Fenwick Elliott
The construction law specialists

Issue 140 February 2012

Dispatch

Dispatch highlights some of the most important legal developments during the last month, relating to the building, engineering and energy sectors.

Adjudication: natural justice, legal advice, severability

Highlands and Islands Airports Ltd v Shetlands Islands Council
[2012] CSOH 12

This case arose out of the construction of an extension to runways at Sumburgh Airport. After the adjudicator's decision had been issued, SIC's solicitors discovered by chance that before reaching his decision the adjudicator had taken advice from senior counsel in relation to the proper construction of clause 41.3 of the NEC Professional Services Contract. The adjudicator did not tell either of the parties that he had taken advice, nor did he tell the parties the terms of that advice, nor did he give the parties any opportunity to address him on the construction of clause 41.3. The adjudicator ordered SIC to pay some £2million. SIC refused to pay saying that there had been a breach of natural justice. HIAL denied this, saying that even if there was such a breach, it affected only the quantification of the Future Remedial Works Cost, which was severable from the remainder of the decision. The court heard evidence from the adjudicator, who had telephoned one counsel who was conflicted. The advice then received had been in the course of a short telephone call in which the adjudicator had asked whether senior counsel agreed with the view he had formed of what clause 41.3 of the contract meant. The call lasted no more than 2 or 3 minutes and it was a freebie, no fee was charged.

The adjudicator further said that he did nothing with counsel's response as he had already formed his own view of the meaning of the clause. In short he did not believe that he was seeking legal advice. In a previous adjudication, where he had required advice on an insurance matter, he had advised the parties of this and gave the parties the opportunity to comment on the identity of the proposed advisor and the advice itself. Indeed, in the adjudication in question, the adjudicator had instructed his own technical expert and again that report had been provided to the parties prior to the decision being given. SIC said that if an adjudicator is uncertain about a material issue and has taken advice from an independent source, he must tell the parties and give them an opportunity to make submissions. Neither of the parties knew that the adjudicator had a concern about the interpretation of the contract clause. If they had known this, they might well have wanted to make submissions about it.

To HIAC, the court should not be concerned with something which was at best a technical breach of natural justice. Here, SIC had the opportunity to respond to any issue (including the interpretation of clause 41.3) raised in the referral document. HIAC said that this was not something new, and the issue was not material to the determination of the dispute. Lord Menzies said that the rules of natural justice were designed to prevent the possibility of injustice. Here, the Judge considered that the confirmation sought by the adjudicator was indeed advice. It was given informally, it did not take long to impart, and no fee was to be paid for it, but nonetheless it was legal advice. It was legal advice which was sufficiently important to the adjudicator that when one counsel declined to speak to him because of a conflict of interest, he went on to telephone another to obtain advice on the point. It was also "*the foundation for any award in favour of HIAL for Future Remedial Works Costs.*"

If the adjudicator had said that clause 41.3 was a matter which concerned him, or that he was intending to seek legal advice on this point, then either party might have made further submissions. You can only ignore non-material breaches of the principles of natural justice if there is a positive indication that the breach has not been material. If there is a significant doubt about the matter, it must be presumed that the breach is material. Therefore, Lord Menzies considered that the question was indeed of considerable potential importance, and was far from peripheral or irrelevant. It was central to the quantification of the largest part of the award made by the adjudicator. Therefore there was a breach and the decision was not enforced.

In relation to severability, HIAC noted that here the adjudicator had made a number of clear findings, which could not be regarded as tainted in any way by what he did in relation to clause 41.3. One example of this was the decision that specified defects either arose or did not arise in consequence of the design failure. Then there was the historic cost figure of £340,872.26 plus VAT. SIC said that this was a single dispute case with only one order for payment. There was a plain breach of natural justice which rendered the decision invalid, and it fell to be reduced in its entirety. It was not the job of the courts to rewrite the decision of an adjudicator. As Lord Menzies noted, Mr Justice Akenhead in the case of *Cantillon Ltd v Urvasco Ltd* had observed that:

"(f) in all cases where there is a decision on one dispute or difference, and the adjudicator acts, materially, in excess of jurisdiction or in breach of the rules of the natural justice, the decision will not be enforced by the court".

Here, the parties had contracted to be bound by is the adjudicator's decision, not a part of that decision nor the decision after the court had rewritten it. Then there was the question of costs. It was far from clear that the adjudicator would have found the pursuer substantially successful in a situation in which the large majority of the adjudicator's award was tainted, and the pursuer only received a sum which was less than one-sixth of the total awarded. Therefore, no part of the decision could be severed.

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Failure to mediate

PGF II SA v OMFS Co & Anr

[2012] EWHC 83 (TCC)

On 10 January 2012, the day before the trial was due to start, PGF accepted a Part 36 offer that had been made on 11 April 2011. This left the question of costs. PGF at the time OMFS made their Part 36 Offer proposed mediation. No response was received. PGF tried again in July 2011. Again no response was received. PGF relied on the *Halsey* principle which says that, as an exception to the general rule that costs should follow the event, a successful party may be deprived of its costs if it unreasonably refuses to mediate. PGF said that the case was well suited to mediation. The Judge, Recorder Furst QC noted that the skill of a mediator lies in drawing out seemingly intractable positions. The costs of mediation would not have been disproportionately high nor would it have caused delay. OMFS said that it was not unreasonable for it to have refused to mediate given what had occurred between these parties at a previous mediation which had taken place in 2010 in relation to another dispute. The Judge was provided with letters which referred to the conduct of that mediation. OMFS further said that it had to wait until autumn 2011 before receiving full disclosure and the expert evidence on air conditioning, one of the main issues dividing the parties, was only exchanged in November 2011. Therefore it would not been able to engage in a reasonable discussion as to settlement in April 2011.

The Judge held that it was it was unreasonable of OMFS not to respond to the suggested mediation. A party does not need to show that the mediation would have been successful, merely that it had a reasonable prospect of success. Here as in most cases, there was a reasonable prospect that well advised commercial parties, such as these, with the benefit of experienced lawyers would have been able to reach an accommodation. The Judge arrived at his decision without considering the conduct at the previous mediation. Mediations are covered by without prejudice privilege, which had not been waived by PGF. Second, had PGF's conduct been a reason for refusing to participate in mediation in relation to this matter then one would have expected that to have been put forward by OMFS in answer to the invitation to mediate. Again the absence of expert valuation evidence on diminution in value was not raised at the time. Further PGF offered to provide OMFS with a copy of its report. The Judge noted that:

"In general . . . the court should be wary of arguments only raised in retrospect as why a party refused to mediate or as to why it cannot be demonstrated that a mediation would have had a reasonable prospect of success. First such assertions are easy to put forward and difficult to prove or disprove but in this case unsupported by evidence. Secondly, and in any event, it is clear that the courts wish to encourage mediation and whilst there may be legitimate difficulties in mediating or successfully mediating these can only be overcome if those difficulties are addressed at the time. It would seem to me consistent with the policy which encourages mediation by depriving a successful party of its costs in appropriate circumstances that it should also deprive such a party of costs where there are real obstacles to mediation which might reasonably be overcome but are not addressed because that party does not raise them at the time. I have little doubt that that is the position here, namely that any such inhibitions to mediation could have been overcome at the time. . ."

Binding agreements to mediate

Sulamerica CIA. Nacionel De Seguros S.A. & Others v Enesa Engenharia S.A. & Others

[2012] EWHC 42 (Comm)

A dispute arose about two all risk insurance policies covering the construction of one of the world's largest hydro electric facilities, in Brazil. Conditions 11 and 12 entitled "Mediation" and "Arbitration", stated:

"11 ...If any dispute or difference of whatsoever nature arises...the parties undertake that, prior to a reference to arbitration, they will seek to have the Dispute resolved amicably by mediation. . ."

"12 ... In case the Insured and the Insurer(s) shall fail to agree as to the amount to be paid under this Policy through mediation ..., such dispute shall then be referred to arbitration under ARIAS Arbitration Rules."

The question arose before Cooke J as to whether the right to arbitrate only arose if the requirements to mediate in condition 11 had been complied with. Here the Judge thought that there were three major difficulties which stood in the way of the submission that condition 11 was an enforceable obligation. First, there was no unequivocal commitment to engage in mediation. The parties had agreed that *"they will seek to have the Dispute resolved amicably by mediation"* but did not bind themselves to do so in clear terms. They only agreed in general terms to attempt to resolve differences in mediation. Second, there was no agreement to enter into any clear mediation process, whether based on a model put in place by an ADR organisation or otherwise. Third, there was no provision for the selection of the mediator. The parties would need to agree upon the identity of the mediator, the location of the mediation and the process in which the parties had to engage. Condition 11 by itself was not enough to establish what the parties had to do.

Therefore there was no binding obligation to mediate and the court would not be able to determine whether or not a party had complied with the "obligations" allegedly imposed. If, for example, the parties were unable to reach agreement on a mediator or on the form of mediation and it was suggested that by one party that had not sought to have the dispute resolved by mediation, how would the court determine which party was in breach? Taken altogether, this meant that there was no condition precedent requiring the parties to mediate prior to any arbitration.

Dispatch is produced monthly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.

Dispatch is a newsletter and does not provide legal advice.

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