Adjudication on large scale energy projects

Is it available and if so, is it a sensible option?

This month, we look at the interesting question of the role that adjudication can, should and does play in the energy sector; as well as some of the key issues and pitfalls to be wary of. In particular, we will look at the circumstances in which statutory adjudication may and may not be available to the parties in an energy sector construction dispute; and consider the consequences of failing to draft dispute resolution clauses properly.

Adjudication in the energy sector – a square peg?

In all sectors of the building industry, adjudication provides a relatively fast, interim means of settling a dispute between the parties to a construction contract. Adjudication can either be contractual (the parties are free to include for it expressly in their agreement) or, should the contract concern what is termed “construction operations”, pursuant to the Construction Act.

In the latter instance, the parties need not have expressly included for adjudication or have even considered it. Where the Construction Act applies, the parties do not have to set out their own adjudication provisions. Instead, effective provisions will be implied into the contract in line with the Scheme for Construction Contracts. These provisions set out the structural framework of the adjudication procedure and also dictate that either party can refer a dispute under the contract to adjudication at any time. As a result, many parties who are involved in building or engineering work now operate on the assumption that statutory adjudication will be available to them and they accordingly fail to consider adjudication when negotiating their dispute clauses. As will be discussed later in this article, whilst correct most of the time, it is not always the case that statutory adjudication will apply to all building contracts, with particular doubt in relation to energy sector projects.

The raison d’etre of adjudication is grounded in its speed – it effectively “greases the wheels” of the supply chain by ensuring that an imbalance of financial power between the parties cannot (or at least should not) create a restriction of access to contractual remedies and/or timely payment. Before the advent of the adjudication process, a party looking to enforce its rights under a construction contract would have to do so via the much longer (and considerably more expensive) means of litigation or arbitration. This meant that a party with a potential claim under a construction contract would often not have the time or money available to seek enforcement. With adjudication available, that party has a relatively quick and cost-effective way to obtain an enforceable decision in its favour. Once an adjudicator has delivered a valid decision, it is enforceable in the interim and can only be altered/overturned in very limited circumstances (where there has been a breach of natural justice or the adjudicator has acted outside his or her jurisdiction). An unhappy party’s only other recourse is to start court or arbitration proceedings to have the whole issue determined from scratch. Thus, particularly in these still uncertain economic times, it is easy to view the speed of the adjudication process as a virtue; particularly for those at the lower end of the supply chain for whom cash-flow is king.
However, as the old adage goes, a great strength can also be a great weakness. The primary purpose of an adjudication, like any dispute resolution procedure, is to produce a just outcome. In that context, the speed with which an adjudication can be conducted only remains a virtue so long as it does not disproportionately hinder the proper consideration of the arguments. In short, there is a clear balance to be struck between rushing to a decision and taking the requisite time to get the decision correct. The consideration is of course one to be taken on a case-by-case basis and where the line is to be drawn between speed and diligence will depend largely on the facts of the case concerned. A contractor/subcontractor adjudication in respect of a small warehouse development will probably not involve a volume or complexity of evidence which might render a speedy decision difficult. However, the definition of “construction operation” – which triggers the statutory access to adjudication – does not just include these relatively straightforward projects and as a result, some incredibly complex disputes arising out of the very largest and most technical projects are being referred to adjudication. One of the most notable examples of this is adjudication within the energy sector.

As the energy sector has grown, the result being the procurement of an increasing number of large scale energy projects. These projects, which are ever growing in scale and complexity, usually involve some very specialised construction works. The projects may be onshore or offshore, and by their very nature they include some extremely technical design and construction elements. In addition, the construction contracts used on these projects are rarely short or simple. A contract for a heat and power upgrade at a biomass plant, the balance of plant works for an offshore wind farm or the installation of a new NOx abatement facility will usually run into hundreds of pages, be accompanied by dozens of technical appendices and littered with technical language and concepts.

Is it really advisable and/or desirable to refer a dispute under such an agreement – which might be valued in the millions of pounds – to one person for a decision in 4-8 weeks? Are the key players in such projects ready to trust one person with the task of digesting and interpreting all of that material in such a short space of time?

It may seem counter-intuitive, but the answer seems to be yes - with more and more large scale energy disputes being referred to adjudication each year. This is seemingly down to a number of factors, but chief among them is perhaps the fact that the players in such contracts are typically cash-rich and time poor. When projects are time sensitive, the preference is often to resolve issues quickly and maintain progress towards completion. Interim decisions are binding but can be revisited when the dust settles and focus turns back towards profit and settling final accounts. To that end, adjudication may well not be ideal; but it is certainly useful.
Specific pitfalls to be wary of – don’t neglect the drafting!

So then - despite the limitations of the adjudication process and its relatively unpredictable nature, as parties have become increasingly familiar with the process, they are now looking to use it to resolve issues under their energy contracts. The increasingly wide-spread use of the process within the energy sector seems to indicate that more and more parties consider this an appropriate forum for resolving energy disputes. Even for those who look at adjudication with a mix of suspicion and cynicism, it is worth considering whether to make the option available. As mentioned briefly above, there is often an assumption that if something is being built, then statutory adjudication will apply. This is however not always the case and the energy sector has thrown up some of the most striking – and, depending on your viewpoint, concerning - examples of that.

Statutory adjudication is available only to contracts that concern “construction operations”; if the contract does not fall within this definition, statutory adjudication is not available. The interpretation of this definition has recently caused confusion with respect to the installation of plant or machinery at energy facilities.

Section 105(2) of the Construction Act sets out certain construction operations that are excluded for the purposes of the Act. These include:

“(a) drilling for, or extraction of, oil or natural gas;

(c) assembly, installation or demolition of plant or machinery, or erection or demolition of steelwork for the purposes of supporting or providing access to plant or machinery, on a site where the primary activity is

(i) nuclear processing, power generation or water or effluent treatment, or

(ii) the production, transmission, processing or bulk storage (other than warehousing) of chemicals, pharmaceuticals, oil, gas, steel or food and drink. …”

This means that if you are contracting for works in relation to an energy project – say at a power plant, water or effluent facility - and have not included adjudication explicitly within the dispute resolution clauses, you may find that adjudication will not be implied by statute, leaving you with the lengthy and costly alternative of litigation or arbitration.

Are the works included in the s105(2) exclusion?

When assessing whether there is a s105(2) exception in play, the first thing to consider is usually the nature of the works. Historically, there has been much debate between a narrow or a broad view of what is excluded.

By way of an example, before a utilities company can install pipelines, it needs to carry out extensive civil and structural work to clear ground and dig trenches. Then once the pipes have been installed, the area around the pipes need to be backfilled and the whole ground made good again.

In this context, the narrow view of s105(2)(c) was that only works relating to the assembly, installation etc. of pipework itself would be excluded. On the other hand, the broader view (e.g. see ABB Power Construction Limited v Norwest Holst Engineering Limited (2000) 77 ConLR 20) was that all the general civils works under the contract would be excluded, not just the pipeline installation works.

The current view seems to be that the narrow position is correct:

- S104(5) of the Act states “where an agreement relates to construction operations and other matters, this part applies to it only so far as it relates to construction operations.” Any works coming within the s105(2) exclusions are ‘other matters’.

- In two decisions (North Midland Construction plc v AE & E Lentjes UK Limited [2009] EWHC 1371 (TCC) and Cleveland Bridge (UK) Limited v Whessoe-Volker Stevin Joint Venture [2010] EWHC 1076 (TCC)), Mr Justice Ramsey held that the narrow view is correct. In particular, he cited s104(5) and also the fact that had the broader construction been intended by Parliament then a subsection akin to s105(1)(e) of the 1996 Act would have been added to s105(2)(c).

In practical terms there will be grey areas and doubt as to which works are excluded and which are not, if the exclusion in s105(2)(c) applies. In the context of adjudication claims, it is worth considering at an early stage the extent to which any dispute being referred relates to an installation operation as opposed to related civil and structural works. For a party seeking to defend such a claim, the opportunity to invoke s105(2)(c) may be worth exploring in such cases.
Is the site covered by the s105(2)(c) exclusion?

The second issue to consider is the nature of the site. The exclusion will not apply where a contractor is engaged to provide a range of services on a site which does not have a primary function of power generation. The potential for this uncertainty was highlighted in the recent Technology and Construction Court decision in Laker Vent Engineering Limited v Jacobs E&C.\(^2\)

The dispute in Laker Vent concerned a large site that included both a paper factory and its own power plant. The original power plant was coal and gas, but in 2008, an agreement was reached to replace the old plant with a new £200 million biomass plant. Green energy from that plant would be exported to the main grid. A number of disputes arose between Laker and Jacobs in respect of the project, and this culminated in Laker commenced three adjudications in accordance with the Construction Act. The parties agreed that all three decisions would be delivered by 7 January 2014.

The adjudicator found in favour of Laker, and delivered a series of decisions, including that Jacobs pay Laker £808,000 plus VAT. Following the failure of Jacobs to make payment, Laker applied to the court for enforcement of the adjudicator’s decisions. Jacobs resisted enforcement, arguing that because power generation was the primary activity of the site there was no construction contract for the purposes of the Act. If Jacobs’ position was correct, the contract would be held exempt from statutory adjudication and the adjudicator’s decisions could not be enforced.

Mr Justice Ramsey held that it was necessary to look at the whole site and to consider

- who owned the site;
- the proportion of the site being worked on in respect of the biomass plant;
- the location of the plant; and
- the overall impression of the project.

In this case for example, it was significant the plant had a limited life span, was not an independent power station, and the leased land where the biomass was to be built comprised only 10 per cent of the whole site. On this basis, it was held that the primary activity on the site was paper manufacture, that the relevant exclusion from the definition of “construction operations” did not apply and that the parties had a construction contract. Accordingly, Laker could enforce the decisions.

Clearly, this is an important case to consider on the application of adjudication in the energy sector; particularly in cases which include work at mixed-use sites which have been carried out under contracts which are silent on adjudication. This decision may well serve to give the parties to those contracts access to statutory adjudication where it was otherwise thought to be unavailable. However, it also brings into sharp focus the consequences if (i) a project does fall within the exceptions stated in s105(2) and (ii) the parties have not expressly agreed that adjudication will be available.

\(^2\) [2014] EWHC 1058 (TCC)
Final thoughts

Adjudication is likely to play an increasing role in the resolution of energy sector disputes. It should however not be taken lightly.

The parties should give careful consideration at the “front end” of the project to whether or not adjudication will be available to them and ensure that their contract is drafted accordingly, particularly when the nature of the works and/or site might create doubt over whether adjudication will be imposed on the project through the statutory regime.

At the back end of a project (or indeed, during the life of the project), the parties should think just as carefully about whether or not adjudication is a suitable forum for the resolution of the dispute that has arisen. It is impossible to establish a rule of thumb in this regard, but on large and complex energy projects and/or final account disputes, adjudication is perhaps unlikely to be an appropriate dispute resolution forum. However, discrete issues within that dispute may well be suitable for adjudication; and the quick resolution of the most important “sub-issues” will often hasten the resolution or settlement of the larger, compound dispute.

Adjudication can be a useful option to have when things go wrong. But what is most important of all is that the contracting parties are clear about which dispute resolution procedures are available to them and ensure that their contracts are drafted and their dispute resolution strategies are formulated accordingly.