

# MDA PRESENTS



## FIRST AID FOR CONTRACTS



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### EMPLOYER RISKS UNDER SUBCLAUSE 80.1 AND THE COST OF “PROCEEDINGS”

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A dictionary definition of ‘*Proceedings*’ is “*an action taken in a court to settle a dispute*”. Wikipedia defines a legal proceeding as “*an activity that seeks to invoke the power of a tribunal in order to enforce a law*”. The same would obviously apply where a party to a contract sought to enforce his or her rights under the contract using the dispute resolution mechanisms in the contract.

Reference to the word ‘*proceedings*’ is found in subclause 80.1 of the NEC3 Engineering Construction Contract (“*NEC3*”). This clause provides a list of the *Employer* risks. It is also found in subclause 83.1 which is the indemnification provision, requiring each party to indemnify the other against events which are at their risk.

The clauses state:

“80.1 *The following are Employer’s risks.*

- *Claims, proceedings, compensation and costs which are payable to.....”*

The clause then goes onto list the *Employers* risks.

“83.1 *Each Party indemnifies the other against claims, proceedings, compensation and costs due to an event which is at his risk.*”

An indemnity clause is a clause in a contract that minimises or exempts one party’s liability to the other party where that liability would normally have to be accepted by the first party.

*Employers* risks are risks that are often referred to as excepted risks and are risks that could result in **damage to the works** where the contractor would normally not be responsible. These risks are generally managed through insurance policies such as for example the contractors all risks policy. *Employers* risks under clause 80.1 are also referred to in clause 60.1 (14) and costs incurred owing to an *Employer's* risk event are therefore recoverable costs as a compensation event. However, the contractors dilemma is that insurance policies (like contractors all risks policies) and compensation events that are quantified in accordance with the Shorter Schedule of Cost Components and the Contract Data, do not make provision for the recovery of the cost of '*proceedings*'. In fact, clause 63.4 states "*that changes to the Prices Completion Date and Key Dates are the only rights the Parties have in respect of a compensation event*".

So, then how, and when does the contractor recover the cost of '*proceedings*', should it have to resort to '*proceedings*' to enforce its rights under the NEC3?

In the recent appeal before the House of Lords in London, of *SSE Generation Ltd v Hochtief Solutions AG and Another*<sup>1</sup> where there was an appeal against decisions delivered in adjudication proceedings and lower tribunals, some assistance might be found. A summary of the facts of this case are as follows:

The case involved the collapse of a hydro-electric water delivery tunnel, at Glendoe, Fort Augustus in Scotland, that had been designed and built by Hochtief Solutions AG and Hochtief (UK) Constructions Ltd (the Contractor) for the SSE Generation Ltd (the Employer) under a NEC contract.

Not long after the completion of the tunnel, there was a major collapse and the tunnel was closed down. The Contractor refused to carry out remedial work unless it was paid for the work involved on the basis that he considered the cause of the collapse to be an *Employers* Risk. This refusal to carry out the repair unless he was paid (in breach of his obligations under clause 82.1) was found also to be a breach of the Contract by the Law Lords. Royal BAM group was then instructed to construct a bypass tunnel and associated works. This ultimately cost about £137 million; a sum not far removed from the original contract's £126 million price tag. A dispute arose as to whether the Employer or the Contractor was liable for the remedial costs.

Many issues were debated, including what caused the collapse of the tunnel and what constituted a defect under the terms of the contract. Much of the arguments centred upon the proper construction of the contract; notably whether the collapse was a contractor's risk. Such a risk included loss or damage to the works which was due to 'a defect which existed at take-over'. In the end, the fact that the contractor had complied with its design duties was not enough to provide a defence since the contract contained a fitness for purpose obligation on the contractor to build a tunnel that would not collapse for 75 years.<sup>2</sup>

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1 *SSE Generation Ltd v Hochtief Solutions AG and Another* [2018] CSIH 26

2 <https://www.rpc.co.uk/perspectives/built-environment/construction-newsletter-july-2018/sse-generation-ltd-v-hochtief-solutions-ag-and-another-2018-csih-26/> - 24 October 2018

This case did not primarily deal with question of how a contractor recovers the costs of *'proceedings'*. However, opinions of the various Lords in their reasoning for their award, provides a basis for dealing with this question.

Lord Glennie opined that subclause 83.1 may have been applicable had the contractor complied with its contractual obligations in respect of the rectifying the works when called upon to do so by the employer, and thereafter he would have been entitled to claim the costs to do so, in terms of the indemnification provisions<sup>3</sup> - if the risk was an Employer's risk. He disagreed with the opinion that allowing a party to have right of action against another under a joint insurance would render subclause 83.1 redundant. In his view, subclause 83.1, indemnifying the other party, applied beyond the instances of loss and damage<sup>4</sup> - i.e. the insured event only. In short that subclause 83.1 is an express indemnification between the Parties, applicable in circumstances beyond a claim for costs incurred due to the occurrence of an insurable event.

Accordingly, having regard for Lord Glennie's comments, it must be concluded that the costs of *'proceedings'* can be included in such an instance where the indemnification applies beyond the instances of loss and damage, if the risk was an Employer risk and therefore, under the indemnification provision, the contractor is entitled to recover the costs of *'proceedings'*.

Since these costs cannot be recovered either from the All Risk Insurance Policy (confined to repairing the

damage to the work) or a compensation event, being costs of carrying out work, there is no means within the NEC3 for this recovery.

It appears therefore that the intention of the NEC3 is that the *'cost of proceedings'* would be recoverable as a cost order where a party was substantially successful in enforcing its rights under the contract via a proceeding such as adjudication or arbitration.

This sits nicely with the normal procedure where the proceeding is arbitration and the party that was substantially successful would be entitled to have it awarded its costs (by the arbitrator) in pursuing the case.

It is not the case in adjudication proceedings. Under these proceedings the adjudicator's contract requires (clause 3.2) that the parties pay the cost of the adjudicator in equal shares and that they absorb their own costs in either pursuing or defending the case.

Similarly, where the Tribunal under clause W1.4, is arbitration and the award of costs by the arbitrator is based on the Tariff of Court Fees (i.e., the costs are taxed), these will inevitably be lower than the costs that will actually be incurred and the contractor would then not be properly indemnified.

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3 SSE Generation Ltd v Hochtief Solutions AG and Another [2018] CSIH 26, para 412

4 Ibid para 407

It appears therefore that there are grounds for requiring that an adjudicator should make an award of costs, based on the indemnity clause or for the arbitrator for the same reason, to award the actual costs (rather than taxing the costs), in both cases to the party that has been substantially successful, where the event giving rise to the claim is an *Employer's* risk event as the **cost of proceedings**.