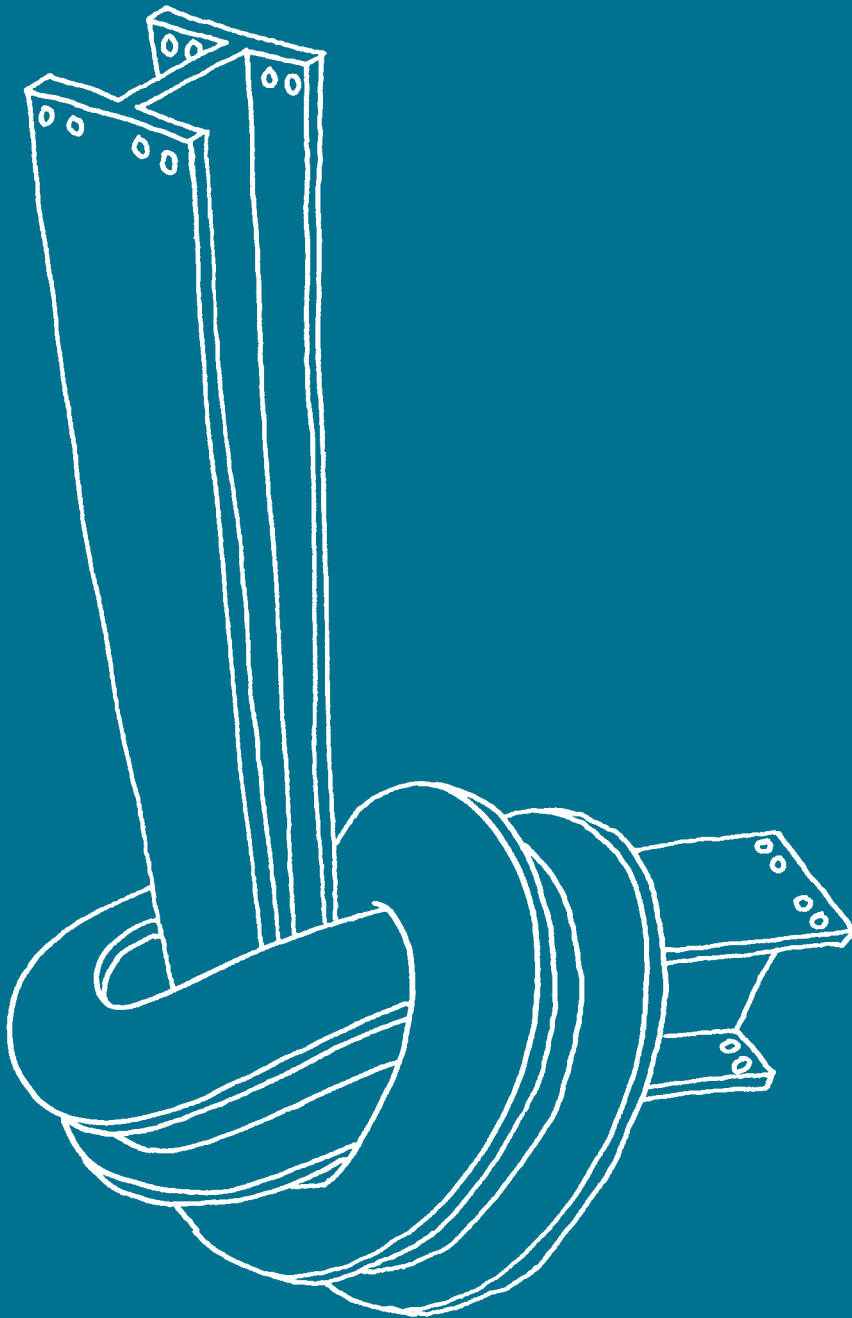
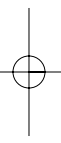


# Kennedys

Construction advice in black and white





# Construction

---

**Our large international construction team comprises 25 partners and 18 solicitors/legal assistants – we have strength and depth.**

**We work on both the contentious and non-contentious side and from concept to completion we have a proven track record for innovative, commercially-aware specialist advice on all aspects of the construction process, including procurement, contract negotiation, professional appointments, health & safety, employment, insurance and dispute resolution.**

## Contents

---

Adjudication

---

Arbitration

---

Employment

---

Health & Safety

---

Mediation

---

PFI/LIFT

---

Professional negligence

---

Settlements

---

Subrogated recoveries

---

Third party rights

---

# Adjudication – CIB v Birse – how will this affect adjudication?



**Nick Carnell**  
Partner

020 7877 8330  
n.carnell@kennedys-law.com

Construction

## The issue

**In its relatively brief lifespan adjudication has come to be the industry preferred method of resolving disputes. It has acquired a popularity far in excess of anything envisaged at the time that it was launched in 1998 under the aegis of the Housing Grants Construction and Regeneration Act.**

This has led to judicial disquiet about the use of adjudication for dealing with complex claims. However, the present view since CIB v Birse appears to be that expressions of judicial unhappiness have been silenced, at least for the time being.

This decision of HHJ Toulmin QC CMG represents the first time that a party seeking to oppose the enforcement of an adjudicator's decision will seek to run the argument that the decision was just too complex to be dealt with by adjudication.

Prior to this decision, in Balfour Beatty v London Borough of Lambeth HHJ Humphrey Lloyd had said

*'...the dispute attracts a simple description but comprises a highly complex set of facts...It may well be doubted whether adjudication was intended for such a situation.'*

A few months later in London and Amsterdam Properties v Waterman Partnership HHJ Wilcox observed that

*'...there may be some disputes particularly arising at the end of a project which are too complex to permit a fair adjudication within the time limits of the scheme.'*

However in CIB, Judge Toulmin said

*'23. In AWG v Rockingham Motor Speedway Limited ...I raised the possibility that there may be disputes which are so complex and the advantages of the procedure are weighted so heavily against the defendant that there is a conflict between the right to refer to adjudication ...and the adjudicator's duty to act impartially...I went on to suggest (erroneously as I now think) that this was a conflict which it might be impossible to resolve.'*

That marks the high water mark in the judgment. It is certainly not the case that Judge Toulmin's otherwise meticulous judgment provides any support for a conclusion that there will never be a case where the matter is so complex that adjudication is impossible.

## How it was addressed

*On the facts* (and this is important) the adjudicator – who was highly experienced and able adopted an approach which was fair to both parties. In particular

the adjudicator appears to have adopted a painstaking and even-handed approach to quantum evidence (which was enormous) involving a series of meetings with experts and the production of a series of evolving schedules.

The effect of this appears to have been that the adjudication process was extended from 42 days to about 100. The adjudicator's approach appears to have been that this was the time he required and he expected the parties to accommodate this – which they did. It is also interesting to note that the adjudicator reminded himself in his decision that he was not duty bound to reach a decision and if he felt that there was a matter on which he lacked the material to make a decision he would not do so. In the event, he felt he was able to form views on all of the matters referred to him. What we also learn from CIB v Birse is that the notion that adjudication is a quick crude process in which the adjudicator holds a finger in the air, flips a coin and plucks a decision from the ether is dead and buried.

## Thoughts going forward

What this may lead to is a process which emerges in steps; if the initial claim fails to produce the desired result; prudence suggests the taking of a time-out, and the production of a claim in a form which will satisfy an adjudicator.

The approach adopted by adjudicators to questions of causation is rapidly approaching the level of sophistication shown by the Courts. For the system to have the confidence of its users it is right that the highest standards should be employed in reaching decisions and hence adjudicators should demand the best quality evidence available within the time constraints.

Increasingly this is leading to adjudicators refusing to be hogtied by the strict time limits imposed by the Scheme and other procedural rules. Adjudicators are increasingly adopting the sensible view that if more time is needed to reach a solution to a problem more time will be taken. Again, the beneficiaries of this are the users of the process. Seldom is a decision so urgent that the 28 day period should be regarded as holy writ. However, for Referring Parties, the operation of the system means that they have one chance and one chance only in which to put their best case.

## Advice notes:

- Treat adjudication with the same care as any other judicial process.
- Be prepared to allow the adjudicator more time, if he says he needs it.
- Remember: you only have one chance to prove your case: don't waste it.

# Arbitration – Boost for London as the arbitration capital of the world

**A well-known advantage of arbitration is that it can resolve disputes quickly outside the public domain whilst in certain cases saving costs in comparison with Court proceedings. One of the reasons why arbitration tends to be quicker and cheaper than Court proceedings is due to the restrictions that exist on challenging awards. A further benefit of arbitration is that confidentiality can be preserved.**

When parties are involved in international construction projects it is not uncommon, in the event of a dispute, for the seat or place of arbitration to be in a completely different country from that of the parties involved.

Often parties involved in such projects choose London as the seat of the arbitration. This is because London is part of a legal system that recognises and supports the arbitration process. Arbitration is meant to be a 'one-stop adjudication'. It is this that many parties, including those from overseas, find attractive about arbitration in England.

The aim of the 1996 Act is substantially to reduce the intervening powers of the court, although the Arbitration Act 1996 does provide recourse to the courts in certain circumstances, such as lack of jurisdiction (s.67), serious irregularity in procedure (s.68) or errors in law (s.69). Section 69 can be excluded and many arbitration rules, such as those of the International Chamber of Commerce (ICC) choose to exclude this section. Sections 67 and 68 cannot be excluded.

The Arbitration Act strives to achieve the right balance between crucial intervention and preserving the autonomy of the arbitral process that makes London the preferred choice for arbitration. However, there are times when that delicate balance is tested.

A good example of this is the recent House of Lords decision in the Lesotho Highland Development Authority v Impregilio SpA and Others case ('Lesotho').

## The Lesotho decision

In the Lesotho case a dispute arose between the contractors (seven international construction countries) and their employer, the Lesotho Highland Development Authority. The parties had mutually agreed to London as the seat of arbitration.

An arbitral award was made in favour of the contractors. The award was made in euros and pounds and interest was awarded on a 'normal commercial basis'. The employer argued that the arbitrator had made an error by disregarding express contractual terms agreed between the parties including the applicable law within the contract. It was an express term that costs, which were the subject of the dispute, be paid in Lesotho Maloti (not European currencies) and that the interest awarded should have been the specified contract rate of interest that did not include pre-award interest, as the applicable Lesotho law did not recognise this.

The Employers could not appeal on a point of law under s.69 of the Act as this had been excluded. Instead a challenge was brought under s.68 of the Act stating that the Arbitrators had exceeded their powers.

The High Court, and subsequently the Court of Appeal, agreed with the Employer and overturned the award. The contractors appealed to the House of Lords in order to give effect to the arbitrator's decision based on their interpretation of the Arbitration Act 1996.

The House of Lords considered the issue of currency and found that at worst this was an error of law. Such an error could have been appealed if s.69 had not been excluded. However, such an error did not amount to an excess of jurisdiction under the Arbitration Act 1996 and the main purpose behind the Act was to 'reduce drastically the extent of intervention of courts in the arbitral process.'

Turning to the issue of interest, the House of Lords ruled that the power of the arbitrators to award interest is derived from s.49(3) of the Arbitration Act.

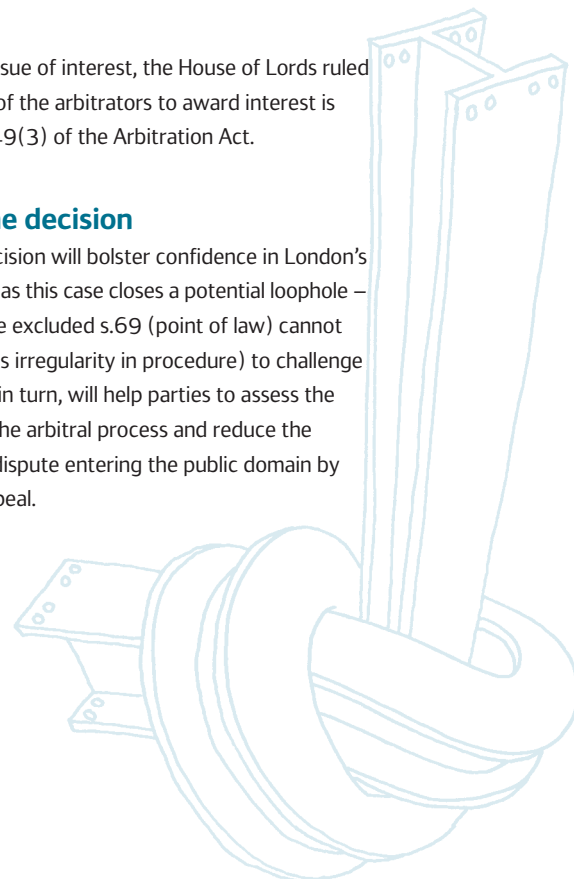
## Effect of the decision

The Lesotho decision will bolster confidence in London's arbitral process, as this case closes a potential loophole – parties that have excluded s.69 (point of law) cannot use s.68 (serious irregularity in procedure) to challenge the award. This in turn, will help parties to assess the likely length of the arbitral process and reduce the chances of the dispute entering the public domain by reason of an appeal.



**Eric Sumner**  
Partner

020 7650 5654  
e.sumner@kennedys-law.com



Construction

# Employment law for the construction industry



**Brian Gegg**

Partner

020 7614 3736  
b.gegg@kennedys-law.com

**The construction industry is by its nature labour intensive. As such the increasing duties placed on employees to comply with employment laws in relation to employees and to 'workers' are of particular concern to the industry. Two current employment issues which are of relevance to the construction world are the reform of the Construction Industry Scheme (and the closely related question of whether construction workers are truly employees or self employed), and the forthcoming planned changes to the TUPE regulations.**

## Reform of the construction industry scheme – employment status

The fact that it is sometimes difficult to assess whether a worker is truly an employee or self employed will be heightened in practice by the planned changes to the Construction Industry Scheme. Clearly the Scheme has been in operation for many years, but proposed changes which are due to operate from 6 April 2006 will highlight the difficulties in practice. In basic terms contractors will be obliged to verify by way of a statutory declaration to H M Revenue and Customs that their subcontractors are the true sub-contractors. A check will be run to see if they are registered for CIS and a decision will be taken as to whether the sub-contractor can be paid gross or net. The contractor will need to formally declare that the employment status of the sub-contractor has been considered and a penalty regime will exist for contractors who make false declarations. The key issue will be for contractors to prepare for this in advance so as to be in a position to prove that they have taken valid business decisions on the status of their workforces and sub-contractors.

## New UK TUPE regulations

In recent years the TUPE regulations have most commonly affected the construction industry in the area of outsourcing deals or changes of service providers performing maintenance or similar service contracts. Since as far back as 2001 the government has been proposing to amend the TUPE Regulations. It was initially proposed that the revised TUPE Regulations would come into effect in October 2005 once consultation had closed. However, this has now been delayed to April 2006, due to the extent of the comments made in consultation. Two proposed changes which may be of particular relevance to the construction industry are as follows, although it should be noted that the drafting currently suggested could change during the new consultation period:

### a) Service provision changes

In addition to the current general concept of a TUPE transfer existing where there is transfer of an undertaking which retains its identity, a new and separate test will apply to service provision changes.

The intention is to create a 'level playing field' in which TUPE will apply to almost all 'service provision changes' (i.e. outsourcing of services, reassignment and insourcing) where the service 'activities' are carried out by the incoming contractor. This is designed to reduce the current commercial uncertainty as to the application of TUPE in these situations. Subject to certain exceptions, service provision changes will be treated as if TUPE applies to them, if prior to the change there are employees assigned to an 'organised grouping', the principal purpose of which is to carry out the service activities on behalf of the client concerned. Therefore this focuses on the position prior to the change.

A number of interesting comments are made as to the government's detailed intentions, which will no doubt lead to necessary interpretation by employment tribunals. For example:

- 1) 'organised grouping' will mean a group essentially dedicated to meeting one client's needs (for example a maintenance contract to work just for one major client or customer). This is an area ripe for dispute.
- 2) TUPE is not designed to apply to the purchase of one-off services (or a series of one-off services) where there is no 'intention' to enter into an ongoing relationship or preferred supplier status.
- 3) A service which constitutes the mere supply of goods or a replacement of such a supplier is not intended to be caught by TUPE.
- 4) There is to be no exception to the application of TUPE where an incoming contractor proposes an 'innovative bid'. Whilst it seems that incoming contractors in service provision changes may no longer be able to avoid the application of TUPE by saying that they are carrying out activities in a different way, nor will they be able to try to avoid TUPE by refusing to take on transferring staff.

### b) Employee information

TUPE currently contains no compulsion to outgoing employees to provide information about transferring staff and liabilities to an incoming employer (which is especially relevant when employees are transferring from an existing contractor to an incoming contractor after a retender).

The proposal is that the outgoing employer must provide the incoming employer with 'employee liability information', with a fine of up to £75,000 payable for failure to do so.

The information will need to be in writing, and can be provided via a third party and in instalments, but must include;

- 1) The identity of any employee.
- 2) Details of rights and obligations to transfer for each employee which are known or ought to be known at the time of the transfer.
- 3) Notification of any change to the information.

# Health & Safety – Investigations and prosecutions

**A company and/or individual employer can be investigated and prosecuted for breaches of health and safety regulations and for breaches of the general duties imposed upon them within the Health and Safety at Work Etc. Act 1974 [HSWA].**

Senior individuals can also be prosecuted in a personal capacity where a corporate body commits a breach and that was as a result of the individual's 'consent, connivance or neglect'.

The Health and Safety Executive (HSE) usually undertake the investigation and prosecution of these offences. In fatal cases the HSE will usually work alongside the police under the terms of the 'Work Related Deaths Protocol' in examining whether this is as a result of gross negligence that would justify a manslaughter prosecution.

## The impact of enforcement action

Enforcement action can have a substantial effect on both a corporate body and individuals within the organisation, whether that action is the issuing of improvement or prohibition notices that changes the way in which an operation undertakes its core functions, or a criminal investigation or prosecution that might result in a criminal conviction.

Individuals in safety critical roles can find themselves stigmatised and it can impact on their employment. In the case of companies they face not only fines but also issues relating to reputation and bad publicity. A health and safety investigation and prosecution may also lead to problems when tendering for new work and have an impact on insurance premiums.

## The investigative process

Following an incident, HSE inspectors and/or police will seek to gather evidence, usually by the interviewing of witnesses and securing documentary evidence. The HSE have wide powers to require copy documents and conduct that obstructs an inspector is a criminal offence.

There are different types of interviews and the response to a request will vary as a result.

### 1) Voluntary witness statements

A potential witness will often be asked to make a signed written statement on a voluntary basis, they do not have to but it is often useful to be seen to be co-operative.

### 2) Compelled s.20 interviews

Where a person who the inspector believes has information relevant to an inquiry refuses to provide a voluntary statement then the inspector may use the powers given to them by s.20 of the HSWA to compel that person to answer questions. In those circumstances the person being interviewed has the right to have

another present during the questioning. As they are answering under compulsion the answers cannot be used to prosecute them or their spouse for health and safety breaches.

### 3) Interviews under caution

Interviews under caution take place within the terms of the Police and Criminal Evidence Act 1984 and must be distinguished from the other types of interview.

A person who is asked to attend an interview under caution is being viewed as a suspect in the commission of a criminal offence and that should be recognised.

These interviews will always be tape-recorded and the answers can be used in criminal proceedings, especially if admissions are made during the interview.

A person interviewed under caution has the right to be legally represented and it is difficult to imagine any situation where an interview should take place without a solicitor being present. This also applies where a corporate body [other than a partnership] is being investigated. In those circumstances a request is often made for a 'nominated representative' to attend an interview with the authority to speak on behalf of the organisation. These interviews are voluntary and it may not always be in the best interests of the company to attend.

## Best practice in dealing with a health and safety investigation

### Do

- Remember that these investigations are criminal in nature.
- Take legal advice at an early stage, ideally straight away after the incident.
- Understand the type of interview that is being undertaken and take advice as to any response to the request.
- Make a proper record of documents supplied to the investigator. Ensure copies are kept.
- Try to ensure that where a company is under investigation it speaks to the investigators through a single voice. Identify a single point of contact.
- Check your insurance policy, it may provide for legal advice for such investigations.
- Think carefully before dealing with the media, their sympathies are unlikely to be with the employer in most cases.

### Don't

- Put your head in the sand – it will not all go away of its own accord!
- Agree to be interviewed without taking legal advice.
- Speak 'off the record' to an investigator.
- Do anything that might commit an obstruction offence.
- Fail to understand the importance of proper document control both in relation to health and safety management generally and in the aftermath of an event during the investigative process.



**Daniel McShee**  
Partner

020 7614 3629  
d.mcshее@kennedys-law.com



**Sean Elson**  
Solicitor

020 7614 3675  
s.elson@kennedys-law.com

# Mediation – Inexpensive and confidential



**Nick Thomas**  
Partner

020 7877 8331  
n.thomas@kennedys-law.com



**Soma Hussain**  
Solicitor

020 7877 8362  
s.hussain@kennedys-law.com

## Why mediation?

**Mediation can be an inexpensive and quick way of resolving disputes in comparison with other forms of dispute resolution such as litigation, arbitration and adjudication. It is a consensual and flexible process where the parties can agree the procedure to suit the particular circumstances of the case. It is also a confidential process, conducted on the same basis as without prejudice negotiations. Essentially this means that nothing raised during the mediation can be referred to in any proceedings or otherwise.**

## What is it?

Mediation involves the parties and a mutually appointed third party meeting over the course of a day/few days. Mediators can be appointed from a body to which they are affiliated or they may be independent individuals. They are usually solicitors or other professionals in a certain field. The mediator's task is to broker an agreement between the parties, not to determine the dispute. Unless specifically asked by the parties, he will not express any views on the merits of the parties' respective positions. Instead, acting as a facilitator, his task is to assist the parties in coming to a settlement.

## When can it take place?

Mediation can take place prior to or during the course of formal proceedings between the parties. Where proceedings have been issued the Court will, as appropriate, direct the parties to attempt mediation usually at the case management conference stage (being an early stage of the proceedings). Where proceedings haven't commenced, the timing will essentially depend upon (a) whether there has been an adequate exchange of information and (b) on the parties' desire to negotiate a commercial settlement (often driven by the likely future costs of litigation).

## Who attends?

The Mediator will usually insist that a party's representative with full authority to settle attend. In any event the presence of a party's decision maker is usually desirable. Further, depending on the size and cost of the case, a party's solicitor, experts, factual witnesses, a party's insurer, and occasionally Counsel.

## How it works

This is flexible but a fairly conventional model is as follows:

### Prior to mediation

- The Mediator and the parties sign a mediation agreement which sets out the dispute, the arrangements and the procedure for the mediation; the attendees; confidentiality; settlement and the

mediator's costs. The parties usually bear their own costs of the mediation and divide the Mediator's fees between themselves.

- The parties exchange position statements and key documents usually a week before mediation. Timing and the amount of information will depend on the size of the case. The position paper is intended to provide an understanding of the key points in the case. It is not a legal pleading, commercial issues as well as legal arguments can be raised in it.

## At the mediation

- Firstly there is a session attended by all parties where they set out their position. The Mediator will usually stress the importance of settling the case and highlight the risks and commercial costs/consequences if the dispute continues.
- Subsequently the parties usually go into separate rooms and the Mediator conducts a form of shuttle diplomacy between them. The Mediator will probe their weaknesses and strengths, all in an attempt to broker a deal, irrespective of where he believes the merits of the case lie.
- Anything said to the Mediator is confidential and can only be relayed to the other party if the Mediator is expressly permitted.
- The Mediator (or the parties themselves) can then ask the parties to reconvene or suggest that particular representatives of the parties meet separately. This often involves senior management in discussions without the lawyers in the hope that this can produce a settlement.
- If the discussions lead to a commercial deal it is sensible for the parties to sign up to a settlement agreement on the day to avoid further time and expense.

## After mediation

- It is not unusual for mediation to fail to produce agreement on the day but for the discussions to lead to negotiations and settlement thereafter.

## Best practice in mediations

- Be prepared; identify both the key strengths and weaknesses in both your own and the other party's case.
- Concentrate on the commercial aspects, how much will it cost in time and expense if the case does not settle.
- Don't despair if it does not bring settlement on the day. Often this is the starting point.
- Don't let professional pride get in the way of a commercial settlement.
- Always have a plan b, otherwise known as an exit strategy.

# PFI and LIFT

## How to harmonise standard documentation and bespoke supply chain contracts

PPP is a successful way to apportion the risks of a major complex project. The UK is a pioneer in the Public Private Partnerships (PPP) world and many countries in Europe and further afield are now drawing on this successful model to modernise their infrastructure and improve the delivery of public services. A key principle of PPP is to apportion the risks in the project such that each partner takes responsibility for those risks it is best able to manage.

## PPP is being increasingly standardised

The documentation regarding certain forms of PPP has been standardised, in particular in the health sector, such as the Private Finance Initiative (PFI) model and more recently the Local Improvement Finance Trust (LIFT) model. The main purpose of standardisation is to provide guidance on the key issues that arise in these complex PPP projects in order to promote the achievement of commercially balanced contracts and enable public sector procurers to deliver best value for money.

## Controversial impact of standardisation

The Department of Health expects the standard form contracts to be used substantially unamended – save for limited project specific considerations. After years of incremental evolution of the documentation, opinions are still divided on the benefits of standardisation. It has certainly provided some comfort to the funders and therefore improved the 'bankability' of PFI and LIFT projects. It may however have generated hurdles at the level of the contractors and service providers delivering these projects.

## Basic structural inconsistency

Standardisation is based on a two-level structure. One of the main assumptions on which any PPP standardisation relies is that the party contracting with the public sector is a Special Purpose Vehicle (SPV) with sub-contractors, referred to as the supply chain, providing the actual performance on its behalf. Contrary to the standard form documentation to be entered into by the public authority and the SPV at the upper level of the structure, each member of the supply chain at the lower operative level is free to use any form of contract. This missing link in the standard documentation is arguably the most important one.

## Passing down all the risks is a difficult process

Since the SPV is effectively sub-contracting the delivery of the project, it will endeavour to pass down to the supply chain all the risks imposed on it by the standard documentation. Supply chain contracts have to be carefully negotiated in order to reflect an optimal transfer of risks on a case-by-case basis. Some risks, such as life-cycle risks, may remain with the SPV who is willing to manage the corresponding fund. Others risks difficult to distribute may have to be managed and shared in common by several members of the supply chain through interface agreements.

## Standardisation fails to save time

Standardisation is intended to speed up the negotiation of PFI and LIFT documentation. However, so far there is no indication that it has been successful in this respect. At the upper level, the parties will argue for months over project specific amendments. At the lower level, the complex negotiation of the supply chain documentation and the due diligence carried out on behalf of investors will generate considerable delays to the financial close of these deals.

## However experience and knowledge does help

Our thorough knowledge of the standard documentation and considerable experience in negotiating an optimal transfer of risks at the level of the supply chain will enable PFI/ LIFT stakeholders to reach financial close on time and on cost. Skillful comprehensive drafting of the provisions regarding the distribution and sharing of risks will avoid disputes over the 30 years or so of the Public Private Partnership.



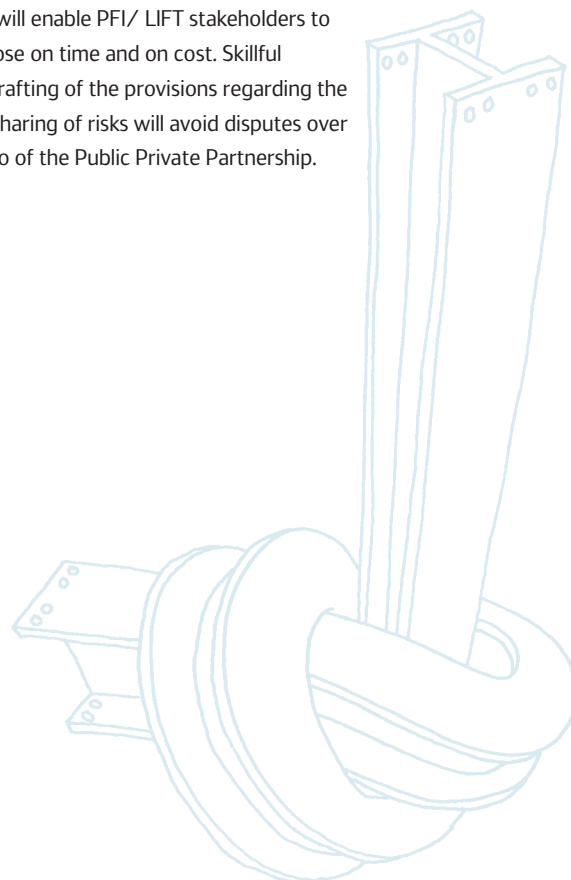
**Alan Hart**  
Partner

020 7614 3799  
a.hart@kennedys-law.com



**Catherine Renault**  
Solicitor

020 7614 3807  
c.renault@kennedys-law.com



Construction

# Professional negligence – Risk management



**Sushma MacGeoch**

Partner

020 7877 8359  
s.macgeoch@kennedys-law.com



**Pat Glenn**

Solicitor

020 7877 8359  
p.glenn@kennedys-law.com

**The standard by which a professional is judged is whether a sizeable body of those of the same profession would in the circumstances and at that point in time have acted (or omitted to act) as he did. Those who profess to exercise a special skill must exercise the ordinary skill of that speciality. Parties to a construction project start with high hopes, a spirit of co-operation and an expectation that the project will be successful and that the venture will prove reasonably profitable for each of them. Unfortunately, it sometimes ends in tears with the involvement of professional indemnity insurers in the ensuing dispute. Many professionals are required by their governing body to take out professional indemnity insurance as a pre-requisite to being able to practice their profession, others (for example large contractors) do so as a matter of commercial prudence.**

## What next?

Notify Brokers as soon as you think a claim is being made or as soon as you become aware of circumstances that might lead to a claim. Late notification is frequently a subject of contention between insurer and insured. The contract may contain a provision dealing with the resolution of disputes and the provisions of adjudication apply as much to professional appointments as they do to the main and sub-contracts. However, it is becoming increasingly recognised that this is not necessarily a suitable forum for what are usually complex disputes.

## Litigation in the Courts

Construction disputes are handled in the Technology and Construction Court which is a specialist division of the High Court. The judges in this division are used to handling complex construction disputes, with the reams of paper that such disputes appear to engender and are familiar with the commonly used forms of contract. Professional indemnity policies almost invariably give insurers the right to appoint solicitors of their choice to handle a claim and once those solicitors have advised that the claim comes within the ambit of policy cover, those solicitors will take over defending the action on the insured's behalf.

The solicitor will usually appoint an expert in the same profession as the insured to advise whether in his view the relevant standard of care has not been achieved. This expert, if also appointed to act as an expert in the litigation, is not a 'hired gun' and is expected to give an unbiased opinion on the insured's actions. The strengths and weaknesses of the insured's case will be weighed up and a joint decision made as to whether early settlement should be attempted.

## Case example

It may become clear during the early stages that the building that the employer desires will cost more than either what he can afford or (more likely) what he is willing to pay.

This can then lead the employer (or the professional) to consider whether there is scope for the project to be 'value engineered'. Value engineering is a valid tool. The 'value engineered' product may result in a compromise in the quality of the building that, whilst not necessarily producing a building that will not perform the function envisaged, the function may be performed in a less than perfect manner. If the professional forms this view this must be thoroughly discussed with and explained to the employer. The advice should be put in writing and be clear and succinct.

If a meeting is considered to be the best forum for explaining the problem, then minutes of that meeting should be produced and manuscript notes retained, as well as the minutes being circulated. When the minutes are circulated, they should be read by the attendees and if they do not agree with the content or consider matters are not minuted that ought to be, then that again should be put in writing.

Professional indemnity insurance does not come cheap. Apart from the possible damage to reputation, the professional will spend a considerable amount of time and effort defending the action, even though the defence costs are borne by his insurers. The employees who were concerned in the project will be required to assist the defence team, to provide witness statements and possibly eventually have the gruelling and unwelcome experience of giving evidence at trial.

## Best practice in avoiding claims

- Keep notes of meetings from an early stage.
- Consider carefully proposed changes to a tried and trusted design.
- Confirm discussions and decisions in writing.
- Inform brokers as soon as you believe a claim may be made.

## Remember

Professional indemnity insurance only extends to cover negligence. If a professional undertakes a greater obligation than the law would normally impose (that of reasonable skill and care), then his indemnity insurance will not cover the failure to reach the higher standard. The more cautious of the professional fraternity use solicitors to cast an eye over their appointments. The assistance of brokers experienced in this field should be utilised.

# Settlements – Popular in complex disputes

**A global settlement is a comprehensive settlement of an entire claim (and if relevant, a counterclaim). It does not show what sum is attributable, if anything, to a specific breach alleged or head of loss claimed, or counterclaimed.**

Global settlements are a popular way of resolving complex construction disputes, as they save the time and cost of litigating or having to agree individual values for individual claims. However, the benefits of global settlements may be outweighed by the risks of not being able to recover money from insurers, and others whose failures triggered some of the claims. It is therefore important to plan for the possibility of recovering money from another party when negotiating the settlement of a claim.

## Settlements and insurance

Most insurance policies which provide cover for design risks will indemnify policyholders for claims against them by others where the policyholder is 'legally liable to pay' that party.

That indemnity will only be provided where the policyholder has been held liable for an identifiable insured loss in respect of an identifiable insured event.

Where a claim is settled, this means that the settlement agreement must clearly identify both the existence and the extent of one party's liability to the other. If the agreement does not achieve this, a claim for the reimbursement of the insured element of the settlement from insurers will fail.

The settlement document is the only relevant document, and external evidence of how and why the settlement was reached is not admissible. For example, legal advice that a policyholder is liable for certain matters, some of which are covered by an insurance, will not establish the policyholder's liability, or its extent, to another.

Unless the settlement agreement spells out what a party is accepting responsibility for, and for how much, that party will not be able to recover its outlay from its insurers.

## Settlements and recovery

Once the original claim has been settled, the paying party might want to pursue other parties who are at fault for a contribution towards its outlay, such as those

further down the contractual chain. For example, following settlement of a claim with an employer, a contractor may wish to claim against its sub-contractor.

Unlike claims under insurance policies, global settlements can form the basis of a contribution claim against other parties, provided certain criteria are met. In each case, a Court will look at external evidence to decide upon the element of the global sum attributable to another party's actions.

However, the recovering party must still prove 4 things:

- 1) that it was itself liable for the loss that it settled;
- 2) the amount of the settlement was reasonable;
- 3) the defendant to the recovery proceedings (in the above example the sub-contractor) was as a matter of fact in breach of his duties; and
- 4) the defendant's breach, in turn, led to the recovering party's liability and its subsequent settlement.

## Best practice in negotiating and agreeing settlements

Seek guidance from your insurers regarding what information and evidence of the ascertainment of liability under your policy they require. If your insurers haven't accepted liability under your policy:

### Do

- Agree figures for each head of claim and any counterclaim, and record them in the agreement.
- If a head of claim is abandoned, record this in the settlement agreement, so that it is clear no payment is made or received in respect of that item.
- Agree and record in the agreement any reduction for contributory negligence.

### Don't

- Rely on legal advice to prove what was agreed and why – explain that in the settlement agreement.
- Assume that keeping insurers aware of settlement negotiations, or sending them a copy of a draft settlement agreement, is enough to guarantee you an indemnity.
- Simply record the net sum in the settlement agreement. Avoid a lack of detail and certainty by recording all the agreed figures, and what they relate to, in the settlement agreement.
- Include the phrase 'without admission of liability' in the settlement agreement. Although the Courts have yet to rule on the point, including these words may make it more difficult to establish that your claim is covered by your insurance policy.



**Paul Carter**  
Partner

020 7877 8348  
p.carter@kennedys-law.com



**Denise Charlwood**  
Solicitor

020 7877 8348  
d.charlwood@kennedys-law.com

# Subrogated recoveries – Missed opportunities?



**Marie-Claire di Mambro**  
Partner

020 7877 8355  
m.dimambro@kennedys-law.com

**Imagine a large construction loss where your company has a sizeable insurance deductible or has incurred losses which are not insured under the project policy. These do not necessarily need to be kissed goodbye forever if a subrogated recovery is possible from a culpable third party.**

## What is a subrogated recovery?

A subrogated recovery action is simply where an insurer who has paid out under an insurance policy seeks to enforce their right under that policy to recover their outlay from a third party. Insurers effectively step into the shoes of their insured and bring proceedings in the name of their insured against the party ultimately responsible for causing the damage/loss to the works.

## Case example

To take a simple example – imagine you are a main contractor who has to put right flood damage to the works caused when your piling sub-contractor and piling design engineer are both responsible for the striking of an underground services drain. Your insurers pay out under the project policy that you were obliged to procure in the joint names of your company and the employer for all risks damage to the works but you are out of pocket due to your relatively large uninsured losses and deductible. There are certain circumstances in this scenario where you may be able to recover the deficit as a result of the subrogated recovery being sought by your insurers against negligent parties.

## Co-insurance obstacles

There are however a number of obstacles which need to be overcome before any subrogated recovery action can be launched. One key obstacle is that there is often co-insurance under a project policy and, as a general rule, if the target is your co-insured then you cannot recover from that party. This is to prevent what is called circuitry of action i.e. to stop insurers from effectively suing themselves.

For instance, in our above example what if one of the key targets, your piling subcontractor, is also your co-insured under the project policy because you were obliged to take out insurance on their behalf for damage caused to the works by specified perils? Well, as this loss was caused by one of the specified perils (i.e. flood) a subrogated recovery action would not be possible against your co-insured. However, in these circumstances as your other potential target (the piling design engineer) is not your co-insured, a recovery action would be possible against them.

If there were no piling design engineer in the frame then in certain limited circumstances a recovery could be possible against your piling subcontractor e.g. in respect of loss of profits losses only. Whether or not this limited recovery will be possible will depend upon the individual wording of the contracts and it is certainly not a general rule. In fact, the extent to which subrogated recoveries will be possible in any case always depends upon the specific wording of both the project policy and the insurance policy itself.

## Will my insurer have first bite of the cherry?

There are well established rules regarding the distribution of subrogated recovery proceeds. The basic principle is that the insured is entitled to obtain a full indemnity before their insurers get their share. This therefore means that, assuming the uninsured loss element were fully recoverable from the negligent third party, those losses would be paid to the insured first out of the recovery proceeds. Then the insurer would get to recover their outlay. The deductible however is recoverable last so, unless a full recovery is made from the third party, an insured is unlikely to recover their deductible.

## Best practice in participating in a subrogated recovery action

### Do

- Make sure that you keep a very clear record of all your losses so that they will be easier to prove
- Co-operate at an early stage with your insurers to assist in the preparation of evidence
- Preserve evidence of damage/losses
- Make your personnel available to give witness statements
- Be prepared to compromise.

### Don't

- Throw away any paperwork regarding the loss
- Dispose of any physical evidence on site relevant to the loss/damage
- Allow your personnel to discuss the loss/damage/liability with the possible targets
- Have unrealistic expectations.

# Third party rights – The ‘Green’ Alternative to Collateral Warranties

**It is a truth universally acknowledged that the negotiation and documentation of collateral warranties takes up far too much time, both for the client and the professional adviser, but also in terms of cost. This is partly because the use of standard form warranties, such as those published by the British Property Federation in conjunction with RIBA, ACE and other professional bodies, has not been universally adopted, nor, regrettably, have those standard forms been universally recognised as establishing accepted parameters, whether as to the class of beneficiary in whose favour a warranty should be given, or as to the terms which those warranties should contain.**

## Contracts (Rights of Third Parties) Act

The introduction of the Contracts (Rights of Third Parties) Act 1999 presents an opportunity to readdress these issues, and the increasing use of Third Party Rights Memoranda, in place of warranties, is helping to reduce the mounds of paperwork.

The Act applies to every contract entered into after 11 May 2000. In the absence of express agreement to the contrary, or unless a contrary intention is evident from a proper construction of the contract, a third party, i.e. someone who is not a party to that contract, may enforce a term of the contract in his own right if the contract expressly provides that he may, or if the relevant contractual term purports to confer a benefit on that third party (Section 1).

## Third party rights

It was always thought to be optimistic to expect that the implementation of the Act would eliminate the need for the collateral warranty. However, after a slow start, there is now increasing acceptance on the part of employers, funders, purchasers and tenants that the blizzard of additional documentation to which the collateral warranty gives rise, can be reduced by the application of appropriately drafted Third Party Rights.

Setting out and acknowledging third party rights in the relevant contract or appointment does not reduce or simplify the nature or scope of the points to be negotiated, as compared with those that would normally arise in negotiating a collateral warranty. However there are a number of potential advantages that do arise, not the least of which is to ensure that the ‘third party issue’ is properly addressed at the time of negotiating and signing the original contract or

appointment rather than (as is too often the case) at the eleventh hour immediately before signing the relevant funding agreement or development agreement or agreement for lease.

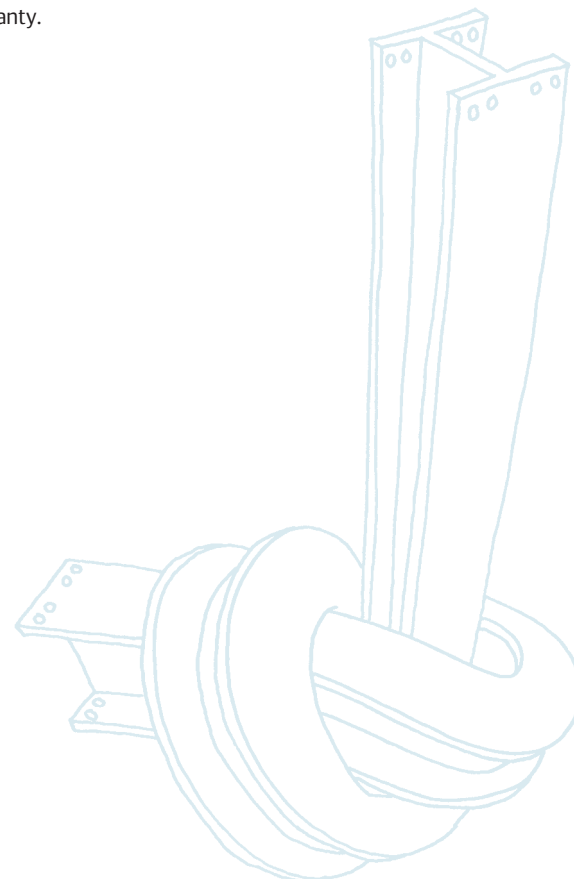
## Practical steps for substituting third party rights for collateral warranties

- The starting point is for the contract to identify, by name or class, those beneficiaries who are to be recognised as third parties entitled to enforce certain terms of the contract. Those third party rights would then be expressly set out in separate schedules to the contract, and the scope and terms of those express third party rights would broadly reflect the same terms and conditions as would otherwise be set out in the collateral warranty. There would be no need to provide for rights of assignment. In the case of a tenant, for example, the ‘recognised’ third parties could be identified as being the first tenant (of the whole or part) and, say, the first two assignees of the relevant leasehold interest.
- If third party rights are specifically acknowledged under the contract or appointment, as described above, it would be important that all other third party rights are expressly excluded.
- Insofar as the express acknowledgement of specific third party rights is to be construed as a voluntary assumption of additional contractual risk, it is submitted that professional indemnity insurers should not be concerned with this approach, provided that the contractual third party rights are no more extensive or onerous than those which would otherwise have been acknowledged under a collateral warranty.



**James Shaw**  
Partner

020 7614 3637  
j.shaw@kennedys-law.com



Construction

### **Longbow House**

14-20 Chiswell Street  
London  
EC1Y 4TW  
UK  
Tel: +44 20 7638 3688  
Fax: +44 20 7638 2212

### **10 Lloyd's Avenue**

London  
EC3N 3AX  
UK  
Tel: +44 20 7638 3688  
Fax: +44 20 7877 8300

### **50 Mark Lane**

London  
EC3R 7QT  
UK  
Tel: +44 20 7638 3688  
Fax: +44 20 7702 9757

### **Chelmsford**

Greenwood House  
91/99 New London Road  
Chelmsford  
Essex  
CM2 0PP  
UK  
Tel: +44 845 838 4800  
Fax: +44 845 838 4801

### **Cambridge**

2nd Floor  
Terrington House  
13-15 Hills Road  
Cambridge  
CB2 1NL  
UK  
Tel: +44 1233 533060  
Fax: +44 1223 533076

### **Belfast**

64-66 Upper Church Lane  
Belfast  
BT1 4QL  
UK  
Tel: +44 28 9024 0067  
Fax: +44 28 9031 5557

### **Hong Kong**

11th Floor  
The Hong Kong Club Building  
3a Chater Road  
Hong Kong  
Tel: + 852 2848 6300  
Fax: + 852 2848 6333

### **Auckland**

Level 6  
70 Shortland Street  
PO Box 3158  
Auckland  
New Zealand  
Tel: + 64 9 379 9011  
Fax: + 64 9 379 9025

### **Madrid**

C/Montalbán No 10  
2° Ext Dcha  
28014 – Madrid  
Spain  
Tel: +34 91 523 7210  
Fax: +34 91 523 7212

### **Associated offices**

Beirut, Dubai, Dublin, Karachi, Moscow, Mumbai, New Delhi, New York, Paris, Riyadh, San Francisco and Sydney



# Kennedys

---

Construction advice in black and white