Winter 2013/2014

Construction and Engineering

Winter 2013/2014 In Site

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Welcome to the Winter 2013/2014 edition of In Site. This edition covers the following topics:

- **Collateral warranties, third party rights and the decisions** in *Parkwood Leisure Ltd v Laing O'Rourke Wales* and *Royal Bank of Scotland v Halcrow Waterman*
- The scrapping of the **Site Waste Management Plan Regulations**
- Recent **natural justice** and adjudication enforcement cases
- Set-off against **adjudicators' decisions**
- Recovering the costs of **adjudication in litigation** and the *National Museums and Galleries on Merseyside (Trustee of) v AEW Architects and Designers Ltd* case; and
- The Court of Appeal decision in *PGF II SA v OMFS Company 1* regarding a **refusal to mediate**

For more information on any of these articles, or on any other issue relating to construction and engineering law, please contact any of the authors or your usual K&L Gates' contact.

Collateral Warranties before the courts

Various issues associated with collateral warranties have come before the courts in recent months.

Parkwood Leisure Limited v Laing O'Rourke Wales and West England Limited [2013]

In the controversial decision in *Parkwood Leisure Limited v Laing O'Rourke Wales and West England Limited* [2013] EWHC 2665 (TCC), the High Court decided that, for the purposes of Part II of the Housing Grants, Construction and Regeneration Act 1996 (the Act), a collateral warranty can and often will be a 'construction contract' as defined in section 104 of the Act (and hence the adjudication provisions of the Act apply to such warranties).

The collateral warranty in this case had been given by a building contractor to the operator of a completed leisure facility, and the judge said he had no doubt that the warranty was 'for… the carrying out of construction operations' (s 104 of the Act) and hence a construction contract subject to the Act.

In common with many collateral warranties, the contractor had given a 'prospective' undertaking to the beneficiary that it would continue to comply with the underlying contract and complete the works in accordance with its contract with the developer. The judge said that this did not mean all collateral warranties were construction contracts but warned that, in his view, such an undertaking in a collateral warranty would amount to an agreement to carry out construction operations and therefore be a 'very strong pointer' that the collateral warranty was a construction contract.

If this judgment is followed, then most collateral warranties issued prior to practical completion of the works and containing the 'usual' type of undertakings could be construed as construction contracts. In contrast, the judge said that 'retrospective' collateral warranties which only warrant a past state of affairs are unlikely to be

construction contracts. Such language is, however, relatively unusual in collateral warranties, unless of course such warranties are only entered into once the works are complete.

Although helpful to have a reported judgment on the question of whether a collateral warranty is a construction contract (the prevailing view generally being that they are not), the decision has been criticised by various commentators, being described as 'a surprise', and even as 'simply wrong'.

If this judgment is followed, issues which it raises include:

- the need for the courts to establish the precise 'tipping point' where the contractor's obligations switch from prospective to retrospective. Some may argue for practical completion, others the end of the defects liability period and final certificate;
- the practical problem of how to apply the payment and suspension provisions of the Act to collateral warranties; and
- that it potentially opens the door to an increase in claims under collateral warranties being referred to adjudication.

Generally speaking, a 'wait and see' approach is being adopted with this judgment pending any appeal and/or consideration in other cases as to whether or not it will be followed.

The Royal Bank of Scotland plc v Halcrow Waterman Ltd [2013]

Also on the topic of collateral warranties, the Scottish decision in *The Royal Bank of Scotland plc v Halcrow Waterman Ltd* [2013] CSOH 173 provides an interpretation of the extent of protection provided to a consultant by a net contribution clause. A collateral warranty given by Halcrow (as structural engineer on a project) to Royal Bank of Scotland (as tenant) included a net contribution clause which apportioned Halcrow's liability and that of 'all Other Consultants' on the usual just and equitable basis. The difficulty however in this case was that 'Other Consultants' was not defined in the collateral warranty (although it was defined in Halcrow's appointment to mean other consultants engaged by the developer). When the bank claimed against the structural engineer under the warranty for defective flooring (the contractor by then being insolvent), Halcrow sought to argue that 'Other Consultants' should be interpreted broadly to include the contractor, thereby reducing the proportion of the bank's loss which Halcrow was liable for under the warranty. The court did not accept this argument, noting that it is open to commercial parties to draft a net contribution clause which covers the contractor as well, but the parties in this case had not done so. In accordance with normal language, a distinction had been drawn between the contractor and the consultants. There was no net contribution clause in the contractor's contract and this supported the argument that they were not viewed as a 'consultant' entitled to share in the benefit of the net contribution clause. As net contribution clauses seek to limit liability for losses, the court also noted that they should be construed with a degree of strictness.

SWMP Repeal in England

The Site Waste Management Plans Regulations (the Regulations) were repealed on 1 December 2013.

The Regulations were originally introduced in England in 2008. They required waste management plans on construction projects with values above £300,000 which detailed the amount and type of waste generated, and how that waste would be recycled, reused or otherwise disposed of. A key aim of the Regulations was to prevent 'fly-tipping'. After a

consultation earlier in 2013 however, the Department of Food and Rural Affairs (Defra) announced that the Regulations are to be scrapped.

Interestingly, at the same time the Regulations are being repealed in England, they are being introduced for projects in Wales as part of the Welsh Government's Construction and Demolition sector plan, which was launched in November 2012.

It would also appear that forms of waste management plan will remain in use in England, with 83% of the respondents to the consultation saying they would still use some form of tool to record and manage waste on site. In light of this, it may be advisable to remove references to the SWMP Regulations in standard schedules of amendments to building contracts but there may remain a call for including an obligation on the contractor to maintain a form of waste management plan as an administrative tool, drafted to suit the particular needs of the site and the project.

Enforcement of Adjudicator's Decisions

Several cases have come before the TCC in recent months developing the law relating to natural justice and enforcement of adjudicators' decisions.

ABB Ltd v BAM Nuttall Ltd [2013]

In *ABB Ltd v BAM Nuttall Ltd* [2013] EWHC 1983 (TCC) Akenhead J held that an adjudicator's decision should not be enforced because the adjudicator had taken Clause 11.1A in the parties' contract (dealing with agreements to vary the contract terms) into account when making his decision. Crucially, as it was not a clause that either party had relied on in their submissions, and because the adjudicator did not tell the parties he was relying on the clause, this amounted to a material breach of the rules of natural justice.

On the one hand, adjudicators are to be praised for using their initiative and they are often required to do so under the terms of their adjudication agreements. Therefore one could reasonably argue that this includes attempting to read the contract as a whole, including examining interpretation provisions such as Clause 11.1A. Akenhead J noted in his judgment that *'a point, fact or argument'* may occur to the adjudicator which has not been argued or mentioned by anyone else. In that situation *'[i]t is perfectly legitimate for the [adjudicator] to raise this with the parties and invite comment, argument or even evidence'.* Having done that it would generally be *'perfectly fair and proper'* for the adjudicator to rely on that point in reaching his decision.

The problem in this case was that the adjudicator did not raise the issue, and he had not been asked to consider whether there had been an agreement about certain design work, but rather what the scope of the agreement had been. A finding that there was no agreement at all was contrary to evidence from both sides. The breach of natural justice was material because there would have been a very real prospect of success for ABB on the Clause 11.1A point if the adjudicator had mentioned it before his decision and allowed the parties to comment on his approach to resolving the dispute.

KNN Colburn LLP v GD City Holdings Ltd [2013]

Natural justice issues were also raised in the case of *KNN Colburn LLP v GD City Holdings Ltd* [2013] EWHC 2879 in the context of the adjudicator not considering a material line of argument, but the case also raised interesting questions regarding the deadline for an adjudicator to issue his decision.

Section 108(2) of the Housing Grants, Construction and Regeneration Act stipulates that a construction contract shall require an adjudicator to reach a decision within 28 days 'of

referral' (or a longer period if agreed). The Scheme for Construction Contracts (which applied in this case) also states (paragraph 19(1)) that the adjudicator is to reach his decision within 28 days after the date of the referral notice. Paragraph 7(2) of the Scheme states that the referral notice is to be accompanied by copies of the relevant supporting documents.

Coupled with these stipulations, an adjudicator is typically granted the power to make various timetabling directions during the course of an adjudication. In the *KNN* case the referring party emailed the referral, with the substantial supporting documents being provided to the adjudicator (in hard copy) the following day. As soon as these were received, the adjudicator issued a timetable, which included the direction that he would issue his decision within 28 days of the date he received the supporting documents (rather than from receipt of the referral notice itself). Both parties complied with the adjudication timetable, and the adjudicator issued his decision (against the contractor) in accordance with the timetable. Significantly, neither party raised any objection, pre-decision, to the timetable set out by the adjudicator.

The contractor challenged the decision on various grounds, including that the decision was issued out of time, because the adjudicator had not counted the 28 days from the date of 'the referral'.

The court followed the decision in *PT Building Services v ROK Build* [2008], finding that, on the facts, serving the referral notice itself was enough to give the adjudicator jurisdiction and start the 28 day period running. It rejected the employer's argument that the supporting documents were critical to allow the adjudicator to start considering the dispute. Following *PT Building v ROK*, the requirements of paragraph 7(2) are merely 'procedural' and a de minimis delay in issuing the supporting documents may, on the facts, be acceptable. Despite this, the court rejected the contractor's challenge that the decision was out of time because the court found that the contractor's full participation in the adjudication process in accordance with the timetable should be taken as acquiescence of the timeline the adjudicator had laid down, including the issuing of the decision 28 days from receipt of the supporting documents. The judge said it was not acceptable for the contractor to stay silent and then *'attempt to spring a procedural trap without any prior warning'.*

Brims Construction Ltd v A2M Development Ltd [2013]

Natural justice arguments were also raised in the case of *Brims Construction Ltd v A2M Development Ltd* [2013] EWHC 3262. The court held that the adjudicator had not breached the rules of natural justice by asking the parties for submissions on points which he did not feel they had fully addressed. Unlike the situation in *ABB v BAM* (where the adjudicator had considered a material clause without telling the parties and giving them an opportunity to make submissions on the point), the adjudicator in *Brims* was held to have behaved properly. The fact that the adjudicator had requested submissions did not preclude either party from producing further evidence as part of those submissions.

The *Brims* decision also dealt with waiving the right to bring a jurisdictional challenge. This was a similar issue to that addressed in the *KNN* case (and the two judgments were handed down within only a couple of weeks of each other). In *Brims*, the defendant only raised a jurisdictional challenge (that the referral notice purported to expand on the notice of adjudication) after the referral, response and reply had all been served (and indeed only a week before the decision was due).

The court held that the defendant had waived its right to raise a jurisdictional challenge owing to the length of time it allowed to elapse before raising the challenge, combined

with the fact it was represented by competent solicitors who had prepared the response document, which gave no hint of any such challenge. This meant that the claimant had relied on the 'unqualified participation' of the defendant in the adjudication in preparing its reply, and hence the key elements of waiver had been made out.

Set-off against adjudicators' decisions

The general rule that sums awarded by an adjudicator should be paid in accordance with the terms of the adjudicator's decision, without set-off or deduction, has been supported by the recent decision in *Thameside Construction Company Ltd v Mr & Mrs Stevens* [2013] EWHC 2071. The case also examines the situations in which set-off may be allowed and provides a useful summary of the case law on the question of when an adjudicator's decision should be enforced.

Akenhead J set out the following principles:

- The first exercise is to interpret or construe what the adjudicator decided, and to distinguish between the decisive and directive parts of the decision;
- Adjudicators' decisions which direct that one party is to pay money should be honoured and a party should not be permitted to set-off or withhold against payment of that amount;
- There are limited exceptions to this general position:
    - if there is a specified contractual right to set-off that does not offend against the statutory requirement for immediate enforcement of an adjudicator's decision (albeit this will be relatively rare);
    - where an adjudicator declares that an amount is due or is due for certification, rather than directing that a balance should be paid, a legitimate set-off or withholding may be justified when that amount falls due for payment or certification in the future (*Squibb Group v Vertase* [2012]); and
    - where it can be determined from the adjudicator's decision that the adjudicator is permitting a further set-off to be made against the sum otherwise decided as payable, that may well be sufficient to allow the set-off to be made (*Balfour Beatty Construction v Serco Ltd*).

The court held that the exceptions did not apply and that the adjudicator was directing Mr and Mrs Stevens to pay a sum within 14 days and did not anticipate that they would try to set-off a disputed claim for liquidated damages as this claim would be 'for another day'.

Adjudication costs and expert witnesses: the decisions in *National Museums v AEW* and *Proton Energy v Lietuva*

The usual position in an adjudication is that each party bears its own costs irrespective of the outcome of the adjudication. With the increasing breadth and complexity of disputes which are referred to adjudication, these costs can be considerable. Since the decision in *Total M&E Services v ABB Building Technologies* [2002], the accepted position has been that the successful party cannot recover adjudication costs in enforcement proceedings if the adjudicator's decision is not complied with.

What however happens if and when the interim binding adjudication decision ends up in litigation or arbitration for final determination?

The question of whether the costs of the initial adjudication can be a head of claim was considered in *National Museums and Galleries on Merseyside (Trustee of) v AEW*

Architects and Designers Ltd and another [2013] EWHC 2403 (TCC). The adjudicator had decided in favour of the contractor in the original adjudication regarding design liability as between the contractor and the architect. When the Museum subsequently brought proceedings for a final determination of the dispute, it claimed the adjudicator's fee (which it had paid), its own legal expenses and expert fees from the adjudication.

As for any head of claim, the issues for the court were the reasonable foreseeability of those costs and causation linking the architect's breaches of contract and the adjudication.

In relation to the adjudicator's fees, Akenhead J held that these were fully recoverable, saying:

- as adjudication was, at the time of this dispute, a well established form of dispute resolution in the construction industry, it was reasonably foreseeable that the contractor may refer such a dispute to adjudication; and
- if the architect had not been in breach of its design responsibilities then the original adjudication would not have arisen and as such there was a sufficient causative link. The *'causative link would only be broken if the Museum had acted unreasonably or if its solicitors had acted negligently in advising the Museum that it had an arguable defence in the adjudication'.*

Akenhead J allowed the Museum's own legal expenses and expert costs on the same principles, albeit with a reduction of around half to ensure that only the 'reasonable costs' were recoverable.

A separate, but very interesting side-issue in this case was the court's criticism of the parties' expert witnesses, with one of the architect's experts acknowledging under cross-examination that he was attempting to 'defend the indefensible' in his report on the architect's design.

In a separate recent case, *Proton Energy Group v Orlen Lietuva* [2013] EWHC 2872 the expert was criticised for his general lack of experience. This case emphasises the importance of ensuring that the expert instructed is qualified and experienced in the specific practice area/issue in dispute. For the expert in the *Proton Energy* case, a dispute relating to a trade for a crude oil mix, the court noted that he was honest, straightforward and highly qualified in the oil industry 'in general'. He did not, however, have any experience with the trading of crude oil or of how oil trading companies operated. His evidence was therefore 'hypothetical' and his evidence was simply 'a set of impressions' which were held to be of little assistance to the court.

This case, therefore, reinforces the importance of balancing, when selecting an expert, the desire to retain an expert one knows to be 'good in the box' against the need to ensure that such an expert's skill set and experience is in fact exactly right for the specific job at hand.

An unreasonable refusal to mediate?

The case of *PGF II SA v OMFS Company* ([2012] EWHC 83 (TCC)) was first heard in 2012 where the court imposed a costs sanction due to an unreasonable refusal to attempt to mediate. The Court of Appeal, in *PGF II SA v OMFS Company 1 Ltd* [2013] EWCA Civ 1288, has now upheld the lower court's decision.

Since the decision in *Halsey v Milton Keynes General NHS Trust* [2004] a successful litigant can be deprived of some or all of its costs if it unreasonably refused to agree to

ADR. The *PGF* decision has expanded on this principle to establish that a failure to respond to an offer to participate in a mediation is, in itself, unreasonable.

In giving this decision, the court also endorsed the approach taken in the Jackson ADR Handbook published earlier this year which sets out the steps which a party faced with a request to engage in ADR, but which believes that it has reasonable grounds for refusing to participate at that stage, should consider in order to avoid a costs sanction. The court summarised this advice as 'calling for constructive engagement in ADR rather than flat rejection, or silence'.

Parties cannot be forced to mediate, and there may be many reasons why it may be reasonable to refuse to mediate (such as another type of ADR being more suitable, the timing of the offer to mediate being 'wrong' etc), but the decision in this case confirms that parties who simply ignore an offer to engage in ADR do so at their costs peril.

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