

Settlement of Construction Disputes – An International Perspective -

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

Hong Kong, 25 June 2019

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Outline

- 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

International use of NEC and FIDIC

“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.”

Ellis Baker, Anthony Lavers and Rebecca Major, Introduction to the FIDIC Suite of Contracts, GAR: The Guide to Construction Arbitration - Second Edition (2018), <https://globalarbitrationreview.com/chapter/1175319/introduction-to-the-fidic-suite-of-contracts>.

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

- 1st 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

Process	Order
1. Senior Representatives process	Primary process
2. Adjudication	Secondary process
3. Arbitration / litigation	Third and final process

➤ 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

NEC4 – Multi-tier dispute resolution / W3

- DAB site visits
- Referral and review of “potential disputes”
- DAB can only make recommendations

NEC4 – Multi-tier dispute resolution / W3

- What are “potential disputes”?
- How to distinguish potential disputes from actual disputes?
- DAB jurisdiction over potential disputes that have become actual disputes?

NEC4 – Multi-tier dispute resolution / W3

- 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
 - [S]ubject 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.
 - Article 20.1; *Hong Kong Housing Authority v. Sui Chong Construction & Engineering Co Ltd & Anor*, HCCT 47/2007 (28 November 2007) (at Paragraph 18) under the then Rule 26 of the HKIAC Domestic Arbitration Rules (1993).

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.”

The Law Reform Commission of Hong Kong, Report on Third Party Funding for Arbitration (October 2016), Paragraph 3.13.

Hong Kong Security for Payment

Hong Kong: Security for Payment [pending]

- 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

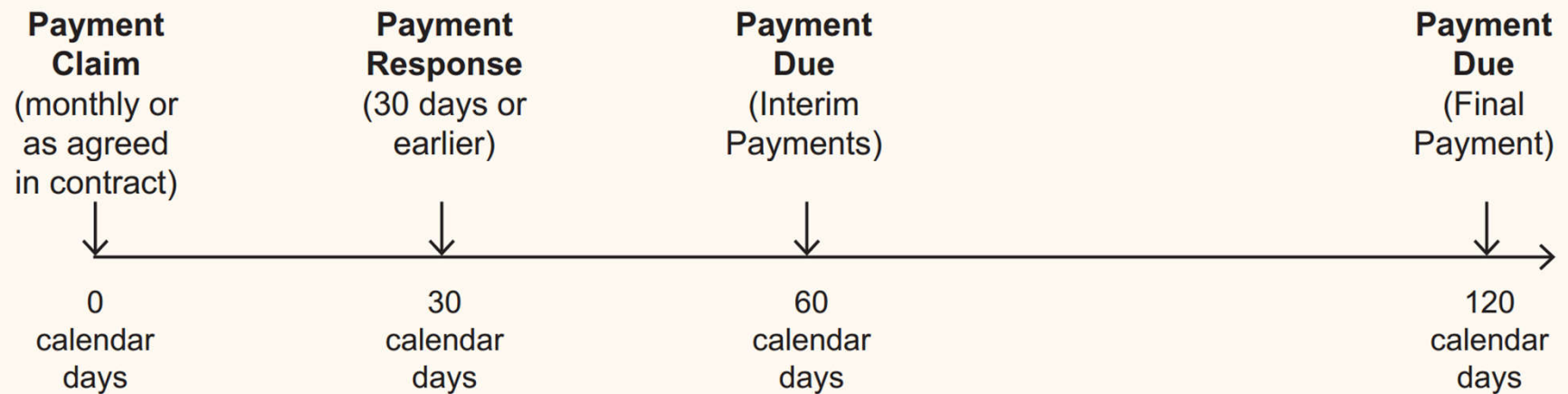
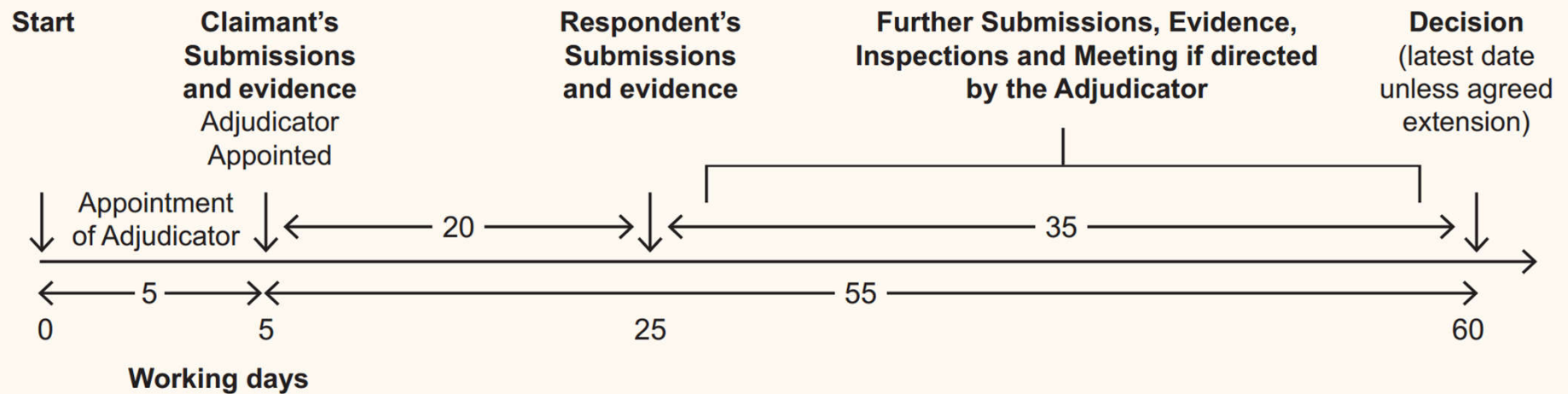


Diagram 2: Typical Adjudication Procedure



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 Red Book 2017 on arbitration

- 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

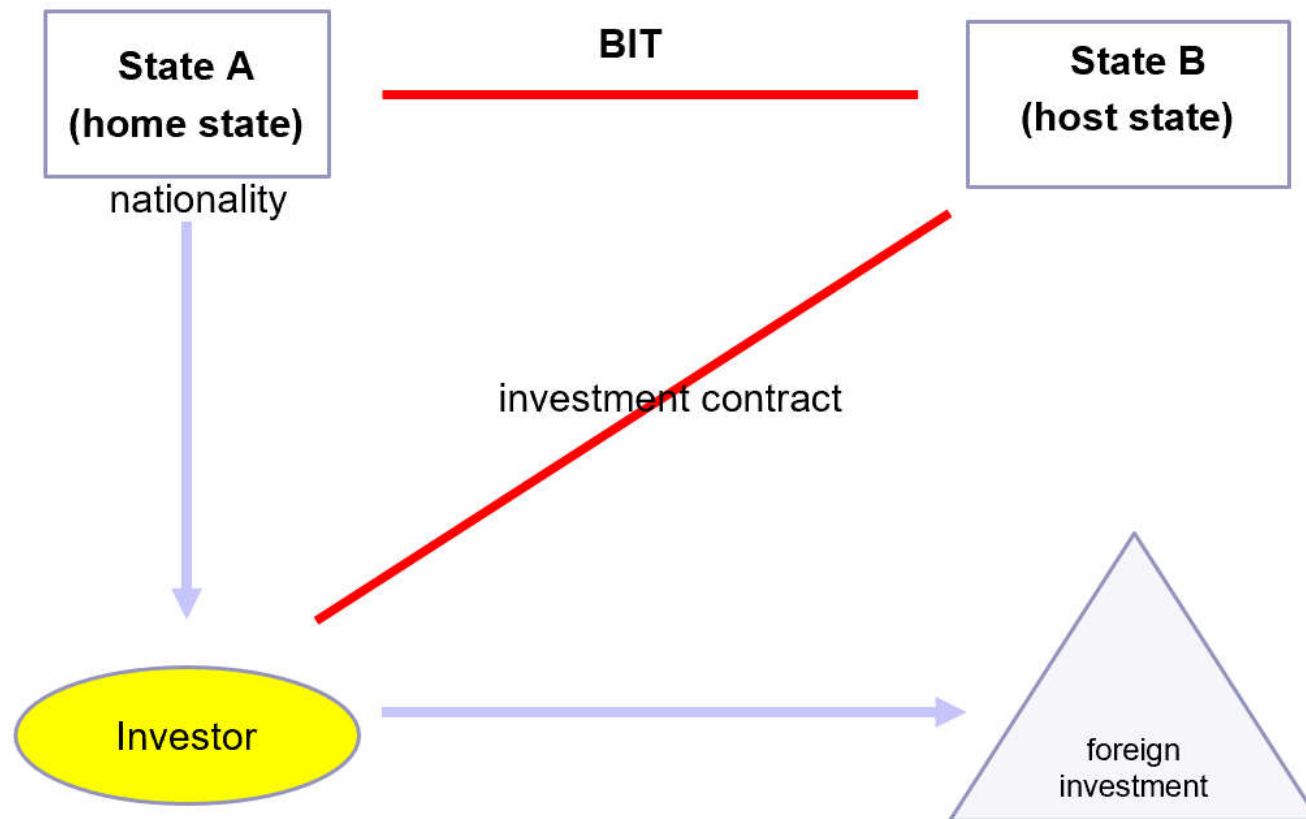
- In 2015: 25% of all ICC disputes were construction disputes
- March 2019: ICC Commission on Arbitration and ADR:
 - Report on Construction Industry Arbitrations
 - <https://iccwbo.org/publication/construction-industry-arbitrations-report-icc-commission-arbitration-adr/>

Queen Mary Survey

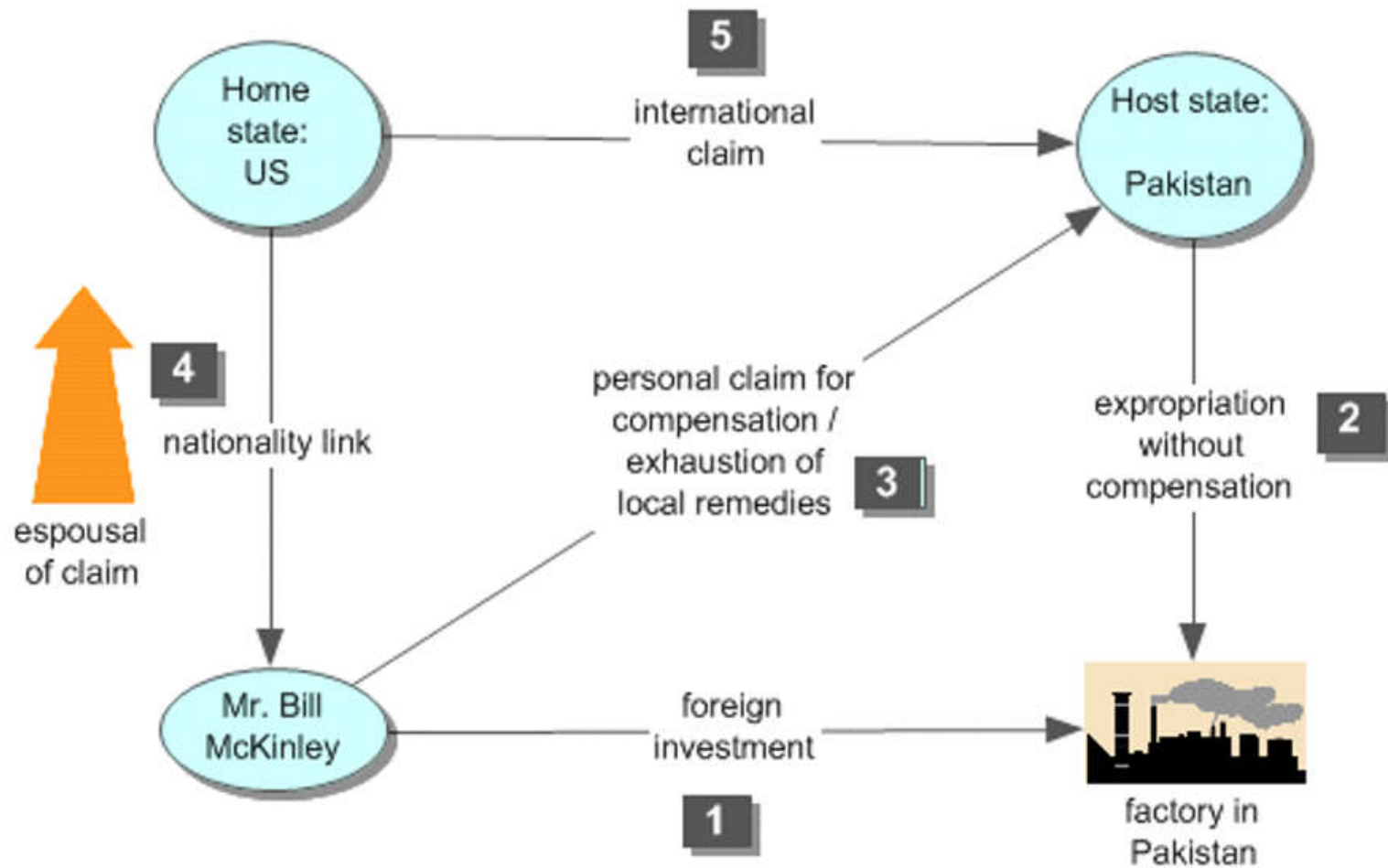
- Queen Mary University of London launched ninth annual international arbitration survey, focus on construction disputes (31 May-26 July 2019)
- To identify causes of inefficiency and high costs
- To suggest practical solutions

International construction contracts and ISDS

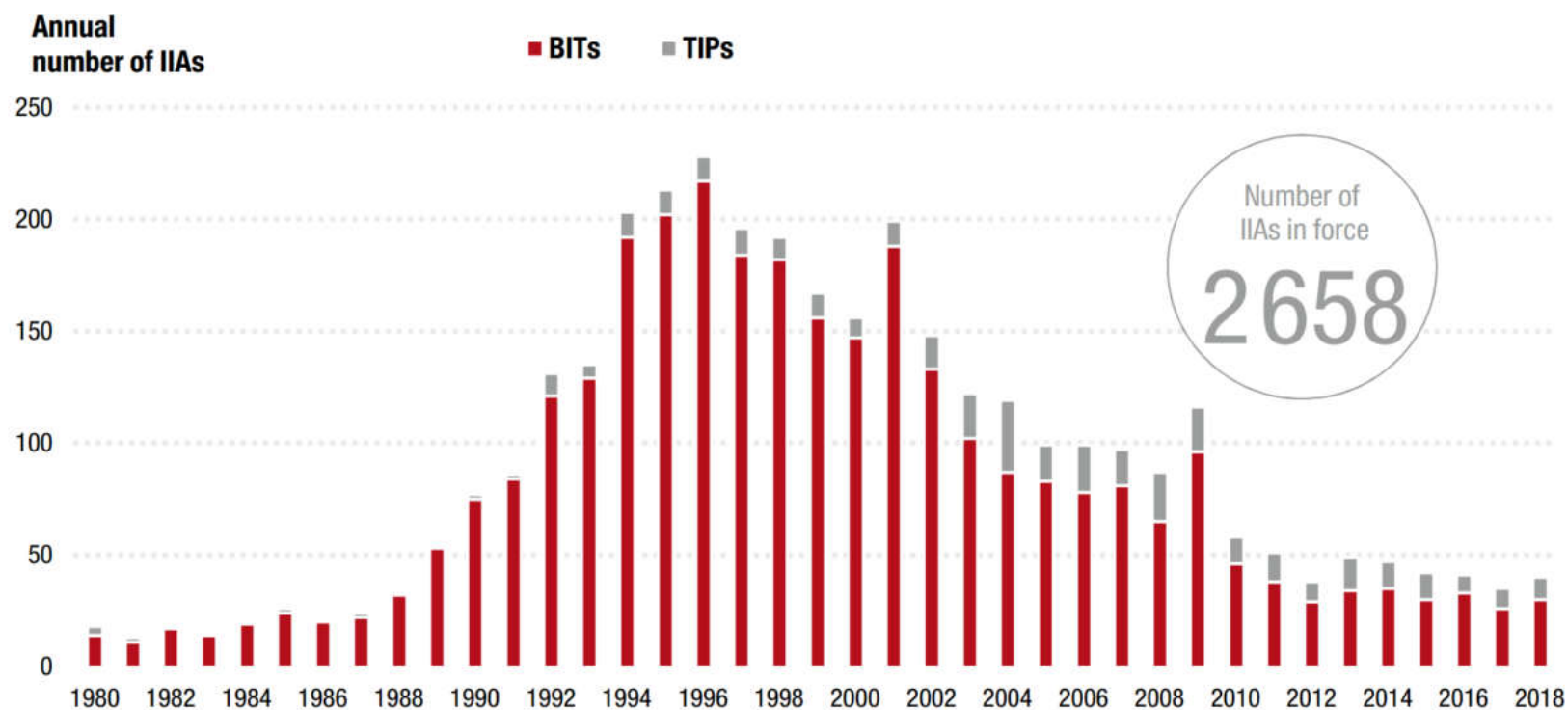
BIT & Investment Contract



Diplomatic Protection



Number of IIAs signed, 1980–2018



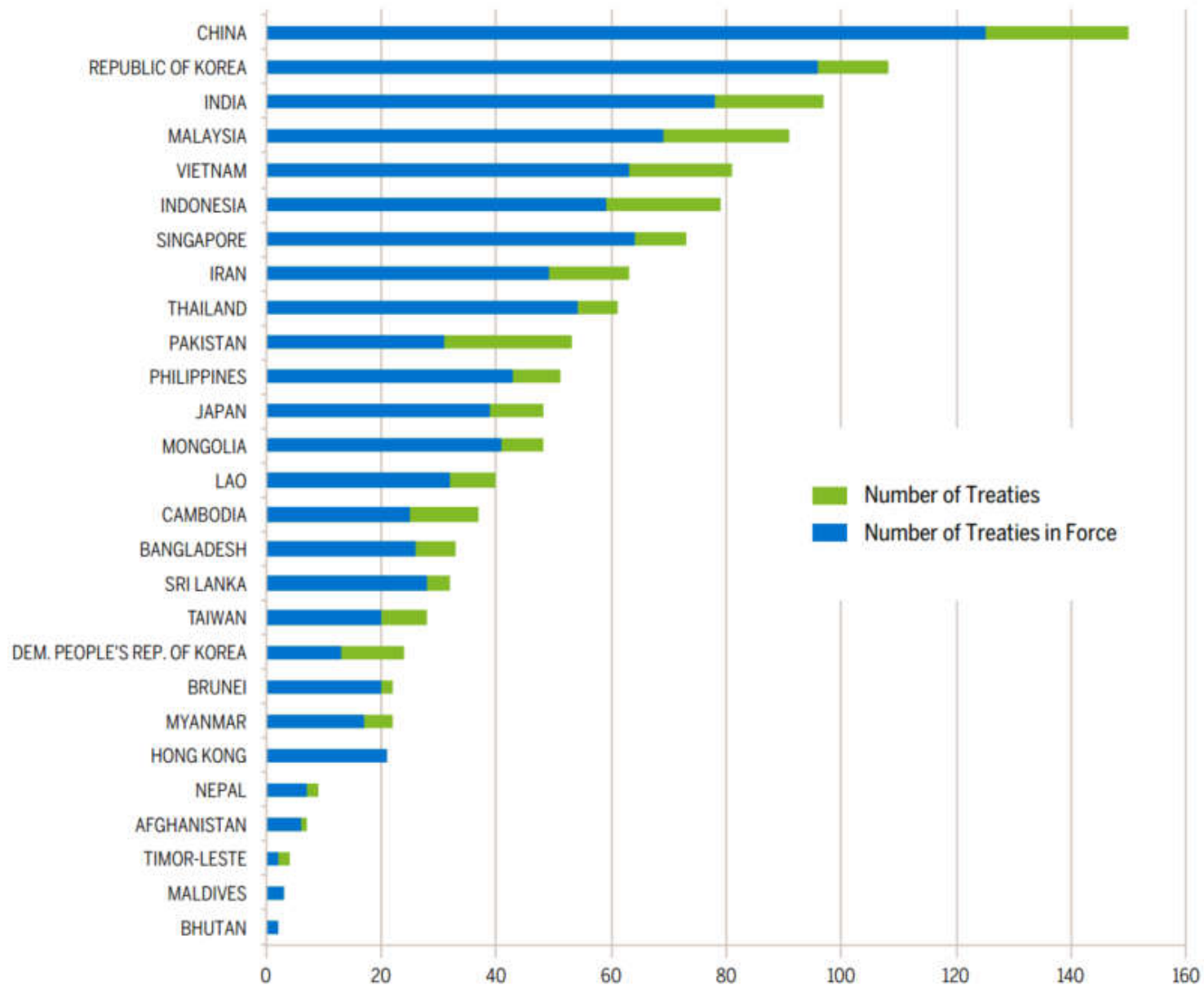
Source: UNCTAD, IIA Navigator.

Number of BITs and TIPs

(as of 11 June 2019)

Bilateral Investment Treaties	Treaties with Investment Provisions (TIPs)	Sum
Total: 2932	Total: 387	3,319
Total in force: 2346	Total in force: 313	2,659

Asia



Hong Kong, China SAR

29/03/2019

Bilateral Investment Treaties (BITs)

No.	Partners	Status	Date of signature	Date of entry into force	Text
1	Australia	In force	15/09/1993	15/10/1993	Full text: en
2	Austria	In force	11/10/1996	01/10/1997	Full text: en
3	BLEU (Belgium-Luxembourg Economic Union)	In force	07/10/1996	18/06/2001	Full text: en
4	Canada	In force	10/02/2016	06/09/2016	Full text: en
5	Chile	Signed (not in force)	18/11/2016		Full text: en
6	Denmark	In force	02/02/1994	04/03/1994	Full text: en
7	Finland	In force	02/07/2009	16/03/2014	Full text: en
8	France	In force	30/11/1995	30/05/1997	Full text: fr
9	Germany	In force	31/01/1996	19/02/1998	Full text: en
10	Italy	In force	28/11/1995	02/02/1998	Full text: en
11	Japan	In force	15/05/1997	18/06/1997	Full text: en
12	Korea, Republic of	In force	30/06/1997	30/07/1997	Full text: en
13	Kuwait	In force	10/05/2010	14/09/2013	
14	Netherlands	In force	19/11/1992	01/09/1993	Full text: en
15	New Zealand	In force	06/07/1995	05/08/1995	Full text: en
16	Sweden	In force	27/05/1994	26/06/1994	Full text: en
17	Switzerland	In force	22/09/1994	22/10/1994	Full text: en
18	Thailand	In force	19/11/2005	18/04/2006	Full text: en
19	United Kingdom	In force	30/07/1998	12/04/1999	Full text: en

Hong Kong, China SAR

29/03/2019

Treaties with Investment Provisions (TIPs)

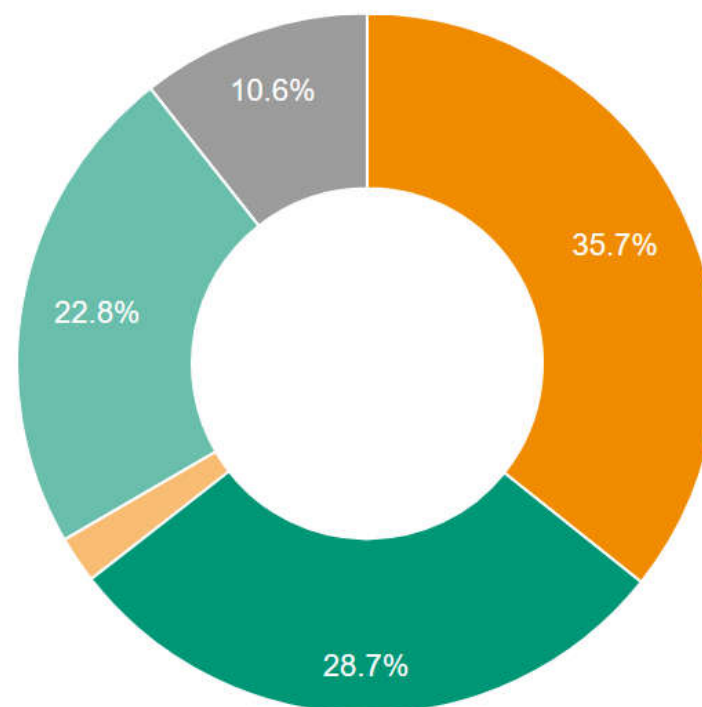
No.	Short title	Parties	Date of signature	Date of entry into force	Text
1	ASEAN - Hong Kong, China SAR Investment Agreement (2017)	ASEAN (Association of South-East Asian Nations)	12/11/2017		Full text: en
2	China - Hong Kong CEPA Investment Agreement (2017)	China	28/06/2017	28/06/2017	Full text: en zh
3	Chile - Hong Kong FTA (2012)	Chile	07/09/2012	09/10/2014	Full text: en
4	EFTA-Hong Kong FTA	EFTA (European Free Trade Association)	21/06/2011	01/10/2012	Full text: en Investment ch.: en
5	Hong Kong-New Zealand CEPA	New Zealand	29/03/2010	01/01/2011	Full text: en
6	China - Hong Kong CEPA (2003)	China	29/06/2003	29/06/2003	Full text: en

Known treaty-based investor-State arbitrations

Total	942
Pending	332
Concluded	602
Unknown	8

<https://investmentpolicyhub.unctad.org/ISDS>
29/03/2019

Concluded original arbitration proceedings

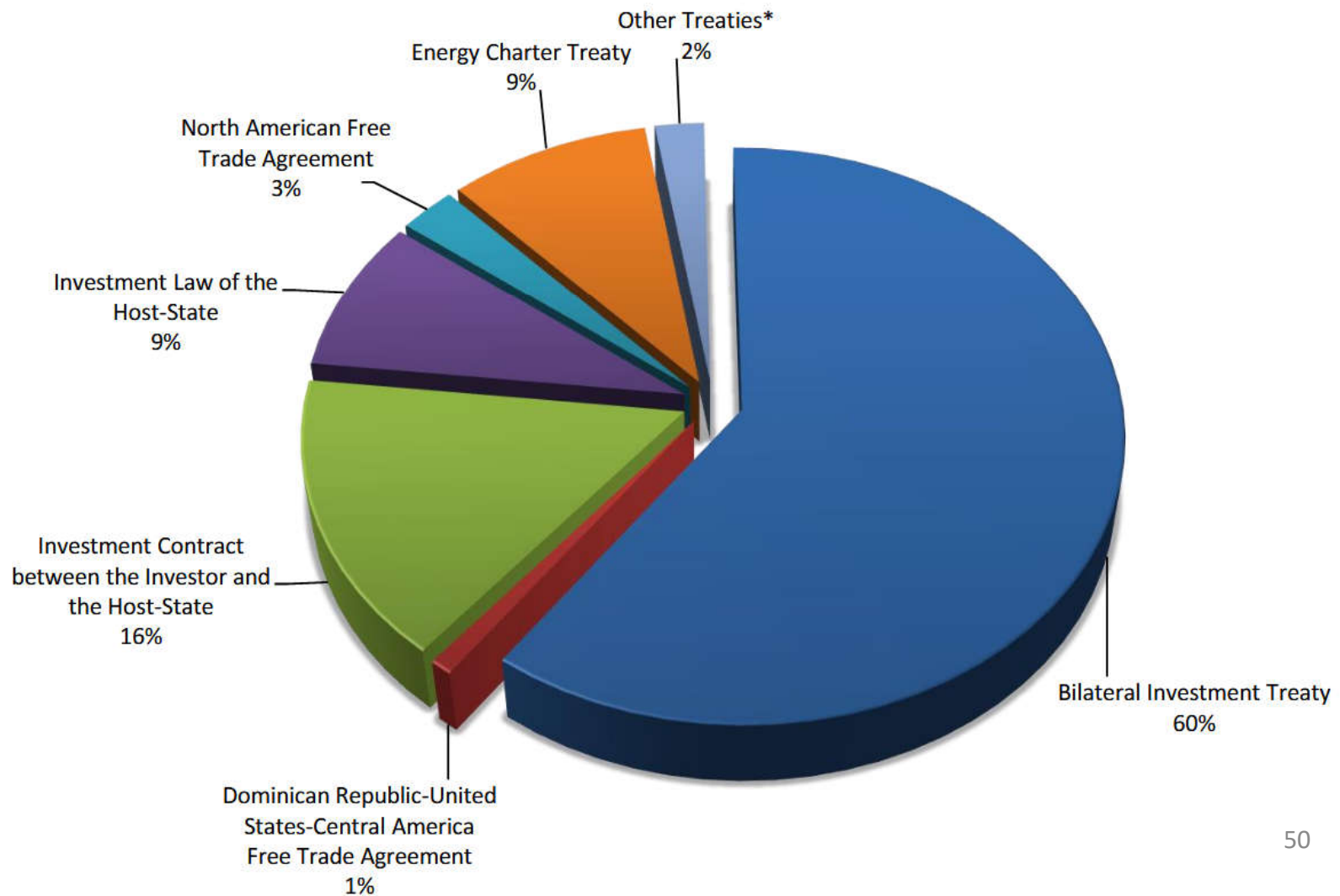


- Decided in favour of State
- Decided in favour of investor
- Decided in favour of neither party (liability found but no damages awarded)
- Settled
- Discontinued

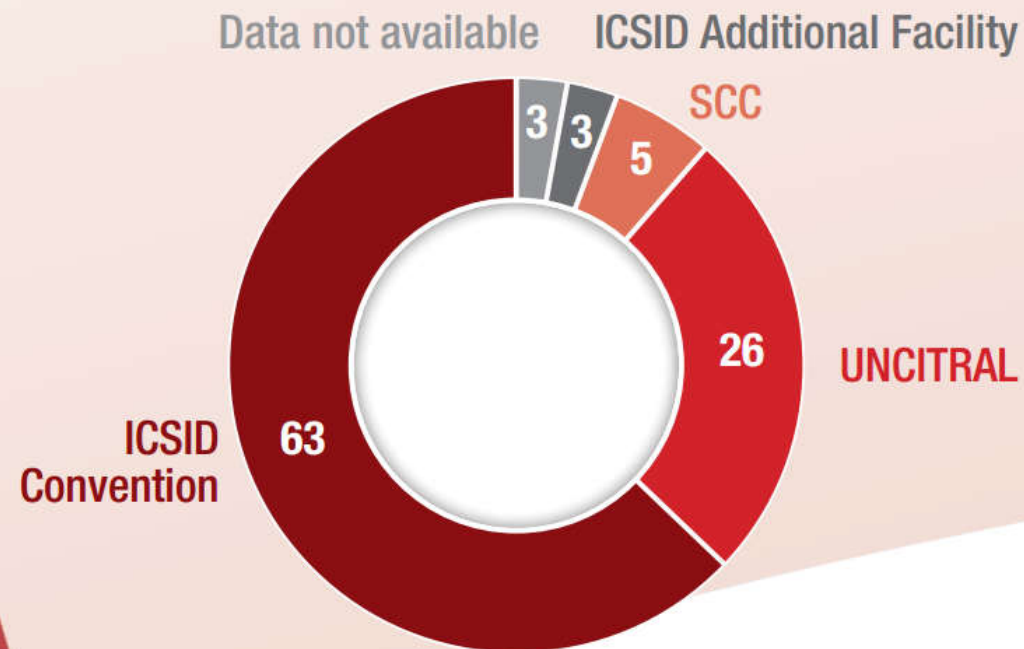
4. Basis of Consent Invoked to Establish ICSID Jurisdiction in Registered ICSID Cases

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

ICSID Caseload Statistics 2019-1



**Figure 5. Known ISDS cases filed,
by arbitral rules, 2015** (Per cent)



Source: ©UNCTAD, ISDS Navigator.

Transnational Construction Projects

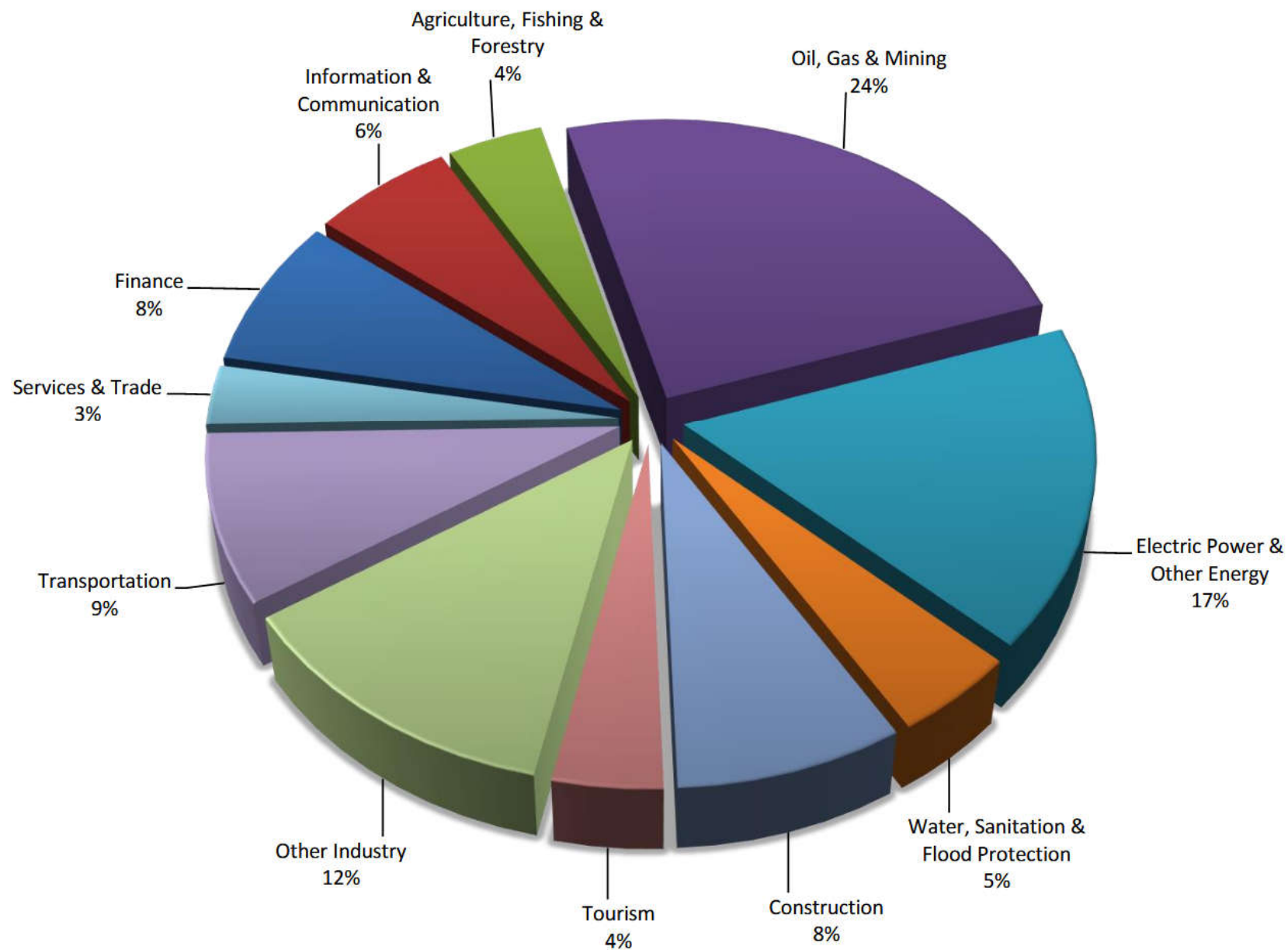
Political Risk

- 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*:



ICSID *Salini* case: on definition of “investment”

- *Salini v Marocco, Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4) (filed in 2000)
- 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)



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

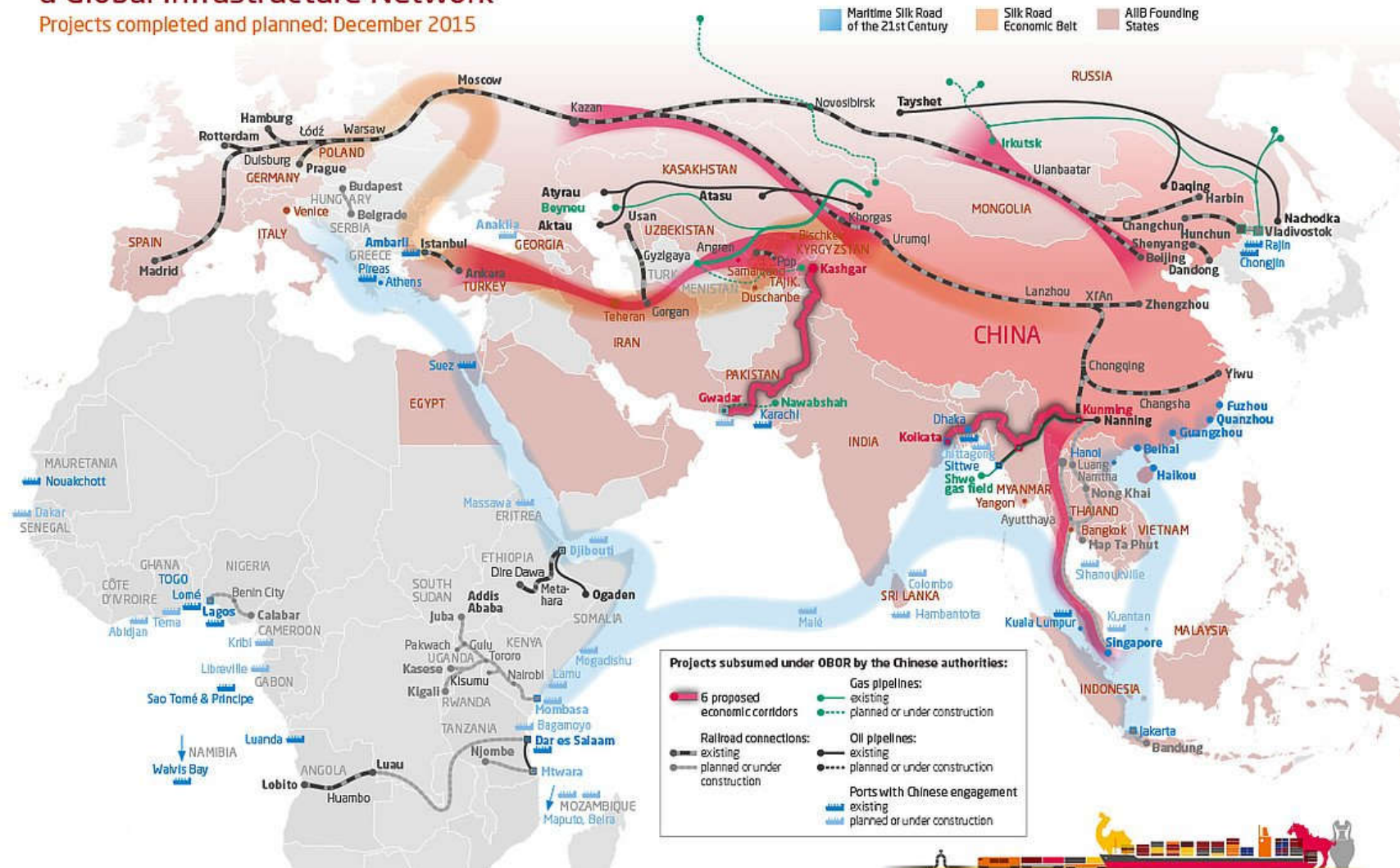
- Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen (ICSID Case No. ARB/14/30) [2014]
- China - Yemen BIT (1998)
- Claims (114m USD) arising out of the alleged forced deprivation of claimant's assets and contract concerning a project for the construction of an airport terminal in Sana'a.
- Decision on Jurisdiction dated 31 May 2017
- Settled in 2018

Belt & Road Construction Disputes and CICC

MERICS China Mapping

One Belt, One Road: With the Silk Road Initiative, China Aims to Build a Global Infrastructure Network

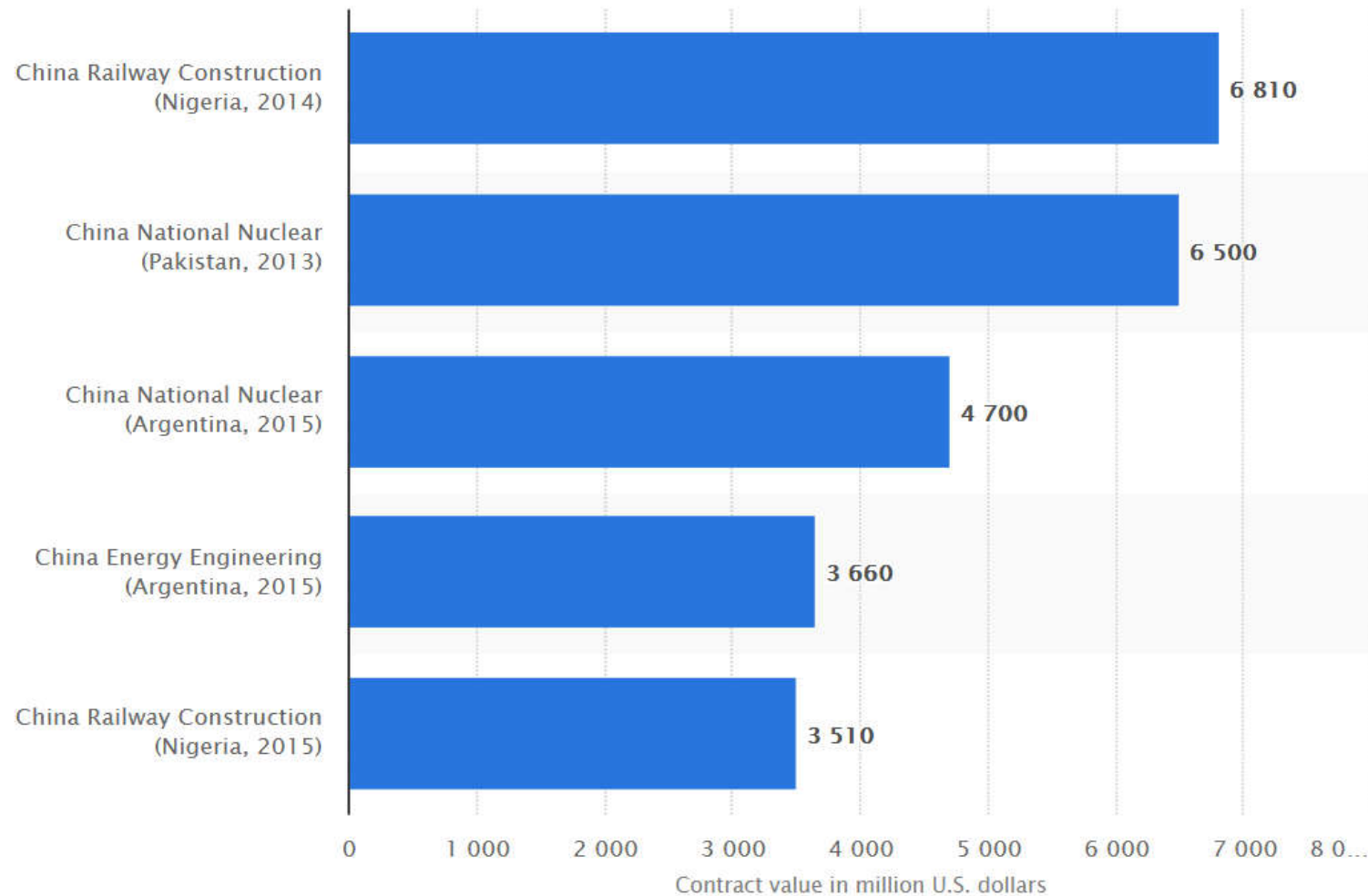
Projects completed and planned: December 2015



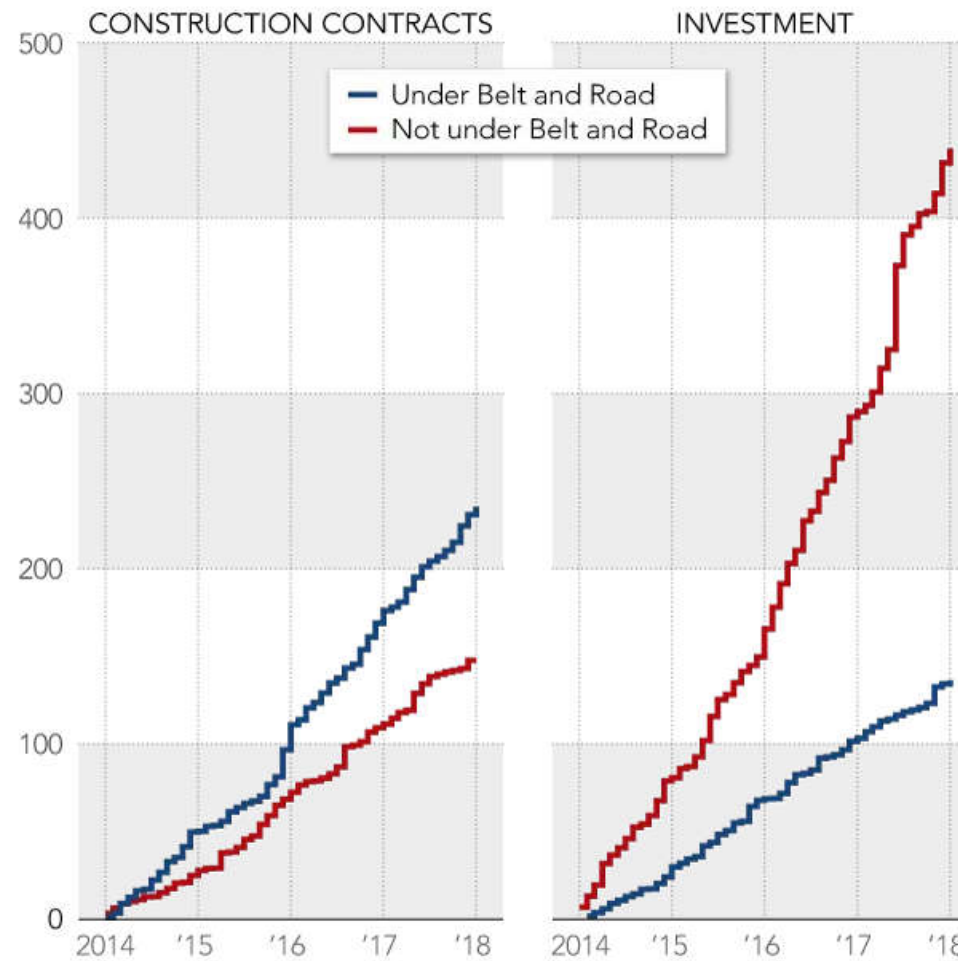
Belt & Road Initiative (BRI) – Key Facts

- 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)*



2018

Sources: China Global Investment Tracker, AEI

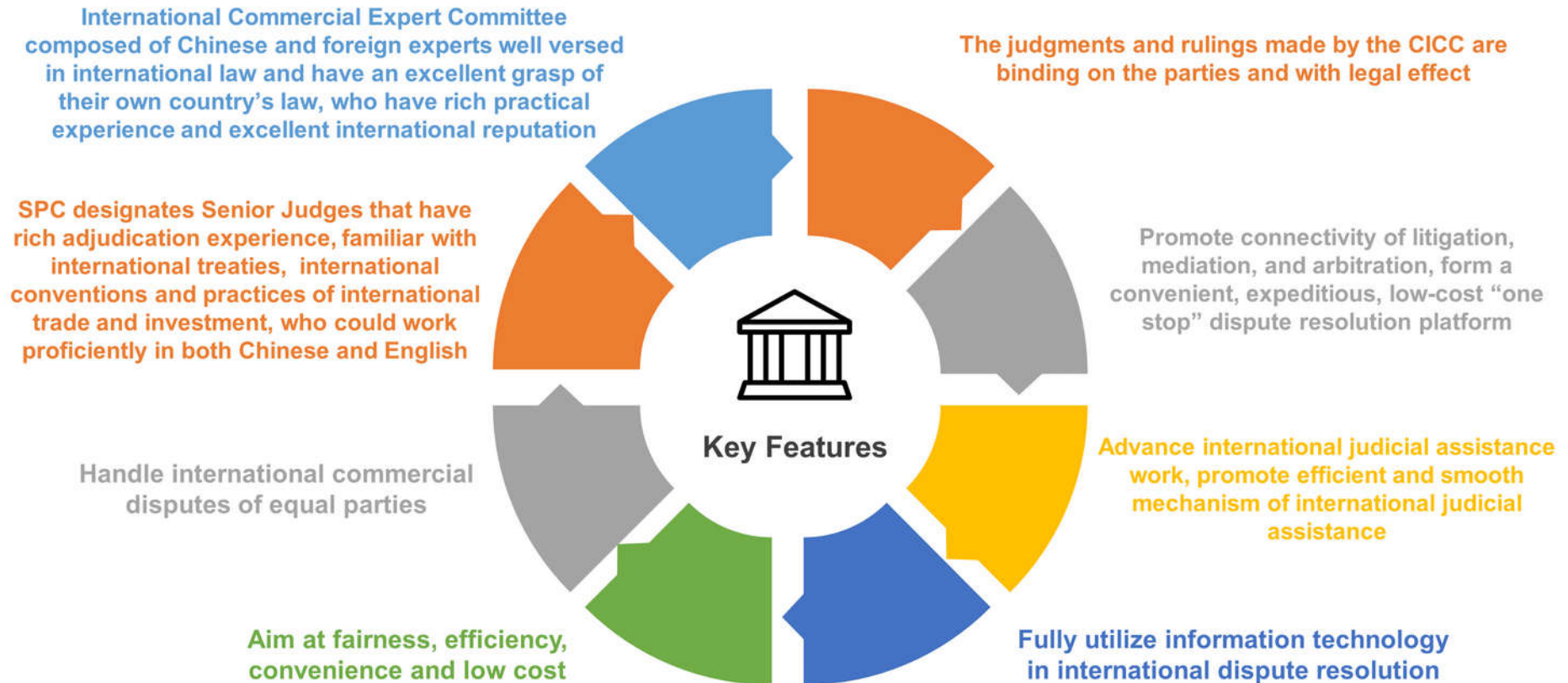
Belt & Road Initiative (BRI)

- 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



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

one or both parties
have their habitual
residence outside
the territory of the
People's Republic
of China

the subject matter in
dispute is 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

CICC International Expert Committee



First Group of 31 Chinese and Foreign Experts were Appointed as Members ⁷⁹

CICC – One-stop mechanism

SPC of China – International Commercial Court



In December 2018, the Supreme People's Court listed SCIA as its “one-stop”, multi-dimensional dispute resolution mechanism for international commercial disputes.