

TRETT CONSULTING

TRETT Digest

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Experience transfer via

Trett Consulting uses the wealth of its experience to assist clients in addressing their training needs, covering commercial, contractual, planning, programming and dispute resolution issues. **Andrew Brown** outlines the variety of courses presented recently by our company.

BEING over 26 years old, there is a wealth of experience within our company to assist in the resolution of disputes in the construction and engineering industries as well as to provide front-end advice on projects. Our members of staff are also well-equipped in delivering bespoke training courses covering the full range of issues relevant to construction and engineering professionals.

Over the years we have provided clients with bespoke courses covering commercial awareness for construction professionals, specific forms of contract, together with more specialist subjects such as delay and disruption (including the SCL protocol), adjudication, alternative dispute resolution, planning and delay analysis, claims avoidance and record keeping, project management and risk analysis. This is by no means an exhaustive list and we discuss clients' specific requirements in

terms of content, duration and number of participants.

The purpose of this article is to provide an overview of some of the more recent training courses presented by Trett Consulting and a selection of the members of staff who carry them out.

Extensions of Time

Tony Farrow (Netherlands office), has presented his 'Methodology and Mythology' seminar to a number of companies and organisations worldwide. A summary of this seminar covering extensions of time has been included in past issues of this Digest. It has also been published by the Society of Construction Law in the UK and in the Australian Construction Law bulletin.

The methodology relates to an examination of the various approaches for assessing a claim for extension of time, while the mythology refers to the unreliable results when certain methods or approaches are adopted. Delegates at these seminars participate in hands-on workshops, arguing the cases for delay, recovery plans, commercial terms and discussing the challenging issues of float, concurrency and entitlement.

In the past year, Tony has taken his seminar to the International Cost Engineering Council conference in South Africa, to Malaysia and Singapore in conjunction with our Asian Director Jon Prudhoe, to Rotterdam and to the New South Wales Bar Association in Sydney. In some cases the popularity of the topic meant that over 100 delegates were in attendance.

Forms of Contract

We also provide training on the standard forms of contract as well as bespoke contracts. Recently, the popularity of training in the NEC (ECC) has meant that Paul Blackburn, head of our Leeds office, is being asked to provide both a general awareness course on the NEC and to address specific areas of need, particularly for civil engineering contractors and also for other contractors and local authorities.

The courses are generally of one day duration and cater for between 16-24 delegates. The emphasis of these courses is on creating the challenges that the delegates will have to deal with in their day-to-day working lives and how to use the NEC in these situations. Thus, the delegates are grouped together in 'Project Teams' to fully replicate the challenges faced on site and the role each of them fulfils. The courses range from an introductory course to the more bespoke courses dealing with specific topics depending on the individual client's needs.

We also run bespoke courses on contract forms which address the specific needs of the organisation in question. For example, Simon Olimi Kabuzi and Richard Swan (London) have provided one and two day courses covering specific options of the NEC. The delegates comprised a selection of quantity surveyors, engineers, planners and project managers, with varying experience of contracts.

In addition to the NEC, we have also been providing a range of clients with specific training on FIDIC forms. Most recently Mark Castell (Netherlands) has been providing major dredging companies with a series of courses on the FIDIC 'blue

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training and seminars

book'. Firstly he reviews this new form of contract, discussing the parties' responsibilities throughout the project. Secondly he provides a more detailed look at the management of a contract under the blue book.

The SCL Protocol

The Society of Construction Law's Delay & Disruption Protocol has provided much recent interest. Chris Foan (Manchester) has presented seminars for local authorities and contractors, while Brian Eagles (Manchester) has run seminars for a cross-section of attendees from the construction and engineering industries. The content of the course covers the range of issues raised since the Protocol's publication in October 2002. These include discussions over the scenario where the Protocol conflicts with case law or common practice, whether the Protocol should be used as a guide or incorporated into the Contract, the issues of float & concurrency and how they are covered by the Protocol, and whether it will become a Contractor's charter or an Employer's charter. In covering the key legal & practical issues, the seminar suggests ways in which both Employers and Contractors can benefit from its adoption.

Adjudication

Since the introduction in the UK of the Housing Grants Construction & Regeneration Act 1996, we have been instrumental in providing courses on adjudication to companies working in the construction and engineering industries. These courses operate in conjunction with our adjudication support services, and provide clients with a better understanding of the practical aspects of referring or responding in adjudication.

Typically, these courses will cover an overview of the Act and the process of adjudication, the risks involved, dealing with the timescales, the role of the adjudicator, how to

prepare a referral, how to defend in adjudication, how to convince the adjudicator and a review of recent cases, as well as any issues specifically relevant to the client's organisation.

Commercial Awareness

A popular topic for many of our clients over the years has been general commercial awareness for construction professionals. In such seminars, our expertise in resolving disputes is utilised in providing training with a focus on avoiding claims. An example of such a package is the recent series of seminars carried out by David Palentine (Manchester) for a building services company. For a wide range of staff including the managing director, quantity surveyors, contracts managers, site & accounts staff, David delivered three half-day courses, all of which were designed to encourage the maximum amount of participation from attendees.

The first of these courses provided an introduction to contracts, contract law and contract award procedures. This covered basic contract law, methods of procurement as well as the client's domestic and maintenance sub-contract orders. In the second course, David moved on to discuss contract administration and vetting tenders in relation to the client's contracts with Employers and Main Contractors. The third course focussed on the commercial management of the contract, early warning systems, record keeping and the preparation and negotiation of final accounts. These courses place strong emphasis on sharing experiences and learning from one another.

In Asia, Peter Phillips (Japan) has delivered bespoke commercial awareness courses to large engineering firms. These generally cover types of contracts, the role of the contract, specification document and bills of quantity in project management, the importance of

notices and ways of adjusting the contract price.

Managing Contracts

As I mentioned at the beginning of this article, we have the ability to provide bespoke training courses on issues pertinent to construction and engineering professionals. In addition to the courses I have highlighted above, my colleagues have delivered further courses including topics such as the pitfalls of contracting - where problems begin and how we can solve them, partnering workshops and insolvency, focusing on legal and commercial aspects.

In conclusion, Trett Consulting has the expertise and ability to provide clients in the construction and engineering industries with the correct package of training for their needs, whether that be general or detailed. We are always happy to discuss your requirements.

To find out more about how our range of training packages can assist you, please contact Andrew Brown in the first instance (tel: +44 161 928 9004, email: andrew.brown@trett.com)

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Adjudication: Case Law Update

Michael Hopkins reviews some recent cases on adjudication which give further guidance on the consequences for the Employer in failing to serve withholding and payment notices, where adjudicators can breach the rules of natural justice and where adjudicators exceed their jurisdiction.

WHILST new cases on the enforcement of UK Adjudication decisions seem to be handed down on a 'daily' basis the following four cases handed down in the last 6 months are worthy of particular attention.

Withholding Notices

In *Rupert Morgan Building Services (LLC) Ltd v David Jervis and Harriet Jervis (12 November 2003)* the Court of Appeal gave judgement in favour of a builder seeking payment pursuant to an interim payment certificate. It agreed with the builder that if a payment certificate has been issued and no effective withholding notice under s.111 served then the certified sum must be paid. Under the terms of the building contract the architect was required to issue interim payment certificates every 14 days and payment was to be made by the employer within 14 days.

The employer refused to make full payment of an interim certificate contending that the certificate included sums in respect of items of work not done, items already paid or incorrectly charged as extras. However, the employer did not serve a notice of intention to withhold payment in accordance with s.111. The employer argued that as the sum certified by their architect included amounts for work not done it was not a sum due under the contract and the requirement to serve a withholding notice under s.111 did not apply as one cannot withhold what is not due.

The Court of Appeal held that because the contract specifically stated that "*the employer shall pay to the contractor the amount certified within 14 days of the date of the certificate, subject to any deductions or*

set-offs due under the contract", it was therefore the certificate that determined the sum due, not the actual work done. Accordingly, the employer was obliged to pay the amount certified having not served a withholding notice.

A number of points follow from this judgment:

- (1) Where an employer wishes to challenge a certificate this case emphasises the need to save a timeous withholding notice.
- (2) It follows that under a contract where there is a certification process, withholding notices must deal with all and any sums that the employer intends not to pay whether they are sums allegedly not due, abatements, set-offs or counterclaims.

This case very much represents a return to the sentiments of Court of Appeal Judgment of Lord Denning MR in the 1971 decision *Dawnays v Minter* in which the Master of the Rolls held that "An interim certificate is to be regarded virtually as cash, like a bill of exchange. It must be honoured".

Payment Notices

In *M.J. Gleeson Group Plc v Devonshire Green Holding Limited (19 March 2004)* the court held that the employer was required to comply with an adjudicator's decision and pay to the contractor the amount that it had applied for on an interim application for payment. The contract between the parties was in the JCT Standard Form of Building Contract with Contractor's Design 1998 which provided that if the employer fails to serve a notice setting out what it considers is due to the contractor and what, if any,

monies it intends to withhold from the sums due, then the amount applied for by the contractor becomes payable in full by the employer.

It was immaterial to the enforcement of the adjudicator's decision that the employer had since raised its own claims in respect of the contractor's delay.

This is yet another case, along similar lines to the cases such as *Watkin Jones v Lidl (2002)*, which concerns the payment provisions particular to the Standard Design & Build form. Employers failing to serve payment notices, and indeed Main Contractors failing to serve payment notices under the DOM/2 form, clearly do so at their peril.

Natural Justice

In *London & Amsterdam Properties Ltd v Waterman Partnership Ltd* the court refused to enforce an adjudicator's decision in favour of LAP on the grounds that the adjudicator had proceeded in breach of the rules of natural justice.

LAP were pursuing substantial claims against Waterman, the consulting engineer, for negligence and breach of contract.

Prior to the adjudication a considerable amount of correspondence was exchanged in relation to the claims, however Waterman repeatedly observed that they had not received sufficient particulars to deal with the claims made against them. Waterman requested further information, however, LAP refused to provide that information relying on the broad assertion that it had paid additional sums to the steelwork contractor and that those costs in their entirety fell to the account of Waterman.

LAP commenced adjudication proceedings and came to rely upon, by way of Reply to Waterman's defence, a great deal of information that the court observed had been available to LAP prior to the adjudication but which it had chosen not to disclose, despite Waterman's request for the same. Waterman complained to the adjudicator that by

dealing with the material put forward by LAP there would be procedural unfairness. LAP refused to grant any further extension of time for the adjudicator to reach his decision and the adjudicator continued and made a decision in favour of LAP.

On enforcement Waterman objected to the adjudicator's decision on the ground that there had been a breach of the rules of natural justice. Waterman referred to LAP's conduct as an evidential "ambush".

The Court confirmed that the adjudicator should either have excluded the additional material put forward by LAP in its Reply or should have given Waterman a reasonable opportunity to deal with it. There had been a breach of natural justice.

The points that follow from this Judgment are:

- (1) The claimant referring party should consider carefully before refusing to supply any material or documentation requested by the respondent, especially if there is a risk that such material may later need to be relied upon;
- (2) If a respondent is faced with material that it has not seen before and is denied a reasonable opportunity to deal with it the respondent should consider immediately inviting the adjudicator to ignore such material or withdraw from acting;
- (3) The courts are starting to express certain disapproval of the applicability of the adjudication process to large and complex disputes.

Jurisdiction

In *Image Decorations Ltd v Dean & Bowes (Contracts) Ltd (5 March 2004)* the court refused to enforce an adjudicator's award in favour of Image on the grounds that the adjudicator had exceeded his jurisdiction.

The parties entered into a construction contract in February 2002 for plastering, partitioning, decorating, drylining and suspended ceiling works on D&B's main contract for works at a leisure club in Epsom. It was alleged that there were a number of variations and Image sought additional payment of

£640,795.15. No further sum was paid.

As a result Image sent D & B a notice of adjudication contending that a dispute had arisen as a consequence of the withholding of monies by D & B, seeking to refer the dispute to adjudication under section 108 of the Act.

Confusion arose between the parties exactly as to what the adjudicator was to decide and during the course of the adjudication, the adjudicator invited the parties to consent to his jurisdiction being extended to allow him to decide upon the sum due under the contract rather than just matters of withholding.

The parties did not consent to the adjudicator's jurisdiction being so extended.

The adjudicator nevertheless went on to decide what sum was due to Image. He sought to justify so doing by reference to the decision in *S L Timber System Ltd v Carillion Construction Ltd 2001*. He stated that under paragraph 20 of Part I of the Scheme he was entitled to take into account matters under the contract which he considered to be necessarily connected with the dispute. He considered that such matters allowed him to make a provisional determination of the sum due under the application for payment.

On enforcement, and on refusing to enforce the decision, the Court stated that the object of paragraph 20 of the scheme was to empower the adjudicator to make such subsidiary findings on disputed matters as are necessary for him to decide the issues referred. It was not to enable him to decide an additional issue. All the adjudicator had to find was that some monies were being improperly held; he did not have to decide how much.

The *SL Timber Systems* case was distinguished on the grounds that in that case, the adjudicator had jurisdiction to decide what sums were due under the contract.

The points that follow from this Judgment are:

- (1) The redress sought by the Referring Party (and therefore jurisdiction of the Adjudicator) must be clearly stated in the

Notice of Intention to Adjudicate;

- (2) The parties are free, during the course of the Adjudication, either to expand or narrow the ambit of the Adjudicator's jurisdiction;
- (3) Adjudicators should be careful in seeking to rely on the powers given to them under paragraph 20 of the Scheme in arriving at a decision, particularly where there is an agreement between the parties that he has no jurisdiction to make that decision. Paragraph 20 is not as wide as one might think.

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Permanent office in the United Arab Emirates

Trett Consulting
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Project Management in Crisis?

In this abridged version of a keynote speech at an International Conference in South Africa, **Jim Zack** of the Fluor Corporation discusses the problems inherent in project management today and offers some words of advice.

Project Management – Science or Art?

A number of professional organisations focusing on project management have grown over the past two or three decades. In order to gain credibility and add value for membership, many offer training and certification in project management. In so doing, most have equated project management to a science, but is this what project management is? Science is generally considered to be knowledge covering general truths or the operation of general laws tested and verified through the scientific method. That is to say, it is systematised knowledge based upon scientific principles.

If project management is really founded upon a set of scientific principles or rules, then, in my opinion, it should be capable of being mastered quite easily; memorise the appropriate rules and apply them at the proper time to derive the 'right' solution and the desired result will follow. The inference from the literature appears to be that becoming a successful project manager is a straightforward task and mastering the scientific rules will accomplish this. In fact, many organisations openly advertise "fast ways to quickly improve career options" by becoming a project manager.

What impression do organisations give to people attempting to become project managers? I suggest that the unintended message is that becoming a successful project manager is simple – take a course, memorise some rules, pass a certification exam and you are on your way to success as a project manager. I refer to this type of project manager as 'theoretical project managers'. That is, they know and

can articulate all the theories of project management, but have little experience in the practical application of these theories on a live project.

This theory-driven approach has been compounded by the explosive growth of project management software over the past decade or so. Reviewing project management journals and magazines, the message is clear. Once a project manager is certified, all he or she need do is select the appropriate project management software, input the data and thus generate the 'right' answer. Is that not the message the software industry is sending out?

What is the result of all these factors? I suggest that many industries have ended up with better educated, more accredited, but less experienced project managers. That is, all too many project managers today are certified, but lack real hands-on project management experience. They come to their projects with briefcases full of computer software but lack the experience of analysing the output and formulating a practical plan for dealing with project problems and challenges. In fact, some do not even know how to interpret the output of traditional project management reporting.

From the perspective of one who deals primarily with troubled projects, it seems to me that the increase in accredited project managers and the ready availability of project management software has **not** resulted in a corresponding decrease in troubled projects. In fact, almost the opposite appears to be true. There

seem to be more projects in trouble today than in previous times, despite the increase in certified project managers. How can this be? Let me offer some thoughts on this trend.

I suggest that project management is **not** a science governed by predictable and immutable rules. Rather, I take the position that project management is an art form. So what is art? Art is a skill acquired by experience, study or observation. It is the conscious use of acquired skills and creative imagination. What is the difference between science and art? Science is governed by unchangeable rules. This is why we can give the same mathematical equation to ten people educated in the science of mathematics and they will each arrive at the same answer. Art, on the other hand, is full of human judgment and is influenced by experience and sense of right and wrong. Give the same

artistic problem to ten people and it is entirely feasible to end up with ten different answers, but each being appropriate to the circumstances.

The difference between these two approaches to project management is simple.

When one relies upon scientific norms or computer software to foresee potential problems, but one lacks hands-on experience, it is likely that problems will go undetected until they are severe. Then, when one relies upon scientific practices and software to create solutions but there is a lack of experience to judge the appropriateness of the proposed solutions, it is more likely that the selected corrective action will prove unsuccessful. To accurately predict and resolve the myriad of problems which arise on projects, a project manager needs experience tempered by good judgment. Therefore, a successful project manager practices the art of project management and relies upon experience and reasoned judgment far more than fixed rules and out-of-the-box computer software.

"... some do not even know how to interpret the output of traditional project management reporting."

Cost Engineering and Project Management

I believe that to be a truly successful project manager, one has to be well grounded in the disciplines associated with cost engineering and project controls. Two of the four measures of a successful project – these being, budget, schedule, quality and safety – clearly fall within the realm of cost engineering and project control. As such, a cost engineer is well placed to provide some valuable input in the other two areas as well. As defined by the Association for the Advancement of Cost Engineering International, cost engineering and project controls encompass the areas of cost estimating, cost control, business planning and management science, profitability analysis and project management, planning and scheduling. In my opinion, to be a successful project manager requires the mastery of these functions. Further, experience has shown me that all too many troubled projects are managed by accredited project managers who have little or no hands-on experience in cost engineering and project controls. As a result, problem trends are not detected early and projects are often in deep trouble before it becomes apparent to the project manager.

Using the standards of The Project Management Institute's "PMBOK® 2000" (Project Management Body Of Knowledge) as a guideline to the skills and knowledge of a successful project manager, there are nine knowledge areas applicable to all projects. These are the management of project integration, scope, time, cost, quality, human resources, communications, risk and procurement. The Construction Extension to PMBOK® 2000, released in late 2003, added four additional knowledge areas for capital construction projects – safety, environmental, financial and claim management. It is my view that, in each of these thirteen key areas, a cost engineering background will fundamentally enhance a project manager's ability to manage successfully.

Individuals with business, design, software or hardware backgrounds

will have demonstrated a level of competence in their own technical fields before being promoted to project manager status. However, most of the skill requirements of project management go well beyond technical matters. A technically competent person who is versed in project management theory but lacking in cost engineering or project controls experience is less likely to spot negative trends early and less likely to take timely and appropriate corrective action. Thus, theoretical project managers are more likely to be in trouble before they even realise it. Firms should be mindful of two possible solutions to improve the chances of realising projects successfully. Firstly, invest in project management staff with cost engineering or project controls background, and/or provide existing staff with formal and, perhaps more importantly, hands-on experience in these areas. Secondly, ensure that solid record-keeping practices are in place and promote training in areas such as commercial awareness, which I note is one of the key courses offered by Trett Consulting.

Cost Engineering – Stepping-Stone or Career?

Having spent some time arguing that a cost engineering or project controls background will make someone a better project manager, should we consider cost engineering merely a stepping-stone on the way to the ultimate goal – project management? I would argue that for some, this may be true. A lengthy stint in the project controls or cost engineering group might be the final training ground prior to taking the step to project manager. In the construction industry where I come from, there are a number of firms that have this as a condition precedent to project management.

If this is your firm's policy, then I applaud your organisation for its foresight and commitment to train or obtain top-notch project managers. I am confident that firms will benefit from such a policy, as I believe that projects managed by such individuals are more likely to be successful – on

time, in budget, with desired quality and safely delivered. If an individual chooses this route to project management, then they too are to be applauded for taking such initiative.

However, we must not forget that, for many, cost engineering or project control is a career in and of itself. Cost engineering covers such a multitude of skills that many find it both challenging and rewarding. However, I would offer a challenge to the career cost engineer. Part of your function on projects should be to mentor younger staff. In the construction industry, it is not at all uncommon for projects to last two to four years. This is sufficient time to train technical staff in the skills of cost engineering. You can significantly and positively influence the careers of those who aspire to become project managers. If you are willing to spend the requisite time and effort to do this, you may even play an instrumental role on future projects – whether you are on them or not!

Conclusion

Let there be no misunderstanding. There will always be theoretical project managers in our midst. As long as professional organisations offer theoretical training and certifications based on project management concepts, there will be individuals attaining certification simply to increase their qualifications. Such project managers will, more likely than not, be found running projects that end in avoidable trouble. Skilled cost engineers have the requisite training and background to spot problems before they become serious challenges to project success and craft workable solutions. I am firmly convinced that cost engineering, whether a stepping-stone or a career, provides significant benefits and advantages for both its practitioners and the projects they manage.

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The NEC: A contract of our time?

The NEC suite of contracts has become the contract of choice for government agencies and authorities but is it a contract of our time?

Brian Eagles discusses and reviews.

THE cornerstone of the NEC form of contract is Programme Evaluation and Review Technique often referred to PERT analysis. The backbone of PERT is the activity network that we now associated with critical path analysis, albeit that technique is only a part of the PERT analysis.

PERT requires a network that models the interdependence of activities within a project, the result of that modelling is often represented as a Gantt or bar chart. The network and bar chart are often confused as being one and the same but this is incorrect. The network is an interactive model of the work to be undertaken and it is this property that has been enshrined within the NEC contract (and is absent from many of the other forms of contract such as JCT, ICE and FIDIC).

Briefly, NEC requires that the programme is:

- a critical path network.
- updated monthly with progress achieved.
- used in determining the actions following a compensation event.

Producing the Network

Sophisticated planning software is used to produce a bar chart. Interdependencies are included to hold the activities in the time frame that 'looks right' but this is far from the interactive network required by the NEC contract. The network needs to be mathematical model of the work undertaken and must be capable of reacting realistically to the input of the status of the work actually being undertaken and the impact of foreseen delays to give a realistic projected completion date.

The requirements for an effective network include:

- all the work of the project.
- sufficient detail to allow the tracking of the work.
- only one start point
- only one end point, although more finishes may be included for projects with sectional completion dates (albeit, in classical terms,

each section would be a separate project).

- allowance for risk and realistic activity durations.
- a hierarchal structure to allow the output to be viewed at various levels of detail.

Using these rules will result in a network that is suitable for use under the NEC.

Progress Updating

The second requirement of the NEC is the project being updated with the actual progress achieved each month. The measurement of progress is sometimes subjective and this may cause difficulties in getting the programme accepted by the Engineer at the end of each review period, as required by the NEC.

In determining the best strategy for updating the programme, the durations of each activity should be kept relatively short to allow the majority of the activities in the network to be either finished or not started since these are the easiest states to determine. Having limited the number of activities which need interpretation a mechanism for calculation of progress should be agreed with the Engineer. It is in both parties interest to keep disagreement and debate to a minimum considering the time allowed to complete and agree each update.

The upside of to this approach is that payment is linked to completion of activities shown on the activity schedule under most variants of the NEC, therefore, activities with reasonably short durations will assist with cash flow.

The downside to this approach is that the network is likely to become very detailed. Clearly, a balance needs to be struck and that balance is unlikely to be the same for different clients. Very detailed networks are also difficult to interpret and can do cause some managers to shy away from using the programme to manage the works, preferring to leave the planner to do his thing while the

manager gets on with the 'real' work. To avoid this situation it is imperative to structure the output from the network so that each member of the management team can appreciate the programme at a level that is relevant to his own needs.

Compensation Events

Events that effect either the time or cost to completion are termed compensation events under the NEC contract. When an event occurs the parties have a duty to agree the implications of the event on the project and possible strategies to be employed in resolving the event must be discussed. The project manager must then decide on the strategy to be adopted in resolving the problem. The programme is a key element in demonstrating the impact of the events on the works and what strategies could be adopted to lessen the effects. Once a decision has been made, that programme becomes the agreed programme for the remaining works and is binding.

The Verdict

To return to my initial question "Is the NEC a contract of our time?" Whilst computing and software tools have advanced almost exponentially, the skills and experience needed to construct and maintain the required networks are harder to find.

The challenge that the NEC presents to industry is to produce and retain those planners with the practical knowledge of the particular industry they work in and to train them in the highly specialised skills required to build the networks required by the NEC. In addition, the management team also needs to be mindful of the level of support the planning function needs in order to succeed under this form of contract.

Progress is being made. We begin to see individuals with the skills and experience required by the NEC emerging. If the use of the NEC becomes more widespread, the industry needs to increase the number of individuals with the appropriate skills. Only then will the NEC become the contract of our time.

Brian Eagles is an Associate Director and is based at Trett Consulting's Manchester office

Arbitrating against States: Jurisdiction Issues

David Scott discusses jurisdictional issues in international arbitration with particular focus on the case of *Zhinvali Development Ltd v Republic of Georgia*

IN domestic arbitrations, the jurisdiction of a person to hear a case is governed by the terms of the particular contract, supported by local laws. Together, these usually provide an efficient process for dealing with challenges to jurisdiction.

Internationally, however, the process can be more difficult. The January 2003 arbitration award in the case of *Zhinvali Development Limited v Republic of Georgia* provides a good example and also serves to introduce to the reader a basis of international arbitration which has, only over the last few years, come to the fore.

Traditionally, any company investing in a 'foreign' State will be wary of submitting any disputes with its contracting party in the host State to the jurisdiction of the courts of that State. This is particularly so in developing States where the legal system may not be as advanced as in more developed countries. In such situations, the usual compromise has been to agree that disputes be resolved through international arbitration, under some defined set of rules, with the jurisdictional seat of the arbitration being in a third party State.

Such arrangements, however, have not always helped the investing party in circumstances in which the host State (or its Government) may have expropriated or confiscated the investment. In this case, any claim for losses will inevitably be met by the defence of 'Act of State', or that the parties are in any event subject to the mandatory laws of the host State. The investor would usually be confined to seeking to persuade its own Government to lodge proceedings against the host State, usually in the International Court of Justice in The Hague. Such remedy would not always be of great use to the investing party, in particular given that its own Government is more likely to want to attempt to deal with the host State on a pragmatic and diplomatic basis.

A new breed of bilateral and multilateral investment treaties ("BITs" and "MITs" respectively) is, however, providing investors with new hope.

Their purpose, essentially, is to promote foreign investment into the host State, usually by guaranteeing fair and non-discriminatory treatment to investors, 'due process', and unrestricted return of capital.

Most importantly for present purposes, the more recent BITs and MITs entitle an investor, in the face of unwarranted expropriation of its investment by the host State, to commence arbitration proceedings directly against the host State. In addition, that investor is not obliged to seek any remedy arising out of or in connection with the underlying contract with the other contracting party in the host State.

The case of *Zhinvali Development Limited v Republic of Georgia* arose out of the attempted negotiation, by Zhinvali, of a contract in Georgia for the rehabilitation of a hydro-electric power plant and its tailrace tunnel. Negotiations between Zhinvali and Georgia, to conclude agreements to finance and implement the rehabilitation, failed, Zhinvali blaming the failure upon, variously, Georgia's breach of contract, promissory estoppel and unjust enrichment.

Zhinvali, a company incorporated in the Republic of Ireland, filed a request for arbitration with the International Centre for the Settlement of Investment Disputes ("ICSID") in Washington, pursuant to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of other States ("the ICSID Convention"). The Republic of Ireland and the Republic of Georgia are both contracting States to the ICSID Convention. ICSID arbitration only applies where the legal dispute is between a Contracting State and a national of another Contracting State (as was the position in the Zhinvali case).

The jurisdiction issue in the Zhinvali case was based on Article 25 of the ICSID Convention which provides that the "... jurisdiction of [ICSID] shall extend to any legal dispute arising directly out of an investment, between a Contracting State... and a national of another Contracting State which the parties to the dispute consent in writing to submit to [ICSID]...".

Georgia challenged the jurisdiction of the tribunal on two principal grounds; namely (i) that Georgia had not "consented" to the jurisdiction of ICSID for the purposes of Article 25 (there was, for example, no BIT providing for ICSID arbitration in force between Ireland and Georgia at the time Zhinvali filed its Request for Arbitration), and (ii) there was no qualifying ICSID "investment" for the purposes of that Article.

With regard to the former, the tribunal decided that domestic Georgian legislation providing that "... disputes between a foreign investor and a government body, if the order of resolution is not agreed between them, shall be settled at the Court of Georgia or at the International Centre for the Resolution (sic) of Investment Disputes..." amounted to the necessary consent. The tribunal, therefore, then had to hear the Respondent's supplementary case that the costs of the "development phase" of an aborted transaction were not, in the words of the tribunal in the earlier ICSID case of *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, 'swept up' under the 'umbrella' of an integrated, three phase investment project because the 'project cycle' was never completed; i.e. the development phase costs did not constitute an 'investment'. In short, the tribunal agreed, and decided that ICSID did not have jurisdiction and that the tribunal was not empowered to hear the merits of Zhinvali's claim.

The stakes in what was clearly going to be a high value claim, were, indeed, themselves high. The reasoning includes a dissenting opinion which notes that "a narrow interpretation of 'investment' would not only tend to discourage the free flow of capital into developing countries; it would also discourage future litigants from resorting to ICSID". Despite winning the jurisdictional debate, costs were awarded by the tribunal against Georgia in light of the very late stage at which the jurisdictional challenge had been made, this award amounting to around US \$600,000.

In conclusion, the door is by no means closed on the interpretation of the term 'investment' as it applies in many BITs and MITs. It may well be that the Zhinvali decision encourages more States to sign up to BITs and MITs. This itself may present investors the opportunity of making claims directly against the host State for all variety of investments jeopardised by the host State, and having the scope of the term 'investment', as it might apply to the particular BIT or MIT in question, tested further.

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Take Notice!

Robert Palmer notes that construction contracts usually contain a number of clauses requiring the parties to give notice of specified events or claims. These notice requirements may apply to both parties and may arise in a variety of situations.

Notification of claims

Notice provisions are most commonly encountered in the context of clauses requiring parties to give due warning of claims as they arise. It is very common for construction contracts to require both parties to give timely notice of any intention to assert claims, or of events that may in due course give rise to claims.

The policy reasons for these provisions are obvious. Parties to construction contracts want to be fully and promptly informed of situations that may lead to claims. They will then be able to assess their options – for example, an employer may decide to cancel an instruction on receiving notice that a contractor intends to claim for additional payment. More generally, long-standing experience shows that potential claims are most effectively resolved if they are tackled quickly, before positions have hardened, and at a time when the relevant facts and circumstances are still fresh in people's minds.

It is important to bear in mind that these requirements also carry disadvantages. In particular, a requirement for formal notice of claims at an early stage can result in positions becoming entrenched at a time when informal discussions might dispose of the issue completely. Obviously, this may greatly reduce the chances of an amicable settlement. Further, contractors who properly comply with requirements for prompt notification may find that they are unfairly labelled as claims-oriented or confrontational, a perception that may then affect the employer's evaluation of claims.

Contractors should also bear in mind that these clauses are often favourable to employers. For example, the FIDIC conditions of contract for construction require employers to give notice of claims *"as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim"*, whereas contractors are required to give notice of claims *"as soon as practicable, and not later than 28 days after the contractor became aware, or should have become aware, of the event or circumstance"* (emphasis added). The requirements for submission of supporting details are similarly less stringent for employers than contractors.

Form

Construction contracts generally require that notice be given in writing and posted or faxed to a given address.

This is to avoid situations where non-receipt is alleged. It is possible that a failure to comply with these requirements will invalidate a notice (in relation to notices of termination, there is some case law to this effect in England and Australia). However, these requirements are sometimes said to be "directory" rather than "mandatory", so that non-compliance is not fatal. The wording of the contract and the governing law will be crucial in this regard but, to avoid the issue arising in the first place, parties should aim to ensure that they comply with any contractual requirements for service of notices.

Time Limits and Continuing Losses

Often, construction contracts will require that notice of an intention to claim (sometimes including specified details) be given within a certain number of days of the event giving rise to the claim. This can cause difficulties.

- A party may not even be aware of the events giving rise to a claim until some time after they occur. This can cause problems under contracts such as FIDIC (above), which require notice within a short period after the contractor should have become aware of those events.
- Where an event or delay is continuing, or where the contractually stipulated time period is a short one, it may be very difficult to provide the required level of detail within the prescribed period. For example, it would be difficult at the outset for a contractor to quantify the likely time consequence of a continuing delay by a preceding trade.

There are no easy solutions to these problems. However, experience shows that provided a party has done its utmost to comply with any notice requirements, an arbitral tribunal or court is likely to take a sympathetic approach.

Notices as Conditions Precedent to Claims

If a contract successfully provides for a notice as a condition precedent to an entitlement to claim, a party may lose its entitlement completely if it does not comply with the contract notice requirements. For example, FIDIC conditions provide that if proper notice is not given, "the Time for Completion shall not be extended, the Contractor shall not be entitled to additional payment, and

the Employer shall be discharged from all liability in connection with the claim".

However, failure to comply with notice requirements is not always fatal. For example, ICE conditions provide that in case of failure to give proper notice the contractor is entitled to payment "only to the extent that the Engineer has not been prevented from or substantially prejudiced by such failure in investigating the said claim".

Disputes Over Proper Compliance

In the midst of lengthy, complex and intensive construction projects, it is easy for contractors to overlook requirements for formal notice or to fail to provide required follow-up particulars. Some contractors also choose not to employ sufficient contract managers to pay full attention to these issues. As a result, arguments about compliance with notice requirements are an all-too-common feature of construction disputes.

It is difficult to generalise about the ways in which these arguments play out in practice. They depend very greatly on the terms of the contract, the governing law and the particular facts of the case. Nevertheless, it may be said, broadly speaking, that courts and arbitral tribunals in many jurisdictions have often been willing to uphold and apply clauses that make notice requirements a condition precedent to claims. In other words, failure to comply with a notice requirement and time bar may be fatal to a claim. At the same time, however, it is also common to see such clauses being given a restrictive interpretation, so that they only 'bite' on cases falling squarely within their terms.

There are a variety of arguments that contractors deploy around the world in an effort to avoid the rigours of these clauses. This article is not the place to embark on an exhaustive analysis of the options, but it is noted that in common law jurisdictions one often sees arguments based on concepts of express or implied waiver or promissory estoppel, while in civil law countries it may be possible to rely on legal duties of good faith or other relevant civil code principles. These are highly technical matters requiring specialist advice in each case.

Conclusion

Contractual notice clauses are fertile ground for disputes under construction contracts. A great deal of time and money may be needed to deal with the consequences of failure to ensure strict compliance. Yet these clauses are not intrinsically hard to follow, they simply require a competent internal programme of contract management. It is in the interests of all parties that contract notice requirements should be properly observed.

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Adjudication: Withholding Payment

John Nestor considers the degree of particularity required when specifying the grounds for withholding under section 111(1) of the Housing Grants Construction & Regeneration Act 1996.

Introduction

Section 111(1) of the UK's Adjudication Act 1996 provides that a party to a construction contract may not withhold payment of a sum due under the contract unless he has given an effective notice of intention to withhold. To be effective, s.111(2) provides that it must specify the amount proposed to be withheld and the ground or grounds for doing so. S.111(2) also provides that the notice must be given within a prescribed period. In the absence of an effective notice, it is relatively settled law that the right to deduct money by way of withholding is excluded: see *VHE Construction v RBSTB Trust* [2000] BLR 187; and *Rupert Morgan Building Services v Jervis* [2003] EWCA Civ 1563.

Unlike s.110(2), the notice need not specify the basis on which the amount was calculated; just the amount proposed to be withheld. But it is the particularity of the grounds for withholding which can create difficulty, and on which the courts seldom, if ever, cast light upon.

There is an important distinction between 'grounds' and 'reasons', and indeed s.83 of the Act employs the distinction. Recently, the Law Commission considered the distinction in the context of bail decisions. Paraphrasing with necessary contextual changes for withholding, they said that a ground relates to a circumstance that is capable of being relevant and sufficient to justify the act of withholding, whereas whether a ground does in fact justify the act of withholding depends on the cogency of the reasons put forward in support of it. This suggests that the inquiry into whether something is capable of justifying the act of withholding demands little more than a look at the face of the notice to see whether the specified grounds are sustainable in law.

Withholding at the payment stage

The mischief of s.111(1) is directed at the abuse highlighted by Sir Michael Latham – namely, that “main contractors were abusing their position to wrongfully withhold payment from sub-contractors who were in no position to make any effective protest.” It addresses this

mischief through a notice that requires the paying party to notify the other party of his intention to withhold a specified amount on account of specified grounds. Generally, the notice imposes a healthy discipline upon the paying party, and helps safeguard against arbitrariness. Specifically, specifying an amount is intended to ensure that information about payment is made available to the payee earlier than it otherwise would be, and specifying the grounds is intended to enable the payee to make a proper assessment as to the validity of the withholding, and in particular, whether the withholding is one that should be challenged, and, if so, to what extent.

Withholding at the payment stage, at least in the context of set-off under a construction contract, consists of a declaration by one party that has the effect of extinguishing or reducing payment of a sum that has become due from that party to the other. Thus, it suggests an equal right to payment of the sum set-off, and therefore leans on validity.

If, because of lack of particularity, the payee cannot make an assessment about its validity, or whether it should be challenged and, if so, to what extent, the notice has not achieved its intended purpose. In these circumstances, it would not, in my view, be an effective notice within the meaning of s.111(2). However, this begs the question: what is needed to make a proper assessment?

Although the particularity required is clearly a question of degree, it could be argued that all that is required to constitute an effective notice is a concise statement of fact asserting breach and a concise statement of fact linking the specified amount to the breach. It seems unlikely that basic causes of action will do, not least because statutes which require the giving of grounds often stipulate them and the Act does not stipulate the grounds for withholding, which seems to suggest that, unlike basic causes of action, the grounds are not susceptible to formulaic expression.

The relative ease by which a party may withhold payment from another is somewhat startling, particularly because the authorities suggest, albeit in the context of quantification rather than grounds, that the party withholding does

not default by withholding a greater sum than can ultimately be established on subsequent information, provided he quantifies his loss by a reasonable assessment made in good faith.

In a recent paper, HHJ Thornton QC seems to suggest that this issue could and should be covered by an ethical code, thereby acting as a necessary and useful adjunct to the Act. However, the real obstacles facing the compilers of a code, as identified by HHJ Thornton QC, suggest that it is at best a distant prospect. Perhaps, therefore, the Society of Construction Law should consider providing ad-hoc guidance on this and the many other issues identified by HHJ Thornton QC in his paper.

Withholding when referring to adjudication

Set-off is a species of withholding, and in legal proceedings it is taken as a point for the defence. When taken, a defendant must state the material facts on which he relies in support of the set-off with the same particularity as he would if he were a claimant in an independent action bringing a claim. Furthermore, the defendant must adduce evidence to prove the facts that he relies on.

By analogy, this also applies to adjudication, notwithstanding that the adjudicator may take the initiative in ascertaining the facts and law. Therefore, the burden of proving that the grounds for withholding are valid (which also means justifying the grounds by way of reasons) falls upon the party who withholds. He cannot merely rely on the issue of an effective notice, because it is clear that a party to a construction contract may refer to adjudication the withholding of a sum of money under a construction contract even if the notice of withholding is effective – see s.111(4) of the Act.

Although adjudication is a welcome step in that a dispute about withholding can be referred for adjudication and a decision made within 28 days, the ease by which a party may withhold from another, which very often is the catalyst for adjudication, is or should be a matter for concern.

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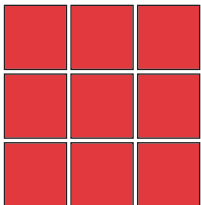
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