



Payment, security and challenging times

by Julie Stagg

Introduction

The education sector is adapting to the still challenging economic climate and must be pro-active in the face of increased insolvency risk at all levels of the supply chain. The sector must also adapt (as must other all other clients and their teams) to legislative changes which demand greater discipline in the commercial management of projects. This paper summarises the recent changes to the payment regime and offers practical advice to assist clients in dealing with the new process. The paper goes on to consider the issue of performance and payment security, which is of great importance when facing an uncertain future economically. Finally, the paper considers what other protection may be available to clients in the sector to relieve the adverse consequences of contractor insolvency.

Payment regime changes

Payment under the Housing Grants Construction and Regeneration Act 1996 (“Old Act”)

The Old Act introduced the requirement for a construction contract to provide an adequate mechanism for determining what payments become due under a contract and when, and provided a final date for payment in relation to any sums which become due. These provisions remain in the New Act.

A payment notice (section 110 notice) was required, under which the paying party informed the payee of the amount proposed to be paid and the basis on which that amount was calculated. However, the Old Act contained no sanction for failure to provide a payment notice and in practice often they were not used.

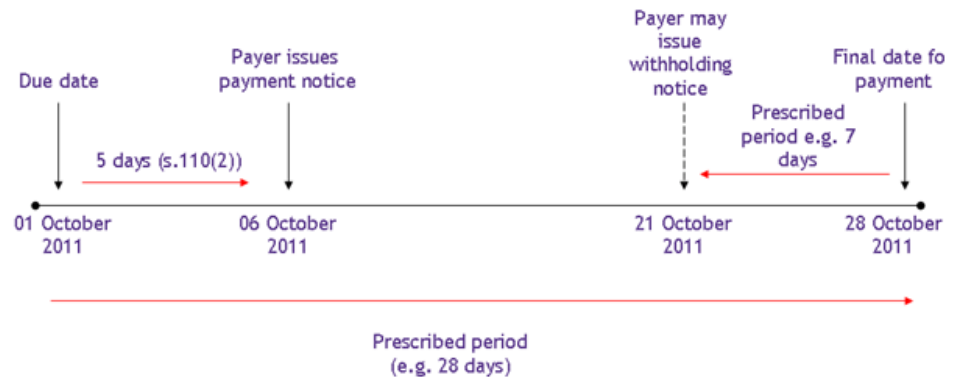
Any paying party wishing to set off a sum against the amount otherwise due to the payee under the Old Act (i.e. the sum set out in the payment notice, valuation or certificate) could do so by serving a withholding notice (section 111 notice) within the prescribed period before the final date for payment. The Old Act required the party seeking to withhold payment to set out the amount or amounts proposed to be withheld and the ground or grounds for each amount.

The absence of a withholding notice has become a way to secure the amount valued or certified through adjudication proceedings. The courts have held that in the absence of a withholding notice, the receiving party was entitled to be paid the amount set out in any valuation or certificate.¹

The Old Act regime will continue to operate for the duration of any contract entered into before 1 October 2011. It is therefore useful now to provide an update as to how the payment provisions operate, the notices which must be served and the timetable for doing so.

The sequence of events required for payments under the Old Act regime is set out below.

¹ See, for example, *Rupert Morgan Building Services Ltd v. Jervis and Another* 2004 1 WLR 1867.



Under the Old Act, the withholding notice is the most important document which is required to be served in order to pay a lesser amount than the amount which has been valued or certified. Failure to serve a withholding notice means that the paying party is entitled to payment of the amount due as set out in the section 110 payment notice, valuation or certificate. If the sum due is not paid, the party which had not been paid can start an adjudication to recover the amount due, which is likely to be successful, or it can suspend the performance of its works.

Pay when paid clauses

Before the Old Act, it was permissible for the main contractor not to pay any of its subcontractors if it had not received payment from the client. The Old Act outlawed "pay when paid" clauses from construction contracts. One exception where such provisions were permitted was when the client, or any other party up the line, was insolvent.

The Old Act defined the circumstances in which a client became insolvent. Any construction contract seeking to incorporate a pay when paid clause must define the circumstances of such insolvency events so as to comply with the Old Act. The relevant section of the Old Act (section 113) was amended by new insolvency legislation² and the list of insolvency events changed. If parties' construction contracts were not updated to incorporate this change, the provision was held not to be effective to prevent the main contractor from paying its subcontractors when the client had become insolvent by the "new" insolvency event.³

Suspension

A further sanction introduced by the Old Act for failure to pay a sum due under a construction contract where there was no withholding notice was the right of the unpaid party to suspend performance of its obligations under the contract. The Old Act states that, "Where a sum due under a construction contract is not paid in full by the final date for payment and no effective notice to withhold has been given ..." the unpaid party could suspend. There was some confusion as to which document set out the "sum due", whether it was the application for payment or the section 110 payment notice, valuation or certificate. In our view the sum due under the contract is the payment notice, valuation or certificate and not the application.

A notice of suspension is required to be served at least seven days before performance can be suspended. This notice has to set out the grounds on which it is intended to suspend performance. The right to suspend continues until the party in default has made payment in full of the amount due.

The right to suspend remains under the New Act with some minor amendments.

² The Enterprise Act 2002, which amended the Insolvency Act 1996 and impacted upon the circumstances.

³ See *William Hare Ltd v. Shepherd Construction Ltd* 2010 BLR 358.



Practical advice

The most important notice under the Old Act was (and remains) the section 111 withholding notices; payment notices were often ignored as there was no sanction on a paying party for failing to provide a payment notice. In the withholding notice the paying party is required to inform the payee not later than a prescribed period before the final date for payment of the amount or amounts it proposes to withhold from any payment otherwise due and to set out the ground or grounds for that withholding.

Withholding notices will continue to be important in all contracts entered into before 1 October 2011 and to which the Old Act regime applies. It is possible, and in our view good commercial practice, for paying parties (where it does not already do so) to start to issue payment notices under the Old Act regime on these contracts, as the New Act requires payment notices to be provided and there are sanctions if a party fails to serve a payment notice under the New Act. This will improve commercial management on the Old Act regime contracts and will assist in the administration of contracts under the New Act regime.

Payment under the LDEDCA 2009 (“New Act”)

The provisions of the New Act in respect of stage payments apply to all contracts unless the contract states that the duration of the work is to be less than 45 days or the parties agree that the duration of the work is estimated to be less than 45 days. All other construction contracts must provide an adequate mechanism for determining what payments become due under the contract, and when, and provide a final date for payment of any sum that becomes due.

The parties to the construction contract are free to agree the due dates for payment in their contract. The parties to the construction contract are also free to agree how long the period is to be between the date a sum becomes due and the final date for payment. The New Act prescribes the periods for payment notices and default notices, but are free to agree the last date before the final date for payment on which pay less notices must be served. Under the Old Act, the parties were free to agree all of these periods.

If the contract does not comply with the Act, the payment provisions of the Scheme will apply.⁴

New timetable

Under the Old Act the important dates to remember in respect of a payment cycle were the due date, the final date for payment and the last date upon which a withholding notice could be served.

The New Act introduces a different regime with increased emphasis on the first notice by the paying party, which replaces the often unused payment notice under Section 110 of the Old Act.

Payment notice

The New Act provides that the payer or a specified person (defined as a person specified in or determined in accordance with the provisions of the contract, namely a client’s agent, contract administrator or quantity surveyor) shall give a notice to the payee not later than 5 days after the payment due date.⁵ The payment notice must set out the sum that a payer considers to be due at the payment due date and the basis on which that sum is calculated.

⁴ See Section 110(3) of the New Act.

⁵ See Section 110A(1)(a) of the New Act.



The New Act does not specify or clarify what is meant by "basis on which the sum is calculated."⁶

A payment notice must still be served even if the amount calculated as due is nil.⁷ Even if the total of the abatements and set-offs reduces the amount due in the payee's notice to an amount the paying party is prepared to pay, a pay less notice may still be served not later than the prescribed number days before the final date for payment, which may be an agreed date or the Scheme period of 7 days.

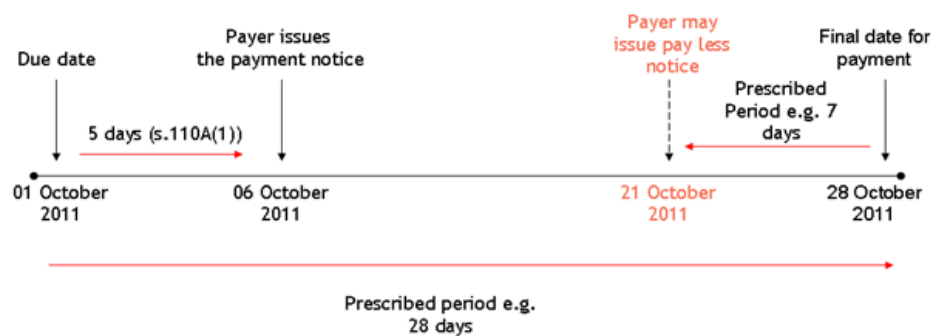
Practical advice

As a matter of good commercial practice, parties should serve very detailed payment notices downstream. To satisfy the New Act's requirement for the "basis on which the sum is calculated" to be set out, at the very least the mathematical calculation of the amount applied for, any reduction calculated during the valuation (for reasons such as work not carried out in accordance with the contract, abatement, and arguably set-off, which would under the Old Act regime have been dealt with in the withholding notices) ought to be included in the payment notice. Alternatively, it would be good practice to provide in the payment notice a similar level of detail to that provided by the payee in any application for payment.

The more detail which is included in the payment notice, the more information the party to whom payment is due has to assist it in understanding the basis of the valuation which ultimately should reduce the risk of disputes arising.

Payment notice flowchart

The following flowchart shows the procedure to be followed where a paying party serves a payment notice.



The parties are free to agree the dates on which the amount becomes due and the final date for payment. However the New Act states that the payment notice must be served within 5 days of the due date.⁸ The parties may agree the last date before the final date for payment on which a pay less notice may be served, in default of which the Scheme applies which requires the pay less notice to be served not later than 7 days before the final date for payment.

Notice in default

If the paying party or a specified person fails to serve a payment notice, the payee can give a notice in default of the payer's notice.⁹

This notice in default can be given at any time after the date on which the payment notice should have been served. Any delay by the payee in serving a notice in default after the date on which the payment notice was due has passed will result in an extension to the final date for payment by the same number of days as elapses between the last date for service of the payment notice and the date on which the default notice is served.

⁶ Section 110A(1)(b) also provides that the payee may give a notice to the payer or a specified person not later than five days after the payment due date along the same lines as a payer notice. However, we would not recommend providing for this within your construction contract and the rest of this paper deals with the procedures where the construction contract provides that the payer issues the payment notice under Section 110A(1)(a).

⁷ See Section 110A(4) of the New Act.

⁸ See Section 110A(1) of the New Act.

⁹ See Section 110B of the New Act.

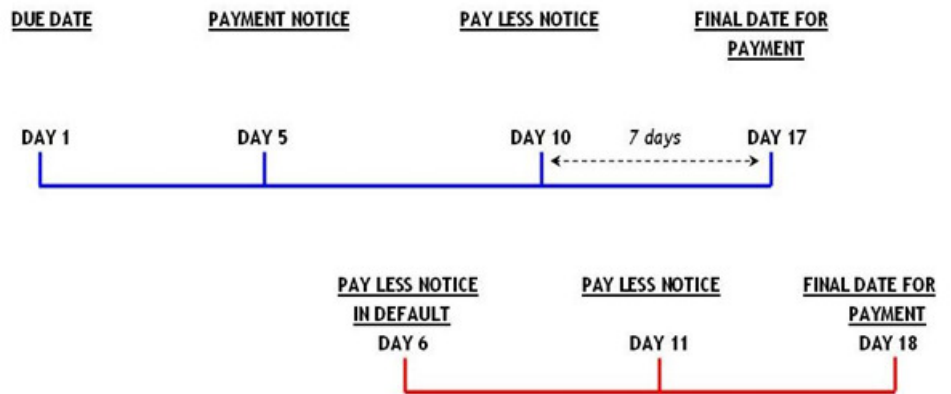


Fenwick Elliott

The construction & energy law specialists

For example, using the Scheme timetable (see below):

NEW SCHEME



Application for payment as notice in default

If the payee has issued an application for payment to start the payment timetable, the New Act provides that any such application made before the payment notice may stand as the payee's notice in default and that the payee may not serve another notice in default.¹⁰

In the absence of a pay less notice, the amount applied for becomes the notified sum which must be paid in full without any abatement, deduction or set off by the final date for payment.

Pay less notice

Following the service either of a payment notice or a notice in default, the paying party is required to pay the notified sum, i.e. the amount set out in the payment notice, default notice or the payee's application for payment.¹¹ The notified sum must be paid and arguments as to whether or not a sum is properly due under the contract are no longer available to the paying party.¹² The only mechanism by which payment of the notified sum can be avoided is by the service of a pay less notice.¹³

The paying party must set out in the pay less notice the sum which it considers to be due on the date the pay less notice is served and the basis on which this sum is calculated. The number of days before the final date for payment when the pay less notice must be served can be agreed in the contract, in default of which the Scheme applies and the pay less notice must be served not later than 7 days before the final date for payment.

Again, as with the payment notice, the requirement in the New Act is for the pay less notice to set out the basis on which the sum is calculated. This is different from a withholding notice under the Old Act, which required the paying party to set out the amount proposed to be withheld and the ground or grounds for withholding that payment.

Practical advice

At a minimum in our view, the mathematical calculation of the notified sum less any amounts which the paying party does not propose to pay ought to be set out in the pay less notice. As a matter of good commercial practice, we would suggest that when a party is the paying party that it sets at least out a similar level of detail as is set out in the application for payment.

¹⁰ Section 110B(4) of the New Act.

¹¹ See Section 111(1) of the New Act.

¹² See Section 111(4) of the New Act.

¹³ See Section 111(3) of the New Act.

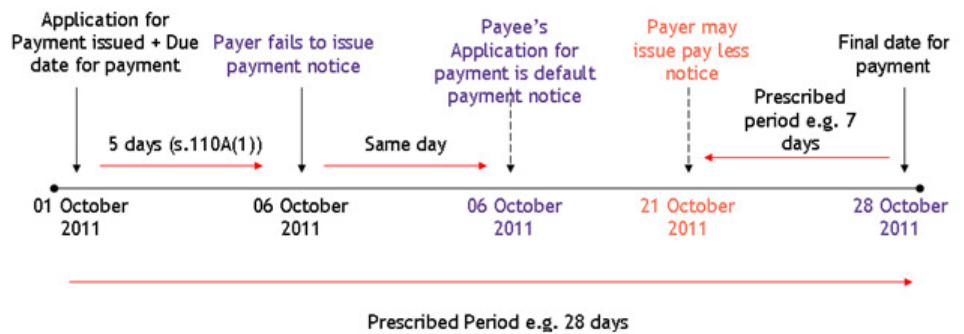


We would suggest that the paying party goes further and includes the level of detail required by the Old Act's withholding notice, i.e. setting each ground of withholding and amounts which add up to the total of the pay less notice. This would in our view reduce the possibility of disputes arising but, if a dispute did arise, the detail in the notice would improve the paying party's position in any subsequent adjudication.

This may be a sensible approach to adopt during the transitional period in any event as it will prevent any differences arising in the approach adopted in respect of the different types of notice that need to be prepared. If a pay less notice were mistakenly served under a contract governed by the Old Act regime, the pay less would then in any event comply with the requirements of a withholding notice.

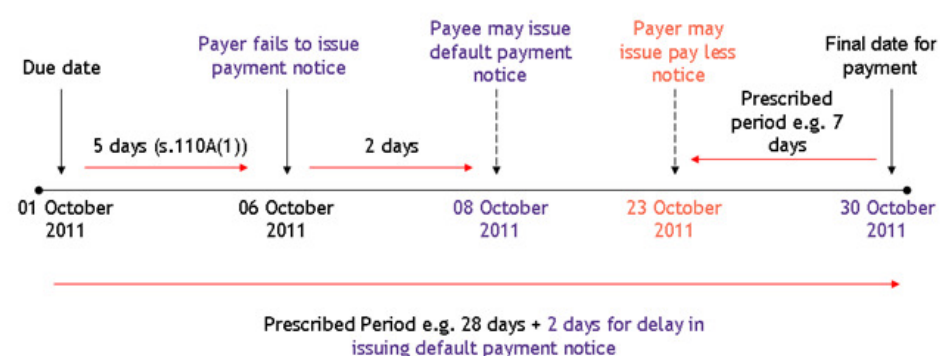
Payment flowcharts – no payment notice served

The first flowchart below sets out the procedure where a payee makes an application for payment but the paying party fails to serve a payment notice, resulting in the application standing as the notice in default and setting out the notified sum.



In this scenario the paying party is able to remedy its initial failure to serve a payment notice by serving a pay less notice. The amount payable by the final date for payment is therefore the notified sum, in this case the amount sought in the application for payment, less any amount set out in the pay less notice.

The following flowchart shows the procedure where a payment becomes due without the payee making an application for payment and where no payment notice is served. Here the payee has served a notice in default which sets out the notified sum.



Again in this scenario the paying party is able to remedy its initial failure to serve a payment notice by serving a pay less notice. The amount payable by the final date for payment is therefore the notified sum, in this case the amount set out in the notice in default, less any amount set out in the pay less notice.



The worst case scenario for a paying party would be if it failed to serve a payment notice and also failed to serve a pay less notice. In these circumstances, the amount applied for or the amount set out in the notice in default would become the notified sum which would need to be paid without abatement, deduction or set off by the final date for payment.

The pay less notice is therefore a critical document which must be served in all circumstances.

Practical advice

Parties should ensure that in all downstream contracts that the payment timetable is commenced by the issuance of an application for payment. The clause should say that the payment due date is a set period after receipt of the application (say 14 days).

The 'paying' party should value the application within this period and ensure that a detailed payment notice is served as soon as possible after the due date and in any event within 5 days; in no circumstances should a payment notice not be served, even if the amount considered to be due is nil.

The New Act allows the parties to agree the number of days before the final date for payment on which the pay less notice may be served. In the absence of an agreement, the Scheme provides that a pay less must be served 7 days before the final date for payment.¹⁴

Parties may wish to consider inserting a clause into its contracts/subcontracts which provides for the pay less notice to be served one day before the final date for payment. This will allow all abatements, set offs or deductions the longest possible period to come to its attention to ensure that they are taken into account before the final date for payment. However, with this in mind, the parties need to be sure that their internal procedures are sufficiently robust to cope with service of notices so close to the deadline. Otherwise, missing the opportunity to issue a pay less notice becomes a real risk.

Payment under the New Scheme

The Scheme has been revised to reflect the changes introduced by the Act. If a construction contract has not been agreed in writing, or if it does not contain an adequate mechanism for payment, the payment provisions of the Scheme apply or will replace the inadequate contractual provisions. It is important therefore to consider the requirements and timetable of the new Scheme.¹⁵

The Scheme provides that the payment notice required by section 110A(1) of the New Act must serve a payment notice not later than 5 days after the payment due date.¹⁶ This reflects the requirements of section 110A(1) of the New Act.

The Scheme does not contain any provisions in respect of the payee's notice in default. The New Act provides sufficient guidance in this regard; if it has not issued an application for payment (which automatically stands as the notice in default) the payee ought to serve a notice in default as soon as possible after the 5 day period for serving the payment notice has elapsed.¹⁷ Any period of delay causes a consequential delay to the final date for payment.

The Scheme requires the pay less notice to be served no later than 7 days before the final date for payment.¹⁸

The final date for payment under the Scheme is 17 days from the due date.¹⁹ The timetable for payment and notices under the Scheme is shown below.

¹⁴ See Paragraph 10 of the Scheme.

¹⁵ See Section 110(3) of the New Act.

¹⁶ See Paragraph 9(2) of the Scheme.

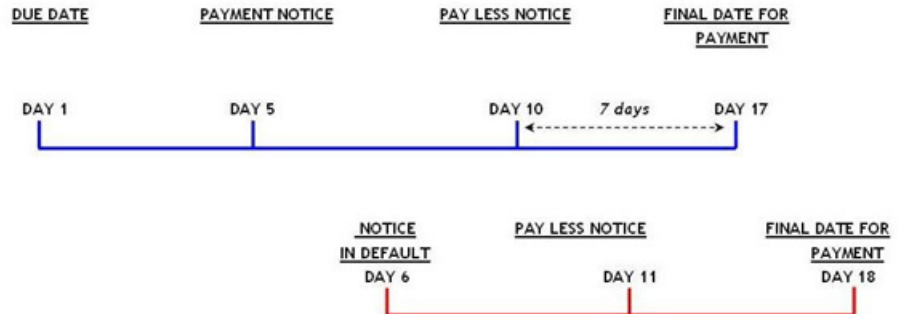
¹⁷ See Section 110B(1)(a) of the New Act.

¹⁸ See Paragraph 10 of the Scheme.

¹⁹ See Paragraph 8(2) of the Scheme.



NEW SCHEME



Additional provisions in respect of payment

In addition to the new notice regime, the New Act has introduced some further changes. In order to provide an adequate mechanism for payment, a construction contract cannot make payment conditional on the performance of obligations under another contract or a decision by any person as to whether obligations under another contract have been performed. Such provisions are known as “*pay when certified*” clauses. A main contractor cannot therefore provide in the contract that payments to subcontractors are conditional upon the client certifying payments to the contractor under the main contract.

If a construction contract contains a pay when certified clause it will not satisfy the requirements of an adequate mechanism for payment for the purposes of the New Act and the payment provisions of the Scheme will be imposed, with its shorter timetable.²⁰

Retention

As the New Act prevents payment under a construction contract from being conditional upon the performance of obligations under a separate contract, this is likely to have a significant impact in respect of retention.

Construction subcontracts frequently provide that the payment to the subcontractor of the final moiety of retention is conditional upon the contractor receiving a certificate of making good defects under the main contract. Such clauses will no longer be permitted.

Contractors in particular will want to prevent a situation from arising where a subcontractor’s second moiety of retention becomes due too early and exposes the main contractor where there is defective work, no certificate of making good defects under the main contract and no retention fund available from its subcontractor. We suggest contractors include a provision that the second moiety of retention will be released in accordance with the date in the articles or contract particulars. The date for release of the second moiety of retention, or number of days from completion of the subcontract works, will need to vary in respect of each subcontractor due to the time during which the project they complete their works; the demolition contractor will complete its subcontract works long before the painter.

Such a provision will protect contractors from the situation outlined above and will not affect the Act as the payment of the second moiety of retention is not conditional upon a certificate being issued under another contract.

²⁰ See Sections 110(10) and 110(3) of the New Act.



Insolvency

Section 113 of the New Act remains as it was under the Old Act, namely that pay when paid clauses are not permitted unless the party up the line is insolvent. All of the insolvency events set out in the Enterprise Act are included. There are further definitions in respect of the insolvency of a partnership and individuals.

Section 111 (10) of the New Act excludes the requirement to pay the notified sum on or before the final date for payment where the contract provides that such a payment need not be made if the payee becomes insolvent. This applies even after the date for serving a pay less notice has passed.

This statutory provision effectively incorporates the decision of the House in Lords in *Melville Dundas Ltd v. George Wimpey UK Ltd* (Scotland)²¹ but ensures that it is restricted to defined insolvency situations.

Suspension for non-payment

The Old Act introduced the right for a party which had not been paid to suspend performance of its obligations under the contract.

The New Act has retained the right of a party which has not been paid to suspend, but has amended the Old Act slightly.²²

The ground on which a party may suspend its works has been clarified in the New Act. A party may suspend if the payer does not pay the notified sum on or before the final date for payment.

Clients should be aware that the New Act allows the party which has not been paid to suspend "any or all" of its obligations under the contract. This means that a party can suspend performance of part of its works. This could be used for tactical advantage and a party could suspend one particular element of its services.

In addition, the New Act has introduced an entitlement for the party which has not been paid and has chosen to suspend its works to be paid by the defaulting party a reasonable amount in respect of cost and expenses reasonably incurred by that party as a result of the exercise of the right to suspend.

Further, the right introduced by the Old Act to exclude the period of any suspension from the computation of the completion date has been extended slightly to include a period "in consequence of the exercise of" the right to suspend. This additional wording seem to us to cover any time spent by the suspending party in demobilising and remobilising.

The requirement to notify the defaulting party at least seven days before the right to suspend its performance remains in place.²³ Failure to comply with this notice provision may mean that the party seeking to suspend does so in breach of contract, which could be construed as a repudiatory breach bring the contract to an end.

Transitional Period – Payment

During the transitional period, Parties may be operating two distinct payment regimes with separate timetables, notice provisions and timetables for payment.

²¹ [UK] UKHL 18.

²² See Section 112 of the New Act.

²³ See Section 112(2) of the New Act.



Careful and thorough commercial management is therefore essential to ensure that the correct regime is operated in respect of the correct contract, the correct notices are served and any payments are made within the correct time period.

Whereas under the Old Act the section 110 payment notice was often (and could be due to the lack of sanction) ignored, the payment notice under the New Act is more important and should always be served and in our view should be as detailed as possible. If there is to be any confusion between the Old Act and New Act regimes, parties would be in a far better position if it adopted the New Act procedure and served a payment notice within 5 days of the due date on all of its contracts.

Failure to serve a payment notice allows the payee to control the amount of the notified sum, either by its application or by serving a notice in default. The payer can still remedy this situation by serving a pay less notice.

Failure to serve a pay less notice where a payment notice has been served may be painful for the paying party, as it will have lost its second opportunity to reduce the amount payable on or before the final date for payment. However in this situation the paying party ought to have valued the payee's entitlement and deducted all abatements and set offs in the payment notice.

The worst case scenario for a paying party is failing to serve a payment notice (the amount set out in the payee's application or notice in default becomes the notified sum) and then subsequently failing to issue a pay less notice. The amount applied for by the payee or set out in its notice of default then becomes the amount payable on or before the final date for payment without abatement, deduction or set off. Good commercial management is essential to avoid this situation from arising.

Bonds, Warranties and Guarantees

Bonds and Guarantees: the basic legal principles

These are the two most common forms of security taken by clients on construction projects and, from a legal point of view, have much in common. However, there is a great deal of misunderstanding about the legal principles underlying them which is not helped by the numerous names which are applied to bonds and guarantees in the construction industry. These include: on-demand bonds, simple bonds, performance bonds, conditional-demand bonds, bank guarantees, demand guarantees, default bonds, performance bonds, surety bonds, surety guarantees, parent company guarantees.

It is important to look beyond the names applied to these documents. The label attached to a document is not conclusive as to the legal principles upon which it is based. Essentially the document should be based on one of two fundamentally different legal principles (but obviously the specific drafting means the position is often less clear than it could be and frequently results in a document falling somewhere in between these two principles).

- (i) Primary obligation. This is simply an undertaking from the bondsman to pay a sum of money to the client without reference to the liability of the contractor. It is this principle which underlies a true "on-demand" bond. These bonds are common on international projects but less so in the UK (except in the case of advance payment and retention bonds).



- (ii) Secondary obligation (guarantee). This is where the bondsman's liability to pay the client is contingent upon a breach by the contractor of the underlying construction contract. So if the client cannot establish a breach by the contractor then the bondsman has no liability to pay. It is this principle that underlies the default bond, which is the more common form of bond used in UK projects, i.e. performance bonds, parent company guarantees etc.

It is not always clear to distinguish whether a bond is truly on-demand or whether it is conditional upon breach of the construction contract. Clever (or not so clever) drafting also sometimes means that bonds fall somewhere in between. Some examples:

- In a true on-demand bond you would usually expect to find wording along the following lines:

"I promise to pay you £X on receipt of your written request without proof or conditions".

Wording to this effect is unusual in bonds used in UK construction projects and bonds tend to have conditions attached to them to limit a call. Unsurprisingly, these are known as conditional on-demand bonds. These conditions may include:

- A statement (usually from the architect/engineer) that the contractor is in default;
- Enclosing copies of warning notices served on the contractor under the main contract;
- An adjudicator's award.

These provisions should not detract from the bond being an on-demand bond; it simply places hurdles in the way of a claim. There is no suggestion that any default on the part of the contractor needs to be demonstrated - the conditions are simply administrative. A true default bond would usually include wording such as:

"The Guarantor guarantees to the client that in the event of a breach of the Contract by the contractor the Guarantor shall discharge the damages sustained by the client as established and ascertained pursuant to and in accordance with the Building Contract"

The confusion that can arise where bonds sit somewhere in between true on-demand and default bonds has been considered recently in the Australian case of *Clough Engineering Limited v Oil and Natural Gas Corporation Limited*.²⁴ Clough was an engineering company engaged by ONGC in relation to the development of oil and gas fields off the coast of India. Various disputes arose which culminated in ONGC terminating the contract and making a call on the bond. The wording in the construction contract between Clough and ONGC provided that Clough was to provide an unconditional and irrevocable bond and ONGC would have the right to claim an amount up to 10% of the value of the contract "in the event of the contractor failing to honour any of the commitments entered into under this contract".

The wording of the bond itself provided for the bank to pay immediately on first demand:

"on breach of contract by the contractor without any demur, reservation, contest or protest or without reference to the contractor."

Clough maintained that the wording in the contract prevented a demand being made and that ONGC had to prove breach on the part of Clough before a claim could be made

²⁴ [2008] FCAFC 136



on the bond. The Judge at first instance rejected this and held that it was sufficient for ONGC to call the bond where it had a bona fide belief that Clough was in breach. When both the contract and the bond were considered together it was clear that a claimed breach of contract was sufficient to trigger payment under the bond. This decision was upheld on appeal.

Formality

A guarantee, which is the legal basis of true default bonds, is similar to a simple contract in that all the requirements for a contract must be present, such as an intention to create legal relations, consideration, etc. In addition to this, a guarantee must be in writing to be enforceable. In the *Action Strength Limited*²⁵ case a subcontractor sought payment directly from the client where the main contractor had become insolvent. The subcontractor's claim was on the basis that the client had said that the subcontractor should carry on working and that the client would ensure that he got paid. The sub-contractor's claim failed on the basis that the apparent "guarantee" by the client in respect of the main contractor's payment obligations had not been recorded in writing and so could not constitute a guarantee. This case is obviously a warning to contractors and subcontractors who proceed on the strength of a verbal assurance from a third party that they will be paid. The effect of the verbal assurance is probably intended to act as a guarantee but must satisfy the requirements of a guarantee before it can be relied upon.

Co-extensiveness

This principle provides, in practice, that the bondsman is only as liable as the contractor but this only applies to secondary obligations. Under an on-demand bond the extent of the bondsman's liability is dictated solely by the wording of the on-demand bond itself. Essentially, the bondsman is put in the same position as the contractor under a default bond.

Further to the above, it is in the clients best interests to try and achieve co-extensiveness throughout the life of a contract (whether that be 6 or 12 years) when negotiating a bond or guarantee. However, many parent companies or bondsmen only offer a bond/guarantee for the duration of the project, or at the very latest on expiry of the 12 month defects liability period. Whilst an expiry period linked to practical completion or the end of the defects liability is more readily accepted for bonds, many clients do insist on co-extensive parent company guarantees wherever possible.

Variation of the construction contract

One of the basic rules of a guarantee is that any variation in the construction contract could discharge the bondsman from liability. It is for this reason that the following will usually be present in any default bond:

"The Guarantor shall not be discharged or released by any alteration of any of the terms, conditions and provisions of the Contract or in the extent or nature of the Works and no allowance of time by the client under or in respect of the Contract or the Works shall in any way release, reduce or affect the liability of the Guarantor under this Guarantee Bond"

There is no need for such wording in on-demand bonds because they are a primary obligation operating independently of the underlying construction contract. However, just because a bond does not contain this wording is not conclusive that it must be an on-demand bond; it is necessary to look at the precise wording in each case.

²⁵ [2003] UKHL 17



A word of warning about relying on such wording. If the amendment to the construction contract is significant then it is still advisable to get the consent of the bondsman. *Hackney Empire Ltd v Aviva Insurance UK Ltd* [21.09.11] supports the principle that a performance bond including an indulgence clause (as above) protects clients where contractual variations are made without consent, but not without qualification.

Framework agreements

It is also important to consider how guarantees may be affected by more modern procurement routes such as framework agreements. The main advantage of frameworks is that contracts are “called off” as and when the client wishes during the framework, with the intention that certain aspects of the project are agreed in advance - one of the most common being the terms and conditions. Frameworks are frequently used by Estates Departments to achieve efficiencies in their supply chains and to promote collaboration and innovation.

When setting up this type of arrangement it is important to consider how any guarantee is drafted. Firstly, frameworks in the private sector have a tendency to go beyond the scope of what was intended of the contractor at the outset. A contractor who has completed a number of successful projects for a client can soon find himself undertaking more complicated and high value projects. Therefore it is important that the client understands what it is getting, and that its long term requirements are covered. Frameworks in the public sector, which are usually subject to OJEU, will be more carefully regulated as regards the scope and value of the projects called off under them.

If the guarantee obtained is in relation to all the obligations assumed under the framework, and these obligations materially change in scope and duration, the guarantor may be discharged. Secondly, careful attention must be paid to the wording of the framework agreement. Often, they are written so that the contract between the parties for the actual work is a separate contract from the framework agreement itself. Any guarantee will need to take account of this.

The meaning of default

As previously mentioned, the most common form of bond issued on UK projects is the default bond as opposed to the on-demand bond. If there is no “default” then no call can be made on the bond (unlike the on demand bond which is a primary obligation not dependent upon any default under the construction contract).

Default bonds are most commonly underwritten by insurance companies (with banks tending to underwrite on-demand bonds) and so, like any other insurer, they will look for a reason to avoid payment. That said, on many occasions the bond issuer will accept a call on the bond simply by demonstrating that the contractor is insolvent and then providing evidence of the actual costs of completion of the construction work. The key practical approach in these situations is to get the bondsman involved early. It is important to remember that the more the client is able to demonstrate that the losses have been reasonably incurred (and properly mitigated) the less chance there is of the bondsman challenging those losses.

However, establishing “default” is not always straightforward and things do not always go smoothly with the bondsman. Given that one of the main reasons a client will want to call a bond is due to the contractor’s insolvency there have been a number of cases which have doubted whether insolvency is actually a default entitling a call to be made.



Involving a bondsman at an early stage can be beneficial to the client. On a recent project, as soon as the contractor became insolvent we involved the bondsman. The various options as to how to complete the works were discussed and “signed off” by the bondsman. These options included tendering the remaining works on a fixed price basis (but with the risk of overrunning and the client becoming liable to a tenant for liquidated damages), or completing the works on a day works basis with far less risk of overrunning and incurring liquidated damages but obviously with less cost certainty. Because of the early involvement of the bondsman the losses were clearly demonstrated, mitigated and settled without delay on the part of the bondsman.

*In Perar BV v General Surety and Guarantee Co Ltd*²⁶ the building contract terminated because the contractor went into administrative receivership. The contract was the JCT Standard Form of Building Contract with contractor’s Design 1981 Edition. Clause 27.2 provided:

“In the event of the contractor having an administrative receiver, as defined in the Insolvency Act 1986, appointed the employment of the contractor under this Contract shall be forthwith automatically determined”

The client made a call on the bond but the Court of Appeal held that the client could not treat the automatic determination of the employment of the contractor as an abandonment of the contract amounting to repudiation. This was because the contract expressly set out what was to happen in such circumstances and set out what liability each party had to the other. It is for this reason that a well-drafted bond should always make clear that termination in these circumstances is a default for the purposes of the bond. For example:

“The Guarantor guarantees to the client that in the event of a breach of the Contract by the contractor or in the event that the Contract or the employment of the contractor is determined by reason of one or more of the events set out in clause [insolvency clause] and notwithstanding any objection that may be raised the Guarantor shall [satisfy the damages sustained].”

Parent Company Guarantee v Default Bond

Given that default bonds are essentially based on the law of guarantee (and so many of the same issues arise) it is often queried why some project documentation still requires both forms of security and whether there are any advantages with one over the other.

Many contractors will argue that it is unreasonable for the client to request both a PCG and default bond. However, whilst legally they may have many similarities the practicalities of how and when they operate means that the client’s request for both can often be justified.

The PCG can be a very practical as well as legal remedy. If a subsidiary is not performing then in practice the client will simply threaten to make a formal call on the PCG. In many cases this is sufficient to ensure that the parent company steps in and resolves the problems with its subsidiary’s performance. The risk, of course, is that if the grounds for non-performance by the subsidiary are financial then there remains a high chance that the parent company may suffer the same fate. It is in these insolvency situations where the bond is likely to prove better security for the client (subject, of course, to the financial standing of the bondsman).

The other major advantage to the PCG is that they tend to be drafted on the basis that the parent company’s liability is identical in terms of duration as its subsidiary. By contrast

²⁶ (1994) CA 66BLR77



most default bonds are drafted to expire at the end of any defects period meaning that latent defects appearing after this date are not caught.

Payment security for the contractor

Capital projects in the education sector are sometimes procured by special purpose companies established by a university or college solely for project delivery. Considered by some to be a more tax efficient approach to development for clients in education, we are aware of and work with a number of development companies. Contractors and consultants entering into agreements with these special purpose companies often do have 'an eye on the balance sheet' and will look for payment security from their prospective clients if they have concerns about the covenant of the development company. Such concerns may not be addressed simply by a 'letter of comfort' from the relevant institution; payments guarantees or 'escrow' accounts (administered by a bank or solicitor) are commonly requested.

When an educational institution is considering whether or not to provide a guarantee in respect of a contract entered into by its subsidiary, it is best advised to propose its own form, which should be a limited guarantee relating only to the development company's payment obligations. If an escrow account is discussed as an alternative, the client should bear in mind the likely administrative costs. Close attention should also be paid to the wording of the escrow agreement, so that the 'triggers' for drawing down payment are clear and appropriate in the circumstances.

Practical advice

Negotiating a Bond or Guarantee:

- 1 Clients proposing a bond or guarantee should have a draft "model" form of wording available for the contractor's consideration at tender stage. Where a model form is being used, parties should still approach so called "tried and tested" precedents with caution. Precedents are only tried and tested to the extent that they have not been analysed by a Court and found to be wanting. It is entirely possible that a precedent form may have been used previously without those signing it have ever fully understood its effects.
- 2 Some general points ought to be considered on first review of a draft form of wording for a bond or guarantee:
 - 2.1 Does the text include phrases like "on-demand", "without proof or condition", "primary obligor" and "indemnity"? (These will obviously point to an intention to impose a primary obligation).
 - 2.2 Is it intended that the guarantee or bond is to be issued by a bank (or by a specific bank) or by a parent company?
 - 2.3 Does the wording mention a fixed or maximum value of the security required?
 - 2.4 Does the wording read like something out of a Victorian novel?
 - 2.5 Is there apparent evidence of amendment of a standard form?
- 3 The priority when being presented with a draft document should be to establish whether or not the client is looking for security in the form of a primary or



secondary obligation. Any request for an on demand bond in a domestic context will be firmly resisted by contractors, and clients should expect to have to fully justify why it feels the need to have such a potentially drastic security option. In most circumstance the negotiated position will be the offer a conditional bond as a reasonable alternative by the contractor or dependant on the strength of a clients negotiating position a negotiated maximum sum. (In the *Edward Owen Engineering Ltd v Barclays Bank International Ltd*²⁷ case the sum covered was for 10% of the contract price).

- 4 Turning to the small print, as with any other contract the general question to think about when considering the detailed terms and conditions is something like: “Does the wording clearly describe the obligations of the parties and prescribe the outcomes for all of the relevant eventualities.” If the client wants a primary obligation and the contractor is willing to concede this then it is in the interests of both parties to make sure this is clearly expressed so that future disputes may be avoided.
- 5 It is important that the small print is consistently clear (ambiguity leads to arguments) as to the following issues:
 - 5.1 The nature of the obligation imposed.
 - 5.2 The period over which the obligation is to be maintained and/or the expiry date.
 - 5.3 The maximum or aggregate maximum sum payable.
 - 5.4 The mechanism by which notice of demand is be provided.
 - 5.5 What amounts to a default?
 - 5.6 If it is necessary for a loss to be “sustained” and how that sustained loss is to be proved.
 - 5.7 Those events that will discharge the guarantor’s obligations.
 - 5.8 How disputes are to be resolved and pursuant to what law (just in case).

Protection from the consequences of (main) contractor insolvency

The most effective method of avoiding contractor insolvency is to employ the right contractor. Clients should not be tempted to accept the lowest tender submission on principle. The trading history and financial position of those submitting tenders should be carefully reviewed and a financial risk assessment made.

In addition, a client (or sub-contractor) should be alert to the following, each of which may indicate that a contractor is in financial difficulty:

- The contractor’s employees not turning up for work or a general decrease in the amount of labour on site.
- A slow-down in progress of the works.
- Plant, equipment and materials “disappearing” from site.
- An increase in the number of defects to the works.

²⁷ [1978] 1 All ER 1976



- The contractor seeking to negotiate further payments or release of the retention, or any other change in payment patterns (such as an advance payment or more frequent instalments or certificates).
- The contractor raising spurious or unjustified claims or contra-charges to increase the amount payable to it.
- The contractor assigning (or seeking the client's consent to assign) the proceeds of the building contract to a bank or other creditor.
- If the contractor is a company, late filing of accounts or annual returns at Companies House or auditor's reports that are signed off subject to a qualification (depending on the nature of the qualification).
- Unsatisfied court judgments against the contractor. These may be revealed by a business information report on the contractor from a specialist business information provider, such as Dun & Bradstreet.
- Sub-contractors not being paid.
- Persistent rumours about the contractor's financial position in the press and from other sources.
- An underlying trend in the contractor's behaviour that suggests it is in financial difficulty.
- The contractor's parent company (or other companies in the same group as the contractor) displaying any of the warning signs listed in this note.

If the client is concerned that the contractor is "struggling" financially, the first port of call should be to enter into dialogue with the contractor to establish whether or not its concerns are founded. If this is not possible, the client should consider what rights it has under the contract in order to ensure that it does not fall victim to contractor insolvency.

Outlined below are a number of contractual and extra-contractual ways in which a client can mitigate the impact of contractor insolvency:

A project bank account: Whilst not mandatory, where public funding has been secured, clients are reminded that the OGC advocates the use of project bank accounts, and has provided a detailed guidance note on the matter.²⁸ It is not unusual for clients to have reservations about using a project bank account because of the increased administrative burden and additional cost.

However, if the contractor becomes insolvent, the project bank account provides the client with a useful safety net, safeguarding funds meant for the contractor's sub-contractors and suppliers, which would otherwise be swallowed up in the contractor's bank accounts (the project bank account will need to create a trust: see *Re Tout and Finch*.²⁹ This may assist the client if it needs the sub-contractors' and suppliers' co-operation to complete the project.

Weighted stage payments: so that payments to the contractor are "back-loaded", with less payable at the start of the project and more as it nears completion. Weighted payments are often commercially unattractive to a contractor, as it will have to finance the project. In

²⁸ Guide to Best Fair Payment Practices, September 2007

²⁹ [1954] WLR 178).



order to pay for the cost of that finance, the contractor may have to increase its price. This, in turn, may make weighted payments less attractive to the clients.

Enhancements to contract terms

In addition to the above, the client might consider taking further action and making further provision in its capital works contract to protect itself from contractor insolvency. Such actions/provisions might include:

- (1) Under the Housing Grants Construction and Regeneration Act 1996 (as amended by the LDEDC 2009), unless a valid pay less notice is served on the contractor within the prescribed period before the final date for payment, the client must make the relevant payment to the contractor. Contracts can provide that, as from the date of the contractor's insolvency, the client is relieved from making any further payments that would otherwise be due under the contract.

The House of Lords has held that such wording in the 1998 editions of the suite of JCT standard building contracts meant that a client did not have to make further payment to an insolvent contractor, even though the appropriate withholding ("pay less") notice had not been served in accordance with the 1996 Act (*Melville Dundas Ltd v George Wimpey UK*³⁰).

The JCT 2005 provides that "other provisions of this Contract which require any further payment or any release of Retention shall cease to apply". They also allow the client to use the unpaid sums (retention) to complete the works and only account to the contractor for any unused amounts. While this gives the client much needed relief, there is a risk of double payment (see below) if the client uses the money to pay subcontractors for work carried out before termination of the contractor's employment.

- (2) To minimise any delay as a result of the insolvency of the contract, it may be in the best interests of the client to retain the subcontractors and enter into direct contract with them for the remainder of the works. It is highly likely that the subcontractors will be seeking payment of any outstanding sums for work previously carried out under the invoice, whilst this may increase the risk of double payment (i.e. having to pay both the contractor and the subcontractor for the same works), it may still be in the interest of the client to "do a deal" in order to ensure that the works are completed on time.
- (3) A provision to allow the client to complete the project using an alternative contractor and recoup the cost of doing so from the original insolvent contractor, or more likely, off-set the cost against sums owed under the contract.
- (4) A provision to allow the client to make direct payments to sub-contractors and suppliers, subject to careful drafting to:
 - Ensure that the client's liability to the contractor reduces by an amount equal to any direct payment the client makes to a sub-contractor, supplier or professional consultant. The client should also ensure that, before the client makes a direct payment, the recipient indemnifies the client against any liability the client might have to pay the same amount to the contractor; and
 - Avoid falling foul of the pari passu rule on insolvency. The pari passu principle is one of the most fundamental principles of insolvency law, and means that all

³⁰ [2007] UKHL 18



unsecured creditors in an *administration* or a *liquidation* must share equally any available assets of the company, or any proceeds from the sale of any of those assets, in proportion to the debts due to each creditor.

- (5) The client might consider a vesting certificate, in order to secure rights over off-site materials, or at least a bond to secure any payment made in respect of such materials.
 - A vesting certificate is confirmation from one party (for example, a contractor) to another (for example, a client) that, when the client pays the contractor for goods or materials (which the contractor has not yet delivered to the client/ the site), they will become the client's property. That is, they will "vest" in the client on payment.
 - While vesting certificates can be useful, they are not always effective. For example, if a client has a vesting certificate from a contractor who is on the brink of insolvency, and goods referred to in a vesting certificate "disappear" from a warehouse, while that disappearance may (or may not) be a theft of the client's property, the certificate itself is unlikely to help the client.
- (6) Both at common law and under the majority of standard building contracts, the client has a right to enter the site to secure the project and any plant, equipment and materials on the site. (If the contractor goes into administration, the client's right may be subject to a statutory moratorium on creditor action (*paragraphs 42 and 43, Schedule B1, Insolvency Act 1986*). However title to materials which has yet to pass to the contractor, from either a supplier or subcontractor, cannot pass to the client. In order to avoid this situation occurring, clients should ensure that subcontracts are procured back to back with the contractor's own contract, and that no retention of title clauses are incorporated into either the contract or any corresponding subcontracts.
- (7) The right to take possession of any plant, equipment and unfixed materials on site sell them and apply the proceeds towards satisfying the contractor's debts under the building contract. The client may want to use plant, equipment and unfixed materials to complete the works before selling it and the building contract may also permit this. The client should consider registering its rights over the plant, equipment and unfixed materials as a floating charge in order to avoid the contractor's insolvency practitioner having a claim over them. If the client decides to register a floating charge, it should do so as soon as possible, as a floating charge may be avoided if it is registered in the six months before a contractor goes insolvent (*section 245, Insolvency Act 1986*).
- (8) Likewise, the client should resist inclusion of any clause restricting or suspending his right to copy and use the design documents.

Julie Stagg, Partner
Fenwick Elliott
December 2011



Recent developments in procurement law

by Jeremy Glover

The primary purposes of this paper are threefold:

- (i) To look at the impact of the Remedies Directive and automatic suspension;
- (ii) To consider what happens if an abnormally low bid is submitted as part of the tender process; and
- (iii) To look at recent case-law in relation to making a challenge to the tender process.

Finally, we look at procurement in the future, with especial regard to the European Parliament resolution of 25 October 2011 on the modernisation of public procurement.

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

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

(i) Automatic suspension

In recognition of the need to allow the courts sufficient time to act within the standstill period, the new regulations required that once an application for review has been made by an aggrieved tenderer, the contract cannot be entered into until the court has made a decision regarding the application. Any such proceedings brought by an aggrieved tenderer must be commenced promptly, and as we will see, from 1 October 2011 must be made within 30 days¹ from the date when the party in question knew or ought to have known of the grounds for bring the claim.

(ii) Ineffectiveness

The new Remedies Directive stated that public contracts will be "ineffective" where there is a breach of the public procurement rules. It was the most significant remedy introduced in December 2009, the reason being that it can be claimed after the contract as been entered into between the contracting authority and the successful tenderer. By way of example, a contract will be rendered "ineffective" in the following circumstances:

- (i) If the contracting authority awards a contract without prior publication of a notice in the Official Journal of the European Union.
- (ii) If a contract is entered into under a framework agreement or dynamic purchasing system in breach of the public procurement rules, usually where the value was in excess of the applicable threshold.
- (iii) Where a contract is concluded without application of a proper standstill period, or where rules governing the suspension of a contract pending court proceedings

¹ This period can be extended by the court in its discretion by up to three months.



have been breached, and has affected the chances of the claimant winning the contract.

Automatic suspension: 18 months on

There have been a number of cases since 1 December 2009 where the Contracting Authority has sought to lift the automatic suspension. One area of interest was the test that the court would apply. Would it apply the usual test that has been used in relation to injunctions since 1975 – that laid down by Lord Diplock in the case of *American Cyanamid Co v Ethicon Ltd*² or perhaps it would apply a more lenient test that was weighted in favour of the aggrieved tenderer?

In all but one of these cases, the Contracting Authority has been successful and the injunction has been lifted.

To take one example, in *Exel Europe Ltd v University Hospitals Coventry and Warwickshire NHS Trust*³, the NHS Trust applied to have the automatic suspension under Regulation 47G lifted. In about 2009, University Hospitals Coventry and Warwickshire NHS Trust, decided to transfer their responsibility for managing and operating the Healthcare Purchasing Consortium (“HPC”) by establishing a framework agreement with a single operator. The HPC is a collaborative procurement hub run by the Defendant on behalf of itself and some 40 NHS Trusts in West Midlands and elsewhere and provides a wide variety of medical services, equipment, medications and other medical related items.

In February 2010, it was resolved that a competitive public procurement process should be undertaken and the framework agreement should be established by no later than 30 September 2010. This date was significant as the agreements with all the current HPC subscribers expired on 31 March 2010. The Contract Notice was published on 11 March 2010. On 19 April 2010, five tenderers pre-qualified, including Exel Europe Ltd and HCA International Ltd.

From an early stage in the procurement process, Exel Europe believed that the information provided in the Invitation to Tender (“ITT”) was insufficient for the restricted procedure which had been identified in the Contract Notice. As a result, Exel Europe eventually withdrew from the tender process on 28 May 2010. The only tenderer to submit a bid was HCA International. In due course the Defendant chose HCA International as its preferred bidder and notified Exel Europe on 15 July 2010.

Exel complained about the Defendant’s lack of contact, lack of communication and lack of a response to its repeated requests regarding various issues. It ultimately issued its claim in the Technology and Construction Court on 28 September 2010, alleging six breaches of duty. On 29 October 2010, the Defendant applied to have the automatic suspension under Regulation 47G lifted.

Mr Justice Akenhead confirmed that the principles with regard to interim injunctions as set out in the well-known case of *American Cyanamid Co. v Ethicon* would apply to these situations. He said that:

“... the Court should go about the *Cyanamid* exercise in the way in which courts in this country have done for many years”.

² [1975] AC 396

³ [2010] EWHC 3332 (TCC)



In other words, the Regulations do not favour maintaining the prohibition on the contracting authority against entering into the contract in question. This means that an aggrieved tender must persuade the court that:

- (i) There is a serious issue or question to be tried;
- (ii) Damages would not be an adequate remedy;
- (iii) The balance of convenience does not favour the contracting authority, i.e. does not mean that the authority can proceed with the award; and
- (iv) There are no other special factors which might influence the court.

In this, the Judge was following the decision of David Donaldson QCs sitting as a Deputy High Court Judge in the case of *Indigo Services v Colchester Institute Corporation*⁴ who said that:

"It was suggested on behalf of Indigo that the Regulations provided a "steer" - said to be a bias not amounting to a presumption - in favour of an injunction. Whether or not that is the case as regards final orders at trial (which I doubt), I can detect nothing of the sort as regards the decision at the interim stage. In any event, the conclusion which I reach at the end of this judgement would be unaffected even if I factored in the suggested "steer"."

Here, Mr Justice Akenhead found that there was a serious issue to be tried only in respect of one of the six allegations advanced by Exel. Exel alleged that the Defendant's discussions/negotiations with, another party, HCA International five months immediately prior to the open public procurement process gave them an unfair advantage, distorted competition or breached the principles of equal treatment and transparency. Mr Justice Akenhead found that this was the only serious issue to be tried and that the remaining five issues were at best weak.

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

Finally, the Judge was wholly satisfied that damages would be an adequate remedy.

In *Halo Trust v Secretary of State for International Development*⁵, a case about mine clearance and related work in Cambodia, the Judge took a similar approach to delay. It was almost inevitable that, if the suspension was continued until trial of the substantive matters in this case, there would be a minimum delay of 5 to 7 months before trial and judgement. Unsurprisingly, the Judge concluded that:

"What will or may well be created by continuing uncertainty is that mine and land clearance may well be delayed or disrupted and people who might not have been injured and killed will be. In this context, the certainty created by the lifting of the statutory

⁴ [2010] EWHC 3237 (QB)

⁵ [2011] EWHC 87 (TCC)



suspension significantly outweighs the uncertainty involved in continuing it. It needs to be borne in mind that all parties agreed in the Framework Agreement that time should be of the essence in relation to the Calldown Contracts.”

The Judge was also satisfied that damages would be an adequate remedy even if ultimately Halo succeeded in the proceedings. There might be redundancies and redundancy costs. These are eminently quantifiable and provable together with other management and overhead losses. Here, because Halo was a charity, there would not be a loss of profits claim. There was too no suggestion that Halo’s reputation, which appears to be good, would suffer as a result.

In *Metropolitan Resources North West Ltd v Secretary of State for Home Department*⁶, a case about the provision of accommodation for asylum seekers, Mr. Justice Newey decided that there was a serious issue to be tried. The claimant suggested that the UK Border Agency’s decision to obtain what was known as Initial Accommodation (“IA”) services for asylum seekers from a new provider who had not provided IA before was either a material change to the existing contract⁷ and/or was unlawful because there had not been any form of competitive tender process.

Further, when it came to assessing whether damages would be an adequate remedy, the Judge agreed that they would not be an adequate remedy. For example how would you assess the chances of the claimant actually winning the bid? In addition, the loss of the contract could cause severe damage to the claimant’s reputation and threaten its prospects of securing new contracts in the future. In doing so, the Judge referred to two previous cases, where the Judges had decided the point in different ways:

In the *Exel* case, Mr Justice Akenhead, as we have seen, considered that damages would be an adequate remedy. They could be satisfactorily assessed on a loss of a chance basis:

*“It is now fairly well established that a claimant who successfully challenges a procurement exercise will be entitled to damages, usually calculable on a lost opportunity or chance basis, not dissimilar to that referred to in *Allied Maples v Simmons and Simmons* [1995] 1 WLR 1602, albeit that case is related to solicitor’s negligence. It is immaterial in considering whether damages would be an adequate remedy that the damages may not be in a substantial amount. The damages will be whatever they will be.”*

However in the case of *Alstom Transport v Eurostar International Ltd & Anor*⁸ Vos J had concluded that damages would not be an adequate remedy. Vos J said in paragraph 129:

“I also accept that the assessment of [the claimant’s] loss would be a complex process requiring the valuation of a lost chance which is always a somewhat difficult process. The evaluation of its reputational and market position losses would be very difficult indeed.”

Judge Newey considered that the difficulties which could arise in assessing the claimant’s loss mean that damages are not a wholly adequate remedy. He also considered the position of the Border Agency. Damages would not provide them with an adequate remedy either. For example, leaving aside the quantification of any loss, the evidence also suggested that, were the claimant ultimately to have lost at trial, it would not be in a position to meet an award in the UK Border Agency’s favour. There was little value in any cross-undertaking. Further, there was the position of the Border Agency having to continue with a contract where there were, on the evidence before the court, a number of problems.

⁶ [2011] EWHC 1186 (Ch)

⁷ See Presstext Nachrichtenagentur GmbH [2008] ECR I-4401

⁸ [2010] EWHC 2747 (Ch)



This led the Judge to conclude that the balance of irremediable prejudice was on the UK Border Agency's side. The possible prejudice to the UK Border Agency (and, potentially, asylum-seekers) far outweighed the difficulties which could arise in assessing any damages to which the claimant may prove to be entitled.

In Northern Ireland, McCloskey J has considered two cases. In the first, he took a similar line in lifting the suspension⁹. The public interest outweighed the disadvantages that may be suffered by the aggrieved tenderer. To not do so would be of clear detriment to vulnerable and socially disadvantaged members of society. The Judge said:

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

The courts seem to be heavily influenced by the need to take into account the public interest in maintaining existing services or providing new ones. There has only been one real exception to this trend, the case of *First4Skills Ltd v the Department for Employment and Learning*¹⁰, which also came before McCloskey J. This case was a little unusual in that the court had already refused the Department's application to lift the suspension in response to a claim brought by a different tenderer. Thus the court wasted little time in rejecting the Department's application. However, the Judge did go on to review the merits. He specifically noted that the correct approach in principle was that expressed by Mr Justice Akenhead in the Exel case. He also noted, contrary to the other cases, that here there was a serious issue to be tried. In the other cases the judges had said that the exercising of the balance of convenience was not influenced by the strength of the claimant's case.

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

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

Ineffectiveness and time limits

Towards the end of the summer, the long-running dispute between Alstom and Eurostar over the award of a contract for a new generation of trains to be used in the Channel Tunnel came to an end. The part of the case discussed here¹¹ is interesting for two reasons. Firstly, Alstom objected to the decision and commenced proceedings in which it sought a declaration of ineffectiveness in relation to a preliminary contract. Second, it was said

⁹ *Rutledge Recruitment & Training Ltd v Department For Employment & Learning & Anor* [2011] NIQB 61

¹⁰ [2011] NIQB 59

¹¹ [2011] EWHC 1828 (Ch)



that the claim was brought out of time. This was the first time that a declaration of ineffectiveness had been sought from the courts.

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

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

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

New amendments to the Public Procurement Regulations

On 1 October 2011, the Public Contracts Regulations 2006 were further amended by the Public Procurement (Miscellaneous Amendments) Regulations 2011. One reason for this was as a result of the Uniplex decision¹². In Uniplex, the European Court had suggested that the current UK requirements to bring procurement challenges promptly were imprecise and uncertain. The result of these changes is to increase the pressure on a contractor who considers that he might want to challenge the tender process, to do so promptly, albeit as the Alstom case demonstrates, that is already something contractors must be alive to, and by promptly we mean from the date when the contractor suspects that there has been a breach, and that is not necessarily at the end of the tender process.

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

¹² *Uniplex (UK) Ltd v NHS Business Services Authority* [2010] EUECJ C-406/08



reason for doing so, subject to an absolute maximum period of three months. If the date of knowledge was before 1 October 2011, then the old time limits, namely three months from the date of knowledge, will continue to apply.

This is essentially the process which was confirmed in the case of *Sita UK Limited v Greater Manchester Waste Disposal Authority*¹³ where the court confirmed that the time period begins to run when the potential claiming party has knowledge of the basic facts which apparently clearly indicate (although they do not necessarily prove) a breach of the Regulations.

So for example, a prospective tenderer cannot argue that it should be entitled to see if it was successful in the tender process before bringing proceedings. This argument was specifically rejected in the case of *Hereward & Forster v LSC*¹⁴, a case brought in September 2010 involving tenders for contracts in immigration law. Here a challenge had been made to award criteria which included a requirement that applicant organisations employ an immigration supervisor regularly working in the office. If attendance was 100%, full marks would be achieved. This requirement had been added between the time of the original consultation and the date the tender documents were issued. The Judge agreed that the criterion indirectly discriminated on the grounds of sex in breach of section 1 of the Sex Discrimination Act 1975, as a significant proportion of part time workers who would be unable to fulfil the requirement for 100% attendance would be women. However the claim had been brought out of time, as the time at which the grounds for the challenge arose was 30 November 2009 - the date when the LSC invited tenders for immigration work and the date when the LSC set out details of the supervisor criterion.

This is a significant point for contracting authorities and tenderers alike. What if there are changes between the time of consultation and the time the tender documents are finalised? A contracting authority must think through carefully the reasons for the changes. It might also feel the need to point them out to the tenderers. For the tenderers themselves, the case is a warning not to delay bringing a claim. If you do, the right to bring that claim may well be lost. It is of course a delicate commercial balance that needs to be maintained – but a tenderer should at least be prepared to acknowledge that the potential right to make a claim later on has been lost.

This was confirmed in the case of *Mermec UK v Network Rail*¹⁵, a case falling under the Utilities Contracts Regulations 2006, as amended. Here, Network Rail Infrastructure Ltd sought tenders for the provision of what is called Plain Line Pattern Recognition (“PLPR”), which is part of a maintenance regime involving high-speed examination of rail track and fittings. Mermec submitted a tender and on 23 September 2010, were informed via email that they had been unsuccessful. The Standstill Letter sent to Mermec included their scores for each of the criteria and the scores of the successful bidders. Mermec thought that there were alleged irregularities in the scoring of their bid when compared with other bidders and that the Standstill Letter issued to them failed to comply with the terms of the Utilities Contract Regulations.

Mermec wrote to Network Rail on 30 September expressing their dissatisfaction with the outcome, and requested a meeting to discuss the scoring system used. There was a meeting on 14 October 2010. The Judgement sets out a copy of some notes made by a Mr Tracy at this meeting. The minutes are interesting for a number of reasons, not least in revealing one of the most difficult commercial dilemmas for tenders in these circumstances:

¹³ [2010] EWHC 680 (Ch)

¹⁴ [2010] EWHC 3370 (Admin)

¹⁵ [2011] EWHC 1847



"...NR insisted that our Price was very high as compared to competition. Our final evaluation through scoring analysis and NR intelligence indicates that for the whole life costs of the pilot project we were about £250,000 more expensive than Omnicom and for the national rollout double Omnicom-£4m higher.

We reviewed the scoring numbers with NR and made many comments as laid out in our notes document...We were ably supported by Mr Shaun Whitlock...both at the meeting and during preparation. It was fairly obvious that NR made significant efforts to "arrange" the technical scoring so that we could not win the bid. We stress the fact that the [Mermec] bid was only for bogey mount and not body mount as Omnicom proposed. We were criticised for not supplying a detailed quote for body mounting. They considered it an omission on our part. We stressed that they [had] not replied to our specific bogey/body mounting questions prior to our submission of the BAFO. They also made several comments regarding the inferior quality of our bid as compared to Omnicom.

It was clear that NR had no intention of changing their decision and felt very comfortable in their position. After 90 minutes of meeting we considered no further progress could be made. We did however request the detailed scoring matrix as per the scoring scheme communicated with the ITT. They will review with their management to determine if they will supply-Systech to follow up.

Our legal position will be supplied by Systech-my view is that any further legal action will jeopardise our long-term position with regard to being able to supply NR with any products..."

On 22 December, just within the (at the time) three month period, a claim form was issued on behalf of Mermec but it was not served on Network Rail until 30 December.

Mr Justice Akenhead held that the basic facts supporting the complaint were and must have been clear in effect on the day on which the email of 23 September was received, that is the same day. The right to sue or make a claim arose on that day. At the meeting on 14 October there was nothing to suggest that this provided any information the bare bones of which could not be established from the letter of 23 September 2010.

The judgment ends with a brisk dismissal of a suggestion that the bidding process was rigged. The Judge says:

"In football supporter terms, it is no more than a cry of "we was robbed""

If a formal claim is to be made, the new regulations make it clear that proceedings will commence, and the time clock will stop ticking, on the issue of the claim form rather than the date of service on the defendant. The claim form must be served on the contracting authority within seven days after the date of issue. The amendments also make it clear that the automatic suspension will be triggered when that authority becomes aware that a claim form has been issued.

Indeed, the test to be applied following the Sita case has recently been made more stringent with the adoption of a constructive knowledge test (and not actual knowledge) by the court in the case of *Matrix-SCM Ltd v London Borough of Newham*¹⁶. The ITT was issued on 18 March 2010. The evaluation of the pricing and savings element of the bid document made up 30% of the marks and the ITT included details of how that 30% would be evaluated including by reference to a table with some worked examples.

¹⁶ [2011] EWHC 2414 (CH)



On 30 September 2010, Matrix found out that it had been unsuccessful. Matrix made a formal challenge on 26 October 2010. Matrix's challenge was based on what they said was Newham's failure to apply the pricing element. Matrix said that the way in which the pricing and savings elements was to have been calculated was unclear from the ITT and that this was a breach of the obligation to act transparently. Newham said that the claim was statute barred and should have been brought within three months of the ITT being issued. Matrix by way of response said that the breach had not become apparent until the decision to award the Contract was made and Matrix was informed of how the pricing calculations had been done, which was different from that shown in the tables. The court agreed with Newham.

The approach that Newham had taken when it came to evaluating the pricing and savings elements, had always been clear from the ITT. The table containing the hypothetical scoring calculations was an integral part of the evaluation model, which provided clear and straightforward examples. Further than this, if there had been any inconsistency between the text and the table, this would have been apparent from the face of the ITT.

The Judge said that:

"a claimant will have constructive knowledge if, upon reasonable enquiries, it should have discovered the alleged infringement".

Thus it was a question of what Matrix ought to have known, not what it actually did know. In *Sita* the judge had referred to:

"knowledge of the facts which apparently clearly indicate, though need not absolutely prove, an infringement."

This approach was tempered slightly by the Judge who also said that:

"the Court should be cautious not to impose too onerous a standard on tenderers who do not have actual knowledge of an infringement, and equally, should not require a claimant tenderer to take steps that would be regarded as unreasonable to discover the infringement."

However, this case reinforces the importance of a Contractor making a claim promptly and in *Matrix* the court referred to the "strong policy interest in challenges to decisions being made rapidly". You cannot wait and see what happens during the tender process. If you are unsure about something ask for clarification.

Notwithstanding that a cautious approach should be taken, this case clearly highlights the importance of carefully reading the ITT in its entirety and raising clarifications at the time if there are any areas of confusion or inconsistency.

Finally, the Regulations have also been amended to reflect the new criminal offences introduced by the Bribery Act 2010, which came into effect on 1 July 2011. Therefore a contracting authority must still automatically exclude any bidder which has a conviction for bribery. Where there is some room for manoeuvre is in relation to convictions for failing to have adequate procedures in place to prevent bribery or corruption. In March of this year, Kenneth Clarke, the Lord Chancellor and Secretary of State for Justice, said this:

"The Government have also decided that a conviction of a commercial organisation under section 7 of the Act in respect of a failure to prevent bribery will attract



discretionary rather than mandatory exclusion from public procurement under the UK's implementation of the EU Procurement Directive (Directive 2004/18). The relevant regulations will be amended to reflect this.¹⁷

However, there appears to be very little evidence that anything further has happened since.

Abnormally low offers

In the current economic climate, with budgets significantly reduced, councils and other contracting authorities are coming under more and more pressure to reduce costs. Procurement and competitive tendering is an obvious route to making economic savings. However in times of recession, tenderers can sometimes be moved to put in a bid which might be considered to be low, even abnormally low. What should a contracting authority do in these circumstances? There are, of course, two considerations:

- (i) what if the bid is so low that ultimately it could lead to higher costs and/or performance issues over the duration of the contract; and
- (ii) what is the position of the other parties to the tender process? Can they challenge the tender process if the contract is awarded to a tenderer who is thought to have submitted an abnormally low price?

To recap, contracting authorities can award a contract on the basis of either:

- (i) Lowest price (which not permitted for competitive dialogue and is not suitable for negotiated procedure).
- (ii) The most economically advantageous offer (taking into account criteria linked to the subject matter of the contract, such as price, quality, technical merit, cost-effectiveness, delivery date and aesthetic and functional characteristics).

Potential for disputes with contracting authorities relating to abnormally low offers usually arises where a contract has been awarded based on the most economically advantageous offer.

The Regulations do not define what constitutes an “abnormally low” offer, nor is there much helpful guidance to date on the point from the ECJ or the courts. Possible things to look out for included:

- (i) Significant variations from the other bids;
- (ii) A bid which comes in, in whole or in part, below what the contracting authority was expecting based on its own market knowledge and costings;
- (iii) The assumption of greater risk than had been anticipated.

The risks to the contracting authority include:

- (i) Non-performance;
- (ii) Missing out on a better overall tender package;
- (iii) Greater overall costs;

¹⁷ <http://services.parliament.uk/hansard/Commons/bydate/20110330/writtenministerialstatements/part009.html>



- (iv) Post tender variations;
- (v) Additional management costs;
- (vi) The costs of retendering;
- (vii) Legal costs of a procurement challenge

Under Regulation 30(6), if an offer for a public contract is abnormally low, the contracting authority can reject it, but only after it has:

- (i) requested in writing from the bidder an explanation of the offer or part of the offer which it considers to be abnormally low (Reg 30(6)(a));
- (ii) taken account of the evidence provided in response to the request (Reg 30(6)(b));
- (iii) subsequently verified the offer or parts of the offer being abnormally low with the bidder (Reg 30(6)(c)).

Regulation 30(7) sets out the types of information that may be requested under Reg 30(6)(a). This could include:

- (i) the economics of the method of construction, manufacturing process or services provided (Reg 30(7)(a));
- (ii) technical solutions suggested by the bidder, or exceptionally favourable conditions available to the bidder relating to execution of the works, supply of goods or provision of services (Reg 30(7)(b));
- (iii) originality of the works, goods or services to be provided by the bidder (Reg 30(7)(c));
- (iv) compliance with relevant local employment/working conditions (Reg 30(7)(d));
- (v) the possibility of the bidder obtaining State aid (Reg 30(7)(e)).

There has been some debate over whether the difference in wording between the Regulations and Article 55 of Directive 2004/18 imposes different obligations on a contracting authority¹⁸. The wording of Article 55 is as follows:

"If, for a given contract, tenders appear to be abnormally low in relation to the goods, works or services, the contracting authority shall, before it may reject those tenders, request in writing details of the constituent elements of the tender which it considers relevant."

Article 55 provides that contracting authority must do certain things (request details from the tenderer) before rejecting an offer that appears to be abnormally low, whereas Regulation 30(6) states that the contracting authority may reject an offer that is abnormally low but only if it has done certain things. The issue has cropped up in two recent cases in which judges seem to have come out with diverging opinions as to whether a contracting authority is under a general duty to investigate tenders that it suspects are abnormally low.

In *Morrison Facilities Services Limited v Norwich City Council*¹⁹ Arnold J held that it was seriously arguable that when a contracting authority suspects there has been an abnormally low tender, it comes under a duty to investigate that tender, and that this is a duty owed to the

¹⁸ See *Morrison Facilities Services Limited v Norwich City Council* [2010] EWHC 487 (Ch) and *Varney v Hertfordshire County Council* [2010] EWHC 1404 (QB).

¹⁹ [2010] EWHC 487 (Ch)



competing tenderers. It was also well arguable on the facts both that the council did have such a suspicion here, and that its investigations had been insufficient.

Morrison provided an analysis of the winning bidder's tender and showed it to be so low in value that it would seriously risk non-performance of the contract and had argued that the tender submitted by the winning bidder, which was £5.5 million less than the second lowest bid, would be insufficient to cover unavoidable costs as well as the necessary capital programme in executing the contract over the five-year period.

In coming to that conclusion, the judge relied upon the use of the word "shall" in article 55 of the Directive, and more particularly upon passages in the decision of the Court of First Instance in *Renco SpA v Council of the European Union*²⁰.

However, this was not a final decision on the point – merely a decision that it was seriously arguable for interim relief purposes. The case subsequently settled without going to trial.

The case is also interesting for two further reasons. First, it is an example of the court actually granting an injunction in favour of the aggrieved tenderer and second, the Judge found that an award of damages would be an inadequate remedy for Morrison. The main reason for this was that had there been improved clarity in relation to the award criteria, the final bids would have been framed differently. This meant that it would be difficult to establish any resultant "loss of chance."

A second case followed shortly after *Morrison* where the argument was raised at trial in *Varney v Hertfordshire County Council*²¹. Varney was one of the unsuccessful tenderers for the contracts for the operation of the 18 Household Waste Recycling Centres in Hertfordshire for the five year period from 2008 to 2013. Varney was the incumbent operator at three sites, for the period 2003 to 2008. It tendered for the contracts to operate all but one of the eighteen sites, but was awarded none.

Flaux J held that there was no substantive difference between the provisions of the Directive and the Regulations – both provide that a contracting authority cannot reject an offer that is abnormally low unless it has investigated certain aspects of that offer. In other words, the relevant provisions operated purely so as to provide procedural protection for a tenderer whose bid might be rejected as being abnormally low, and created no duty in favour of other tenderers.

Furthermore, in this case the unsuccessful tenderer, Varney, had argued that the council was under a general duty to investigate tenders that are abnormally low generally. Flaux J rejected this argument and stated that there was nothing in the provisions of either the Directive or the Regulations that supported such a contention – the council was under no duty to investigate suspect tenders where it had no intention of rejecting those tenders on that basis. He went on to clarify that, in any event, such a duty could only arise where the council either knows or suspects that the tender in question is abnormally low. The Regulations only require a contracting authority to investigate a tender which appears to it to be abnormally low and which it proposes to reject for that reason.

In reaching that conclusion, the Judge referred to the in *Renco SpA v Council of the European Union*²², where the Court stated:

"75 The Court finds that the applicant cannot criticise the Council for checking many of the prices quoted in its tender. It is apparent from the wording of Article 30(4) of Directive 93/37 [the predecessor of the current Directive] that the Council is under a duty, first, to

²⁰ Case T-4/01, [2003] ECR II-171

²¹ [2010] EWHC 1404 (QB)

²² [2003] ECR II-171 – a decision of the European Court of First Instance (now the General Court)



identify suspect tenders, secondly to allow the undertakings concerned to demonstrate their genuineness by asking them to provide the details which it considers appropriate, thirdly to assess the merits of the explanations provided by the persons concerned, and, fourthly, to take a decision as to whether to admit or reject those tenders ... The Court notes, for example, that the Council, in its defence, stated that it had questioned the applicant about very many of the abnormally low prices, namely the price of 319 items in the summary out of a total of 1 020. It also asked the applicant for clarification regarding a series of very blatant anomalies and particularly about the price of the doors, which are the same for single doors, double doors or glass doors. The applicant has not provided adequate explanations for those anomalies either in its reply or at the hearing.

76 In that regard, the Court observes that, although Article 30(4) of Directive 93/37 does not require the Council to check each price quoted in each tender, it must examine the reliability and seriousness of the tenders which it considers to be generally suspect, which necessarily means that it must ask, if appropriate, for details of the individual prices which seem suspect to it, a fortiori when there are many of them. Furthermore, the fact that the applicant's tender was considered to conform to the contract documents did not relieve the Council of its obligation, under the same article, to check the prices of a tender if doubts arose as to their reliability during the examination of the tenders and after the initial assessment of their conformity."

Flaux J agreed that this was not a case where the European Court was saying that the relevant authority owed a duty to investigate "abnormally low" tenders generally, as opposed to where the authority was considering rejecting the tender. Here, the authority was proposing to reject the tenders in question. The Judge therefore concluded that:

"It follows that, on the correct interpretation of both the Directive and the Regulation (save in the case of Fourways where the Council did consider the tender abnormally low and was contemplating rejecting the tender at least in part if not totally), the Council was not under a duty generally to investigate so-called "suspect" tenders in circumstances where the Council had no intention of rejecting those tenders...

Furthermore, I consider that there is another fundamental obstacle to Varney's case that the Council was in breach of duty in failing to investigate the other tenders. Although Regulation 30(6) talks in the abstract of an offer which is abnormally low, the Directive refers to tenders which "appear to be abnormally low" which only makes sense as a reference to what "appears" to the relevant authority. In the circumstances, it seems to me that the duty for which Varney contends could only arise where the Council either knows or suspects that the tender in question is abnormally low. Leaving Fourways out of account, it is quite clear on the evidence of Mr Shaw and Mr King (which I accept) that neither of them actually knew or suspected that the other tenders were abnormally low."

However, it was open to the aggrieved tenderer to complain that the contracting authority had made a manifest error in deciding whether the tender was abnormally low and therefore deciding not to investigate. The Judge said such a duty can only arise in the case where the relevant authority actually knows or suspects that a tender is abnormally low. To argue that a contracting authority ought to have known or suspected, but did not know or suspect, is not sufficient to impose the duty. Otherwise, a contracting authority would have to investigate all tenders in detail to satisfy itself of the economic viability of each tender. This was, the judge said, an unrealistic and onerous burden.



Given that the decision in the *Morrison* case was only issued followed an interim application for interim relief purposes, it would seem that the decision of Flaux J is the one to be followed. Certainly, the prudent contracting authority, where it has concerns that any bid is abnormally low, should fully investigate whether that bid is sustainable. But that is a matter of commercial common sense as much as it is one of good procurement law practice. An abnormally low tender which may be rejected is one that is priced at such a level that the authority considers itself, in all the circumstances, unable to rely upon the contract being properly performed. That conclusion might follow even if the contract was not actually loss-making, if it did not generate a normal level of profit, but it would not necessarily follow even if losses would be sustained.

So what can the Contracting Authority do? Well it is interesting to see what the Council in *Varney* did. There was another bid which was a suspected abnormally low bid. They established that the tenders other than that of the suspect one were not considered abnormally low, because they were consistent with one another and did not deviate from the mean average of all tenders received for the sites for which they had tendered. This is the “anomaly threshold” test.

An authority has a discretion as to what test it uses for identifying what may be an abnormally low tender and that it is permissible to use a comparison with the average of the tenders submitted for the contract as a threshold for determining whether a tender is abnormally low²³.

It was argued that the Council was under a duty to investigate the tender price against the likely cost of performing the relevant services. The Judge said that there was nothing in the existing case law to suggest that an authority is under a duty to apply a number of criteria or “thresholds” or that other unsuccessful tenderers can come along later and say that the authority should have applied another threshold. As it happened, the Council had taken this point up. To take site attendance costs, they were expecting to pay more by way of site attendance charges under the new contracts. The abnormally low contract stood out because its proposed site attendance charges were all less than was being charged under the existing contract.

Finally, what happened in the *Varney* case was that three of the sites were awarded to the tenderer who had the abnormally low overall tender. Whilst it was felt too much of a risk to offer more than the three sites the Council felt that it was a risk worth taking to offer them the sites they already operated. The court agreed. The evidence showed that there was no evidence that the tenders for the three sites had been unsustainable and that overall the contracts were making a small profit.

Criteria

The *Varney* case reached the Court of Appeal²⁴ in June of this year. There were three grounds of appeal, namely that:

- (i) The Council had failed to disclose the criteria, sub-criteria and weightings which would be applied when determining which of the tenders was the most economically advantageous;
- (ii) The Council applied criteria, sub-criteria and weightings which were inconsistent with the information which it had disclosed; and

²³ See *Impresa Lombardini v ANAS* [2001] ECR I-9233

²⁴ [2011] EWCA Civ 708



- (iii) The Judge wrongly held that Varney had failed to bring its claim within the time limit imposed by regulation 47(7).

Stanley Burton LJ noted that Varney's "basic grievance" was that it had been led to believe by the ITT that "staffing levels proposed by tenderers would play a very significant part in the evaluation of tenders". In consequence, Varney's tender "proposed high levels of good quality staff for each site (with a consequent increase in price) yet, in the event, staffing levels were given very little significance by the Council when it came to marking tenders." As a result, Varney had little chance of winning any tender, since it overpriced its bid.

Varney claimed that Regulation 30 required a contracting authority to disclose to tenderers in advance of tenders being submitted the criteria which will be used for evaluating tenders and the weightings to be accorded to those criteria. The obligation of transparency in Regulation 4(3) requires a contracting authority to disclose to tenderers in advance of tenders being submitted the sub-criteria which would be used for evaluating tenders and the weightings to be accorded to those sub-criteria. Disclosure of criteria and sub-criteria does not consist merely of stating relevant matters in the ITT. Criteria and sub-criteria must actually be identified as such. Finally, a contracting authority must actually apply the criteria, sub-criteria and weightings which it has disclosed.

The Council said that the Return Schedules (i.e. which showed the staffing levels) did not constitute award criteria but rather sub-criteria. The award criteria "were 'customer satisfaction' and 'price' and the Return Schedules were not separate principles or standards or tests but no more than sub-sets of those principles or standards or tests. Further, it was entitled not to identify sub-criteria and disclose their weightings provided that the conditions set out the judgment of the European Court of Justice in *ATI EAC v ACTV Venezia*²⁵ were satisfied, which they were. In particular, the disclosure of sub-criteria and their weightings could have made no difference to the preparation of tenders. Finally, the defects in the ITT alleged by Varney were evident when it was published and it could then have brought proceedings against the Council, well before the date when it did in fact bring proceedings.

Stanley Burton LJ noted that Varney relied on the case *Letting International v Newham LBC*²⁶, in which Silber J applied the definition of "criterion" in the Shorter Oxford English Dictionary as meaning "principle, standard, or test by which a thing is judged, assessed or identified". That would, he said:

"mean that regulation 30 requires every standard by which a bid is to be evaluated, no matter how minor or subsidiary, to be disclosed as such with its proposed weighting. This would seem to me to be impracticable, and I do not think it is what Community law requires."

The Court of Appeal noted that transparency is achieved under the Regulations in two ways: first, in requiring the criteria for the awarding of a contract to be identified to tenderers, with the weighting attached to each criterion, so that those matters are known and applied equally to all tenderers; and secondly, in requiring a public authority to provide the information specified in regulation 32 to the tenderers as soon as possible after making the decision as to the successful tenderer or tenderers. They agreed that the crucial case was the *Venezia* one, which concerned a public contract for passenger transport in three lots. The European Court said that:

²⁵ Case C-331/04, [2005] ECR I-10109

²⁶ [2008] EWHC 1583 (QB); [2008] LGR 908



“Accordingly, the answer to the questions referred must be that Article 36 of Directive 92/50 and Article 34 of Directive 93/38 must be interpreted as meaning that Community law does not preclude a jury from attaching specific weight to the subheadings of an award criterion which are defined in advance, by dividing among those headings the points awarded for that criterion by the contracting authority when the contract documents or the contract notice were prepared, provided that that decision:

- *does not alter the criteria for the award of the contract set out in the contract documents or the contract notice;*
- *does not contain elements which, if they had been known at the time the tenders were prepared, could have affected that preparation;*
- *was not adopted on the basis of matters likely to give rise to discrimination against one of the tenderers.”*

Flaux J had found as a fact that each of these three conditions was satisfied. Therefore the key question was whether the Return Schedules constituted sub-criteria (or, to use the language of ATI, “subheadings of an award criterion”), rather than criteria.

The application of the principles laid down in ATI was reaffirmed in relation to a regulation with materially the same provisions as Directive 2004/18 in *Evropaiki Dynamiki – Proigmena Systemata Tilepikoinonion Pliroforikis kai Tilematikis AE v European Maritime Safety Agency (EMSA)*²⁷, where the Court said this:

“148 In accordance with settled case-law, it is, none the less, possible for a contracting authority, after expiry of the period for submission of tenders, to determine weighting coefficients for sub-criteria of award criteria previously established, on three conditions, namely that that ex post determination, firstly, does not alter the criteria for the award of the contract set out in the contract documents or the contract notice; secondly, does not contain elements which, if they had been known at the time the tenders were prepared, could have affected that preparation; and, thirdly, was not adopted on the basis of matters likely to give rise to discrimination against one of the tenderers (see, to that effect and by analogy, ATI EAC e Viaggi di Maio and Others, paragraph 146 above, paragraph 32, and Lianakis and Others, paragraph 131 above, paragraphs 42 and 43).

This all led the Court of Appeal to conclude that:

“It follows from these authorities that the definition of criterion adopted and applied by Silber J in Letting International is too general and too wide. It is necessary to decide whether the standards applied by the contracting authority were criteria or sub-criteria; and if the latter, whether they were defined in advance, if so whether the requirements of ATI are satisfied.”

So did the Return Schedules relate to sub-criteria or criteria? Here, the criteria for the award of the contract were identified by the Council in the contract notice as price (65%) and customer satisfaction (35%). The Court of Appeal felt that to require such matters as the Return Schedules and their weightings to be identified at such an early stage would be a significant imposition on contracting authorities. The matters referred to in the Return Schedules were relevant to the criteria identified in the contract notice. They were identified in advance, in the ITT and Varney knew that the information sought by the Schedules was to be used in awarding the contracts.



The Return Schedules were not separate award criteria. The Return Schedules 1 to 15 dealt with different aspects of customer satisfaction, one of the stated award criteria and therefore were sub-criteria or a sub-set of that award criterion. As such, there was no absolute requirement that their weightings be specified in the ITT. There was no breach of the principles of equality and transparency. Every tenderer was given the same information. It was obvious to Varney that the information required by the Return Schedules would be used to decide on the award of the contracts. Further, Varney's tender was unaffected by the fact that the Return Schedules were not identified as criteria or sub-criteria and they did not know the weightings to be attributed to them. Specifically in relation to staffing levels, which was the subject of the major complaint, Varney had accepted that the staffing levels put in its tender were unaffected by how the tenders were marked. The Court of Appeal agreed with the trial Judge who had said that:

"... in reality it was perfectly obvious that the award criteria were going to be marked by reference to the information provided in response to the Return Schedules and if any of the tenderers had wanted clarification of that or of what marks would be attached to each Return Schedule, they would surely have asked. Accordingly I am satisfied that this is a case where, within the ATI principle, there was no requirement to disclose in advance the sub-criteria or the weighting attached to each of them, because such disclosure could not have affected the preparation of any of the tenders. In the circumstances, the Council was not in breach of the obligation of transparency in that regard."

So what does this mean?

The conclusions of the *Varney* decision make it clear that contracting authorities must provide sufficient detail so that tenderers can understand what is expected of them, provided they follow the *Venezia* principles. This seems to be a more commercial, pragmatic and common-sense approach than suggested by previous case law. Certainly the *Varney* case seems to give contracting authorities a potentially broader line of defence than might have been thought previously.

Does this mean that there should be any change to what has become the accepted best practise of adopting the cautious approach of disclosing sub-criteria, weightings, model answers and methodology to be applied to tenders?

Probably not: a prudent contracting authority must continue to look to manage and reduce risk especially when we are in an economic climate which had contributed to the increase in procurement challenges. For example in *Varney* "Customer Satisfaction" was held to be award criteria and the more distinct topics beneath it were sub-criteria. What if there is a dispute about where the first layer of criteria sits? How relevant do sub-criteria need to be? What if the "award" criteria is found to be too vague? So the prudent contracting authority should continue to take all enquiries seriously and reply to them.

From a tenderer's perspective, the situation will remain that some will continue to make enquiries for tactical reasons to increase the scope of challenge later. Of course, if they do not, it is possible that the tenderer will miss the chance of complaining later about the information in the ITT.

Ps – Costs

Earlier in the year, the court had taken a similar pragmatic approach to that in *Varney* in the case of *Mears Ltd v Leeds City Council*²⁸. Mears had said that the Model Answers used by

²⁸ [2011] EWHC 1031 (TCC)



Leeds in carrying out the evaluation of the tenders included matters which should have been disclosed to tenderers. Mr Justice Ramsey held that:

“(1) The contracting authority must disclose to tenderers those award criteria or sub-criteria which it intends to apply to the award.

(2) The contracting authority is obliged to disclose to tenderers any rules for the relative weighting of the selection criteria which it intends to use.

(3) The contracting authority could attach specific undisclosed weight to sub-criteria by dividing among those sub-criteria the points awarded to a particular criterion if that weighting:

(a) does not alter the criteria for the award of the contract set out in the contract documents or the contract notice;

(b) does not contain elements which, if they had been known at the time the tenders were prepared, could have affected that preparation;

(c) was not adopted on the basis of matters likely to give rise to discrimination against one of the tenderers.

(4) There is a distinction to be drawn between award criteria which are aimed at identifying the tender which is economically the most advantageous and criteria which are linked to the evaluation of the tenderers’ ability to perform the contract in question.

(5) There is a level of assessment below the criteria, sub-criteria and weightings which the contracting authority may use in evaluating the award criteria which it does not have to disclose for a number of reasons. First, because it does not, on a reasonable view, introduce different or new criteria, sub-criteria or weightings. This aspect must be considered in the light of what would be reasonably foreseeable to a reasonably well-informed and normally diligent tenderer. Secondly, because it could not have affected the tenders. Thirdly, because it is not a matter aimed at identifying the most economically advantageous tender but instead is linked to the evaluation of the tenderers’ ability to perform the contract in question....”

The Judge considered the status of the Model Answers. He had no doubt that the intention was that the Model Answers were provided to the Evaluation Panel so that they were aware of particular aspects which might be expected to be in the answers. If the Model Answers introduced relevant new criteria, sub-criteria or weightings they should, in principle, have been disclosed. He then evaluated the complaints made by Mears and found that two Model Answers introduced criteria, sub-criteria or weightings which Leeds should have disclosed. The other Model Answers covered matters which would have been reasonably foreseeable and which a reasonably well-informed and diligent tenderer such as Mears might have been expected to deal with under this question in response to the relevant question. They dealt with aspects which were covered by the tender instructions and not new criteria and were within the margin of appreciation or discretion where the court will only disturb the contracting authority’s decision if the authority has committed a manifest or clear error. The Judge therefore concluded that:

“Where, as is now common, the contracting authority provides those people who evaluate tenders with information such as model answers then, as shown in this case, there is generally no reason to disclose those. I accept that to have to do so would raise



practical difficulties in being able to assess tenders when the tenderers had seen those model answers. However, the information such as model answers needs to be scrutinised to ensure that undisclosed criteria, sub-criteria and weightings are not introduced in this way."

This means that contracting authorities need to make it clear in their instructions to evaluators where they only intend their model answers to form non-prescriptive guidance for evaluators in identifying suggested qualities to enable a consistent approach to scoring. The model answers too need to be predictable from the question presented to the bidders. This would provide a defence to an argument that, as here in the case of some of the answers, the model answers were in fact applied as a comparative standard and so were part of the formal evaluation machinery.

Recently, Mr Justice Ramsey had to decide the question of costs²⁹. Both parties claimed to have been successful. Mears obtained judgment for damages to be assessed, albeit only on part of its claims, but did so in the face of a strongly asserted defence by Leeds. Leeds said they were the overwhelmingly successful party because they strike out and/or defeated almost all of Mears' claims and Mears did not succeed in obtaining an order setting aside the award of the relevant contract under the Procurement.

Mears sought an order for costs in their favour, alternatively an order for no lower than 80% to 90% of their costs and accordingly sought a payment on account of costs of £70,000, their costs inclusive of VAT being some £145,000. Leeds contended that Mears should pay 90% of their costs up to 22 December 2010 and 80% of their costs after 23 December 2010, save that Mears should pay all the costs of and occasioned by the amendment to the Particulars of Claim. Leeds' costs were some £217,000 excluding VAT.

The Judge considered that the appropriate starting point should be based on the fact that, overall, Mears were the successful party in obtaining a judgment against Leeds for damages to be assessed. Whilst it might be said that Leeds was successful in their defences to a number of claims and to the relief claimed, they were not successful in defending the claim on which Mears succeeded. That was the starting point. The Judge did have to take into consideration the extent to which Leeds were successful which meant that this was a case where Mears have failed on a substantial part of the case and a part of the case on which clearly both parties have spent significant time and costs.

Leeds also claimed that it was unreasonable for Mears to delay issuing proceedings and to delay making an application for an interim injunction when it knew that the procurement was continuing towards completion. For example, in July 2010, Mears sought an undertaking that no contract award would be made by Leeds yet they delayed until 12 October 2010 before bringing proceedings, with Particulars of Claim being served on 1 November 2010 and the application for interim relief being issued on 3 November 2010. The Judge did not consider that the timing gives rise to conduct which should affect the order for costs. There was correspondence between the parties in which Mears was seeking and Leeds were providing further information relevant to the failure of Mears' tender. There was a period from mid September until mid October 2010 when there was little apparent progress but the Judge did not consider that Mears could be fairly criticised for delay whilst they were considering the next step and preparing proceedings or that there was any conduct in terms of delay during this period which merits being taken into account in considering the appropriate costs order.

²⁹ [2011] EWHC 2694 (TCC)



Ultimately this was a case where, whilst Mears could be properly characterised as, overall, being the successful party, a proportionate costs order was appropriate to reflect the extent to which a successful party has not been selective in the points they have taken and should not recover all of their costs. Significant time and cost was spent in dealing with claims on which Mears did not succeed and it was neither just, fair nor reasonable that Mears should recover the costs of dealing with those claims, or that Leeds should bear those costs. The Judge concluded that Mears were entitled to 35% of their costs.

Conclusions – Looking to the future

The courts, particularly the TCC, are well set up to deal with these cases promptly. The cases suggest that the courts are increasingly taking a pragmatic and commercial approach to procurement claims. The number of cases where the contracting authority has succeeded in overturning the initial injunction obtained under the Remedies Directive is a testament to this. It is also clear that time limits are being tightened, claims must be made when the economic operator first knew, or ought to have known, that grounds for starting proceedings had arisen. You cannot wait and see if you win the bid or not.

And yet, change is in the air. Heide Ruehle MEP, spokesperson for the Committee on Internal Market and Consumer Protection, seems to agree. She has said that the procedures are too complex and too bureaucratic. The procurement rules need revision to remove legal uncertainties and the costs of legal challenges. Her solutions³⁰ include:

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

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

“underpin a balanced policy which fosters demand for environmentally sustainable, socially responsible and innovative goods, services and works. This revision should also result in simpler and more flexible procurement procedures for contracting authorities and provide easier access for companies, especially SMEs³¹.”

Indeed, the beginnings of these proposals can be found in the European Parliament resolution of 25 October 2011³² on modernisation of public procurement - (2011/2048(INI)).

The resolution preamble begins as follows:

“A. whereas a properly functioning EU public procurement market is a key driver of growth and a cornerstone of the single market, and is, furthermore, fundamental to stimulating competition and innovation and to addressing fast-emerging environmental and social public-policy challenges, as well as quality-of-work issues including adequate pay, equality, social cohesion and inclusion, while achieving optimal value for citizens, businesses and taxpayers;

B. whereas European public procurement rules have contributed substantially to increased transparency and equal treatment, to combating corruption and to professionalising the procurement process;

³⁰ eg Magazine June/July 2011

³¹ Evaluation Report: Impact and Effectiveness of EU Public Procurement Legislation

³² For details of the full resolution click here: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20111025+SI T+DOC+WORD+V0//EN&language=EN>



Whereas the current economic climate makes it more important than ever to ensure optimal efficiency in public spending, whilst limiting costs borne by businesses as much as possible, and a better functioning procurement market would help achieve these two objectives;

The resolution then sets out the following six key tasks for the new legislation:

- (i) First task: improving legal clarity;
- (ii) Second task: developing the full potential of public procurement - value for money;
- (iii) Third task: simplifying the rules and allowing more flexible procedures;
- (iv) Fourth task: improving access for SMEs;
- (v) Fifth task: ensuring sound procedures and avoiding unfair advantages; and
- (vi) Sixth task: expanding the use of e-procurement.

The comments in relation to task two are of particular interest. The resolution confirms that in order to develop the full potential of public procurement, the criterion of lowest price should no longer be the determining one for the award of contracts, and should be replaced by the criterion of most economically advantageous tender, in terms of economic, social and environmental benefits – taking into account the entire life-cycle costs of the relevant goods, services or works, as well as the question of price.

It also notes that the current provisions on subcontracting should be strengthened, as the use of several levels of subcontracting can cause problems in terms of compliance with collective agreements, working conditions and health and safety standards. The suggestion is that public authorities be informed of all details relating to the use of subcontractors before a contract is concluded. It may also be that further rules on the award of subcontracts are needed, to avoid SME subcontractors being subject to conditions worse than those applicable to the main contractor awarded the public contract. The second task also calls on the Commission to reassess the appropriate level of thresholds for supply and services contracts, and if necessary raise them, so as facilitate access to public procurement by, amongst others, not-for-profit and social-economy operators and SMEs.

The aims of the third task, namely “simplifying the rules and allowing more flexible procedures” begin by highlighting what are perceived by some as some of the difficulties with the current legislation:

“...the directives are often perceived as too detailed and that they have become increasingly technical and complex, while at the same time the legal risk of non-compliance has increased considerably for contracting authorities and suppliers alike; notes that the fear of challenge leads to a risk-averse approach, which stifles innovation and sustainable development, resulting far too often in contracting authorities opting for the cheapest price rather than the best value; asks for more space for negotiation and communication, combined with measures to assure transparency and to prevent abuse and discrimination, and urges that market consultation be explicitly allowed as a possible first step.”

The third task proposes and recommends the following:



- (i) The application of clear, transparent and flexible procedures, and allowing European businesses to compete on an equal footing throughout the Union;
- (ii) The use of clear, simple and flexible rules, reducing the level of detail and making procurement procedures simpler, less cumbersome, cheaper, more open to SMEs and more conducive to investment. The simplification of the rules on public procurement would make it possible to reduce the risk of error and to pay greater heed to the needs of small contracting authorities;
- (iii) An assessment should be made as to whether wider use of the negotiated procedure with prior EU-wide publication might be allowed so that contracting authorities and economic operators can communicate better, and supply and demand can be coordinated effectively;
- (iv) Reiterates the value of allowing alternative bids (or variants), as they are crucial to promoting and disseminating innovative solutions. Specifications referring to performance and functional requirements and the express admission of variants give tenderers the opportunity to propose innovative solutions.
- (v) Clarifications should be introduced into the regulatory framework on public procurement, particularly in relation to the contract execution phase (e.g. on the questions of 'substantial modification' of a contract in force, on changes concerning the contractor and on the termination of contracts);
- (vi) Asks that the Commission look into the possibility of allowing tenderers greater opportunity to rectify omissions in their bids;
- (vii) Contracting authorities should be able to benefit from previous experience with a tenderer on the basis of an official evaluation report;

Finally, here the resolution observes that only 1.4% of contracts are awarded to undertakings from another Member State and stresses that professionalisation and better training of those who award contracts, and of tenderers, would foster EU-wide competition and exploit more fully the advantages of an internal market for public contracts;

The fifth task's primary focus is corruption. The resolution, calls on the Commission to assess the problems associated with exceptionally low bids proposing that contracting authorities provide, in the event of abnormally low bids being received, for early and sufficient information to other bidders, in order to allow them to assess whether there is ground for initiating a review procedure.

Finally, the sixth task welcomes the proposed expansion of the use of e-procurement.

We shall see what happens in reality when Commission issues its legislative proposals for reforming the procurement rules at the end of 2011.

Jeremy Glover, Partner

Fenwick Elliott

December 2011



The art of negotiation in a difficult market¹

by David Bebb

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

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

Design responsibility

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

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

Time-bars

Construction contracts have always required the contractor to serve a variety of notices on the employer. These notices usually, but not always, relate to circumstances in which the contractor considers himself to be entitled to additional time and/or money. The JCT is no different. In clause 2.24 of the Design and Build form the contractor is supposed to give a notice of delay "*forthwith*". Similarly, his claim for loss and expense must be made as soon as it becomes apparent to him that progress is being affected.³ But then enter the time-

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

² See clause 2.11 which provides "the Contractor shall not be responsible for the contents of the Employer's Requirements or for verifying the inadequacy of any design contained in them".

But note that the contractor does still retain responsibility for ensuring that the ERs comply with all Statutory Requirements (see clause 2.15).

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

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



bar. Drafted properly, these are not difficult to spot in a set of amendments and will usually specify a precise time for service of the notice (e.g. 5 days) and state clearly the effects of non-compliance. But it never ceases to amaze me how contractors think that the law will somehow come to their rescue if they miss the date. Generally speaking, it won't.⁴ The words "*you will not be entitled to any [time/money] if you do not serve the notice within 5 days*" does exactly what it says on the tin.

Omission of work

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

How to make the process slicker

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

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

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

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

The lawyer then sets to work and 60 or so pages later produces the goods to slot into the tender. The next time the amendments see the light of day (note they will rarely be read by the employer's agent/project manager⁵) is when they land on the contractor's desk. So what now? Three options spring to mind. First, the head-in-the-sand approach: accept them and hope for the best. (It is this approach, by the way, that keeps my litigator colleagues in gainful employment). Second, the "this could really wind up my client before

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

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



we even start" approach: say you will accept them and try to wriggle out of them once you have a foot in the door such that the employer will risk a serious delay to his project if he goes elsewhere. It is this approach that ensures my contractor clients are no longer kept in gainful employment through a lack of repeat business and referrals. Here's the third (and best) approach:

Can you manage the risk?

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

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

Be proactive and take control of the negotiations

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

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

Avoid the email merry-go-round

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

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

Lawyer: "Yes."

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



Fenwick Elliott

The construction & energy law specialists

Lawyer: "You asked me to."

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

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

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

Conclusion

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

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

David Bebb, Associate
Fenwick Elliott
December 2011