SQUIRE PATTON BOGGS

Construction Matters

August 2016 Edition

In this month's edition of Construction Matters:

Laing O'Rourke Australia Construction Pty Ltd v Samsung C&T Corporation

Although it is recognised that adjudicator's determinations under the Construction Contracts Act 2004 (WA) (**CCA**) are not reviewable for errors of law, recent Supreme Court decisions have suggested adjudicators may commit jurisdictional errors by misidentifying or misapplying the terms of the construction contract when determining a payment dispute.[1] In its recent decision in *Laing O'Rourke Australia Construction Pty Ltd v Samsung C&T Corporation*,[2] the Western Australian Court of Appeal has:

a) Limited the scope of judicial review of adjudication determinations by finding that the purpose and objectives of the CCA ensure that "an adjudicator will not exceed jurisdiction…merely because he or she misconstrues the contract or makes an error in the application of its terms to the facts"; and

b) Clarified the extent of enquiries to be made by courts when an application for leave to enforce a determination under section 43 of the CCA is made.

Key Takeaway

The key point to be taken from this decision is that an adjudicator does not commit a jurisdictional error by misconstruing the terms of a construction contract or misapplying these provisions to the facts. The findings of the Court of Appeal in this regard are likely to be significant to principals and contractors as the scope of adjudication determinations liable to being judicially reviewed for jurisdictional error will be substantially reduced.

Background

Progress Claims

Samsung C&T Corporation (**Samsung**) engaged Laing O'Rourke Australia Construction Pty Ltd (**LORAC**) in relation to "port landside work" on the Roy Hill Project (**Subcontract**).

In January, LORAC submitted a progress claim for AU$43,443,517 for works performed in the preceding month (**January Progress Claim**). Samsung issued a response to the January Progress Claim (described as an "assessment"), which assessed AU$16,954,744 as payable by Samsung. However, on the day Samsung was obliged to formally respond to the January Progress Claim by issuing a Progress Certificate, Samsung terminated the Subcontract.

The parties entered an "interim deed" to govern the transition of the Works post-termination. Pursuant to the interim deed, Samsung was required to pay LORAC AU$45 million on account.

LORAC subsequently submitted a claim for AU$54,713,156.47 under the Subcontract's compensation provisions, which had been activated by the Subcontract's termination (**February Progress Claim**). The February Progress Claim was rejected by Samsung.

The payment disputes that arose after Samsung's partial disputation of the January Progress Claim and rejection of the February Progress Claim were referred to adjudication under the CCA by LORAC. The adjudicator determined that the following amounts were payable by Samsung under the Subcontract:

a) AU$20,965,076 in relation to the January Progress Claim (**First Determination**).

b) AU$23,175,442.01 in respect of the February Progress Claim (**Second Determination**).

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1 *Laing O'Rourke Australia Construction Pty Ltd v Samsung C & T Corp* [2015] WASC 237; *BGC Construction Pty Ltd v Citygate Properties Pty Ltd* [2016] WASC 88.

2 [2016] WASCA 130.

Supreme Court Decision

LORAC applied to the Supreme Court for leave to enforce the First and Second Determinations and Samsung sought judicial review of the Determinations. These applications where heard together by Justice Mitchell, who held that:

a) In both the First and Second Determinations, the adjudicator misapprehended the nature of his statutory function under the CCA by failing to determine the payment disputes by reference to the terms of the Subcontract.

b) Accordingly, each determination ought to be quashed for jurisdictional error; and

c) Leave to enforce the First and Second Determinations should be refused because:

- The determinations were invalid; or
- The on account payments made under the Interim Deed satisfied the liabilities created by the First and Second Determinations.

Appeal

Justice Mitchell's principal decision was appealed to the Court of Appeal by LORAC. As when originally heard by Justice Mitchell, there were three primary issues:

a) Whether the First Determination ought to be quashed because there was no payment dispute.

b) Whether the adjudicator failed to exercise his statutory jurisdiction in the First and Second Determination by adopting illogical or irrational reasoning.

c) Should leave to enforce the First and Second Determination be a) refused for the reasons outlined by Justice Mitchell.[3]

Decision

The Court upheld LORAC's appeal against the principal decision to quash the First and Second Determinations, but dismissed the appeal regarding the decision to refuse leave to enforce the determinations. The leading judgement was delivered by Chief Justice Martin.

Jurisdictional Error

The key conclusion reached by Chief Justice Martin was that an adjudicator will not exceed his or her jurisdiction simply by misconstruing the construction contract or applying the facts to the contract erroneously. In this regard, it was emphasised that:

a) The adjudication process involves a trade-off between "contractual and legal precision" and "speed and efficiency" such that it is expected that adjudicators will make errors in determining whether a party to a payment dispute is liable to make a payment on the balance of probabilities; and

b) Payments made under a determination are on account only and subject to adjustment after the parties' rights are finally determined.[4]

The Court of Appeal considered recent High Court authorities regarding jurisdictional error and noted that the current approach is to identify the scope of a decision maker's jurisdiction by first construing the statute conferring jurisdiction before determining whether the actions of the decision maker have taken them outside this jurisdiction. Although it was considered that an adjudicator would commit jurisdictional error by taking no account of the construction contract whatsoever, the purpose of the CCA leads to the conclusion that errors construing the contract or applying its terms are not jurisdictional errors liable to be quashed upon judicial review.

Crucially, it was determined that even if the adjudicator had made the errors alleged (which was not found), such errors could not take the adjudicator outside of his jurisdiction under the CCA. Accordingly, Chief Justice Martin determined that Justice Mitchell's decision to quash the First and Second Determinations ought to be overturned.

Timing of Payment Disputes

Chief Justice Martin agreed with Justice Mitchell that the proper interpretation of section 6(a) of the CCA is that a payment dispute arises at the point in time where the amount claimed has not been paid in full by the due date for payment or the payment claim is rejected or partially disputed.[5]

Although this same conclusion was reached by President McLure, her Honour preferred a different construction of section 6(a) of the CCA. In particular, she held that the word "due" in section 6(a) meant "earned in the sense of having an entitlement…to lodge a payment claim" under the relevant construction contract.[6]

Enforcement Process

Although Chief Justice Martin noted that the enforcement provisions under the CCA do not permit a court to undertake a de novo review of an adjudicator's determination, it was held that courts are not simply limited to ascertaining whether a determination had been made.[7] Although the extent of a court's jurisdiction under section 43 of the CCA was stated to depend upon the circumstances of the case, here it was sufficiently broad to consider whether the liability created by the First and Second Determination had been discharged by the on account payments made pursuant to the Interim Deed.[8]

Chief Justice Martin agreed with Justice Mitchell's construction of the Interim Deed such that the liabilities created by the First and Second Determinations were liabilities that fell within the scope of the Interim Deed.[9] In other words, it was held that Samsung's payments under the Interim Deed satisfied its obligation to pay the amounts payable under the First and Second Determinations.

3 Ibid, [54]

4 Ibid, [107].

5 Ibid, [78] and [89].

6 Ibid, [204].

7 Ibid, [141].

8 Ibid, [148].

9 Ibid, [161].

Unfair Contract Terms – Time to Audit your Construction Contracts

In the course of contracting in the construction industry, it is not unusual for contractors to enter into arrangements where the risk allocation is so heavily weighted in favour of one party (usually principals or head contractors) that parties with a weaker bargaining position have no option but to agree to contract terms that would generally be considered unfair. Smaller contractors are particularly vulnerable to these terms, particularly in the current market.

Such vulnerability is at the heart of the recent amendments to the Australian Consumer Law (**ACL**) by way of the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (Cth) which also amends the Australian Securities and Investment Commission Act 2001 (Cth) (in relation to financial products and service contracts).

These amendments apply to small businesses. They extend certain protections with respect to unfair terms in standard form contracts, so as to "reduce the incentive to include and enforce unfair terms in small business contracts, providing a more efficient allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts".[1]

These new protections are of particular significance to those in the construction industry who contract with smaller subcontractors or are party to consultancy agreements, minor works contracts and low value supply contracts.

Scope of Protections

Once these amendments come into effect on 16 November 2016, a term of a "small business contract" will be deemed void if:

a) The protections apply to the relevant contract

b) The term is considered unfair; and

c) The contract is a standard form contract.

What is Small Business Contract?

The new protections will only apply to contracts:

a) For the supply of goods and services (including construction and related contracts)

b) Where at least one party to the contract employs less than 20 people (not including casual employees unless employed on a regular and systematic basis); and

c) The upfront price payable under the contract is AU$300,000 or less (for contracts less than 12 months long) or AU$1,000,000 (for contracts longer than 12 months).

The value of the upfront price of a contract is to be calculated based on the consideration provided or to be provided for the supply under the contract and does not include any other consideration contingent on the occurrence or non-occurrence of a particular event.

Unfair Terms

A term of a "small business contract" will be considered unfair if it:

a) Causes a significant imbalance in the parties' rights and obligations under the contract

b) Is not reasonably necessary to protect the legitimate interests of the party advantaged by the term; and

c) Will cause detriment (financial or otherwise) to the vulnerable party if enforced.

What is a Standard Contract?

Under the ACL, a contract is presumed to be a "standard form contract" unless otherwise proven. Although "standard form contracts" is not defined, it is clear that the protections will apply beyond the usual unamended standard form contracts common in the construction industry, with a variety of factors to be considered in determining whether a contract is a standard form for the purposes of the legislation.[2]

In particular, a contract is likely to be considered a "standard form contract" where there is an inequality of bargaining power between the parties and the terms of the contract are offered by the stronger party on a "take it or leave it" basis.

Enforcement of Protections

Although it is not an offence to include unfair terms in small business contracts, small businesses and the ACCC will be entitled to apply to the Federal Court to declare that a term of a small business contract is an unfair term. If a term is found to be unfair, the consequences may include:

a) The unfair term being rendered unenforceable; or

b) The entire contract may be considered void where the unfair term cannot be severed from the contract, meaning the risk of claims for quantum meruit or restitution may arise.

Eligible parties may also apply for:

a) The grant of an injunction restraining the enforcement of an unfair term of a contract; and

b) Compensation orders against a contract party seeking to enforce the unfair term.

[1] Explanatory Memorandum - Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015, http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r5497

[2] ACL section 27(2).

Implications of the Reform

This new regime has the potential to render unenforceable, a number of clauses common in contracts in the construction industry. For example:

a) Terms that permit a party to unilaterally vary "the characteristics of the goods or services to be supplied" under a contract are identified in the ACL as an example of a potentially unfair term.

b) Time bars and monetary caps may potentially fall foul of the unfair term regime as they tend to be imposed on one party to the contract (creating an imbalance) and, if relied upon, cause a detriment by restraining a party's entitlement to make claims for time or money; and

c) Liquidated damages clauses which are not considered penal on the test in Andrews v ANZ, may nevertheless be rendered unenforceable as unfair because the standard required to be considered unfair is arguably lower than the standard for a penal clause.

Key Takeaways

To limit exposure to the new protections extended to small businesses, principals and contractors are encouraged to immediately:

a) Undertake a review of their contracting practices and systems to determine whether any of their existing standard contracts contain terms which may be considered unfair under the new regime.

b) Take steps to amend any non-compliant standard contracts; and

c) Consider the implications of these new amendments in respect of contractual arrangements up the contracting chain, especially in the case of "back to back" contractual provisions.

Further Information – Seminar on Unfair Contract Terms

On the evening of 25 August 2016, Emily O'Mahony and Eu-Min Teng of our Perth office will be presenting on the unfair contract term legislation. The speakers will consider the impact of the amendments on the drafting of construction contracts, as well as the potential back-end implications of the regime for contractors and principals. Further information regarding the event and how to register is available here.

Update on Choice of Law Clauses Part Two: New York, New York

In our last edition of Construction Matters in June 2016, we reported on the litigation conducted in the Victorian Supreme Court involving Lew Footwear Holdings Pty Ltd (**Lew**) and Madden International Limited (**Madden**).

Lew had commenced proceedings in Victoria under the Trade Practices Act 1974 (Cth) and the Australian Consumer Law in breach of choice of law and forum selection clauses contained in a Licence Agreement between the parties. Despite this, Justice Elliot of the Victorian Supreme Court refused Madden's application for a stay of the proceedings on the basis that Australian public policy ensured that a forum selection clause would not be a proper basis for staying proceedings in circumstances where:

It was established that an overseas corporation engaged in misleading or deceptive conduct, and a plaintiff could establish that such conduct was committed within Australia or caused damage suffered wholly or partly in Australia; and

There was a real risk that the misleading and deceptive conduct claim would be dismissed without consideration in the foreign forum because there was no equivalent law in that jurisdiction.

However, the Australian litigation was only the first round of the dispute between Lew and Madden. After the Victorian Court of Appeal rejected Madden's appeal of Justice Elliot's decision, Madden sought a temporary restraining order preventing further steps from being taken in the Australian litigation from a New York court.

New York Litigation

In January 2015, Madden commenced proceedings in the Supreme Court of the New York County, seeking a temporary restraining order preventing further steps being taken in the Australian litigation, and to prevent further litigation being commenced outside of the New York, Queens or Nassau counties.

Among other submissions, Madden argued that a restraining order ought to be granted because it would suffer irreparable harm if it were forced to litigate matters within the scope of an exclusive forum selection clause in a different forum. Madden also argued that Lew was seeking to avoid the application of New York law altogether or, at the very least, to ensure that Australian courts would be applying New York law, despite being "unfamiliar with its nuances."

In response, Lew argued that Madden could not establish irreparable harm because of its delay of almost 2 years in seeking relief from a New York Court. Lew also argued that Madden had waived its right to rely on the forum selection clause and that public policy, and the principles of international comity, required the decision of the Australian court to be upheld.

On 15 January 2016, Justice Saliann Scarpulla upheld the choice of law and forum selection clauses and granted a preliminary injunction preventing further prosecution of the proceeding commenced in the Victorian Supreme Court and the application for an anti-suit injunction, as well as preventing Lew from commencing further proceedings in breach of the choice of law and forum selection clauses of the Licence Agreement. Relevantly, it was determined that:

a) The balance of equities supported Madden's position, because the potential harm of becoming open to potentially unforeseen foreign statutes was greater than the inability of Lew to obtain relief under the TPA or ACL.Madden had not waived its rights in relation to the choice of law clause by defending its position in the Australian litigation.The principles of international comity did not require the New York court to follow the decision of the Australian Court that it may void the choice of law and forum selection clauses; and

b) The public policy of New York courts is to protect "New York based corporations' New York contractual forum selection and New York choice of law provisions."1

Key Takeaways

The key lesson drawn from the Australian litigation was that public policy and other considerations may potentially influence Australian courts to override an exclusive forum selection clause providing for proceedings in non-Australian jurisdictions.

The opposite point may be taken from the New York litigation. Australian principals and contractors who contract with foreign corporations and accept foreign choice of law and foreign selection clauses must be aware of the real risk that even where the Australian courts decide to ignore an exclusive forum selection clause, non-Australian courts may not necessarily uphold the public policy position of Australian courts and may instead uphold these clauses.

Parties who accept such clauses are likely to lose remedies that may have otherwise been available to them under Australian law, such as those available pursuant to the *Australian Consumer Law*. Accordingly, parties should only agree to foreign choice of law clauses and forum selection clause where they are willing to submit to the jurisdiction of the specified country.

More generally, the Lew and Madden dispute highlights the significant costs (in terms of both money and time) that will be expended where a dispute arises regarding the appropriate forum for the determination of claims. To prevent such unnecessary expenditure of resources, parties should:

a) Ensure choice of law and forum selection clauses are properly drafted; and

b) As far as possible, ensure proceedings are not commenced in breach of such clauses.

1 *Madden International, Ltd.v Lew Footwear Holdings Pty Ltd, 50 Misc.3d* 1210(A), 1217 (NY, 2016).

Samsung C&T Corporation v Duro Felguera Australia Pty Ltd

Justice Le Miere's recent decision in *Samsung C&T Corporation v Duro Felguera Australia Pty Ltd*[1] is the latest episode in the dispute between Samsung C&T Corporation (**Samsung**) and Duro Felguera Australia Pty Ltd (**Duro**) in relation to the Roy Hill Project. Previously, the litigated dispute concerned whether Samsung was entitled to have recourse to bank guarantees provided by Duro.

In this case, Duro was successful. The way is clear for its claims, which Samsung sought to be resolved by litigation, to be referred to international arbitration in Singapore.

Key Takeaways

The key principles that may be taken from the decision of Justice Le Miere are as follows:

a) For a stay to be granted under section 7 of the Act, Australian courts are likely to adopt the English position that the necessary requirements must be established on the balance of probabilities.

b) Jurisdiction clauses are not necessarily inconsistent with arbitration agreements; and

c) Where parties have included both jurisdiction clauses and arbitration agreements in a contract, whether the parties have validly submitted to arbitration is a question of construction.

1 [2016] WASC 193.

Facts

Samsung entered a Subcontract with an unincorporated joint venture of Duro and Forge Group Constructions Pty Ltd (**Forge**). The Subcontract contained an arbitration agreement providing for arbitration in Singapore. Upon Forge's insolvency, the Subcontract was terminated by Samsung. Samsung and Duro subsequently executed a Term Sheet in relation to Duro's remaining scope under the Subcontract (**Interim Subcontract**). The Interim Subcontract was entered on the same terms as the Subcontract, as amended by the terms of the Term Sheet, which contained a governing law clause and a jurisdiction clause, but no separate arbitration agreement.

In responding to Samsung's notice of arbitration, Duro made offsetting claims against Samsung, some of which arose under the Interim Subcontract (**Duro Claims**). Samsung sought a declaration from the Supreme Court of Western Australia (**SCWA**) that:

a) There was no binding arbitration agreement covering the Duro Claims under the Interim Subcontract; and

b) The jurisdiction clause in the Term Sheet covered the Duro Claims and that the SCWA is an appropriate forum to determine such claims.

Samsung argued that there was no arbitration agreement in the Interim Subcontract because the inclusion of the jurisdiction clause fundamentally changed the dispute resolution mechanism contained in the Subcontract from arbitration to litigation.

Duro opposed Samsung's argument on the basis that the Interim Subcontract contains an arbitration agreement by reason of the arbitration clause in the Subcontract. Accordingly, it sought the proceedings initiated by Samsung to be stayed pursuant to section 7 of the International Arbitration Act 1974 (Cth) (**Act**).

The International Arbitration Act

Section 7 of the Act creates a mandatory stay procedure whereby an Australian court must stay proceedings where it applies. The arbitration agreements to which the section applies are set out in section 7(1) of the Act and section 7(2) provides the circumstances where a court must stay proceedings, namely where:

a) Proceedings are instituted by a party to an arbitration agreement to which section 7 applies; and

b) The proceedings are within the scope of the arbitration agreement and capable of settlement by arbitration.

There is a general principle of arbitral law, known as "competence-competence", providing that an arbitral tribunal has the power to determine its own jurisdiction. However, the enquiries undertaken by a court when determining whether to grant a stay under section 7 of the Act require the court to form a view as to the existence and scope of an arbitration agreement; in other words, the tribunal's jurisdiction. Justice Le Miere identified a threshold issue in this case, being the standard of review a court should apply when considering such matters.

The arbitration-friendly Singaporean courts have applied a test that, if it is satisfied on a prima facie standard that the conditions for a stay exist, the stay will be granted.[2] English courts, however, have required the court to be satisfied that the conditions for a stay to have in fact been met.[3]

Decision

In relation to the threshold issue, Justice Le Miere applied the full merits approach adopted by English courts. In this regard, he considered a decision of the Federal Court which considered a substantially similar provision in the Commercial Arbitration Act 2010 (NSW).[4] Justice Le Miere characterised the case as one in relation to whether an arbitration agreement existed rather than whether the scope of an arbitration agreement covered certain claims. In the circumstances, he considered it proper to determine this question on the balance of probabilities. However, it may be arguable that the approach adopted by the Singaporean courts may apply where the question is to the scope of an arbitration agreement rather than its existence. The Duro Claims clearly fell within the scope of the arbitration agreement, meaning the central issue was whether the Interim Subcontract contained an arbitration agreement. For the following reasons, Justice Le Miere preferred Duro's argument that the arbitration agreement from the Subcontract applied to the Interim Subcontract:

a) The provision incorporating the terms of the Subcontract into the Interim Subcontract was properly construed as providing that the Subcontract was only modified to the extent it was inconsistent with the Term Sheet.[5]

b) The jurisdiction clause in the Term Sheet was not inconsistent with the arbitration agreement because:

   i) The proper interpretation of the jurisdiction clause is that the parties submit to the jurisdiction of Western Australian courts in relation to proceedings that may be commenced consistently with the arbitration agreement (e.g. enforcement proceedings or urgent interlocutory applications);[6] and

   ii) The ordinary and natural meaning of the jurisdiction clause is that the parties submit to the jurisdiction of Western Australian courts in respect of relevant proceedings.7It would be commercially inconvenient if disputes concerning work under the Subcontract were referred to arbitration and the continuation of work under the Interim Subcontract must be resolved by litigation.[8]

Accordingly, Justice Le Miere found that the Duro Claims were within the scope of an arbitration agreement between the parties, granted a stay of the proceedings and referred the parties to arbitration.

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2 *Tomolugen Holdings Ltd v Silica Investors Ltd* [2015] SGA 57.

3 *Golden Ocean Group Ltd v Humpuss Intermoda Transportasi Tpk Ltd* [2013] EWHC 1240.

4 *Rinehart v Rinehart* (No 3) [2016] FCA 539.

5 [2016] WASC 193 [58]-[59].

6 [2016] WASC 193, [68 (Le Miere J).

7 [2016] WASC 193, [69] (Le Miere J).

8 [2016] WASC 193, [70] (Le Miere J).

Upcoming Seminar and Networking Drinks

Unfair Contract Terms Legislation – Overview and Impact on the Construction Industry.

Thursday 25 August, 5 – 7 p.m.

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