (client/employer), the main contractor and subcontractor(s). This interactive chain naturally gives rise to a number of contractual and legal issues. This paper aims at considering these issues under the UAE law.

The UAE Civil Transactions Code allows the main contractor to subcontract the whole or part of the works to a third party without the need to obtain a permission from the employer, unless otherwise stipulated in the contract, or, if the performance of the works depends on the personal competence of the contractor. This is provided for under Article 890(1) of the UAE Civil Transactions Code. However, in practice, employers tend to have a sort of control over the main contractor in subcontracting the works and the selection of subcontractors. The degree of such control varies. The contract may restrict the scope of subcontracting by way of prohibiting subcontracting the whole of the works. This provision is quite common in standard forms of contract, for example Clause 4.4 of the FIDIC Red Book 1999 states that "[t]*he Contractor shall not subcontract the whole of the Works*." The contract may further require the main contractor to obtain the prior consent of the employer or the engineer to engage a proposed subcontractor if that subcontractor is not nominated by the employer. In this respect, it may be advisable in some instances to ensure that the contract contains a provision that "… [s]*uch consent shall not be unreasonably delayed or withheld* […]"[1]

The subcontractor may be nominated by the employer (nominated subcontractor) or selected by the main contractor (domestic subcontractor). In both cases, the subcontract agreement is to be concluded as between the main contractor and the subcontractor. Hence, there is no direct contractual relationship between the employer and the subcontractor. As a result:

i) the subcontractor is not contractually liable towards the employer for delayed delivery or defective works; and

ii) the employer is not contractually liable towards the subcontractor for the payment of its entitlements under the subcontract agreement. These two issues will be dealt with in turn.

Subcontractor's Liability to the Employer

Privity of contract is a well-established doctrine under the UAE law. The subcontractor being not a party to a contract with the employer, it is not under any contractual obligation towards the employer or the subsequent owners in the normal circumstances. The construction agreement between the employer and the main contractor may not impose an obligation on the subcontractor unless such obligation is accepted by the latter.[2]

In practice, employers may require the subcontractors to provide a collateral warranty that the employer can rely upon to seek the subcontractor's direct liability for defective works. A collateral warranty is enforceable under the UAE law. It is deemed a unilateral act according to Article 276 of the Civil Transactions Code; thus, the subcontractor is bound by its terms according to Article 278 of the same Code. A collateral warranty typically contains provisions for the assignment and step-in rights to ensure that the employer may assign the obligations set out in the warranty to other beneficiaries such as subsequent owners or tenants.

Regardless a collateral warranty is provided or not, according to Article 890(2) of the Civil Transactions Code, the main contractor remains liable to the employer for the subcontractor's performance. In many cases, the UAE courts emphasized that the main contractor remains contractually liable for the acts or defaults of the subcontractor even if the subcontractor in reality performed the employer's instructions during the course of the project.[3]

In the case of a nominated subcontractor, the general rule is that the main contractor's liability remains in place since Article 890(2) referred to above does not draw a distinction between nominated subcontractors and domestic subcontractors. However, there might be a defence ground to the main contractor by way of attacking the element of causation that is a prerequisite for the establishment of the contractual liability.

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In the well-known decision of the Dubai Court of Cassation in case No. 266 of 2008, the court held that "*when the subcontractor is selected by the employer or its consultants, the employer shall be liable for any delay in the performance of the subcontracted part and the main contractor shall not be liable for any delay fines if they can prove that the delay is caused by such subcontractor and the main contractor played no part in the delay.*" The grounds of this decision have been debatable as the court provided no specific criteria to disregard the general rule set out in Article 890(2). Thus, this controversial decision is deemed an exception to the general rule that the main contractor's liability remains in place even so with nominated subcontractors. A main contractor may nonetheless rely upon the above decision as a defence ground in certain cases. For this defence to succeed, the main contractor must properly demonstrate to the court that it has performed its contractual obligations including its supervision duty yet the delay or defective performance could not be avoided for reasons solely attributable to the nominated subcontractor's fault. There might be a supporting argument for this defence to succeed if the main contractor had no right to object to the nominated subcontractors.[4]

To minimize its scope of liability, the main contractor – typically if the contract does not provide for a right to object to nomination - may require to include an indemnity clause in the main contract whereby the employer is to indemnify the main contractor against and from the consequences of the nomination.

Employer's Liability to the Subcontractor

As illustrated above, there is no direct contractual relationship between the employer and the subcontractor. Consequently, the employer is under no obligation whatsoever to the subcontractor. Further, Article 891 of the Civil Transactions Code provides that the subcontractor may not claim from the employer any dues to the main contractor unless it was assigned by the main contractor to do so.

The subcontractor has therefore no option but to seek the payment of its dues from the main contractor. Practical problems occur when the subcontract agreement contains a "pay-when-paid" clause, which is commonly imposed by main contractors. Pay-when-paid clauses are enforceable under the UAE law. The effect of a pay-when-paid clause is that the subcontractor is not able to claim its dues from the main contractor until the latter has been paid by the employer. If the subcontractor brings legal proceedings against the main contractor before the latter has been paid, the court may dismiss the case on the ground of premature filing of the claim.

To reduce the harshness of "pay-when-paid" clauses, the subcontractor may attempt to obtain a direct payment obligation from the employer during the negotiations of the

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contract. However, in practice, this is rarely acceptable by employers.

In some cases the subcontractor may argue that the non-payment by the employer is solely attributable to the main contractor's fault. For example, if the main contractor fails to provide the performance bond as required under the main contract. In other circumstances, the subcontractor may argue that the main contractor is in breach because of its failure to pursue its claim against the employer. In this connection, it may be advisable that the subcontractor tries to agree a contractual clause whereby the main contractor will be under an obligation to pursue its claims against the employer to the greatest extent.

Finally, the subcontractor may rely upon Article 247 of the UAE Civil Transactions Code to suspend the performance of the works if not paid. However, this right has to be exercised carefully, particularly in the absence of a contractual right to suspend the performance of the works for non-payment. A subcontractor must seek a legal advice to ensure that the right of suspension provided for under Article 247 can be exercised in their particular case. There are a number of factors that should be taken into consideration in determining whether the subcontractor can exercise the suspension right, this includes for example the proper notification of the main contractor, the successful performance of the subcontractor's primary obligations under the contract, and whether the payments are certified not.

Conclusions

Subcontracting is permissible under the UAE law and is prevalent in practice. Standard forms commonly provide for mechanisms restricting the scope of subcontracting. Under the UAE law, subcontracting does not create a direct relationship between the employer and the subcontractor. Thus, the main contractor generally remains liable for the timely completion and quality of the subcontracted works. The main contractor may have grounds to defend itself against the liability for nominated subcontractors in particular circumstances. The subcontractor may not claim payments from the employer unless a direct payment obligation exists. Pay-when-paid clauses commonly used in the UAE. However, there are means to limit the effect of such clauses in each particular case .

Footnotes

1. This wording is used in Clause 3.7.1 of the JCT Standard Building Contract.
2. Article 252 of the Civil Transactions Codes states that "[a] contract may not impose an obligation upon a third party but it may vest a right to him.
3. See for example the High Federal Court decision in Petition No. 307 of 11 where the court held that the subcontractor's performance of the employer's instructions does not qualify to create a contractual relationship between the employer and the subcontractor. As such, the main contractor's liability remains in place.
4. Usually standard forms of contract provide for the main contractor's right to object to the nominated subcontractors. For example Clause 5.2 of the FIDIC Red Book 1999.

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On Demand Bonds: a strategic retreat?

By Claire King, Senior Associate Fenwick Elliott

An On Demand Bond[1] is as an unconditional undertaking to pay a specified amount to a named beneficiary, usually on demand and sometimes on the presentation of certain specified documents[2]. In other words, Big Bank promises to pay Mr Employer £x immediately, and without hesitation or further investigation, on presentation of the correct documents (normally a certificate) to him, completed in the way specified on the face of the On Demand Bond. The contract to pay out in these circumstances is directly with Big Bank and Mr Employer. (Big Bank will have a separate agreement with Mr Contractor to ensure he doesn't end up out of pocket).

Historically, under English Law, the only circumstances in which the courts would prevent a call on an On Demand Bond once it has been made, and monies being paid out, were "*when there is a clear fraud of which the bank has notice.*"[3] This was a hard test to satisfy.

In 2011 and 2013, two TCC cases on the issue of whether calls on On Demand Bonds could be restrained via injunction seemed to indicate that the Courts may be moving away from such a rigid adherence to these principles and, arguably, closer to the more relaxed position in other jurisdictions (for example, in Singapore where the notion of "*unconscionability*" has developed)[4].

In Simon *Carves -v- Ensus*[5], the contract provided that the bond was to become null and void upon the issue of an Acceptance Certificate, save in respect of pending or previous claims. An Acceptance Certificate had been issued, but a dispute arose as to whether any claims were pending or had been previously notified by the time of its issue. Simon Carves then sought an injunction restraining a call being made on the Bond, and later, requiring the beneficiary to withdraw a call that had been made in the meantime. Akenhead J stated that, if the underlying contract in relation to which the Bond had provided by way of security, clearly and expressly prevented the beneficiary from making a demand under the Bond, then the beneficiary could be restrained by the court from making such a demand. In his view, there was no legal authority permitting a call on a bond when it is expressly disentitled from doing so and, in his view, the party seeking the injunction had a "strong case" that the call was not a permitted one.

In the case of *Doosan Babcock –v- Comercializadora de Equipos*[6] ("**MABE**"), (Mr Justice Edwards-Stuart) used the principles set out by Akenhead J in *Simon Carves v Ensus*, to grant an injunction restraining calls on two On Demand type Bonds issued in respect of a Brazilian Power Plan contract. Again, the Judge assessed the merits of the right to make the call under the underlying contract in order to reach his decision. In Mr Justice Edwards-Stuart's view, Doosan Babcock had a strong case that the Employer's refusal to issue a Taking Over Certificate for various units was a breach of contract and that it was only as a result of that breach that the Employer was in a position to make the call on the On Demand Bond in question.

Mr Justice Edwards-Stuart noted that Akenhead J was concerned with whether or not there had been a breach of the underlying contract, had decided (on a non-binding basis) that there was a strong case there had been one, and then applied the American Cyanamid principles[7] which apply to injunctions generally. Indeed, he explained that:

> *"I accept that this decision has extended the law, but in my view it is done so adopting a principled and incremental approach that does not undermine the general principles applicable to interim injunctions to restrain a party making call under a bond".* [Emphasis added]

Has this *"principled and incremental approach"* been followed and accepted since 2013? The answer appears to be "*no*".

In Mr Justice Stuart-Smith's judgment, (MW High Tech Projects UK Ltd –v- Biffa Waste Services Ltd)[8], of February 2015, a retreat seems to be indicated back to the strict fraud test outlined above. In that case, the contractor sought to argue that the call on a Retention Bond was invalid. The ground relied on was that the claim made on a Parent Company Guarantee (which was expressed to be a condition precedent before any call on the Bond could be made within the underlying construction contract) was not a valid one in that the claim made under it was disputed. As such, it could not be regarded as a claim under the Parent Company Guarantee for the purposes of calling the Retention Bond.

Mr Justice Stuart-Smith refused to get involved in the dispute between the parties under the underlying contract in question. Instead, he relied heavily on a non-construction Court of Appeal case in 2014 (*Wuhan Guoyu Logistics Group Company Limited & Another –v- Emporiki Bank of Greece SA (No. 2)*)[9] in which the principle of autonomy was re-emphasised. In that case, Mr Tomlinson J had stated:

"21… The rationale for this well understood

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and well hallowed approach is that the guarantee is intended to be an autonomous contract, independent of disputes between the seller and buyer as to their relative entitlements pursuant to the different contract between themselves…"

It was also noted by Mr Justice Stuart-Smith that, by the time the *Wuhan* case had reached the Court of Appeal, it had been established in separate arbitral proceedings that the basis of the call was contractually unjustifiable and that decision was final and finding. Despite that (i.e. despite the fact the call on the bond was unjustifiable and unjustifiable under the underlying contract), the Court of Appeal held that the beneficiary was entitled to summary judgment upon his call upon the Bond.

Mr Justice Stuart-Smith noted:

> *"It seems to me, both on the principle and authority that the only established acceptance to the rule that the court will not intervene should be where there is a seriously arguable case of fraud, or it has been clearly established that the beneficiary is precluded from making a call by the terms of the contract."*

He did not consider it was sufficient that:

> *"There is a seriously arguable case that the beneficiary was not entitled to draw down. It must be positively established that he was not entitled to draw down under the underlying contract".*

He therefore rejected that the seemingly less vigorous test found in *Simon Carves* and *Doosan Babcock*.

Conclusion

For now then, it looks as if the apparent extension to the fraud exception in Doosan Babcock and Simon Carves is in retreat. If parties do provide On Demand Bonds, they should be very aware that they will face real difficulties in restraining a call on that bond if one is made.

Parties offering (or having no choice but to offer) On Demand Bonds that are subject to English law, should also check the underlying contract to ensure that there is a clear and express duty on the beneficiary to account for any excess proceeds from a bond call under the underlying Construction Contract, including damages by way of direct costs and indirect costs (such as the bank charging a higher fee for future bonds) or caused by the damage to reputation that can often accompany a call on such a bond. While some standard forms do provide for this, others do not and, where there is an entire agreement clause, the implied duty of account may be excluded.

Footnotes

1. Also commonly referred to as Performance Bonds, Unconditional Guarantees, Performance Guarantees and/or Demand Guarantees
2. Geraldine Andrews QC and Richard Millett QC, Law of Guarantees, London, Thomson: Sweet & Maxwell 5th Edition, 2008, Chapter 16 – 001, page 575
3. As per Lord Denning in *Edward Owen Engineering Limited -v- Barclays Bank International* [1978] 1 All ER 976 (CA)
4. See for example *Raymond Construction Pte Ltd v Low Yang Tong* [1996] SGHC 136, in which Lai Kew Chai J stated that the "*concept of 'unconscionability' to me involves unfairness, as distinct from dishonesty or fraud, or conduct of a kind so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party.*"
5. [2011] BLR 340
6. y Materiales Mabe Limitada [2013] EWHC 3201 (TCC)
7. See *American Cyanamid Co (No 1) v Ethicon Ltd* [1975] UKHL 1 (05 February 1975) in which the test for whether an interim injunction should be granted was stated to be: (1) Whether the claimant had a strong or merely an arguable case; (2) The adequacy of damages as a remedy; (3) The balance of convenience; and (4) Whether the status quo should be maintained.
8. [2015] EWHC 949 (TCC)
9. 2013 EWCA (CIV) 1679
10. *See Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1996] 4 All ER 563 (QBD)

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Fenwick Elliott
The construction & energy law specialists

International Quarterly

News and events

Trends, topics and news from Fenwick Elliott

Issue 14, 2015

This edition

Fenwick Elliott to open a Dubai office

The firm's practice in the MENA region has seen steady growth in recent years, particularly in the energy and power sectors, and we have advised on various general commercial and corporate matters relating to a wide range of construction projects in the UAE and MENA region.

The partners of Fenwick Elliott and Ibrahim Law Firm are delighted to announce that we are opening a new office in Dubai, headed up by partner Nicholas Gould. This exciting development builds on our many years' experience advising clients on construction and energy projects in the region, and on our close partnership with Dubai-based Ibrahim Law Firm, whose partners Ahmed Ibrahim and Heba Osman will join our new branch, further strengthening the team. The new branch will be based at Jumairah Lakes Towers, Dubai. For more information about our new office and the services we provide please contact Susan Kirby, skirby@fenwickelliott.com .

Fenwick Elliott's Autumn seminars

As we mentioned in the last edition of IQ, Fenwick Elliott regularly holds seminars around the world relating to various construction law topics include FIDIC contracts.

Dubai Seminar, 7 September - "Termination of contracts and labour issues - a Middle East perspective"

The seminar will be held on 7 September in Dubai. The seminar will consider the topic of Suspension and Termination and will consider the following issues:

- General principles of termination
- The right to terminate or claim damages or both
- Common law termination or repudiation
- Contractual termination clauses
- Suspension
- Contractual procedures for termination and suspension (FIDIC, ICE, NEC, JCT)
- Entitlement to damages and costs arising from termination
- Labour issues in the UAE

If you would like to book a place at this complimentary seminar, please contact Susan Kirby, skirby@fenwickelliott.com.

FIDIC conference, Africa

We are very pleased to announce that we are supporting the inaugural African FIDIC Contract Users' Conference. The two day conference will take place in Zambia on 13-14 October 2015. Nicholas Gould and fellow partner Jeremy Glover will speak about **"Dispute Boards in Action"** on 14th October at 14:00.

Conference attendance discount

As supporters of this event, we are delighted to offer you a 30% saving on the cost of registration. Simply quote the code ***FKW82584FWE*** when you register to obtain this discount, or go to http://www.ibclegal.com/FKW82584FWE and quote VIP: FKW82584FWE.

Ankara and Istanbul Seminars, November 2015

We are hosting follow-up seminars to the FIDIC workshops we held in Turkey earlier this year. These seminars will take place in Ankara and Istanbul on the 17 and 18 November 2015 respectively. If you would like to be put on the invitation list for these seminars please email Susan Kirby, skirby@fenwickelliott.com.

Fenwick Elliott's Annual Review

Our *Annual Review* which features a round-up of key developments in the construction, engineering and energy arena, is due for publication in early November and we will provide more information about this publication in our next edition of IQ.

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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