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Ask a question

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Construction & Engineering group news

We are hosting a series of breakfast update seminars in London, as follows:

Demystifying development vehicles – an introduction to joint ventures and corporate structures
(15/10/09)

Sustainable development and green issues (22/10/09)

Latest developments in EU procurement law (05/11/09)

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International Procurement – Recent Initiatives

Summary and implications

There has been a recent increase in challenges to the way public bodies evaluate tenders, and there have been various initiatives which relate directly to the way in which infrastructure-related services are procured in the United Kingdom and internationally. For example:

- the Technology and Construction Court (the “TCC”) in England and Wales has been active in developing jurisprudence in the field of public procurement, notably in *Amaryllis Ltd v HM Treasury*. In this 2009 case the TCC considered (amongst other things) whether the claim against the defendant was brought promptly and in any event within three months as required by the Public Contracts Regulation 2006;
- on 10 September 2009 it was announced that the Construction Sector Transparency Initiative has initiated a three month pilot to enhance transparency and accountability in public procurement; and
- in the next article in this Newsletter my colleague, Steven Williams, provides a narrative on recent developments in European Community Law which will impact on the way public bodies may structure their procurement processes.

There are also initiatives relating to procurement being discussed at the United Nations under the auspices of Working Group I (Procurement) (the “Working Group”) established by the United Nations Commission on International Trade Law (the “Commission”).

If adopted, the initiatives, in the form of revisions to the 1994 *UNCITRAL Model Law on Procurement of Goods, Construction and Services* (the “Model Law”), will affect how major internationally-funded infrastructure projects are procured by public bodies, and specifically those projects that are financed by the World Bank. The revisions to the Model Law have also been the subject of discussions with other international organisations, including: the European Union; Asia-Pacific Economic Co-operation; and the World Trade Organisation.

Background to the Model Law

In 2004, the Commission decided that that the Model Law required updating to reflect changes in public procurement. Alongside amendments to the Model Law, the Working Party would publish a Guide to Enactment to address the amendments in more detail where appropriate, and provide guidance to the legislators in enacting States.

The focus of the Working Group’s work includes:

- new practices in public procurement such as electronic procurement;
- the avoidance of abnormally low tenders (“ALT”);
- Electronic Reverse Auctions (“ERAs”);

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- Framework Agreements (“FAs”); as well as
- simplifying and clarifying the Model Law.

Electronic Procurement

The Working Party has formulated proposals to amend the Model Law to reflect the rapid technological advances in enacting States, whilst appreciating that the level of advancement is not uniform across all enacting States.

The main proposals concern the use of electronic procurement, advertisement of procurement-related information (including the publication of the laws and regulations governing procurement contracts), the solicitation of documents and related information and contract awards, and the use of electronic communications in the procurement process.

The use of electronic means was thought to make information more available than traditional paper means by making it more accessible to suppliers. The Working Party accepted, however, that electronic publication should be optional to preserve the principle of flexibility and reflect the different situations that apply in enacting States.

The Working Party considered the use of electronic communications in the procurement process. In particular, they considered whether the use of electronic communications should only be by consent or should be a requirement of one policy. They discussed also the conditions of use to safeguard procurement law obligations, so as to avoid the electronic means chosen from operating as a barrier to access, to secure confidentiality, and to ensure authenticity and security of transactions and the integrity of the data. The Working Party agreed that the Model Law should be revised to enable the promotion of the use of electronic communications. However, this is subject to a general requirement not to unreasonably restrict access to the procurement and to set out a number of guiding principles (see table).

ERAs

ERAs are structured as tendering proceedings in which suppliers are provided with information on the other tenders. Suppliers post tenders electronically through an electronic auction site, using information on ranking or amount requirement to beat the other offers. Suppliers are able to view electronically the progress of the tenders as the auction proceeds and amend their own tenders accordingly. ERAs usually take place over a set period of time.

Changes to the Model Law

- *Electronic Procurement* – encouraging the use of electronic communication and technologies in procurement, and make appropriate provisions in a technologically neutral manner.
- *ATL* – allowing a procuring entity to reject low tenders that raises concerns as to the supplier’s or contractor’s ability to undertake the works.
- *ERAs* – allowing a procuring entity to operate an ERA.
- *FAs* – regulating the adoption and use of FAs, including the criteria used for selection of participants.

Guiding Principles on the Use of Electronic Communications in the Procurement Process

- The means of communication should not present an unreasonable barrier to participation.
- There should be appropriate procedures and systems to establish the origin of communications.
- The means and mechanisms used should ensure that the integrity of the data is preserved.
- The means and mechanisms used should ensure that the tenders and other significant documents are not accessed by the procuring entity or other persons prior to the set deadlines.
- Confidentiality of information submitted by or relating to other suppliers should be maintained.

The Model Law does not address ERAs; the tendering method used for procurement assumes a single-tendering stage, and prohibits substantial changes to tenders – including price – after submission; see, for example, Article 34(1)(a) of the Model Law.

The Working Party has edged towards adopting a framework for the use of ERAs, in part because certain enacting States commonly use ERAs and could generate significant savings and promote transparency. It was suggested that in future ERAs could be incorporated into the Model Law as a distinct procurement method, such as the publication of prices during the tender process and a two-phase evaluation of tenders.

FAs

FAs are arrangements used by procuring entities when they require particular products or services over a period of time, but do not know the exact quantities, nature or timing of their requirements. Initial tenders are obtained against set terms and conditions. The supplier(s) is/are then selected, and periodic orders or contracts are subsequently placed with the supplier(s) chosen, as particular requirements arose.

FAs can enhance value for money but, at the same time, can result in a lack of transparency and competition if not managed correctly

In some countries, like the United Kingdom, FAs are regulated by national law. The use of FAs has been acknowledged by some regional bodies and by international leading institutions.

The potential benefits of FAs, as opposed to initiating a new procurement procedure, include the saving of procedural costs and time in procurement. In particular, the arrangements avoid the need to advertise individual contracts and to assess suppliers' qualifications for each order placed. FA also enhances value for money.

The Model Law does not contain any specific provisions on FAs. Tender solicitation documents must state the quantity of goods required, but under the FA arrangement, the quantity is normally not known. Further, the Model Law's tendering proceedings do not contemplate arrangements that involve entering into a binding contract, for example, when orders are placed. Indeed, Article 36(4) of the Model Law provides that a contract arises when a tender is accepted, but does not provide for contracts that arise only when the procuring entity *later* decides to make specific purchases. Also, the procedure in the Model Law relating to the publishing of a public notice of a "contract award" (i.e. Article 14) is not suitable for providing publicity for FAs.

The Working Party recognised that there are a number of potential problems with FAs. In particular, there was a concern amongst a number of enacting States that FAs may result in a lack of transparency and competition at every step of the procurement process. FAs may also create a marketplace based on relationships between suppliers and purchasers, rather than on competition amongst suppliers.

In conclusion, the Working Party proposed that the Model Law should reflect FAs which appreciated:

Related item:

Papers produced by the Working Party can be found at:

http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html

- the desirable level of competition in a multi-supplier framework;
- whether FAs should be exclusive;
- appropriate criteria for establishing the duration of FAs;
- suitable types of procurement for FAs; and
- procedures for selecting the participants in a framework arrangement and for awarding purchase orders.

Concluding thoughts

The Working Party is finalising the proposed revisions to the Model Law for consideration by the Commission. That process may still take a number of months or years. When finalised, and given the World Bank's reported support for the policy considerations that underpin the revisions, it is likely that the revised Model Law will result in a radical change to the way in which international construction projects are procured.

Changes to procurement procedures which reflect current policy objectives should be welcome.

The New Remedies Directive: New Sanctions for Public Procurement Abuses

Summary and implications

The new rules which are due to come into force on 20 December 2009 give the courts the power to set aside contracts as a result of public procurement infringements. This raises the stakes of getting public tendering processes right but also passes some of the risk of non-compliance from the authority to the successful contractor.

The European Commission has become increasingly concerned about abuses in public procurement compliance including: illegal direct awards and the race to contract signature to close out contract award challenges. The New Remedies Directive* is designed to close such loopholes and by the introduction of the new remedy of 'ineffectiveness' provide a serious deterrent to would-be infringers.

The key reforms include:

- the introduction of contractual 'ineffectiveness' as a remedy for certain serious breaches of the procurement rules;
- the operation of a harmonised standstill period between contract award decision and contract award.

Ineffectiveness

The draft regulations provide that the court must declare a contract ineffective if satisfied of any of the following grounds:

- The contracting authority has failed to publish a contract notice in the Official Journal of the European Union (OJEU Notice) when it was required to do so (unless the contracting authority considers that an OJEU Notice is not required, publishes its intention to enter into the contract and holds a ten day stand still period).
- The contract has been entered into without complying with the rules on review procedures (such as standstill obligations and the requirement to suspend the tender process pending a court decision) and so deprived the bidder of the opportunity to pursue pre-contractual remedies for a breach of the procurement rules and that has affected the bidder's chances of winning the contract.
- In the case of a dynamic purchasing system or framework agreement, the authority has breached the rules on mini-competition or award of contracts under dynamic purchasing systems and the call-off exceeds the relevant threshold.

The ineffectiveness sanction is subject to an exception where the court considers there to be an overriding general interest reason to maintain the effects of the contract.

Ask a question

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* Directive 2007/66 (the "New Remedies Directive")

Where a contract is declared ineffective by the court, the ineffectiveness will be prospective. This means that the parties will be discharged from any obligations arising under the contract after the date of the declaration. Previously the only remedy for the aggrieved tenderer was damages. The potential consequences of a ruling of ineffectiveness will be severe including:

- the cost and delay of refinancing a procurement procedure;
- the damage caused to the contracting authority's reputation.

The court must also impose a financial penalty on the procuring authority. The level of penalties are left to the discretion of the court provided they are 'effective, proportionate and dissuasive'.

Time Limits

Claims for ineffectiveness will need to be brought within either 30 days of the day of the contract award notice (where an OJEU Notice was not published and the Contract Award Notice sets out the justification for not doing so) or otherwise six months from the day of contract signature.

All claims other than for ineffectiveness (e.g. pre-contract remedies) must be brought promptly and within three months from when the cause of action arises.

Stand Still Provisions

The new regulations retain a standstill period of 10 calendar days if the notice is sent by fax or electronic means and provide for a period of 15 days where the notice is sent by other means of communication. The standstill period runs from the beginning of the day following the day that a notice is sent.

Very few changes to these provisions are required as a result of the new Directive.

No stand still period is to be required where:

- a contract does not require the publication of an OJEU Notice;
- there is only one bidder;
- where the contract is called-off from a framework agreement or a dynamic purchasing system is being established.

Conclusion

The key reform under the new rules is the remedy of ineffectiveness. It is a new concept under English law and it is unclear how this will work in practice. How will the court unravel the contractual relationship between the successful contractor and the procuring authority? How will the contractor be compensated for the work carried out up to the date of termination? Will any contractual clauses such as warranties or early termination provisions survive? Should the contracting parties

The Remedy of Ineffectiveness

Where a contract is declared ineffective by a court, the ineffectiveness will be prospective. This means that the parties will be discharged from any obligations arising under the contract after the date of the declaration. Previously the only remedy for the aggrieved tenderer was damages.

continue to perform the contract pending an appeal of the court's ruling on ineffectiveness?

In practice, on most contracts involving significant capital spend, an OJEU procedure and a standstill period will have been implemented. In these circumstances, the ineffectiveness remedy will not be available and aggrieved unsuccessful contractors will need to pursue a pre-contract remedy or seek damages after contract signature. The real impact of the New Remedy will be in cases where the contracting authority has elected not to use an OJEU Notice when it should have done. This is likely to affect a limited part of the market, but will nevertheless be a major deterrent to any contracting authorities who negotiate contracts with favoured suppliers without advertising the opportunity. It will also mean that successful contractors will no longer enjoy protection when the contract has been signed and will share the risks of a non-compliant tendering process.

Currently there is no suggestion that the legislation will have retrospective effect, but authorities and tendering contractors will need to be ready for the changes by the turn of the year.

Pre Construction Services Agreements: key provisions and the new JCT forms

Summary and implications

In the past few years Pre-Construction Services Agreements (“PCSAs”) have become commonplace on construction projects. Until recently all such agreements were bespoke documents, but the JCT has now published two standard PCSAs. This article explores:

- the key terms of PCSAs and the content of the new JCT General and Specialist documents;
- key issues relating to the use of PCSAs in general and the JCT forms in particular;
- the commercial issues.

Ask a question

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What is a PCSA?

In recent years there has been a marked increase in the use of two stage tenders to obtain early contractor involvement and increase cost and programme certainty. This involves using the contractor’s expertise in the design development and project planning period (the “pre construction period”), and, in certain cases, using the time to procure sub-contract tenders to assist in building up a fixed price for the main contract. The provision of these contractor services is governed by a PCSA, in effect an interim contract, until a main building contract is executed, whether with the initial contractor or otherwise.

PCSAs can be used in two contexts:

- where the developer anticipates appointing the contractor under a main building contract at a future time, but wishes to achieve a higher level of cost and/or programme certainty before doing so; and
- where the developer is not yet in a position to commit to a contractor, for example where the contract is part of a PFI/PPP bidding process and the proposed developer has not yet been selected.

Key clauses – always required
Obligation to perform listed services
Duty to exercise appropriate skill, care and diligence
Obligation to liaise with the project team
Copyright licence
Payment provisions – either during services or deferred
Termination

Services

The crux of a PCSA is the list of services which the contractor is to provide, which need tailoring to the particular circumstances. The approach is based upon the contractor working as part of the project team to progress and finalise the design and enhance the accuracy of pricing/programming. The JCT PCSAs do

not include model services, which is unfortunate as for many parties a sample menu of suggested services would be helpful.

A PCSA is, in effect, a form of consultant appointment and many of the key provisions of PCSAs follow this analogy, such as an obligation to perform the services with the level of skill, care and diligence to be expected of a contractor experienced in projects of a similar size, scope and complexity. Ideally, following completion of the pre-construction period, these services should be subsumed into the main contract to achieve single point responsibility, make it simpler to identify the contractor’s scope of responsibility and deliver rights to third parties if required.

Design responsibility

In most lists of pre construction services there will be an element of design input, and bespoke PCSAs generally make the contractor responsible for such design advice. An unusual feature of the JCT PCSAs is that they expressly provide that the contractor has no design responsibility unless and until the contractor is appointed on a main building contract for the project.

JCT PCSAs expressly place no design responsibility on contractor

Where the developer is receiving advice from the contractor, it appears illogical that the developer should have no recourse against the contractor for any deficiencies in his advice insofar as it relates to design. Where the main building contract for the project is a design and build contract and a different contractor is later appointed, that main contractor may be reluctant to accept entire design responsibility, since the main contractor would be unable to seek redress from the PCSA contractor for such design advice. Third parties seeking rights in relation to the project may also query their rights in relation to such early design advice.

Payment

The approach to payment varies widely between PCSAs, from a nominal or nil fee, to a lump sum fee or weekly rate payable either in instalments during the pre construction period or deferred until conclusion of the period. The level of fee payable will be linked to the level of certainty of the contractor’s selection for the main building contract, i.e. the level of commitment the developer is willing and/or able to give to the contractor in the context of either its commercial position or, in a PFI/PPP context, its bidding status.

Early orders

Bespoke PCSAs sometimes give the developer the ability during the pre construction period to instruct the contractor to carry out enabling works or place orders for long lead items. This may be on the basis of the contractor either doing the legwork to enable

JCT Forms of PCSA
General – for developer/contractor agreement
Specialist – for developer/specialist subcontractor or contractor/specialist subcontract agreements

the developer to place the order in its own name, or, alternatively, the contractor placing the order but on terms that it can be novated to the developer or an alternative contractor if required. The placing of any such orders and any related payments will clearly need to be taken into account in the payment provisions.

The General JCT PCSA does not cover this possibility, but the Specialist JCT PCSA is the vehicle for the developer to place orders, and allows the benefit of the agreement to be assigned to the selected main contractor. Note, however, that this is assignment of the benefit not the burden, i.e. the payment obligations would remain with the developer.

Care should be had to avoid placing instructions for carrying out permanent works as this will make it harder to appoint a different main contractor for the project, and accordingly strengthen the PCSA contractor's commercial negotiating position on any unresolved contract issues such as price or programme.

Termination

A PCSA needs to make provision for its possible termination, the need for which could arise in various contexts – insolvency of either party, material breach of contract by either party or the cancellation of the project. The real issue is how the consequences of termination are dealt with. This will be a particular issue where the contractor is receiving a nil or nominal fee for its services, and where termination is not due to any contractor default, the contractor will probably, understandably, seek some recompense for its provision of what were, in effect, speculative services.

If a JCT PCSA is being used, there will also be a question of responsibility for any design advice provided by the contractor, to ensure that the developer has the benefit of any design advice for which it has paid.

Commitment to enter into a full building contract

Whilst the JCT PCSAs contain no commitment on either party in relation to the main building contract, many bespoke forms of PCSA provide for this.

Often a developer will seek contractor proposals on overhead and profit percentages and weekly preliminaries figures as part of its initial selection process, and the PCSA can be used as a means of getting the contractor to commit to those figures if later selected for the main building contract.

Equally, at the time that the developer is making its initial contractor selection, discussions may take place on the potential legal terms and conditions for the main building contract. From the developer's perspective this is desirable as it enables developers to negotiate such matters at a time when there is competition between potential contractors. Having agreed the relevant terms and conditions then the

PCSA can be used to record that, if selected, the contractor will be appointed on the pre-agreed terms and conditions.

Whilst a PCSA may include a commitment on the contractor to enter into a main building contract on identified terms if requested by the developer, it should not contain any commitment on the developer to appoint the contractor on these terms or at all. At the time the PCSA is entered into the developer does not have the level of cost certainty which would enable it to make such a commitment, and its commercial position may change in the intervening period. The developer needs to retain a discretion to encourage delivery of a competitive price from the contractor.

Consider using the PCSA as a vehicle to achieve contractor commitment to rates or contract terms if later appointed

Longer term responsibility

An issue in most contractual relationships is the extent of a party’s responsibility following completion of services or work. Most building contracts and consultant appointments for substantial projects are executed as deeds giving a 12 year limitation period for claims. It seems logical that a PCSA should follow the same principle, yet the JCT PCSAs make no provision for execution as deeds. Aside of the resulting discrepancies, this will create an anomaly where the specialist version of the PCSA has been used to place early orders and are later assigned to the main contractor. This issue is often addressed in bespoke agreements by making provision in the main building contract to subsume any services performed during the pre construction period, and so create a single contract covering all the advice and works undertaken by the contractor.

Bespoke PCSA or JCT document?

Whether a developer chooses to use a bespoke form of PCSA or a JCT form, in either case they should give careful consideration to its use and suitability including the points set out above. Use of a standard form document often provides a helpful framework for a contractual relationship, but in the JCT PCSA, consideration needs to be given to the various issues which that agreement it does not address, and limited amendments, largely additions, to the JCT documents may be desirable, including careful consideration of the services to be provided, and which are fundamental to the arrangements and success.

JCT Forms of PCSA – Key points to note
No design responsibility
No commitment to main contract terms or prices
Executed under hand, i.e. six year limitation period
No list of services

So is a PCSA a good idea?

Properly used a PCSA can benefit a project by early integration of the contractor into the team. However, it will not always be the best approach, for example where the developer wants to instruct early permanent works, a separate early works contract or an overall construction management structure may be more appropriate.

Extension of time provisions – Origins and purpose and the distinctive approach taken by NEC3

Summary and implications

The reality during a project is that events will arise which may delay completion.

Those delay events may constitute events for which the employer is responsible under the contract. Without an extension of time (“EoT”) mechanism capable of addressing that delay event, the employer would lose its right to deduct liquidated damages.

The responsibility for delays is a common problem in construction and gives rise to great uncertainty and friction between the parties. An extensive retrospective review of what actually happened takes time, and will only increase the friction and uncertainty.

Consistent with its underlying objective, NEC3 requires the parties to resolve all such issues as they rise and does so by adopting a distinctive approach as follows:

- an express contractual preference for a timely but theoretical projection of delay to the date on which the contractor planned to complete the works in lieu of a wait and see approach to retrospectively assess what delay (if any) has actually occurred to the contractual completion date; and
- the use of the contractor’s planned completion date as the benchmark to assess an EoT as distinct (as is common to most other forms of contract) from the contractual completion date.

Origins and Purpose

The basic legal principle was set in 1902 when a court ruled that an employer cannot insist that a contractor finishes its works by a fixed date if it was the employer which prevented the contractor from achieving that date. This is known as the prevention principle.

When that principle is overlaid with:

- a) the commercial necessity for a fixed completion date combined with a right to deduct liquidated damages in the event the contractor runs late;
- b) a flexibility to instruct changes to the scope of the works as they proceed; and
- c) a contractor’s requirement to re-allocate risks to the employer which would otherwise fall to the contractor, e.g. bad weather, fire, flood, etc.,

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then it becomes clear that the key purpose of an EoT mechanism is twofold namely to: (i) confront the prevention principle head-on by providing a basis for extending time in the event that a delay occurs which is the responsibility of the employer and in doing so protects the employer's right to liquidated damages; and (ii) to re allocate risks to the employer which would otherwise be the responsibility of the contractor.

Basic Approach to an Extension of Time

Two points of caution: (i) the correct approach to an EoT will vary from contract to contract, and (ii) the position in Scotland may be different to the position in England and Wales.

JCT approach – a logical after the event analysis of the facts as to whether a particular event caused actual delay to the contractual completion date

Nevertheless and taking a JCT type approach in England and Wales, the following propositions can be derived from case law:

- a) it is a question of fact whether a particular event causes actual delay to the contractual completion date;
- b) in defending an EoT claim, an employer is entitled to say; (i) it did not cause delay because the work affected was not critical and/or (ii) the true cause of delay was something else;
- c) on all but the simplest of projects some form of critical path analysis is necessary to establish criticality, i.e. which activities, if delayed, have the capacity to cause delay to the completion date;
- d) before the delay impact of an event can be assessed, the parties must confront all delays and delay events which have occurred up to that date;
- e) an impressionistic assessment of an EoT under the guise of 'fair and reasonable' is not good enough. What is required is a logical analysis of the impact of an event and for that analysis to be undertaken in a methodical way; and
- f) if the event makes no difference by reason of a pre-existing delay which is the contractor's responsibility, then no EoT would be due.

The NEC approach

Consistent with NEC3's overall objective to manage and resolve issues as the works progress, NEC3 takes a quite different approach as follows:

- a) the parties are to act in a spirit of mutual trust and cooperation;
- b) the submission and acceptance of a programme;
- c) the regular updating of the programme to reflect actual progress and the impact upon the completion date;
- d) the parties must give early warnings of delays as soon as they become aware of them;

NEC approach – a contemporaneous theoretical assessment of the anticipated time implications of a particular event

- e) to seek to address those delays;
- f) to seek to pre-agree the time and cost consequences of compensation events; and
- g) to use the programme to project the theoretical impact of a delay event.

Accordingly, the key distinctions of the NEC approach are:

- a) an express contractual preference for a timely but theoretical projection of delay to the date on which the contractor planned to complete the works in lieu of a wait and see approach to retrospectively assess what delay (if any) has actually occurred to the contractual completion date;
- b) the use of the contractor's planned completion date for which to assess an EoT in place of the contractual date;
- c) the need to pre-agree or pre-assess an EoT before a compensation event is implemented.

This de-linking of theory from reality can be problematic because it will always give rise to an EoT which:

- a) is inadequate because the actual delay incurred by the contractor is greater than the theoretical projection calculated from the accepted programme and, as a result, a compensation may have the effect of increasing the contractor's exposure to liquidated damages; or
- b) over compensates the contractor by granting an EoT in circumstances where there was no actual delay at all, or an EoT which is significantly greater than the delay actually incurred and as a result, gives rise to significant delay costs to the employer.

Nevertheless, it is clear that NEC3 considers that its primary objective of timely certainty by resolving issues as they arise to be worth the price of disregarding reality and adopting such a theoretical approach.

Mediation: a worrying trend undermining confidentiality

Summary and implications

Mediation can be a successful method of resolving construction and engineering disputes. It is supposed to be a confidential process allowing the parties to discuss their respective positions openly and candidly. But an increasing number of cases have demonstrated that those who mediate might later find their conduct subject to the court's scrutiny.

Three things you should note:

- what you say or do during a mediation will not necessarily remain a confidential and private matter;
- the court will be prepared to investigate your mediation if there are questions as to whether a binding settlement has been agreed or whether one party should pay costs because of its conduct at the mediation;
- the mediator may be compelled to give evidence about what was said and done during your mediation.

A confidential process

The parties to a dispute should always be encouraged to settle their differences without resorting to litigation. They should not have to be concerned about whether anything said in an attempt to reach a settlement might be held against them in later proceedings. This key principle applies to mediation.

The fact that participants assume that mediations are confidential, and feel able to fully and frankly put their cards on the table, probably explains why mediation is so successful. A 2009 survey, supported by the Technology and Construction Court, found that the majority who used mediation said that it resulted in settlement.

'Confidential' means two things

Mediations are typically confidential for the following reasons:

- the process is a type of 'without prejudice' discussion
 - there is a general rule that written or oral communications made in a genuine attempt to resolve a dispute may not be admitted in evidence. For this reason, every proper mediation will be treated as being on a without prejudice basis, regardless of whether the participants have used that expression. To put things beyond doubt, mediation agreements often include a clause confirming the without prejudice status.

Ask a question

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- mediation agreements usually include a confidentiality clause
 - irrespective of any without prejudice status, mediation agreements usually include a clause that requires confidentiality to be maintained in relation to all matters connected with the mediation.
 - a confidentiality clause will typically only allow exceptions where the parties agree that confidentiality can be waived, or where there might be a statutory obligation to disclose.

The start of the trend?

Despite the concepts of without prejudice communications and confidentiality clauses, privacy is by no means guaranteed.

The Court of Appeal has issued a judgment* setting out a number of circumstances in which the without prejudice rule would not protect a party from having its conduct at a mediation scrutinised by the court. They include questions as to whether the parties have entered into a binding settlement agreement, or whether a settlement agreement should be overturned due to misrepresentation, fraud or undue influence.

These principles have been applied in a number of subsequent disputes.

Related item:

* *Unilever Plc v Procter & Gamble* [2000] 1 WLR 2436

The next significant case

In a 2007 case* the court had to decide whether a dispute had settled following a mediation. The dispute had not settled during the course of a 13 hour mediation. But one party said that the other had left an offer on the table, which it decided to accept the following morning. The court said that it was entitled to look into what was said during the mediation, and dismissed any suggestion that the process should be kept confidential.

Related item:

* *Brown v Rice* [2007] All ER (D) 252 (Mar)

Examining conduct at mediations

In another 2007 case* the court said that it was entitled to take into account the offers that each party had made during a mediation when deciding whether to award one party the costs of having participated in an unsuccessful mediation.

Related item:

* *Chantrey Vellacott v Convergence Group plc* [2007] EWHC 1774 (Ch)

The interests of justice are more important than confidentiality

In May 2009, the Technology and Construction Court issued one of the most recent, and significant, judgments dealing with questions of confidentiality attaching to the mediation process*.

Related item:

* *Farm Assist Limited (in Liquidation) v Secretary of State for Food Environment and Rural Affairs* [2009] EWHC 1102 (TCC)

The claimant had started court proceedings against Nabarro's client, DEFRA. The two parties had resolved a dispute at a mediation some years earlier, and entered into a written settlement agreement negotiated by the claimant's lawyers. The claimant wanted the court to decide that the settlement was not binding. DEFRA said that there was nothing wrong with the settlement.

This was a continuation of the trend and it was another example of the type of case where the court would consider it necessary to investigate what happened at a mediation.

The court had to decide whether the mediator should give evidence at the trial.

- The mediator did not want to give evidence. The mediator had co-signed the mediation agreement, which contained a confidentiality clause. On that basis, the mediator argued that mediators were entitled to insist that confidentiality be preserved.
- DEFRA took the view that if the court was going to review the mediation, it would help the court if the mediator, as an entirely neutral participant in the process, gave evidence.
- The claimant did not support the attempts to have the mediator give evidence at the trial.

In circumstances where the claimant had called into question the mediation process, the court decided that the interests of justice outweighed the mediator's right to rely on the confidentiality clause. As a result, the court said that the mediator should give evidence. Following this particular hearing, the claimant chose to discontinue its claim.

Statutory right to adjudicate extended as the TCC adopts a narrow approach to exclusions

A recent Technology and Construction Court decision has confirmed that the 'construction operations' which are excluded from the Housing Grants, Construction and Regeneration Act 1996 (the "Construction Act") should be interpreted narrowly to ensure that non-specialist contractors and subcontractors down the contractual chain are not unfairly excluded.

Ask a question

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- Where there is no contractual provision for adjudication, in order to refer a dispute to adjudication, a party must establish that the contract falls within the definition of a 'construction contract' under s104 of the Construction Act, which is defined as the 'carrying out of construction operations';
- Certain 'construction operations' are excluded from the Construction Act by s105 (2) of the Act;
- The extent of the exclusion in s105 (2) has been the subject of debate for a number of years. In June this year, Mr Justice Ramsey provided clarification of the position in his decision in *North Midland Construction Plc v AE & E Lentjes UK Ltd [2009] EWHC 1371 (TCC)*.

Construction operations: which are caught by the Construction Act?

The 'construction operations' which are caught by the Construction Act are wide-ranging and encompass all alteration works which are integral or preparatory to such operations. The majority of disputes that have been considered by the court in recent years have centred on the interpretation of the type of 'construction operations' which are excluded from operation of the Construction Act. In particular, the precise meaning of s105(2)(c) which deals with the exclusion of the works involving the assembly, installation and demolition of plant or machinery or the erection or demolition of steelwork where the primary activity is either nuclear, power generation, water treatment, or bulk storage of chemicals, oil or gas. Prior to this decision, case law had adopted two different interpretations of s105(2)(c), referred to below as the broad and narrow approach.

Recent case law: narrow interpretation to exclusion preferred

North Midland Construction Plc v AE & E Lentjes UK Ltd

The facts were that AE&E Lentjes UK Ltd, was appointed as turnkey contractor by Scottish and Southern Energy plc to provide flue gas desulphurisation units to two coal fired power stations at Fiddler's Ferry,

Cheshire and Ferrybridge, West Yorkshire. These units required enabling works and civil works before the units could be installed. AE&E Lentjes UK Ltd entered into four sub-contracts in respect of the enabling works and civil works with North Midland Construction Plc. The enabling works included the construction of temporary roads, services and construction of the foundations of the site offices and demolition of buildings. The civil works included the construction of foundations for components of the plant such as tanks, gas heater, absorbers, pump house, de-watering and waste treatment.

A dispute arose over the final account and North Midland Construction Plc sought a number of declarations under CPR Part 8 including whether the enabling works and civil engineering works fell within the excluded works in s105(2)(c). AE&E Lentjes UK Ltd argued that the enabling works and civil works were all necessary and effective parts of the flue gas desulphurisation units and so were caught by the exclusion in s105(2)(c).

Mr Justice Ramsey confirmed that the court should generally adopt a narrow interpretation of s105(2)(c). It was held that the works under the agreements for enabling works and civil works could not be described as 'the assembly, installation or demolition of plant or machinery' and accordingly, did not fall within the exclusion. The works amounted to 'construction operations' and were therefore caught by the Construction Act, even though they had been carried out at a site where the primary activity was power generation, one of the excluded activities under s105(2)(c)(i).

Mr Justice Ramsey considered that if the intention of the section had been to exclude all the construction operations on a site where the primary activity was power generation that could easily have been achieved by adopting different wording. Equally, if it had been intended to exclude all preparatory activities, then a sub-section similar to s105(1)(e) could have been added.

The purpose of the Construction Act was to improve the construction industry by providing a rapid dispute resolution mechanism and improving the certainty of payment provisions. It was carefully drafted to exclude only operations where the relevant specialist process engineering industry was deemed sufficiently organised and regulated so as not to need legislative protection. Other construction operations, where the work is not of a particularly specialist nature, were not intended to be caught and so should not be exempt.

Mr Justice Ramsey's view was that a broad interpretation of the exclusions would significantly reduce the application of the Construction Act and unfairly exclude certain contracts.

Whilst it is likely that there will always be certain aspects of every contract where the applicability of

Summary of previous case law

Narrow approach*	Broad approach†
Exclusion does not apply to construction operations which are part of, or preparatory to a specifically excluded operation. These will still be covered by the Construction Act.	Exclusion applies to any construction operations which are necessary to achieve the aims and purposes of the owner or principal contractor where the primary activity of the site is excluded.

* *Palmers Ltd v ABB Power Construction Ltd* [1999] BLR 426

† *ABB Power Construction Ltd v Norwest Holst Engineering Ltd* [2000] TCLR 831

Mr Justice Ramsey's view was that a broad interpretation of the exclusions would significantly reduce the application of the Construction Act and unfairly exclude certain contracts

the exclusion would be debatable, his view was that it was not the intention of the Construction Act that there should be a detailed analysis as to whether a particular construction operation fell within the exclusion, when a straightforward common sense analysis gave a clear answer.

Comment

Those with particular involvement in the negotiation of contracts for work at power stations, water treatment and process plants and similar facilities will welcome this decision because it attempts to provide some consistency to the approach taken by the court to the meaning of s105(2).

It also upholds the underlying intention of the Construction Act which is to provide a rapid dispute resolution method to those engaged in construction work, with only very limited exceptions.

Nevertheless, it seems unlikely that this will be the end of the matter as it gives rise to the odd result that the steelwork which supports the plant on a power station would be excluded from the Construction Act whilst the foundations which support the steelwork would not. It is also questionable whether the paintwork to the same steelwork would also be regarded as excluded from the Construction Act.

Pre-Action Conduct: Sanctions for Failure to Comply Now and in the Future

Summary and implications

The Pre-Action Protocol for Construction and Engineering Disputes (the "Protocol") may be considered to be merely a procedural step by some whereas to others it serves a very practical purpose in assisting parties to resolve disputes. Whatever your view of the Protocol is, it remains the case that the courts require parties to comply with the spirit if not always the letter of the Protocol and that parties who fail to comply may be punished severely in respect of costs. The court may also consider a party's conduct when awarding interest on damages.

Current Position

The sanctions available to the court are set out at paragraph 4.6 of the Practice Direction on Pre-Action Conduct (the "Practice Direction")* which are:

- the power to stop proceedings until the required Pre-Action steps have been taken;
- the power to make costs orders against a party failing to comply;
- the power to make orders in respect of interest against a party failing to comply.

Possible Changes

The issue of costs and Pre-Action conduct has been considered by Lord Justice Jackson in his on-going review of the costs of civil litigation. It has been proposed that the Protocol process would take place after proceedings have been issued at which point the court would have the power to manage the Protocol process and the costs of the process would become costs of the action. This is in response to concerns that the current Protocol process front loads costs too much and that those costs incurred Pre-Action may not be recoverable as the courts do not have the power to make awards in respect of costs incurred Pre-Action.

Sanctions and Examples of Failure to Comply with the Protocol

The Practice Direction gives the court wide powers to penalise parties who have failed to comply with the Protocol.

In circumstances where a party has issued proceedings without first going through the Protocol process, the defendant could seek to have the proceedings stayed to ensure those steps that should be taken Pre-Action have been. The court has been willing to make such orders and force the parties to comply with Protocol. This may be a useful option to

Ask a question

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Related item:

* [Practice Direction - Pre Action Conduct](#)

Sanctions Available to the Court

- The power to stay proceedings until the required Pre-Action steps have been taken.
- The power to make costs orders against a party failing to comply.
- The power to make orders in respect of interest against a party failing to comply.

a defendant who feels they have been ambushed by a claimant and who genuinely does not know the claim it is expected to answer. The exception is where a claimant needs to issue proceedings because the limitation period is set to expire and there is not enough time to go through the Protocol process. In those circumstances the claimant must apply to the court for directions as to the timetable and form of the procedure to be adopted by the court at the same time that it requests the court to issue proceedings.

Where a party has issued proceedings without complying with the Protocol and has then carried on with that claim the court has made adverse costs orders against that party. In a 2002 case* the claimant had tried, unsuccessfully, to pursue a claim without first issuing a letter of claim setting out its case. Even though no Pre-Action Protocol applied to the case the court held that a failure to issue a letter of claim was unreasonable conduct and as a result the claimant had indemnity costs awarded against it. The award of indemnity costs means that the party who has the benefit of the award is likely to recover closer to 80% of its costs rather than the 60% it is more likely to recover if costs are assessed on a standard basis.

Related item:

* *Phoenix Finance Ltd v FIA (Costs)* [2002] EWHC 1242

Where a party has failed Pre-Action to set out its claim with any clarity and has then gone on to amend its claim, time and again, the court has been willing to make a costs order against that party. In one particular case a claimant was ordered to pay the defendant's costs of proceedings up to the date when the claimant finally presented a case to which the defendant could properly respond*.

Related item:

* *Daejan Investments v Park West Club* [2003] EWHC 2872

The court's powers in respect of interest extend to awarding interest at a lower rate than a claimant failing to comply would otherwise have received or awarding interest at a higher rate, of up to 10% above base rate, against a defendant that has failed to comply.

Consequences of Technical but not Serious Non-Compliance

Whilst the court has the power to make severe orders against parties failing to comply with the Protocol it remains at the court's discretion to do so. In the case of technical non-compliance with the Protocol the court has been unwilling to impose severe sanctions.

The Technology and Construction Court (the "TCC") has recently considered technical non-compliance*. In this case the defendant sought a costs order against the claimant for failure to comply with the Protocol. Specifically the defendant argued that the claimant had failed to serve a Protocol compliant letter of claim. It was held that the court's approach should be to look at the substance of the issue of alleged non-compliance and not the technical details of any failure to comply.

Related item:

* *TJ Brent and another v Black & Veatch* [2008] EWHC 1497 (TCC)

The court found that whilst there may not have been in strict terms a Protocol compliant letter of claim, the defendant had been presented with a clear summary of the basis of the claim against it with details of the main contractual terms and what the claimant was seeking. The

court did not make an order against the claimant for failure to comply with the Protocol.

It can therefore be seen that whilst the threat of seeking a costs order against a party that has failed to comply with the Protocol may be a useful tool, particularly given the potential severity of the sanctions open to the court, the court will equally look unfavourably on a party who seeks to force a slavish compliance with the exact letter of the Protocol. There is clearly a balance to be struck between ensuring you have satisfied the substance of the Protocol without requiring such strict compliance that the time and costs expended become disproportionate to the value of the dispute.

The courts will equally look unfavourably on a party who seeks to force a slavish compliance with the exact letter of the Protocol

Civil Litigation Costs Review: Preliminary Report

On 8 May 2009 Lord Justice Jackson published his preliminary report into the costs of civil litigation. The report looked in part at the conduct of proceedings in the TCC and one of the issues it considered was costs incurred in the Protocol process.

Concerns have been raised for some time in the industry that the Protocol process in the TCC forces parties to incur substantial costs before proceedings have been issued and that those costs may then not be recoverable as the court only has the power to make awards in respect of costs that are incidental to the actual proceedings. This means that if the parties spend considerable time and money narrowing the issued between them that it is very unlikely those costs will be recoverable.

Lord Justice Jackson has suggested that the Protocol process takes place after proceedings have been issued. The proceedings will be stopped to allow this to happen.

Lord Justice Jackson has suggested that this would have a number of benefits as the court could take control of the process and prevent one party from obstructing the Protocol process, something that can currently commonly occur. The court would also be able to bring the Protocol process to an end if it was going nowhere, something that can currently be difficult for parties to agree on. Moving the Protocol process post issue of proceedings would also bring the costs of the process within the costs of the action and remove some of the current problem of costs of complying with the Protocol being irrecoverable.

The report is currently the subject of a consultation that is due to be completed in December this year. However, It has already been suggested that the TCC may pilot the Protocol process taking place after proceedings have been issued. My colleague Ian Radford discusses the potential reforms in more detail in the following article.

Moving the Protocol to After Proceedings are Issued: summary of the proposed benefits

Current Position	Proposals
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Case Management

<ul style="list-style-type: none"> • One party can seek to delay or obstruct the Protocol process without penalty. • Parties can struggle to agree if the Protocol process has come to and end. 	<ul style="list-style-type: none"> • The court could order a party to comply with the Protocol. • The court could decide when the Protocol process has come to and end and start the court process.
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Costs

<ul style="list-style-type: none"> • Costs of the Protocol process can be very difficult to recover unless they are incidental to subsequent proceedings. 	<ul style="list-style-type: none"> • The court would have jurisdiction over all the costs of the Protocol process.
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Getting back the cost of going to court-reforms are in the pipeline

Summary and implications

A comprehensive report on the cost of court proceedings will emerge at the end of the year. It will recommend a number of changes that will potentially benefit those involved in construction disputes. These include:

- a possible extension of fixed costs regimes to include lower value claims. This may in many cases render court proceedings more attractive than adjudication;
- reforms to make it easier to recover the costs incurred in the earliest stages of a dispute. At present, costs incurred in complying with the court's pre-action protocols (as mentioned in the earlier article in this newsletter by my colleague Matthew Taylor) are frequently not recoverable;
- changes to the way that claims can be funded – including the possible introduction of American-style 'contingency fees'. This may encourage more 'gainshare – painshare' arrangements between litigants and their lawyers.

Ask a question

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What is the problem?

The cost of resolving disputes has always been a thorny issue for the construction industry. The desire to reduce those costs has driven a number of reforms over recent years, most notably the introduction of a statute-backed adjudication system.

Unfortunately, adjudication has not been a universal cure-all. It is usually an interim measure only – so if one party doesn't like the result, it can still go on to have the issues resolved in court. Often, the rules do not permit the parties to recover the considerable costs they may incur in securing adjudicator's decisions. And such decisions, frequently produced under tremendous time pressure, by individuals without the large range of highly technical skills needed to resolve highly technical disputes, can be of such indifferent quality that the parties are forced to turn to the court (or to highly-paid specialist arbitrators) to provide definitive answers.

The legal costs associated with court proceedings can devour the profits generated by otherwise successful projects; and the cost of taking or defending such proceedings thus remains of fundamental importance to the construction industry.

Earlier this year Lord Justice Jackson, a senior judge who spent much of his previous career as a barrister working on construction disputes, produced a draft report analyzing how the litigation costs system has

reached its present (unsatisfactory) stage of evolution. He is now assimilating the comments of the many parties keen to see change in the system - and the rather fewer parties who are content with the status quo. His final report is due out at the end of the year, and can be expected to champion some changes that will be of great interest to our somewhat beleaguered industry. This briefing considers some of the measures that may be implemented.

Fixed costs for smaller claims

The amount of costs a party currently has to pay to have a dispute determined by the court can be pretty indeterminate.

In only a few categories of cases – uncontested claims, road traffic accidents, employer's liability claims – are fixed and proportionate costs the norm. Lord Justice Jackson is now considering whether fixed cost regimes should be extended to cover all 'fast track' cases – a category which includes (or might be extended to include) many lower-value construction claims.

This may make litigation much more attractive than adjudication as a way of resolving many disputes. Typically, the court fees for a smaller case will be a lot lower than the fees payable to an adjudicator. There will be much less scope for procedural manoeuvres about 'jurisdiction' and fewer fights about the enforceability of the decision. And, perhaps most importantly, there will be some prospect of a successful party recovering its own costs – whereas in a typical statutory adjudication, both parties have to bear their own costs, even where one party has clearly been shown to be in the wrong.

Easier recovery of costs incurred early on

Under the present system, disputants must go through some elaborate procedures, set out in a formal protocol, before they can get to the point of issuing a claim form at the court. These procedures are designed to help highlight and narrow the scope of the issues in dispute, and thus reduce the amount of time the parties would otherwise spend before a Judge. Unfortunately, costs incurred in refining and resolving claims that are sorted out through the protocol procedures are usually treated by the court as being irrecoverable. This is unfair.

Lord Justice Jackson has suggested that the protocol procedures could in future be undertaken *after* a claim form has been issued at court. This will have the dual benefit of making it much easier to recover the costs spent on the process of attempting to narrow differences; and of enabling the specialist construction judges to supervise the process – which, as Lord Justice Jackson notes, in itself can lead to the avoidance of unnecessary costs, and the recovery of a much greater proportion of the costs actually spent.

Alternative ways of funding proceedings

Lord Justice Jackson notes that whilst there has been considerable growth in litigation where the claimant's costs are underwritten by 'After the Event' ("ATE") insurance policies, this has resulted in costs for defendants spiralling upwards – partly because the claimant is having his costs paid by others and has less incentive to control what is spent; and partly because the cost of the ATE policy, which is in principle recoverable from a defeated defendant, can be ruinously high and, in some cases, totally disproportionate to the risk being undertaken by the insurer.

The judge is considering whether the entire costs of such policies should continue to be recoverable. If he decides that they should not be, we can expect a cooling-off of insurance-backed litigation. He recognizes, however, that ATE policies can create an avenue to justice for those who would otherwise be unable to afford to litigate; and that it may be necessary to create other avenues to ensure that such access to justice is maintained. This is perhaps doubly important in current economic circumstances, where companies may simply be too strapped for cash to fund court proceedings in the normal way.

Interestingly, one of the ways Lord Justice Jackson thinks that justice might in future be pursued is by permitting 'Contingency Fees' – where the lawyers are paid a pre-agreed proportion of the sums recovered, and get nothing if nothing is recovered. This is a commonplace of American litigation, but has previously been scorned in this country. If the idea is adopted, it may see widespread use in construction cases. Partnering between contractors and developers and their lawyers - pain sharing and gain sharing – may suddenly become fashionable; ironically just as such concepts are starting to fall out of favour in many other construction industry contexts.

Court - a better bet than Adjudication?

Lord Justice Jackson is proposing a fixed costs regime that may be applied to smaller construction claims – will this make court proceedings a more attractive option than adjudication?

Perhaps yes, because:

- There will be some prospect of getting your costs back. With most adjudications, there is no such chance.
- The fees the court will charge will be lower than those many adjudicators will charge.
- Lots of the current wrangling about jurisdiction, and the enforceability of adjudicator's decisions will be bypassed.

However:

- Fixed costs may be set at too low a level to repay the cost of properly preparing complex technical issues for the court to consider.
- Judges dealing with lower-value claims may not have enough specialist knowledge of the industry.

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