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The construction & energy law specialists

International Quarterly

Issue 19, 2016

Our newsletter provides informative and practical information regarding legal and commercial developments in construction and energy sectors around the world.

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Recovery of third-party funding costs in arbitration

By Jeremy Glover
Partner, Fenwick Elliott

The right of a successful party to his costs in arbitrations governed by the UK 1996 Arbitration Act is provided by sections 59–65. The essential features of the costs rules (almost all of which are subject to contrary agreement) are as follows:

- The Tribunal must award costs on the general principle that costs follow the event, except where it appears to the Tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.
- This applies not only to the legal or other costs of the parties, but to the arbitrators' fees and expenses and the fees and expenses of any arbitral institution concerned.
- The Tribunal may (and normally will) determine by award the recoverable costs of the arbitration on such basis as it thinks fit. In practice, the award quantifying the costs will have to come after the substantive award, so that the parties can make their submissions as to the amount of costs.
- If the Tribunal does not quantify the costs, the court can either do so, or order how they are to be determined.
- The basic principles most Tribunals will adopt are that (a) there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and (b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party.

Until recently, there had not been any English decision where a Tribunal awarded the successful party the third-party funding costs it had incurred as well as the more traditional legal and experts' fees. Third-party funding can mean many different things. Typically, third-party funders offer to provide funds for a party's costs in return for a percentage of any damages recovered or a bonus multiple of the sums advanced. If the claim is unsuccessful, the funder recovers nothing.

However, in a decision which is currently unreported[1] made by the Commercial Court in September 2016, Judge Waksman QC held that third-party costs were recoverable in principle pursuant to section 59(1)(c) of the 1996 Arbitration Act and Article 31 (1) of the ICC Rules.

Section 59(1)(c) provides that the costs of an arbitration include:

"the legal or other costs of the parties".

Article 31 (1)[2] of the old 1998 ICC Rules provides that:

"Decision as to the Costs of the Arbitration

The costs of the arbitration shall include the fees and expenses of the arbitrators and the ICC administrative expenses fixed by the Court, in accordance with the scale in force at the time of the commencement of the arbitral proceedings, as well as the fees and expenses of any experts appointed by the Arbitral Tribunal and the reasonable legal and other costs incurred by the parties for the arbitration."

In the arbitration in question, Norscot, the successful party, had sought its costs in the usual way. However, its claim included the costs of the litigation funding which it said it had been forced to incur in order to pursue the claim. The third-party funding consisted of an advance of £647,086, which was repayable either at 300% of

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the sum advanced from the damages recovered, or 35% of the damages, whichever was the greater.

Essar disputed the Tribunal's jurisdiction to make an award in respect of third-party funding. Having lost before the Tribunal, it obtained permission to appeal from the High Court. But giving the substantive judgment last week, HHJ Waksman QC accepted that the terms of section 59(1)(c) and the reference to "*legal and other costs*" were wide enough to permit the recovery of third-party funding costs.

It is understood that the Tribunal had awarded indemnity costs against the unsuccessful party which is likely to have influenced the Tribunal's decision to allow the recovery of the third-party funding. For example, if the conduct had been such that Norscot had had no option but to turn to third-party funding to continue with the arbitration, then that might have been a factor that influenced the Tribunal.

Therefore whilst it is important to bear in mind the specific circumstances of the decision, until the full transcript has been released, the consequences of the judgment cannot be fully assessed. That said, the decision is potentially a very significant one and we will be reporting in detail on the decision in Issue 20 of IQ.

Footnotes

1. Although unreported, the case has provoked much discussion, and our summary of the case is based on information from 4 New Square, Nicholas Bacon QC having acted for the successful party. See http://www.4newsquare.com/news/article.aspx?Id=305
2. See also, Article 37 of the 2012 ICC Rules.

Jeremy Glover, Partner
Fenwick Elliott
jglover@fenwickelliott.com

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No general organising principle of good faith in English law: the Court of Appeal's decision in *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2016] EWCA Civ 789

By Sana Mahmud
Associate, Fenwick Elliott

Back in Issue 05 of IQ, we examined the decision in *Yam Seng PTE Ltd v International Trade Corporation Ltd* and looked at whether a general obligation of good faith could be implied into contracts made in accordance with English law. The decision in *Yam Seng* was seen at the time as a change in the established approach that could potentially open the door to the possibility of implying a pervasive duty of good faith in commercial contracts. A number of subsequent cases followed the approach in *Yam Seng*, including the first instance decision in *MSC*. *MSC* eventually went before the Court of Appeal, where Lord Justice Moore-Bick advocated a return to the orthodox view that English law does not recognise any general duty of good faith in matters of contract.

A brief recap - good faith under English law: a recognised concept?

Many jurisdictions[1] expressly include in their civil codes references to the concept of good faith in commercial dealings. In that context, an obligation to act in good faith in the making and performance of a contract becomes an express obligation on all parties. It also should be noted that the recognition of a general doctrine of good faith is not limited to just common law jurisdictions. For example, Australian courts have been known to imply broad duties of good faith into commercial contracts, and the Supreme Court of Canada recently recognised a new common law duty of honest performance.[2]

Whilst it is accepted that broad concepts of fair dealing can be reflected in the English court's response to questions of construction and the implication of terms, the long-standing position under English contract law is that courts have been reluctant to recognise any general pervasive duty of good faith.[3]

The historical reluctance of the courts to imply a general duty of good faith is due in part to concerns that doing so would likely undermine contractual certainty. Instead, the English courts have, as Bingham LJ put it in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*,[4] preferred to develop "*piecemeal solutions in response to demonstrated problems of unfairness*". There is no generally accepted definition of the concept under English law, but in the same judgment, Bingham LJ described good faith as being most aptly conveyed by colloquialisms such as "*playing fair*", "*coming clean*" or "*putting one's cards face upwards on the table*", concluding that it "*is in essence a principle of fair and open dealing*".

If the term is not expressly defined in a contract, parties will have scope for argument about what an obligation of good faith in a particular context means. Where parties have expressly included good faith obligations in their contract, the general approach is that the courts will seek to give effect to those express provisions which relate to the actual performance of a particular obligation. However, whether a party can successfully rely on such a provision will depend to a great degree on the specific wording of the particular clause. The usual principles of contractual interpretation will apply.[5]

Often in cases where there is an express clause incorporating an obligation of good faith, parties seeking to rely on the clause have attempted to argue that the duty is general one that can apply across other provisions of the contract. The courts have generally favoured a narrow interpretation of express contractual obligations of good faith, and in cases where the duty relates to a specific provision, they have been hesitant to imply a wider overarching contractual duty. The judgment in the 2013 case of *Yam Seng Pte Ltd v International Trade Corporation Limited*[6] which we examined in Issue 05, however, briefly raised expectations that the courts were open to a pervasive duty of good faith being implied more commonly in commercial contracts. A number of subsequent cases, including the first instance decision in *MSC*, followed the approach in *Yam Seng*.[7] The Court of Appeal has in *MSC* recently restated the traditional position that English contract law does not recognise a general duty of good faith. Prior to the Court of Appeal judgment in *MSC* the decision in *Mid Essex Hospital Services*, which we also look at briefly below, had already cast some doubt on the approach in *Yam Seng*. Consequently, *Yam Seng* should now be treated with caution.

Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd

Shortly after the judgment in *Yam Seng* the Court of Appeal took a much more narrow and restrictive approach in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd*. Here, the court made clear that the obligation to act in good faith under a particular provision did not extend to all conduct under the contract.

The factual background to the case was that the respondent, Compass, agreed to provide cleaning catering services to the appellant Trust under a substantial commercial contract. Under this contract, Compass was required to meet certain agreed performance levels and criteria. Failure to meet the agreed performance levels or criteria by Compass would result in the levying of certain deductions. The dispute concerned the levying of those deductions, and a question of whether the Trust had been entitled to terminate the contract on the basis that Compass has exceeded the number of service failure points permitted in any given 6 month rolling period.
Clause 3.5 of the contract, which contained an express duty to cooperate in good faith, read as follows:

"The Trust and the Contractor will co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract."

The Court was asked to decide whether this clause provided an overarching obligation on the parties to cooperate with each other in good faith. Compass relied heavily on the decision in *Yam Seng*, arguing that the good faith obligation in Clause 3.5 should be construed widely so as to apply to the contractual provisions relating to performance level failures and / or that a general duty of good faith should be implied in to the contract. Reversing the decision of the High Court at first instance, the Court of Appeal held that the obligation to act in good faith was limited to the purposes identified in the clause: to transmit information and provide full benefit of the contract to the customer. The court found that that commercial common sense did not favour the addition of an overarching duty to cooperate in good faith in circumstances where good faith had been provided for in the contract in such a precise manner at clause 3.5. The Court of Appeal emphasised that "*if the parties want to impose a duty they must do so expressly*".

MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt

The case concerned a dispute between a carrier, *MSC*, and a shipper, Cottonex in respect of demurrage on 35 containers used for the carriage of raw cotton from Bandar Abbas and Jebel Ali to Chittagong. Cottonex engaged *MSC* to transport the cotton in three consignments under five bills of lading. Each of these bills of lading contained a clause providing for a period of free time for the use of the containers at their destination, after which demurrage became payable at a daily rate.

In the time it took to ship the consignments to their destination, the price of cotton collapsed and the consignee refused to accept the goods. Cottonex received payment for the consignments by presenting its documents to a bank which had

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opened a letter of credit in its favour and subsequently argued that it had no right to deal with the goods as property in them had passed to the consignee. The bills of lading contained terms which under certain circumstances gave *MSC* the right to unpack the goods and dispose of them, however, the customs authorities at Chittagong refused to allow anybody to deal with the containers without permission from the court. Consequently, nobody was able to take delivery of the goods or dispose of them. At the time of the Court of Appeal judgment, it was understood that the cotton was still there. Under the terms of the bills of lading, demurrage would become payable at a daily rate of US $840 a day upon the expiry of the period of free time for the use of the containers. The continued impasse meant that the period expired, and *MSC* claimed demurrage of US $577,184, which was said to be still accruing at the daily rate during the appeal.

The case mostly dealt with the right to affirm in the context of repudiatory breach, however, in its decision the Court of Appeal took the opportunity to make some observations on remarks made by Leggatt J in deciding the case at first instance. The High Court had held that *MSC* was not entitled to keep a contract alive indefinitely for the purpose of claiming ongoing demurrage following Cottonex's repudiatory breach. The High Court had further held that an innocent party's decision to terminate or affirm a contract after a counterparty's repudiatory breach (akin to a contractual discretion) must be exercised in good faith and must not be exercised arbitrarily, capriciously or unreasonably.

In his Court of Appeal judgment, Moore-Bick LJ stated that he did not believe there was any justification in applying principles of good faith when considering whether

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an innocent party had a legitimate interest in affirming a contract following a repudiatory breach. He noted that the "*recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences*" and that in his view "*the better course is for the law to develop along established lines than to encourage judges to look for what the judge called in this case "some general organising principle" drawn from cases of disparate kinds*". He concludes with the warning that there is:

"*a real danger that if a general principle of good faith were established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement*".

The approach taken by the Court of Appeal appears to be one that seeks to limit what Moore-Bick LJ fears might otherwise be an opening of floodgates to claims which undermine express terms agreed between parties. The judgment makes it clear that there is no general organising principle of good faith in English law and effectively curtails the line of authority that began with the decision in *Yam Seng*.

Conclusion

In another very recent case concerning a long-term contract, *Globe Motors Inc v TRW Lucas Variety Electric Steering Ltd* the Court of Appeal rejected the concept that "*relational contracts*" are likely to be subject to duties of good faith. Instead, the court confirmed that "*the implication of a duty of good faith will only be possible where the language of the contract, viewed against its context, permits it. It is thus not a reflection of a special rule of interpretation for this category of contract.*" In circumstances where a party argues that an implied term based on the concept of good faith applies, the term would still need to meet strict implications tests.[8] In practice this means that a term of this nature would be unlikely to be implied unless a party could properly demonstrate that the contract would lack commercial or practical coherence without it.

In light of the above, if a party wants to rely on a good faith obligation in a contract, it should expressly provide for one. Where a party chooses do this, it is important that the scope and substance of that obligation is made clear to avoid any ambiguity as to what it means or to which provisions of the contract it applies. Certainty is key. Parties should also remember that good faith will not trump an absolute contractual right.

Footnotes

1. For example, French, German and UAE Civil Codes
2. *Bhasin v Hrynew* 2014 SCC 71
3. *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (trading as Medirest)* [2013] EWCA Civ 200. It should be noted that duties of good faith are relevant in the context of certain kinds of contracts, such as contracts of agency, insurance, employment and contracts with consumers, however, these are beyond the scope of this article.
4. *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433.
5. *Marks and Spencer Plc v BNP Paribas Security Services Trust Company (Jersey) Limited* [2015] UKSC 72.
6. *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB).
7. *Bristol Groundschool Limited v Whittingham* [2014] EWHC 2145 (Ch); *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB).
8. *Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72.

Sana Mahmud, Associate
Fenwick Elliott
smahmud@fenwickelliott.com

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Bribery in international construction

By James Mullen
Associate, Fenwick Elliott

In Issue 18 of IQ, Sarah Buckingham reviewed the extra-territorial reach of the UK anti-bribery legislation. In Issue 19, we take a more global look at the risks of bribery on construction projects.

A recent report[1] by *Global Construction Perspectives and Oxford Economics* forecasts that by 2030 the volume of construction output will grow by 85% to US$15.5 trillion worldwide, with China, the US and India leading the way and accounting for 57% of all global growth. There is no doubt that global construction is big business, particularly in the emerging markets where large construction and infrastructure projects are being carried out more and more. However, construction (both at home and abroad) has always been viewed as a sector that is extremely vulnerable to bribery.

Why is international infrastructure and construction seen as being so vulnerable and at high risk of bribery?

There are numerous reasons, including:

1. Many of the large international construction and infrastructure projects are carried out in the emerging markets which are often seen as high risk jurisdictions for bribery.
2. The significant scale of international infrastructure and construction projects can make it easier to hide bribes or inflate costs.
3. Large international infrastructure and construction projects often have complex structures with hundreds (if not thousands) of contractual links and supply chains. Each link/chain can be an opportunity to pay or receive a bribe, whilst the complicated structure of a project provides opportunities for the concealment of unlawful activity.
4. Foreign construction companies working abroad will almost inevitably require the services of local agents and third party intermediaries. However, it is through these third party channels that bribes are often paid.
5. There may be various cultural differences. For example, what a local agent or contractor considers to be acceptable in their jurisdiction may not be considered acceptable in, for example, the UK or the US.
6. Almost all large international infrastructure and construction projects will have some form of government involvement at one level or another. For example, the majority of infrastructure projects are government-owned, whilst even projects in the private sector will require government approvals, permits and licences etc. which, if not controlled properly, provide easy opportunities for officials to extract bribes.

Opportunities for bribery at different phases of a project

There are opportunities for bribery to occur at virtually every phase of a construction project, whether domestic or international.

Tendering and procurement

Tendering and procurement is the stage of a construction project that is often considered to be the most vulnerable to bribery. An obvious example is the payment of bribes to a representative of, or an advisor to, the employer or a government to secure a contract. Further down the contractual chain, subcontractors could bribe an employee of the main contractor to win a subcontract, or a supplier could bribe the main contractor to ensure that it chooses them instead of a rival supplier. Notwithstanding the illegality of such payments, they will inevitably affect the value and quality of the work being procured.

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Bribes could be paid direct but most often they are made through third party intermediaries. Alternatively, local well-connected third party procurement agents may themselves receive bribes from local suppliers to influence the contractor's choice of supplier. Indeed, the use of third party intermediaries, not only at the tender and procurement stage but also throughout the project, is seen by many as the most high risk area for bribery taking place. As the prominent global anti-corruption organisation, Transparency International ("*TI*"), says in their recent guidance on managing third party risk:

"Third parties and intermediaries in particular are the single greatest area of bribery risks for companies. These risks are growing as companies move into new markets and put ever more of their operations in the hands of third parties…" [2]

As noted above, on international projects a contractor will inevitably need to obtain various permits, licences, planning permission and approvals from "*government officials*" (a title that can be interpreted widely'). This may provide the officials with opportunities to extract bribes in exchange for the award of these.

Construction

Various opportunities for bribery arise during the construction stage. For example, often on international construction projects contractors will import goods and materials, and sometimes "*facilitation payments*" may be required to get these through customs.

Another example could be where substandard materials are used or substandard work is carried out in order to save money. Some of the money saved is then used to bribe the relevant checkers to sign off the substandard materials or work as acceptable. As most works or materials on construction projects are eventually covered up by other components, the substandard materials and work can be easily concealed.

What are governments and organisations doing to tackle bribery?

The Organisation for Economic Co-operation and Development's (OECD) Anti-Bribery Convention ("*Convention*") came into force in 1999 and established legally binding standards to criminalise bribery of foreign public officials in international business transactions. All 35 OECD members (including the UK and the US) and 6 non-member countries (including Russia and South Africa) have adopted the Convention.

Bribery Act 2010

In July 2011, the UK's Bribery Act 2010 ("*Act*") came into force which makes it an offence for a person to pay or receive a bribe, whether directly or indirectly. In addition, under section 7 of the Act a corporate body is guilty of an offence if an "*associated person*" (who can be an employee, agent or subsidiary company) bribes another person intending to obtain or retain business or a business advantage for the company.

Sanctions for failing to comply with the Act include fines, imprisonment, disqualification of company directors and confiscation of property.

The liability on companies under section 7 is strict and the only defence to a section 7 prosecution is if the company can show that it had "*adequate procedures*" in place designed to prevent bribery (see below).

The territorial scope of the Act is wide. It applies to bribery committed by anyone in the UK or, if overseas, by a British citizen, or any other person with a "*close connection*" with the UK can be prosecuted. Further, the corporate offence under section 7 applies to any UK incorporated entity and any overseas entity that carries on a business or part of a business in the UK.

Therefore, even if a project is aboard, UK companies could still find themselves caught by the Act if, for example, it is found that their employees, agents or subsidiaries are paying or accepting bribes in exchange for the award of contracts. In Issue 18 of International Quarterly, we reported on a recent prosecution of a UK-listed construction company involved in a project in the UAE (the case is the first conviction under section 7 of the Act and highlights its extraterritorial reach).

Foreign Corrupt Practices Act 1977

The US's equivalent to the Act is the Foreign Corrupt Practices Act 1977 ("*FCPA*"). The FCPA has two key elements: (i) the prohibition of bribes to government officials to obtain or retain business;

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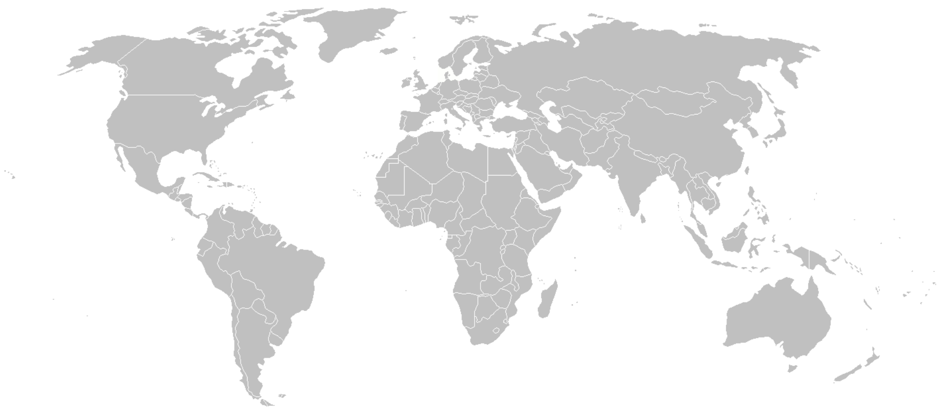

and (ii) the requirement that companies maintain accurate books and records and adequate internal accounting controls (this is intended to prevent accounting practices designed to hide corrupt payments).

The FCPA applies to unlawful activities by US persons (US citizens, nationals or residents) or any company that is registered or has its principal place of business in the US, or is organised under US laws. It also applies to foreign companies or persons who engage in any act in furtherance of a corrupt payment while in the US.

Sanctions under the FCPA include fines and imprisonment. Further, companies and individuals may be excluded or debarred from certain federal programmes and also be ineligible to receive export licences. In addition to these sanctions, a corporation or individual may also be subject to civil or criminal actions.
The FCPA also includes certain defences. For example, unlike the Act, the FCPA permits certain "*facilitation payments*" to foreign officials to make them perform routine government actions. However, this exemption (which is commonly known as the "*grease payment*" exemption) is construed narrowly and only applies in certain situations. Another exemption under the FCPA is where the payments are lawful under the written laws and regulations of the foreign official's country.

United Arab Emirates

In the UAE there is currently no stand-alone or equivalent piece of legislation to the Act. However, in Issue 18 of International Quarterly, we briefly discussed the steps being taken in the UAE to combat bribery (see IQ Issue 18).

Why should companies work towards preventing bribery and corruption?

The obvious reason is that a failure to prevent bribery could result in a prosecution, with heavy financial penalties and even penal sentences. However, there are also other reasons, for example the legal costs of investigating allegations of bribery which are likely to be significant, the risk of debarment from government contracts and, importantly, the damage to reputation which may affect a company's ability to win contracts in the future. As TI says on their website:

"Foreign bribery has significant adverse effects on public well-being around the world. It distorts the fair awarding of contracts, reduces the quality of basic public services, limits opportunities to develop a competitive private sector and undermines trust in public institutions.

Engaging in bribery also creates instability for companies themselves and presents ever-growing reputational and financial risks…"

What steps can companies take to prevent bribery?

The number of global investigations, prosecutions and adjudications for bribery is increasing. In a recent interview,[3] the Chair of the OECD Working Group on Bribery emphasised that the OECD's next phase of implementing the Convention would involve focusing on two important areas. First, it will continue to seek to enforce the Convention (i.e. it will continue to investigate, prosecute and adjudicate those that breach the Convention). Secondly, however, the OECD will look to engage the private sector more and work with them as partners to ensure that effective compliance systems are in place. In other words, they want to do more to prevent bribery happening in the first place rather than having to address it after it has already happened.

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As noted above, under the Act an organisation may defend itself if it can prove that "*adequate measures*" and codes of conduct are in place to prevent bribery. The Ministry of Justice ("*MOJ*") has published guidance (albeit, at a high level) in the form of six principles to help companies consider whether they have adequate measures in place.[4] These principles are:

1. Proportionality: the action taken should be proportionate to the risks faced and the size of the business. For example, a company might need to do more to prevent bribery if the organisation is large or working abroad in a market where bribery is known to be commonplace.
2. Top level commitment: ensuring that the people at the top of the company are committed and active in preventing bribery within the organisation.
3. Risk assessment: companies should think about the risks they may face. For example, a company may research the markets it operates in and the people it deals with, particularly if it is entering into a new business arrangement or a new market overseas.
4. Due diligence: knowing exactly who you are dealing with can help to protect the organisation from taking on people who might be less than trustworthy. Therefore, a company may want to carry out due diligence on the people/other companies that it will be dealing with.
5. Communication: communicating company policies and procedures to staff and to others who will perform services for the company enhances awareness and helps to deter bribery. Therefore, a company may wish to consider whether additional training and awareness raising is required depending on the size and type of business.
6. Monitoring and review: the risks a company faces and the effectiveness of its procedures may change over time. Therefore, a company may want to regularly monitor and review its anti-bribery procedures to keep pace with any changes in the bribery risks, for example if a company enters into a new market.

In addition to the MOJ's guidance, other steps that a construction company may want to consider taking include:

1. The inclusion of anti-bribery and anti-corruption clauses in contracts.
2. Ensuring that effective financial and audit procedures are in place to monitor (both internally and externally) for bribery during the project.
3. Ensuring that employees are fully aware of the company's procedure for reporting bribery, in particular the procedure for whistle-blowing (this is still an area that needs significant work – only about 2% of all reported instances of cross-border bribery and corruption have come from whistle-blowers).
4. As to due diligence, a construction company working abroad should carry out due diligence on any joint venture partners (a company could potentially fall foul of anti-bribery legislation because of the actions of their JV partner(s)), subcontractors and local suppliers, agents and intermediaries.

Conclusion

Bribery will always be a risk in the construction sector. However, international governments and organisations have made it clear that they are committed more than ever to enforcing anti-bribery legislation. Therefore, companies need to be aware that even on a global construction project, they could still fall foul of domestic anti-bribery legislation, such as the Act. Accordingly, companies should ensure that they have an effective compliance system in place to try to prevent bribery occurring in the first place but also, if it does occur, to try to give themselves as much protection as possible against prosecution.

James Mullen, Associate
Fenwick Elliott
jmullen@fenwickelliott.com

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The Letter of Intent in the UAE – a binding contract?

By Heba Osman
Partner, Fenwick Elliott

The use of Letters of Intent ("*LOIs*") as the basis for construction projects has mushroomed in the Gulf in rent years. However the practice carries a significant risk to the parties involved, who may end-up finding themselves in a legal predicament. Heba Osman, Partner, Fenwick Elliott LLP, writes.

In many countries in the Gulf region, construction projects start with a hand shake followed by the issuance of a Letter of Intent setting out some basic information about the project, the parties, type of works, payment, project duration and other terms.

Typically, the LOI gets issued, along with a notice to commence the construction works, by the client and countersigned by the contractor to allow the project to start. The parties usually anticipate that a more detailed and final contract will be signed at a later stage. However in many instances a final contract does not get signed.

This might be due to the parties' inability to reach an agreement on the final contract terms, or not having enough time to finalise the negotiations, or simply

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because the parties forgot.

Whatever the reason, it is undeniable that using LOIs to commence construction projects has mushroomed in the Gulf region, particularly prior to the global financial crisis, and has significantly assisted parties to start projects a lot faster than if they had to wait for final contract negotiations to be completed.

This practice, however, carries a significant risk to the parties who may end-up finding themselves in the unenviable position of not knowing their rights or obligations and trying to second-guess these rights through the ambits of the applicable law. This is, of course, in addition to the question of whether an LOI is binding or not in itself. In short, an LOI without the signing of a final agreement is pretty much similar to playing football in a major tournament without rules: the outcome of the game would then be determined based on the power of the players, not the rules.

The question of whether the LOI is a binding contract or simply a promise to contract appears to be quite theoretical and of little value to many non-lawyers. In the legal realm this is not the case, as the answer to this question will determine the rules of play and the type of remedies and/or damages available to the party relying on the LOI.

In many jurisdictions around the world, LOIs are not considered binding agreements. In the UAE, Qatar and many other civil law jurisdictions, whether or not the LOI will be considered binding is based on the terms of the LOI itself and what is contained in the LOI. In order to determine whether an LOI is binding or not, one must turn to the provisions of the relevant law in each country and the requirements that the law sets for a document to be considered a binding contract.

The position in the UAE and Qatar

The UAE Civil Code does not specifically deal with LOIs nor does it contain any reference to LOIs. However, the Code determines that a contract is binding if it contains the parties' agreement on the essential terms of the obligation that this contract covers as well as the parties' agreement on other terms that the parties consider essential.

The UAE Civil Code also allows the parties to stipulate in the LOI that further conditions will be agreed at a later date and to state that the LOI would not be binding if these terms are not agreed. Consequently, an LOI will be binding if it contains the essential terms and does not contain a provision invalidating it if an agreement on remaining terms is not reached . The logical question now becomes: what are these essential terms exactly?

These essential terms, from a legal perspective, can be summarised in the following points:

- For any contract to be binding, there must be an acceptance matching the offer. LOIs are no exception if they were to be considered binding. Therefore, the LOI must show that there is an acceptance matching the offer. In simpler terms, the LOI terms must be accepted as they are rather than with amendments. Or if there are amendments, then these amendments must be accepted too. This is a general requirement for all contracts to be binding and must be satisfied for the LOI to be considered binding.

- For construction contracts to be valid, the UAE Civil Code requires that construction contracts contain details of the project, its type, amount of works, how the works will be done, time for completion and price . Accordingly, and as the LOI is essentially a construction contract, it is essential that, at the very least, the LOI deals with all these points otherwise the LOI could be considered non-binding.

- Other provisions that the parties consider essential. The conditions, of course, would differ from one project to another and would be determined by reference to correspondence exchanged between the parties prior to the signing of the LOI. In the writer's view, these types of essential terms dictated by how the parties view them impose the biggest problem in determining whether the LOI is binding or not due to the amount of correspondence usually exchanged between the parties from tender stage until the signing of the LOI.

- The Qatari Civil Code adopts a similar position to the UAE and requires that a contract contains all of the essential elements in order to be binding. If that contract (or LOI for that matter) leaves certain elements for agreement at a later date but does not stipulate that the contract would not be binding unless agreement is reached on these elements, then the contract will be binding. This is essentially the same position as set out above in respect of the UAE law. Therefore, all that has been said in respect of the UAE remains valid for Qatar.

How to ensure that the LOI is binding?

While legal practitioners would generally advise against using LOIs because of the significant risk they carry, there are some points that the parties should consider incorporating into their LOI if they insist on using it. While not an exhaustive checklist, including the above list of points in an LOI is quite likely to reduce risk in the event that no final contract is signed.
LOIs can be a very useful tool for the fast-paced construction industry allowing projects to progress as fast as possible. However, any contract that is not fully prepared or negotiated will expose its parties to a risk that eventually translates into a loss of money of some sort.

In a perfect world parties should not use LOIs, but since it has somehow become the norm in the construction industry, parties are cautioned to ensure that the LOI they are signing covers as many of the possible terms that govern their contractual relationship in the event that no final agreement is signed. In other words, when agreeing an LOI parties should sign it with the mindset that it might be the only document governing their respective rights and obligations in case of a dispute.

Checklist for a LOI

- Full details of the project and the parties (including ensuring that the parties named on the LOIs would be the parties of the intended final contract);
- Exact scope of works to be carried out by the contractor;
- Duration of the works;
- Contract price and payment method;
- Other major and essential terms of the contract such as sub-contracting, insurance, bonds,defects liability period … etc.
- Atermination provision;
- Aprovision regarding applicable law and dispute resolution method;
- Alist of terms that are yet to be agreed between the parties;
- Areference to a standard form of contract or a specific contractual document to be adopted in case the final agreement is not reached or signed;
- Astatement that the LOI is binding until the date of signing the final agreement.

Heba Osman, Partner
Fenwick Elliott
hosman@fenwickelliott.com

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International issues around the globe

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Contractual pre-conditions to arbitration in England and the UAE

By Jeremy Glover & Heba Osman
Partners, Fenwick Elliott

Under the FIDIC form, whether it is the 1999 Rainbow suite or the 1987 Fourth Edition, which is still used fairly widely in the Middle East today, obtaining a decision from either the Engineer (4th Edition) or a DAB (1999 suite) is generally a pre-condition to a party being entitled to commence arbitration. This can often result in two conflicting questions:

1. What can I do if the other party to the contract refuses to assist in the appointment of the DAB? How do I resolve my dispute if there is no Engineer and no Engineer's decision? Can I go straight to arbitration?
2. Do I have to go through the DAB process? The contract is at an end. Obtaining a decision of the DAB is just an unnecessary duplication of costs

There has been a recent decision in Dubai on this very question, but first a recap of the position in the UK.

England: Peterborough City Council v Enterprise Managed Services Ltd[1]

Here, following completion of a project, where the contract was based on the FIDIC 1999 Form, Peterborough alleged that the plant had failed to achieve the required power output and claimed the Price Reduction. On 6 January 2014, Peterborough issued a letter of claim under the Pre-action Protocol. EMS responded that in accordance with the Contract terms the dispute ought to be referred to a DAB. Mr Justice Edwards-Stuart was therefore asked to consider whether or not the terms of the Contract required a dispute to be referred to adjudication by a DAB first as a pre-condition to any court proceedings. If that was correct, should the court exercise its discretion and order that the Council's proceedings be stayed?

On the first issue the Judge decided that upon a proper interpretation of the Contract, sub-clause 20.8 would only apply to give Peterborough a unilateral right to opt out of DAB adjudication if the parties had agreed to appoint a standing DAB at the outset. Accordingly, given that sub-clause 20.2 provided for ad hoc DAB appointments, the Judge accepted EMS's argument that the Contract required the determination of the dispute through DAB adjudication prior to any litigation. The right to refer a dispute to adjudication arises under sub-clause 20.4 as soon as a DAB has been appointed, whether under sub-clause 20.2 or 20.3.

Peterborough then argued that sub-clause 20.8 provided an opt-out from DAB adjudication but that if reference of a dispute to a DAB was mandatory, the court proceedings should be allowed to continue on the grounds that:

1. what was a complex dispute was unsuitable for a "*rough and ready*" DAB adjudication procedure; and
2. any DAB adjudication would be an expensive waste of time as it was inevitable that the losing party would go to court.

Peterborough submitted that any decision by the DAB would almost inevitably provoke a notice of dissatisfaction from one or other party. Accordingly, to embark on the fairly lengthy (and therefore expensive) adjudication procedure under the contract would be a wholly or at least largely unproductive exercise. The dispute raised complex questions of construction and application of legislation, mandatory codes and standard industry practice and would require extensive disclosure. Therefore the "*rough and ready*" process of adjudication was entirely inappropriate to resolve this dispute.

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However, the Judge noted that this was nothing new: the complexity of a potential dispute about when the required power output was achieved was foreseeable from the outset, yet nevertheless the parties chose to incorporate the adjudication machinery in the FIDIC form of contract. Both parties therefore agreed to the "*rough and ready*" adjudication procedure.

That said, in circumstances where the parties had not yet invested time or money in the DAB adjudication, the Judge was sympathetic to Peterborough's case that the court proceedings should not be supplanted by adjudication. However, the overriding principle, as illustrated by the English legal authorities, clearly showed a presumption in favour of leaving parties to resolve their disputes in the manner they had agreed to in their contract. DAB procedures must be treated as mandatory.

Accordingly, the Judge ordered that the court proceedings were to be stayed.

Dubai: Commercial Case 757 of 2016

The Dubai Court of First Instance in a recent ruling (Commercial Case 757 of 2016 dated 15 August 2016) confirmed the principle that recourse to the Engineer for a decision under clause 67 FIDIC is a pre-condition to the validity of the arbitration. The judgment does not appear to specify which FIDIC Standard Form; however, from reading it appears to be the modified version of the FIDIC Red Book 4th Edition.

Summary of facts

The Claimant in this case is a contractor who entered into a construction contract with the Respondent for the construction of a factory and its associated buildings (the Project). The value of the contract is approximately AED 48 million and the Claimant submitted a performance bond amounting to 10% of the value of the contract. It is understood that the Claimant completed the works and handed over the Project to the Respondent. It is also understood that the Respondent failed to make certain payments to the Claimant and refused to release the performance bond as required under the terms of their contract. However, the judgment does not state the reasons or the grounds on the basis of which the Respondent refused to make

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the payments to the Claimant and/or release the performance bond.

However, on the basis of the Respondent's failure, the Claimant filed an arbitration case in accordance with clause 67 FIDIC before the Dubai International Arbitration Centre (DIAC), which appointed the arbitrator. The parties and the arbitrator then signed terms of reference. It is understood that the terms of reference did not contain any provision indicating that the Respondent waived its right to challenge the arbitral award on the basis that the dispute was not referred to the Engineer; on the contrary, it appears that the Respondent did raise a jurisdictional objection due to the lack of referral to the Engineer. The arbitral award was issued on 9 March 2016 obliging the Respondent to pay the Claimant an amount of AED 7.3 million along with interest, arbitration costs, legal fees, etc.

The Claimant then filed a case before the Dubai Court of the First Instance seeking, inter alia, the enforcement of the arbitral award. The Respondent filed a counterclaim seeking the annulment of the arbitral award.

The Respondent's grounds for the annulment of the arbitral award include the Claimant's failure to refer the dispute for the Engineer's decision in accordance with clause 67 and hence the Respondent submitted that the arbitration was filed prematurely. In particular, the Respondent submitted that clause 67 has set a mechanism for the settlement of disputes which requires that:

1. there be a dispute between the parties;
2. the dispute has not been resolved amicably; and
3. the dispute was referred to the Engineer for a decision to be issued within 84 days from its referral.

The Dubai court decision

Before making its decision, the Dubai court recited the following principles:

1. In accordance with the general principles of contract, arbitration is a contract between the parties and therefore it is permissible for the parties to this contract to include pre-conditions that must be fulfilled prior to arbitration being commenced. As such, if any of these conditions is not satisfied or fulfilled then it is not possible to resort to arbitration. This is in line with the established legal principle that the contract is the law of the parties.
2. The principle that the contract is the law of the parties does not disallow these same parties, either after entering into the agreement or at any time, from expressly or impliedly amending the terms of their arbitration agreement as these agreements are not part of the public order.
3. It is an established principle that the parties to a contract are entitled to decide on the types of disputes in respect of which recourse to arbitration can be made. The parties are not obliged to utilise arbitration for all disputes that may arise between them. Moreover, since arbitration is an exception to the original jurisdiction of the courts, arbitration agreements must be narrowly construed in a manner that does not exceed the intent of the parties.

On the basis of these principles, the Dubai Court of First Instance was of the view that the parties have agreed that certain disputes arising between them may be referred to arbitration and these are the disputes which were (1) referred to the Engineer for a decision but have not become final and binding (clause 67.1) or (2) referred to the Engineer for a decision and have become final and binding but one of the parties failed to comply with the Engineer's decision (clause 67.4). The Court, therefore, concluded that the parties' agreement was that it was essential that a dispute be first referred to the Engineer before the parties can proceed to arbitration.

The Court then ordered the annulment of the arbitral award on the basis that the Claimant has produced no evidence showing that the dispute was ever referred for the Engineer's decision under clause 67.

Commentary

This is a decision from the Dubai Court of First Instance and is therefore still subject to appeal. However, this decision shows a consistency in the Dubai Court's position that clear pre-conditions contained in

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multi-tier dispute resolution clauses must be respected by the parties.

This position, nonetheless, is to be contrasted with a decision from the Dubai Court of Cassation last year in which that Court did not accept a provision requiring amicable settlement to be attempted prior to resorting to arbitration as a pre-condition. In particular, the Dubai Court of Cassation found that if the agreement does not offer guidance as to how this amicable settlement should be approached or set out any specific steps for this amicable settlement, and a party proceeds to arbitration, then it is deemed that the amicable settlement attempts have failed.

The importance of considering the specific requirements of an arbitration clause cannot be overemphasised. It is not in any claimant's interest to commence arbitration proceedings and expend time and money to end up with an annulled arbitration award due to the failure to follow a procedural step, especially when this could have been avoided from the start.

Parties contemplating arbitration should, before commencing any arbitration proceedings, carefully review the wording of the full dispute settlement or arbitration provision contained in their agreement. In particular, a simple check-list would include:

- Ensure that the arbitration agreement itself is binding (i.e. signed by the authorised persons).
- Check if the arbitration agreement can in fact be applied (for example: it actually refers to arbitration rather than to the court).
- Consider carefully the pre-conditions contained in the provision. Is there a requirement to submit the dispute to an Engineer or a Dispute Adjudication Board (DAB)?
- Is there a time limit for submitting the dispute? When can arbitration be commenced?
- Is there a requirement for amicable settlement or referral to senior management following the Engineer's or DAB's decision?
- Is the other party a governmental entity or some other entity subject to a special law that sets specific requirements prior to commencing arbitration?

Whatever the requirements of the arbitration clause, it is quite important to comply with these provisions even if the other party is uncooperative. The question before a court enforcing the arbitral award (or a tribunal considering whether it has jurisdiction or not) is whether the party did attempt to comply with the requirements of the arbitration agreement or not.

Conclusion

Both these cases confirm that DAB and Engineer determination procedures should be treated as mandatory. And if one of the parties tries to frustrate the appointment process, can you still go to arbitration even if there is no Engineer's or DAB Determination? Well you may recall that there is a recent Swiss case, Decision 4A_124/2014, where the Supreme Court agreed that the DAB procedure was mandatory, but at the same time took into account the reasons why there had been no DAB upholding the decision of the Respondent Contractor to go to arbitration and concluding that:

"In this respect, considering the circumstances germane to the case at hand … they cannot be criticized for failing to denounce the Respondent's failure to sign the DAA from the point of view of the rules of good faith. Pursuant to these rules and considering the process of constitution of the DAB, it is indeed impossible to blame the Respondent for losing patience and finally skipping the DAB phase despite its mandatory nature in order to submit the matter to arbitration."


Heba Osman, Partner
Fenwick Elliott
hosman@fenwickelliott.com

Jeremy Glover, Partner
Fenwick Elliott
jglover@fenwickelliott.com

Fenwick Elliott
The construction & energy law specialists

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Enforcement of foreign judgments: location, approbation, reprobation

By Jonathan More
Senior Associate, Fenwick Elliott

The recent case of *Golden Endurance Shipping SA v RMA Watanya SA and others* [2016] EWHC 2110 (Comm) provides a useful reminder of the principles surrounding the question of whether or not a party has submitted to a foreign jurisdiction in respect of a judgment in non-EU court proceedings.

Background

In the Golden Endurance case, a shipment of cargo to Morocco was found to be damaged and subject to a cargo claim in the Moroccan courts by the recipient's insurers ("*the insurers*"). Golden Endurance Shipping ("*GES*"), however, disputed that the Moroccan courts had jurisdiction as each of the three bills of lading contained a London arbitration clause.

Parallel proceedings then unfolded in London and Morocco.

Arbitration proceedings were commenced in London by GES against the cargo recipient and the insurers arising from one of the bills of lading ("*the Lome bill*"). In these proceedings:

(i) An injunction was granted restraining proceedings in relation to that Lome bill taking place anywhere else other than before arbitrators in London;

(ii) A jurisdictional challenge raised by the insurers in respect of the cargo carried under the other two bills of lading was dismissed; and finally

(iii) An application for injunctive relief in respect of the Moroccan proceedings, insofar as they related to the cargo under the other two bills, was refused.

Within a couple of months the Moroccan court awarded the insurers damages in respect of the cargo carried under these two bills.

GES referred the following preliminary issue to the Commercial Court in England:

Should the Moroccan judgment be recognised by the court so that GES was stopped from pursuing its claim for a declaration of non-liability?

Underpinning this issue was the question of whether or not GES had submitted to the jurisdiction of the Moroccan courts, or should be treated as having done so as a consequence of its conduct in the English proceedings. The insurers argued that GES had not made a jurisdictional challenge in the Moroccan proceedings. They said that the submission that the dispute should be referred to arbitration was a procedural defence and further that GES had lodged a substantive defence as to the merits. Finally insurers said that the argument that GES submitted in the English proceedings was different from that it put forward in the Moroccan court, which was an abuse of process.

Decision

In short it was held that the judgment from the Moroccan court was not entitled to recognition by the English courts. The clear primary argument of GES in those proceedings had been that they should be dismissed due to the London arbitration clauses. There was no abuse of process in challenging the jurisdiction of the Moroccan proceedings as there was no inconsistency of positions between the two cases.

Key principles

Jurisdiction v admissibility

An interesting sub-plot in the hearing related to the status of Moroccan law, and the distinction it made between jurisdictional challenges and admissibility challenges.

A jurisdictional challenge focuses on the court's ability to hear the case in question and requires the relevant party to request the transfer of proceedings to another court. A transfer to an arbitration tribunal was not possible.

An admissibility challenge focuses on the other party's right to bring the claim itself. This required the court to consider the merits of the case in order to properly reach a decision on the point. To this extent GES had taken the action it required (i.e. using the only option open to it) in order to make the challenge it did.

Court discretion

Notwithstanding these facts, the insurers argued that the court had the power to consider other relevant facts and exercise discretion in deciding whether or not GES had in fact submitted to the Moroccan jurisdiction.

Mr Justice Phillips held that it was the role of the court, in reaching a decision on such matters, to consider both the facts and the issues of law. This is not an exercise of discretion, simply an analysis of the relevant material issues that allows the court to come to a conclusion.

Approbation and reprobation

The insurers argued that the fact that GES had issued proceedings in England without referencing that two of the bills of lading had arbitration clauses meant it had taken a conflicting and inconsistent position with regard to the case in Morocco. In other (more legal) words, the fact that the dispute should be heard in arbitration proceedings was an example of approbation and reprobation.

Approbation and reprobation describe the scenario where a party takes an inconsistent position in proceedings. This is not permitted. Further, once a party takes a particular stance it cannot revert to the previous adopted position.

It can sometimes be the case that there is tension between the positions adopted by a party where parallel proceedings take place in different jurisdictions governed by different laws. Here the Judge found that whilst there was indeed some tension between GES's positions in both proceedings, those positions were not entirely at odds. There was no "*blatant inconsistency*" which is what would cause the court to prevent a party from relying on the position it had undoubtedly properly adopted in the foreign proceedings.

Commentary

The ever increasing globalisation of doing business makes such cross-border/jurisdiction issues likely to continue to feature in the courts. Bills of lading, and letters of credit for example, in respect of which we have recently been involved in a dispute spanning three jurisdictions, are commonplace within the construction industry, and are the sort of instruments that might be particularly subject to such issues.

What was shown in this case was a practical approach and a healthy degree of pragmatism. Equally it is clear that, as ever, the particular facts and circumstances of a case will be determinative as to the decision.

Jonathan More, Senior Associate
Fenwick Elliott
jmore@fenwickelliott.com

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International Quarterly

News and events

Trends, topics and news from Fenwick Elliott

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This edition

This edition once again focuses on a number of issues relevant to international arbitration. We look at two recent but important cases from the courts. In England, the Commercial Court has held that third-party costs were recoverable in principle in arbitration proceedings, whilst in Dubai, the Commercial Court has been reviewing whether or not an Engineer's decision under clause 67 of the 1987 FIDIC Red Book, is a pre-condition to arbitration. Staying in the UAE, we look at the use there of Letters of Intent. Good faith is part of the UAE Civil Code, but it is not, as we discuss, something which is likely to be implied into contracts based on English law. Finally in a follow up article, we take a deeper look at the growing emphasis across the globe, on ensuring that corruption and bribery are eliminated.

Upcoming events

Fenwick Elliott collaborate with R.I.C.S.

As members of the Royal Institute of Chartered Surveyors, we collaborate several times a year to host a CPD event. Ahmed Ibrahim and Heba Osman spoke on the topic of "*Letters of Intent*" which was held in Dubai and Abu Dhabi on 26 and 27 September. The seminars covered; Pros and cons of Letters of Intent, binding contracts and check-list terms for a binding Letter of Intent.

We frequently offer in-house training/talks for our clients on a wide range of legal topics. If you would like more information about these talks, please contact Jeremy Glover, jglover@fenwickelliott.com.

Legal Disputes in the Middle East

This CIOB CPD event was delivered by Fenwick Elliott on 28 September, the first of 2 events, the second taking place on 23 November 2016 and will cover:

- Fundamentals of the Civil code in relation to contracts
- Commercial Code v Civil Code and relation to Construction Contracts
- Commencement, delays and completion
- Penalty damages
- Breach Damages and loss of profit

Please contact CIOB www.ciob.org, if you would like to attend.

International Construction Disputes 2016

This original conference brings together leading experts in international construction disputes from some of the most reputable international construction law practices. These experts are joined by representatives from organisations such as FIDIC and ICC to brief you on the latest approaches to successfully handling disputes, claims, dispute boards, ADR, termination issues and much more besides.

Nicholas Gould and Jeremy Glover will be speaking 4 October on the topic of "*Mediation & Conciliation*", covering the following points:

- The three pillars of dispute resolution;
- A brief guide to the types of ADR available;
- How appropriate are these techniques for international projects?;
- What does the FIDIC form say?;
- Preventing contested claims from becoming disputes in the first place;
- Ingredients for successful mediation/ conciliation.

Nicholas will also be part of the panel session "*Managing disputes and effective ways to avoid arbitration: view from industry experts*"

FIDIC Africa Contract Users' Conference 2016

Nicholas Gould and Jeremy Glover will be speaking at the essential annual update on the latest developments in FIDIC contracts, 11 October in Nairobi, on the topic of "*Managing claims under FIDIC: the road to dispute avoidance*"

This session will discuss ways to try to avoid claims arising in the first place but then, if they do, how to present and pursue a claim under a FIDIC Contract with particular reference to the following topics:

- How to minimise claims from Day 1 of your project;
- Preventing contested claims from becoming disputes;
- Putting your claim together;
- Getting your notice of claim right;
- What is a fully detailed claim?;
- The differing approaches under civil codes and the common law;
- Dealing with the FIDIC time bar;
- The Engineer's obligations

As you may know Fenwick Elliott is expert in FIDIC contracts, including in a civil law environment. Both Nicholas Gould and Jeremy Glover are experts in their field and are regularly invited to talk at major FIDIC conferences such as this one.

We advise on a large number of projects under the FIDIC form of contract around the world, from airports in Asia to hospitals in Africa.

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.

International Quarterly is produced quartely by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.

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Edited by Jeremy Glover, Partner, Fenwick Elliott LLP
jglover@fenwickelliott.com Tel: + 44 (0) 207 421 1986
Fenwick Elliott LLP
Aldwych House, 71-91 Aldwych
London , WC2B 4HN
www.fenwickelliott.com