

# Essentials of Contract Drafting and Negotiation for Construction Professionals

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# Contents

Preface	viii
List of Contributors	ix
Chapter 1: Overview and Features of Construction Contracts <i>Solomon Lam</i>	1
Chapter 2: The Interpretation of Construction Contracts <i>Isaac Yung</i>	15
Chapter 3: Pre-contractual Documents, Communication, and Misrepresentation <i>Isaac Yung</i>	46
Chapter 4: Structure and Format of Construction Contracts <i>Solomon Lam</i>	73
Chapter 5: Contract Drafting Techniques and Common Mistakes <i>Ronald Pang</i>	108
Chapter 6: Important Clauses in Construction Contracts <i>Ronald Pang</i>	133
Index	159

# Preface

*Essentials of Contract Drafting and Negotiation for Construction Professionals* is a practical and user-friendly guide designed for construction professionals involved in contract drafting and negotiation. Knowledge of how to draft an effective contract is crucial in order to consolidate and properly document the ideas agreed upon by the contracting parties. This book is an essential tool for creating contracts which are sound in both form and substance, as clarity and precision are no less important than legal correctness in avoiding traps and pitfalls in contract negotiation and enforcement.

This book contains six chapters and is best read with its companion text, *Construction Contract Essentials in Hong Kong*, which together provide readers with a thorough understanding of the legal aspects of the successful drafting and development of a construction contract. Chapter 1, 'Overview and Features of Construction Contracts', highlights the specific points to note in contract drafting and negotiation. Chapter 2, 'The Interpretation of Construction Contracts', illustrates how the legal rules of interpretation apply to construction contracts. Chapter 3, 'Pre-contractual Documents, Communication, and Misrepresentation', demonstrates the essential elements to be included, and elements to be avoided, in a contractual document. Chapter 4, 'Structure and Format of Construction Contracts', explains the different forms of construction contracts. Chapter 5, 'Contract Drafting Techniques and Common Mistakes', and Chapter 6, 'Important Clauses in Construction Contracts', explain the drafting of those vital clauses in a construction contract and their negotiation while providing techniques to attain clarity and avoid common mistakes in drafting.

It is hoped that this book will serve to enhance and refresh the knowledge of legal practitioners, construction professionals, students, and the public at large in the legal aspects of construction-related industries for the advancement of knowledge and the enhancement of their practical skills.

Gary Soo

# Contributors

(In alphabetical order)

**Peter Cheng** is a director of a listed property developer. He has a wealth of experience in property development and management. He took an active part in the development of the Hong Kong Convention and Exhibition Centre, the Macau Ferry Terminal, and the drainage construction project in Macau. He has also made substantial contributions to property projects in mainland China. Peter has experience mediating both commercial and family disputes and is on the lists of the mediators of Hong Kong Mediation Accreditation Association Limited (HKMAAL), Hong Kong International Arbitration Centre (HKIAC), Hong Kong Mediation Centre (HKMC), and Financial Dispute Resolution Centre (FDRC).

**Solomon Lam** is a practising barrister, chartered civil engineer (CEng), a member of the Institution of Civil Engineers (ICE), a fellow of the Hong Kong Institute of Arbitrators (HKI Arb), a member of the Chartered Institute of Arbitrators (CIArb), and a mediator accredited by HKMAAL and HKIAC. He practises mainly in the areas of construction, arbitration, personal injury, building management, and land disputes.

**Ronald Pang** has been a practising barrister in Hong Kong since 2016 and is developing a broad civil and commercial practice. He has, in different capacities, worked on cases involving land, trusts, wills and probate, shareholder disputes, insolvency, and matrimonial matters. He has also been instructed to provide advice on Hong Kong law in matters involving cross-border litigation disputes.

**Gary Soo** is an international arbitrator, practising barrister, and chartered engineer. He has practised civil litigation involving commercial and construction disputes and arbitration for 20 years. From 2008 to 2010, he served as the secretary-general of the HKIAC. He was also the president of the HKI Arb from 2006 to 2008 and from 2010 to 2011.

**Isaac Yung** has been a practising barrister in Hong Kong since 2015. He maintains a broad practice across the full spectrum of civil disputes, recently focusing on general commercial disputes, land related disputes, trusts, and probate matters. Between 2020 and 2021, he served as a judicial associate to the Court of Appeal and assisted civil appellate judges by researching points of law and analysing and writing memoranda on appeals and leave applications. He will do so again in 2022.

# 1

## Overview and Features of Construction Contracts

Solomon Lam

- 1.1 Construction contracts *always* need careful handling. From negotiating to drafting, from administering to applying, and from disputing to settling the terms and meaning of what is stipulated and what is not provided, a construction contract calls for thoughtful consideration and proper understanding. This is partly due to the unique features of construction contracts, as compared to other commercial contracts; it is also due to the fact that the amounts and consequences at stake and the uncertainties involved are often substantial.

### Aim and Structure of This Book

- 1.2 Contracts are important instruments governing commercial activities in Hong Kong. The guiding principles of contracts must be properly understood by those operating them to avoid legal pitfalls. Apart from negotiating and performing contracts, it is also important for contracting parties to beware of the guiding principles in drafting and interpreting contractual documents.
- 1.3 Construction contracts involve complex activities and huge sums of money. It is therefore particularly important for contracting parties in the construction industry to understand the guiding principles of drafting and interpreting construction contracts. This applies to construction professionals such as architects, engineers, surveyors and project managers, as well as executives, managers and directors of construction entities and those involved in the daily administration or performance of construction contracts. This is also vital for construction lawyers who may find drafting and dealing with construction contracts to be particularly challenging in view of the technical nature and unique features of construction projects.
- 1.4 With a practical and pragmatic approach, through case review and practical examples, this publication aims to enhance, update, and refresh the essential legal knowledge for legal practitioners, construction professionals and personnel, construction law academics and students, and the

public-at-large who may be involved with or affected by the construction industry.

1.5 There are six chapters in this book:

Chapter 1: Overview and Features of Construction Contracts

Chapter 2: The Interpretation of Construction Contracts

Chapter 3: Pre-contractual Documents, Communication, and Misrepresentation

Chapter 4: Structure and Format of Construction Contracts

Chapter 5: Contract Drafting Techniques and Common Mistakes

Chapter 6: Important Clauses in Construction Contracts

1.6 Chapter 1 serves as an introduction to this publication. It discusses the features of construction contracts as compared to other contracts. It provides the legal fundamentals of the interpretation of construction contracts. It also examines new legal issues arising out of the latest trends of adopting Building Information Modelling ('BIM'), Modular Integrated Construction ('MIC') and NEC4 in relation to the Hong Kong construction industry.

1.7 Chapter 2 discusses the legal principles of contract drafting and negotiation. It explains the *contra proferentem* rule, the parol evidence rule and the *ejusdem generis* rule and illustrates their relevance to construction contracts.

1.8 Chapter 3 discusses the legal effects of pre-contractual documents and communications, and their importance in the interpretation of construction contracts. It includes discussion of the various effects of letters of intent, letters of comfort and the concept of good faith in contract negotiation and drafting.

1.9 Chapter 4 discusses the structure and format of construction contracts. It covers the different types of contractual documents commonly used in the construction industry and their legal effects. It also discusses the legal effects of different contract terms typically found in standard form construction contracts. It further deals with the legal issues in relation to missing items, consideration in issuing certificates and concurrent delays, all of which are important topics commonly associated with disputes involving construction contracts adopting such standard forms.

1.10 Chapter 5 discusses different contract drafting techniques relevant to construction contracts and the common mistakes by contracting parties leading to disputes.

1.11 Chapter 6 discusses some particularly important clauses of construction contracts and how arguments over such clauses are resolved in arbitration or in court. It covers delay clauses, variation clauses, liquidated damage clauses, dispute resolution clauses and arbitration clauses.

## Construction Contracts Follow General Contract Laws

- 1.12 The laws governing construction projects are the same laws that apply in other spectrums of substantive matters. The laws governing construction contracts follow the general principles of contract law.
- 1.13 The areas of general contract law principle pertinent to construction contracts, which are often argued by the parties in arbitration and in court, include:
- interpretation of contract terms
  - breach of contract and damages
  - missing items
  - delays
  - liquidated damages
  - variations
- 1.14 It is important for construction professionals and stakeholders to understand the relevant legal principles and their effects before they can properly negotiate and draft their construction contracts. Therefore, with reference to the construction industry context, these general principles are covered in this book.
- 1.15 Apart from general principles, this book will cover specific issues and pitfalls that should be addressed by parties negotiating and drafting construction contracts.

## Features of Construction Contracts

- 1.16 Construction works are highly technical by nature. Additionally, new techniques and methods of construction are regularly introduced, new approaches to contracting are adopted, and new applications of data and technology feed continuous innovation in all areas. Along with the positive side of these developments comes a new frontier of risks associated with trespassing on new paradigms. For example, the use of Building Integrated Modelling ('BIM') is meant to help eliminate errors (such as buildability of the design) prior to construction but it also brings in new forms of errors (database update error) when put to use. The adoption of new construction technologies is always challenging, technically and legally. The wide adoption of Modular Integrated Construction ('MIC') brings new perspectives and focal areas for potential contractual confrontations.
- 1.17 Construction projects often last for a long period of time, in terms of years, and many exigencies can arise during the contract period. The uncertainties and changes may come from outside the project, such as due



to an economic downturn, a change in society's expectations or even a pandemic. The longer the project duration, the greater such risks.

- 1.18 Due to the industry practice of division of labour and subcontracting, a construction project involves many contracting parties. There can be multiple layers of subcontracting and their respective rights and obligations may affect each other. There are also third party professionals like architects, engineers and surveyors who are not parties to the construction contract between the contractor and the employer, but the construction contract confers roles, functions and powers upon them, and thus the rights and obligations of the contractor and the employer are affected by these third parties.
- 1.19 All of these features make construction contracts a specialised area of their own.
- 1.20 Accordingly, the way construction contracts are put together is also specific to the industry. This is particularly so when standard forms of contracts are adopted. Very often, project-specific and in-house amendments are made to the standard forms of contracts, drawing from previous experience and lessons learnt. Not all of these amendments have been tested in court or in arbitration. How to read them together with the rest of the standard conditions of contract, the standard methods of measurement, the general specifications and the standard drawings are always challenging, particularly when thorough consideration of them may not always be possible due to time constraints in drawing up a tender. The number of pages involved in construction contracts is always stunning and references in it to the various codes, standards and guidelines are quite nonstop.

## Types of Procurement Methods

- 1.21 Apart from the general features of construction contracts, it is also important for lawyers, construction professionals and other involved parties to understand the usual procurement methods and the methods of payment associated with construction contracts, in order to better understand the essentials of contract drafting and negotiation discussed in this publication.
- 1.22 The more common procurement method is usually referred to as the traditional procurement method. In this method, the employer engages the architect or engineer to translate its wishes into detailed plans and the surveyor to measure the amount of labour and materials necessary to complete the works according to the plans and set them out in the bills of quantities.<sup>1</sup>

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1. Stephen Furst and Sir Vivian Ramsey, *Keating on Construction Contracts*, 10th ed. (Sweet & Maxwell, 2016), para. 1-030.

# Pre-contractual Documents, Communication, and Misrepresentation

Isaac Yung

## Introduction

- 3.1 In the construction industry, the time taken by the parties to enter into a contract can sometimes be lengthy, involving the main contracts, the subcontracts, various pre-contractual documents and communications between the parties. The process may be protracted for a number of reasons; for example, preliminary investigations may need to be conducted or tender queries may need to be sought and answered; there may be one or multiple tenderer meetings; there may be alternative bids or designs or cost-saving designs involved. It can be expected that numerous discussions and meetings (by way of different media such as emails, teleconferences, in-person meetings, etc.) will be conducted before the parties formally enter into a contract.
- 3.2 When a dispute arises, it is not uncommon for parties to seek to introduce (usually voluminous) pre-contractual discussions or documents, contents of negotiations, and other extrinsic evidence to assist in the construction of the contract.<sup>1</sup> The drafting and wording of such documents and communications may sometimes be no less important than terms of the contract proper.

## Letter of Intent

- 3.3 It is not uncommon for parties to issue and be issued with letters of intent during or after negotiations, especially in the construction industry. Depending on the wording and drafting of such a letter, a party may issue the letter without intending it to have any legal effect but merely to act as a form of reassurance to the other party; sometimes, the party issuing it may request the other party to proceed with necessary preparatory works in anticipation of entering into the contract; sometimes, the parties may

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1. *Hyundai Engineering and Construction Co Ltd v Vigour Ltd* [2005] 3 HKLRD 723 at para. 41; *Konwall Construction Engineering Co Ltd v Strong Progress Ltd* [2013] 3 HKLRD 503. Such extrinsic evidence is subject to the parol evidence rule discussed in Chapter 2.

utilise the letter of intent as the contract between them pending the execution of a formal contract.

- 3.4 Thus, different parties may use letters of intent for different purposes. Ultimately, the parties will outline some of the most basic, fundamental terms of an agreement before they negotiate and settle the finer points and details. However, depending on how it is drafted, a letter of intent may contain all the elements of a binding contract. Consequently, it is not uncommon for the parties to subsequently dispute whether the letter of intent constitutes a binding contract, particularly when works have proceeded but no formal contract has been executed.
- 3.5 A common dispute is therefore whether the parties have intended the letter of intent to be a binding contract, in full or in part, or otherwise.
- 3.6 This can be resolved by an express provision in the letter of intent or a true construction of the letter of intent. For example, the inclusion of a 'subject to contract clause' may prevent a court from concluding that there was already a contract, although, as with many issues, each case will have to be decided on its own facts.<sup>2</sup>
- 3.7 It is important to be mindful that, when considering the nature of the agreement, the relationship between or past dealings of the parties will be considered. Generally, if the relationships or dealings were business-related rather than social or gratuitous, then the party who asserts that there was no legal effect to the agreement between the parties has a heavy onus to prove as such.<sup>3</sup> Furthermore, it is well-established that 'contractual intention is to be ascertained objectively. Evidence of the subjective intention of the parties is of limited value'.<sup>4</sup>
- 3.8 Therefore, if the language of the letter of intent does not expressly negate the parties' intention to contract, it is open to the court to hold parties bound by the document.<sup>5</sup>
- 3.9 A letter of intent can still have contractual or other effect even if the parties contemplate that the letter is to be superseded by a later, more formal, contractual document.<sup>6</sup>
- 3.10 Depending on the wording used in a letter of intent, it may be drafted in such a way that certain terms of it will have contractual force, while

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2. Once a 'subject to contract' qualification is introduced into negotiations, it will only cease to apply if the parties expressly or by necessary implication agree that it should be expunged: *Cohen v Nessedale Ltd* [1982] 2 All ER 97 (CA).

3. *Cable & Wireless (Hong Kong) Ltd Staff Association v ng Kong Telecom International Ltd* [2001] 2 HKLRD 809 at para. 30, citing *Edwards v Skyways Ltd* [1964] 1 WLR 349; [1964] 1 All ER 494 with approval.

4. *Best Star Holdings Ltd v Lam Chun Hing Others* [2012] HKCFI 211 at para. 116.

5. *Associated British Ports v Ferryways* [2008] EWCA Civ 189.

6. *Diamond Build Ltd v Clapham Park Homes Ltd* [2008] EWHC 1439 (TCC).

other terms may not. There can also be *quantum meruit*<sup>7</sup> in the absence of contract. In *British Steel Corporation v Cleveland Bridge & Engineering Co Ltd*,<sup>8</sup> as requested, works had begun before all elements of the contract had been agreed and no contract was later entered into.

## Letters of Comfort

- 3.11 A letter of comfort is a tool of commerce developed to provide an alternative to guarantee or surety.<sup>9</sup> For example, a parent company may be unwilling to give a more conventional form of security for its subsidiary's liabilities, or party who deals with a subsidiary may seek assurance from the parent company concerning the liabilities undertaken by its subsidiary. Furthermore, the parent company may not wish to incur legal liability, or may want to protect its own credit rating, or wants to avoid showing a contingent liability on its balance sheet.<sup>10</sup>
- 3.12 A typical example in the field of construction occurs when a creditor makes a loan to the subsidiary. While the parent company may refuse to provide an official guarantee, it may decide to provide the creditor with a statement assuring the subsidiary's capacity to meet the necessary obligations. Such an assurance, usually by way of letter, is often referred to as a letter of comfort.
- 3.13 If the subsidiary defaults on the loan, the creditor may consider pursuing the parent company to meet the subsidiary's obligations. Whether or not the creditor is successful in seeking relief against the parent company turns on whether the letter of comfort was intended to create an enforceable contractual relationship between the creditor and the parent company.
- 3.14 In *Kleinwort Benson Ltd v Malaysia Mining Corporation*,<sup>11</sup> the plaintiff bank made a loan to the defendant's subsidiary. The defendant provided two 'letters of comfort', each stated 'it is our policy to ensure that the business of [the subsidiary] is at all times in a position to meet its liabilities to you under the above arrangements'.
- 3.15 The defendant's subsidiary defaulted on the loan and the plaintiff bank sought to recover from the parent defendant company on the basis that

7. *Quantum meruit* is a category of remedy with restitutionary effect. It is available when a party has provided a benefit but for some reason cannot obtain payment under a contract. In such circumstances, that party may recover the reasonable value of the benefit so provided. It means 'the amount he deserves' or 'what the job is worth'. One common example of *quantum meruit* is where no price is stated for works carried out within an existing contract and the employer is obliged to pay a reasonable sum.

8. [1984] 1 All ER 504.

9. *Bouygues SA v Shanghai Links Executive Community Ltd* [1998] 2 HKLRD 479 at para. 28.

10. *Bouygues SA v Shanghai Links Executive Community Ltd* [1998] 2 HKLRD 479 at para. 28.

11. [1989] 1 All ER 785; [1989] 1 WLR 379.

the letter of comfort constituted a contractual guarantee. At trial, the plaintiff bank succeeded when the court held that the parent company had failed to rebut the presumption against contractual intention in commercial agreements.<sup>12</sup> The parent company appealed.

- 3.16 The English Court of Appeal held that the material clause was merely a statement of present fact of the intentions of the parent defendant company and not a promise as to its future conduct. Therefore, the letter created no contractual obligations between the plaintiff bank and the parent defendant company.

### *Case illustrations*

- 3.17 Nonetheless, the use of letters of intent or sometimes letters of comfort, particularly in the construction industry, is understandable. Prior to the signing of the contract, there are numerous issues to be resolved and there is often immense pressure to commence works as soon as possible as deliverables are often on a tight schedule.
- 3.18 One would think that the existence of a contract itself would never be the subject of dispute in construction litigation. Yet, this is not necessarily the case.
- 3.19 In *British Steel Corporation v Cleveland Bridge*,<sup>13</sup> the subcontractor successfully tendered for the fabrication of steel works in the construction of a building. The contractor sent a letter of intent to the subcontractor which recorded the contractor's intention to enter into a contract with the subcontractor, proposed that the subcontract be on the contractor's standard form, and requested the subcontractor to commence works immediately 'pending the preparation and issuing to you of the official form of subcontract'.
- 3.20 Even though there were extensive discussions on a number of issues, the subcontractor proceeded to manufacture and deliver the steel nodes. However, there was delay in delivering one steel node. The contractor refused to pay for the steel nodes.
- 3.21 Although Goff J initially discussed the possibility that the letters of intent could give rise to two different types of contract, his Lordship ultimately rejected both on the basis that the letters of intent in question applied 'pending a formal subcontract the terms of which were still in a state of negotiation'.

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12. [1988] 1 All ER 714; [1988] 1 WLR 799.

13. [1984] 1 All ER 504.

- 3.22 Similarly, in *Four Sea Union (Holdings) Ltd v Hong Kong & Macau Scent On Engineering & Construction Ltd*,<sup>14</sup> both parties to the dispute were construction companies. The defendant was a contractor on the Hong Kong Government List of Contractors for Public Works, whereas the plaintiff was not. There was an arrangement between the plaintiff and the defendant, and thereafter the plaintiff submitted a tender to the government for works and was successful. The original plan was that the plaintiff would carry out the works and the defendant would receive 4% of the contract payments as management fee. The plaintiff commenced works on 1 March 2001, but quickly ceased at the end of May as neither parties were able to agree to the terms upon which the contract between them should be signed.
- 3.23 On the evidence, as well as the plaintiff's own pleadings, the court ruled that there was no binding agreement between the parties.

### Tender Documents<sup>15</sup>

- 3.24 Main contractors in construction projects often acquire such works through a tendering process. It is important to have a good understanding of the legal principles before discussing the actual documents involved in the tendering process.
- 3.25 There is sometimes a general but incorrect presumption that tenders are and can only be invitations to treat, or otherwise known as invitations to other parties to make an offer.<sup>16</sup> Such a presumption will usually be displaced when the surrounding circumstances and the words used in the invitation for parties to make offers could be reasonably interpreted as the party calling for tenders intended as offers.
- 3.26 When the tender is accepted by the inviting party, a contract is concluded. However, a prior collateral contract may arise before the conclusion of the principal contract in the following manner—there is an implied obligation on the party inviting the tender to consider all confirming tenders according to the invitation to tender, thereby providing consideration for a collateral contract, i.e. the 'process' contract, brought into being upon the submission of a tender.<sup>17</sup> This is a natural consequence of the tenderer's own obligation to be bound by the conditions of tendering.

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14. [2003] 1 HKLRD 653.

15. Information obtained from 'Reference Material on Section of Contractors' by the Construction Industry Council, dated December 2019.

16. *Spencer v Harding* (1870) LR 5 CP 561. Such an invitation is an invitation to others to make an offer and the invitation in itself is not an offer that can be accepted into forming a contract.

17. *City University of Hong Kong v Blue Cross (Asia-Pacific) Insurance Ltd* [2001] 1 HKC 463.

- 3.27 In *Pioneer Catering Equipment & Engineering Ltd v Secretary for Justice*,<sup>18</sup> Pioneer Catering specialised in the supply and installation of catering equipment and was on the list of Approved Suppliers of Materials Specialist Contractors for Public Works (the List) that was maintained by the Architectural Services Department (ASD). With reference to three separate construction contracts, all the contractors on the List were invited to submit tenders. Pioneer Catering responded to all three invitations by submitting three separate tenders, two of which were the tender.
- 3.28 There was no dispute that the government had not considered Pioneer Catering's three tenders at all, which was the construction company's chief complaint.
- 3.29 The issue was whether the government was entitled *not* to consider the tenders in the circumstances. This was dependent on the terms of Conditions of Tender for each of the invitations. As it turned out, the second and third invitations contained a 'Suspension Clause'—its effect was that by the tender closing date, if the tenderer was under suspension from tendering for public works, his tender would not be considered unless the suspension was lifted within 40 days from and including the tender closing date.
- 3.30 At the time of submitting the tenders, Pioneer Catering was in fact suspended and its suspension was never lifted. Furthermore, the second and third invitations to tender contained the Suspension Clause. While the first invitation did not contain such a clause, the court found it equitable to imply such a clause.
- 3.31 As the construction company was bound by the conditions of the tender, its failure to adhere to those conditions entitled the government to not consider any of its tenders.

### *Form of tendering*

- 3.32 There are typically two types of tendering—open tendering and selective tendering.
- 3.33 In open tendering, a public announcement for invitation to tender is made, typically in a local newspaper or on the company's website. Interested contractors who meet the prescribed requirements in the announcement may submit a tender.
- 3.34 In selective tendering, only contractors that meet a pre-qualification process are invited to submit a tender. During the pre-qualification assessment, the contractor may be asked to show records relating to its

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18. [2004] 3 HKC 357.

qualifications, finances, and technical expertise, and to identify any conflicts of interests.

- 3.35 Once potential tenderers have been identified, whether through open or selective tendering, the employer typically provides a compilation of documents (i.e. tender documents) to such tenderers. Tender documents in construction projects typically include the following:
1. conditions of tender
  2. form of tender
  3. articles of agreement
  4. general conditions of contract
  5. special conditions of contract
  6. specifications
  7. drawings
  8. technical submissions
  9. bills of quantities or schedule of rates (as may be the case)
  10. other standard documents incorporated by the above

### *Conditions of tender*

- 3.36 The Conditions of Tender provide the general framework of which the tenderer should be aware of when preparing their tender. Common information includes the name and title of the project, how the tender should be completed and returned, place and date for return of tenders, and documents and information to be provided with the tender.

### *Form of tender*

- 3.37 A potential tenderer will first receive an invitation to submit a tender. The form of tender is then submitted by the tenderer. Typically, the form of tender will incorporate the following:
1. the name of the employer to whom/which the offer will be made
  2. the price of the works, which should be the same as other parts of the tender documents
  3. the validity period of the offer
  4. warranties that will be provided outside the contract, if any
  5. a disclaimer by the employer stating that there is no obligation to accept the lowest or any tender returned



- 3.38 It is often the case that the form of tender must be signed by an authorised person on behalf of the tenderer.

### *Articles of agreement*

- 3.39 The Articles of Agreement set out the agreement in substance and the signatories. These define the parties to the contract and its contents.

### *General and special conditions of the contract*

- 3.40 The General Conditions of the Contract will typically simply be one of the standard forms of contract that is widely available in the market.
- 3.41 As most construction projects will use such a standard form contract, Special Conditions of the Contract designed for the particular construction project will also be inserted and must be read in conjunction with the general conditions. Usually, special conditions are drafted to suit the preferences of the employer. These may include:
1. the tenderer's contractual/statutory obligations
  2. the use of materials which are new, free from defects and of good quality
  3. variations of works
  4. contract bills
  5. insurance requirements
  6. extension of time
  7. liquidated damages

### *Specifications*

- 3.42 In general, specifications refer to the information describing the type and quality of materials and workmanship needed to complete the project. Specifications may be further divided into different parts. These are typically the preliminaries, the general technical specification and the particular technical specification.
- 3.43 Preliminaries will list the general requirements that will be applicable across the whole project.
- 3.44 General technical specifications are usually a generic set of specifications and it is not uncommon to use publicly available technical specifications.
- 3.45 Particular technical specifications are specifications that are specific to the project at hand. Special technical requirements or materials needed for the completion of the project will be included.

## 5

# Contract Drafting Techniques and Common Mistakes

Ronald Pang

### Overview

- 5.1 In the construction industry, for one reason or another, parties often fail to fully appreciate the importance of good contract drafting. Instead, they spend millions of dollars on resolving disputes, engaging lawyers and dispute resolution professionals, when many issues could have been readily avoided if they had ensured the initial drafting of the contract was done in a proper and effective manner.
- 5.2 However, it is important to bear in mind that there is no such thing as a perfectly drafted or absolutely dispute-proof contract. Each contract may have its own issues and uncertainties. As Lord Carnwath said, in the English Supreme Court decision in *Arnold v Britton*,<sup>1</sup> “[a]s Tolstoy said of unhappy families, every ill-drafted contract is ill-drafted “in its own way””.
- 5.3 This chapter discusses the important elements of a contract that parties should bear in mind when embarking upon drafting. It seeks to help them make use of good drafting techniques and provide guidance to better ensure that the contract is sound and reflects the true intention of the parties.
- 5.4 Certain drafting techniques that are commonly used by contract drafters to avoid pitfalls are also examined and illustrated, and common mistakes highlighted.

### Contract Drafting Techniques

#### *Use of checklists*

- 5.5 Like many professionals, contract drafters, including those in construction, are strangely averse to the use of checklists. However, time and time

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1. [2015] UKSC 36 at para. 108.

again, it has been shown that in almost any industry the use of checklists helps reduce the number of mistakes by a considerable margin.

- 5.6 For example, aviation professionals have been using checklists since the 1930s and are adamant as to their usefulness. One of the perhaps best examples of the use of checklists is the pre-flight checklists used by pilots of B-17 Bombers in World War II, which reportedly allowed pilots to fly the bombers in hundreds and thousands of missions without accidents.
- 5.7 When properly used, checklists can reduce mistakes in contract drafting to a minimum while taking very little time to complete.
- 5.8 To ensure that each contract has been properly checked and vetted, it is best to include a checklist with each contract and to ensure that it has been properly completed before allowing the contract to be sent for endorsing or signing.
- 5.9 The elements that should be included on a contract checklist will depend on the individual, specific contract or project. However, a good starting point is as follows:
  - Are the names of the parties correct?
  - Have the addresses and other places been cross-referenced?
  - Has spelling and grammar been checked?
  - Are there any definitions undefined and are definitions consistent throughout the documents?
  - Are the documents or drawings referred to in the contract all included as appendices or attachments? Are they coloured or black and white as required?
  - Is the version to be executed and signed the final version of the contract?
  - Are there any boilerplate clauses included in the contract? If so, have they been tailored to the parties and the contract?
  - Is a dispute resolution clause included in the contract? If so, is it operative to match the needs of the parties?
  - When is the date of execution of the contract? Are there any parts of the contract that will be or have been executed prior to or after the contract? Have these been explained or provided for in the contract?
  - Are there any works that were commenced prior to the signing of the contract? Are these addressed in the operative parts of the contract?
- 5.10 In this book we cannot provide a one-size-fits-all checklist. The complicated nature of construction contracts will inevitably lead to checklists which are somewhat cumbersome. However, the careful development and implementation of checklists should pay significant dividends.

## *Use of headings*

- 5.11 In some construction subcontracts, parties do not use boilerplate or *pro forma* contracts and instead rely on short form contracts that incorporate the main contract text and have reference to other documents intended to be incorporated. At the other end of the spectrum, there is also a reliance on outdated or overly complicated *pro forma* contracts which results in its own set of problems, but this is a matter for another section.
- 5.12 As it will be shown below, the use of short form contracts creates confusion and issues over whether and what clauses should be incorporated.
- 5.13 More importantly, short form contracts are hard to read due to the way they are normally drafted. They are usually drafted in a few paragraphs and commonly in the form of a quotation and a letter of intent or a letter of award. These rarely contain all the necessary terms to properly protect the parties' interest and to fully cater for all situations that may arise. Without checking for inconsistencies with all the other documents intended to be incorporated or referred to, arguments over discrepancy or ambiguity may surface later. Worse still, some short form contracts make reference to or incorporate other documents that the contract drafters may not have fully or ever read through.
- 5.14 The documents that are referenced or incorporated are sometimes inconsistent or completely at odds with the short form contracts. In some cases, for example, there are clauses in the referenced or incorporated documents that expressly prohibit incorporation by reference.
- 5.15 It is understood that in smaller projects contractors and subcontractors may not have the resources or time to prepare a comprehensive contract. In such cases, it is recommended that important terms are mapped out using headings.
- 5.16 By adopting the usage of headings, it can at least be ensured that the most important terms are catered for within the contract. For example, a heading of 'Payment Terms', an area of utmost importance to almost any contract, will ensure that the appropriate thought and care is given to this term.
- 5.17 Headings also allow third parties to examine the contract in an efficient manner by letting them see what is contained in the contract from a bird's eye view and to be quickly able to focus on the important aspects.
- 5.18 Further, when used appropriately with word processing software, headings allow quick access to the relevant parts, particularly when coupled with search and find functions in word processing software.

## *Use of technology*

- 5.19 This is now a world where most if not all parties have access to word processing capabilities, which allow for complex contractual documents to be handled easily and quickly, at least relative to the past.
- 5.20 In particular, typical word processing software contains many useful functions that should be put to use by every professional, whenever contracting drafting forms part of their workflow or forms a major part of their duties. Coupled with optical character recognition technologies, documents that were not searchable in the past are now more easily put to editing and checking.
- 5.21 Aside from more commonly used tools such as word proofing, word counting, and find-and-replace tools, there are many less commonly used features that should form part of one's repertoire.
- 5.22 The one feature that is used most frequently is the navigation pane which allows for the drafter to quickly move back and forth in a complex contract. By using heading styles, the software will automatically generate a navigation pane that will list out the document's contents by each various heading style. This not only allows the contract drafter to navigate the document quickly but also allows the contract drafter to reorganise the document as seen fit and to move large and small sections of the document quickly within the context of the rest of the document.
- 5.23 In addition, the use of headings allow the contract drafter to utilise the automatic table-of-contents generator to produce (and to automatically update) a table of contents with a click of a button.
- 5.24 The second feature, which is rarely used but invaluable, is the cross-reference tool, which allows the contract drafter to cross-reference paragraphs within the document. This function also highlights to the contract drafter if a cross-referenced paragraph has gone missing or is errant. More importantly, the cross-reference will be automatically updated if the underlying reference text itself is changed. For example, if one refers to (say) paragraph 4 of a document but subsequently change paragraph 4 to (say) paragraph 23, the reference will automatically change the number to paragraph 23 instead of paragraph 4.
- 5.25 The use of cross-referencing and macros in documents allows for other documents to be referenced or incorporated. This can be achieved using bookmarks and field text. Not only will this save a significant amount of time, but this cross-reference tool also allows for the document to automatically update when the referenced document has been changed. A good example is addresses or boilerplate clauses which are repeated in multiple documents.

- 5.26 Then there is the use of the cloud storage and other document sharing tools. Such tools allow documents to be accessed anywhere and allow for consistency when dealing with drafts, particularly when there are multiple drafters involved. In the past, as a result of human error, disputes have arisen over the wrong 'final' draft being engrossed for signing or last-minute changes being added to drafts. With this, the risk is reduced provided that synchronising of the cloud drive in the various devices of the contract drafters is ensured.
- 5.27 Lastly, before executing a contract, one should always use the compare function to see whether any change has been implemented that was not discussed before. The compare function will highlight any additions, modifications or deletions. There are some contract drafters that ignore the use of compare functions and merely rely on tracked changes. This sometimes can be unreliable and inconsistent as it does not show changes where track changes has been turned off or where changes have been accepted.
- 5.28 There are also extensions or add-ons that have been created to assist contract drafters, which streamline the drafting process by providing powerful tools that allow the drafter to ensure that terms have been properly defined, to allow for cross references, and to track appendices and annexes. These extensions or add-ons, while normally requiring extra payment, can be quite invaluable tools in a contract drafter's arsenal.
- 5.29 In addition to the above word processing tools, there is also the advent of machine learning and artificial intelligence (AI) being incorporated into contracts. Even in its relatively infancy, AI has made its mark in contract drafting, being used to check for inconsistencies within a contract, to highlight problematic areas within a contract, and to reduce errors and areas of disputes.
- 5.30 Another area where technology can assist contract drafters and reduce disputes is the use of building information modelling within a contract. There is no reason why such modelling cannot be referenced within the contract so as to provide clarity to stakeholders that mere specifications and drawings cannot provide on paper.
- 5.31 In addition to AI, there is the advent of smart contracts that utilise blockchain technology. Contract professionals should explore such smart contracts and see how they can be incorporated in their everyday workflow. In essence, smart contracts are contracts with built in algorithms that are executed at a specified event or time. Even at a glance, one can see how such smart contracts can assist contract professionals. One example relates to conditions precedent. A smart contract can be coded to detect incidents that require conditions precedent, such as applications for extension of time or assessment of liquidated damages, which usually require certain

steps to be taken before they can be properly invoked, and a smart contract can notify users that such steps have or have not been taken.

- 5.32 It is important to bear in mind that the use of technology can lead to its own problems. For example, there can be issues with privacy, susceptibility to hacking or social engineering, as well as storage limitation issues. There is also, of course, the familiar problem of over-reliance on technology.

### *Use of simple language and jargon*

- 5.33 Many drafters habitually use archaic language and jargon when drafting contracts.
- 5.34 Words like ‘forthwith’, ‘furnish’, ‘hereinafter’ and ‘determine’ are examples of such archaic and outdated language. These words are extremely common in contracts, despite the fact that they are rarely used in spoken English and rarely in any reasonable person’s vernacular; instead, words such as ‘immediately’, ‘provide’, ‘below’, and ‘decide’ should be used.
- 5.35 The persistence of archaic language seems to stem from two sources. First, the extensive use of precedents and *pro forma* contracts. There has been much reliance placed on them without proper understanding of the context and the situation these precedents and *pro forma* contracts are dealing with and addressing. Contract drafters often adopt the tone and style found in such precedents and *pro forma* contracts without being recognising that the tone and style is inappropriate in context. The sort of language used in precedents or sample forms recurs in new contracts as it is difficult to change the language and tone of precedents or forms.
- 5.36 Second, most legal systems rely on archaic language out of tradition and for historical reasons, particularly legal systems that adopt a case law system in which law is determined or declared through adjudication of past events. As a result of this, legal practitioners and contract drafters, out of prudence and conservatism, will be slow to lead change if it is yet to be adjudicated by the legal system. However, the lack of progress in this regard can be risky in itself as language continues to evolve, leading some jargon and archaic language to lose its initial meaning. This creates issues for interpretation.
- 5.37 While jargon and archaic language has its place in certain situations, one can appreciate the difficulties that such language can pose when one considers that to properly understand the content of such a contract, one must learn how to read it, which is seemingly contrary to the principles behind a contract based on a meeting of the parties’ minds.
- 5.38 Additionally, using words that are not a common part of a person’s everyday vocabulary means that, during drafting, the chances of misunderstanding the meaning of words increases. No one would choose to

draft a contract using a foreign language they were uncomfortable with. As such, there is no reason for a person to include in a contract words that they rarely use and are unfamiliar with.

- 5.39 While in some cases archaic language and jargon may be suitable, it is important for the contract drafter to review the matter critically and see whether the word is used properly to reflect the intended meaning or if it is needed as there is a law governing its use.
- 5.40 Contract drafters also have a common habit of using pairs of words that have substantially the same meaning instead of simply using one word. For example, 'save and except' and 'sell and convey'. It is clear that many drafters do not understand the reason to pair such words and merely do so out of habit. In fact, the reason is historical and dates back to the time when England was using two different legal systems at the same time, common law and equity. Nowadays, a 'combined' legal system is essentially in place, which means that the pairing of words is redundant but persists because contract drafters maintain old habits out of fear of being misinterpreted. The result is the contract becoming verbose, which increases the chance of misinterpretation and the intended meaning being lost.
- 5.41 Another form of word pairing quite common to construction contracts is the use of 'and/or'. If used without good reasons, such usage unnecessarily complicates matters as it increases the number of possibilities and scenarios by a factor of two. This can be significant when a contract already attempts to cater for a large number of possibilities in a construction project.

### *Use of schedules and appendices*

- 5.42 When a contract becomes too hefty, it becomes difficult to read through. To allay this issue, construction practitioners use different methods to reduce the pages of operative parts of the contract. One common method is the use of schedules and appendices.
- 5.43 Schedules and appendices are particularly useful when a contract contains many standard terms that are intended to be used multiple times, with minor changes or changes to the same item over and over again. For example, schedules are prevalent in sale and purchase agreements involving land as most transactions involve the same terms and the only change from transaction to transaction involves the identities of the parties and the land being sold. This is akin to the use of contract data in the NEC forms of contract in the construction industry.
- 5.44 Schedules and appendices allow for the operative parts of the contract to stay consistent and therefore reduce errors and possible issues arising out



of multiple appearing or repeating of same text. There are particular situations specific to construction projects in which the use of schedules and appendices are desirable and sometimes invaluable, such as:

- (a) detailed requirements and specifications which are referred to multiple times throughout a contract;
- (b) timetables or project programmes which can be subject to change and evolve over time;
- (c) detailed and complicated payment provisions;
- (d) terms and conditions relevant to other parties, such as contractors, subcontractors and other specialists.

- 5.45 Despite this, there is a risk inherent in using schedules and appendices that certain parts of such schedules and appendices are left blank due to their voluminous nature.
- 5.46 For example, in the case of *Sutton Housing Partnership v Rydon Maintenance Ltd*,<sup>2</sup> Sutton appointed Rydon to carry out repair and maintenance works to Sutton's projects for a period of five years. The contract included performance indicators and minimum acceptable performance levels, which were clearly of importance as Rydon's entitlement to additional payments depended on meeting such factors.
- 5.47 However, the figures that Rydon was supposed to meet were contained in tables in schedules labelled as 'examples'. During the course of the contract, Sutton sought to terminate the contract on the basis that Rydon had failed to meet the performance indicators and performance levels. However, Rydon argued that the contract did not contain any specific levels, the tables in the contract being labelled merely as examples.
- 5.48 The English Court of Appeal held that the tables were not just examples but were actual figures that Rydon had to meet. In the course of the court's judgment, the principles in *Manchester Ship Canal Company Ltd v Environment Agency*,<sup>3</sup> *Arnold v Britton*,<sup>4</sup> and *Rainy Sky SA v Kookmin Bank*<sup>5</sup> were applied. Jackson LJ stated (at para. 53):

[B]oth parties must have intended (and any reasonable or indeed unreasonable person standing in the shoes of either party would have intended) the contract to specify MAPs. The only place where MAPs appear is in the three so-called 'examples' in the framework. In my view, applying the approach mandated by the Supreme Court in *Rainy Sky* and *Arnold*, the contract properly construed must mean that the

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2. [2017] EWCA Civ 359.

3. [2013] EWCA Civ 542.

4. [2015] AC 1619.

5. [2011] 1 WLR 2900.

MAP figures set out in examples 1, 2 and 3 are the actual MAPs for the year 2013/2014, not hypothetical MAPs by way of illustration.

- 5.49 This case shows that, while common sense arguably prevailed, disputes can be easily avoided by ensuring that the schedules contain the proper content which is properly labelled.
- 5.50 Although this issue arose from schedules and appendices, one should appreciate that issues are more likely to occur if performance indicators are included at various points throughout the contract; the chance to miss such details can only increase if they appear in the contract multiple times.
- 5.51 This dispute could also have been easily avoided if checklists have been used prior to the execution of the contract to check things over prior to signing, as one of the things to be checked must inevitably be the schedules.

### *Guidelines for revising drafts of contracts*

- 5.52 Revision occurs after writing in the drafting process and concentrates on small-scale organisation, sentence structure, transitions, paragraphing, grammar, punctuation, etc. There are two things to remember about revision and amendments of contracts.
- 5.53 First, one should not revise while one writes. This slows down both the writing and the revision processes. When one is writing, one should concentrate solely on the ideas to be included in the writing, no matter how unpolished the writing may seem. The advice is to revise later.
- 5.54 Second, when one revises, one should do it in stages. It is exhausting and inefficient to try to revise on every level once and for all at the same time. One should use the time for revising to move from general writing problems to more specific ones.
- 5.55 Some further highlighted points are set out below.

Accuracy: No amount of readability will replace accuracy. So, make sure first to check the content of each legal point. Ask the following questions:

- (a) Is the content accurately stated?
- (b) Could any point be misunderstood because of ambiguity?
- (c) Are irrelevant facts or other irrelevant information excluded?
- (d) Are terms of art used correctly?
- (e) Are key terms used correctly?
- (f) Are paraphrases accurate?
- (g) Are the names of parties and their status correct?
- (h) Are citations accurate?

# Index

- acceleration: 106
- acceptance: 28, 31, 73, 89, 126, 128–129, 131–132
- access: 8, 19, 27, 66, 89, 110, 111, 126, 145
- account: 26, 81, 84, 87, 93–94, 102, 105, 121, 136–139, 153, 155
- adjudication: 80, 113, 148
- alternative dispute resolution: 40, 124, 151
- apparent: 21, 74–76
- appeal: 11–13, 18, 21–22, 25, 37, 42–43, 49, 62, 66, 68–69, 71, 75, 79, 83–84, 96, 115, 119–120, 128, 138, 150–151, 153–154
- apportionment: 98–99, 101–103
- arbitration: 2, 4, 54, 74, 77–80, 84, 119, 123–124, 129, 131, 133, 139, 146, 151–156
- arbitrator: 44, 64, 70, 81, 97, 123
- architect(s): 1, 4, 5, 18, 23–25, 32, 54, 60, 73, 78, 81, 86, 92–94, 99–102, 145–147
- award(s): 63–64, 79, 101, 103, 110, 119–120
  
- back-to-back: 134, 141
- bids: 46
- bills of quantities: 4–6, 52, 54, 73, 82–88, 90–92, 122, 132, 135–138
- bonds: 118
- breach(es) of contract: 3, 37, 63, 103, 106, 144–146, 154–155
- builder(s): 25, 60, 129–130, 136, 147
- building(s): 2–3, 6, 9–10, 15, 18–19, 25, 27, 36, 41, 49, 58, 66–67, 77–79, 81–83, 85, 93–94, 96, 102, 112, 134, 136, 139, 141–145, 147, 151
  
- Building Information Modelling: 2–3, 6–9, 13
- burden of proof: 103
  
- capacity: 8, 48
- case law: 8, 29, 67, 99, 113
- causation: 101–102
- cause of action: 56, 74
- cause of delay: 95, 97, 102–103, 143
- certainty: 30, 33, 87, 124, 133, 137, 142, 148, 151
- certificate(s): 2, 19, 78, 80–81, 89, 92, 139–140
- cheque: 26
- claims: 69, 75, 85–87, 91–92, 95, 97, 103, 142, 146
- client(s): 7, 8, 13, 14, 39, 69, 92, 150
- collateral: 34, 50, 67–68, 118
- commencement: 27, 37, 129, 131
- common: 2, 4–5, 8–9, 11, 16–17, 20, 23–24, 28, 30–31, 33, 36, 39–42, 47–48, 52, 55, 58–59, 61, 65, 67, 69, 71, 74, 77, 84, 94, 96, 99–100, 105, 108, 110, 112–114, 116–122, 124–126, 128, 130, 132–133, 136, 139–141, 146, 148, 156
- compensation: 15, 97, 104, 106, 148–150, 157
- completion: 6, 8, 11–13, 18–19, 22, 25–28, 53, 65, 71, 78, 80–81, 86, 89, 92–95, 97–100, 102–105, 142–143, 146, 148, 157
- concrete: 86
- concurrent delay(s): 2, 95–105, 143
- condition(s): 4, 9, 23, 27, 31–33, 35, 37, 50–54, 57, 73, 76–82, 84–85, 87–90,

- 92, 112, 115, 118, 127, 129–130, 132,  
 137, 141–142, 145, 151  
 conduct: 25, 44, 49, 58, 67, 72, 74–75,  
 127–129, 131–132, 147, 149  
 confidentiality: 124  
 consequential losses: 37  
 consideration(s): 1–2, 4, 8, 12, 24, 30–31,  
 34, 50, 61, 66, 68, 78, 92, 99, 102, 137,  
 146  
 construction contract(s): 1–5, 7–8, 10–16,  
 18, 23, 32, 38, 44, 51, 73–74, 76–77,  
 80–87, 95–96, 98, 102–103, 107,  
 109–110, 114, 117, 119, 121, 123–124,  
 126, 133–134, 137, 141–143, 146, 148,  
 150–151, 156–158  
 construction mediation: 80  
 contract drawing(s): 9, 11, 84  
 contract sum: 6, 27, 137, 144  
 contractor(s): 4–6, 8–9, 11–13, 18–19,  
 23–25, 27, 31–32, 37, 49–51, 77–80,  
 81–87, 92–106, 110, 115, 118,  
 121–122, 124–126, 131, 133–135,  
 137–138, 140–143, 145–148, 151,  
 156–157  
 convention: 11  
 co-operation: 14, 23–24, 41, 43  
 cost(s): 5–6, 10, 27, 37, 39, 46, 65, 88–89,  
 91, 98, 104, 106, 123–124, 127,  
 134–136, 145, 157  
 counterclaim: 68, 103  
  
 defective work(s): 27, 147  
 defect(s): 5, 11, 13, 53, 66, 71  
 defence: 93, 120  
 defendant(s): 11, 20, 23, 25, 27–29, 31–32,  
 36, 39, 41, 48–50, 56, 58, 60, 62, 64,  
 67, 71–72, 83, 103, 106, 127, 134–136,  
 138–139, 146–147, 150, 152, 155–156  
 delay(s): 2–3, 12–13, 19, 23, 25, 28, 49, 82,  
 93–106, 127, 141–144, 148, 154  
 delivery: 7, 37, 127  
 deposit: 12  
 description(s): 6, 15, 66, 73, 84–88, 90, 92  
 design(s): 3, 5–10, 12–14, 24, 46, 54, 60,  
 78, 82, 88, 118, 123, 134, 136, 144, 146  
 determination: 80, 99, 127  
 direct: 5, 25–26, 99  
 dispute resolution: 2, 14, 24, 40, 78–80,  
 108, 109, 124, 129, 151–152, 154–155  
 disruption: 22, 82, 95, 97, 104–105, 144  
  
 documentation: 8, 86, 120  
 duties: 5, 18, 23, 69, 111  
 duty to: 18, 22–25, 105–106, 144  
  
 economic: 4  
 employer(s): 4–6, 8–9, 12–14, 18–19,  
 23–25, 32, 48, 52–54, 74, 77–82, 84,  
 86–89, 95, 97, 102–105, 118, 122,  
 124–125, 133–134, 137, 140–149, 151,  
 157  
 engineer(s): 1, 4–5, 18, 23–25, 35, 54, 73,  
 80–81, 85, 89, 91–92, 97, 141  
 entire contract: 18, 35, 57, 129  
 equipment: 23–24, 32, 36–37, 51, 89, 106  
 equity: 114  
 error(s): 3, 6, 85–87, 92, 112, 114  
 estimate: 135, 148–151  
 estoppel: 11, 155  
 evidence: 2, 20, 29–30, 33–35, 46–47, 50,  
 55, 57, 62, 67, 75–76, 81, 97, 123–124,  
 127, 139, 153–154  
 exception(s): 16, 34, 117, 121  
 excess: 138  
 exemption: 67, 70–72  
 expense(s): 9, 89, 102–104, 157  
 expert evidence: 139  
 express term(s): 13, 17, 20, 22, 26–28, 30,  
 43–45, 135  
 extra work: 20  
  
 fault: 13, 37, 98  
 final account: 81, 121, 139  
 fixtures: 9, 36  
 flood: 14  
 form(s): 2–4, 10–11, 13–14, 17, 24, 27,  
 32–34, 45–46, 48–49, 51–55, 71, 73,  
 75, 77–79, 80–82, 84, 86–87, 92–94,  
 102, 107, 110–111, 113–114, 120, 124,  
 127, 131, 133, 136, 141–142, 145, 147,  
 153–154, 156–157  
 foundation(s): 7, 60–61, 77, 86, 137  
 fraud: 35, 60, 63, 66, 69  
 fraudulent misrepresentation: 59–60,  
 62–65, 68  
  
 good faith: 2, 24, 38–45, 122, 145  
  
 hearing: 123  
  
 implied obligation: 50

- implied term(s): 17, 19–28, 30, 35, 41–42, 68
- injunction: 8, 155
- innocent misrepresentation: 61–63, 65
- insurance: 50, 53, 69, 118, 120
- intention(s): 9, 11, 15–16, 29–31, 33, 36, 43, 47, 49, 55–56, 58–60, 62, 69, 77, 79, 86, 108, 119, 126, 128, 130, 147, 156
- interest(s): 24, 32, 39, 52, 62, 66, 110, 131, 139, 150, 155
- interim certificates: 139
- interim payment(s): 5, 12, 122, 125, 132, 134, 138–140
- interpretation of contract(s): 3, 16, 17, 29, 91
- investigation(s): 7, 14, 46
- investment(s): 16, 18, 22, 25, 40, 43, 66, 69, 99, 131, 142
  
- judge(s): 16, 42, 44, 56, 58, 60, 65, 71–72, 96, 99, 104, 118–120, 122–123, 130, 136, 139, 153
- judgment: 8, 18, 25–26, 34, 39, 62, 76, 93, 99–100, 104–105, 115, 123, 125–126, 128, 131, 136, 145, 151
- jurisdiction: 24, 42, 101, 119, 152, 155
  
- labour: 4, 9–10, 18, 35, 87–88, 98, 104, 106, 124, 127, 135
- liability: 5, 13, 48, 67–71, 81, 102, 143, 146, 157
- limit(s): 28, 67, 70, 81, 93, 126
- limitation(s): 26, 37, 74, 86, 113, 145
- loss(es): 20, 37, 40, 60, 64–67, 97, 101–106, 144–146, 148–150, 157
- loss of profit(s): 145–146
  
- machinery: 32
- main contractor(s): 11, 27, 50, 84, 118, 122, 124, 133–134, 137, 140
- maintenance: 5, 13, 36, 81, 83, 89, 115
- management contracts: 5
- material(s): 4, 6, 23, 27, 33, 37, 49–51, 53, 66, 69, 81–82, 87–89, 94, 106, 120, 125–127, 135, 140, 147, 157
- mediation: 78–80
- mercantile: 33
- merchantable quality: 27
- methodology: 82
  
- misrepresentation(s): 2, 28, 35, 46, 48, 50, 52, 54–56, 58–72
- mistake(s): 2, 16, 30, 35, 59, 65, 83, 108, 109–110, 112, 114, 116–118, 120, 122, 124, 126, 128, 130, 132, 156
- mitigation: 105
- Modular Integrated Construction: 2–3, 9–12
  
- NEC: 13–14, 24, 77, 80, 114
- NEC3: 13–14, 24, 80
- NEC4: 2, 13–14
- necessary implication: 47, 130
- negligence: 102
- negotiation(s): 2, 4, 16–17, 33, 35, 38–39, 46, 47, 49, 55, 57, 67, 71, 78–79, 118, 128–133, 137, 139, 153
- nominated subcontractor: 23, 25, 31, 140
  
- offer(s): 5, 41, 50, 52, 61, 124, 126–129, 131, 132, 148
- officious bystander: 22–23
- omission(s): 32, 36, 84–86, 143, 146
- overhead(s): 87, 89, 135
  
- parol evidence: 2, 33–35, 46, 55, 57
- partnership: 115
- payment(s): 4–6, 8, 12, 41, 48, 50, 86, 102, 110, 112, 115, 122, 125–126, 132–134, 137–141, 157
- penalty: 25, 148–151
- performance: 1, 7, 19, 22–23, 35, 40–44, 81–82, 115–116, 127, 145
- period of delay: 100–101, 103
- permit(s): 8, 75, 89, 102–103, 135–136, 145
- personnel: 1, 37, 60, 125
- plaintiff(s): 20, 23, 25, 27–29, 31–32, 36, 39, 41, 48–50, 56, 58, 62–65, 71, 83, 100, 106, 124, 127, 134–135, 137–139, 147, 150, 152–153, 156
- plant: 87–89
- possession: 142
- practical completion: 13
- precedent(s): 31–32, 78, 80, 112–113, 121, 123–124, 141
- presumption(s): 30, 35, 49–50, 57, 120–121, 149, 151
- prevention principle: 25

- price: 6, 18, 25, 28, 35, 41, 48, 52, 62, 66, 73, 83–87, 91, 127, 134–135, 139, 144, 147
- procedure(s): 40, 79, 87, 89, 91, 99, 124
- procurement: 4–5
- promise(s): 20, 49, 67–68, 119
- quality: 9–10, 18, 27, 53, 94, 146
- quantum: 48, 62
- rectification: 16, 83
- reference: 3, 6, 9, 11, 17, 20, 23, 27, 30, 33–34, 38–39, 50–51, 68, 77, 80–81, 87–88, 90–91, 105, 110–111, 121, 125, 133–134, 136, 141, 144, 147, 149–150, 153
- reform: 63
- representation(s): 11, 35, 55–59, 61, 63–65, 68–72, 74–75
- repudiation: 28
- rescission: 59, 61–66
- respondent: 93
- rights: 4–5, 18, 21, 26, 39, 44, 143, 155
- scope of work(s): 6, 119, 123, 125–126, 144, 146
- set-off: 140–141
- settlement: 80, 123, 131, 154
- statutory: 7, 53, 80
- subcontract: 14, 19, 24–25, 28–29, 49, 54, 78, 84, 121–122, 134–136, 140, 147, 157
- subcontractor(s): 5, 12, 19, 23–25, 27, 31, 37, 49, 84, 97, 110, 115, 121–122, 126, 133–135, 137, 140, 146
- subject to contract: 47, 128–131
- supervision: 5
- supplier(s): 13, 31, 51
- tender(s): 4, 6, 8–9, 46, 50–54, 73, 82, 84, 107, 127, 136–138
- tender documents: 52, 54, 138
- termination: 28–29, 41, 76, 80, 129, 144, 146–149
- terms of a contract: 35, 125
- third party(ies): 4–5, 12, 25–26, 37, 39, 60, 62, 64–65, 74–76, 110, 120, 155
- time limit(s): 28, 81, 126
- time of performance: 19
- tort: 86, 129
- trial(s): 28, 49, 66, 89, 123, 136, 139
- tribunal(s): 78, 80, 123–124, 153
- unenforceable: 29, 40, 129, 148, 151
- unliquidated: 148
- value(s): 12, 19, 20, 42, 47–48, 62, 65, 85, 87–88, 90
- variation orders: 146
- variation(s): 2–3, 9, 53, 74, 82, 84, 86, 93, 118, 127, 134, 142, 144–146
- void: 29, 129
- warranty: 67, 76
- witness: 123
- workmanship: 53, 81