



Fenwick Elliott

The construction & energy law specialists

Annual Review

A round-up of key developments in the construction, engineering and energy arena



2011/2012

Complying with the revised ICC Rules of Arbitration

The art of negotiation in a difficult market

Operating the new adjudication and payment regimes

Ineffectiveness? Suspension? The impact of the Remedies Directive

ANNUAL REVIEW 2011/2012

Fenwick Elliott is the UK's largest specialist construction law firm with clients across the world. We advise on every aspect of the construction process in the building, engineering and energy sectors, including oil, gas, nuclear and power.

Our expertise includes procurement strategy, contract documentation and negotiation, risk management and dispute avoidance, project support, and decisive dispute resolution, including international arbitration, mediation and adjudication.

Our approach is commercial. We aim to add value to transactions and find practical solutions to disputes.



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November 2011

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Simon Tolson
Senior partner

First word

I am delighted to introduce once again the latest Fenwick Elliott Annual Review. To those that may break this open with their morning mail may I say, in the words of Stephen Fry: "Good morning, Sir. I'm delighted you have survived another night. May I add my own congratulations to the roar of the world's approval?" Smile!

Given the challenging difficulties the construction market continues to face across the global market, we thought it important to support *Building* in their survey of CEO's views, contained in the first CEO State of the Nation White Paper, which provides expert intelligence and insight into the state of the construction industry. I attended the launch of the white paper at the Savoy on 23 September 2011 (nice job Chorus by the way!). The Report comes at a time of uncertainty around recovery. On top of this, the deep cuts to public sector spending are only just now starting to bite, add to that unemployment at a 17 year high and the chemistry is taxing. Certainly, the problem over the lack of availability of financing remains. Only 15% of those surveyed said that the willingness of banks to lend had improved over the last six months, with 42% saying it had remained the same. These concerns mean that it is likely that the next year will remain a period of consolidation.

The survey also highlighted Building Information Modelling (BIM) and the government's apparent intention through its recently published 'Construction Strategy' to make this mandatory on public sector projects - the principal aim of the plan is to cut costs on government projects by 20%. Stacy Sinclair explains on pages 18-19 exactly what BIM is all about.

In the legal sphere, the latest TCC Annual Report shows that the construction courts have maintained their high workload with over 500 new cases started in the London TCC this year. This contrasts with a near 25% drop in claims overall across the country. Of the TCC claims just under 18% relate to adjudication. It will be interesting to see what the impact of the adjudication reforms will be. A word of warning however, whilst understandably we have all been concentrating on what the changes to the Construction Act mean, remember, they only apply to contracts entered into after 1 October 2011, beware the 'inbetweenies' (as the late great Ian Drury coined it) and part oral part in writing scenarios.

Here at Fenwick Elliott, the diversity of our workload continues apace, whether providing procurement advice or project support when things start to go awry. We continue to work on many major international energy and process engineering projects. Our geographical spread now ranges from wind farm projects in Northern Europe to the major gas fields and pipelines in Turkmenistan and from energy projects in Wales, Iraq and the Caribbean to the Kashagan field in Kazakhstan, and power and desalination projects throughout the Middle East. Our infrastructure work, for example advising on disputes on transport projects across the UK, Eastern Europe, the Middle East and Africa continues to flourish. Whilst in the domestic sector the nature of our work is equally varied ranging from PFI management of hospitals, schools, universities and hotels and Olympic venue contracting to providing pro bono legal advice to the Serpentine Gallery on its redevelopment of an exhibition space in Kensington Gardens.

Finally yet importantly, some of that international work could also end up in the new Rolls Building, which became the new home of TCC in October 2011. A building, fit for the 21st century, housing 31 court rooms, including three "super courts" to handle the largest international and national disputes and four courts configured in "landscape" format for multi-party cases. The move to the Rolls Building will knit in with improvements to the courts' digital systems. There has been a significant increase in the amount of international work within the TCC involving both foreign parties and projects as far away as Africa, New Zealand and the Far East. For this work, clients will often seek to use legal teams and from London. These remain challenging times and international work is so important to the UK, which as the history books tell us has always been the case.

Your feedback is always valued by us, and I remain available to discuss whatever may be on your mind.

Simon Tolson



Fenwick Elliott

The construction & energy law specialists



Jeremy Glover

Partner

Editor

In this issue

Welcome to the fifteenth edition of our Annual Review. As always, our Review contains a round-up of some of the most important developments from the past 12 months including our customary summaries - from page 41- of some key legal cases and issues, taken from both Dispatch and the Construction Industry Law Letter.

You will also see that right at the end of the Review, we have included a copy of one of our recent newsletters, *Insight*, which takes a practical look at what the latest legal developments might mean for you. If you would like to know more, please contact Lisa Kingston, the editor. The copy at pages 51-52 looks at the changes made to the payment regime which finally came into force on 1 October 2011. Remember though, as Simon said, that these changes only affect contracts entered into after that date.

Naturally this year's Review highlights the changes introduced by Part 8 of the Local Democracy, Economic Development and Construction Act 2009. Sana Mahmud, at pages 23-24 explains how the standard forms have been amended, whilst Andrew Hales, at pages 21-22 looks at the changes made to the adjudication process.

Given that the new adjudication rules also extend the right to adjudicate to those with contracts which are either wholly or partly oral, we have also taken the opportunity to include a number of articles between pages 25-30 about contract formation, including one by James Mullen on implied terms whilst Charlene Linneman looks into the "battle of the forms". Both James and Charlene take as one of their examples a case about a fire at a popcorn making facility. Before the question of liability could be addressed, the court had to decide just what contractual bargain the parties had entered into.

David Bebb too looks at contract formation from a slightly different angle, namely when it comes to negotiating the contract terms and conditions. His article, entitled "The art of negotiation in a difficult market" can be found at pages 31-34.

One other consequence of the difficult market that we currently find ourselves in, is the increase in cases which relate to bonds and guarantees. And I just don't mean in the law reports, in her article on this topic, at pages 10-13, Rebecca Saunders includes discussion of the ground-breaking case she and Simon Tolson were involved in, where the court held that fraud was not the only ground upon which a call on a bond can be restrained by injunction.

In the courts too, considerable attention is being paid to the question of costs. So much so that from 1 October, as Claire King sets out at pages 37-38, a pilot scheme has been introduced at the TCC to give the courts greater case management powers to monitor and thereby control expenditure. The pilot itself is being monitored by a team led by Nicholas Gould, in his capacity as a Senior Visiting Lecturer at King's College London. Given the success of the Mediation In Construction Disputes Report prepared by the same team, we await their interim findings with interest towards the end of next year.

The question of costs is equally in the minds of those involved in international arbitration. As Richard Smellie, explains in our lead article, the ICC has revised its Arbitration Rules. These new rules, which come into effect from 1 January 2012 include an express obligation on both the parties and Tribunal to make every effort to conduct the arbitration in an expeditious and cost effective manner.

Internationally, the ability to enforce FIDIC DAB decisions has always been a live issue. As Fred Gillion explains in his article, at pages 7-9, a case from Singapore has perhaps raised as many questions as it answered. It may be that in time all the FIDIC contracts will adopt the approach of the Gold Book, which expressly provides that a DAB decision is binding notwithstanding that a Notice of Dissatisfaction has been served

Finally, at pages 14-17, I take a look at the impact of the Remedies Directive to date, which has not necessarily been quite as expected.

As always, I'd welcome any comments you may have on this year's Review. Just email me at jglover@fenwickelliott.com.

Jeremy Glover

International arbitration

The new ICC Arbitration Rules

As Richard Smellie explains, the ICC International Court of Arbitration has revised its Arbitration Rules. The present Rules were published in 1998. The new Rules come into effect from 1 January 2012¹. Unless an existing ICC arbitration clause calls for the application of the ICC rules as at the date of the contract, the new Rules will apply to any arbitration commenced after 1 January 2012.

The ICC International Court of Arbitration is now arguably the dominant source of administered arbitration, and a core business for the International Chamber of Commerce. The new Rules are an update, and in a number of respects set out the practice developed by the Court over the past 10 years, providing transparency and greater certainty, particularly in relation to multi-party arbitration, consolidation and jurisdictional challenge.

A number of the changes are updates: the Chairman of the Tribunal is now the President, references to telex have been replaced with email, and the rules are said to cover simply “disputes” rather than “business disputes” so that there is no suggestion that disputes involving States are somehow excluded. The early quantification of claims in the Request for Arbitration is now encouraged by Article 4(3)(d), and Article 11 now requires arbitrators to be impartial, and to confirm their impartiality (it having been previously assumed that “impartiality” was covered by the confirmation of “independence”). Further, by Article 13, where the Court does not accept the proposal of a National Committee, or one party is a State, or the President of the Court considers it necessary, then the Court now has the power to appoint as arbitrator any person it considers suitable.

The much debated topic of confidentiality has also been addressed. Contrary to the understanding of many users of international arbitration, it is not automatically confidential. The new ICC Rules do not change that for ICC-administered arbitration, but expressly provide at Article 22 (3) that the Tribunal may, upon the request of the parties, make orders concerning the confidentiality of the arbitration.

The most significant changes are in three areas: case management (which the rules require and actively encourage), interim and conservatory measures (where the ICC has introduced an Emergency Arbitrator procedure) and multi-party disputes (which are now provided for, the practice of the Court having been enshrined in the Rules).

Case management

The 1998 Rules called for the arbitration to be complete within 6 months, and the practice has been that the Court will approve extensions to that time frame as needed (and extensions have usually been needed). Under the new Rules, Article 22 now includes an express obligation on the parties (as well as the Tribunal) to make every effort to conduct the arbitration “in an expeditious and cost effective manner”, (Article 22(1)) and at 22(2) obliges the Tribunal to adopt measures to ensure effective case management (provided any such measures are not contrary to any agreement of the parties).

Article 24 and Appendix IV are entirely new. Article 24 requires the Tribunal to call a Case Management Conference, at the outset of the proceedings, when the Terms of Reference are drawn up (this being a particular feature of ICC arbitration: it is the first task of the Tribunal following receipt of the file from the Court), or immediately thereafter. The objective – and indeed obligation – is to consult with the parties on procedural measures that might be adopted pursuant to Article 22(2) “to ensure effective case management”.

In order to further encourage case management, Article 24 calls on the Tribunal to hold subsequent “Case Management Conferences” to ensure continued effective case management, and at 24(4) the Tribunal is empowered to request the attendance of a party representative at a Case Management Conference, the intention being to secure the party’s “buy in” to effective case management procedures.

Appendix IV provides examples of case management techniques that might be adopted.

The new rules provide transparency and greater certainty, particularly in relation to multi-party arbitration, consolidation and jurisdictional challenge.

¹ A copy of the new rules can currently be downloaded from the ICC website - www.iccwbo.org.

International arbitration

None of the proposals in this appendix are in themselves radical, but the appendix provides a useful list of possible case management techniques. The list includes various proposals aimed at limiting disclosure, and looking for areas where the parties or their experts might agree, limiting the length of written submissions and evidence, and looking at bifurcation, the use of IT, and giving consideration to whether there are issues that might be decided on a documents only basis. It also includes encouragement to the parties to consider settlement.

The case management provisions conclude at Article 27, where a new obligation is placed upon the Tribunal: at the conclusion of the proceedings, when the Tribunal declares the proceedings closed, the Tribunal must now also inform the Secretariat and the parties of the date by which the Tribunal expects to submit its draft award to the Court for approval.

Emergency Arbitrator

Whilst the 1998 Rules made provision for the issue of interim or conservatory measures by the Tribunal once established, they did not provide a mechanism for urgent application pending the Tribunal being constituted. Consequently parties with an ICC arbitration clause would have to look to local courts for any urgent interim or conservatory measures, or wait for the Tribunal to be constituted – a process that could take several months.

The new Rules, however, now provide, at Article 29 and Appendix 5, for the appointment of an Emergency Arbitrator to make orders for urgent interim or conservatory measures, a procedure that has been included in a number of other administered arbitral rules (the SIAC and Stockholm rules being examples).

Appointment of the Emergency Arbitrator is made upon request to the Secretariat (Article 29(1)). The request must be made before the transmission of the file to the Tribunal if a Request for Arbitration has already been lodged. The appointment is made by the President of the ICC Court, who also decides whether the emergency provisions apply. Further, the fee (\$40,000) must be paid before the application will be notified to the parties under Appendix IV Article 2, and the emergency procedure commenced.

The Emergency Arbitrator must act fairly and impartially, and allow each party reasonable opportunity to present its case (Appendix IV, Article 5 (2)). By Appendix IV, Article 6(4) the Emergency Arbitrator must send his order to the parties within 15 days from the date the file is transmitted to him, and the date of transmission is expected to be on the Emergency Arbitrator's appointment, which should be within two days of the request for the appointment having been made (2(1)).

If a Request for Arbitration has not already been made by the party seeking the urgent interim relief, that Request must be made within 10 days of making application, failing which the President must terminate the emergency proceedings (Appendix IV, Article 1 (6)).

It is important to note that by Article 29(2), the Emergency Arbitrator's decision takes the form of an order, and not an award, and by Article 29(3) does not bind the Tribunal ultimately established to resolve the dispute. It is not therefore in the nature of a final, binding decision of an arbitrator, with the result that it is unlikely to be enforceable as an arbitrator's award. Its "teeth", however, are found in the power given at Article 29(4) to the Tribunal appointed to determine the dispute, to decide upon any claims relating to the emergency arbitrator proceedings. Noncompliance with an Emergency Arbitrator's order could, therefore, result in a claim.

It is also important to note that the parties are expressly given the option to opt out of these provisions. As arbitration is a process born of contract, parties could, by agreement, say that any particular parts of the Rules do not apply, but if that included rules which the ICC Court considers fundamental to ICC arbitration, then the ICC Court would decline to administer the arbitration. Whether the emergency arbitrator procedure might be regarded as fundamental is not known, but the parties have been given the express right to opt out should they so choose.

The Emergency Arbitrator can make orders for urgent interim or conservatory matters.

International arbitration

Further, by Article 29(6), these provisions will not apply to arbitration agreements entered into before 1 January 2012, and by Article 29(7), it is not intended to prevent a party applying to local courts for interim or conservatory relief.

Multi party disputes/multiple contracts

For the first time, the ICC Rules now include provision for multi-party disputes and multiple-contract arbitrations. These are found at Articles 7, 8 and 9, with Article 6 (Effect of the arbitration agreement) and Article 10 (Consolidation of arbitrations) having been amended to take account of the new multi-party provisions.

It is important to note that these provisions do not answer whether a party might be joined and/or whether all disputes referred might be heard in a single arbitration. Rather, they set out a framework for the resolution of these issues. The framework reflects the present practice of the ICC Court.

Article 6 now gives the Court the power to make a *prima facie* decision where a proposed Respondent raises an issue as to whether all of the claims made in an arbitration can be heard in a single arbitration. If the matter is referred to the Court by the Secretary General, to allow the arbitration to proceed the Court must be satisfied that, for multi-parties, there is *prima facie* arbitration agreement under the ICC Rules that binds all of the parties, and for multiple contracts, that there are *prima facie* compatible arbitration agreements and that all parties have agreed that the claims can be determined together in a single arbitration.

Any decision of the Court remains subject to the decision of the Tribunal. For the joinder of additional parties (Article 7), the Request for Arbitration against the additional party must be made before the confirmation or appointment of any of the arbitrators (unless the parties agree otherwise), and the request must include information concerning the arbitration agreement relied upon, and, if there is more than one arbitration agreement, the arbitration agreement relied upon for each claim made.

A party so joined files an Answer, and may bring a cross-claim against any party in the arbitration. By Article 8 however, like the Request that joined this party, where it makes a cross-claim its Answer must include information concerning the arbitration agreement relied upon, and if there is more than one arbitration agreement, the arbitration agreement relied upon for each claim made.

Through this procedure therefore, any party that is joined is given opportunity to play a part in the constitution of the Tribunal, and to raise any jurisdictional objection from the outset. Further, and importantly, the Tribunal is provided with the basic information it will need where there is an issue as to jurisdiction.

Article 9 supplements these provisions, by confirming that subject to the Court allowing the arbitration to proceed under Article 6, claims arising from more than one contract can be brought in a single arbitration. This does not however impinge on the Tribunal's authority to determine any jurisdictional issue that might be raised.

Finally, by Article 10, the Court is now empowered to consolidate arbitrations where claims are made under more than one arbitration agreement, and the disputes arise in connection with the same legal relationship, and where the Court finds that the arbitration agreements are compatible.

Conclusion

The new ICC Rules are to be welcomed. They bring the ICC Rules up to date, and into line with modern practice and expectations. There will inevitably be some uncertainty as to how some of the more complex provisions concerning emergency arbitrators and multi-party disputes will work, but the new Rules have been carefully thought through and drafted, and appear fit for purpose.

The new Rules have been carefully thought through and drafted, and appear fit for purpose.

FIDIC - DAB decisions

Enforcement of DAB decisions

A number of arbitral awards have recently come to light confirming the enforceability of non-final DAB decisions by ordering the losing party to pay immediately to the winning party the amounts ordered by the DAB even though a notice of dissatisfaction had been given in respect of those DAB decisions. As Fred Gillion discusses¹, recent decisions from the High Court and the Court of Appeal of Singapore seem to go against the tide and are sending a confusing message to contractors and construction practitioners dealing with the FIDIC form of contract.

Introduction

In *PT Perusahaan Gas Negara (Persero) TBK ("PGN") v CRW Joint Operation ("CRW")*², the High Court of Singapore set aside an ICC arbitral award on the basis that the tribunal had exceeded its powers in making a final award ordering PGN to make immediate payment to CRW of the sum which the DAB had decided was due to CRW. Following an appeal by CRW, the Court of Appeal confirmed the lower court's decision to set aside that arbitral award in a judgment dated 13 July 2011³. Further, the Court of Appeal concluded that the Arbitral Tribunal had, by summarily enforcing a binding but non-final decision by way of a final award without a hearing on the merits, acted in a way which was "unprecedented and more crucially, entirely unwarranted under the 1999 FIDIC Conditions of Contract".

Although some of the findings of the Singapore court are questionable, they serve as a valuable reminder to those involved with FIDIC contracts that the enforcement of DAB decisions is not a simple matter. A number of jurisdictional pitfalls exist which may prevent a winning party from obtaining in arbitration the amounts awarded by the DAB.

The facts of the Singapore case

In 2006, PGN, an Indonesian state-owned company, entered into a contract with CRW for the construction by CRW of a pipeline and optical fibre cable from Grissik to Pagardewa in Indonesia. The contract incorporated the General Conditions of the FIDIC Conditions of Contract of the 1999 Red Book. The law governing the contract was that of Indonesia.

A dispute arose between the parties regarding certain variations in respect of which CRW sought additional payment. Following a referral of that dispute to the DAB, the DAB issued several decisions, all of which were accepted by PGN except for one dated 25 November 2008 ordering PGN to pay CRW a sum in excess of US\$ 17 million ("the DAB Decision"). The following day, on 26 November 2008, PGN gave notice of its dissatisfaction with the DAB Decision in accordance with Sub-Clause 20.4 of the Contract. PGN subsequently refused to comply with the DAB Decision. This led CRW to file a request for arbitration with the ICC International Court of Arbitration (ICC Case No. 16122) in respect of PGN's failure to comply with the DAB Decision. The dispute was referred to arbitration, and the key point of this case was whether CRW was entitled to immediate payment by PGN of the sum awarded by the DAB in its Decision of 25 November 2008 ("the Dispute").

CRW's position was that, notwithstanding PGN's notice of dissatisfaction, PGN still remained bound by the DAB Decision and was required to "promptly give effect" to that decision in accordance with Sub-Clause 20.4 of the Contract. In its defence, PGN argued that the DAB Decision was not "final and binding" as it had served a notice of dissatisfaction and that a binding but not final decision could not be converted into a final arbitral award without first determining whether the DAB Decision was correct (or ought to be revised) on the merits by opening up and reviewing the DAB Decision. PGN in particular sought to argue that the powers of the Arbitral Tribunal set out in Sub-Clause 20.6³ did not include the power to direct a party to make immediate payment of the sum awarded by the DAB without a review confirming the correctness of the DAB Decision.

On 24 November 2009, a Final Award was rendered holding that the DAB Decision was binding and that PGN had an obligation to make immediate payment to CRW of the sum set out in the DAB Decision, namely US\$ 17,298,834.57. The Arbitral Tribunal also dismissed in its award PGN's interpretation of Sub-Clause 20.6 and its argument that the

The enforcement of DAB decisions is not necessarily a simple matter under FIDIC contracts.

¹ A full version of this article was published in the October 2011 issue of the International Construction Law Review.

² *PT Perusahaan Gas Negara (Persero) TBK v. CRW Joint Operation* [2010] SGHC 202.

³ *CRW Joint Operation v. PT Perusahaan Gas Negara (Persero) TBK* [2011] SGCA 33.

⁴ Sub-Clause 20.6 of the Conditions of Contract: "The arbitrator(s) shall have full power to open up, review and revise any certificate, determination, instruction, opinion or valuation of the Engineer, and any decision of the DAB, relevant to the dispute."

FIDIC - DAB decisions

Arbitral Tribunal should open up and review the DAB Decision, and noted that PGN had however still the right to commence a separate arbitration to open up, review and revise the DAB Decision. CRW then proceeded to register the Final Award as a judgment in Singapore. In response, PGN applied to set aside the registration order and also sought an order from the High Court of Singapore to set aside the Final Award, on the basis *inter alia* that the Arbitral Tribunal had exceeded its jurisdiction by converting the DAB Decision into a Final Award without determining first whether the DAB was correct on the merits.

By its decision dated 20 July 2010 ("the High Court Decision"), the High Court of Singapore found in PGN's favour and set aside the Final Award for lack of jurisdiction of the Arbitral Tribunal. Dissatisfied with the High Court Decision, CRW filed an appeal, which was dismissed by the Court of Appeal of Singapore in its judgment dated 13 July 2011 ("the Court of Appeal Decision").

The High Court Decision

In reaching its decision to set aside the Final Award, the High Court of Singapore examined the contractual framework set out in Clause 20 for the resolution of disputes between the parties and in particular the requirement for a dispute to have gone through various steps, including a referral of the dispute to the DAB, before it may be referred to arbitration. It also considered the distinction between the proceedings envisaged by Sub-Clauses 20.6 and 20.7 of the Condition of Contract. The High Court held that the Arbitral Tribunal had acted outside its jurisdiction in two respects:

- (i) The Dispute that CRW referred to arbitration in ICC Case No. 16122 (namely PGN's non-payment of the sum set out in the DAB Decision as opposed to the underlying dispute) had not first been referred to the DAB and was therefore "*plainly outside the scope of sub-cl 20.6 of the Conditions of Contract*"⁴.
- (ii) The arbitration proceedings commenced by CRW were made pursuant to Sub-Clause 20.6 of the Conditions of Contract, which, according to the Singapore Court, requires "*a review of the correctness of the DAB Decision*"⁵ and must be distinguished from proceedings brought under Sub-Clause 20.7 which do not require the Arbitral Tribunal to consider the merits of the DAB Decision. That distinction meant that the Arbitral Tribunal had acted outside its jurisdiction by making final a binding DAB Decision without first hearing the merits of that DAB Decision.

What should CRW have done, according to the Singapore Court, to enforce its binding but not final DAB Decision? The Singapore Court dismissed the simple option of a referral to arbitration of the losing party's failure to comply with the DAB Decision. It held obiter that a winning party should do the following: (1) refer the underlying dispute covered by the DAB Decision to arbitration and ask the Arbitral Tribunal to review and confirm the DAB Decision; and (2) include a claim for an interim award in respect of the amount that the DAB ordered the losing party to pay.

The Court of Appeal Decision

Although the Court of Appeal ultimately confirmed the High Court Decision to set aside the Final Award, the basis on which it reached its decision is quite different. The basis of that Decision dated 13 July 2011 essentially lies with the matters which the Arbitral Tribunal was appointed to decide as set out in the Terms of Reference signed by the parties. The Court of Appeal explains the following:

"The TOR stated clearly that the Arbitration was commenced pursuant to sub-cl 20.6 of the 1999 FIDIC Conditions of Contract. Further, it is plain that under the TOR, the Arbitral Tribunal was, by the parties' consent, conferred an unfettered discretion to reopen and review each and every finding by the Adjudicator. In other words, the Arbitral Tribunal was appointed to decide not only whether CRW was entitled to immediate payment of the sum of US\$17,298,834.57... but also "any additional issues of fact or law which the Arbitral Tribunal, in its own discretion, [might] deem necessary to decide for the purpose of rendering its arbitral award"."⁶

The Tribunal had acted in a way which was "unprecedented and more crucially, entirely unwarranted under the 1999 FIDIC Conditions of Contract".

⁴ Judgment, paragraph 31.

⁵ Judgment, paragraph 37.

⁶ Court of Appeal Decision, paragraph 43.

FIDIC - DAB decisions

With what the Court of Appeal describes as “this crucial backdrop in mind”, it went on to consider whether the Final Award was issued in accordance with Sub-Clause 20.6. It was not by refusing to open up, review and revise the DAB Decision and proceeding instead to make a final award without reviewing the merits of that decision, the Arbitral Tribunal had ignored the clear language of Sub-Clause 20.6 to “finally [settle]” the dispute between the parties. The Court of Appeal considered that “What the Majority Members ought to have done, in accordance with the TOR [Terms of Reference] (and, in particular, sub-cl 20.6 of the 1999 FIDIC Conditions of Contract), was to make an interim award in favour of CRW for the amount assessed by the Adjudicator (or such other appropriate amount) and then proceed to hear the parties’ substantive dispute afresh before making a final award.”⁷

The Court of Appeal considered that the Final Award was therefore not issued in accordance with Sub-Clause 20.6, which in turn raised the question of whether the Arbitral Tribunal exceeded its jurisdiction in making the Final Award (Article 34(2)(a)(iii) of Model Law) and whether it breached the rules of natural justice (section 24(b) of the Singapore International Arbitration Act). These were the two grounds relied upon by PGN for setting aside the Final Award and accepted by the Court of Appeal in this appeal⁸.

Implications of the Singapore case

The implications of these decisions are difficult to predict. One thing is certain, the conclusion of the High Court is already being relied upon in other arbitration proceedings in support of defences to claims for immediate payment of amounts awarded by DABs as well as in enforcement proceedings. For this reason, the decisions of the High Court and the Court of Appeal of Singapore merit careful examination.

A thorough analysis of the High Court Decision shows that the Singapore Court seems to have been misguided in its interpretation of Sub-Clauses 20.6 and 20.7. There is nothing in the FIDIC Conditions that would prevent a winning party from referring to arbitration simply the issue of the other party’s failure to comply with a DAB decision, as a second dispute, without having to refer also the underlying dispute. It should therefore be possible for a winning party to commence a relatively straightforward arbitration simply based on the other party’s breach of Sub-Clause 20.4. Only one condition should not be overlooked by the winning party before doing so: that second dispute must have been first referred to the DAB and an adequate and timely notice of dissatisfaction must have been served in respect of that second DAB decision.

In that respect, the High Court of Singapore was correct when it concluded that since the Dispute which CRW referred to arbitration (namely non-payment of the DAB Decision) had not first been referred to the DAB, it was plainly outside the jurisdiction of the Arbitral Tribunal. Sub-Clause 20.7 makes it clear that the only situation where a party may refer directly to arbitration the other party’s failure to give effect to a DAB decision without having to comply first with the requirements of Sub-Clause 20.4 and Sub-Clause 20.5 is in the event that no party has expressed dissatisfaction with the DAB decision and that DAB decision becomes as a result final and binding. In ICC Case No. 16122, a notice of dissatisfaction had been given by PGN, making the DAB Decision binding but not final. Sub-Clause 20.7 was therefore not applicable.

It will be interesting to see how the problem of the enforcement of DAB decisions will be addressed in the second edition of the 1999 FIDIC Books which is expected to be published next year. One approach which the FIDIC Contracts Committee might adopt will be to amend Clause 20 along the lines of the FIDIC Gold Book 2008 by adding in Sub-Clause 20.6 that the DAB decision is binding and that the parties have to comply with it “notwithstanding that a Party gives a Notice of Dissatisfaction with such a decision” and by providing in Sub-Clause 20.7 that in the event that a party fails to comply with a decision of the DAB, whether binding or final and binding, then the other party may refer that failure to arbitration without having to refer first that matter to the DAB and then to wait for the amicable settlement period to expire. These amendments would bring more certainty to what is currently an ambiguous section of the 1999 suite of FIDIC contracts and would no doubt give parties more faith in the DAB process and its outcome.

Under the FIDIC Gold Book the DAB decision is binding and the parties have to comply with it “notwithstanding that a Party gives a Notice of Dissatisfaction with such a decision”.

⁷ Court of Appeal Decision, paragraph 79.

⁸ PGN did not dispute the decision of the High Court to reject its submissions on Article 34(2)(a)(iv) of the Model Law, namely that “the arbitral procedure was not in accordance with the agreement of the parties, which required the merits of the underlying dispute and/or the question of whether the DAB Decision was made in accordance with the Contract to be determined prior to making that decision a final award” (High Court Decision, paragraph 9).

Bonds and guarantees

Bonds and guarantees

The purpose of a performance bond or guarantee is to ensure a third party delivers goods or performs services in accordance with the terms of an underlying contract. The issuer of a bond (usually a reputable trading bank) or a guarantee (often a parent company) undertakes to pay to the beneficiary (such as an Employer) a sum of money if the third party (such as a Contractor) fails to comply with its obligations under the contract. These bonds and guarantees are common forms of security in the construction industry. Perhaps unsurprisingly, the law in this area has undergone something of a shake-up in the past 12 months. Rebecca Saunders reviews some recent cases¹, and draws together some points to consider when entering into or making a call under, a performance bond or guarantee.

Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd²

This first case provides a reminder as to what constitutes an on demand performance bond, and what constitutes a conditional guarantee. The terms “performance bond” and “guarantee” are often used synonymously in the construction industry but they are in fact quite different forms of security.

Vossloh is the parent company of the Vossloh Group – a group of rail infrastructure and technology companies. Its subsidiary, Vossloh Locomotives (“VL”), manufactured and supplied trains to a number of companies owned by Alpha. This arrangement was recorded in a master purchasing agreement (“MPA”). In conjunction with the MPA, Vossloh provided a parent company guarantee of VL’s obligations under the MPA to Alpha, which included guarantees as to VL’s performance of the MPA, an undertaking to pay – on demand - sums owed to Alpha under the MPA in the event that VL did not pay, and an indemnity against any losses suffered by Alpha in the event VL failed to perform. Disputes arose between the parties and Alpha argued that the guarantee given by Vossloh was in the nature of an “on demand” bond in that it constituted an unconditional independent promise to pay on demand all amounts demanded, i.e. Vossloh’s liability was triggered by a demand alone. Vossloh argued that liability under the guarantee was triggered upon proof of a breach of contract, i.e. Vossloh’s liability was conditional upon a breach of the MPA by VL. In reaching his decision, the Judge, Sir William Blackburne provided a helpful summary of the law in this area:

“There is in this field of law a spectrum of contractual possibilities ranging from the classic contract of guarantee, properly so called, at the one end, where the liability of the guarantor is exclusively secondary and will be discharged if, for example, there is any material variation to the underlying contract between principal and creditor, to the performance or demand bond (or demand guarantee) at the other end, where liability in the giver of the bond may be triggered by mere demand and without proof of default by the principal (and indeed where it may be apparent that the principal is not in default). There may be little to distinguish (and it may not matter) whether the obligation undertaken is in the nature of a guarantee (strictly so called) or an indemnity. Where it does matter, the question is whether the liability to be enforced is secondary (or ancillary) to that of the principal (however qualified that liability may be), in which case the obligation is in the nature of a guarantee, or primary, in which case it will be in the nature of an indemnity and, if the latter, may be enforceable merely on demand (as with a performance or demand bond) or conditional on proof of default by the principal or on satisfaction of some other event or requirement. Where on the spectrum a particular case falls may call for a nice judgment on the part of the court faced with the task of construing the instrument in question. The instant case calls for just such a judgment.”

Alpha’s claim failed. The Judge held that there is a presumption that an instrument is not a performance bond unless it is issued by a bank in the form of a banking instrument. Alpha had not rebutted that presumption. The mere use of the expression “on demand” was insufficient to establish that the guarantee was in fact “on demand”. Vossloh’s liability was secondary to VL’s. To establish that Vossloh was liable under the guarantee, Alpha had to show that VL was in default in performing the underlying contract or making a payment that was due; Vossloh was not liable to pay against a mere assertion in that regard.

Fraud is not the only ground upon which a call on a bond can be restrained by injunction.

¹ In addition, readers interested in this topic are referred to the Golden Ocean case summarised on pages 45-46 below, which warns of the potential perils of electronic signatures.

² [2010] EWHC 2443 (Ch).

Bonds and guarantees

*Simon Carves Ltd v Ensus UK Ltd*³

This case raises issues rarely addressed as to the extent to which a beneficiary may be prevented from seeking payment under a demand bond by the terms of the contract in respect of which the bond is provided. SCL was employed by Ensus to construct a bioethanol plant on Teesside. The contract incorporated the IChemE "Red Book" with some bespoke special conditions including one requiring SCL to provide a performance bond as security for its performance of the contract. This was duly issued by SCL's bank, Standard Chartered. The bond itself was an unconditional autonomous document between Standard Chartered and Ensus, allowing Ensus to make a call on the bond at any time for any reason before its stated expiry date of 31 August 2010.

Importantly, the special conditions also provided that on the issue of the Acceptance Certificate by Ensus's Project Manager, the bond would "*become null and void (save in respect of any pending or previously notified claims)*". The conditions further provided that the bond should be returned to SCL as soon as it became null and void, "*save where there are pending claims (including previously notified claims), in which case it shall be returned following final determination and (if applicable) payment of such claims and shall in the meantime remain valid*". If the bond was subject to a fixed expiry date, SCL should extend or replace the bond if it had not yet been returned by Ensus. If SCL failed to extend the bond, Ensus could call the outstanding balance of the bond and hold it as security, making any deductions for the amount of any outstanding claims. The Acceptance Certificate was issued on 19 August 2010 and listed a number of known defects which SCL was bound to make good, one of which related to odour emissions. SCL said that the bond was null and void and that it should be returned along with any retained monies because Ensus had not made any "claims" under the Contract. Ensus sought approval for return of the bond from its financiers – they declined, saying that Ensus needed the security for the list of defects attached to the Acceptance Certificate.

In late August 2010, with the bond about to expire, SCL and Ensus entered into talks about extending the bond. At the eleventh hour, under threat of a call from Ensus, the bond was extended to the end of 2010. It was later extended again to 28 February 2011. On 15 February 2011, Ensus issued a "claim" in respect of the odour problem. On 25 February 2011, SCL sought an injunction restraining Ensus from making a call. This was granted. However unbeknown to SCL, Ensus had already made a call earlier that week but the bank had not yet paid out on it, so SCL had to seek a variation to the injunction, requiring Ensus to withdraw its call. This was also granted. Following a full hearing, Mr Justice Akenhead held that the injunction was valid and should continue. He recognised that there was little authority addressing circumstances where there are contractual provisions between a contractor and employer which impose restrictions or prevent calls being made on bonds. The Judge summarised the law as follows:

- (a) Unless fraud is established, the court will not prevent a bank from paying out on a demand bond provided the conditions of the bond itself have been complied with (such as formal notice in writing). However, fraud is not the only ground upon which a call on a bond can be restrained by injunction.
- (b) The same principles apply in relation to a beneficiary seeking payment under the bond.
- (c) There is no legal authority that permits a beneficiary to make a call on the bond when it is expressly disentitled from doing so.
- (d) If the underlying contract clearly and expressly prevents the beneficiary from making a demand under the bond, it can be restrained by the court from making a demand under the bond.
- (e) The court did not need to make a final determination on whether the underlying contract prevented payment at the interim injunction stage. It only needed to satisfy itself that the party resisting the demand had a "strong case". It cannot be expected that the court at that stage will make in effect what is a final ruling.

There is a presumption that an instrument is not a performance bond unless it is issued by a bank in the form of a banking instrument.

³ [2011] EWHC 657 (TCC)

Bonds and guarantees

*AES-3C Maritza East 1 Eood v Crédit Agricole Corporate and Investment Bank and Another*⁴

Maritza and two Alstom group companies were parties to a contract for the construction of a power plant in Bulgaria. Alstom, as contractor, provided an on-performance bond from its bank, Calyon, in favour of Maritza. The bond was separate and independent to the construction contract. The monies secured by the bond were payable to Maritza on receipt of a demand made in accordance with clause 4 of the bond, which provided that:

"The Bank shall have no liability in respect of a demand which does not satisfy all the following requirements.

...

(b) the demand contains a statement (or statements) to the effect (or substantially to the effect) that either:

(i) the Contractor has failed to comply with its obligations in accordance with [the EPC Contract];

...

(f) the demand contains any notice to or claim against the Contractor relating to the respective breach of its obligations to which the demand refers."

The bond was payable against an appropriately worded demand accompanied by such documents as the demand required and without proof of the existence of a liability under the construction contract. In this case the only documents that were required were a notice to or claim against Alstom under the construction contract.

It was clear by December 2010 that Alstom would fail to finish certain aspects of its works on time – it had deadlines for 25 and 31 December 2010 for completion of units 1 and 2. So on 20 December 2010, Maritza demanded 93m euros from Calyon, which purported to cover Alstom's existing liabilities and those it seemed clear would arise by 25 and 31 December when Alstom would be late. On 28 December 2010, before a court in France, Alstom obtained interim injunctions preventing Calyon from making any payment under the performance bond. Alstom took the view that the demand was ineffective because it only enclosed notices or claims against Alstom in the sum of 27m euros – not the 97m euros demanded. Three days later, Maritza applied for summary judgment to enforce the first demand. Then on 17 January 2011 Maritza issued a second demand against Calyon in the sum of EUR96.6m, this time attaching letters and invoices which substantiated the sum claimed. Alstom was granted a further injunction, Maritza applied for summary judgment and in late January 2011 both claims were heard in the TCC.

Mr Justice Ramsey decided that the question of whether there had been a relevant demand under an on-demand bond depended upon the wording of the particular bond. In this case, the bond was payable against an appropriately worded demand accompanied by such documents as the demand required and without proof of the existence of a liability under the construction contract. The only documents that were required were a notice to or claim against Alstom under the construction contract. Given that Maritza had failed to substantiate some 66m euros of the sum it claimed under its first demand, that demand failed. However, Maritza substantiated all of the monies demanded the second time around, therefore that demand succeeded and Maritza was accordingly granted summary judgment in the sum of 96.6m euros.

*Hackney Empire Ltd v Aviva Insurance UK Ltd*⁵

HEL, the owner of the Hackney Empire engaged a contractor ("STC") to carry out extensive refurbishment work to the theatre. Aviva issued a bond in favour of HEL to secure the performance of STC under the contract. Then HEL and STC entered into a side agreement which limited the amount of liquidated damages payable by STC and prevented the parties from referring disputes to adjudication for a period of time. They also agreed that if STC did not meet the target completion date, it would repay all of the sums paid under the side agreement. STC went into administration. HEL duly demanded repayment of the money paid under the side agreement, confirmed it had suffered losses as a result of STC's failure to complete the work and made a claim under the bond for the full amount.

⁴ [2011] EWHC 123 (TCC).

⁵ [2011] EWHC 2378.

Bonds and guarantees

What is the difference between entering into a side agreement and varying the terms of an existing contract?

Aviva argued that the old rule in *Holme v Brunskill* meant that the payments to STC under the side agreement had discharged its liability under the bond. This rule provides that if there is any agreement between the principals (in this case HEL and STC) to alter the principal contract (i.e. the building contract) then the surety should be consulted and if the surety has not consented to the alteration, or if it is not self-evident that the alteration is unsubstantial or cannot be prejudicial to the surety, then the court will not go into the merits of the alteration or the question of whether it is prejudicial but will instead allow the surety to be discharged from its obligations. Aviva argued that they did not consent to the agreement and it was not self-evident that the alteration was unsubstantial or could not be prejudicial to Aviva. On this basis, the court should not go into the merits of the alteration in question or whether or not it is prejudicial but should allow Aviva to treat itself as discharged. HEL said that the rule only applied if the variation of the principal contract is such that it increases the risk of default by the principal and therefore that there will be a call on the bond. HEL argued this is quite different to the position where the variation merely affects the amount of the surety's ultimate liability but leaves the risk of default unchanged. Put another way, the payment of sums on account only create or increase the indebtedness but do not increase the risk of STC not performing under the building contract.

The court agreed with HEL. Whilst the side agreement did vary the building contract it did so only in two ways, both of which fell within the exceptions to the rule in *Holme v Brunskill*. This is because the side agreement effectively limited the amount of liquidated damages HEL could claim to £100,000.00 if STC met the target completion date (which was beneficial, rather than prejudicial, to Aviva) and it provided that neither HEL or STC would refer disputes to adjudication for an agreed period (which the court held was of no consequence to Aviva). However, the court held that whilst Aviva were not discharged from their obligations under the bond that bond did not extend to the obligations under the side agreement as these obligations had not been contemplated by Aviva when assuming liability under the bond.

Conclusion

Following *Vossloh*, it seems likely that the courts will only find that there is an "on demand" bond where it is clear on a proper interpretation of the document as a whole that the parties intended the liability of the bondsman to exist separately from the underlying liability of the contractor. Further, the use of the words "on demand" will not in every case suggest that a bond is in fact "on demand" in nature, if it is clear that on a proper construction the parties intended it to be "conditional" in the sense that there are preconditions to the issuer's liability.

The *Maritza* case provides a reminder to beneficiaries seeking to make a call under a performance bond to comply with the formal requirements of the bond itself (specifically, providing the relevant supporting documentation if the performance bond so requires) before making a call; failure to do so can be fatal.

Some might argue that the *Simon Carves* decision means that employers will no longer be able to rely on performance bonds issued by banks – which the courts have historically avoided interfering with – to cover problems created by recalcitrant contractors. But that cannot be so. SCL demonstrated that it had a "strong case" that the bond had expired by virtue of the underlying contract. This, coupled with the concern about the effect a call on the bond would have on SCL, warranted the injunction being maintained. An employer cannot in effect agree to withhold from making a call on a bond by contract and then make a call; that is profoundly unfair and cannot be in the interests of commerce. If anything, this case serves to add a string to a very lean bow for contractors seeking to rely on the terms of an underlying contract as to the validity of a performance bond.

Finally the HEL case provides valuable clarification about the difference between varying the terms of an existing contract and entering into a separate side agreement, as well as of the importance of ensuring that everyone affected by the side agreement knows, and agrees with, what is going on.

EU Procurement

So what is the impact of the Remedies Directive so far?

The changes implemented by the Remedies Directive and the Public Contracts (Amendment) Regulations 2009 came into force on 20 December 2009. Prior to their introduction, there was a lot of talk about their likely impact. So, as Jeremy Glover asks, what actually happened? The new regime increased the level of detail contracting authorities are required to give to tenderers. Award letters had to include: (i) the award criteria; (ii) the bidder's score; (iii) (in the case of an unsuccessful tenderer) name and score of the successful tenderer; (iv) a statement of the standstill period and a summary of the relevant reasons for the decision. The other two main changes introduced were:

(i) Automatic suspension

In recognition of the need to allow the courts sufficient time to act within the standstill period, the new regulations required that once an application for review has been made by an aggrieved tenderer, the contract cannot be entered into until the court has made a decision regarding the application.

(ii) Ineffectiveness

The new Remedies Directive stated that public contracts will be "ineffective" where there is a breach of the public procurement rules. By way of example, a contract will be rendered "ineffective" in the following circumstances:

- (i) If the contracting authority awards a contract without prior publication of a notice in the Official Journal of the European Union.
- (ii) If a contract is entered into under a framework agreement or dynamic purchasing system in breach of the public procurement rules.
- (iii) Where a contract is concluded without application of a proper standstill period, or where rules governing the suspension of a contract pending court proceedings have been breached, and has affected the chances of the claimant winning the contract.

Automatic suspension: 18 months on

There have been a number of cases since 1 December 2009 where the Contracting Authority has sought to lift the automatic suspension. In all but one, the Contracting Authority has been successful. In *Exel Europe Ltd v University Hospitals Coventry and Warwickshire NHS Trust*¹, the Defendant applied to have the automatic suspension under Regulation 47G lifted. Mr Justice Akenhead confirmed that the principles with regard to interim injunctions as set out in the well-known case of *American Cyanamid Co. v Ethicon* would apply to these situations. He said that "... the Court should go about the Cyanamid exercise in the way in which courts in this country have done for many years". In other words, the Regulations do not favour maintaining the prohibition on the contracting authority against entering into the contract in question².

Accordingly, the Judge applied the *American Cyanamid* principles. The first question to be answered is whether or not there is a serious question to be tried and the second question involves considering whether the balance of convenience lies in favour of granting or refusing the interlocutory relief sought. The governing principle in relation to the balance of convenience test is whether or not the claimant would be adequately compensated by an award of damages. Here, Mr Justice Akenhead found that there was a serious issue to be tried only in respect of one of the six allegations advanced by Exel. Exel alleged that the Defendant's discussions/negotiations with, another party, HCA International five months immediately prior to the open public procurement process gave them an unfair advantage, distorted competition or breached the principles of equal treatment and transparency. Mr Justice Akenhead found that this was the only serious issue to be tried and that the remaining five issues were at best weak.

"The potent desirability of awarding the relevant contract without further delay, interruption or uncertainty is, by some measure, the dominant factor in the balance of convenience equation, comfortably eclipsing the sundry countervailing considerations advanced by the Plaintiff."

¹ [2010] EWHC 3332 (TCC).

² The Judge took a similar view in the *Halo Trust v The Secretary of State for International Development* [2011] EWHC 87 (TCC).

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With respect to the balance of convenience test, the Judge found that this was an appropriate case which required that public interest be taken into account. He held that an important area of public interest is the efficient and economic running of the National Health Service and the procurement of medical goods, drugs, equipment and services. Here, the Defendant had clearly established an urgency for the procurement of this contract, as the existing agreements for the provision of the services had expired in March 2010. If the suspension was not lifted, a judgment would likely not be obtained before May or June 2011 at the earliest, thereby further jeopardising the services currently being provided. Finally, the Judge was wholly satisfied that damages would be an adequate remedy.

In Northern Ireland, McCloskey J has considered two cases. In the first, he took a similar line in lifting the suspension³. The public interest outweighed the disadvantages that may be suffered by the aggrieved tenderer. To not do so would be of clear detriment to vulnerable and socially disadvantaged members of society. The Judge said:

"I am of the opinion that, considered collectively and dispassionately, these factors pale when juxtaposed with the public interest in play, identified above. The status quo in the Foyle area is plainly intolerable and should not be permitted to continue, absent some compelling justification. In my view, no such justification exists. The potent desirability of awarding the relevant contract without further delay, interruption or uncertainty is, by some measure, the dominant factor in the balance of convenience equation, comfortably eclipsing the sundry countervailing considerations advanced by the Plaintiff."

The courts seem to be heavily influenced by the need to take into account the public interest in maintaining existing services or providing new ones. There has only been one exception to this trend, the case of *First4Skills Ltd v the Department for Employment and Learning*⁴, which also came before McCloskey J. This case was a little unusual in that the court had already refused the Department's application to lift the suspension in response to a claim brought by a different tenderer. Thus the court wasted little time in rejecting the Department's application. However, the Judge did go on to review the merits. He specifically noted that the correct approach in principle was that expressed by Mr Justice Akenhead in the *Exel* case. He also noted, contrary to the other cases, that here there was a serious issue to be tried. In the other cases the judges had said that the exercising of the balance of convenience was not influenced by the strength of the claimant's case.

Here the Judge had to balance the projected savings to the public purse; the improvements in the proposed new contractual arrangements; the advantages to both trainees and employers; the requirements of legal certainty; the limitation on any potential contract extension (not beyond March 2012); and the desirability of uniformity throughout the United Kingdom in the provision of training to apprentices against the plaintiff's cross-undertaking in damages and the reasonable prediction that the proceedings would be completed to the stage of judgment in advance of March 2012, when the contract extension will expire. One significant difference between the two Northern Irish cases appears to be the lack of public interest factors in the *First4Skills* case.

So to date, the evidence from the courts is that the balance is in favour of the contracting authority being able to persuade the courts to lift any suspension, leaving the aggrieved tenderer to seek the remedy of damages.

Ineffectiveness and time limits

Towards the end of the summer, the long-running dispute over the award of a contract for a new generation of trains to be used in the Channel Tunnel came to an end. The part of the case discussed here⁵ is interesting for two reasons. Firstly, Alstom objected to the decision and commenced proceedings in which it sought a declaration of ineffectiveness in relation to a preliminary contract. Second, it was said that the claim was brought out of time. This was the first time that a declaration of ineffectiveness had been sought from the courts.

To date, the evidence from the courts is that the balance is in favour of the contracting authority being able to persuade the courts to lift any suspension, leaving the aggrieved tenderer to seek the remedy of damages.

³ *Rutledge Recruitment & Training Ltd v Department for Employment & Learning and Anr*, [2011] NI QB 61.

⁴ [2011] NI QB 59.

⁵ *Alstom Transport v Eurostar International Ltd and Anr*, [2011] EWHC 1828 (Ch)

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Here, Alstom argued that the contract eventually entered into with Siemens was materially different to the contract tendered for, which meant that the contract had been awarded without prior publication of a notice in the *Official Journal*. Further, this material difference meant that Eurostar had not observed a proper standstill period; both reasons why a proper procurement process had not been followed. Mann J looked at the qualification notice issued by Eurostar to commence the tender process and held that it was wide enough to cover the contract signed with Siemens, even in its varied form. The Judge said that the test of whether a proper notice has been provided is a "mechanistic" one which was satisfied here.

The key change introduced is that the time limit for bringing a procurement claim will be reduced to 30 days from the date of knowledge, that is the date on which the economic operator first knew, or ought to have known, that grounds for starting proceedings had arisen.

There was a further problem for Alstom in that, on the facts, there was no reason why Alstom could not have brought its claim for ineffectiveness before the end of the standstill period and so before the contract had actually been entered into. Alstom needed to establish that there was a breach of the standstill requirement and that that breach prevented Alstom from starting proceedings before the conclusion of the contract, or prevented it from bringing those proceedings to a conclusion. Here, there was a standstill period announced by Eurostar. There was a moratorium. Within that period Alstom managed to formulate and bring proceedings seeking to stop the contract. While those proceedings at that time did not have all the material currently available, it was apparent that the essence of the current argument about the varied contract was recognisable. Accordingly, either there had either been no breach of the standstill obligation, or if there had been, it had not deprived Alstom of the chance of starting proceedings. Mann J said:

"To some extent the ineffectiveness provisions are obviously intended to operate only when anticipatory proceedings could not be brought. One can understand that as a rationale - it was obviously thought that it would be better to try to stop a contract than to try to bring an existing contract to an end. Particularly after it has been on foot for some considerable time. The possibility of the former should exclude the latter; the latter should only be available when the former has not been possible because of act of the utility in not holding its hand on contracting to the requisite extent. In the present case Alstom's own acts have demonstrated that it was able to launch proceedings before the contract was entered into."

New amendment to the Public Procurement Regulations

On 1 October 2011, the Public Contracts Regulations 2006 were further amended by the Public Procurement (Miscellaneous Amendments) Regulations 2011. One reason for this was as a result of the *Uniplex* decision⁶. In *Uniplex*, the European Court had suggested that the current UK requirements to bring procurement challenges promptly were imprecise and uncertain. The result of these changes is to increase the pressure on a contractor who considers that he might want to challenge the tender process, to do so promptly, albeit as the *Alstom* case demonstrates, that is already something contractors must be alive to, and by promptly we mean from the date when the contractor suspects that there has been a breach, and that is not necessarily at the end of the tender process.

The key change introduced is that the time limit for bringing a procurement claim will be reduced to 30 days from the date of knowledge, that is the date on which the economic operator first knew, or ought to have known, that grounds for starting proceedings had arisen. The court will continue to have discretion to extend this period where there is good reason for doing so, subject to an absolute maximum period of three months. If the date of knowledge was before 1 October 2011, then the old time limits, namely three months from the date of knowledge, will continue to apply. If a formal claim is to be made, the new regulations make it clear that proceedings will commence, and the time clock will stop ticking, on the issue of the claim form rather than the date of service on the defendant. The claim form must be served on the contracting authority within 7 days after the date of issue. The amendments also make it clear that the automatic suspension will be triggered when that authority becomes aware that a claim form has been issued.

Finally, the Regulations have also been amended to reflect the new criminal offences introduced by the Bribery Act 2010, which came into effect on 1 July 2011.

⁶ Uniplex UK Ltd v NHS Business Services Authority [2010] 2 CMLR 47.

EU Procurement

Procurement regulations – the future

On 24 June 2011, the European Commission published the Evaluation Report: Impact and Effectiveness of EU Public Procurement Legislation¹. In light of the forthcoming changes to the procurement regulations, the conclusions of that report provide interesting reading.

The conclusions included that whilst the Procurement Directives had helped achieve greater transparency and competition within the EU, direct cross-border procurement had not increased as anticipated. It was felt that many tenderers were deterred from bidding in other member states by a combination of competitive administrative and legal factors. Costs had been reduced by around 4% creating savings of €20 billion. However, the report also suggested that the average tender procedure takes 108 days at a cost of €28,000 – and three-quarters of that cost will be borne by the tenderers. The difference between the quickest and slowest performers is approximately 180 days. Further, the average time necessary to award a contract is 58 days, with a range of 45 to 245 days depending on the complexity of the contract. The report also has interesting conclusions about the different approaches, saying that public procurement:

The procedures are too complex and too bureaucratic and the rules need revision to remove legal uncertainties and the costs of legal challenges.

“is not only about obtaining the lowest price per contract. Qualitative and other performance considerations – including contribution to other policy objectives – may be integral to the procurement outcome. In general, contracting authorities do not focus on the lowest price but look for the economically most advantageous offer overall, taking into account quality or life cycle cost. Indeed 70% of all contract notices (and nearly 80% in terms of value) use the economically most advantageous tender criteria rather than lowest price. Lowest price is used more frequently for smaller contracts and less complicated procedures. The evaluation also finds that the integration of green or socially responsible requirements in tender specifications is effective in ensuring that [the successful tenders] embody these features.”

The report also revealed that many respondents believed that there remained a number of problems with the current legislation. There was also a consensus that streamlining the procedures and making them more flexible and less formal was particularly important. Many thought that there would be a benefit in being able to discuss offers during the tender exercise or that contracting authorities should be able to take into account their experience, if any, with bidders - despite all the attendant non-transparent risks of favouritism and discrimination. Heide Ruehle MEP, spokesperson for the Committee on Internal Market and Consumer Protection, seems to agree. She has said that the procedures are too complex and too bureaucratic. The procurement rules need revision to remove legal uncertainties and the costs of legal challenges. Her solutions² include:

- *make it easier for public procurers and SMEs*
- *be clear about the messages*
- *“cheapest possible” criteria must be abandoned*
- *adopt “most sustainable and economic” criteria including life cycle cost*
- *more flexibility in procedures.*

The EU has said that it intends to use the report findings when it publishes its new legislative proposals at the end of 2011. The revision of EU Public Procurement Directives is one of 12 key actions identified in the Single Market Act, which:

“underpin a balanced policy which fosters demand for environmentally sustainable, socially responsible and innovative goods, services and works. This revision should also result in simpler and more flexible procurement procedures for contracting authorities and provide easier access for companies, especially SMEs³.”

We shall see whether that is reflected in the new legislation.

¹ A copy can be found at www.ec.europa.eu/internal_market/publicprocurement/modernising_rules/evaluation/index_en.

² *eg Magazine* - June 1 July 2011.

³ EC Evaluation Report.

Building information modelling

Building information modelling (BIM): the devil is not in the legal detail

BIM is the construction industry's buzzword at the moment. If you want to secure that next project or market your company as the leader in innovative and efficient design, you would be well advised to include the acronym "BIM" at the forefront of any tender submission. Indeed, employers often request evidence of BIM from contractors and consultants on tender returns and even the government may soon be requiring the use of BIM on all of its projects.² Even so, as Stacy Sinclair discusses, a recent survey carried out by NBS³ revealed that almost half of the UK construction industry had not even heard of BIM. Only 13% of those surveyed were actually aware of and had adopted BIM. Do you know what BIM is?

What is BIM?

BIM is essentially the process of creating and managing information, typically in a three-dimensional computer model, which embeds data relating to construction and utilises parametric design. If employed to its full extent, it is a tool used as part of the design process and from construction through to maintenance of the completed project. NBS defines BIM as:

"a rich information model, consisting of potentially multiple data sources, elements of which can be shared across all stakeholders and be maintained across the life of a building from inception to recycling (cradle to cradle). The information model can include contract and specification properties, personnel, programming, quantities, cost, spaces and geometry."⁴

Some may view BIM simply as a glorified 3D model. The aim of BIM is to do away with the two-dimensional plans, sections and elevations traditionally used in construction. However, the intention and its capacity go well beyond this. Although the ability of BIM is arguably limitless, it is often not used to its full extent and therefore the degree to which it is used varies greatly. The BIM Industry Working Group, a group invited by BIS and the Efficiency Reform Group from the Cabinet Office to look at the benefits of BIM, recently identified four "Maturity Levels" to ensure clear articulation of the expectation and extent to which BIM would be used on a project.⁵ These levels ranged from Level 0, which is the unmanaged use of CAD probably in a 2D format, to Level 3 which is a fully open and integrated process with a collaborative 3D model with common data and potentially employing concurrent engineering processes. With such a diversity of options, it is imperative for everyone involved to define right from the outset of the project the extent to which BIM will be employed.

The good and the bad

On a positive note, 72% of those surveyed⁶ agreed that BIM was the future of project information. This is not surprising as some of the advantages cited of BIM include:

- (i) the detection of clashes between the various structural and service elements prior to commencement on site;
- (ii) the use of the 3D model by the supply chain;
- (iii) greater cost certainty;
- (iv) increased productivity; and
- (v) greater collaboration throughout the design, procurement and construction process.

However, it is also frequently claimed that various legal, contractual and insurance issues arise with the implementation of BIM which ultimately pose a barrier to its development or success. Common issues include copyright, intellectual property rights, ownership of the model and sharing of data, insurance and liability, and integration within the existing

Companies who fail to adopt BIM run the risk of being "Betamax'd" in years to come.¹

¹ The comments of Paul Morrell, the government's chief construction advisor at a NBS round table event in May 2011.

² The Final Report of the Low Carbon Construction Innovation & Growth Team, Autumn 2010, recommended that all central government projects over £50 million should be required to use BIM.

³ NBS BIM Report, March 2011, NBS, www.thenbs.com/bim.

⁴ Ibid, page 10.

⁵ BIM Strategy Paper, A report for the Government Construction Client Group, BIM Working Party, March 2011.

⁶ NBS BIM Report, March 2011, p 11.

Building information modelling

standard form appointments and building contracts. This was recognised by the BIM Industry Working Group and one work stream was dedicated to reviewing these issues.

Intellectual property rights

Of all the possible legal issues associated with BIM, intellectual property rights and copyright issues appear to cause the most concern. This is likely to be because when using BIM to its full extent, it is often not simply one 3D model that many consultants and subcontractors contribute to. BIM is more likely to be made of several models, each created by different consultants each with their own embedded data. All models are then referenced and coordinated to create the whole picture by an "information model manager". If this is the case, then who owns the model and the intellectual property rights contained within? In short, ownership may well rest with more than one party.

In the traditional method of construction with the use of 2D paper drawings, the usual position, unless otherwise agreed, is that the designer retains the intellectual property rights of its own design and the employer has licence to use that design for the construction and other related uses. With BIM, the position is no different. Unless otherwise agreed, each designer or manufacturer owns the intellectual property rights in its own 3D model. So, in some respects, provided that any issues are addressed right from the outset and are appropriately incorporated into the appointment documents where necessary, intellectual property rights should not be a major stumbling block to the use of BIM, this follows the traditional approach. Where they become somewhat more complex is because of the inherent collaboration required in the use of BIM.

The BIM Industry Working Group did not consider that intellectual property rights would be a barrier to BIM adoption. However, it did identify that where BIM is used at Maturity Level 3, it is unclear where ownership of the copyright of the whole model will reside. Ownership of the copyright of the individual contributions from the consultants or subcontractors will not be affected; however, where the model manager uses sufficient skill in the software to produce the model, he or she may then have the copyright ownership of the model. The BIM Industry Working Group advises employers to be aware of this issue and to obtain an adequate licence or assignment where required.

Confidentiality

Confidential information, however, may prove to be a more sensitive issue for some consultants or suppliers. Trade secrets and confidential details necessary for the manufacture of certain components may need to be incorporated into the suppliers' BIM models. Some may feel uncomfortable with the release of this information for use in other consultants' models, particularly as the ease of data transfer offered by today's technology increases the likelihood of third-party access. Confidentiality clauses can be incorporated into appointments or a project-wide confidentiality agreement can be signed by all parties. However, on a more practical and tangible level, parties must first consider how and to what extent each consultant is going to use the other's model. Is it essential that all manufacturing and material information be embedded in the model provided to the architect? Depending on the extent to which BIM is used, could symbols or labels be used on the model accessed by the design team until the time for fabrication arrives at which time the confidential manufacturing information can then be inserted?

Conclusion

The first step in tackling any legal issue related to BIM is to understand how the project is going to use which aspects of BIM. This needs to be done at the outset so that any contract document can take BIM into account and include a schedule of BIM deliverables and BIM protocol. Given the close collaboration envisaged by BIM and the likely use of a shared model, it must be made clear who is responsible for which elements of the design. The key to BIM is not in the legal details. Its success depends on close collaboration at the outset by all designers, contractors and suppliers. Whilst, this ultimately may be a fundamentally different way of procuring a project, if the advantages and efficiencies of BIM are to be maximised, then this shift in methodology must be adopted by all.

The key to BIM is not in the legal details. Its success depends on close collaboration at the outset by all designers, contractors and suppliers.

Changes to the Construction Act

Changes to the Construction Act

As most people will know, on 1 October 2011 the Local Democracy, Economic Development and Construction Act 2009 ("LDEDCA") came into force in England and Wales. LDEDCA amends the adjudication and payment provisions of the Housing Grants, Construction and Regeneration Act 1996 ("HGCRA"). The amendments also led to the drafting of a new Scheme which also came into force on 1 October 2011.

Naturally this year's Annual Review includes a number of articles that relate to issues arising out of the changes, including articles on the following pages about the adjudication changes and some key contractual issues and then right at the end on pages 51-52 a copy of September's issue of Insight, our new newsletter which summarises the key changes relating to the payment provisions. The changes to the legislation themselves may not seem extensive on paper but the changes they introduce, especially in relation to the payment provisions, are wide-ranging.

The three main changes are:

- (i) a new payment regime including the introduction of a new default notice, and the current withholding notice is replaced with a pay less notice;
- (ii) an enhanced right of suspension; and
- (iii) limited changes to the statutory adjudication process.

Do not forget: the changes are not retrospective

However, first of all, we begin with an important proviso. Remember that, despite all the attention given, and rightly so, to the changes, the amendments introduced by the LDEDCA only relate to contracts entered into on or after 1 October 2011. This means that we are in a transitional period and it is important to remember that the new regime is not retrospective and will not apply to your existing contracts. This means the two systems for adjudication and payment will co-exist side by side. The existing regime will continue to apply until all contracts entered into before 1 October 2011 have been completed - this could be a period of many many years.

Further, parties may well find that they end up on some projects where both the new and old schemes will apply. For example, if you have entered into a main contract before 1 October 2011, you may well find that there are a number of subcontract packages that were not let until after 1 October 2011. It is not the date that the project started that matters, it is the date of the individual (sub)contract.

So you could find yourself having to operate two sets of payment regimes with, as our Review explains, different notice requirements and different timescales. It is therefore more important than ever to remember to adhere to the payment and notice timetable that applies to the particular (sub)contract in question. Therefore, if you have not already done so, you should amend any standard or template construction documents to comply with the new provisions.

This means that the need for careful monitoring of incoming post, faxes and emails at all project sites and at each regional office and head office will continue to be essential, as will careful and detailed diary entries on receipt of applications for payment or certificates or valuations from architects or contract administrators on each project in respect of the dates upon which all notices and payments are required by the contract (or the Scheme) to be made.

Remember, too, that it is quite possible that given the changes in the requirements for contracts in writing, whilst you cannot adjudicate under the main contract you will find that your subcontractor is perfectly free to adjudicate at any time.

The amendments introduced by the LDEDCA only relate to contracts entered into on or after 1 October 2011.

Changes to the Construction Act

How adjudication will change

Andrew Hales provides a summary of the changes to the adjudication provisions of Part II of the Housing Grants, Construction and Regeneration Act 1996 ("HGCRA") and their likely impact on adjudication arising from the implementation of Part 8 of the Local Democracy, Economic Development and Construction Act 2009 ("LDEDCA") and the Scheme for Construction Contracts (England) Regulations 2011 ("Revised Scheme"), which came into force in England and Wales on 1 October 2011.

As we have said, only construction contracts entered into on or after 1 October 2011 will be affected. The three main changes to adjudication introduced by LDEDCA are:

- (i) oral contracts can now be referred to adjudication;
- (ii) "Tolent" clauses which provide that one party will be responsible for both parties' costs of the adjudication have probably¹ been outlawed.
- (iii) a statutory slip rule has been introduced.

In addition, there have been a number of consequential amendments to the Scheme.

Contracts no longer in writing

One of the key changes to the HGCRA is that construction contracts will no longer have to be "in writing" to fall within its remit. This means that contracts that are (1) wholly in writing but have subsequently been amended orally, (2) partly in writing and partly oral, and (3) wholly oral, will become subject to the payment and adjudication provisions within the HGCRA (as amended). Certain adjudication provisions must be in writing under the HGCRA (as amended), so if a contract is concluded orally, or is partly oral, without all of the mandatory adjudication provisions being recorded in writing, the adjudication provisions of the Revised Scheme will apply.

The express intention behind this change was to widen the scope of eligibility to adjudication. The restrictive definition given by the Court of Appeal in the *RJT* case² of what constituted a contract in writing served to exclude many, especially the smaller sub-contracts, from the adjudication process. Undoubtedly this change will lead to more parties being able to refer disputes to adjudication. Practically, it is likely that this change will also serve to increase the time and costs involved in dealing with the adjudication process.

A variety of new issues may arise as to (1) whether there was a contract in existence at all, (2) whether the oral element of the contract was incorporated into the written contract, and (3) what the terms of any oral contract are. Inevitably, Letters of Intent will also be contentious. This is likely to increase the range of issues to be resolved, and the amount of witness evidence that will be presented and tested, in adjudication proceedings. Typically, an adjudicator may well require a hearing to test the credibility of those witnesses before making a decision on the existence and/or terms of any contract.

To avoid the difficulties that will undoubtedly arise with oral or partly oral contracts, tender reviews, notes of pre-contract meetings, and all pre-contract discussions should be marked "subject to contract" to reduce the risk of a contract being created inadvertently. In *Immingham Storage Company Ltd v Clear plc*³, the Court of Appeal held that the use of the words "a formal contract will then follow in due course" in an email accepting a signed quotation, did not mean that a binding contract had not been formed in circumstances where all essential terms of the contract had been agreed, the necessary internal approval had been obtained and, notably, the negotiations were not conducted "subject to contract". Contracts can be created in circumstances where one party holds a genuine view that no formal contract was ever concluded and, following the *Immingham* case, it is more important than ever that the words "subject to contract" are used as standard.

To avoid the difficulties that will undoubtedly arise with oral or partly oral contracts, tender reviews, notes of pre-contract meetings, and all pre-contract discussions should be marked "subject to contract".

¹ See the *Profile* case summarised on pages 43-44 below

² *RJT Consulting Engineers v DM Engineering (NI) Ltd* [2002] EWCA Civ 270.

³ [2011] EWCA Civ 89

Changes to the Construction Act

Adjudication costs and *Tolent* clauses

Under the HGCRA, it was open to parties to agree who would pay the costs of the adjudication prior to service of the Notice of Adjudication (these clauses became known as "Tolent Clauses"). They had a tendency to act as a fetter to the statutory right to adjudicate "at any time" because they usually required contractors to assume responsibility for adjudication costs regardless of the outcome, a potentially onerous requirement given the wide range of issues that are typically raised and the level of costs that can be incurred in adjudicating. The HGCRA (as amended) and the Revised Scheme permit parties to confer power on the adjudicator to allocate and apportion responsibility for his own fees and expenses between the parties.

In so far as the parties' own costs are concerned, the HGCRA (as amended) and the Revised Scheme only allow parties to agree liability for such costs following service of the Notice of Adjudication, albeit an apportionment would be very difficult to agree in practice in the midst of a dispute. However, the HGCRA (as amended) is notably silent on whether a single clause which (a) confers power on the adjudicator to allocate his costs between the parties and also (b) permits the parties to allocate responsibility for their costs prior to service of the Notice of Adjudication, would be lawful. Indeed, following the Scottish case of *Elmwood v Profile Projects*⁴ further doubt was cast on whether or not the amendment, as drafted, actually abolished such clauses for good. This issue will therefore probably fall to be considered by the Technology and Construction Court ("TCC"). Parties will probably try to circumvent the true intention of the LDEDCA (which was to prohibit Tolent Clauses), but the TCC has historically been reluctant to accede to technical arguments and, if the TCC were to follow the views already expressed by Mr Justice Edwards-Stuart in the *Yuanda* case⁵, it would be more likely to support Parliament's intention and strike out such a clause and bring a final end to Tolent Clauses.

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The slip rule

The HGCRA (as amended) partially codifies the common law position in regard to slips which was established in *Bloor Construction (UK) Ltd v Bowmer & Kirkland (London) Ltd*⁶, namely that an adjudicator can correct a slip in the decision arising from an accidental error or omission or clarify or remove any ambiguity in the decision within a reasonable time and without prejudicing the other party. The HGCRA (as amended) provides that a construction contract must include a slip provision in writing which gives power to an adjudicator to correct his decision so as to remove a clerical or typographical error arising by accident or omission. Unlike the common law position, the amendment does not refer to the correction of any ambiguity in the decision or the absence of prejudice to the other party. Further, the amendment does not impose a specific time limit unlike the Revised Scheme, where paragraph 22A(2) says that the decision must be corrected within five days of delivery of the original decision to the parties.

The Revised Scheme

The Revised Scheme will continue to apply where any of the adjudication provisions in the contract do not comply with the HGCRA as amended. There have only been minimal changes to the Scheme, for example, the slip rule at paragraph 22A(2) which can be utilised by the adjudicator on his own initiative or on the application of either party.

The Revised Scheme does amend the adjudication timetable slightly in that by paragraph 7(3) it requires the adjudicator to advise the parties of the date on which he received the Referral Notice. In accordance with paragraph 19(1), the date for reaching a decision will then be calculated from this date and not the date when the Referral was sent. This should reduce the risk of disputes arising over whether a decision has been published on time.

Finally, the Revised Scheme has also been amended to incorporate the changes made by LDEDCA in relation to costs and states that subject to any provision in a construction contract pursuant to section 108A(2) which deals with costs, the adjudicator may determine how his fees are to be apportioned. If a contractual provision does not comply with the HGCRA, this provision of the Scheme will apply.

⁴ See pages 43-44 below.

⁵ *Yuanda (UK) Ltd v WW Gear Construction Ltd* [2010] EWHC 720 (TCC)

⁶ [2000] BLR 314

Changes to the Construction Act

Recent changes to JCT and NEC standard form contracts

The amendments to the statutory payment, adjudication and suspension rules mean that construction contracts entered into on or after 1 October 2011 will require amendment. Sana Mahmud explains what the JCT and NEC have done.

Due to the delay in the implementation of the LDEDCA, in May 2011 the Joint Contracts Tribunal ("JCT") published versions of its contracts showing tracked changes from the 2009 revisions to the 2005 editions of those contracts. The JCT duly published its updated 2011 editions incorporating those changes in September 2011. In addition, the new JCT contract suite also includes wording to conform with the Site Waste Management Regulations 2008, and a statutory reference to the Bribery Act 2010. The requirement to obtain insurance for asbestos and fungal mould has now been removed due to difficulties faced by Contractors in obtaining such insurance. The 2011 editions also include references to the updated Construction Industry Model Arbitration Rules.

The NEC has also published amendments to the NEC3 suite as a separate supplement. These are relatively straightforward amendments simply relating to the new adjudication and payment provisions required by LDEDCA. They are certainly not as extensive as those to be found in the new JCT suite. It is anticipated that the recent NEC3 amendments will be incorporated into NEC4, but there is no fixed date as yet for publication of an updated NEC suite.

Amendments to the JCT forms

The most important and widespread changes, however, remain those related to payment provisions. These, along with some other notable changes, are summarised below using, as an example, the JCT Design and Build contract ("DB11").

Payment (Section 4)

DB11 makes significant amendments to section 4 of DB05. However, DB05 had already provided for the Contractor to apply for payment, and it has been argued that many of the detailed changes to this section were in fact unnecessary.

Clause 4.8 of DB05 now forms part of clause 4.7 of the new DB11. DB11 clause 4.8 provides that the Contractor must make an application (an "Interim Application") to the Employer stating the amount that the Contractor considers due to him by way of Interim Payment. DB11 clauses 4.8.2 and 4.8.3 apply in relation to due date for payment for, respectively, Alternative A (Stage Payments) and Alternative B (Periodic Payments).

DB11 clause 4.9 deals with the final date for payment, which is stated to be 14 days from the due date. Not later than 5 days after the due date for payment, the Employer must give a notice (a "Payment Notice") under DB11 clause 4.10.1 specifying the sum which the Employer considers to be due and also the basis on which that sum has been calculated.

Clause 4.9.4 introduces a new concept of a "pay less notice", which is similar to a notice of intention to withhold under DB05. This must be served in accordance with clause 4.10.2. The Pay Less Notice must be served no later than 5 days before the final date for payment.

Where the Contractor suspends the carrying out of works on grounds of non-payment, DB11 clause 4.11.2 now provides the Contractor with the right to receive a reasonable amount in respect of costs and expenses incurred by him in exercising that right. Clause 4.12 (Final Statement and final payment) has accordingly been amended to take into account the new definitions of "Payment Notice" and "Pay Less Notice".

The new amendments have been criticised for not adding any further clarity to previous payment provisions which had been viewed by some as unnecessarily complex. However, there are some positive elements to the changes, including the fact that JCT has

The new amendments have been criticised for not adding any further clarity to previous payment provisions which had been viewed by some as unnecessarily complex.

Changes to the Construction Act

attempted to keep as much consistency as possible between DB11 and the JCT Standard Building Contract, 2011 edition (SBC11). The new adopted language is also often the same as, or as similar as possible to, the language used in the HGCR (as amended).

Injury, damage and insurance (section 6)

Risks covered by "All Risks Insurance" are defined by reference to exclusions. The changes now incorporated in DB11 reflect those in the JCT December 2009 update, including a new clause 6.10 dealing with policy extensions and premiums in relation to terrorism cover. Schedule 3 (Insurance Options) has also been amended accordingly.

Termination (section 8)

The aim of the changes to section 8 was to bring the definition of insolvency in DB11 in line with the statutory definition in section 113 of the HGCR (which the LDEDCA has not amended). Clause 8.1 introduces new definitions of insolvency specific to companies, partnerships and individuals. There are some notable differences between the definition of insolvency under DB11 clause 8.1 and the HGCR. The right to terminate under DB11 arises under a broader definition than that set out in section 113 of the HGCR. Under clause 8.7.3.2, if a Contractor becomes insolvent after the last date when the Employer could serve a Pay Less Notice, and no such notice has been served, then the Employer does not need to make a payment to the Contractor despite the fact that this sum will now be due for payment. Finally, clause 8.6 now refers to the new Bribery Act 2010.

Settlement of disputes (section 9)

DB11 now refers to the JCT 2011 version of the Construction Industry Model Arbitration Rules. However these do not contain any changes from the 2005 rules. DB11 did not need to amend its adjudication provisions because, like DB05, it applies the Scheme. That definition, together with the change of legislation provisions in clause 1.4.5, ensures that DB11 will apply the Scheme, as amended, to any adjudication. This is also applicable to other JCT forms.

Amendments to NEC3 forms

The changes to the NEC3 contracts are much less detailed. The amendments revise the adjudication provisions in Option W2 and the payment provisions in Y(UK)2. In the short contracts the LDEDCA changes are reflected by way of an additional clause. With regard to its adjudication provisions, NEC has revised its reference to the slip rule which now states that errors must be amended within 5 days (W2 currently refers to 14 days). In light of changes brought about by LDEDCA (in that parties can no longer include contractual terms that deal with their own legal costs), provision has also been made for the adjudicator to allocate his fees and expenses for the adjudication. Furthermore, if the adjudicator's decision amends the amount notified as being due, payment of the new amount is due no later than 7 days from the date of the decision or final date for payment of the notified amount, whichever is later.

The new payment provisions also include substantial amendments to reflect the new payment notice requirements, and as with the JCT amendments, NEC has replaced the withholding notice provision with a Pay Less Notice requirement in line with the new rules. This has involved a subtle change to its withholding notice provision by requiring the notice to state the amount considered due (as opposed to simply the amount being withheld) along with the basis for that calculation. Unlike JCT, provisions of the NEC do not specifically provide for what happens when no valid payment notice is issued. Covering this eventuality is not strictly necessary as the LDEDCA provide, that, in the absence of a valid payment notice, the (sub)contractor will be entitled to determine the sum due. This will normally happen automatically through the application for payment.

Finally, a right to suspend has been included in all NEC3 contracts as a compensation event (this only affects the short contracts, where previously no right to suspend existed).

It is anticipated that the recent NEC3 amendments will be incorporated into NEC4, but there is no fixed date as yet for publication of an updated NEC suite.

Contract formation

Battle of the forms

One of the intentions behind the recent amendments to the HGCRA was to increase access to adjudication. One of the by-products of this is that the number of disputes about the precise nature of the contract is likely also to increase. With this in mind, Charlene Linneman discusses one of the potential areas of disagreement, namely whose terms and conditions apply. A building contract should define the relationship between the parties so that each knows what is going to be built, how long it should take and how much it is going to cost. The general requirement is that at some point, the parties who want to enter into a contract reach agreement on the terms of that contract - what is sometimes far from clear is when that point of agreement is reached. Implementing the principles applied to the battle of the forms cases is a good way of working out when that point is reached.

In order for a contract to be formed, there must first be agreement. Generally this is shown by an offer by one party to the contract which is accepted by the other party (either in writing or through that party's conduct such as starting work on site) for valuable consideration (generally money): this is then incorporated into the formal written contract. However, on occasions, parties exchange, for example, quotations or purchase orders without proceeding to sign any formal contract. Two problems can arise here: what if the negotiations are marked "subject to contract", and if the parties exchange their own standard terms and conditions, which set will apply? The first question has already been addressed by Andrew Hales, when he reviewed the *Immingham v Clear* case.

Although the terms of the contract were clear in the *Immingham* case, if Clear had sent back its agreement to the quotation on its standard order form with its own terms and conditions, which terms and conditions would apply? In these situations, known as "battle of the forms", the general rule is "the last past the post", i.e. the last terms and conditions that were exchanged form part of the contract. For example, if a supplier offers to supply equipment subject to the seller's terms and conditions; the buyer places an order on its own form setting out the buyer's terms and conditions; and the supplier then signs and returns the buyer's form, the buyer's terms and conditions will govern the parties' contract. Where you have a "battle of the forms", the approach of the court will typically be this:

- (i) as in any other construction contract, the test is objective, albeit that the court must take into account the factual matrix – i.e. what actually happened;
- (ii) in most cases, a contract is formed as soon as the last set of forms is sent and no objection is taken;
- (iii) acceptance by conduct can be inferred, although conduct will amount to acceptance only if it is clear that the party intended to accept the terms. Acceptance of a delivery, of itself, may not be enough;
- (iv) where the parties have not agreed which set of standard terms applies, then the only inference that can be drawn is that their agreement was made on the basis that neither set of standard terms would apply;
- (v) if neither party's terms and conditions are to be incorporated into the contract this will usually mean that the contract will be subject to the terms and conditions implied by statute, for example, the Supply of Goods and Services Act 1982; and
- (vi) whilst the subsequent conduct of the parties may be relevant to the enquiry as to whether particular terms were or were not agreed, the subsequent conduct of the parties cannot be relied upon as an aid to the construction of the contract.

In the case of *Claxton Engineering Services Ltd v TXM Olaj-es Gazkutato Kft*¹, the parties disagreed as to whether an arbitration clause was incorporated into a number of contracts in relation to the manufacture and delivery of engineering equipment. Claxton was an English company that manufactured specialist engineering equipment; TXM was a Hungarian company that was engaged in drilling and exploration in Hungary.

Acceptance by conduct can be inferred, although conduct will amount to acceptance only if it is clear that the party intended to accept the terms. Acceptance of a delivery, of itself, may not be enough.

¹ [2010] EWHC 2567

Contract formation

In late 2005 and early 2006 Claxton supplied equipment to TXM on the basis of a quotation and TXM's purchase order. Although TXM's purchase order referred to its terms and conditions Claxton had not seen them. TXM later sent purchase orders to confirm items that Claxton had already delivered. These included provision for arbitration in Hungary. In June 2006 Claxton proposed some amendments to TXM's terms, including giving the English courts exclusive jurisdiction. TXM did not respond to these. From mid-2006 to late 2007 Claxton signed further TXM purchase orders but queried the terms. Claxton then signed a further six purchase orders but without querying the terms.

TXM argued that the parties' contract incorporated its own terms. The court disagreed. TXM's initial offer had been rejected by Claxton's counter-offer of an English jurisdiction clause and that TXM had then accepted that counter-offer through its continued performance. This was the key factor and it did not matter that TXM had continued to send purchase orders referring to its standard terms and conditions without amendment. TXM were therefore bound by terms and conditions it had never expressly agreed to.

This decision was reinforced by the Court of Appeal decision in *Tekdata Interconnections Ltd v Amphenol Ltd*². Here, the sellers quoted on their terms and conditions, the buyers generated a purchase order which stated that the purchase was on their terms and conditions, and when the sellers acknowledged the purchase order, they repeated that their own terms and conditions applied. The judge at first instance said that whilst the traditional view would be that the contract terms were those of the sellers, since their acknowledgement was the last shot, in fact other circumstances indicated that the parties intended that the buyers' terms should apply. Here there was a commercial history under which the parties had contracted on the buyers' terms.

The Court of Appeal disagreed. The traditional analysis had to be adopted unless the parties' previous conduct showed that their common intention was that some other terms were intended to prevail. There needed to be a clear course of dealing. There was not one here. Dyson LJ said:

"But the rules which govern the formation of contracts have been long established and they are grounded in the concepts of offer and acceptance. . . it seems to me that the general rule should be that the traditional offer and acceptance analysis is to be applied in battle of the forms cases. That has the great merit of providing a degree of certainty which is both desirable and necessary in order to promote effective commercial relationships."

This mattered in the *Trebor v ADT*³ case because Trebor had argued that there was a previous course of dealing between the parties which incorporated their own terms and conditions. What had happened was that ADT was invited to quote for a job because they were the suppliers of the fire protection systems to Trebor at Monkhill. ADT was provided with very little information on which to quote. They had some generic drawings and they scaled from these and made various assumptions as to the size of the hoppers and elevators. Those assumptions were then set out in their specification and quotation of 28 August 2003. On 3 September 2003, the claimant sent to the defendant a purchase order which was based on the claimant's terms and conditions. The defendant then started work and on 17 September 2003, the defendant produced an updated specification.

So what was the last shot? The answer was the 3 September 2003 purchase order. The critical work was carried out by the defendant in accordance with the exchanges made at the end of August and the beginning of September. Therefore, work was taking place in accordance with the 3 September 2003 purchase order. This meant that the revised specification of 17 September was immaterial, because the work was being undertaken pursuant to earlier documents.

Finally, remember to ask to see the other party's standard terms and conditions if these have been referred to but not provided. If the order says they have been supplied then you have not only alerted the defendant to the existence of these other terms and conditions, but also alerted them at least to the possibility, if not the probability, that you have already contracted on them in the past.

Remember to ask to see the other party's standard terms and conditions if these have been referred to but not provided.

² [2009] EWCA Civ 1209.

³ *Trebor Bassett Holdings Ltd & Anr v ADT Fire & Security Plc* [2011] EWHC 193 (TCC)

Contract formation

Implied terms

The question of whether or not you can imply any terms is of course another crucial question when it comes to considering contract formation. As James Mullen notes, cases concerning implied terms are like buses, you wait ages for one, and then four come along at once - a comment reinforced by the number of judgments issued by the courts during the month of July 2011. Terms can be implied into contracts by statute (Sale of Goods Act 1979, and the Supply of Goods and Services Act 1982) or by common law, particularly in relation to supplying goods that are fit for purpose and of satisfactory quality, and carrying out works with reasonable skill and care. The cases below consider all of these.

Machell knew that the staircase when provided as specified in the contract would breach building regulations and should have warned the Lowes of this.

Lowe v W. Machell Joinery Ltd¹

Mr and Mrs Lowe had decided to convert a barn for residential use and had ordered a bespoke staircase, which had to be paid for prior to delivery. Lowe rejected the staircase upon delivery. At trial, Lowe said that the staircase would not have complied with the building regulations. There was no written contract between the parties, only a simple handwritten quote. Therefore, Lowe used the Sale of Goods Act to say that the staircase should have been of satisfactory quality (14(2)), fit for its purpose (14(3)) and should have been constructed in such a way so as to satisfy the building regulations. The slightly odd position that transpired was that the staircase complied with Lowe's requirements but its use would have been unlawful because it did not meet the building regulations. This was sufficient to entitle Lowe to reject the goods. It was appropriate for Lowe to rely on the skill and judgement of Machell, who was the seller of the goods in question. Even though the goods supplied were in exact conformity with the contract, Machell knew that the staircase when provided as specified in the contract would breach building regulations and should have warned the Lowes of this. It was therefore not reasonably fit for its purpose. Therefore, Lowe was entitled to be refunded the price paid.

Harrison and Others v Shepherd Homes Ltd and Others²

The Court of Appeal's ink had barely dried on the *Lowe* judgment when three days later, the TCC issued this decision. Here, the claimants were the owners of a number of properties at a housing development in Hartlepool which had been built by Shepherd. Defects had subsequently become apparent in a number of the houses, which were covered by the NHBC Buildmark Scheme. The work itself had been supervised by NHBC Building Control Services. Eight of the ten claimants had entered into a contract for sale directly with Shepherd, and claimed under the law of contract. The remaining two claimants were subsequent purchasers of properties and therefore did not have a contractual claim against Shepherd under an original contract for sale. The trial covered a number of issues including Shepherd's express or implied obligations under the sales contracts, the operation of exclusion clauses in the sales contracts, whether the contracts were impacted on by the Unfair Terms in Consumer Contracts Regulations 1999 or the Unfair Contract Terms Act 1977, and also the owners' ability to claim under the Defective Premises Act 1972 and the NHBC Buildmark cover.

Mr Justice Ramsey held that Shepherd was liable to the eight claimants who had purchased their property directly under the sales contract on the basis that on its proper construction, the contract imposed an express obligation on Shepherd to design the houses with proper skill and care and provide houses that were fit for habitation and they had failed in this obligation. However, although it was not necessary for the Judge to do so, he proceeded to consider the claimants' argument concerning implied terms. Here, he held that even if the sales contracts did not include express obligations in respect of design and fitness for habitation, these obligations would have been implied under s.13 of the Supply of Goods and Services Act 1982 as well as at common law.

At trial, Shepherd had argued that clause 8 of the sales contract was an entire agreement clause which excluded any implied terms. The Judge rejected Shepherd's argument and held that the entire agreement clause did not exclude the implied term relating to Shepherd's standard of care because the clause was evidently aimed at precluding "terms,

¹ [2011] EWCA 794.

² [2011] EWHC 1811 (TCC)

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undertakings, promises or agreements” which were the subject of discussion or other consideration by the parties and which could have been but were not set out in the sales contract. Undertakings and promises evidently came within that category and the Judge considered that the word “terms” should not be construed consistently with the other words in the phrase as being of the same kind. If it had been intended that terms normally implied were to be excluded, then “clear and unequivocal” words would be required.

*BSS Group Plc v Makers (UK) Ltd (t/a Allied Services)*³

A week later, the Court of Appeal issued another judgment. Here, the issue was whether BSS was in breach of the implied term to fitness for purpose imposed by s.14(3) of the Sale of Goods Act 1979. BSS had supplied Makers with an adapter and valve for use in connection with plumbing. The threads on the adapter and valve turned out to be incompatible so that the connection of the two components became insecure under pressure. The valve blew off and caused flooding to a pub. The key question here was whether Makers had made it known how the valves were going to be used. As the *Lowe* case made clear, under s.14(3) of the Sale of Goods Act, where the seller sells goods in the course of the business and the buyer, either expressly or by implication, makes known any particular purpose for which the goods are being bought, there is an implied term that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgement of the seller or credit-broker.

Here, the Court of Appeal agreed with the Judge at first instance that Makers had specified a particular purpose to BSS, namely that the valves were being bought for use with a particular type of plastic pipe. BSS had supplied components made by that manufacturer for the project. It knew that the valves were for use with the same system. Therefore, it could be inferred that BSS knew that Makers intended to use the valves in conjunction with the plastic pipe. The question of whether or not the valves were fit for their purpose was more simple. The valves were designed to be used with copper piping. The piping here was plastic. The valves were not reasonably fit for their purpose.

*Trebor Bassett Holdings Ltd & Anr v ADT Fire and Security plc*⁴

This Decision of Mr Justice Coulson followed just two days later. The case arose out of a fire at a popcorn-making facility. There were two key questions.

- (i) Was there an implied term that the CO₂ system (i.e. fire suppression) would be of satisfactory quality?
- (ii) Was there an implied term that the CO₂ system would be fit for its purpose?

There was no dispute that the contract included an implied term that ADT would exercise reasonable skill and care in the provision of its services. Services included the design of the CO₂ suppression system. The term was of course implied by s.13 of the Supply of Goods and Services Act 1982. As Mr Justice Coulson said, this was an obligation to take reasonable skill and care, not a guarantee of success. However, ADT had to do “rather more than just provide a CO₂ system, as requested”. Just because ADT was providing design services, that did not mean the defendant did not owe a high obligation and the duty to use reasonable skill and care in the absence of special circumstances.

There was no need to consider the question of an implication of a term as to satisfactory quality, as referred to in s.4 of the Supply of Goods and Services Act. This was because the argument was redundant as Trebor’s terms and conditions included an express term that the goods supplied would be of “good quality”. Note, of course, that good quality is more onerous than satisfactory quality.

Finally, there was the question of fitness for purpose. The fitness for purpose duty is stricter than the ordinary responsibility of a consultant carrying out design where the implied

“The virtue of an implied term of fitness for purpose is that it prescribes a relatively simple and certain standard of liability based on the ‘reasonable’ fitness of the finished product, irrespective of considerations of fault and of whether its unfitness derived from the quality of work or materials or design.”

³ [2011] EWCA Civ 809.

⁴ [2011] EWHC 193 (TCC)

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obligation is one of reasonable competence to “exercise due care, skill and diligence”. In *Greaves v Baynham Meikle*⁵, Lord Denning had said this:

“Now, as between the building owners and the Contractors, it is plain that the owners made known to the Contractors the purpose for which the building was required, so as to show that they relied on the Contractors’ skill and judgement. It was therefore the duty of the Contractors to see that the finished work was reasonably fit for the purpose for which they knew it was required. It was not merely an obligation to use reasonable care, the Contractors were obliged to ensure that the finished work was reasonably fit for the purpose.”

The duty is, therefore, absolute. In *Viking Grain Storage v T.H. White Installations Ltd*⁶, Judge John Davies said:

“The virtue of an implied term of fitness for purpose is that it prescribes a relatively simple and certain standard of liability based on the ‘reasonable’ fitness of the finished product, irrespective of considerations of fault and of whether its unfitness derived from the quality of work or materials or design.”

Just because a contract does not expressly state that the works are to be carried out in a good and workmanlike manner does not mean that the contractor is off the hook if they fail to do so.

Whilst s.4(4) of the Supply of Goods and Services Act potentially provided for the implication of a fitness for purpose obligation, the difficulty for Trebor was that there was no evidence that they had made known to ADT any particular purpose for which the goods were being acquired, a specific requirement of s.4(4). Whilst the CO₂ system was being acquired to suppress fire, that was not a particular purpose - it was merely the condition which the system was then being designed to deal with. For there to be a particular purpose, some sort of specific request was required. In the circumstances here, it would be along the lines of a request that the system ensured that no single piece of burning popcorn ever escaped from the popper. Indeed, Trebor, when they approached ADT for the first time, had already decided they were going to replicate the existing fire suppression system. They were simply interested in making sure that the same system that operated in another facility could operate here. In the absence of anything other than general reliance, the implied terms of fitness for purpose could not be incorporated.

Conclusion

The decisions in *Lowe*, *Shepherd*, *BSS* and *Trebor* demonstrate the “hidden” obligations imposed on sellers and building contractors when it comes to supplying goods that are fit for purpose or carrying out works to a satisfactory standard. If the contract is silent on the quality of the goods to be supplied or the works to be carried out, terms will be implied by the courts under statute and common law. In order for the fit for purpose term to be implied into a contract, the intended purpose must have been made known to the seller, either expressly or by implication. In *Lowe*, it was obvious (or at least it should have been) to the seller that the intended purpose of the stairs was for use in a residential home. Likewise, in *BSS*, it was obvious that the intended purpose of the valves was for use with the plastic piping system. Conversely in *Trebor* the purpose of the particular goods was not made known to the seller.

Where the intended purpose is made known to the seller, and assuming that a conclusion has been reached that the goods are not fit for that purpose, the seller’s only real “out” is if they can show that the buyer did not rely on their skill and judgement as a supplier. This burden will be particularly hard to discharge where the seller is someone who specialises in the area within which they carry out business, while the buyer does not hold such similar expertise in the area. For example, in *Lowe* the seller was an experienced joinery company while the buyer was a lay person. Likewise, in *BSS* the seller was a specialist dealer whose expertise the buyer was entitled to rely upon. Contrast this with *Trebor* where there was only a general reliance by the buyer and so no fitness for purpose obligation could be implied. Likewise, for building contractors, if a contract does not expressly contain provisions concerning the standard to which the works are to be carried out, this will be implied. Therefore, just because a contract does not expressly state that the works are to be carried out in a good and workmanlike manner does not mean that the contractor is off the hook if they fail to do so.

⁵ [1975] 1 WLR 1095.

⁶ [1986] 33 BLR.

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The “Without Prejudice” Rule

The principle that statements made in the course of without prejudice negotiations are not admissible in evidence is a long-standing one. The rule is founded upon the public policy of encouraging litigants to settle rather than litigate them to a finish. Despite this, the use of without prejudice material has made its way into adjudication proceedings.

*Volker Stevin Ltd v Holystone Contracts Ltd*¹

The issue for the court here was whether the adjudicator’s knowledge of the fact that Holystone had made a without prejudice offer meant that it was arguable that the adjudicator was biased towards Volker. During the adjudication, Holystone had complained that Volker’s reference to Holystone’s offer was improper. Following this complaint, but before he communicated his decision, the adjudicator sent a letter to the parties which stated that his task “*had not been informed in any way either by Holystone’s information in its Response or Volker’s disclosure*”. Mr Justice Coulson held that the adjudicator’s knowledge of the fact that a without prejudice offer had been made did not mean that he was biased towards Volker. The Judge was in no doubt that a fair-minded and informed observer would not reach any such conclusion in the circumstances of this case and any suggestion to the contrary was entirely unrealistic. On the face of the adjudicator’s decision and his correspondence with the parties, he had made it clear that he was wholly unconcerned with the fact that an offer had been made.

Obviously, such material should not be put before an adjudicator. Lawyers who do so may face professional disciplinary action.

*Ellis Building Contractors Ltd v Vincent Goldstein*²

Following the issue of the Adjudication Notice, Mr Goldstein’s solicitor wrote a without prejudice letter which stated that although it was Mr Goldstein’s view that no further sum was payable, his “commercial view of the matter” was such that he was prepared to offer a further sum to Ellis. Ellis referred to the letter in its Reply, albeit that the sum itself was redacted. No objection was made, by Mr Goldstein. In his Decision, the adjudicator said he had taken into account all submissions made whether or not they were mentioned in the decision. Sixteen days later, Mr Goldstein’s solicitors raised the without prejudice issue. Following a review of the law, including *Volker*, Mr Justice Akenhead concluded that:

- (a) Obviously, such material should not be put before an adjudicator. Lawyers who do so may face professional disciplinary action.*
- (b) Where an adjudicator decides a case primarily upon the basis of wrongly received ‘without prejudice’ material, his or her decision may well not be enforced.*
- (c) The test as to whether there is apparent bias present is whether, on an objective appraisal, the material facts give rise to a legitimate fear that the adjudicator might not have been impartial. The Court on any enforcement proceedings should look at all the facts which may support or undermine a charge of bias, whether such facts were known to the adjudicator or not.”*

Here, the complaint was made late and it was clear that the adjudicator did not base his decision at least openly on the contents of the without prejudice letter.

Comment

In *Ellis*, the Judge commented that unfortunately it is now not wholly uncommon for without prejudice material to be put before an adjudicator but stressed that it is a practice to be strongly discouraged. It is clear that when such material is used the adjudicator must be able to disregard the knowledge gained from it when making his decision and should inform the parties that he has done so. The nature of any disclosure may have a bearing on the question of bias as it is more likely that a fair-minded observer would conclude that there was a real possibility of bias if the actual terms of the offer were brought to his attention rather than the mere fact that an offer had been made.

¹ [2010] EWHC 2344 (TCC).

² [2011] EWHC 269 (TCC)

The art of negotiation

The art of negotiation in a difficult market¹

Times remain tough for contractors. In David Bebb's view it's definitely a buyer's market out there and given some of the amendments to standard contracts that land on his desk, it is clear that employers know it. The days when the parties used an unamended standard form and the playing field was less lopsided are long gone. Of course, tenders have always asked for the contractor's acceptance to the terms "without qualification" but there was usually some scope for manoeuvre. Nowadays, "qualifications to the contract terms will not be accepted" can frequently mean exactly what it says. So faced with such fierce competition, what should contractors do? His advice is always twofold. First, don't give up on the negotiation; it is surprising what can be achieved if you go about it the right way. Second, even if this approach is unsuccessful at least understand what you are signing up to so you can go into the job with your eyes open.

In this article, David looks at some of the most common amendments to standard contracts designed to shift risk firmly to the contractor's doorstep and offers some tips on negotiating your way into a position where you can sleep a little easier at night.

Design responsibility

The JCT Design and Build Contract is a misnomer. Whilst the "building" bit of the work is down to the contractor, the extent to which he is responsible for the "design" bit depends on the Employer's Requirements ("ERs"). And the ERs, of course, vary enormously from job to job. At one end of the scale, they may comprise no more than half a dozen sides of A4 setting out briefly what the employer is looking for. These are then developed with the contractor – which includes, importantly, his input in the design – and finally agreement is reached as to what's to be done and the price to be paid for it. At the other extreme, the ERs comprise 15+ lever arch volumes of detailed designs and specifications which, obviously, limit the contractor's scope for design input. But under the JCT Design and Build Contract, the contractor does not take responsibility for all that design². No prizes then for guessing the most common form of amendment required by employers.

I cannot recall the last time that I saw this part of the standard contract remain intact. Instead, the amendments clearly place the responsibility for all design contained in the ERs firmly at the contractor's doorstep. From a practical point of view, where the ERs comprise a few sides of A4, contractors are generally willing to accept the risk. The issue becomes far more problematical where a substantial element of the design is already comprised in the ERs and the contractor is being required to take responsibility for it. Traditionally, this is where the employer's design team are novated across to the contractor. Depending on the wording of any novation agreement this can offer some comfort for contractors, but ultimately this is a bitter pill that contractors are frequently being asked to swallow.

Time-bars

Construction contracts have always required the contractor to serve a variety of notices on the employer. These notices usually, but not always, relate to circumstances in which the contractor considers himself to be entitled to additional time and/or money. The JCT is no different. In clause 2.24 of the Design and Build form the contractor is supposed to give a notice of delay "forthwith". Similarly, his claim for loss and expense must be made as soon as it becomes apparent to him that progress is being affected.³ But then enter the time-bar. Drafted properly, these are not difficult to spot in a set of amendments and will usually specify a precise time for service of the notice (e.g. 5 days) and state clearly the effects of non-compliance. But it never ceases to amaze me how contractors think that the law will somehow come to their rescue if they miss the date. Generally speaking, it won't.⁴ The words "you will not be entitled to any [time/money] if you do not serve the notice within 5 days" does exactly what it says on the tin.

The words "you will not be entitled to any [time/money] if you do not serve the notice within 5 days" does exactly what it says on the tin.

¹ The large print giveth, the small print taketh away.

² See clause 2.11 which provides "the Contractor shall not be responsible for the contents of the Employer's Requirements or for verifying the inadequacy of any design contained in them". But note that the contractor does still retain responsibility for ensuring that the ERs comply with all Statutory Requirements (see clause 2.15).

³ Just so that none of you fall at this hurdle please note that the precise wording of clause 4.20 is to make your application "as soon as it has become, or should reasonably have become, apparent to [you] that the regular progress has been or is likely to be affected".

⁴ See for example the articles by my colleagues in the previous two Annual Reviews - www.fenwickelliott.com.

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Omission of work

By this, I mean a variation clause that allows the omission of work which expressly allows the employer not only to omit it but to award the same work to another contractor (and without compensation by way of profit and loss to the current contractor). The theory, of course, is that the employer may somehow be able to secure a better price than the one he's been given by his current contractor and that this re-tendered work can be carried out seamlessly alongside the existing contractor's work. I have no doubt in some cases this may be the case. But in the majority of cases it is not a viable option for the client. Like time-bars this requires some very clear wording to achieve the desired effect.

How to make the process slicker

In the current market I am frequently asked by contractor clients to keep my comments, when reviewing the contract to a minimum. My instructions consist usually of *"the absolute showstoppers only please Dave"* or words to that effect. (For the clients reading this you know who you are). Understandably, in a competitive market, the contractor who raises the most points on the contract may well find himself falling at the first hurdle. But that said, my experience is that this is more of an idle threat by employers. It would, of course, be a sorry state of affairs, if the contractor who offers the best price, product and project team, fails to deliver simply on the basis that a reasonably balanced contract cannot be agreed. This would be an unfortunate case of the legal tail wagging the project dog. Don't get me wrong, the contract is important but so is ensuring the right contractor to deliver a quality project on time and at the right price. In my experience, provided the process of negotiating the contract is gone about the right way, contractors can, and do, persuade employers either to drop amendments or at least to meet them halfway. So how should contractors approach the thorny issue of onerous amendments? Before answering this, we need to take a step back and see how the contract amendments came about in the first place. The conversation between the employer and his lawyer a few weeks before the tender went something like this:

Employer: "I've got a project. Please send me your standard amendments."

Lawyer: "Certainly. Ideally, though, we need to go through some of the changes just to make sure I am covering the sort of risks that may crop up on your new project and that I have got the balance right. I need to tailor your contract to your job."

Employer: "Hmm. How long will that take [i.e. cost]? Not really got the time. Just make them tough. Must dash."

The lawyer then sets to work and 60 or so pages later produces the goods to slot into the tender. The next time the amendments see the light of day (note they will rarely be read by the employer's agent/project manager⁵) is when they land on the contractor's desk. So what now? Three options spring to mind. First, the head-in-the-sand approach: accept them and hope for the best. (It is this approach, by the way, that keeps my litigator colleagues in gainful employment). Second, the "this could really wind up my client before we even start" approach: say you will accept them and try to wriggle out of them once you have a foot in the door such that the employer will risk a serious delay to his project if he goes elsewhere. It is this approach that ensures my contractor clients are no longer kept in gainful employment through a lack of repeat business and referrals. Here's the third (and best) approach:

Can you manage the risk?

Distinguish those risks which simply cannot be taken from those which can be managed. Sounds obvious doesn't it? The inclusion of time-bars referred to above is a good example. From a contractor's point of view it is difficult to argue against the inclusion of such time-bars other than that they are *"extremely unfair if we miss the date"*. But life's tough guys. Live with it. This is not a credible argument to run with an employer and one I advise contractors to avoid.

"The absolute showstoppers only please Dave"

⁵ He will have had his fee pared to the bone so there's no money in the pot for this. There's certainly no money in the pot for extensive negotiations over the contract so consider whether the message *"qualifications to the tender will not be accepted"* is really being driven by the employer or his agent/project manager?

The art of negotiation

Much better is to ensure that the notice periods are achievable and manage the risk internally by ensuring project teams and commercial managers are well aware of what is required of them (if needs be by tattooing the timescales and consequences on their arms).

Be proactive and take control of the negotiations

Simply saying the amendment is not agreed will get you nowhere. You need to explain in the context of this particular project *why* it is not acceptable. But if you really want to move things forward suggest a compromise position and justify it early on. This gives the employer something to chew on. The worst that can happen is that your suggestion is rejected - but your response of "not agreed" was going to be met in the same way anyway, wasn't it?

Make sure your lawyer earns his fee. You don't just want to be told the risks of the amendment, you want the solution. Your lawyer should know where compromises can be found, understand the employer's concerns, know what's generally acceptable in the market and be able to sell the whole shebang to the employer with charisma and ideally by way of a meeting lasting no more than a couple of hours. And this brings me on to my next point.

Avoid the email merry-go-round

You just can't beat a face-to-face meeting. Contract negotiations can quickly become nothing more than a merry-go-round of emails upon which every member of the project team and his brother are copied, with views becoming increasingly entrenched with each email. This is a wholly counter productive, time-consuming and expensive way of going about things. Much more effective is a meeting with the contractor, the employer and their respective lawyers. Once the first few amendments have been raised by the contractor and his lawyer - and the real effect of that amendment explained to all present (ideally by way of a practical example) - another conversation between the employer and his lawyer quickly sparks up. This (rather hush-hush) conversation goes something like this:

Employer: "Is this really the effect of the amendment?"

Lawyer: "Yes."

Employer: "Hmm. That was never my intention. Why did you draft that?"

Lawyer: "You asked me to."

Employer: "Well, on reflection it does seem a bit harsh so let's drop it and move on because this is becoming tiresome [i.e. expensive]"

Lawyer (to all in the meeting): "We'll concede it."

And so the amendment that started life all those weeks ago in the lawyer's office bites the dust, never to see the light of day again (well at least until the next project). Joking aside, the point is this. A full and frank face-to-face discussion about the effect of the amendment can be extremely productive in moving the negotiations forward.

Conclusion

So there you have it. A few pointers to securing a balanced contract in a world where balanced contracts are few and far between.

It is still possible to secure a balanced contract in the current market if you go about the negotiations in the right way. As can be seen from the above, the onerous amendment is not always what the employer intended so that time to shout out is before the contract is signed.

Ensure that the notice periods are achievable and manage the risk internally by ensuring project teams and commercial managers are well aware of what is required of them (if needs be by tattooing the timescales and consequences on their arms).

Cross-contract set-off

Cross-contract set-off

The question of whether a party can look to reduce its liability on one contract by setting off that liability against debts due under another contract, is always a live one. As Richard Bailey explains, the unanimous judgment of the Court of Appeal in the case of Geldof Metaalconstructie NV v Simon Carves Ltd ("Geldof") has provided useful clarification as to equitable set-off and cross-contractual set-off provisions.

Background to the law of set-off

Why is set-off important? Set-off is the ability of a debtor to reduce or eliminate entirely the debtor's liability to a creditor by taking into account monies owed by the creditor to the debtor. In litigation set-off operates as a defence to a claim rather than a separate stand-alone counterclaim. Commercially set-off can be used not only as a defence to a claim, but also to reduce or eliminate monies owed to another party. In construction we are all used to the section 111 of the Housing Grants, Construction and Regeneration Act withholding notice. Indeed, today this will be the most common type of set-off used in the construction industry. There are three main categories of set-off:

Legal set-off - a procedural remedy which applies only in litigation. It applies where there are mutual debts which are both due and payable at commencement of the action. The amounts of debts must be readily ascertained, therefore excluding unliquidated damages claims. The debts need not be connected, that is in relation to the same contract of the same subject matter.

Equitable set-off - the old leading case of *Rawson v Samuel*¹ held that equitable set-off was available as a defence when "the title of the Plaintiff to his demand is impeached". A classic example of this is a claim for unliquidated damages in negligence being used to set off a claim for monies payable under a contract. Equitable set-off can be used not only as a defence for the claim but also as grounds to withhold payment of a debt.

Insolvency set-off - the final form of set-off is insolvency set-off which derives from the Insolvency Act 1986 and the Insolvency Rules 1986. This relates purely to mutual dealings of the parties where one party is insolvent. This simply assists the creditor who might be otherwise required to pay debts owed to the insolvent party to avoid paying those debts.

Equitable set-off pre-Geldof

In his judgment, Rix LJ reviewed the law as it stood on equitable set-off. He identified that the modern law of equitable set-off is generally considered to date from the case of *Hanak v Green*² where Morris LJ in his judgment set out the law in these terms:

"The position is, therefore, that since Judicature Acts there may be (1) a set-off of mutual debt; (2) in certain cases a setting up of matters of complaint which, established, reduce or even extinguish the claim; and (3) reliance is a matter of defence upon matters of equity which formally might have called for injunction or prohibition..."

The cases within group (3) are those in which a Court of equity would have regarded the cross-claims as entitling defendants to be protected in one way or another against the plaintiff's claim."

Rix LJ also referred to the case of *Bankes v Jarvis*³ where Morris LJ identified two critical factors, that it would have been "manifestly unjust" for the claim to be enforced without regard to the cross-claim and that "there was a close relationship between the dealings and transactions which gave rise to respective claims". The Judge reviewed the law in detail including Lord Denning's judgment in *Federal Commerce & Navigation Co. Ltd v Molena Alpha Inc*⁴ ("The Nanfri"). In this case the Court had to consider whether claims against a shipowner could be set off against time charter hire. The issue had to be decided against a background of the historical rule excluding set-off against voyage charter freight and special terms in the time charter in question permitting deductions in certain circumstances. Lord Denning said:

Equitable set-off can be used not only as a defence for the claim but also as grounds to withhold payment of a debt.

¹ [1848] CR and TH 161, 41

² [1958] 2 QB 9

³ [1903] 1 KB 549

⁴ [1978] 2 QB 927

Cross-contract set-off

“But one thing is clear: it is not every cross-claim which can be deducted. It is only cross-claims that arise out of the same transaction or are closely connected with it. And it is only cross-claims which go directly to impeach the plaintiff’s demands, that is, so closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim.”⁵

Lord Brandon in the case of *Bank of Boston Connecticut v European Grain and Sugar Ltd*⁶ (“The Dominique”) also considered the position and stated:

“But rather that it was a cross-claim, flowing out of and inseparably connected with the dealings and transactions which also gives rise to the claim.”

However, although the cases above appear to be moving away from restricting equitable set-off to matters arising from the same contract, all of the cases above related to the same contract, and so *Rawson* remains good law. In the case of *Dole Dried Fruit and Nut Co. v Trustin Kerwood Ltd*⁷ the Court considered a claim for equitable set-off where there were two contracts, one an overarching agreement and the other part of a series of sale contracts. Rix LJ summarised the case as follows:

“The plaintiff was now claiming for the price of goods sold under the latest of such sale contracts, and the defendant was seeking to set off its counterclaim for repudiation by the plaintiff of the distribution agreement. This Court held that the counterclaim could be set off and that there was thus an arguable defence to the claim for the price of goods sold.”

Therefore a multi-contract set-off was allowable.

Finally, we have the case of *Bin Kemi v Blackburn Chemicals Limited*⁸, a case concerning a claim by the claimant for damages for repudiation of a 1994 distribution agreement for the supply of a product called Dispelair. The defendant denied the existence of the agreement and in the alternative counterclaimed for damages for repudiation by the claimant. Under the heading of “Close Connection” Potter LJ reviewed the authorities and commented as follows:

*“The Dole Fruit case illustrates the wise refusal of this Court to become bogged down in the nuances of differences between the formulation of the test propounded in *The Nanfri*, both in relation to the earlier criterion of “impeachment of title” disapproved by Lord Brandon in the *Bank of Boston* case, and in relation to the need for a “close connection” between claim and cross-claim . . . It seems that, insofar as there may be a difference, the Court has been content for the outcome to be governed by the notion of fairness involved in the proposition that it must be “manifestly unjust” to allow one to be enforced without regard to the other. For myself, I consider that Lord Brandon’s formulation is to be preferred because on the one hand it emphasizes that the degree of closeness required is that of an “inseparable connection”, while on the other it makes clear that it is not necessary that the cross-claim should arise out of the same contract; all that is required is that it should flow from the dealings and transactions which gave rise to the subject of the claim . . .”*

What is perhaps most interesting about all of the above judgments is that they go to support the comment of Thorpe LJ in *Esso Petroleum Co. Ltd v Milton*⁹ that “claims to equitable set-off ultimately depend upon the judge’s assessment of the result that justice requires”. What we are left with, prior to *Geldof*, is a lack of clarity on two points: the role of the justice element of the *Hanak* test and whether or not the “inseparable connection” referred to in *The Dominique* was denying a right to rely on equitable set-off in a case of multiple contracts in all but the rarest of cases. That clarification came in the *Geldof* case.

Geldof Metaalconstructie NV v Simon Carves Ltd

Geldof supplied pressure vessels and storage tanks for bioethanol plants. *Simon Carves Ltd* (“SCL”) was the lead contractor for the construction of a bioethanol plant on Teeside. SCL entered into a supply contract with *Geldof* for the supply of pressure vessels in July 2007. SCL then, after a separate tender process, entered into an installation contract with *Geldof* for storage tanks in December 2007. Therefore, the only relationship between the

⁵ At 974G/975A.

⁶ [1989] AC 1056

⁷ [1990] 2 Lloyd’s Rep 309

⁸ [2001] 2 Lloyd’s Rep 93

⁹ [1997] 1 WLR 938, 953

“For myself, I consider that Lord Brandon’s formulation is to be preferred because on the one hand it emphasizes that the degree of closeness required is that of an “inseparable connection”, while on the other it makes clear that it is not necessary that the cross-claim should arise out of the same contract; all that is required is that it should flow from the dealings and transactions which gave rise to the subject of the claim . . .”

Cross-contract set-off

two contracts was the parties and the site. At this stage it would be difficult to argue that these two contracts were in any way closely connected or, to use the language of case law, inseparably connected. Relations between Geldof and SCL deteriorated and in August 2008 Geldof stopped work under the December 2007 installation contract and refused to resume work unless outstanding invoices arising both under the installation contract and the supply contract were met. Geldof maintained this position again in December 2008 and in response SCL terminated the installation contract.

It will come as no surprise that litigation then followed, with Geldof seeking summary judgment for payments of, among others, one of the invoices under the supply contract. SCL sought to set off against Geldof's claim its claim for unliquidated damages for repudiation of the installation contract. At first instance His Honour Judge Raynor QC granted the application for summary judgment, primarily on the grounds that Geldof's claim and SCL's claim lacked the necessary close inseparable connection and SCL was not entitled to set-off. SCL appealed. On the review of the law Rix LJ determined that the law needed clarification and established a test with two elements: a functional and formal element where each element performed a different role as follows:

The formal element ensures "*that the doctrine of equitable set off was based on principle and not discretion*"*(not a view shared by Thorpe LJ); and

The functional element is required "*to remind litigants and Courts that the ultimate rationality is equity*".

Rix LJ stated that the best statement for the test for equitable set-off was Lord Denning's formulation in *The Nanfri* less any reference to impeachment of title. The formal element is the requirement of a close connection that need not flow out of the same contract, and the functional element is the need for equitable set-off to be deployed to avoid "manifest injustice". Rix LJ's formulation of the test is as follows:

"cross-claims . . . so closely connected with [the plaintiff's] demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim".

The result of the application of this test was to overturn the judgment of HHJ Raynor QC in the lower court. The reason being that Geldof by making payment of the invoices under the supply contract a condition of its resuming work under the installation contract had brought the two contracts into "*intimate relationship with one another*". SCL then made the relationship "*inseparable and irrevocable*" by terminating the installation contract in reliance on Geldof's poor performance and raising demands for payment. The two contracts were therefore brought into "*close and inseparable relationship with one another*", thus fulfilling the formal requirement for close connection. He then determined that it would be manifestly unjust not to deploy equitable set-off in this situation.

Rix LJ confirmed that this would be enough to meet the test for equitable set-off on its own, but then went on to note that the contracts were also connected practically because they both related to the bioethanol plant, the vessels supplied on the supply contract were useless without proper performance and installation contract, and the warranty under the supply contract was linked to practical completion of the plant. On this basis it would "not be fair", i.e. it would be "manifestly unjust", to enforce payment under the supply contract when there was a claim under the installation contract.

Conclusion

In conclusion it is possible unwittingly to link two contracts but based on *Geldof* it is only in limited circumstances where the courts feel that it is manifestly unjust for one party to enforce a right under a contract when a claim exists for the other party under a separate contract that the courts will consider equitable set-off across contracts. The courts may, by their own admission, have slightly widened the rule, but as this is equity it will be applied more on a case-by-case basis.

The two contracts were therefore brought into "close and inseparable relationship with one another", thus fulfilling the formal requirement for close connection. He then determined that it would be manifestly unjust not to deploy equitable set-off in this situation.

Costs Management Pilot

The Costs Management Pilot

On 1 October 2011 the Costs Management Pilot (the "Pilot") started in the TCC and Mercantile Courts. As Claire King explains, the Pilot applies to any case which has its first Case Management Conference on or after 1 October 2011¹ and is scheduled to run until 30 September 2012.

The purpose of the Pilot, as stated by Jackson LJ in the introduction to the questionnaires being distributed by the courts to those participating in the Pilot, is to ascertain:

- (a) the benefits and disadvantages of costs management; and
- (b) how the process might be improved for the benefit of court users.

The Pilot has potentially wide implications for costs management in the TCC and has already been the subject of heated debate amongst practitioners regarding its potential advantages and disadvantages. It is therefore worth setting out in some detail the background behind the Pilot's introduction as well as the provisions of Practice Direction 51G that govern the Pilot itself.

Background to the Pilot

The Pilot arises out of Lord Justice Jackson's *Review of Civil Litigation Costs: Final Report* (the "Final Report") and builds on an earlier costs pilot which ran in the Birmingham TCC and Mercantile Courts from 1 June 2009 (the "Birmingham Pilot").

In the Birmingham Pilot (which was voluntary), those who had agreed to take part had to complete an estimate of costs. Budget documents were to be lodged with the court before each Case Management Conference or Pre-Trial Review and the judge had the power to order regular hearings by telephone, if appropriate, to monitor expenditure. At each hearing, the judge would record approval or disapproval for each step of the action, either by agreement between the parties or after hearing argument. The judge would then give a direction for any party to apply to the court for assistance if it felt that another party was behaving oppressively in seeking to cause the party to spend more money unnecessarily.

As at 31 October 2009, the parties in eleven cases had voluntarily participated in the Birmingham Pilot. The results indicated that, done efficiently, the budget form took about two and a half hours for a solicitor to fill in. Solicitors commented that it was helpful in that it did force the solicitor in question to focus on the issues and what needs to be done to put up a good case. It was also reported that it was helpful to see what the other side's costs were likely to be.

Judges had a mixed response. They generally found it to be an extremely useful aide to case management, but said that the Case Management Conference took longer with greater demands being made upon the court. Judge Brown of the Mercantile Court reported that reading and considering the costs budget form took about 15 minutes, whilst the TCC Judge, David Grant, said it took 15 to 30 minutes.

In his Final Report, Jackson LJ concluded that while no case had yet been made for introducing costs management in the commercial court, a powerful case had been made for introducing costs management in "those rather more modest multi track cases, where the level of costs is a matter of concern for the parties, or at least to the paying party".²

In relation to the TCC, Jackson LJ did not recommend that costs management should be made compulsory but instead that a decision should be made by the judge in each case as to whether it would benefit the parties and the case.³

The stated objective of the Costs Management Pilot is to "control the costs of litigation in accordance with the overriding objective".

¹ See Practice Direction 51G – Costs Management in Mercantile Courts and Technology & Construction Courts – Pilot Scheme paragraph 1.1(3).

² See paragraph 7.4, Chapter 40 of the Final Report.

³ See paragraph 5, Chapter 29 of the Final Report.

Costs Management Pilot

The Pilot: Practice Direction 51G

The Pilot is governed by Practice Direction 51G. This provides that for claims that fall within the Pilot, each party must file and exchange a costs budget in the form set out in the Precedents at the same time as filing the Case Management Information Sheet. Within the cost budget, reasonable allowances must be made for:

- (i) intended activities: e.g. disclosure (if appropriate, showing comparative electronic and paper methodology), preparation of witness statements, experts reports, mediation or any other steps which were deemed appropriate to the particular case;
- (ii) identifiable contingencies: e.g. specific disclosure application or existing applications made or threatened by an opponent; and
- (iii) disbursements: in particular court fees, counsel's fees, any mediator or expert fees.

The stated objective of the Costs Management Pilot is to “control the costs of litigation in accordance with the overriding objective”.⁴ The court will have regard to any costs budget filed pursuant to the Practice Direction at any Case Management Conference or Pre-Trial Review and will decide whether or not it is appropriate to make a Costs Management Order. If the court decides to make a Costs Management Order, it will, after making any appropriate revisions, record its approval of a party's budget and may order attendance at a subsequent costs management hearing (by telephone, if appropriate) in order to monitor expenditure.⁵ Paragraph 4.5 also provides that a party may apply to the court if the party considers another party is behaving oppressively in seeking to cause that party to spend money disproportionately on costs.

The party submitting the costs budget to the court is not required to disclose it to any other party save by way of exchange. However, the parties are required to discuss their costs budget during the costs budget building process and before each Case Management Conference, Costs Management Hearing, Pre-Trial Review or trial. Where a Costs Management Order is made, then at least 7 days before any subsequent Costs Management hearing, Case Management Hearing or Pre-Trial Review, as well as before trial, a budget revision must be filed showing the reasons for any departures. The court may then approve or disapprove such departures from the previous budget.⁶

Seven days after any hearing, each party's legal representative must notify its client in writing of any Costs Management Orders made at such hearing and also provide its client with copies of any new or revised budgets that the court has approved. When assessing costs on a standard basis, the court will have regard to the receiving party's last approved budget and will not depart from such approved budget “unless satisfied that there is good reason to do so”.⁷

Monitoring the Pilot

Nicholas Gould, a partner here at Fenwick Elliott, will, in his capacity as a Senior Visiting Lecturer at King's College, London, be monitoring the effectiveness of the Pilot. He will be assisted by Claire King, an Associate of Fenwick Elliott, and also by Christina Lockwood, a lawyer and mediator with CEDR Solve, as well as by Thomas Hutchinson, an Associate of Freshfields. Nicholas and Claire previously headed up a team analysing the results of a questionnaire into the use of mediation in construction disputes that were conducted while Lord Justice Jackson was head of the TCC. Two questionnaires have been designed. First, a questionnaire for judges and second, a questionnaire for solicitors. Solicitors will be provided with the questionnaire whenever the issue of costs budgets is considered by the court as well as once the issue of who is to pay costs, and what amount, has been finally determined. They will be asked to fill in the questionnaire and then return it to the monitoring team. Judges will likewise be asked to complete a questionnaire whenever a costs budget is considered by the court. The aim of the questionnaires is to provide objective data on the effectiveness of the Pilot. Given the heated debate already generated by the Pilot, such data should prove extremely useful in determining whether or not to make costs management a permanent feature and, if so, in what form.

When assessing costs on a standard basis, the court will have regard to the receiving party's last approved budget and will not depart from such approved budget “unless satisfied that there is good reason to do so”.

⁴ See paragraph 4.2 of PD 51G.

⁵ See paragraph 4 of PD 51G.

⁶ See paragraph 6 of PD 51G.

⁷ See paragraph 8 of PD 51G.

Dictionary

Dictionary of construction terms

Fenwick Elliott's Dictionary of Construction Terms is to be published in early 2012. It offers clear and concise explanations of the most common legal and technical terms, phrases and abbreviations used throughout the construction industry. It is unique in its broad and authoritative coverage of the subject area and provides a user-friendly and convenient reference for construction lawyers, practitioners and students, as well as those in related industries including planning, property and insurance.

The Dictionary of Construction Terms saves valuable time by providing a dependable and trustworthy guide to construction industry terminology. In addition to offering thorough coverage of frequently-used terms, this practical dictionary also includes details of legal and technical acronyms, drawings and diagrams to illustrate both legal and technical terms and terminology relating to common institutions. We set out some example definitions below.

A&E	Acronym, commonly used for 'Architect and Engineer' or 'Architecture and Engineering'.
Aerated concrete	A light weight concrete used in situations where less dead load is required, for example the handling of concrete blocks in residential construction. It is produced by incorporating gas or air into a base mortar mix. Foamed concrete and autoclaved aerated concrete (AAC) are two types of aerated concrete. See Autoclaved aerated concrete and Foamed concrete .
AFC	See Approved for construction .
Affidavit	A written, sworn statement of evidence. Written evidence is now usually given in the form of a signed witness statement verified by a statement of truth. See Witness statement .
Affirmation	<ol style="list-style-type: none">1. A formal declaration by a witness before (s)he gives evidence to tell the truth and often used instead of a religious oath.2. An election by an innocent party faced with a repudiatory breach of contract to endorse the contract and treat it as continuing. See Repudiation.
A fortiori	Latin: 'more strongly', to a greater extent.
A-frame building	A building whose section is in the shape of an "A". The name originates from its distinctive roofline. The roof beams extend from the ridge line down or towards foundation level. The walls of the interior rooms may be formed by the steep slope of the lower roof. This building type is often used in cold climates to facilitate the transfer of snow to the ground thereby minimising heavy snow build-up on the roof.
AGA	See Authorised guarantee agreement .
Agency	The relationship between a principal and an agent and the law relating to this relationship and dealings with third parties. See Agent and Principal .
Aggregate	A granular material (typically of crushed stone or sand) which forms one of the essential components of plaster, mortar and concrete in order to give it compression strength and cohesion. See also Fine aggregate and Coarse aggregate .
Aggregate/cement ratio	The ratio, by weight or volume, of cement to aggregate which will normally be specified by a designer according to the required characteristics of the finished product.
Aggregates levy	A tax on the use of extracted rock, sand and gravel introduced by the Finance Act 2001, which can be a significant cost in projects such as those involving road building. Express contractual provisions will usually be made in construction contracts. Those responsible for exploiting aggregates for commercial reasons must register with the HMRC.

Dictionary

Calderbank Offer

An offer to compromise litigation made “without prejudice save as to costs”, first recognised in *Calderbank v Calderbank* [1976] Fam 93. The need for such offers has largely been removed by the revised provisions of CPR Part 36: see **Part 36 Offer**. The term is sometimes also used to describe a sealed offer in arbitration: see **Sealed Offer**.

Cavity Wall

External wall constructed of an inner and outer leaf. The outer leaf is typically brickwork with the inner leaf being constructed of blockwork or timber framing. The air space (“cavity”) is usually at least 50mm (2 inches). The purpose of the cavity is to prevent water or dampness from passing between the outer (wet) leaf and the inner (dry) leaf and to prevent condensation from occurring in the inner leaf (dew point calculations are required to confirm this). Insulation is used in the cavity to comply with Building Regulations, although to make further energy savings and comply with “green” best practice, these requirements are now commonly exceeded. If timber construction is used for the inner leaf, insulation is normally placed between the timber studs. See **Figure 1** below.

Cladding, cladding panel

A term used to describe any lightweight material or panelling system which forms the external enclosure of a building or structure. A cladding system or cladding panel is non-load bearing and must resist the usual environmental conditions such as wind, rain, snow and heat. Examples of cladding include glazed curtain walls, rainscreen cladding systems, and insulated infill panels or non-load bearing brick panels which are fixed back to the superstructure. See **Façade, Load bearing,** and **Rainscreen cladding**.

Guide to Safety at Sports Grounds (“Green Guide”)

A guide produced by the Football Licensing Authority (FLA) for the Department of Culture Media and Sport which provides detailed design and safety management guidance for both existing and new sports grounds for architects, engineers and public authorities. The guidance is not mandatory but it sets out best practice and UK building control departments will require compliance with its principles.

Mareva injunction

The previous name for a freezing injunction, after *Mareva Compania Naveira SA v International Bulkcarriers SA* [1975] 2 Lloyd’s Rep 509. See **Freezing injunction**.

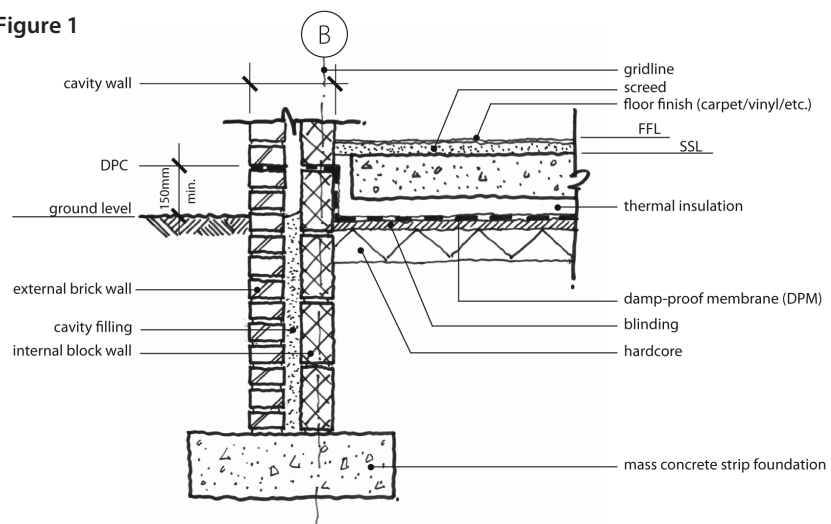
Part 36 Offer

An offer made by either the Defendant or Claimant in accordance with the Civil Procedure Rules Part 36 which imposes severe costs sanctions in the event that the offeree rejects the offer and at trial fails to recover a higher sum. The offer has to be in writing and open for acceptance for 21 days. If it is accepted within the 21 days the offeror is to pay the costs of the offeree up until the date of acceptance.

In the event that the offer is rejected by the Defendant and judgment is granted against him for a higher amount the Court can order interest on any sums payable at up to 10% starting from the date the offer was made and for the Claimant’s costs to be paid on the indemnity basis or with interest not exceeding 10%, or both.

If the Defendant makes a Part 36 offer and judgment is entered for less than the offer the Court will order that the Claimant pay the Defendant’s costs from the last day the offer could have been accepted until the conclusion of the trial.

Figure 1



Case law update

Case law update

Our usual case round-up comes from two different sources. First, there is the Construction Industry Law Letter (CILL), edited by Karen Gidwani and Ted Lowery. CILL is published by Informa Professional. For further information on subscribing to the Construction Industry Law Letter, please contact Catherine Lauder by telephone on +44 (0) 20 7017 7974 or by email: catherine.lauder@informa.com.

Second, there is our long-running monthly bulletin entitled Dispatch. This summarises the recent legal and other relevant developments. If you would like to look at recent editions, please go to www.fenwickelliott.com. If you would like to receive a copy every month, please contact Jeremy Glover.

We begin by setting out the most important adjudication cases as taken from Dispatch.

Adjudication - Cases from Dispatch

Adjudication: what is a single dispute?

Witney Town Council v Beam Construction (Cheltenham) Ltd

Beam's Adjudication Notice included claims for money and time and that the Council was in breach of contract. The Council promptly made it clear that it considered that more than one dispute had been referred, but the adjudicator equally clearly and promptly said that he did not consider the point a good one. The Council duly reserved its position and the parties found themselves before Mr Justice Akenhead. The parties accepted that, unless otherwise agreed, only a single dispute may be referred to adjudication. The Judge noted that construction contracts are commercial contracts and parties can be taken to have agreed that a sensible interpretation will be given to the meaning of "dispute". Some disputes are simple: what is due to one or other of the parties? The Judge continued:

"A particular dispute, somewhat like a snowball rolling downhill gathering snow as it goes, may attract more issues and nuances as time goes on; the typical example in a construction contract is the ever increasing dispute about what is due to the contractor as each monthly valuation and certificate is issued; a later certificate may accept amounts in issue previously not certified but then reject some more items of work. One may in the alternative have a dispute, like the proverbial rolling stone gathering no moss, which remains the same and unaffected by later events; an example might be disputed responsibility over an accident on site."

This led the Judge to conclude that:

- (i) Disputes arise generally when and in circumstances in which a claim or assertion is made by one party and expressly or implicitly challenged or not accepted.*
 - (ii) A dispute in existence at one time can in time metamorphose into something different to that which it was originally.*
 - (iii) A dispute can comprise a single issue or any number of issues within it. However, a dispute between parties does not necessarily comprise everything which is in issue between them at the time that one party initiates adjudication.*
 - (iv) What a dispute in any given case is will be a question of fact. Courts should not adopt an over legalistic analysis of what the dispute between the parties is.*
 - (v) The Adjudication and Referral Notices are not necessarily determinative of what the true dispute is or as to whether there is more than one dispute. One looks at them but also at the background facts.*
 - (vi) Where on a proper analysis, there are two separate and distinct disputes, only one can be referred to one adjudicator unless the parties agree otherwise.*
-

"A particular dispute, somewhat like a snowball rolling downhill gathering snow as it goes, may attract more issues and nuances as time goes on."

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(vii) *Whether there are one or more disputes again involves a consideration of the facts. It may well be that, if there is a clear link between two or more arguably separate claims or assertions, that may well point to there being one dispute. A useful if not invariable rule of thumb is that, if disputed claim No 1 cannot be decided without deciding all or parts of disputed claim No 2, that establishes such a clear link and points to there being only one dispute."*

Here, the Council said that there were effectively four disputes being referred, (i) the draft final account, (ii) the actual final account, (iii) a claim for interest on underpayment of retention and (iv) the claim for the whole retention based on repudiatory breach. Beam said that in essence there was one dispute, namely what was due and owing to it from the Council. Mr. Justice Akenhead agreed with Beam. There was in reality only one dispute.

Adjudication - natural justice

Carillion Utility Services Ltd v SP Power Systems Ltd

This dispute arose out of contracts made under a framework agreement whereby Carillion carried out certain excavation, installation and reinstatement works for SP. Carillion were awarded £2.7million by an adjudicator in respect of claims for payment for the provision of lamping and guarding of cable excavations during periods when it was waiting for SP personnel to carry out and complete cable jointing operations.

SP said that the adjudicator had failed to comply with the rules of natural justice in the method which he adopted to quantify Carillion's claim. In short, he did not adopt the method of quantification which Carillion had put forward and which SP had criticised but used his own experience of what would constitute reasonable commercial rates for the additional equipment used at the time the contract was formed. Further, he did not give the parties an opportunity to consider and comment on his proposed methodology and the material on which it was based. The adjudicator had concluded:

"that additional payment is due but the adoption of a multiplier which is simply the application of a number derived by dividing the actual plan perimeter of the excavated area by the theoretical plan perimeter of the standard excavation as stated in the Contract is not appropriate... I have decided therefore to evaluate the applicable charge for excavations that are larger than that specified in the Contract on the basis of my experience of what would constitute reasonable commercial rates for the additional equipment employed at the time the contract was formed..."

SP further said that this meant that the adjudicator had decided the case on undisclosed factual material and on a basis which neither party had advanced. Lord Hodge referred to the comments of Lord Drummond Young in the case of *Costain Ltd v Strathclyde Builders Ltd* who listed 9 principles of natural justice including at number 6:

"6. An adjudicator is normally given power to use his own knowledge and experience in deciding the question in dispute... If the adjudicator merely applies his own knowledge in assessing the contentions, factual and legal, made by the parties, I do not think that there is any requirement to obtain further comment. If, however, the adjudicator uses his own knowledge and experience in such a way as to advance and apply propositions of law or fact which have not been canvassed by the parties, it will normally be appropriate to make those propositions known to the parties and call for their comments."

In the Judge's view, an adjudicator should disclose to the parties information, which he has obtained from his own experience or from sources other than the parties' submissions, if that information is material to the decision which he intended to make. The potential importance to the decision is a question of degree which must be assessed on the facts of each case. Here, the adjudicator did not go off on a frolic of his own.

The adjudicator's task was to fix a reasonable price for the lamping and guarding of the larger excavations. He had before him Carillion's claim which he considered to be overstated but which disclosed the size of the excavations in respect of which it claimed

"If, however, the adjudicator uses his own knowledge and experience in such a way as to advance and apply propositions of law or fact which have not been canvassed by the parties, it will normally be appropriate to make those propositions known to the parties and call for their comments."

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payment. Having concluded that the perimeter multiplier overstated Carillion's claim, he was entitled to look at the sizes for which Carillion claimed and form the view from that material that on average the equipment that was needed amounted to what he stated. In doing so, he applied his knowledge and experience to assess both Carillion's claim and SP's comments on that claim. Here the adjudicator derived his reasoning from the parties' submissions rather than adopting a wholly extraneous methodology.

However, the Judge was concerned about the way in which the adjudicator had applied the commercial rates which, from his experience, he saw as reasonable and about which there appears to have been no evidence. This was a material part of his decision. It could not be regarded as being in any way peripheral or insignificant. The Judge noted that this was an addition to a daily charge and that even a minor adjustment could have a large impact. A change of some 30% would have altered the markup that he allowed by over £100,000. Therefore parties were entitled to know of this input into the adjudicator's reasoning and to have a chance to comment on it. This was a breach of natural justice as the parties were entitled to have notice of the commercial rate which the adjudicator proposed and the way in which he proposed to apply it in reaching his conclusion.

Adjudication – Preliminary views

Lanes Group Plc v Galliford Try Infrastructure Ltd

Here, the court considered whether the adjudicator's decision was the product of apparent bias arising from the fact that during the course of the adjudication, the adjudicator had issued a document entitled "Preliminary Views and Findings of Fact". This 35-page document was issued before Lanes had served its Response and the date for the decision had still not been agreed. Lanes alleged that the Preliminary Views document looked and read like a decision, and suggested that the adjudicator had already made up his mind. Judge Waksman QC held that the Preliminary Views document "*reads like a judgment and one that must have taken some days to prepare. Given that on its face it looked like a draft judgment, and one made before any Response from the other party, it does indeed appear as if the author has made up his mind*".

"... in the normal run of an adjudication I would not have thought that documents expressing provisional views on which parties were then invited to comment were likely to be helpful or appropriate."

The Judge did note that there were words of qualification on the face of the document; however, his overriding impression was that the adjudicator had already made up his mind at a time when the timetable was still being discussed and Lanes had not even served its Response. In light of this case, those adjudicators whose practice it is to issue a "preliminary views" document may wish to revisit and carefully consider either its wording and/or its intention. As Judge Waksman QC stated:

"... in the normal run of an adjudication I would not have thought that documents expressing provisional views on which parties were then invited to comment were likely to be helpful or appropriate. They may be, where the parties expressly ask the adjudicator to do just that although it is not clear that this will always assist in a process which is meant to be concluded in a narrow time frame and confined in scope. Of course, where the adjudicator considers that there might be another basis for one or other party's claim, which had not been addressed by either, it is obviously incumbent upon him to put this to the parties for their comment ... But that is an entirely different situation".

Adjudication: Tolent clauses and Yuanda

Profile Projects v Elmwood (Glasgow)

The changes to the adjudication legislation came into force on 1 October 2011. One part of the 2009 Act seeks to outlaw so-called Tolent clauses which require a party to pay both parties' costs of the adjudication, win or lose. In England and Wales, the 2009 Act was followed by the case of *Yuanda v Gear Construction* (see Issue 119) where Mr Justice Edwards-Stuart held that Tolent clauses served to discourage adjudication and so accordingly were contrary to the requirement of the HGCRA that parties should be able to refer a dispute to adjudication at any time. However, in Scotland there is no such

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symmetry between the forthcoming legislation and the courts. Profile Projects' contract included a clause which said that:

"the referring party shall bear the whole costs of the adjudication including, but not limited to, the Adjudicator's fees and costs in their entirety and both parties' legal expenses (on a solicitor client basis and upon the scale of charges applicable to Court of Session business) in and incidental to the adjudication ..."

The "mischief" that Parliament was seeking to address was to prevent the "party with greater clout" from using the costs of the adjudication process as a barrier.

The view of Lord Menzies was that this clause was not incompatible with the HGCRA. He said that if Parliament had wanted to make provisions regarding the allocation of costs in adjudication, it could have done so. The clause here was not identical to the Yuanda version requiring the referring party to pay the costs, and so was not as one-sided as the Yuanda contract where the contractor had to pay regardless as to whether they were the referring party or respondent. In addition, here, there was a clause limiting costs to a figure based on a court scale. However, Lord Menzies went further and also commented upon the likely meaning of the new Act. He reviewed the parliamentary debates and noted that the "mischief" that Parliament was seeking to address was to prevent the "party with greater clout" from using the costs of the adjudication process as a barrier. The Judge noted that the effect of the new s108A would be to render a *Tolent* clause ineffective unless it was made in writing, was contained in the construction contract and conferred power on the adjudicator to allocate his fees and expenses as between the parties, or was made in writing after the giving of notice of intention to refer the dispute to adjudication. In other words the Judge thought that the new Act does not prevent the enforcement of *Tolent* clauses, as parties will still be entitled to agree such clauses in some circumstances.

This led the Judge to comment that if the decision in *Yuanda* was correct and *Tolent* clauses had been nullified then the new Act will "actually have a liberalising effect" by allowing agreements as to allocations of costs which, on the reasoning of *Yuanda*, were already banned. As the Judge noted, this was precisely the opposite of what Parliament thought it was doing. So the law on adjudication cases diverges between England and Scotland and a surprising question mark has seemingly been raised about a clause many had previously thought was pretty straightforward.

Adjudication - same dispute

Redwing Construction Ltd v Wishart

Amongst the questions here was whether the dispute decided in a second adjudication had been effectively decided in an earlier adjudication. Mr Justice Akenhead noted that the basic approach of the courts in these circumstances was that the decision in the first adjudication is binding upon the parties unless and until it is overturned by the tribunal of final resort. There was however one possible exception, where it is clear that the dispute in the first adjudication is materially different from the second but the adjudicator's reasoning effectively establishes a proposition which directly relates to the second adjudication. This led the Judge to outline the following process:

- (i) Determine what the dispute referred in the first or earlier arbitration was. That dispute may be wide or narrow.
 - (ii) Determine whether and to what extent the parties gave the adjudicator in that adjudication jurisdiction to address matters not obviously within the ambit of the referred dispute. This could cover a defence not raised before the referral but legitimately raised as a defence to the referral. The adjudicator will need to rule on that.
 - (iii) Examine what the adjudicator has decided, first in relation to the referred dispute and any arguable defence put up, and second, if he has purported to decide something which has not been referred or which has not become within his jurisdiction.
 - (iv) Any decision which can be described as deciding the dispute, as referred or as expanded effectively within the adjudication process, is binding and cannot be raised or adjudicated upon again in any later adjudication.
-

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- (v) In contrast, any decision or part of a decision which can be described as not deciding the dispute, as referred or as expanded effectively within the adjudication process, is not binding and can be raised or adjudicated upon again in any later adjudication.

Therefore, where an adjudicator who, in court terms, offers an "obiter" opinion on a point which is not part of the dispute for which he does have jurisdiction, that opinion is not jurisdictionally part of his decision.

Other cases

Construction Industry Law Letter

Guarantees - electronic signature

Golden Ocean Group Ltd v (1) Salgaocar Mining Industry Private Ltd; (2) Mr Anil V Salgaocar

Queen's Bench Division (Commercial Court): before Mr Justice Christopher Clarke:
judgment delivered 21 January 2011

The facts

Golden Ocean was a shipping company. Mr Salgaocar was a majority shareholder in Salgaocar Mining Industries Private Ltd ("SMI"). In early 2008 Golden Ocean offered to charter to SMI or to an account guaranteed by SMI, a vessel with an option to purchase that vessel at the end of the charter period. The entity nominated by SMI to enter into the charter was a related company, Trustworth Shipping Private Ltd ("Trustworth"). The negotiations following SMI's offer were conducted by email and proceeded on the basis "Trustworth fully guaranteed by SMI". The emails constituted the underlying contract between SMI and Trustworth and were signed by the electronically printed signature of the persons who sent them. Golden Ocean claimed that the charter had been repudiated by Trustworth and, further, that the charter had been guaranteed by SMI. Golden Ocean wished to issue proceedings against SMI and obtained an order granting permission to issue a Claim Form for service out of the jurisdiction on SMI and Mr Salgaocar in Goa, India.

The potential defendants applied to have the order set aside. They argued that there was no serious issue to be tried on the grounds that Golden Ocean could not demonstrate that its claim had a reasonable prospect of success. There were a number of issues but for construction practitioners the most interesting were those relating to whether the email chain could constitute a guarantee under s4 of the Statute of Frauds 1667.

Section 4 of the Statute of Frauds provides that an action cannot be brought upon a "special promise to answer for the debt, default or miscarriage of another person" unless the agreement upon which the action is based is recorded in writing and signed by the party (or someone authorised by the party) against whom the action is being brought. SMI and Mr Salgaocar argued that the email chain was too disjointed to constitute a guarantee within the meaning of s.4 of the Statute of Frauds and further that the electronic signatures in the emails were not sufficient to comply with the requirement in s.4 of the Statute of Frauds that the agreement be signed.

Issues and findings

Was the email chain too disjointed to constitute a guarantee within the meaning of the Statute of Frauds?

No. On the facts, it was arguable that there was a binding agreement, albeit one that was contained in a series of email communications and without any form of recap or summary at the time the agreement was entered into.

Was the guarantee signed for the purposes of the Statute of Frauds?

It can be argued that an email signature block can be sufficient to act as a signature on a guarantee.

Case law update

Yes. The electronically printed signatures of the persons who sent the emails were sufficient to constitute a "signature" within the meaning of the Statute of Frauds.

Commentary

This judgment illustrates that those conducting commercial negotiations using email should be extremely careful that they do not unintentionally enter into agreements. The Judge here did not have to decide whether there was actually a guarantee in place, only whether there was a serious issue to be tried. However, he made clear that a series of emails could be read together to comprise sufficient evidence of an agreement to provide a guarantee and that it was "well arguable" that the Statute of Frauds had been satisfied. Further, the Judge indicated that there is no need to sign a document manually in order to comply with the Statute of Frauds. This may mean that an email signature block would be sufficient. As these email signature blocks are often added automatically, considerable caution should be used when negotiating guarantees via email.

Limitation – economic loss

James Andrew Robinson v P. E. Jones (Contractors) Ltd

Court of Appeal (Civil Division): before Lord Justice Maurice Kay, Lord Justice Stanley Burnton and Lord Justice Jackson: judgment delivered 18 January 2011

The facts

In December 1991 Mr Robinson contracted with Mr Jones for the purchase of a house that was then still under construction. The Contract provided that the parties would enter into the National House-Building Council's standard form of Agreement No. HB5 (1986). Clauses 8 and 10 of the Contract provided that Jones' liability for defects would be limited to liability for defects covered by the NHBC Agreement. Whilst the house was under construction Mr Robinson informed Jones that he would like to have a second gas fire fitted. It was agreed that Jones would construct an additional chimney flue and that Mr Robinson would then contact British Gas directly to supply and install the second fire. The house was completed in April 1992 and the Robinson family moved into the property.

In September 2004 a British Gas service engineer attended to service the fires. The engineer disconnected the fires for safety reasons having found that one of the fires had a poor flue run. A surveyor later reported that both flues had not been constructed in accordance with good building practice or the relevant Building Regulations. Mr Robinson was required to arrange remedial works at a cost of £35,000. Following extensive correspondence Mr Robinson initiated proceedings in 2006 claiming in both contract and tort for the cost of the remedial works and general damages for loss of use of the fires.

At first instance the Judge found that the contractual claim was time-barred under the Limitation Act 1980. As to the tortious claims, the Judge found that in relation to economic loss, a builder could in principle owe a duty of care in tort concurrent with a duty in contract. Applying s.14 of the Limitation Act he also found that where Mr Robinson's claims in tort had been commenced within 3 years of the discovery of the problem, these claims were not statute-barred. However, the Judge concluded that clause 10 of the Contract satisfied the requirements of reasonableness under UCTA and thereby was effective as to exclude any liability in tort. Both parties appealed.

Issues and findings

Did Jones owe Mr Robinson a concurrent duty of care in tort in relation to economic loss?

No. As per *Henderson v Merrett Syndicates Ltd*, the existence of a contract does not prevent a tortious duty from arising but for that duty to embrace economic loss there must have been an assumption of responsibility by the builder. On these facts, there was no suggestion of an assumption of responsibility by Jones or reliance by Mr Robinson.

The existence of a contract does not prevent a tortious duty from arising but for that duty to embrace economic loss there must have been an assumption of responsibility by the builder.

Case law update

Commentary

This case should be regarded as essential reading. It provides clear guidance from the Court of Appeal on the extent to which a builder owes a duty of care in tort concurrent with any obligations arising under the building contract. Ordinarily that duty of care will be limited to a duty to protect the client (and others who foreseeably own or use the building) against personal injury or damage to property, other than to the building itself. The builder will have no tortious liability for pure economic loss unless it can be shown that there has been some assumption of responsibility by the builder, and reliance by the client, sufficient to create a relationship of sufficient proximity on *Hedley Byrne v Heller* principles. As Jackson LJ noted in his leading judgment, duties arising in contract and tort have different origins and objectives and are not to be regarded as being coextensive.

Applying these principles, Jackson LJ stated that he would in any event have been disinclined to find for Mr Jones but he regarded clauses 8 and 10 of the Contract as putting the matter beyond doubt. He concluded that whilst the NHBC Agreement did not provide Mr Jones with “total” protection, the protection provided was substantial, in particular against the risk of the builder’s insolvency. He therefore considered it “quite impossible” to say that the terms of the NHBC Agreement were unreasonable, and as such, clauses 8 and 10 did not fall foul of ss 2 and 3 of UCTA.

Jackson LJ stressed the importance of looking at the relationship and dealings between the parties in each case. On these facts he noted the absence of a “professional relationship” between Jones and Robinson. It follows that the duty in tort will not be so restricted where the contract is for the provision of professional services such as design. It would also appear arguable that where the building contract features some form of professional relationship, for example in a design and build scenario, the duty in tort of the builder may be wider and may embrace economic loss.

Refusal to mediate – Part 36 offer – costs consequences *Rolf v De Guerin*

Court of Appeal: before Lord Justice Rix, Lord Justice Elias and Lord Justice Tomlinson:
judgment delivered 9 February 2011

The facts

In June 2007, Mrs Rolf contracted with Mr De Guerin for the construction of a garage and a loft at Mrs Rolf’s home in London. The total contract sum was £52,000, split into £34,000 for the garage and £18,000 for the loft. The payment terms agreed were for 25% to be paid in advance and for the balance to be paid in weekly instalments. The building work did not go smoothly, mainly due to the interference of Mrs Rolf’s husband, Mr Mislati. Due to this and the cessation of the weekly payments by Mrs Rolf in August 2007, Mr De Guerin walked off site. By this time, the garage had been substantially constructed but the loft had barely been started. Mrs Rolf instructed other builders to finish the garage and claimed to have spent £20,000 in completing it.

In July 2008, Mrs Rolf issued a claim in the county court for damages in the sum of £50,000. Over the course of the proceedings, the value of Mrs Rolf’s claim fluctuated between approximately £44,000 and approximately £92,000. At the time of trial, the amount claimed by Mrs Rolf was approximately £73,000.

In June 2009, Mrs Rolf’s solicitors wrote to Mr De Guerin’s solicitors with a Part 36 offer to settle the claim for £14,000 plus reasonable costs. The offer included an offer to attend a formal mediation or a meeting with a view to discussing settlement. Mr De Guerin’s solicitors did not reply to that letter. On 29 July 2009, Mrs Rolf’s solicitors sent a chasing letter requesting a response to the Part 36 offer or the offer to mediate/discuss settlement. Again, Mr De Guerin’s solicitors did not reply to that letter. On 1 October 2009, Mrs Rolf’s solicitors wrote again to Mr De Guerin’s solicitors, once more pressing for the answer to her Part 36 offer and her invitation to mediate or discuss settlement.

An unreasonable refusal to mediate can affect costs recovery and that in low-value construction claims, where the cost of litigation is likely to quickly become disproportionate to the amount in dispute, mediation and negotiation should be pursued.

Case law update

There is nothing in the Part 36 procedure which states that an offeror is to be prejudiced as to costs because they have expressed a willingness to accept less than their formal claim.

Yet again, there was no reply. On 5 January 2010, on the eve of the trial, Mr De Guerin's new solicitors wrote to Mrs Rolf's solicitors with an offer to settle for £14,000 plus reasonable costs payable in monthly instalments over 36 months. Mrs Rolf's solicitors responded by amending the Part 36 offer to accept £21,000 plus reasonable costs. The increase in the amount offered reflected a recent amendment to the claim. Mrs Rolf's solicitors reiterated the willingness to mediate or to meet to discuss settlement. In response, Mr De Guerin said that he was willing to attend a mediation or settlement meeting but that due to his financial difficulties his best offer was £14,000 payable over 3 years. The parties were not able to reach a settlement before the trial.

At trial, the Judge rejected Mr De Guerin's defence that the contract had been with his company and not with himself, but did accept that Mrs Rolf had repudiated the contract. With regard to Mrs Rolf's allegations of defective work, the Judge accepted one defect out of three and awarded her damages of only £2,500, far less than the sum that Mrs Rolf had claimed, and also less than her Part 36 offer. The Judge considered that Mr De Guerin had been right not to accept the Part 36 offer, and held that there should be no order for costs up to the expiry of the period for acceptance of Mrs Rolf's first Part 36 offer, but that Mrs Rolf should pay Mr De Guerin's costs thereafter. Mrs Rolf appealed saying that the Judge had erred fundamentally in his appreciation of the significance of the Part 36 offer.

Issues and findings

Should a costs order be made against a claimant where judgment given was substantially less than their Part 36 offer?

No. There is nothing in the Part 36 procedure which states that an offeror is to be prejudiced as to costs because they have expressed a willingness to accept less than their formal claim.

Commentary

The Court of Appeal made it quite clear that a claimant should not be penalised in costs if the judgment given does not equal or exceed the offer made. Had the Court of Appeal upheld the decision of the trial judge this would have had grave implications on the effect of a claimant's Part 36 offer and could well have discouraged parties from making such offers. Given the emphasis placed by the courts on encouraging parties to settle, this would not have been a satisfactory outcome. The Court of Appeal also took the opportunity to restate the principle that an unreasonable refusal to mediate can affect costs recovery and that in low-value construction claims, where the cost of litigation is likely to quickly become disproportionate to the amount in dispute, mediation and negotiation should be pursued.

Contract formed by conduct

TTMI Sarl v Statoil ASA

Commercial Court: before His Honourable Mr Justice Beatson: judgment delivered 9 May 2011

The facts

On 12 October 2005 TTMI Sarl ("TTMI") took the vessel *Sibohelle* on a time charter. TTMI instructed Galbraith as its broker. Galbraith described the contact as "Sempra" (Sempra Energy being TTMI's ultimate parent company at the time). Statoil was interested in a sub-charter and TTMI instructed Galbraith to charter the *Sibohelle* to Statoil. On 17 October 2005 a recap email was sent from PF Bassoe (Statoil's chartering brokers) to Navion (Statoil's managing agent) and to Galbraith. The email confirmed the fixture and recorded the charterer as "Navion Chartering for and on behalf of Statoil ASA" and (incorrectly) the time-chartering owner as "Sempra Energy". The email also recorded Shellvoy 5 as the form of charter-party, 17 October 2005 as the charter-party date, and the laydays. It also included a section that listed the clauses of the Shellvoy 5 form of charter-party, with the arbitration clause having the notation "OK" marked against it.

Case law update

The voyage (from Norway to Houston, Texas) was performed. The Notices of Readiness were tendered and accepted in Norway on 18 November 2005 and in Houston on 10 December 2005. The Notices referred to the “terms and conditions of Charter Party/ Contract dated 17 October 2005” and identified TTMI as the time-charterer and Navion as the voyage-charterer. The Notices were accepted by Navion’s local representatives.

The cargo was discharged on 12 December 2005. The statement of facts issued in Norway on 19 November 2005 identified the time-charterer as “Sempra Energy” and the statement of facts issued at Houston on 12 December 2005 was addressed to “Sempra Trading”. On 13 December 2005 an invoice for freight in respect of the voyage was sent to “Navion Chartering for and on behalf of Statoil ASA”. The invoice was issued on Sempra Energy Trading’s paper but it stated the “total amount due TTMI” and that payment was to be made to an account in the name of “TTMI Sarl”. Statoil did not query the invoice and paid the freight to TTMI. TTMI’s solicitors then sent a demurrage claim to Navion “for and on account of Statoil”. When Statoil did not pay, TTMI commenced arbitration proceedings.

Statoil challenged the arbitrator’s jurisdiction on the basis that there was no contract between TTMI and Statoil and therefore no arbitration agreement. The arbitrator issued an award on his jurisdiction, agreeing with Statoil and stating that Sempra Energy did not contract as TTMI’s agent. The consequence was that TTMI was not the principal under the charter-party and the fixture was concluded between Sempra Energy and Statoil. TTMI challenged the arbitrator’s award in the High Court.

Issues and findings

Was a Contract concluded between TTMI and Statoil on or shortly before 17 October 2005?

No. The fixture recap email of 17 October 2005 did not evidence a contract between them nor did the “undisclosed principal” rule apply as there was no evidence to suggest that Sempra had been authorised to act as the agent of TTMI through Galbraith or did so act.

Did a contract between TTMI and Statoil come into existence by conduct because the voyage was performed by and the freight paid to TTMI?

Yes. Based on the facts, Statoil had in fact dealt with TTMI throughout and a contract had been formed between them, with formation probably taking place when the freight was paid, if not when the first Notice of Readiness was accepted or when the cargo was loaded.

If a contract had come into existence by performance, was there an arbitration agreement in writing sufficient for the Arbitration Act to apply?

Yes. The Notices of Readiness referred to terms and conditions of the recap email of 17 October 2005. The recap email identified the form of charter-party and also included the explicit reference to the arbitration clause which had the notation “OK” marked against it.

Commentary

This case highlights the importance of checking the correctness of both contractual and recap documents. Recap documents, particularly recap emails, are frequently used in commercial business to record the main terms of oral agreements between parties. A written document that purports to evidence an oral agreement will usually act as the main evidence of the parties’ bargain. Therefore, written evidence will usually be presumed to be conclusive in identifying the contracting parties, even if that evidence mistakenly identifies an incorrect party. Where such a mistake has been made and there are no other documents to evidence the parties’ bargain, the courts are prepared to look at the formation of contract by performance. Whether a court finds formation by performance will depend on the individual facts in each case. Here, the Judge identified a combination of facts which meant that, despite the mistake in the recap email, Statoil had in fact been dealing with TTMI throughout and a contract had formed between them.

Written evidence will usually be presumed to be conclusive in identifying the contracting parties, even if that evidence mistakenly identifies an incorrect party.

Fenwick Elliott news

Our team

As Simon Tolson acknowledged in his introduction, it has been another busy year at Fenwick Elliott which is one reason why we are pleased to welcome the arrival of Peter Collie who joined us as a partner on 1 November 2011. Peter, a former legal advisor to Carillion, has for the past 10 years been working as a barrister at No 5 Chambers in Birmingham.

We are also pleased to announce the appointment of two new associates, Stefan Cucos and Andrew Davies as well as the arrival of a new associate Jatinder Garcha from Maxwell Winward. He was not the only new arrival as over the last 12 months we also welcomed two new assistants Michelle Knight and James Mullen.

Seminars

We continue to host regular seminars throughout the year including our annual Construction Law Update and Capital Projects in the Education Sector Seminars. These seminars are intended to be both informative and practical, and we are fortunate to have external speakers renowned within the construction industry participate at these events, including current and previous Technology and Construction Court judges.

We have also been involved in other events such as providing a number of workshops to clients on the changes to the Construction Act, hosting a workshop in Romania on the FIDIC Yellow Book and supporting and participating in the Introduction to International Adjudication conference held at King's College, London.

We also host various other focused events throughout the year such as our market update events to discuss and debate topical construction and energy industry issues. We often conduct in-house seminars for our clients on topics you want us to address. If you would like us to come and speak at your organisation or would like more information about our seminars, then please contact Susan Kirby – skirby@fenwickelliott.com

Sierra Leone

We have continued our involvement with CODEP over the past year. One particular highlight¹ was our involvement in the First National Festival of Literacy & Culture which took place in Waterloo, Sierra Leone in February 2011. As well as hosting a number of guest speakers, most notably the Minister of Education, Dr Bah, CODEP was able to run a series of training workshops for the local teachers. For further information contact Jeremy Glover jglover@fenwickelliott.com or go to the CODEP website - www.codep.co.uk.

Website and resource material

Our newly launched website continues to draw an increasing number of unique visitors. One reason for this, we believe, is that we regularly upload a valuable archive of newsletters, papers and articles written by the Fenwick Elliott team. The "Articles and papers" pages of our website covers a wide breadth of topics including international arbitration, litigation and adjudication as well as alternative dispute resolution and contract issues. Examples of these articles can be found throughout this *Review*. Our website will also feature a Blog page containing the comments and views of our team on the issues and topics being discussed within the industry. We welcome your participation and comment in these discussions.

As you may know, *Dispatch*, our monthly newsletter, continues to highlight some of the most important legal developments during the previous month. If you would like to receive a regular copy please contact the editor, Jeremy Glover. You can find a copy of our latest newsletter *Insight* on the pages which follow this one. *Insight*, edited by Lisa Kingston, provides practical information on topical issues. Our *International Quarterly* newsletter focuses on legal issues of particular relevance to overseas projects. If you would like to subscribe to receive an email of the above newsletters go to the "Research and insight" section of our website www.fenwickelliott.com and complete the short subscription form.

www.fenwickelliott.com

A valuable archive of newsletters, papers and articles written by the Fenwick Elliott team

¹ It would be remiss of us not to mention another highlight - our triumph at the five-a-side tournament held on behalf of CODEP.



Welcome to the September edition of **Insight**, Fenwick Elliott's latest newsletter, which provides practical information on topical issues affecting the building, engineering and energy sectors.

In this issue find out what you need to know about Payment under the New Construction Act & Revised Scheme.

Insight

Payment under the New Construction Act & Revised Scheme

3 October 2011 marks the first working day of the operation of Part 8 of the Local Democracy, Economic Development and Construction Act 2009 (the "New Act") and the Scheme for Construction Contracts (England and Wales) Regulations 1998 (as amended) (the "Revised Scheme") in England and Wales.*

This note provides pointers on how the New Act and Revised Scheme are likely to operate in practice. For full details of the payment procedure under the New Act and Revised Scheme please see the second issue of *Insight*.

* The effective date for Scotland is 1 November 2011.

Practicalities

Who serves the payment notice?

The New Act alters the previous regime whereby only the payer could serve a payment notice. The contract must now dictate by whom the payment notice should be served and this can be either the payer, a specified person (for example, the architect or contract administrator) or the payee.

If (as is the position under most standard forms) the contract provides for payment applications to be made and the payee has issued an application that complies with the requirements of a payment notice, the compliant application will stand as the payment notice.

If the contract is silent on service of the payment notice, the payer must serve the payment notice under the Revised Scheme.

I have received a 'nil' payment notice. Is this permitted?

Yes. A payment notice must be served on all contractual due dates even if the sum due is zero. Zero payment notices will probably most commonly be seen during the defects liability period.

What happens if I am the payee and no payment notice is served by the payer?

It is open to the payee to serve a default payment notice provided no payment application or payment notice has already been issued by the payee. Service of a default payment notice should be effected immediately following non-service of a payment notice. This is to prevent the final date for payment being extended by the number of days between the date upon which the payment notice should have been served and date of service of the default notice. If service is delayed, this will prolong the payment periods under the contract.

A payless notice has just been served – what now?

Payless notices substitute the old withholding notices and their validity

can be challenged if they do not state (i) the sum the payer considers to be due on the date the payless notice is served and (ii) the basis on which that sum is calculated.

Exactly what a payless notice should include will no doubt occupy the Technology and Construction Court before too long, but until the requirements are clarified, at the highest, a payless notice would have to present the sum due in the form of a breakdown and include any ground(s) for withholding with reference to the alleged contractual breaches and the factual matrix. If this level of detail does not appear, then an argument might be available to the payee that the payless notice is invalid in which event the sum notified by the payment application, payment notice or default notice (as the case may be) would become due at the final date for payment. The consequences of a failure to serve a valid payless notice are such that payless notices (and indeed all other types of payment notice) should include much more detail than has been the case historically.

What happens if (i) a payless notice is not served (ii) a payless notice is served but is invalid or (iii) payment is not made?

If any of the above apply, or if any requisite timescales are not met, the payee is now entitled to suspend performance of all or part of its obligations under the contract upon (i) service of a payment application / payment notice or default payment notice (as the case may be) and (ii) the provision of seven days' written notice which notice should include the ground(s) for suspension. If payment is later made in full, the payee must immediately resume all work as the entitlement to suspend will cease to exist.

Provided the suspension is valid, the payee can claim (i) the direct costs and expenses reasonably incurred as a result of the suspension (for example, de-mobilisation, costs incurred during the period of suspension and re-mobilisation costs) and (ii) an extension of time for the delay caused in consequence of the suspension.



Insight

Any claim under (i) will not include legal fees or any loss of profit as such losses would be regarded as consequential unless express contractual provision was made for their recovery in the event of a valid suspension.

Suspension rights for non-payment will be more frequently invoked as a tactical alternative to adjudication; even the threat to suspend might now result in payment, particularly if the threatened suspension relates to an item of work important to the payer, or a commissioning obligation in circumstances where the works are otherwise almost complete. In order to counter payees' improved suspension rights, it is likely that payers will seek to increase the period of notice prior to any suspension to allow more time for disputed payment items to be discussed and possibly negotiated.

The payment provisions in my contract are linked to payment under another contract. Is this allowed?

No. 'Pay when certified' clauses (i.e. clauses whereby a sub-contractor is unable to obtain payment until sums are certified under the main contract to which he is not party) are now illegal. Four separate issues arise:

- (1) the main contractor can no longer agree his sub-contractor is only paid when he receives payment under the main contract;
- (2) payment can no longer be made conditional upon a decision by any person as to whether obligations under another contract have been properly performed;
- (3) the payment due date can not be determined by reference to a notice given to the payee; and
- (4) release of the retention can no

longer be triggered by an event occurring pursuant to an upstream contract, for example, a sub-contract which relies on Practical Completion under a main contract to trigger release of the first moiety of retention.

In order to prevent cash flow problems from arising, main contractors might now seek to increase sub-contract payment periods during contract negotiations to avoid finding themselves in a situation whereby they are obliged to make payment to sub-contractors when they are not themselves in funds.

What about management contracting and PFI contracts – are they any different?

Yes. There are two possible exceptions to the ban on 'pay when certified' and only time will tell whether they will operate as effective exclusions.

The first is where a construction contract is an agreement between two parties which requires a third party to carry out the construction operations (for example, a management contract). In this situation, parties will be able to agree that payments are conditional upon the third party carrying out its obligations.

The second is first-tier PFI sub-contracts where the contractor only becomes entitled to payment by the project company once it has become entitled to such payment under the project agreement. Lower-tier sub-contracts entered into by the first-tier design and build sub-contractor or operating sub-contractor will however probably still be caught by the prohibition on 'pay when certified' clauses.

I am a payee and I have become insolvent. What happens now?

Everything depends on when the insolvency event occurred and what the contract says. If the contract provides for withholding in the event of insolvency

and insolvency occurs after the date on which a payless notice is due to be served (regardless of actual service of the payless notice) and prior to the final date for payment, then payment will not have to be made. Where a payee goes insolvent shortly prior to a payless notice falling due, the payer will have to make payment regardless.

This is because the preceding payment application / payment notice or default payment notice (as the case may be) will stand as the notified sum and will trigger the obligation to make payment. Any contractual clause that states otherwise will be ineffective.

Conclusion

From now on, all new contracts will have to comply with the New Act and (through default) the Revised Scheme and amendments to existing contracts and project documentation will invariably be required. Standard terms that are already in place that apply to construction works will need to change and be amended to be brought into line with the new payment procedures under and the terminology of the New Act. Where work is sublet, any bespoke sub-contracts and professional appointments will have to be amended to expressly reflect the provisions of the New Act.

Changes will also be needed on the ground. Those who deal with payments under construction contracts will have to become fully familiar with the changes and the new regime and the potential consequences of a failure to issue timely notices, or risk being 'caught in the Act'.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. lkingston@fenwickelliott.com. Tel +44 (0) 207 421 1986

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