Settlement of Construction Disputes – An International Perspective -

HKLTI Seminar:
"NEC Contracts in Hong Kong - The Legal Landscape and Beyond"

Hong Kong, 25 June 2019

Professor Peter Malanczuk
• Introduction
• Domestic practice in Hong Kong and international practice
  • Standard form contracts
  • Commercial construction dispute settlement
• International construction contracts and ISDS
• Belt & Road construction disputes and CICC
Introduction
Domestic practice in Hong Kong and international practice
Standard Form Contracts

- Hong Kong Practice & International Practice -
Models of standard form contracts

• History

• Wide spectrum:
  • FIDIC
  • Institution of Civil Engineers
  • Institute of Chemical Engineers
  • Joint Contracts Tribunal
  • Engineering Advancement Association of Japan
  • Civil Engineering Contractors Association
  • American Institute of Architects (AIA)
  • Design Build Institute of America (DBIA)
Hong Kong domestic practice

- Broad use of standard forms of contract in Hong Kong construction industry

- Private sector
  - e.g. Standard Form of Building Contract

- Public sector
  - Shift of HK Government since 2009 towards New Engineering Contract (NEC)
International use of NEC and FIDIC

• NEC drafted for international use
  • But actual reception globally rather limited

• Dominant standard forms in international cases:
  • International Federation of Consulting Engineers (FIDIC), especially Red Book
International use of NEC and FIDIC

- FIDIC also used in ML China,
  - but not domestically in Hong Kong

- Hong Kong companies use FIDIC for international construction contracts
  - including ICC or LCIA arbitration
“The FIDIC contracts are the pre-eminent standard forms in the international construction market.

Although there are individual sectors where other standard forms rival this supremacy, such as …contracts in the Offshore Oil & Gas industry and … the water and process industries, no competitor can equal FIDIC's global reach nor its penetration into so many types of construction and engineering work.

The NEC127 suite is said by its proponents to be a potential challenger, but it is still a distant one.”

Commercial Construction Dispute Settlement

NEC4 and HK Domestic Practice
NEC3 to NEC4 – Dispute Settlement

- Philosophy underlying changes
- Section’s title change from “Dispute Resolution” to “Resolving and Avoiding Disputes”
- Dispute Avoidance Board (“DAB”) in the new Option W3
- Senior Representatives in Options W1 and W2
NEC4 – Multi-tier dispute resolution

- 1\textsuperscript{st} stage: Senior Representatives in W1 and W2
- Specified in Contract Data
- Reflects often required Z-Clause
NEC4 – Multi-tier dispute resolution

W1 & W2

• W1: referral to Senior Representatives (SR) mandatory before adjudication

• W2: referral to SR advised, but recourse to adjudication available at any time

• Adjudication really helpful?
NEC4 – Multi-tier dispute resolution W1 & W2

• Balancing between strict and flexible approaches

• Statement of Case within 1 week (10 p. A4)

• Senior Representatives free as to number of meetings and procedure
NEC4 – Multi-tier dispute resolution
W1 & W2

• Outcome:

• List of issues agreed and not agreed

• “Without prejudice”
NEC4 – Multi-tier dispute resolution W1 & W2

W1 and W2

<table>
<thead>
<tr>
<th>Process</th>
<th>Order</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Senior Representatives process</td>
<td>Primary process</td>
</tr>
<tr>
<td>2. Adjudication</td>
<td>Secondary process</td>
</tr>
<tr>
<td>3. Arbitration / litigation</td>
<td>Third and final process</td>
</tr>
</tbody>
</table>

- New NEC4 Dispute Resolution Service Contract
NEC4 – Multi-tier dispute resolution / W3

- New W3 option: new Dispute Avoidance Board (DAB)

- Obligatory referral of all “potential disputes” to DAB

- Composition: 1 or 3 members
• DAB site visits

• Referral and review of “potential disputes”

• DAB can only make recommendations
• What are “potential disputes”?

• How to distinguish potential disputes from actual disputes?

• DAB jurisdiction over potential disputes that have become actual disputes?
• Clause W3.3(2): Notice of Dissatisfaction

• Legal consequences? What if not served?
NEC4 – Evaluation

- Supports the original NEC cooperation and partnership impetus
- Active engagement seeks to promote international use
- Global FIDIC dominance under challenge?
Hong Kong Construction Arbitration
Domestic Construction Arbitration in Hong Kong

- Standard Forms reference to HKIAC 2014 Domestic Arbitration Rules
- Sub-contracts and main contracts
Domestic Construction Arbitration in Hong Kong

- HKIAC domestic arbitration rules
- Duty of confidentiality
  - Subject to the exception, [inter alia], that disclosure is permitted when, and to the extent to which it is reasonably necessary for the protection of the legitimate interest of an arbitrating party, and that means reasonably necessary for the establishment or protection of an arbitrating party's legal rights vis-à-vis a third party in order to found a cause of case against that third party or to defend a claim (or counterclaim) brought by the third party.

Domestic Construction Arbitration in Hong Kong

- HK Arbitration Ordinance Schedule 2 as applied to construction contracts
- Default: domestic arbitration
Domestic Construction Arbitration in Hong Kong

- Conditions for automatic application of Schedule 2 (domestic arbitration)
- Sub-contracts
Domestic Construction Arbitration in Hong Kong

• Schedule 2 provisions:
  • sole arbitrator;
  • consolidation of arbitrations;
  • the Court's decision of preliminary question of law;
  • the challenge of an arbitral award on ground of serious irregularity;
  • appeal against arbitral award on question of law;
  • application for leave to appeal against arbitral award on question of law; and
  • supplementary provisions on challenge or appeal against an arbitral award
Domestic Construction Arbitration in Hong Kong - Third party funding

- Law Reform Commission:

“As most construction disputes are commercial in nature, whether Third Party Funding for arbitration is available would naturally form part of the commercial consideration when parties pursue their claims in arbitration. Hong Kong is known for its multitiered subcontracting arrangements in the construction industry. Many of the smaller subcontractors may not necessarily have the financial means or flexibility in resource allocation to pursue their claims against the larger, more resourceful contractors or project employers despite having meritorious claims. A third party may also have a vested interest in a dispute. Take the example when progress of work is disrupted when a small scale subcontractor is having a dispute with his supplier. It would be of genuine interest to the main contractor if he could fund the subcontractor’s case. Third party funding for arbitration in Hong Kong should provide these less resourceful contractors or subcontractors with alternative options when considering whether they should pursue their claims.”

Hong Kong Security for Payment
• 2016 Report on Public Consultation completed

• Interim and final payments must be paid within 60 and 120 calendar days

• Interim amounts decided by an adjudicator must be paid pending litigation or arbitration
Hong Kong: Proposed Security of Payment Legislation (SOPL) for the Construction Industry

Summary and Guide, Development Bureau, June 2015

Diagram 1: Longest permissible Payment Response and payment periods under SOPL

- Payment Claim (monthly or as agreed in contract): 0 calendar days
- Payment Response (30 days or earlier): 30 calendar days
- Payment Due (Interim Payments): 60 calendar days
- Payment Due (Final Payment): 120 calendar days
FIDIC Contracts on Dispute Settlement and Arbitration
FIDIC Red Book 2017 on arbitration

- FIDIC Clause 21, Sub-Clause 21.6 addresses:
  - Advantages of arbitration
  - Compatible arbitration rules, reference to ICC
  - Number of arbitrators and language
FIDIC Clause 21, Sub-Clause 21.6 further addresses:

- Need to deal with mechanism to appoint of arbitrators and administer arbitration if UNCITRAL Rules or other non-ICC Rules adopted
- Transnational contracts: place (seat) of arbitration, good arbitration law, plus 1958 New York Convention
FIDIC Red Book 2017 on arbitration

- FIDIC Clause 21, Sub-Clause 21.6 also reminds parties of:
  - Joinder and multi-party arbitration
  - Problem of Currencies of Payment after award issued
NEC4 on arbitration

• NEC4: very little information on arbitration option:

“If the *tribunal* is arbitration, the *arbitration procedure*, the place where the arbitration is to be held and the method of choosing the arbitrator are those stated in the Contract Data.”

W1.4 (5); W2.4 (4); W.3.3 (4).
ICC and Construction Arbitration

• In 2015: 25% of all ICC disputes were construction disputes

• March 2019: ICC Commission on Arbitration and ADR:
  • Report on Construction Industry Arbitrations
Queen Mary Survey

• Queen Mary University of London launched ninth annual international arbitration survey, focus on construction disputes (31 May-26 July 2019)

• To identify causes of inefficiency and high costs

• To suggest practical solutions
International construction contracts and ISDS
BIT & Investment Contract

State A (home state)  
- nationality

BIT

State B (host state)  
- investment contract

Investor

foreign investment

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Number of IIAs signed, 1980–2018

Annual number of IIAs

Source: UNCTAD, IIA Navigator.
### Number of BITs and TIPs
(as of 11 June 2019)

<table>
<thead>
<tr>
<th>Bilateral Investment Treaties</th>
<th>Treaties with Investment Provisions (TIPs)</th>
<th>Sum</th>
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<tr>
<td>Total: 2932</td>
<td>Total: 387</td>
<td>3,319</td>
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<tr>
<td>Total in force: 2346</td>
<td>Total in force: 313</td>
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Source: https://investmentpolicyhubold.unctad.org/IIA
Asia

## Hong Kong, China SAR

### Bilateral Investment Treaties (BITs)

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<tr>
<th>No.</th>
<th>Partners</th>
<th>Status</th>
<th>Date of signature</th>
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<td>15/09/1993</td>
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<td>3</td>
<td>BLEU (Belgium-Luxembourg Economic Union)</td>
<td>In force</td>
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<tr>
<td>4</td>
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<td>In force</td>
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<td>06/09/2016</td>
<td>Full text: en</td>
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<tr>
<td>5</td>
<td>Chile</td>
<td>Signed (not in force)</td>
<td>18/11/2016</td>
<td></td>
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<td>6</td>
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<td>04/03/1994</td>
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<td>19</td>
<td>United Kingdom</td>
<td>In force</td>
<td>30/07/1998</td>
<td>12/04/1999</td>
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</tbody>
</table>
### Hong Kong, China SAR

#### Treaties with Investment Provisions (TIPs)

<table>
<thead>
<tr>
<th>No.</th>
<th>Short title</th>
<th>Parties</th>
<th>Date of signature</th>
<th>Date of entry into force</th>
<th>Text</th>
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<tr>
<td>1</td>
<td>ASEAN - Hong Kong, China SAR Investment Agreement (2017)</td>
<td>ASEAN (Association of South-East Asian Nations)</td>
<td>12/11/2017</td>
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<td>Full text: en</td>
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<td>3</td>
<td>Chile - Hong Kong FTA (2012)</td>
<td>Chile</td>
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<td>09/10/2014</td>
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<td>4</td>
<td>EFTA-Hong Kong FTA</td>
<td>EFTA (European Free Trade Association)</td>
<td>21/06/2011</td>
<td>01/10/2012</td>
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<td>5</td>
<td>Hong Kong-New Zealand CEPA</td>
<td>New Zealand</td>
<td>29/03/2010</td>
<td>01/01/2011</td>
<td>Full text: en</td>
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http://investmentpolicyhub.unctad.org/IIA/CountryOtherlias/93#iiaInnerMenu
### Known treaty-based investor-State arbitrations

<p>| | |</p>
<table>
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<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Total</td>
<td>942</td>
</tr>
<tr>
<td>Pending</td>
<td>332</td>
</tr>
<tr>
<td>Concluded</td>
<td>602</td>
</tr>
<tr>
<td>Unknown</td>
<td>8</td>
</tr>
</tbody>
</table>

### Concluded original arbitration proceedings

- Decided in favour of State: 35.7%
- Decided in favour of investor: 28.7%
- Decided in favour of neither party (liability found but no damages awarded): 22.8%
- Settled: 10.6%
- Discontinued: 1.0%

[https://investmentpolicyhub.unctad.org/ISDS](https://investmentpolicyhub.unctad.org/ISDS)
29/03/2019
4. Basis of Consent Invoked to Establish ICSID Jurisdiction in Registered ICSID Cases

**Chart 5**: Basis of Consent Invoked to Establish ICSID Jurisdiction in Cases Registered under the ICSID Convention and Additional Facility Rules:

ICSID Caseload Statistics 2019-1
Figure 5. Known ISDS cases filed, by arbitral rules, 2015 (Per cent)

Source: ©UNCTAD, ISDS Navigator.

UNCTAD IIA Issues Note, No. 2, June 2016
Transnational Construction Projects
Political Risk

- Risk of political interference and economic instability
- Lack of contractual remedies
- Impact of general state measures on foreign investment (e.g. Argentina, 2000)
Investment Treaty Arbitration as Alternative Option

- Increased use of PPPs and joint ventures with state-owned entities
- Investment treaty claims in construction industry now common
Chart 7: Distribution of All Cases Registered under the ICSID Convention and Additional Facility Rules, by Economic Sector:

- Oil, Gas & Mining: 24%
- Agriculture, Fishing & Forestry: 6%
- Information & Communication: 4%
- Transportation: 9%
- Finance: 8%
- Services & Trade: 3%
- Electric Power & Other Energy: 17%
- Water, Sanitation & Flood Protection: 5%
- Tourism: 4%
- Construction: 8%
- Other Industry: 12%
ICSID Salini case: on definition of “investment”


- Italy - Morocco BIT (1990)

- Claim: 132639.00 mln ITL (62.40 mln USD) out of public procurement agreement for highway construction.
Construction Contracts: Frequent Issues in ISDS

- “Investor”
- “Investment”
- Claims based on contract or on breaches of IIA
- Alleged breaches attributable to the host state?
Contractor and Investor Nationality

- Individuals
- Legal entities
- Nationality planning / structuring of the investment
Investment in case of a Construction Contract

- What qualifies as “investment”?
- Today, most international construction projects likely to qualify
Examples of qualifying investments in ISDS cases

• Construction of
  hydro-electric power facilities;
  a gas pipeline;
  a dam;
  roads and motorways;
  bridges;
• construction and operation of
  an international airport;
  a transfer station for hazardous waste;
• development of
  a touristic resort;
  a golf club and condominiums;
• development and construction of a real estate project;
• dredging of a canal; and
• improvement works at an oil refinery.
Treaty Claims and Contract claims

- **Who is party to the construction contract?**

- **Vivendi v. Argentina:**
  - Whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law - in the case of the BIT, by international law; in the case of the Concession Contract, by the proper law of the contract, in other words, the law of Tucumán.[43]
  - …
  - A treaty cause of action is not the same as a contractual cause of action; it requires a clear showing of conduct which is in the circumstances contrary to the relevant treaty standard.[44]

*Vivendi v. The Argentine Republic* (ICSID Case No. ARB/97/3) Decision on Annulment, 3 July 2002, Paragraph 96 and 113
Parallel Claims

• *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29) Decision on Jurisdiction, 14 November 2005.
Ordinary Contract Breaches?

- *Toto Costruzioni Generali SPA v. Republic of Lebanon* (ICSID Case No. ARB/07/12) Award, 7 June 2012

- *Impregilo SpA v. Pakistan* (ICSID Case No. ARB/03/3) Decision on Jurisdiction, 22 April 2005

- *Consortium RFCC v. Morocco* (ICSID Case No. ARB/00/6) Decision on Jurisdiction, 16 July 2001
Breach of Treaty Standards

- Five main standards typically relevant to construction and infrastructure disputes:
  - No expropriation without compensation
  - Fair and equitable treatment
  - Full protection and security
  - Non-discrimination
  - Observation of obligations ("umbrella clauses")
Figure 8. Breaches most frequently alleged and found, 1987–31 July 2017 (Number of known cases)

- **Fair and equitable treatment or minimum standard of treatment**: 401
  - Breaches alleged: 103
  - Breaches found: 359
- **Indirect expropriation**: 206
  - Breaches alleged: 51
  - Breaches found: 15
- **Full protection and security, or similar**: 168
  - Breaches alleged: 20
  - Breaches found: 8
- **Arbitrary, unreasonable and discriminatory measures**: 114
  - Breaches alleged: 26
  - Breaches found: 15
- **Umbrella clause**: 111
  - Breaches alleged: 15
  - Breaches found: 8
- **National treatment**: 89
  - Breaches alleged: 26
  - Breaches found: 8

*Source:* ©UNCTAD, ISDS Navigator.

*Note:* Based on the number of cases for which such information was available.
Umbrella clauses

• Also called ‘elevator' or ‘mirror effect' clauses

• Commitment by the host state to comply with obligations it has entered into with regard to investments

• Attempt to create parallel cause of action
Umbrella Clauses: Controversy

• Can umbrella clauses elevate contractual breaches into treaty breaches?

• Opposite conclusions:

  • *SGS Société Générale de Surveillance SA v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13) Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003

  • *Société Générale de Surveillance SA v. Republic of the Philippines* (ICSID Case No. ARB/02/6) Decision on Jurisdiction, 29 January 2004
Attribution to the host state

• Commercial disputes between private parties not covered by investment treaty arbitration

• Issues to consider:
  • Is the entity who committed the wrongful act a state organ?\
  • If not, does it exercise governmental functions, and was the conduct in question governmental rather than private or commercial activity?
  • If not, was it acting under the control or direction of the state?
Beijing Urban Construction v. Yemen

- Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen (ICSID Case No. ARB/14/30) [2014]
- China - Yemen BIT (1998)
- Claims (114m USD) arising out of the alleged forced deprivation of claimant's assets and contract concerning a project for the construction of an airport terminal in Sana’a.
- Decision on Jurisdiction dated 31 May 2017
- Settled in 2018
Belt & Road Construction Disputes and CICC
One Belt, One Road: With the Silk Road Initiative, China Aims to Build a Global Infrastructure Network

Projects completed and planned: December 2015
Belt & Road Initiative (BRI) – Key Facts

- China has signed cooperative documents with 126 countries and 29 international organizations (April 2019)
Leading China's Belt and Road Initiative's construction contracts as of February 2018, by value (in million U.S. dollars)
Cumulative growth in China’s overseas construction and investment (in billions of dollars)

Sources: China Global Investment Tracker, AEI

https://asia.nikkei.com/Spotlight/Datawatch/The-diverging-figures-behind-Belt-and-Road
Belt & Road Initiative (BRI)

- Importance of FIDIC contracts
- Relevance of Public Private Partnerships (PPPs)
China International Commercial Court (CICC)

- established in June 2018 by the Supreme People's Court of China (SPC) to adjudicate international commercial cases

  - First International Commercial Court in Shenzhen
  - Second International Commercial Court in Xi’an
  - Coordinated by Fourth Civil Division of SPC
CICC – Key Features

International Commercial Expert Committee composed of Chinese and foreign experts well versed in international law and have an excellent grasp of their own country's law, who have rich practical experience and excellent international reputation.

SPC designates Senior Judges that have rich adjudication experience, familiar with international treaties, international conventions and practices of international trade and investment, who could work proficiently in both Chinese and English.

Handle international commercial disputes of equal parties.

Aim at fairness, efficiency, convenience and low cost.

The judgments and rulings made by the CICC are binding on the parties and with legal effect.

Promote connectivity of litigation, mediation, and arbitration, form a convenient, expeditious, low-cost “one stop” dispute resolution platform.

Advance international judicial assistance work, promote efficient and smooth mechanism of international judicial assistance.

Fully utilize information technology in international dispute resolution.

CICC - Jurisdiction

First instance international commercial cases in which the parties have chosen the jurisdiction of the Supreme People’s Court according to Article 34 of the Civil Procedure Law, with an amount in dispute of at least 300,000,000 Chinese yuan.

First instance international commercial cases which are subject to the jurisdiction of the higher people’s courts who nonetheless consider that the cases should be tried by the Supreme People’s Court for which permission has been obtained;

First instance international commercial cases that have a nationwide significant impact.

Cases involving applications for preservation measures in arbitration, for setting aside or enforcement of international commercial arbitration awards according to Article 14 of these Provisions;

Other international commercial cases that the Supreme People’s Court considers appropriate to be tried by the International Commercial Court.

CICC – Definition of “international commercial cases”

- one or both parties are foreigners, stateless persons, foreign enterprises or other organizations
- the subject matter in dispute is outside the territory of the People’s Republic of China
- one or both parties have their habitual residence outside the territory of the People’s Republic of China
- legal facts that create, change, or terminate the commercial relationship have taken place outside the territory of the People’s Republic of China

The definition of "International Commercial Cases" of the CICC

First Group of 31 Chinese and Foreign Experts were Appointed as Members
In December 2018, the Supreme People’s Court listed SCIA as its “one-stop”, multi-dimensional dispute resolution mechanism for international commercial disputes.