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Insurance - and risk allocation

Welcome to this latest edition of the Construction & Engineering Legal Update.

The key theme for this issue is insurance. The courts have very helpfully provided a number of recent decisions that we feature in the first part of this Update, together with a leading article by Tom Duncan on project insurance.

The remainder of the construction landscape has not been neglected and elsewhere in the Update the reports and articles range from a review of the ICC Model Turnkey Contract for Major Projects to a round-up of EU (and other) procurement decisions, not to mention a guide to the UK Site Waste Management Plans (for those who are not already fully up to speed with the new regime).

We hope you enjoy the contents.

Project Insurance

All sorts of projects have all sorts of insurance for all sorts of participants in the works. But can it all be made much simpler, and cheaper, by getting people covered by the same policy? It already happens, to some extent; construction contracts often contain clauses requiring one party to take out joint names insurance for its benefit and that of other parties on the project. The insurance is intended to allocate risk to the policy, rather than the parties, for the circumstances insured against, but does it really work?

Joint insurance – the problems

Even that deceptively simple step, however, of joint insurance is a legal minefield. There is a substantial body of law on the meaning and effect of joint insurance, which might mean that the parties' intentions at the start of a project are not necessarily reflected in the contractual and insurance arrangements between them.

The recent Court of Appeal decision in ***Tyco Fire v Rolls-Royce*** (considered in detail on page 8 below) is a good example of the problem and is also a reminder of the importance of having in place contractual and insurance regimes that are co-ordinated and clear and which achieve the stated aims of the parties. One of the issues considered in ***Tyco*** was the inter-relationship between the provisions for joint insurance and the indemnities provided in the contract and how this affected the right of one joint insured to sue another in respect of damage for which they were jointly insured.

It has previously been said that there is a rule of law that prevents an action between two or more persons who are insured under the same policy against the same risk. Perhaps the best known cases in this area are ***Petrofina (UK) Limited v Magnaload*** and ***Mark Rowlands Limited v Berni Inns***. The basis for this "rule" has been the subject of much academic debate but the purpose of this article is not to revisit this area, except to note that in recent times (most notably in the House of Lords decision of ***Co-operative Retail Services v Taylor Young***) the courts have suggested that the basis of the rule is to be found in the contract between the parties.

In ***Tyco*** the contract provided for the contractor's liability to the employer for negligence but also contained provisions concerning joint names insurance. Lord Justice Rix stated

that the existence of insurance in the names of both the contractor and the employer did not, in itself, prevent a subrogated action being pursued by the insurer in the name of the employer against the contractor. Such an action would only be prevented by an express term in the policy prohibiting subrogation. If that is correct then it must also be correct that, unless there is an express term to the contrary, the employer may sue the contractor under the indemnities provided in the contract rather than claim under the policy (even though the contractor is a joint insured). The employer would certainly choose to do so if the insurance company were to fail or if the insurance company were to deny cover. In either case, this may leave the co-insured contractor facing a liability for losses which it envisaged would be covered under the joint names policy.

This scenario can be avoided by careful contract drafting to make the indemnities provided by the contractor subject to the joint insurance provisions. This underlines the importance of giving the insurance regime careful thought prior to the start of a project and ensuring the contracts reflect what is intended.

What joint insurance is available for construction projects?

The traditional approach

Most standard form contracts provide for joint names insurance for the works with a requirement for the contractor to have in place its own public liability and professional indemnity insurance as appropriate.

The joint insurance in question is normally a Contractor's All Risks (or CAR) policy,. A CAR policy provides an indemnity against the costs of repairing damage to the works caused by "all risks". Usually the employer, contractor and sub-contractors are named as joint insureds in the policy.

CAR policies differ but the trigger for cover is "damage" to the insured property. For the purposes of CAR insurance, it is important to distinguish between what is damage and what is a defect, damage being covered by the policy and defects (and the effect of defects) being excluded to varying degrees. Generally, damage will exist if there has been a physical alteration which impairs the usefulness of the property insured. In ***Pilkington v CGU Insurance***, the Court of Appeal decided that damage does not extend to the incorporation of a defective product in property where the defective product does not physically harm the property and the harmful effect of any later defect is contained within the product.

If there is damage, whether the CAR policy will respond depends upon the exclusions in the policy. The most important exclusions relate to damage caused by defective design or workmanship. There are five defect exclusions widely used in the London insurance market, DE1 to DE5. These provide as follows:

- DE1 is an outright defects exclusion which excludes all loss or damage to the property insured due to a defect in design, plan, specification, materials or workmanship.
- DE2 excludes all loss or damage to the property insured which is:
  - (a) in a defective condition due to a defect in design, plan, specification, materials or workmanship;
  - (b) relies for its support on (a); or
  - (c) which is incurred in order to assess and repair (a) or (b).

However, DE2 does cover loss or damage to property insured which is not in a defective condition but which is damaged by insured property in a defective condition.

- DE3 gives the same cover as DE2 save that (b) above is also covered provided it is not in an defective condition and is not damaged during the repairs of (a).
- DE4 excludes only loss or damage to the component part or item of the property insured which is defective in design, plan, specification, materials and workmanship as well as damage incurred to insured property to access and repair the defective part. However, DE4 writes back in cover to all other parts of the insured property which is not defective but is damaged as a consequence of the defect.
- DE5 gives the widest cover because it only excludes the cost of redesigning the defective insured property. The defective component part, the damage caused by that part and the access costs are all covered.

The most commonly used design exclusion is DE3 but the parties can choose how wide the cover should be under the CAR policy by opting for one of these five options. The premium obviously increases as the scope of cover widens.

Issues to consider when selecting an insurance regime

As highlighted in ***Tyco***, when choosing the scope of cover the parties should consider how that will affect the contractual obligations. If the parties intend to transfer the risk to the policy this should be made clear in the contract. The easiest way of doing this is by expressly making clear that the relevant contractual obligations are subject to the requirement to take out the joint names policy.

Another issue to watch for is that many standard contracts contain obligations to take out a certain level of cover, for example JCT contracts require existing structures insurance to be taken out in respect of "specified perils". Wider cover is available and if it is obtained the contract obligations should be reviewed to ensure they are compatible.

CAR insurance plays an important role during the life of the construction project but the cover it provides is only for the costs of rectifying damage to the works. It is therefore still necessary for all the parties to have liability insurance in place during the life of the works to cover claims against or by one or more of the parties relating to losses other than damage to the works.

Project insurance

For many projects, particularly for more complex high value works, CAR insurance is not sufficient because of its limited scope. On such projects it is common to put in place joint names project insurance covering damage to the works, third party liabilities and delays.

The works cover is the same as a CAR policy and relates to damage to the works. The third party public liability cover is for damage to third party property or physical injury to third parties arising during the course of the works. The trigger for cover under this section is a legal liability to a third party but the scope of cover tends to be limited to damage or injury to the public (although financial loss extensions are available at an increased premium). The works and third party sections will have all the parties to the project named as joint insureds.

Delay in start up cover is normally only available for the employer and any funders or future owner/operators of the works. The cover is for loss of cash flows generated by the

completed project in the event of delay to the completion of the works but only where the delay is the result of damage to the works. Delay insurance is often required by funders on large projects to protect the income stream, as those cash flows are required to service (and repay) the debt.

Project insurance is normally taken out by the employer at its cost on behalf of the other joint insureds. This arrangement usually places the risk that the scope and amount of cover is sufficient for the needs of the project on the employer and gives the employer control over the administrative tasks, particularly notification. If the project policy is paid for by the employer there may be a reduction in the contractor's bid price but that is by no means certain as a design and build contractor will still have to bear the cost of its own professional indemnity insurance.

Project policies for high value works may also have large deductibles, and consideration needs to be given to how the deductible will be allocated as between the parties. One option is to limit the parties' contractual liabilities to the level of the deductible, so that the party responsible for the damage pays the deductible and thereafter the policy responds. The same fault-based approach can be taken to losses within the scope of the policy but which exceed the limit of indemnity. In both cases, however, disputes can still arise as to responsibility for the damage, and therefore the deductible and/or the uninsured losses, despite the existence of joint insurance.

It has been estimated that two-thirds of construction professional indemnity claims are made prior to completion, which suggests that the joint names insurance currently used in the industry can, at best, have only a limited effect in preventing significant disputes arising between the parties during the life of the project.

The future?

Collaboration and partnering have long been identified as the way to overcome the "blame culture" that can arise on construction projects. Much has been written about these concepts and how they lack contractual teeth when relationships break down but many contracts are cast in this mould and clients, particularly in the UK public sector, are now looking for an insurance regime to help facilitate the partnering ethos.

In response, the Strategic Forum for Construction has proposed "integrated project insurance", which is joint names insurance that insures against the financial effects rather than occurrences (such as damage) or liabilities. It is implemented under a contractual regime where the parties agree to waive their rights to claim against each other and instead look to the policy to recover their losses, however those arise. The intention is that integrated project insurance would replace the parties' own policies (including professional indemnity and public liability policies) and put an end to the often competing and contradictory insurance arrangements covering particular projects.

It is proposed that insurers would be brought into discussions at the start to agree the target cost plan for the project. Each member of the project team is then incentivised under its contract to meet the target cost using a pain/gain-share formula and the deductible under the policy, if applicable, would become part of the pain element. Over and above this pain share insurers would bear any financial losses up to the limit of indemnity.

At this stage the idea is in its infancy but pilot projects are being initiated to test the idea in practice and a project team comprising insurers, brokers and advisers will monitor the projects to develop the practicalities of the proposals. While it remains to be seen whether it can achieve its stated aim of eliminating disputes during the life of the project, some have estimated that integrated project insurance could save the industry 1% of its total costs. If this is correct (which remains to be seen) it is likely that those ultimately responsible for procuring projects will be keen to do their best to make it work.

Tom Duncan

The scope of public liability insurance

What a public liability policy covers may not be as obvious as you think. In April this year, in ***Tesco Stores Limited v Constable & Others***, the Court of Appeal looked at coverage under a public liability policy and had to decide how far that cover extended. Did it extend to liability in contract for pure economic loss?

In 2003 Tesco embarked on a project to build a supermarket over a railway cutting near Gerrards Cross station. The railway line was to be enclosed in a tunnel with the supermarket being built on the infill site above it. Part of the tunnel collapsed in 2005 while the work was being carried out and the railway line was closed for 51 days.

The train operator that used the line had entered into a Deed of Covenant with Tesco which required Tesco to pay the train operator:-

> *"on demand such sums as shall from time to time fairly compensate them for all and any costs, losses or expenses arising out of or resulting (directly or indirectly) from ... the carrying out of the Works...and its existing and/or future railway passenger business"*

Tesco had to take out public liability insurance of £155,000,000:-

> *"... in respect of legal liability which may be incurred by [the insured] in respect of death or bodily injury to any person and loss or damage to property arising from the activities authorised by each licence holder."*

The description of cover in the public liability policy taken out by Tesco said that:-

> *"The insurers will indemnify the Insured against all sums for which The Insured shall be liable at law for damages in respect of:*
>
> *a) death of or bodily injury to or illness or disease of any person*
>
> *b) loss or damage to material property...*
>
> *c) obstruction, loss of amenities, trespass, nuisance or any like cause*
>
> *happening or consequent upon a cause occurring during the Construction Period or any extension thereof and arising out of and in connection with The Project"*

There was a contractual extension to the cover which provided that:

> *"[1] Contractual Liability*

> *Other than as may be stated or implied in The Contract, liability assumed by The Insured under contract or agreement and which would not have attached in the absence of such contract or agreement shall be the subject of indemnity under this section only if the conduct and control of any claim so relating is vested in The Insurers and subject to the Exceptions and Extensions of this section."*

Lord Justice Tuckey said that a public liability policy provides cover against liability to the public at large whereas private liability arises from contracts between individuals. Public liability in this sense arises in tort and does not and cannot arise only in contract and, as a general rule, a claim in tort cannot be based on pure economic loss. This was, he said, a strong, but not conclusive, pointer to the meaning of the words used.

Lord Justice Tuckey looked at the classes of liability set out in a) to c) of the description of cover and noted that each class of liability corresponded with a familiar class of liability arising in the law of tort, or its effect, from physical interference with a third party's person, property or property rights and was typical of harm associated with a project of this kind.

There was nothing in the wording to indicate that liability in contract under a contract of indemnity was intended to be included. Nor did the contractual liability extension assist Tesco. This did not apply, said Lord Justice Tuckey, because any loss which the train operator suffered was not "*in respect of*" (meaning *for)* physical impact on its property or property rights. Its loss was only the consequence of such impact on the property and property rights of others. The train operator's claim under the contract extension ran into precisely the same difficulty as its claim in tort. It was not a typical public liability claim but simply a contractual claim for economic loss.

Tesco had not damaged the train operator's property or property interests, and the train operator could not base its liability to the train operator on the ground that it had damaged the property or property interests of Network Rail. Things might have been different, of course, if the train operator had suffered the necessary damage. However, on the facts in this case, the train operator had not suffered damage, because it only had a limited interest in the railway.

Interestingly, Lord Justice Tuckey noted that if Tesco had wished to provide insurance cover for this liability:-

> *"It would have been a simple matter to provide a copy of the deed of covenant to insurers and agree a simple clause to cover that liability, if insurers had been prepared to do so at a premium acceptable to Tesco".*

Outside its insurance context, this case is a useful reminder to those drafting contracts of the limiting effect of the phrase "*in respect of*". If less limiting language is required, phrases such as "*in connection with*" or "*arising from*" are to be preferred.

Michael Regan

Environmental insurance - the pollution reinsurer pays

A key environmental theme is that the polluter pays. With a growing environmental insurance market the obligation to pay rests with insurers and reinsurers, if the relevant specialist policies cover the pollution in question. Cases on environmental insurance are generally few and far between but a recent ruling by the Court of Appeal may prompt pause for thought by the environmental insurance market and insureds.

In ***Wasa International Insurance Company Limited v Lexington Insurance Company and Others*** the Court of Appeal had to consider whether back to back reinsurance covered the clean-up costs of manufacturing sites in the United States. In the early 1990s the US Environmental Protection Agency and various state environmental agencies had required Alcoa (the Aluminium Company of America) to clean up pollution and contamination of ground water, surface water and soil at various manufacturing sites in the US used by Alcoa.

Alcoa issued proceedings in the courts of the State of Washington against various of its insurers that had provided cover over a period of approximately 30 years, seeking a declaration of entitlement to insurance cover in respect of the clean-up costs at 35 manufacturing sites in the USA. The courts of Washington State applied the law of Pennsylvania and the Supreme Court of Washington State found that Alcoa could recover the full costs of remediation at any particular site provided only that *some* damage had occurred at the relevant site during the years when Lexington was at risk.

Lexington were Alcoa's property damage insurers for the period between 1 July 1977 and 1 July 1980 but the consequences of the Supreme Court's decision were that Lexington was then faced with a hefty claim of the order of US$ 180 million, which they eventually settled for a figure of US$ 103 million.

Lexington had, however, reinsured their risk on the London reinsurance market on the same terms and conditions "as original" including, specifically, the insured period of 1 July 1977 to 1 July 1980. The reinsurers, Wasa and AGF, declined to pay on the basis that the reinsurance policy was governed by English law and that, as a matter of English law, reinsurers could only be liable for the costs of remedying damage to property which actually occurred between 1 July 1977 and 1 July 1980. They said they could not therefore be liable for the cost of remedying damage occurring before or after that period.

Those arguments failed. The Court of Appeal held that the reinsurers were bound by the decision of the Supreme Court of Washington State. Lord Justice Longmore said:

> *"In the present case one has to determine whether as a matter of construction of the contract the parties intended the period clause to have the same meaning, whatever that meaning may be. It seems to me that they did..."*

And Lord Justice Sedley added that:

> *"Save to the limited extent that the terms of reinsurance pushed them apart, the two contracts were back to back, because that...is what reinsurance prima facie is."*

Lord Justice Longmore referred to the evolution of the Bermuda Form in which the parties agree to English or Bermuda arbitration but agree also that the substantive law of the insurance (or reinsurance) is to be that of New York, noting that this *"...sensible arrangement might avoid some, at least, of the problems thrown up by this difficult case"*

Cate Sharp, head of our Environment Group, comments:

This case highlights the relevance of environmental insurance as an option for businesses in their management of environmental risks. Although it has been said many times before, the case also demonstrates how important it is for all parties to check the risks that are being covered. Environmental insurance premiums can certainly be costly and businesses will want to ensure that their cover is activated in the intended circumstances and protracted litigation is avoided.

Environmental insurance inevitably presents its own particular issues. A particular issue with respect to specific policies covering contamination by gradual migration or seepage is ensuring adequate disclosure to the insurer of all known issues at the site. It is also important to note that a typical exclusion in environmental insurance policies is where there is any voluntary reporting to a regulator. This can limit coverage in circumstances where, as a matter of internal policy, a company is proactive in its environmental management or where a third party (such as a landlord or former owner) makes such a report.

If you have any questions about environmental insurance, please contact:

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Indemnities and joint names insurance

As the latest adventure of Indiana Jones goes to show, some themes just keep coming back. Take joint names insurance and indemnities. A burst pipe, a flood and the old familiar argument about who should pay for the damage may not be in the same league as Harrison Ford's exploits but the twists and turns of the Court of Appeal decision in ***Tyco Fire & Integrated Solutions Limited v Rolls-Royce Motor Cars Limited*** surely provided an ending to talk about and enough ammunition for a sequel in the House of Lords.

In principle it's all very simple. A contractor gives an indemnity to the employer against its negligence but elsewhere in the contract the contractor or the employer is required to insure the works, and perhaps the existing structures, in their joint names. The question is, does the joint names insurance arrangement cut down the application of the indemnity, to the extent of the insurance obligation? Did the parties intend an insurance funded solution? Sometimes the parties say so but sometimes they do not, which is where the problem begins, as it did in ***Tyco***.

Tyco contracted with Rolls-Royce to provide fire protection services, including a sprinkler system, at a new Rolls-Royce manufacturing plant near Goodwood in West Sussex. One of the main supply pipes burst and caused a flood, damaging not only the works but other parts of the plant. Tyco repaired the damage to the Works, but the Court of Appeal had to decide whether Tyco was liable to Rolls-Royce for damage to "*existing structures*" (i.e. other parts of the development).

For the purposes of the proceedings, Tyco accepted that the flood was caused by its negligence in failing properly to connect or fasten a joint in the main supply pipe, which had caused the burst and consequently the flood. Clause 13.5 of the contract, which was not an industry standard form, began with this critical wording:

> *"The Employer shall maintain, in the joint names of the Employer, the Construction Manager and others including, but not limited to, contractors, insurance of existing structures….. against the risks covered by the Employer's insurance policy referred to in Schedule 2 (ie the Specified Perils) subject to the terms, conditions, exclusions and excesses (uninsured amounts) of the said policy."*

Rolls-Royce had apparently not taken out this insurance in joint names but the parties agreed that the court should resolve the case as if it had.

The first key issue was whether the first sentence of clause 13.5 made Tyco a joint insured in respect of the existing structures. The first instance judge looked at the phrase "….. *others including, but not limited to, contractors….*". and commented:

> *"It is difficult to think of a wider scope of persons intended to be covered"*.

The Court of Appeal did not agree. They found a number of things striking about the insurance of the existing structures:

- The "*Contractor*" was not named, although the "*Contractor*" was named in connection with insurance of *the Works* and it would have been "*so easy*" to include the contractor in the first part of the clause.
- The rest of clause 13.5 was about insurance of the Works and nothing further was said about how a joint names policy in respect of the existing structures was intended to work.
- "*others, including but not limited to, contractors*" was an odd phrase; "*contractors*" were at least identified by description but "*others*" were wholly undefined.
- What was the insurable interest in respect of which "*others*" were to be insured?
- Schedule 2 (referred to in 13.5) contained a "*Notice To Contractors On Insurance Provisions*" which suggested that cover in respect of the Specified Perils was limited, where contractors were concerned, to their Works.

Lord Justice Rix also noted that there was no obligation on Tyco to take out professional indemnity insurance (which he thought, had it been taken out, would have applied to Tyco's assumed faulty pipe tightening) but commented that it would be a brave contractor who undertook work without putting such insurance in place.

The opening part of clause 13.5, said the Court, was not intended to give Tyco or any individual contractor separate liability insurance in respect of the existing structures outside the area of its own Works.

"All that this phrase is intended to do is to state that the Employer's Policy insuring its own property on the Site embraces a series of joint named policies which protects "others" including but not limited to contractors. Contractors are told this so that they may have the confidence that, if disaster strikes the development, the employer will have the resources to reinstate it including the resources to prepare and see to completion the performance of contractor's Works. It seems to me that "others" is not a natural way to refer, even inclusively, to the Contractor under an individual package contract, and that the position is not improved by saying that "others" includes "contractors", a phrase which does not in terms embrace the "Contractor".

There was no special regime in relation to the existing structures (or even, it seems, in relation to the Works) which excluded Tyco's other contractual obligations, in particular its indemnity to Rolls Royce against negligence.

Lord Justice Rix considered the challenging case law and found the Court of Appeal's decision in ***London Borough of Barking & Dagenham v Stamford Asphalt Company Limited*** the closest case, in terms of the facts (although the issue in ***Tyco*** was, of course, one of construction of the particular contract that Tyco made with Rolls-Royce).

Barking was apparently not cited (and was therefore unaffected) by the key House of Lords' decision in ***Co-operative Retail Services Limited v Taylor Young Partnership Limited.*** The ***Barking*** analysis that, in this situation, an obligation to insure in joint names only extends to specified perils so far as loss by such perils has *not* been caused by negligence, was, in Lord Justice Rix's view, binding on the Court of Appeal in the absence of the distinguishing wording in, for example, the ***Co-operative*** case.

The Court of Appeal did not have to decide the second main issue, whether, as a matter of insurance law, the provision for joint names insurance by itself provided an overriding reason to construe the contract so as to override Tyco's contractual liability for negligence. Lord Justice Rix did consider the issue but "*cautiously*", as the House of Lords had explored the issue in the ***Co-operative*** case.

Different doctrines had, he noted, been put forward to explain why an insurer cannot sue by subrogation in the name of one co-assured to recover, from another co-assured, monies paid out on the basis of the latter's negligence or default. One doctrine is circuity of action and another is an implied term in the insurance contract, the latter now apparently replaced by the doctrine of the true construction of the underlying contract for the provision of joint names insurance.

A provision for joint names insurance might, he said, as a matter of construction, lead to the carving out of an exception from the underlying regime so far as specified perils were concerned. An implied term could not, however, withstand express language to the contrary and if the underlying contract envisaged that one co-assured might be liable to another for negligence even within the sphere of the policy's cover, in the absence of any express exclusion of subrogation, there was nothing in the doctrine of subrogation to prevent the insurer suing in the employer's name to recover the proceeds paid out by the insurer.

The latest thinking, said Lord Justice Rix, is to the effect that "*...it is all ultimately a matter of the parties' intentions as found in their contracts.*" and not, therefore, a rule of law. Nothing in considering the second issue, therefore, caused him to change his mind on the first.

One clear message that does emerge from the judgment is just how important it is for parties to agree what risks are to be covered by insurance and how far (if at all) to make express reference to the sensitive issue of negligence. Despite that clear message, however, and despite the growing emphasis on risk allocation, do not bet against a sequel or two. Some themes just don't seem to go away.

Richard Craven

Notification, notification, notification

Although not quite as exciting as the UK TV home-hunting series "*Location, location, location*", following the notification provisions of your insurance policy can be just as crucial as taking the plunge and plugging your life-savings into purchasing a swanky new flat. The recent decision in ***Kajima UK Engineering Ltd v The Underwriter Insurance Company Limited*** serves as a key reminder of the importance of sufficient notification.

Kajima was the main contractor for the construction of a block of apartments, which were in the form of pre-fabricated, stacked accommodation pods. Kajima took out professional indemnity insurance with the defendant underwriters for a two year period. The policy stated:

"The Insured shall give written notice to the Underwriters as soon as possible after becoming aware of circumstances which might reasonably be expected to produce a claim...."

The effect of the policy wording was that, if circumstances were notified under the policy which later led to a claim, the policy would respond as long as the circumstances (and not necessarily the claim) were notified within the policy period.

During the policy period, Kajima duly made a notification that the pods were settling, which was causing adjoining roofing, balconies and walkways to distort. The notification also referred to other potential damage and risk and that an investigation was underway. Shortly afterwards, the policy expired and the investigations were completed.

The investigations revealed a number of serious and extensive problems, only some of which were in the same area of the defects originally notified. Further, some of the problems uncovered were not the same as those originally notified. The question arose, whether the problems that occurred after the policy expired formed part of the circumstances originally notified in the policy period, or whether the additional problems were new circumstances which would not be covered by the policy.

The insured, Kajima, argued that the investigation had led to further discovery of additional defects and so there was a continuum of events which were related, beginning with the initial investigation. The court disagreed. There had to be some relationship between the defects and damage that occurred after the policy had expired and the previously notified circumstances. On the facts of the case there was no such relationship and therefore the insured had no claim even though the investigation (which was notified) uncovered the additional defects and problems.

And the message?

The case is a sharp reminder that if a policy is to respond, every insured must be careful to notify the specific circumstances or claim. If there has already been a notification, new circumstances that arise may need to be notified, even if the insured believes there to be some link to the original notification. Taking a precautionary approach to notification is the safe course. Taking a more relaxed approach might mean that insurers are entitled to reject a claim under the policy, and that could be seriously bad news.

Gemma Houghton

Down with liability - and how to fix the ceiling

You always need a plan B. Especially with contracts, and the construction industry is well versed in risk allocation between employers, contractors, subcontractors and the other industry players. With potential liabilities on construction, oil and gas projects running into the millions, effectively drafted exclusions, indemnities and limitation of liability clauses can be vital; as can be the choice of law which ultimately governs them.

Such clauses should ideally be drafted using clear wording which accurately captures the intentions of the parties. What happens, however, when an exclusion clause or indemnity is silent, for example, as to damages or loss which flows from a party's own negligent or intentional act? What is the approach of the English courts in such circumstances?

Among the various questions of fact and law explored in the recent decision of Mr Justice Ramsey in ***Biffa Waste Services Ltd and Biffa Leicester Ltd v Maschinenfabrik Ernst Hese Gmbh and another*** was the scope and extent of limiting wording contained in a clause of an agreement between Biffa Waste and MEH.

Biffa Leicester and Leicester City Council entered into a PFI contract for the collection, recycling and disposal of Leicester's domestic waste. The PFI contract required the construction of a recycling plant, a key part of which was a Ball Mill. Biffa Leicester then entered into a back to back agreement with Biffa Waste who in turn contracted with MEH under a Design and Build Deed for MEH to design and build the relevant plant. MEH also provided a warranty in favour of Biffa Leicester (the Direct Agreement).

MEH subcontracted the supply of the Ball Mill. While post completion modification works were being carried out in the Ball Mill by a third party a fire broke out. Biffa Leicester and Biffa Waste brought proceedings in the Technology and Construction Court against MEH and a subsubcontractor of MEH to recover losses resulting from the delay caused by the fire to the operation of the recycling plant. (Two of the parties to the proceedings were apparently insolvent.)

In determining whether MEH was liable to Biffa Leicester and if so, to what extent, Mr Justice Ramsey had to consider the effect of clause 2.2 of the Direct Agreement and to decide if the wording was sufficient to exclude or limit liability in tort. The clause read:

"The Contractor shall subject to the terms of this agreement owe no liability, duty or obligation to Biffa Leicester which is greater than would have existed if Biffa Leicester had been named Provider under the Supply Contract"

Biffa relied on the principles of interpretation set out by Lord Morton, in 1952, in ***Canada Steamship Lines v The King.*** Those guidelines provided that, in cases where there is no express reference to negligence, the court must consider if the words used are wide enough, in their ordinary meaning, to cover negligence and if they are, then the court must consider whether "*the head of damage may be based on some ground other than that of negligence*". If this is found to be the case (and that head is not so fanciful or remote) then ***Canada Steamship*** provided that liability for a party's own negligence would not be excluded.

Mr Justice Ramsey analysed the authorities, including the relatively recent case of ***HIH Casualty and General Insurance Ltd v. Chase Manhattan Bank***, and helpfully summarised the position:

> *"(1) Limitation of liability clauses are construed with less rigour than exclusion of liability clauses or indemnity clauses.*
>
> *(2) The guidelines in Canada Steamship provide helpful guidance on the proper approach to interpretation but do not lay down a code which prescribes rigid rules to be applied mechanically to interpret a particular clause.*
>
> *(3) The relevant clause must be construed in the context of the whole instrument and against the admissible background, to ascertain whether the wording, although literally wide enough to cover negligence, did not do so.*
>
> *(4) In the case of exclusion clauses or indemnity clauses it is inherently improbable that one party intended the clause to release the other party from liability for negligence or impose an indemnity for the other party's negligence. But, in the case of a limitation of liability clause there is no such high degree of improbability."*

On the basis of these principles, Mr Justice Ramsey found that clause 2.2 of the Direct Agreement was sufficient to limit MEH's liability in tort for delay caused by negligence as:

- clause 2.2 was a limitation of liability clause and as such was to be construed less rigorously than an exclusion clause,
- although there was no express reference to "negligence" in clause 2.2, the reference to "liability" and "duty" was sufficient to cover liability in tort for negligence, and
- there was nothing improbable about MEH wishing to exclude liability in tort for negligence.

The judgment in ***Biffa v MEH*** therefore indicates that the courts have distanced themselves from inflexible application of the rules set out in ***Canada Steamship***, especially in circumstances where to do so would, as Lord Scott of Foscote said in ***HIH v Chase Manhattan***:

"produce a result inconsistent with the commercial purpose of the contract in question".

As with all matters of drafting, the question could be avoided altogether if the relevant contract clause contains wording that makes clear whether or not the particular exclusion or indemnity applies to a party's own negligence or intentional acts. How easy or difficult it may be in practice, however, to negotiate what may be a sensitive issue, is, of course, another matter.

Monica Chaplin

The meaning of consequential loss

Just like the English monarchy, English cases on the interpretation of consequential losses run in a relatively long and established line. "*Consequential*" losses, concluded the Court of Appeal in ***British Sugar v NEI Power Projects***, are losses that fall within the second limb of ***Hadley v Baxendale***, which are losses that may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

While clear in principle, like so many things, the difficulties start to surface when the test is applied in practice. Take, for example, the 1997 case of ***Deepak Fertilisers and Petrochemical Corporation v Davy McKee (London) Ltd and ICI Chemicals & Polymers Ltd*** where the Court of Appeal had to consider the following clause:

"*and in no event shall DAVY by reason of its performance or obligation under this CONTRACT be liable...for loss [of] anticipated profits, catalysts, raw material and products for indirect or consequential damages*".

Deepak had made a claim against Davy which included a claim for fixed costs and overheads, arising from an explosion at a methanol plant which was rebuilt, together with loss arising due to the fact that the new plant used more catalyst per charge than the original plant. In this instance, the Court came to the conclusion that the fixed costs and overheads together with the losses relating to the higher catalyst charges were not *"indirect or consequential*" and therefore Davy could not rely on the exclusion clause.

Some sixty years previously, in ***Saint Line v Richardsons, Westgarth & Co***, where marine engines to be fitted in a ship were rejected as unsuitable, loss of profit claimed by the owners of the ship was also held not to be an "*indirect or consequential loss*". More recently, in ***Hotel Services Ltd v Hilton International Hotels (UK) Ltd*** the Court of Appeal found the cost of removal and storage of defective chiller units and loss of profits not to be indirect or consequential losses.

A number of standard form contracts have similar exclusion clauses. For example:

- Clause 17.6 of the FIDIC Silver Book:

  "Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract..."

- Clause 44.2 of MF/1:

  "...neither the Contractor nor the Purchaser shall be liable to the other...for any loss of profit, loss of use, loss of production, loss of contracts or for any financial or economic loss or for any indirect or consequential damage whatsover that may be suffered by the other".

Clause 44.2 was considered in ***The London Fire and Emergency Planning Authority v Halcrow Gilbert Associates and Others***, where a state of the art fire-fighter training facility in Southwark itself caught fire and burnt down due to a leak in the ductwork. The claimant sued its consulting engineers and its building services engineers, Lorne Stewart, who had installed the ductwork.

Lorne Stewart had been appointed pursuant to an MF/1 form of contract and one issue the court had to consider was whether the cost incurred by the claimant in paying for alternative training facilities, while the firehouse was shut down following the fire, was excluded by clause 44.2 of MF/1. The claimant argued that the alternative fire training costs could not be excluded by the clause as the wording was not sufficient to exclude costs that fell within the first limb of ***Hadley v Baxendale***.

The judge disagreed. He said that "*Clause 44.2 must be construed disjunctively, not conjunctively. It is not intended to include loss of profit etc as examples of indirect or consequential loss. It is intended to specify categories of loss which are to be excluded*".

This reasoning might arguably apply to clause 17.6 of the FIDIC Silver Book as the wording is similar.

What about this clause, however?

"*…neither the tugowner nor the hirer shall be liable to the other party for loss of profit, loss of use, loss of production or any other indirect or consequential damage for any reason whatsoever.*"

Eagle eyed readers will no doubt have noticed the word "*other*" in this clause but does this make a difference? This wording was considered in ***Ease Faith v Leonine Marine Management*** where the court concluded that this clause only excluded liability for indirect loss of profit, because of the reference to "*or any other*". Similar wording was considered in ***BHP Petroleum v British Steel*** but there Mr Justice Rix came to the view that the word "*other*" should just be disregarded, so there is no clear authority on the point. This could be significant when one considers the phrase:

"*…the Contractor's liability for loss of use, loss of profit or other consequential loss …*"

which appears in the JCT 2005 Design and Build Contract (as it did in the equivalent 1998 standard form) and which also has that magic word "*other*" in it.

But, just like the monarchy, glitches in the line can occur and the Australian Court of Appeal of Victoria has very recently challenged the established thinking. In ***Environmental Systems Pty Ld v Peerless Holdings Pty Ltd*** the Court thought that, in principle the ***British Sugar*** test appeared to be flawed. It is not correct, it said, to confine "*consequential losses*" to the second limb of ***Hadley v Baxendale***. The real distinction was between:

1. "normal loss" which is a loss that every claimant in a like situation will suffer; and
2. "consequential losses" which are all losses other than "normal loss".

According to the Court:

> "*…in my view, ordinary reasonable business persons would naturally conceive of "consequential loss" in contract as everything beyond the normal measure of damages, such as profits lost or expenses incurred through breach*".
>
> The Court agreed with the approach taken by *McGregor on Damages* which noted that:

"*It is illogical and fails to make practical sense to confine consequential loss in contract to loss falling within the second rule in Hadley v Baxendale, being contradictory for one contracting party to communicate special circumstances to the other so as to fix him with*

the liability for loss to which he would not otherwise be subject and at the same time to accept an exclusion of liability in respect of the selfsame loss."

It is an interesting argument, although it failed to convince the English Court of Appeal in the ***Hotel Services*** case. Whether the Victoria approach revives the debate and ultimately derails the ***British Sugar*** line of authority remains to be seen, ideally in the House of Lords. In the meantime, however, if you want to be contractually exclusive, say exactly what you mean and agreed and don't mention you know what.

Emily Monastiriotis

Liability for "costs" under a collateral warranty

The Scottish Court of Session recently considered the meaning of the phrase 'Sub Consultant's liability for costs' in a collateral warranty. The case of ***Glasgow City Airport Limited v Messrs Kirkman & Bradford*** provides us with a classic example as to why, when attempting to limit liability for consequential losses, the language used must be clear and unambiguous.

The claimant, Glasgow Airport Limited sought to recover £2 million with interest for breach of a collateral warranty provided by the defendant (Kirkman & Bradford) who had installed a floor slab at the claimant's property. The claimant's tenant brought an action against the claimant seeking to recover the cost of having the floor slab replaced and also sought to recover their losses due to disruption to business and loss of profit. The claimant subsequently claimed against the defendant.

In defending the claim, Kirkman & Bradford sought to rely on a term of the collateral warranty that stated:

" *1. The Sub-Consultant warrants that it has exercised and will continue to exercise all reasonable skill, care and diligence in the performance of the services under the appointment. In the event of any breach of this warranty:*

> *(a) The Sub-Consultant's liability for costs under this Agreement shall be limited to that proportion of such costs which it would be just and equitable to require the Sub-Consultant to pay having regard to the extent of the Sub-Consultant's responsibility for the same..."*

The defendant submitted that the opening words of the clause limited their liability. They relied on the word '*costs*', claiming that the term was confined to the costs of repair or reinstatement of the floor slab and did not extend to consequential losses. This would mean they were only liable to pay £775,000, the cost of replacing the floor slab.

The claimant said that the collateral warranty should not be interpreted so restrictively, that the first full paragraph of the warranty in clause 1 (above) was unrestricted and so, unless restricted from doing so elsewhere, they were entitled to recover all losses caused by breach of that warranty, subject to satisfying the ordinary common law test of remoteness.

The court agreed with the claimant, holding that the proper interpretation of the words *'liability for costs'* had to be considered in conjunction with the general warranty granted at the outset. The warranty had been given in general and unqualified terms and would, unless clearly restricted (and subject to the remoteness rules), entitle the claimant to recover all losses directly caused by the breach.

Louise Barber and Richard Craven

What's been happening at Mayer Brown?

February 2008 – Mining Indaba

For the past 13 years, the world of international mining has converged on Cape Town, South Africa for an annual conference, known as "Indaba", a Zulu word, referring to a meeting or convention of tribal leaders. Members of our Construction & Engineering Group have been attending the Mining Indaba for a number of years as part of the Mayer Brown Mining Group (see article on page 30).

At each Mining Indaba, ministerial panels provide a forum to learn about new mining opportunities and allow delegates to interact with dozens of cabinet-level government representatives eager to secure new investments in their countries. This presents something of a dilemma, given the issue of political risk. Delegates heard about mining companies in Zimbabwe who had had their entire assets expropriated by the government of Mr Mugabe. At the other end of the spectrum the presentation by the Finance Minister of Botswana demonstrated that Botswana recognises the need to cultivate inward investment to bring much needed foreign capital and currency into the country in order to aid its development. That said, political risk remains an important issue for project sponsors and lenders on international mining projects.

March 2008 – MIPIM

In March Chris Fellowes and Jon Olson-Welsh from our Construction & Engineering Group had the tough assignment of going to Cannes to attend this year's MIPIM, billed as one of the largest real estate conferences in the world.

The event is attended by investors, developers and advisers and while the atmosphere was slightly subdued because of the credit crunch, Jon reports that there appeared to be no let up in the number of development opportunities being discussed and the organisers have in fact since announced record attendances at this year's event.

If you are attending MIPIM next year be sure to let us know as Chris and Jon would be delighted to meet you there.

May 2008 – Houston Energy Conference

Jonathan Hosie was one of three London-based partners who attended Mayer Brown's annual Energy Conference in Houston. Houston is often referred to as the Energy capital of the world, being home to major energy companies, contractors and specialist service companies. Over 100 delegates from the energy industry and the specialist finance and corporate advisory world attended the conference. Jonathan presented one of the workshops "Power Plant Development: EPC contracting issues"' The workshop examined how best to structure completion risks, both through the EPC model and other forms of procurement, when developing power plants.

May 2008 – Construction Law 2008

On 22 May, in London, Jonathan Hosie, Sally Davies and James Fielden from the London Construction and Engineering Group were speakers at the Construction Law 2008 Conference which was billed as providing a *"Practical, comprehensive and tactical analysis of the latest developments affecting the construction industry"*.

The all day conference was chaired by Jonathan, and Sally spoke on "*Insurances to underwrite your risks*", dealing with:-

- common risks for D & B contractors;
- the roles and risks assumed by design consultants;
- how to hedge the risk; and
- how to avoid errors and omissions in your insurance cover.

James Fielden spoke on The Community Empowerment, Housing and Economic Regeneration Act 2009, considering what the recently announced legislation to amend the Construction Act might contain.

June 2008 - ICC/FIDIC and a master class

Nick Henchie had a busy start to June. At the beginning of the month Nick spoke at the ICC/FIDIC conference in Houston "*International construction contracts and the resolution of disputes*" and then returned to London to speak at a two day master class "*Delay and Disruption in Construction Contracts*".

2008 – Welcome to Kevin Owen

At the end of January 2008 we were not only delighted to welcome our new colleagues from JSM (see issue 55) but, in particular, to welcome the JSM Construction & Engineering team. In this issue we are very pleased to introduce Kevin Owen, a partner in our Hong Kong office.

Kevin specialises in all aspects of non-contentious construction and project work in Hong Kong and South East Asia, including rail projects, airports, water treatment and power-related transactions in Indonesia, Vietnam, Thailand and the PRC.

Kevin is involved in advising on:-

- procurement methods for large scale infrastructure projects and drafting construction, consultancy and equipment supply contracts and project documentation for infrastructure and project finance transactions;

- dispute resolution mechanisms in construction projects and environmental law aspects of projects in Hong Kong.

Kevin acts for Government-funded statutory corporations, real estate developers, project sponsors, consultants, contractors and sub-contractors, insurers, financial institutions and all participants in the construction process.

Notable among the projects with which Kevin has been involved are the West Rail, Tsimshatsui Extension, Kowloon Southern Link and Bangkok rail projects, Hong Kong Container Terminal CT9, the PPP Asia World Expo project, a Bangkok waste water treatment project, the Hong Kong Convention and Exhibition Centre Atrium Link Extension and a new cargo terminal at Hong Kong International Airport.

Kevin's efforts have not gone unnoticed. Asia Pacific Legal 500 have ranked Kevin as a Leading Construction Lawyer for a number of years, as did Chambers Asia in 2008, and Asia Pacific Legal 500 described Kevin in 2007/08 as *'very impressive' non-contentious specialist'*.

Construction judge rules that parties have no contract

"Is there a contract?" is a regular theme in construction cases but the judgment in ***Haden Young Limited v Laing O'Rourke Midlands Limited*** is a powerful (and perhaps, to some, surprising) reminder of just how far parties can go without actually concluding the contract. Mr Justice Ramsey, in the Technology and Construction Court (TCC), ruled that the parties had no contract some two years after their project had reached practical completion.

Haden Young Limited (HYL) carried out the design and installation of mechanical and electrical works at the Ricoh Arena in Coventry. There were lengthy and detailed discussions between HYL and the main contractor, Laing O'Rourke Midlands Limited (LOR), concerning the terms of a sub-contract between them but none was ever signed. HYL proceeded with the work, for which LOR paid HYL in accordance with its terms. The project reached practical completion and eventually the parties arrived at the TCC wanting to know if there was a contract.

Mr Justice Ramsey found that the parties had not agreed on all the essential terms, in particular because the parties had not agreed the limit of liability under warranties or the sub-contract and had not entered into a signed and executed agreement. He ruled that the proforma warranties had been regarded as being vital to the parties. He also held that the test of whether a contract had been concluded was an objective one.

LOR argued that HYL were estopped from contending that no sub-contract had been concluded because applications for payment and contractual claims had been made by HYL without any qualification or suggestion that HYL were not entitled to the payments in accordance with the agreed price and terms of the sub-contract.

This argument also failed. Mr Justice Ramsey said:-

> *"There are many cases where contractors or sub-contractors start on site without having a concluded contract. Whilst those in a managerial capacity are negotiating the terms of the contract, those involved in carrying out the work necessarily conduct the day to day operations by reference to the draft contract documentation so that, when the expected contract is concluded and applied retrospectively, the necessary procedures have been in place for the obligations subsequently agreed. That conduct is not a representation that a contract exists...*
>
> *...In any event, for there to be a sub-contract based on estoppel, there would have to be a sub-contract incorporating all terms, including the limitation of liability under the warranties and sub-contract. In the absence of agreement on these essential terms, how could the parties be estopped to particular limits? The parties did not resolve this essential term and the Court cannot fill the gap by an estoppel. The difficulty is that the estoppel would have to resolve the very question of the essential term on which the parties themselves could not agree."*

Accordingly, HYL were entitled to be paid on a quantum meruit basis for the works they had carried out.

Whilst parties may often carry out (and even complete) works on the assumption that a contract will be agreed it is dangerous, as this case demonstrates, to assume that a contract has been concluded. Making a contract can, in its way, be just as challenging as carrying out the works.

Richard Craven

ICC Turnkey – unlocking the potential?

It's new and it's different but will it be popular? The new ICC Model Turnkey Contract for Major Projects, produced by the ICC Commission on Commercial Law and Practice, is intended for use on the design, procurement, supply and construction of works on a lump sum turnkey basis. The Contract is said to be suitable for use in both public and private contracts, whether tendered or individually negotiated, as part of build, operate and transfer projects and in externally financed projects.

The Commission maintains that it is in business for business, and therefore represents all parties in international transactions. Accordingly, the ICC Contract seeks to distinguish itself from other lump sum contracts already in the market (such as the FIDIC Silver Book and the IChemE Red Book) on the basis that it is a more balanced contract which is "*fair to all parties*" whilst still maintaining certainty of both price and scope.

The ICC Contract uses a number of drafting devices in an attempt to achieve this aim, including:

- in several cases, setting out the purpose of an Article at its beginning, in an attempt to make the purpose clear and avoid it being interpreted out of context;

- seeking to maintain reciprocity in the parties' obligations wherever possible (eg, mirrored indemnity provisions); and
- the incorporation of obligations of good faith and fair dealings, along with descriptions of what these involve for both parties.

But is the ICC Contract actually more balanced and how different is it in reality?

Key Features

- **Evidence that the contract price can be paid**

  The ICC Contract adopts a key feature of the FIDIC Silver Book by enabling the contractor to request evidence of the employer's ability to pay. The ICC Contract takes this a step further by making the contractor's commencement of work conditional upon production of such evidence.

- **Responsibility for documents**

  Responsibility for the accuracy of documents and information under the ICC Contract is very similar to the position under the IChemE Red Book, with each party retaining the responsibility for documents and information provided by it or on its behalf. The FIDIC Silver Book, on the other hand, places sole responsibility for any inaccurate data on the contractor.

  Despite this, under the ICC Contract each party is required to review the other's documents prior to the commencement of work and subsequently as circumstances require. Since neither party will be liable for the documents and designs prepared by the other and there is no sanction for failure to undertake such a review, is there any real incentive for either party to carry it out?

- **Design Responsibility**

  The contractor is responsible for developing the design, except to the extent otherwise agreed or as is reasonable in the circumstances. No guidance is provided as to when it would be reasonable for the employer to be responsible for design development; the employer has a right to be informed of design development, but no right to determine methods of working.

  This is different to the IChemE Red Book and the FIDIC Silver Book which place design responsibility solely on the contractor. More importantly, the ICC Contract states that the final design responsibility "*may be shared*" between the parties. This may apply where, for example, the employer specifies a performance requirement and the contractor proposes a method of meeting that requirement, or where the employer specifies a material or proprietary substance or method and the contractor agrees it is suitable for its intended purpose. Just how any defect in a "shared" design would be dealt with, however, is not explained.

- **Design development**

  The design submission procedures are very similar to those in the IChemE Red Book and the FIDIC Silver Book. Notably, the review period under the ICC Contract is 21 days, a week longer than that of the IChemE Red Book.

- **Variations**

  The process for issuing variations, whilst apparently similar to that under the FIDIC Silver Book, is actually quite different in overall effect. Both contracts require the contractor to provide a variation proposal in response to a variation requested by the employer, containing such information as:

  1. a description of the proposed design and the work to be executed;
  2. a programme for the execution of the variation;
  3. the effect that the variation will have on the programme and the date for completion (or "Time to Taking Over");
  4. a lump sum or price estimate for the variation; and
  5. any other elements of the contract likely to be effected by the variation.

  Significantly, under the ICC Contract the contractor has the right to object to any variation, is entitled to be paid for the cost of preparing such a variation proposal (irrespective of whether the employer decides to proceed), and a variation may not omit a part of the work from the contract.

- **Site information**

  As in the FIDIC Silver Book, the ICC Contract requires the employer, at the time of calling for tenders, to undertake a survey of the site and its surroundings and to make this available to the contractor. The contractor will subsequently be deemed to have considered this information when determining the contract price.

  The ICC Contract also provides that the contractor is entitled to an extension of time and/or additional costs if it experiences site conditions which could not reasonably have been foreseen or which vary from any assumptions it has expressed in writing to the employer prior to signing the contract.

- **Extensions of time and additional costs**

  The contractor is entitled to both an extension of time and additional costs (where applicable), where there has been a delay giving "*an entitlement to an extension of time*" (including an event of force majeure). Significantly the ICC Contract does not clarify what will constitute a delay "*giving rise to an entitlement to an extension of time*", but does contain a very wide definition of force majeure.

  The ICC Contract also distinguishes itself from the IChemE Red Book and the FIDIC Silver Book by providing for a mandatory reassessment of all events and circumstances of the works 90 days prior to the Time to Taking Over, to determine whether the contractor is entitled to any further extensions of time.

- **Delay Damages**

  Unlike the IChemE Red Book and the FIDIC Silver Book, the ICC Contract contains a fall-back rate of liquidated damages for circumstances where one is not stipulated by the parties. This is 0.5% of the contract price (or if there is a delay to a section, then 0.5% of the value of that section in proportion to the value of the whole of the works) for each complete week of delay up to a maximum of 10% of the contract price.

- **Bonus**

  The ICC Contract further distinguishes itself by providing for a bonus in addition to the contract price if the contractor achieves practical completion before the Time to Taking Over. If the parties do not state a rate for the bonus, then the default is 0.5% of the contract price for each complete week that the works were completed prior to the Time for Taking-Over, up to a maximum of 10% of the contract price.

- **Limitations of liability**

  The ICC Contract contains considerable limitations of liability. Neither party is liable for:

  1. any loss of profit, loss of income, loss of production, indirect or consequential damage; or
  2. losses which "*are difficult to estimate or provide for or are out of proportion with respect to the value of the Contract obligations*", whatever they may be; or
  3. "*treble, exemplary, moral or punitive damages or any other non-compensatory damages*".

  In addition, and unlike the IChemE Red Book and the FIDIC Silver Book , the ICC Contract caps both parties' liability at 7.5% of the initial contract price in respect of each and every claim (except for those related to intellectual property rights or defect rectification), and caps the parties' *total* liability at 30% of the initial contract price in the aggregate.

- **Termination**

  Either party may terminate the ICC Contract on the occurrence of a material breach or any force majeure event which impedes a party's progress for more than 180 days. Importantly, the ICC Contract sets out indicative circumstances of what will constitute a material breach on the part of either the employer or the contractor.

- **Dispute resolution**

  The dispute resolution process is very similar to the FIDIC Silver Book with all disputes being resolved by a dispute board in accordance with the ICC Dispute Board Rules.

Is it a winner?

Parties will need to think carefully about using the ICC Contract, as its change in emphasis and unusual provisions are sure to surprise many. It shifts the risk profile established by other contracts; persuading employers used to adopting FIDIC Silver or IChemE Red Book-type contracts (with their pro-employer risk allocation systems) to adopt the new ICC Model Turnkey Contract will perhaps be the greatest challenge.

Stephen Natoli

Withholding of liquidated damages - Reinwood v Brown

Having broken its duck with ***Melville Dundas v George Wimpey*** (see issue 54), the House of Lords soon had a second challenging Construction Act case to resolve in ***Reinwood Ltd v L. Brown & Sons Ltd.***

Once again a withholding notice was involved. The withholding notice had been issued by the developer employer, Reinwood, to enable deduction of liquidated damages under the JCT 98 based building contract but, after it had been issued, the contractor, Brown, was awarded an extension of time. Did this extension of time and the cancellation of the certificate of non-completion retrospectively invalidate the withholding notice? If it did, the contractor would be able to rely on its default notice, in respect of non payment, which had been an essential ingredient of its later determination of its employment under the building contract. The Court of Appeal, reversing the first instance decision (also see issue 54), said the withholding notice remained valid, which was not good news for Brown. There was an appeal to the House of Lords.

These were the key events:

Timeline

- 7 December 2005 – Brown makes application for extension of time;
- 14 December – Architect issues certificate of non-completion;
- 11 January 2006 – Architect issues interim certificate 29 showing a net amount payable of £187,988 (final date for payment 25 January);
- 17 January – Reinwood issues a notice of its intention to deduct liquidated damages (under clause 24) in respect of the period of delay from 14 December 2005 and a withholding notice for the liquidated damages (total £61,629) to be deducted from the sum specified in Certificate 29;
- 20 January – Reinwood pays Brown £126,359 (£187,988 less £61,629);
- 23 January – Architect awards Brown extension of time to 10 January 2006;
- 24 January – Brown informs Reinwood that the effect of the extension of time is to reduce the liquidated damages to £12,236 and increase the amount to be paid under Certificate 29 to £175,662;
- 26 January – no further payment; Brown says that Reinwood has failed to pay the amount owed by the final date (25 January) and serves notice of default under the contract;
- 27 January - Reinwood tells Brown that it will pay £49,503 (£61,629 less £12,236); and
- 1 February - Reinwood pays Brown £49,503.

The House of Lords decided that the extension of time awarded on 23 January did not retrospectively cancel the non-completion certificate and deny Reinwood the right to rely on that certificate to justify the sums it had withheld in respect of Certificate 29. (Both the issue of Certificate 29 and payment, it should be remembered, were made prior to the extension of time award).

In giving the leading judgment, Lord Neuburger considered that to find that the extension of time did cancel the non-completion certificate retrospectively would be to give the word "cancel" an "absurd" meaning. It would mean that if an extension of time was granted after the final date of 25 January, the employer would have underpaid. The policy reflected in the Construction Act was that the parties should know in advance exactly where they stood.

The Law Lords agreed with the Court of Appeal that the extension of time award only cancelled the certificate of non-completion going forward. This meant, in these circumstances, that s110(1) of the Act "is engaged" and Brown could have applied for any sums to which it had become entitled due to the extension of time. As no time for payment was specified, in default the Scheme would apply and payment would be due 7 days from an application made for the further amount, the final date for payment falling 17 days from that date.

Another difficult issue for the House of Lords to resolve but then that is, of course, what they are there for.

Catrin Rees

Procurement round-up

On breathing apparatus, project management and measured term contracts

Tendering is difficult enough without facing the obstacle course of the EU procurement rules. It's all in a good cause, of course, in the interests of fairness and equality but sometimes, and perhaps inevitably, public authorities trip up over an obstacle in the administration or interpretation of the relevant rules.

In this round-up of procurement decisions, we go first to Scotland to look at the consequences of failing to follow the EU public procurement rules and then to the European Court of Justice to see how it interpreted the (now replaced) Works Directive's application to the procurement of the project management aspect of a public authority development.

To complete the trilogy, we are pleased to reproduce an article by Kevin Owen on terms of fairness and good faith that were implied in the tender process for a public works contract, quite independently of the procurement rules.

The price of non-compliance

It goes without saying that it is important to follow the EU public procurement rules when a contracting authority is seeking offers for the supply of goods, works or services. In ***Aquatron Marine t/a Aquatron Breathing Air Systems v Strathclyde Fire Board*** the Court of Session in Scotland highlighted just how important.

Strathclyde sought tenders for a three year contract to service, maintain and repair breathing apparatus. Strathclyde had opted for the "*open procedure*" and advertised the intended procurement in the Official Journal. Bids were submitted by three parties including Aquatron.

The tenders of Aquatron and one other were rejected on the grounds they were "*non-compliant*". The reasons given for rejecting Aquatron's tender were:

- that Aquatron had not supplied evidence of quality standards achieved by its workforce, that its workforce failed to meet quality standards; and
- that its ISO 9001 quality accreditation was unacceptable because of doubts over the body that had awarded the accreditation. (It was undertaken by a private body rather than a government body).

The Court did not accept either ground for rejection of the bids. In relation to the first ground, the specification did not set any minimum requirement to be met in order to proceed to the full evaluation of the tender. In addition, Aquatron had set out the quality of the workforce in a covering letter which had not made its way to those persons evaluating the tender.

In relation to the second ground, the specification stated "*accreditation to ISO 9001:2000 issued by a recognised accreditation centre*". It did not specify from which body the accreditation was to be obtained.

The court therefore found that the tenders had been evaluated on different criteria from those which were advertised in the Official Journal and this was in breach of the EU public procurement rules. The court awarded Aquatron damages, amounting to £122,149, representing the profit it would have earned had it been awarded the contract plus interest. This was on the basis that if Aquatron's tender had not been rejected, on the award criteria Aquatron would have been awarded the contract (which the court accepted).

The case highlights the dangers of a contracting authority failing to follow the EU public procurement rules – it can be a very costly mistake.

Jon Olson-Welsh and Lisa Lernborg

Regeneration Complications at Roanne

Sometimes, EU procument rules can turn up unexpectedly. In ***Jean Auroux and Others v Commune de Roanne*** the European Court of Justice had to decide whether, where one contracting authority engaged another to carry out the project management aspects of the development, the agreement constituted *"public works"* so that the procurement rules applied.

The Municipal Council of Roanne, a town on the edge of the French Alps, had plans to regenerate. It entered into an agreement with a semi-public regional development company, SEDL (whose capital included private funds), to project manage the works, including the tender process. The agreement provided that the subsequent procurement process that would be required for the project was to be in accordance with the French Public Procurement Code (that followed the Works Directive 93/37/EEC, now superseded by the current Works, Supplies and Services Directive).

There were three questions for the ECJ:-

- **Was the agreement between Roanne and SEDL a public works contract?**

  Yes, said the ECJ, it was. The execution of works was involved, it was not necessary that the person who entered into the contract was capable of direct performance and SEDL did have a pecuniary interest in the project. The Directive's requirements for a Public Works Contract were therefore satisfied.

- **What is the method of determining the value of the contract for the purpose of the threshold in article 6?**

  The Court said that the valuation of projects should be considered from the tenderer's point of view. The overall value of the project was the relevant value and revenue to be received from third parties therefore had to be taken into account in calculating that value.

- **Was the contract awarded by Roanne to SEDL exempt from the public procurement rules?**

  No. The contracting authority was not exempt from the procurement procedures if it planned to conclude its contract with the second contracting authority. There is an exemption where a contracting authority exercises similar control over the other party as it would over one of its own departments but as SEDL was a semi-public body, that exemption does not apply.

Not good news, therefore, for the prospects of public sector co-operation.

Christopher Wright and Richard Craven

Tender Contracts - Duties of Fairness and Good Faith

The decision of the Northern Ireland High Court in ***Gerard Martin & Others v Belfast Education and Library Board*** confirms that a "tender contract" can be implied between a prospective employer and a tenderer for public works contracts and that the Employer will have duties to act fairly and in good faith during the tender process.

Background

The plaintiffs were tendering contractors for a contract to be placed by the defendant. They sought an interim injunction restraining the defendant from awarding a contract on the basis that they could not prepare a tender on an equal basis due to mistakes and/or ambiguities contained in the tender documents issued by the Employer.

The High Court's decision

The court held that an implied contract with implied terms of fairness and good faith can arise from the issue of tender documents for a public works contract, both from the scheme of the tendering process and the presumed intention of the parties.

Weatherup J. stated that the duty to act fairly in administering a tender applies in a number of respects. First, it applies to the nature and application of the specified tender procedures in a particular contract; secondly, to the assessment of tenders according to the criteria stated in the tender documents, and thirdly, to the evaluation of tenders in a uniform manner as intended by the tender documents.

Weatherup J. made reference to the decision in ***SIAC Construction Ltd v Mayo County Council*** (a case decided by the European Court of Justice) and stated that in order to verify compliance with a duty to treat all tenderers equally, an obligation of transparency is implied, meaning that the award criteria must be formulated in the tender documents in such a way as to allow all reasonably well-informed and normally diligent tenderers to interpret them in the same way, and to enable the adjudicating authority to interpret them in a uniform manner.

The Judge stated that issues of unfairness can arise in situations where tender documents contain mistakes and ambiguities. In the case of mistakes, however, the mere misinterpretation of a tender document by a tenderer would not result in unfairness. Unfairness could, however, occur when the mistake of the tenderer is occasioned by the Employer. For example, where one or more tenderers adopted an approach to the tender which was different to that intended by the tender documents due to an error which adversely affected the uniform evaluation and assessment of tenders, the fairness of the tender process as a whole may be affected.

Unfairness may also arise in the case of ambiguities contained in tender documents. In the present case, a mistake by the Employer in preparing the tender documents led to an undetected ambiguity which was only revealed after submission of tenders. Fairness of the tender process may be affected if ambiguities have an impact on the approach of tenderers in completing their tenders or procedures for the assessment of tenders according to the stated criteria, where the uniform evaluation of tenders is adversely affected.

Weatherup J, however, imposed two important qualifications to the duty of fairness arising under tender contracts due to ambiguities. First, the ambiguity causing the unfairness must be 'material', resulting in tenderers proceeding on a mistaken basis or on a different basis to other tenderers, and secondly, the ambiguity must have a 'significant' effect on the tender, causing a tenderer to submit a tender which is more than negligibly different from the tender which would otherwise have been submitted.

Commentary

The decision confirms that a contract can be implied between a prospective Employer and tenderers during the tender process for public works contracts. Further, an Employer must act fairly and in good faith under such implied contracts and ensure that the tender documents do not contain mistakes or ambiguities

This is an important decision and will no doubt be used as authority for claims by unsuccessful tenderers to challenge the award of contracts when they believe that there has been a breach of implied duties on the part of the Employer to act fairly and in good faith.

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Mining – what goes on beneath the surface?

In every sense, there is more to mining than meets the eye. The Mayer Brown Mining Group has been very busy over recent months.

There are obvious parallels between the issues encountered on international mining projects and projects in the UK construction market. In particular and in terms of economic drivers, the international mining market shows many of the signs encountered (at least up until the credit crunch) in the UK construction market. Thus, the mining arena is typified by an overheated market where demand outstrips supply, driving up procurement costs and driving down the supply side's appetite for risk. This has led to the introduction of two-stage tendering and long lead procurement processes.

However, despite the credit crunch, strong demand for mined commodities means that mining (along with oil and gas) remains one of the most robust project finance sectors in a faltering global economy.

Gestation, in terms of a mining project, begins with a feasibility study to assess the ore qualities and the overall viability of the project. This is worked up through engineering into a series of studies, with the EPCM contractor engaged to engineer, procure and eventually construction manage the project. The project financing will need to be in place before the equity sponsor commits its available capital (typically between 30%-40% or sometimes more of the total capital cost). In terms of capital cost, most projects will range from US$100 million through to US$400 million for an open-cast mine producing various mined commodities from gold to nickel, copper, platinum, silver, zinc, iron ore or coal.

The rapacious appetite of growing economies such as India and China mean that the demand for these mineral commodities remains high, as do their prices. This in turn drives the exploration and development of mines in a number of different parts of the world. In addition, new technologies means that old mines can be re-mined to produce required reserves.

One of the challenges for sponsors, lenders and contractors in this market is that these natural resources are often located in countries where there may be little infrastructure (power supply, road and rail for goods in and out, water supplies and so forth). This means that there will often be a significant infrastructure construction component to the mine, in addition to buildings for the onsite construction works and the eventual operational facilities. There will need to be stores and warehouse facilities, a camp for the workers and eventual operators of the mine facility, logistics facilities, explosives stores and so forth.

The location of many of the mineral deposits also presents problems in terms of political risk. The World Bank produces an index each year for Ease of Doing Business, a 178 country survey which reflects the perception from investors about a country's ability to provide an environment that is favourable to the survival of foreign capital. Singapore is ranked the best country in which to do business and the Democratic Republic of the Congo is named the worst. The challenge for mining companies is that many of the world's mineral deposits are found in places like the Congo and these come with a material degree of political risk. The host government may decide, when it sees the rising price of the commodity, that the project sponsor is making rather too much of a good return on its investment. At that point the host government may seek to expropriate the asset altogether or put pressure on the project sponsor in order to achieve a larger slice of the action.

Some protection can be obtained at the investor level, as between project sponsor and host government when negotiating terms of the initial mining concession. ICSID arbitration terms can be included, giving the investor the right to refer disputes to arbitration where the award will be binding on the host government (assuming it to have entered into a Bi-lateral Investment Treaty with the government of the country in which the investor is incorporated).

As part of the Mining Group, the Construction and Engineering Team have to review project documents to ensure that they are "bankable".

This means looking at the key completion risks of schedule, capital and operating costs and guaranteed performance levels to ensure that these are all assured (to the extent possible in the current market). This is vital in a project financing because it is the revenue produced by the completed project that is the principal recourse for the lenders, providing the means for servicing and repaying the debt and returning the equity investment to the project sponsors.

Current mining project keeping the Group busy range from projects in Eastern Europe (Kazakhstan, Turkey and the Ukraine) and Africa (Burkina Faso in Francophone West Africa, Eritrea in East Africa and in the Central African Republic). Both the Eritrean and Central African Republic projects will be "*firsts*"; no-one has completed a project financed mining deal in either country before. The team are looking forward to the opportunity.

Jonathan Hosie

Morals but no moral rights? Architects and the RIBA *Standard Conditions of Appointment*.

One sunny day in the Spanish city of Bilbao, wandering back to my hotel after a quick trip to admire Frank Gehry's Guggenheim Museum, I crossed the River Nervion via the "Zubi Zuri" footbridge, designed by the architect Santiago Calatrava. The elegant steel bridge crosses the river in a gentle curve and its green glass floor tiles merge with the colour of the river below, making it a rather attractive feature of the city's riverscape.

It is perhaps not surprising then that when a rather pedestrian (no pun intended) extension was added to the bridge to connect it to a neighbouring housing development designed by Arata Isozaki, Santiago Calatrava was not best pleased. In fact so unhappy was he that Señor Calatrava commenced legal proceedings in 2007 against the city council who permitted the addition and the two construction firms who built it, claiming that the extension "breaks the symmetry of the bridge, clumsily distorts the design … and damages the integrity of his work."

Calatrava relied on his moral right under Spanish Intellectual Property law, as the architect of the bridge, to object to any derogatory treatment of it. So offended were his morals, that he demanded the dismantling of the extension, compensation of up to €250,000 for damage to his reputation and the publication of the sentence by the defendants or, in the alternative, if those demands were not met, a declaration that his moral right was infringed and damages of €3 million.

The judge did acknowledge that the extension was an appreciable alteration of the bridge and "changes its unmistakable personality". However, unfortunately for Calatrava, although the judge went on to find that the architect's moral right was infringed, he held that this had to be weighed against the public interest, which required the addition of the extension to allow pedestrians to cross easily from the bridge to the housing development (the only alternative being to use a long series of steps). Public need won out over the architect's right to the integrity of his vision and the judge decided that the extension did not have to be demolished and Señor Calatrava was not entitled to any compensation or damages.

In the UK it is not necessary to weigh up the public interest against an architect's moral rights. Architects do have a moral right, under the Copyright, Designs and Patents Act 1988, to be identified as the author of plans or models for a building, including where graphic representations or photographs of it are issued to the public, and to have their name displayed on the building as constructed. (Where more than one building is constructed to a design, this is limited to the first to be constructed). They also have a right to object to derogatory treatment of their work. An addition, deletion or alteration to a work is considered "derogatory" if it amounts to a distortion or mutilation of the work or is otherwise prejudicial to the honour or reputation of the author. However, if a building is subjected to derogatory treatment, the architect's only remedy in the UK is to have their name removed.

The moral right to be identified is not an automatic one: it must be asserted by the architect, in writing. The assertion can be general or in relation to a specific act or description of acts. RIBA's *Standard Conditions of Appointment (CA-S-07-A)*, introduced in 2007, include such a general assertion in Clause 6 (as did RIBA's previous set of standard conditions). For architects who work alone this is a perfectly adequate solution to ensure that they are identified as the author of their designs and any building that is constructed as a result.

However, under the CDPA 1988 only the "author" of a work possesses moral rights in it and the author is the individual or individuals who create it. Legal entities such as companies, partnerships and limited liability partnerships do not have moral rights. A firm of architects has no moral right to be identified as the author with regard to the work it creates. Further, the moral rights of the individual employee or employees who create such a work to be identified as the author(s) or to object to derogatory treatment of it, cannot be asserted if their employer permits something to be done with the work, for example by granting a licence to a developer to use plans, drawings and models to construct a building, as envisaged by the *Conditions of Appointment*. So an employee of a firm of architects cannot insist that their name is added to a building and if a firm of architects permits a client to make changes to a building, the individual employee cannot object to this.

As a result of this hole in the RIBA terms, under UK law many architects find themselves with morals but no moral rights. However, a company (or partnership) will normally be the owner of copyright in works created by its employees, therefore a firm of architects could make it a contractual condition of any licence of its work that it is identified, by the licensee, as the copyright owner. Since this is not provided for by the RIBA *Conditions of Appointment*, architects may wish to consider adding it as an extra term to their contracts.

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A Guide to the Site Waste Management Plans Regulations 2008

Site waste management plans (**"SWMPs"**) were introduced on a purely voluntary basis in 2004, but they have become compulsory for many construction projects.

1. **The Site Waste Management Plans Regulations 2008** (the **"Regulations"**) **are now in force**

Since when?

- 6 April 2008

Where can I find a copy of the new regulations?

- A copy of the new regulations is available at:

http://www.opsi.gov.uk/si/si2008/uksi_20080314_en_1.

What about guidance?

- In April 2008, Defra published non-statutory guidance for SWMPs, available at:

http://www.defra.gov.uk/environment/waste/topics/construction/pdf/swmp-guidance.pdf

Where can I find an example of a SWMP?

- The Waste and Resources Action Programme has produced a template SWMP, available at:

http://www.wrap.org.uk/construction/construction_waste_minimisation_and_management/swmp_templates.html

2. **What is a SWMP?**

A SWMP is a plan that sets out the amount and type of waste that will be produced on a construction site, along with details of how it will be reused, recycled or otherwise disposed of. As the construction project progresses, the plan is updated to record how the waste is managed and to confirm the disposal of any materials which cannot be reused or recycled.

3. **Who is affected by the Regulations?**

Any person intending to carry out a construction project on a single site with an estimated cost of over £300,000 (excluding VAT) *must* prepare a SWMP before starting construction work. Many kinds of construction work may now, therefore, require a SWMP, for example new-build work, alterations, installation/removal of services such as sewerage/water...

The "*principal contractor*" is responsible for preparing the SWMP. If there is no contractor, the "*client*" must prepare it. (Both of these terms are defined in the Regulations.)

A construction project which relates to a Part A installation (as defined in Schedule 1 to the Pollution Prevention and Control (England and Wales) Regulations 2000 – for example, a coal-fired power station) is exempt from the Regulations.

The Regulations also do **not** apply to a construction project for which a SWMP would otherwise have to be prepared if:

- the project was planned before 6 April 2008; and
- construction work began before 1 July 2008.

4. **What are the key features of SWMPs?**

(a) **Responsibilities**

The SWMP must identify:

- the client;
- the principal contractor; and
- the person who drafted the SWMP.

(b) **Details of the construction work**

The SWMP must describe the proposed construction work, including the location of the site and the estimated cost of the project.

(c) **Materials resource efficiency**

The SWMP must record any decision taken before the SWMP was drafted in order to minimise the quantity of waste produced on site. Such decisions may relate, for example, to the materials used, the design of the project or to the construction method.

(d) **Waste management**

The SWMP must:

- describe each waste type expected to be produced during the project;
- for each waste type, estimate the quantity of waste that will be produced; and
- for each waste type, identify the waste management action proposed.

(e) **The declaration**

The SWMP must contain a declaration stating that all waste produced on the site is dealt with in accordance with the waste duty of care and that all materials will be handled efficiently and waste managed appropriately.

5. **What happens next?**

SWMPs have to be updated whenever waste is removed from projects but the way in which they are updated depends on the projected expenditure of the project.

For all projects with an estimated cost of **less than £500,000**, the principal contractor must record on the SWMP:

- the person removing the waste, the types of waste removed and where the waste is going; and

- (within three months of the completion of the works), confirmation that the SWMP has been regularly monitored and updated, along with reasons for any deviations from the terms of the SWMP.

For larger projects, with an estimated cost of **more than £500,000**, the principal contractor must *additionally* record:

- the waste carrier's registration number;
- a copy of, or reference to, the written description of waste required under s34 Environmental Protection Act 1990;
- the type(s) and quantities of waste being reused, recycled or recovered, sent to landfill or otherwise disposed of; and
- (within three months of the completion of the works) a comparison of the estimated quantities of each waste type against the actual quantities produced, as well as an estimate of the cost savings that have been achieved by the SWMP.

6. **And after the event?**

The principal contractor must keep the SWMP for two years after completion of the construction project, either at the principal contractor's principal place of business or at the site of the project.

7. **Enforcement**

The Regulations may be enforced by the Environment Agency or by a local authority.

It is an offence to fail to comply with any of the main provisions of the Regulations. Additionally, however, it is an offence to:

- knowingly or recklessly make a false or misleading statement in a SWMP; or
- intentionally obstruct or, without reasonable cause, fail to assist, or produce a SWMP for, a regulator.

The penalties are potentially severe, ranging from a maximum fine of £50,000 on conviction in a magistrates' court, to an unlimited fine on conviction in a Crown Court. Directors may be personally liable if a company is found guilty of an offence and the offence took place through the consent, connivance or neglect of a director.

8. **It is also worth remembering that...**

Local authorities have recently begun producing supplementary planning guidance requiring details of how construction waste will be recycled/reduced to be submitted at the planning stage. The local authority may impose much more onerous requirements than those set out in the Regulations.

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