MAEDA V BAUER: THE LONG AND WINDING ROAD

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The Court of Appeal's decision in Maeda Kensetsu Kogyo Kabushiki Kaisha also known as Maeda Corporation and another v Bauer Hong Kong Limited [2020] HKCA 830

Summary

We have previously written about the Court of First Instance's decision in Maeda Kensetsu Kogyo Kabushiki Kaisha also known as Maeda Corporation and another v Bauer Hong Kong Limited [2019] HKCFI 916, which concerns an appeal against an arbitrator's decision on the issue of compliance with notice provisions in a sub-contract.

The Court of First Instance (CFI) held that a sub-contractor who had submitted notices of claim but subsequently succeeded on a different contractual basis in the arbitration, had failed to comply with the notice provisions of a sub-contract. The Court of Appeal (CA) has affirmed the CFI decision. It is understood that the case may now to go to the Court of Final Appeal (CFA).

The construction industry lobbied hard for the inclusion of Schedule 2 into the Arbitration Ordinance, one of the main features of which is to provide a right of appeal from a tribunal's decision to the courts. Opinions have always differed between whether businesses prefer domestic construction arbitration to be final and binding, or there should be limited rights of appeal to the courts. Most local construction contracts currently seem to incorporate Schedule 2 and to include the right of appeal. However, this is not always the case, and some vary or exclude the right of appeal.

Aside from whether the CFA will agree with the courts below on the legal (but important) issue of notice, one of the unintended and potentially more far-reaching consequences of the Bauer case is

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inevitably going to be to question the wisdom of continuing to agree to a right of appeal to the courts, allowing the decision of an arbitrator to be delayed for years and be overthrown on a narrow point of law.

For, after what must be many millions of dollars in costs, enough documents to kill several forests, piles of witness statements and expert reports, weeks or months of technical evidence, and probably a lengthy and closely reasoned award by one of the world's most eminent construction arbitrators, the parties have still not achieved a final result, and we are but poised for a third appeal.

Consequently, will parties to construction contracts be more likely to leave the ultimate decision in the hands of specialist construction arbitrators in future? Especially in a subcontract?

We think that everyone will have to think at least twice.

The root of the problem is probably that the parties can never know the quality of the arbitrator that they might get when they sign the contract (particularly in the case of a sole arbitrator, which is the norm in Hong Kong), and so err on the side of caution and include the right of appeal as a safety net. However, if they knew that an arbitrator like Sir Vivian Ramsey QC would be appointed, how many would leave open the prospect of multiple appeals through the entire court system?

Turning now to the decision.

Background

As you may recall, the JV was the main contractor in one of the MTRC Express Rail Link projects. It entered into a sub-contract with Bauer to carry out excavation and installation of diaphragm wall works.

Various disputes arose from the sub-contract works. Bauer made claims for unanticipated ground conditions and issued notices to the JV to claim additional payment. It relied on clause 21.1.6 of the sub-contract, claiming a variation in respect of the ground conditions. However, when the parties went to arbitration, Bauer included an alternative basis of claim, i.e. a "like rights" claim pursuant to clause 21.1.1 of the sub-contract, by claiming that the unanticipated ground conditions also entitled the JV to additional payment and loss and expense under the Main Contract.

The notice provisions of the sub-contract expressly required Bauer to state the contractual basis of claim in the relevant notice and give notice within 14 days of occurrence of the event giving rise to the claim became apparent. Compliance with the notice provisions was a condition precedent to any additional payment[1].

It was not in dispute that no reference was made to the "like rights" claim in all notices submitted by Bauer to the JV. The question was whether Bauer was considered in compliance with these notice provisions in the circumstances.

The Arbitrator looked at the question with a purposive approach. He observed that:

"Firstly, to expect a party to finalise its legal case within the relatively short period and be tied up to that case through to the end of an arbitration is unrealistic. Secondly, what was most important from the point of view of the Main Contractor was to know the factual basis for the claim so that it could assess it and decide what to do."

He concluded that the contractual basis of the claim stated in the notice did not have to be the same contractual basis on which the party in the end succeeded in an arbitration. He held that Bauer had complied with the notice provisions.

Court of First Instance

The JV appealed against the arbitrator's decision[2]. M Chan J of the CFI disagreed with the arbitrator. In the Judge's view:

1. The notices submitted by Bauer stated that the contractual basis of the claim was variation under clause 21.1.6 of the sub-contract. There was no basis to find that Bauer had complied strictly with the notice provisions in relation to any "like rights" claim under clause 21.1.1 of the sub-contract. Bauer had failed to give proper notices as required by the sub-contract and was not entitled to the additional payment claimed.
2. The sub-contract used clear and mandatory language for the service and contents of notice without any qualifying language. There was no basis for a court or tribunal to rewrite the notice provisions of the sub-contract for the parties after the event.

Court of Appeal decision

Dissatisfied with the CFI's decision, Bauer brought the matter to the CA[3]. Bauer's appeal centred around the interpretation of the notice provisions and the commercial purposes underlying them. The

[1] The relevant sub-contract clause is set out in the Appendix to the CA's judgment.

[2] The appeal to CFI also involved another question of law regarding valuation of variations. See our previous article.

[3] Leave to appeal to the CA was only granted in respect of the notice issue.

three judges (Kwan V-P, Yuen JA and Barma JA) unanimously dismissed the appeal.

In relation to the interpretation of the notice provisions, the CA held that:

1. According to the plain wording of the notice provisions, the relevant notice must cover three things: the contractual basis, full and detailed particulars and the evaluation of the claim. Where the relevant event had a continuing effect or where Bauer was unable to determine if any event would be continuing, the sub-contract allowed further submissions to be made in respect of the particulars and evaluation of the claim. Such allowance did not extend to amending or substituting the contractual basis of claim.

2. The wording of the notice provision was clear and unambiguous. Within the stipulated time, Bauer was required to give notice of the contractual basis (i.e. the "like rights" claim under clause 21.1.1), not any possible contractual basis which may turn out not to be the correct basis (i.e. the variation claim under clause 21.1.6).

3. There was no justification to give the notice provisions a narrow construction by applying the principle that "parties do not normally give up valuable rights without making it clear that they intend to do so". In construction contracts, exemption clauses should be seen as part of the contractual apparatus for distributing risk and there should be no pre-determined mindset to cut them down.

The CA also considered that the arbitrator's interpretation would undermine the commercial purposes of the notice provision to:

1. achieve finality, as a claim can be advanced on a different contractual basis in an arbitration which may be years down the line.

2. allow the contractor to know whether the sub-contractor's claim would need to be passed up the line.

As regards this last point, the judgment does not rehearse the submissions of the parties in detail or indicate how deeply the court considered the issue of the commercial purposes of this notice provision.

IN A SITUATION LIKE BAUER WHERE A SUBCONTRACTOR HAS A "LIKE RIGHTS" ENTITLEMENT, THIS MAY BACKFIRE SINCE THE MAIN CONTRACTOR MAY NOT BE ABLE TO RECOVER THE SUBCONTRACTOR'S SHARE IF THE EMPLOYER CAN SHOW THERE IS A DEFECT IN THE SUBCONTRACTOR'S NOTICE.

It is unclear for example whether there was evidence that the main contractor had not passed the claim up the line, or, for that matter, received payment. If the main contractor had been paid in respect of the "like rights" claim, then the logic of the court's ruling is that the main contractor might not have been entitled to such payment.

Conclusion

In drafting and negotiating future construction contracts, it is likely that fresh consideration will have to be given to whether to include the right of appeal in Schedule 2 of the Arbitration Ordinance.

This will not be the only unintended consequence of the decision. Since the case concerns strict adherence to notice provisions, paying parties will undoubtedly be likely to concoct ever more ferocious conditions precedent to entitlement. In a situation like Bauer where a subcontractor has a "like rights" entitlement, this may backfire since the main contractor may not be able to recover the subcontractor's share if the employer can show there is a defect in the subcontractor's notice.

Parties claiming payment will be compelled to fire off more notices and to cover every eventuality, effectively defeating the purpose of providing a real notice and further fueling the vicious circle that leads to disputes.

The CA's decision is also yet a further indication of the trend towards applying a literal rather than purposive interpretation to contract terms.

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