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### Welcome

In this edition of the ADR Digest, James Longbottom takes a further look at the Hong Kong Government's new Handbook which replaces the Standard Method of Measurement for Civil Engineering Works and considers the commercial and contractual effects of the end of the item coverage system, which has been used in Hong Kong for the last twenty years.

Our guest writers in this edition of the ADR Digest, Vincent Connor, Head of Office, Hong Kong and Wei Yaw Lam, Registered Foreign Lawyer of law firm Pinsent Masons, review the long running Scottish case of City Inn Limited and Shepherd Construction Limited. The judgment covers a number of interesting points including whether a condition precedent provision for notifying extensions of time can be waived by an architect and the apportionment of delay and prolongation costs where there are concurrent causes of delay.

Avan Fan considers the growing importance of building services and whether the commercial management of this sector could be given more prevalence.

Resolving conflicts in contract terms can be a complicated affair - our ADR Analysis series in this edition offers some aides in determining the preference of such terms.

Finally, many of you will be aware that Michael Keys sadly passed away in September 2007 after a long battle against cancer. We are most grateful to Sandra and Diana Keys who have kindly asked us to make good use of Michael's extensive library collection of professional books and papers - see our news section for further details.



# > The end of **Missing Items?**



By James B Longbottom BSc(Hons) LLB(Hons) FRICS FHKIS FCIArb RPS - Managing Director, ADR Partnership Ltd

#### Introduction

In November 2007, the Government of the Hong Kong Special Administrative Region published the latest revision to its controversial Handbook, first introduced in December 2006, for Preparing Bills of Quantities for Civil Engineering Works (the Handbook) which is to replace the Standard Method of Measurement for Civil Engineering Works, 1992 Edition (the SMM). This article is the second of two. analysing some of the major changes in the method of measurement contained in the Handbook from those in the SMM, and concentrates on one aspect of the Handbook which is to end the Item Coverage system.

The Preface to the Handbook sets out the objectives of the Bills of Quantities which are similar to those in the SMM and are to give information:

- upon which tenders can be obtained; and
- provide for the valuation of work executed.

However, the Handbook seeks to achieve these objectives in quite different ways to the SMM by placing further risk of errors in the production of the Bills of Quantities on the contractor rather than the person responsible for its preparation.

#### **SMM & Item Coverage**

The old SMM adopted the Item Coverage system. This provided a full list of the items which a contractor was required to allow for when pricing a work item described in the Bills of Quantities. If something was omitted from that The advantage of the Item
Coverage in the SMM was that
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list, then arguably it became a missing or omitted item from the Bills of Quantities which was to be corrected and valued in accordance with GCC Clause 59(3); i.e.

"Any error in description in the Bills of Quantities or item omitted therefrom shall not vitiate the Contract ... The Engineer shall correct any such error or omission, shall ascertain the value of the work actually carried out in accordance with Clause 61, and shall certify in accordance with Clause 79."

The advantage of the Item Coverage in the SMM was that it clearly defined the extent of the work covered by each item description in the Bills of Quantities so that it could be priced with certainty. Any specified work not covered by an Item Coverage or separately itemised in the Bills of Quantities was valued and added to the Contract Sum.

#### **The Handbook**

The new Handbook ends the concept of Item Coverage and shifts the risk of missing items onto the contractor with a view to ensuring that the price tendered represents the all-inclusive value of the work required by the Conditions of Contract, Drawings and Specification.

Provision is also made in the Handbook to limit the opportunity for contractors to strategically price items with small quantities in the hope that those quantities increase substantially and providing a potential financial windfall for the contractor.

# Item of work not covered by item description extensions

The use of Item Coverage is replaced in the Handbook by what is referred to as 'item description extensions'. Their purpose is essentially the same as the Item Coverage system which is to list those components that are required to be included under any item of work.

However, Preamble Part II, paragraph 1.1 of the Handbook provides that these:

" ... descriptions or identifications may not be exhaustive. The exact nature and extent of an item of work must be ascertained by reference to the Drawings, Specification, General Conditions of Contract and Special Conditions of Contract, as not all requirements may be stated in the item description or its item description extension."

Further, the rates inserted against an item in the Bills of Quantities are, by virtue of Preamble Part II, paragraph 1.2, to include the full inclusive value of carrying out the item of work including "incidental work". The expression "incidental work" is defined as including:

" ... but not limited to, the carrying out of all work and services and complying with all obligations which are specified or reasonably implied in the Contract and which are related to, arise out of or connected with the item of work as described in its heading, subheadings, item description and item description extension."

What does all this mean? Well, if an item of work is not properly covered by an item description extension or if that item includes work incidental in nature, then the contractor is now deemed to have allowed for this in his tender. In effect, the item coverage becomes superfluous. It should also be noted that as a precursor to the new Handbook, similar provisions have already been introduced into the SMM by Corrigendum No. 1/2007 and these have already been incorporated into some recent major Government projects. An outline summary of the old SMM and new Handbook position is provided in **Figure 1**.

Figure 1: Correcting and valuing missing items

Missing Item	Can an omitted item of work be corrected and valued in accordance with GCC Clause 59(3)?	
	SMM	Handbook
Item of work not covered by item coverage / item description extensions	Yes (If Corrigendum No. 1/2007 is not incorporated)	<b>No</b> (Items include full inclusive value of work including incidental work)
Item of work not separately itemised in the Bill of Quantities		
<ul> <li>Described or identified in the specification, GCC or SCC and not shown on the Drawings</li> </ul>	Yes	<b>No</b> (Included in Section 30)
- Shown on the Drawings	Yes	Yes

#### Items of work not separately itemised

Section 30 of the Handbook is for 'Works and Services Not Separately Itemised' and includes the following item description which should be priced as a lump sum:

"Execute, complete, maintain and/or supply all work and services described or identified in the Specification, General Conditions of Contract or Special Conditions of Contract and which are not shown on the Drawings and covered or separately measured under any other items of work."

The contractor is, therefore, expected to identify all such omissions during the tender period and price these items against the item in Section 30 – a Herculean task.

Does the introduction of this catch-all provision mark the final nail in the coffin for all missing items? Well almost, but not quite, as is made clear by the following exceptions.

What happens to work and services which are shown on the Drawings and have not been covered or separately itemised in the Bill of Quantities?

Part I, paragraph T(ii) of the Guidelines for Preparing Bills of Quantities clarifies the position, as follows:

"Where work and services are shown on Drawings but are not particularly itemised or covered by any other items in the bills, irrespective of whether or not they are described or identified in the Specification such work and services will not fall within the scope of the item in Section 30. Such work and services should be corrected in accordance with GCC Clause 59(3)."

Therefore, Section 30 does not apply for an item of work shown on the Drawings (e.g. provision of sign gantries) but not itemised in the Bill of Quantities. Such work will still be treated as an omitted item pursuant to GCC Clause 59(3) irrespective of whether the item of work is described or identified in the specification, GCC or SCC (see summary in Figure 1). However, in our opinion, differences or disputes may still occur, for example, where work is shown on the Drawings and not separately itemised in the BQ but which the Engineer claims is "incidental work" (e.g. a safety hand rail fixed to a sign gantry could be itemised separately as hand railing in accordance with Section 4 of the Handbook or, alternatively, could be deemed to be incidental work to the sign gantry itself).

What happens to work and services which are not shown on the Drawings but are described in the General Specification even though no such work is required to be constructed by the contractor under the Contract?

The example provided in the Handbook is where specification of masonry work is given in GS Section 24 but the Contract does not require the construction of any masonry work. Part I, paragraph T(iii) clarifies that where the need for such work and services is only made known to the contractor after the Contract has been awarded (by way of instructions) the matter will be dealt with as a variation and Section 30 does not therefore apply.



The new Handbook ends the concept of Item Coverage and shifts the risk of missing items onto the contractor with a view to ensuring that the price tendered represents the all-inclusive value of the work required by the Conditions of Contract, Drawings and Specification.

#### Items of work with small quantities

Guideline R of the Handbook notes that it is not unusual as part of a contractor's pricing strategy to price items of work with small quantities with high rates on the basis that the quantities may later substantially increase and provide the contractor with a financial windfall. In reality, this may not be a financial windfall at all, as the contractor may have identified such opportunity, strategically priced the rates but already made allowance for such future income by discounting his tender price to win the tender. The Guidelines in the Handbook provide that if the only purpose for including these items is to obtain rate(s) from the contractor, these items of works should not be included and the works should be dealt with as variations during construction. The Handbook, therefore, further limits the ability of canny contractors to secure work by strategically pricing such items.

#### Conclusions

The end of the Item Coverage system and introduction of a catch all item for "works and services not separately itemized", changes the balance of the risk of errors in the production of Bills of Quantities; i.e. the Handbook increases the risk to contractors who now have to carefully check that the Bills of Quantities accurately reflect the work to be performed.

However, if Bills of Quantities were properly and comprehensively prepared in the first place then there would be no missing items - the important point being that it is not the Bills of Quantities themselves which lead to claims, but those which are prepared erroneously. <

The November 2007 version of the Handbook can be downloaded at:

www.cedd.gov.hk/eng/downloading/index.htm

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# City Inn Limited& Shepherd ConstructionLimited

By **Vincent Connor**, Head of Office, Hong Kong and **Wei Yaw Lam**, Registered Foreign Lawyer, Pinsent Masons

#### Introduction

Entitlements to time and costs in the event of delayed completion of construction projects are frequently the subject of disputes between contractors and employers. We review a recent decision of the Court of Session in Scotland in City Inn Limited v Shepherd Construction Limited [2007] CSOH 190 below, which usefully sets out the court's guidance on a number of important matters of particular concern to contractors, including:

- when a contractor is precluded from seeking extensions of time as a result of non-compliance with notice provisions; and
- (2) whether the architect has the power to waive the requirement for compliance with notice provisions.

#### City Inn Limited and Shepherd Construction Limited [2007] CSOH 190 - The Facts

City Inn employed Shepherd to construct a hotel in Bristol. The building contract incorporated the conditions of the JCT Standard Form with additional provisions. Shepherd was obliged to complete the works by 25 January 1999; Shepherd would otherwise be liable to pay liquidated damages (£30,000 per week). There was a delay of 9 weeks to the completion of the works.

City Inn sought various remedies, including a declaration that the completion date for the works is 25 January 1999 and for payment by Shepherd to City Inn of liquidated damages for Shepherd's late completion of the works. Apart from a declaration that it was entitled to an extension of time of 11 weeks as well as certain consequential orders, Shepherd sought payment of "direct loss and expense".

Shepherd, as City Inn submitted, was not entitled to any extension of time beyond the contractual completion date of 25 January 1999 because: (i) Shepherd did not follow the procedures specified in clause 13.8 of the contract; and (ii) none of the architect's instructions caused any delay to the completion of the works; and even if any delays were caused by the architect's instructions, those were concurrent with delays arising from matters that were Shepherd's fault.

Shepherd submitted, among other things, that it was entitled to an extension of time of 11 weeks altogether with particular reference to: the architect's instruction to use an alternative form of gas membrane incorporated into the substructure of the hotel; the late issue by the architect of its instructions in relation to the roof cladding to the hotel; and the series of "significant" instructions for "variations and additional work and late confirmation of details in the work" issued late by the successor architect.

# Failure to comply with the notice provisions in Clause 13.8

Clause 13.8 sets out certain procedures that are to be followed if the contractor considers that any architect's instruction will require either an adjustment to the contract sum or delay the completion date. The court distinguished delays to the works caused by late instructions from the architect to Shepherd from those arising from the substance set out in the architects' instructions per se. The court found that clause 13.8 could not be intended to operate in the former situation, and that it only precluded Shepherd from claiming an extension of time in one case, namely the architect's instruction relating to the gas membranes.

...the architect had no power to vary or waive the terms of a building contract in relation to matters of substance; this, however, did not apply to matters of procedure.

#### Waiver

Shepherd conceded, in relation to the gas venting scheme, that the delay to the works was attributable to the substance of the architect's instruction. Shepherd, however, did not use the procedure described in clause 13.8. It transpired that City Inn's representatives had dealt substantively with this delay issue raised by Shepherd, and had, without reference to clause 13.8, indicated that Shepherd was not getting an extension of time. Separately, the architect later granted an extension of time in relation to Shepherd's claim for a time extension as a result of the gas venting instructions in one of the architect's letters to Shepherd on this issue with no reference to clause 13.8.



In relation to the gas venting scheme, the judge decided that City Inn had waived Shepherd's compliance with the requirements of clause 13.8 through both its own conduct at a meeting held on 8 April 1998 as well as the architect's approach to Shepherd's claim for extension of time intimated on 31 March 1998.

In addition, the court stated, based on the case authorities, that the architect had no power to vary or waive the terms of a building contract in relation to matters of substance; this, however, did not apply to matters of procedure. The court concluded in this case that the architect did have the authority to waive the procedural requirements set out in clause 13.8.

#### **Concurrent delays**

The court noted that the majority of the causes to the delay in the completion of the works were the result of the architect's late instructions, and were, as such, "relevant events" under the contract. The judge concluded that the delay in the completion of the works was the result of concurrent causes, and explained that the correct approach to deal with a claim for extension of time arising from concurrent delays would involve the architect exercising his judgment to determine on a fair and reasonable basis (considering the particular circumstances) the extent to which completion has been delayed by the "relevant events", to include, where appropriate, the apportionment of responsibility for the delay between a "relevant event" and a contractor default. Such an approach would involve a determination of the aggregate period within which the works as ultimately defined should have been completed having regard to the incidence of "relevant events".

It is advisable to note that the employer will, where similar provisions to clauses 24 and 25 apply, probably not be able to successfully claim absolute immunity for delay arising from the contractor's default to complete the works by the contract completion date at the outset where any delay attributable to the employer did, in fact, prevent the completion of the works by the contractor, as the contractor will, in accordance to the contract provisions, be entitled to an extension of time on a "fair and reasonable" basis considering the conduct of or on behalf of the employer in affecting the completion of the works.

#### **Prolongation costs**

Shepherd claimed the costs it had incurred as a result of the prolongation of the duration to complete the contract works on the basis that Shepherd did not receive necessary instructions from the architect in due time.

The judge decided that Shepherd did not receive instructions in due time in respect of the roof steelwork and the other nine items where instructions were given following the change of architect in respect of the works. The court concluded on the evidence that the regular progress of the works was accordingly "materially affected".

The court decided that Shepherd's claim for prolongation costs should follow the result of the claim for extension of time even though a claim for prolongation costs, in the judge's view, need not automatically follow. Further, the court acknowledged that in an appropriate case where loss is caused both by events for which the employer is responsible and events for which the contractor is responsible it is possible to apportion the loss between the two causes. The court decided that Shepherd was entitled to its prolongation costs for 9 weeks.

It appears that the Scottish courts are averse to taking a strictly literal construction of contractual provisions ... where it would otherwise be more sensible to give effect to commercial reality and where such construction also accords with the intention of the parties under the contract.

#### Conclusion

The court concluded, among other things, that City Inn was not entitled to a declaration that the completion date was 25 January 1999, and Shepherd was entitled to an extension of time of 9 weeks for the completion of the works and prolongation costs incurred in that period.

#### **Some observations**

It appears that the Scottish courts are averse to taking a strictly literal construction of contractual provisions, such as those in clause 13.8, where it would otherwise be more sensible to give effect to commercial reality and where such construction also accords with the intention of the parties under the contract.

Contractors should always be mindful to comply accordingly with the requisite provisions with regards seeking time and costs entitlements respectively arising from any delay caused by the architect and/or the employer to the completion of the works. In any event, contractors should, where practicable, not weaken any potential argument that the employer did waive such compliance of these steps by their conduct following their own failure to so comply.

These points are illustrated by the recent decision of the Technology and Construction Court in England in Steria Limited v Sigma Wireless Communications Ltd, TCC 15 November 2007, in which the court highlighted the importance of the contractor's compliance with contractual procedural requirements, including issuing notices, in order to preserve its entitlement to extensions of time to the contract date for completion. Even though the wording of the relevant clause may not be expressly clear, the contractor may lose such rights if he does not comply. <

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# > Commercial **Management** of Building Services

By **Avan Fan** LLB(Hons) BSc(Hons) Dip (China Construction) -Consultant, ADR Partnership Ltd

#### Introduction

In recent years, the proportion of construction costs represented by building services has greatly increased. Nowadays, building services can account for around 30-50% of total construction costs depending on the type of construction. These projects requiring building services can range from large scale infrastructure works, such as tunnels and bridges requiring specialist fans, controls, etc. to small scale new build works, requiring routine electrical, mechanical, plumbing and drainage, and fire services installations.

Despite the growing importance of building services, the employment of suitably qualified professional staff and/or consultants by some building services contractors to look after their financial interests remains surprisingly low. More often than not, lawyers and consultants are employed on projects only when those projects run into problems and engineering staff are left to fulfil any day-to-day commercial duties.

One reason for this under-use of professionals, is simply a consequence of the senior management of some building services contractors not being aware of the full scope of services that are capable of being provided from tender to the final account stage of a project. It is not uncommon to hear the view that a quantity surveyor's principal role merely involves taking-off quantities, a task which engineering staff can equally perform. This situation has resulted in an overall lack of commercial acumen by some building services contractors.

This article briefly reviews the building services industry and outlines some of the areas which might lend themselves to be better commercially managed.



#### **Tender stage**

In practice, building services contractors rely on specialist estimating staff or their own internal engineering staff to prepare tenders. However, commercial staff and consultants can also play a vital role in:-

- reviewing the subcontract conditions;
- identifying risks and opportunities;
- advising on pricing strategy, where it may be beneficial to load certain rates with a view of increasing the profit margin upon re-measurement of the works; and
- cost planning, where the subcontractor has design responsibilities.

#### **Construction stage - commercial management**

During the construction phase of a project, commercial staff should ideally be able to play their most valuable role in maximising value, reducing costs and improving cash flow on a building services project, including:

- the measurement and valuation of the installation works for the purposes of interim payment applications;
- the valuation of variations;
- the preparation of cost and value reconciliation statements and forecast reports including the expected recovery from claims or variations and cash flow projections; and
- the procurement of subcontractors and managing subcontract accounts.

#### **Construction stage - claims management**

The start of building services work is often constrained by the weather tightness of the building and is, therefore, one of the last trades on a construction site to which access is given. Progress is also dependent on the coordination with other trades (e.g. plastering, painting and suspended ceilings), for first, second and third fix installations. However, it is during this stage of a project that contractors invariably try to make up lost time for earlier delays. Building services contractors are, therefore, often required to reduce the duration of their site activities, work in parallel with other trades and introduce delay recovery or acceleration measures in order to complete work in a compressed timeframe (see **Figure 1**). The building services contractor, therefore, faces numerous potential interface problems with both other trades and preceding work (e.g. builders work, plinths and holes not being ready) which can cause further delays and disruption to the building services installations.

Figure 1: Accelerated Programme



Building services contractors, are, or should be, in the business to make profit on the use of the assets of the business, labour and plant.

Commercial staff and consultants can manage the time and cost effects of these problems by:

- drafting correspondence related to contractual issues, including the provision of notices and particulars for claims for extensions of time and additional payment; and
- monitoring progress including recording hand-over dates and preparing as-built programmes to demonstrate potential problems including any late, piecemeal and out-of-sequence handover of work areas.

#### Final account stage

The final account stage is a crucial stage of a project where commercial staff and consultants can perform a key service. Building services contractors are, or should be, in the business to make profit on the use of the assets of the business, labour and plant. Nevertheless, it is my experience that engineering staff often prefer to concentrate on new projects rather than the financial closure of existing accounts; i.e. engineers by their nature like to build! However, if the final installment of monies due is not vigorously pursued then the hard work and effort during the installation period may be lost.

#### **Conclusions**

A successful building services project is both a team and multi-disciplinary effort. A good commercial manager or consultant can play an important role in this team, and this may be a role in which engineering staff may not always be suitably experienced and qualified to carry out to the same degree of success. 🕻

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# ADR | Analysis

## **Preference of terms**

Contracts are becoming ever more complicated, often incorporating many documents which often leads to problems when conflicting requirements occur. In this ADR Analysis we look at some of the rules for determining the preference of conflicting terms:

- Check the contract documents, for example:
- General Specifications (GS) commonly specify that the provisions in the Particular Specification (PS) and Drawings prevail over those in the GS (e.g. GS for Civil Engineering Works). Some GS go further and state the precedence of other documents (e.g. Technical Circulars) with regards to the interpretation of conflicting technical requirements (e.g. GS for Fire Services Installation in Government Buildings of the
- General Conditions of Contracts (GCC) commonly state that the Special Conditions of Contract (SCC) take precedence over the GCC, whereas the GCC prevail over all other documents forming a part of the Contract (e.g. GCC for Civil Engineering
- SCC sometimes go as far as stating the precedence of all the documents forming a part of the Contract.

However, this is not always the case, and, even when it is the case, conflicts do arise and standards of preference exist in order to assist in interpretation.

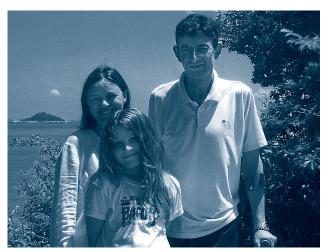
- An interpretation which gives a reasonable, lawful and effective meaning to the terms is preferred, to an interpretation which does not.
- Greater weight is placed upon express terms, over course of dealings and trade use. This may mean that an interpretation following a common practice or requiring a common standard of material, employed with regularity in the industry (i.e. trade usage), is given preference to an interpretation which does not.
- Specific terms are to be given greater weight than general terms. Hence, if the GS provides a general term specifying that blinding concrete is to be grade 30/20, however, in the GS for culverts, it is specified that the blinding to the culverts is to be grade 20/20, then the grade for the specific clause for the culverts would normally apply, requiring the blinding concrete to be grade 20/20.
- Negotiated terms are to be given greater weight than standard terms.

The above is a very general analysis and is by no means an exhaustive list of aides to contract interpretation, as the interpretation with regards to preference of terms of contracts will ultimately depend on numerous factors and the circumstances and contents of each individual contract.

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# ADR | News

## > Michael Keys 1961-2007



Sandra, Diana and Michael Keys

Many of our readers will have known Michael Keys, who after a long battle sadly lost his life on 6 September 2007 to an extremely rare form of cancer - cardiac leiomyosarcoma at the young age of only 46.

Michael was a committed, unassuming professional who was well respected within the industry and had made many friends in Hong Kong. Having being given only a few months to live, Michael, his wife Sandra and daughter Diana were an inspiration to all in their eventual eight year battle against this disease which they fought together as a family against all odds.

We were, therefore, most pleased and grateful to receive a call from Sandra asking if we could make use of Michael's books. Michael had built-up a formidable library of over 65 professional and legal text books, together with an extensive collection of professional papers, law reports, forms of contract, articles and journals, all of which had been meticulously categorized and filed.

This major extension to our library is an impressive and valuable reference base that will serve Michael's memory well in a profession which he cared for so passionately. 🕻

## **ADR Diary 2008**

17 Apr	Chartered Institute of Arbitrators - Branch Annual
	Dinner, Hong Kong Club

29 Apr	Chartered Institute of Arbitrators - AGM,
	Hong Kong Club

Based in Hong Kong, ADR Partnership Limited is a dynamic practice of construction professionals providing specialist commercial and contractual services to the construction industry.

If you would like to discuss any of the articles published in this Digest or your project requirements, please contact James Longbottom, Patrick O'Neill or David Longbottom at ADR Partnership Limited on (852) 2234 5228 or e-mail us at info@adrpartnership.com

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