

Construction and the Hotel Sector

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Background

Many hotel projects are continuing to be developed across the GCC while several high profile and established hotels have recently undertaken (or are on the verge of undertaking) significant renovation or refurbishment projects, having been in operation for a number of years.

In the hotel and hospitality industry, quality and appearance (including small details) are of the utmost importance. Indeed, expectations of guests are becoming increasingly sophisticated, while positive online reviews are important for the purpose of enticing future patronage. In recognition of this, agreements with hotel operators often contain detailed and high quality specifications, while penalties frequently apply if the required levels (as well as times for completion) are not achieved.

However, satisfactory levels of delivery can only be achieved with a significant amount of careful planning and preparation.

Over recent years, we have received several instructions to assist with hotel projects that have not gone according to plan and that have encountered difficulties (including in the forms of delay and substandard quality of work). We therefore set out below what we have identified as some key 'pressure points', together with our recommendations regarding how these issues can be best mitigated.

Provision of Inadequate Works

Given the importance of quality, a frequent complaint we have encountered relates to substandard Works.

Some quality issues can emanate from the fact that the Contractor simply lacks the necessary skill, experience and/or resources to satisfy the requirements set out in the Operator's (usually stringent) requirements (which need to form part of the Construction Contract). To address this risk, we recommend that the Employer invests the time in undertaking a thorough tender process to ensure that the Contractor that is engaged is well positioned to properly perform the Works (i.e. having previously undertaken Works of a similar nature).

While inadequate Works that are visible should, in theory, be identified and dealt with relative ease (i.e. such Works should be rejected by the Engineer), more challenging issues arise if substandard Works have been covered up and/or additional Works have been undertaken 'on top' of defective Works, meaning that the defects in question are no longer visible and may only manifest themselves at a later date (sometimes after the expiry of the defects liability period).

Although Works obviously should not be covered up without being inspected and approved (and many Construction Contracts contain provisions to this effect), defective Works appear to be covered up with alarming regularity (either on account of inspections not taking place or the inspections failing to identify defects).

In this situation, the focus falls upon what the Employer can do to remedy the situation and the appropriate remedy often depends on when the defect was identified (as the Employer's remedies and causes of redress typically decrease with the passage of time).

If, for example, the defect was discovered prior to the issue of the Taking Over Certificate, then the defect could be used as a compelling reason for not Taking Over the Works, thus meaning that the Contractor

would be required to correct the defective Works as a precondition to the issue of the Taking Over Certificate. This often constitutes a strong incentive for the Contractor to address the defect. Alternatively, the Employer could invoke its rights under the Defects Liability Period if the defect is discovered after the Works have been Taken Over but prior to the expiry of the Defects Liability Period. However, complications may arise if the hotel is operational and is accepting guests at this stage, particularly as repair Works (i.e. to MEP systems) can be slow, expensive and disruptive (to the extent that it may be necessary to even close part of the hotel).



A further difficulty that the Employer may encounter is that the Performance Security that it is holding is insufficient to cover the cost of the rectification Works. This can cause significant issues if the Contractor is failing to cooperate and voluntarily comply with its rectification obligations, meaning that the Employer is required to step in and independently undertake the necessary Works (usually on an urgent basis). Indeed, it is not usual for Construction Contracts to provide that the Employer's Performance Security is halved upon the issue of the Taking Over Certificate (while we are aware of some Construction Contracts which even state that the Employer relinquishes all entitlements to Performance Security upon the issue of the Taking Over Certificate).

The situation is even more undesirable for the Employer if a material defect is only discovered after the expiry of the Defects Notification Period, in which case all Performance Security will have invariably been released while the Contract may even provide that the Contractor is released from all liability upon the expiry of the Defects Notification Period. Even if the Contractor is not released from liability, the Contractor may be reluctant to remedy the defect voluntarily, particularly if its Performance Security has been returned. This may result in the Employer having to make good the defect at its own cost in the first instance before potentially bringing proceedings against the Contractor.

However, liability for the performance of defective Works does not exclusively lie with the Contractor as the Certifier (typically the Engineer (if a FIDIC based Construction Contract is being used)) should be responsible for erroneously certifying defective Works. The basis upon which and the extent to which a claim can be brought against the Certifier will be largely determined by the provisions of the Certifier's appointment. In our experience, it is not unusual for Certifiers to be engaged on either terms of engagement that do not prescribe the Certifier's obligations in detail or are on favourable terms from the Certifier's perspective (usually at the request of the Certifier's professional indemnity insurer). For instance, liability for indirect and consequential loss (such as loss of profit) may be excluded while the Certifier's liability may be capped at a relatively low amount. This may mean that there is little point, in

practice, in bringing a claim against the Certifier.

On account of the importance of ensuring the delivery of good quality Works, it is not unusual for the Employer to engage a Project Manager to proactively supervise the Works as well as the certifications of the Engineer, while the Operator may also engage its own inspector. We endorse this approach as it can safeguard quality, thus aligning with the adage that 'prevention is better than cure'.

Coordination & Interface

Coordination and interface issues are significant if an existing hotel is being refurbished in phases (i.e. parts of the hotel remain open to the public while other parts are closed for renovations), but we note that this approach is usually only adopted if the refurbishment Works are 'cosmetic' as opposed to, say, substantive structural Works.

Even if the refurbishment Works are relatively minor in nature, it is important that the Construction Contract contains a detailed programme that sets out the times (as well as restrictions) regarding when the Works can be performed in order to minimise interference and nuisance to guests. Additionally, the health and safety aspects of performing Works in such circumstances need to be carefully considered (particularly given the potential interface with the public) and fully addressed in a comprehensive health and safety plan.

Given that renovation Works are invariably disruptive, we recommend that (as with any Construction Contract) the Construction Contract in question contains a detailed delay damages regime to incentivise the Contractor to complete the Works as quickly as possible and this should be allied with a clear mechanism that requires the Contractor to accelerate the Works (including through the deployment of additional manpower) if the actual progress fails to correspond with the requirements of the programme.

If commercially viable, the Employer may wish to consider paying a bonus if the Works are completed ahead of schedule.

Payment Issues

Payment issues frequently afflict projects, including in the hospitality sector.

Failure to make payments can come in several forms and include failure by the Employer to make due payments to the Contractor, which will obviously have a detrimental effect on the Project as a whole (and in respect of which the Contractor should ensure that it has clearly defined rights of suspension (and ultimately termination)).

However, a more common issue, in our experience, is that of the Contractor diverting payments from the Employer to satisfy other commitments that are not related to the Project. This approach frequently results in the non-payment of key Subcontractors (some of whom may be nominated by the Employer or by the Operator). This, in turn, can mean that progress and quality can be severely compromised while delays are a further likely consequence.

In this situation, an option (depending on the specific drafting) may be for the Employer to terminate the Contractor, but termination is clearly a disruptive and confrontational process that can entail both unforeseen and costly consequences and is therefore often regarded as the remedy of last resort.

As such, an alternative approach may be for the Employer to make direct payments to the Subcontractor and to deduct such payments from sums that would otherwise be due to the Contractor. However, such rights do not exist at law so it is important that the Construction Contract confers such rights upon the

Employer. It is also helpful for the Employer's right to make direct payments to be supplemented by a clear right of audit, which enables the Employer to accurately access the sums that are rightfully due to the Subcontractors in respect of whom direct payments are contemplated. This can help circumvent the common concern that direct payments to Subcontractors may result in the subcontractor receiving payments to which it is not entitled.

If the Employer decides that termination is the only solution, then the consequences of termination and the next steps need to be carefully considered and strategised. As well as ensuring that the Construction Contract has a clear basis upon which it can be terminated (and that any local law nuances have been satisfied), the Employer frequently requires the ability to directly engage (either itself or through a replacement main contractor) the Contractor's key Subcontractors (and this right needs to be clearly provided for in the drafting of both the Construction Contract and the relevant Subcontracts). It is therefore important that such Subcontractors have been engaged on sufficiently robust terms and do not contain any provisions (including in the confidentiality provisions) that prevent such Subcontractors from being directly engaged. This is particularly the case in respect of any specialist Subcontractors that are specifically identified in any agreements with the Operator.

Variations

Finally, variations need to be carefully considered.

We are aware of Employers instructing variations that are incompatible with the base design. In our experience, this can be particularly problematic in the context of projects that are in the process of being completed having been on hold for a number of years and the requirements of the Employer or the Operator have evolved since the design was initially finalised. In this regard, it is important to ensure that the variations (particularly in the form of expansions) do not negatively impact the availability of key utilities and services and issues of this nature need to be carefully considered prior to the Variation in question being instructed.

In this regard, the Contractor (and the Engineer) should be under an express obligation to proactively advise on the impact on a proposed variation.

Concluding Thoughts

Hotel projects tend to be complicated and focus on quality (especially finishes). Although each hospitality project needs to be considered on a case by case basis (and tailored for the specific circumstances in question), certain fundamental issues apply to all hotel projects and need to be clearly addressed. These include the need to ensure that an experienced Contractor is engaged, that Works are properly and independently certified and that the Employer has clearly defined contractual remedies to mitigate the impact of any breaches by the Contractor.

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