

Chapter 6

**Department of Environment, Heritage
and Local Government**

6.1 Contract Termination Costs

Background

The Department of Environment, Heritage and Local Government (the Department) is the overall sponsor, manager and provider of funding for the Water Services Investment Programme.

Provision of schemes under the Programme is the responsibility of County and City Councils who are also the contracting authorities. Generally, Councils engage engineering consultants to design, plan, invite tenders for, and supervise construction.

The Limerick Main Drainage Scheme involved the planning and construction of an integrated collection, treatment and disposal system for both waste and storm water for Limerick City and environs at an estimated total cost of €130m.

My examination focussed on how one small part of this overall scheme, which was originally expected to cost less than €10m in 2000, ultimately will cost in the region of €83m as a result of the termination of a contract and the consequences of that action.

The key dates in these events are set out in Table 28 below.

Table 28 Key Dates

| Date | Event |
|-------------------|--|
| April 1997 | Limerick City Council (LCC) selected Consultant Engineers to plan, design and supervise the scheme |
| 26 February 1999 | First of 20 Contracts in Scheme awarded |
| 25 May 1999 | Contract 3.6 awarded to UCL Construction Ltd |
| 23 May 2000 | Contract 4.2 awarded to UCL Construction Ltd |
| 6 June 2000 | Work commenced on Contract 4.2 |
| March 2001 | Contractor notified LCC of difficulties |
| 2 May 2001 | Engineer issued Notice to Contractor expressing concern at lack of progress |
| 29 May 2001 | LCC issued written warning to UCL |
| 19 September 2001 | LCC issued termination notice to UCL |
| 5 November 2001 | LCC expelled contractor and took possession of site |
| 28 June 2002 | Conciliator appointed |
| 27 January 2003 | Conciliator made first recommendation |
| 12 February 2003 | Conciliation findings rejected by LCC |
| 10 July 2003 | Arbitrator appointed |
| 9 November 2003 | Conciliator made final findings |
| February 2004 | New contract awarded to replace 4.2 |
| June 2005 | Arbitrator made first award |
| November 2005 | High Court Appeal |
| September 2006 | Final Arbitrator award excluding costs |

Planning and Design

Limerick City Council (LCC) appointed, as consultant engineers, a consortium of engineering firms for the design and construction phases of the entire scheme. The appointment was made on the recommendation of the City Engineer, on behalf of the Interview Board set up as part of the competitive procedure to select consultant engineers.

I asked the Accounting Officer of the Department what was the role of the City Engineer and if the choice of a consortium of engineering firms might have contributed to the difficulties subsequently encountered.

In reply she said that the City Engineer, with his staff, (in particular through a full-time Project Manager/Senior Engineer), was responsible for managing the delivery of consultant services and the procurement of the works contracts for the entire Limerick Main Drainage Project. Once a contract was awarded, the consulting engineer is appointed “Engineer” in the contractual sense, for the purposes of administering the Contract, while the City Council remains the “Employer”. The City Engineer (and his staff) continued to have a monitoring role throughout the contract period, and gave advice to the City Manager on all major decisions required of the Employer, as well as reporting on the overall level of progress on the delivery of the contract.

It was quite common on larger projects for a consortium of firms to provide engineering services. The three firms in this consortium, two based in Limerick and one in Dublin, were among the leading consulting engineers in the country with significant specialist civil and structural engineering experience on water services and other major projects. Similar consortia of consulting engineering firms have provided, and continue to provide, engineering services on nearly all the major water services projects procured since the mid- 1990s.

Tendered Cost of Overall Works

Tenders were sought for 20 distinct parts of the overall scheme and 20 contracts were placed between 1999 and 2004. The total amount tendered for the 20 contracts was €188m. The final accounts for these contracts have not been agreed for all cases at the date of my Report.

Uniform Construction Limited Contracts

Two of the 20 contracts were awarded to Uniform Construction Ltd (UCL). The Abbey River contract (3.6) was awarded in June 1999 for an amount of €9,048,020, and was substantially completed by 31 March 2001 at a cost of €11,820,468. The North Interceptor Sewer – Contract (4.2) for €9,570,570 gave rise to the difficulties and substantial costs to the State examined in my audit.

North Interceptor Sewer – Nature of Work and Tendered Cost

The work involved the construction of the Northern Interceptor Sewer Upper from Watch House Cross, Ballynanty, going under the river at the Shannon Bridge, and meeting up with the Dock Road Tunnel at Bishop's Quay. The contract requirement was for the installation of approximately 2.6 kms of sewer by open cut and trenchless methods underneath the city of Limerick. Tenders were sought in 1999, and eight tenders were received ranging from €9,570,570 to €21,224,560. The two lowest tenders were €9,570,570 and €10,811,082, and the Minister approved LCC's acceptance of the contract of UCL in December 1999 for the amount of €9,570,570. The Contract Start Date was 6 June 2000, with a completion date of 6 December 2001.

Contract Disputes

In March 2001 UCL wrote to the Limerick Main Drainage Project Office in LCC, informing them that difficulties had been discovered in the path of their tunnelling, and it was likely that the natural ground was much lower than that indicated on the engineering drawings. UCL stated that it was self evident that significant additional costs to the contract would be incurred and progress would be severely delayed, and gave notice that they intended to claim payment of the additional costs involved and an extension of time for completion, commensurate with the delays caused to the completion of the works.

On 23 May 2001 LCC's City Engineer wrote to the Department advising that

- 64% of the time had elapsed with only 25% of the work completed
- Negligible progress had been made in the previous 3 months, and serious problems had arisen including road collapses
- The consultant Engineer's view was that conditions currently existing should not prevent the satisfactory construction of the tunnel and that the problems were due to over-mining which suggested inadequate control and monitoring of the operation of the micro tunnelling boring machine
- No tunnelling had taken place since 26 February 2001 and UCL were refusing to recommence until further investigations were carried out
- UCL claimed unforeseen ground conditions and artificial obstructions existed and would be seeking recovery of costs and all delays would be reflected in their claim
- Solutions offered by UCL of ground stabilization and lowering the tunnel would have significant cost implications
- LCC considered that UCL did not have the expertise to deal with the problem.

LCC put forward 4 options to deal with the situation

- Employ a specialist sub-contractor with UCL's agreement at a cost of €5.71m.
- UCL to put in place and maintain a management structure capable of doing the work satisfactorily. However, LCC believed that UCL would remain insistent on further investigations and ground treatments at a cost of €5m.
- Employ a specialist sub-contractor without UCL's agreement at a cost of €5.71m.
- Terminate the Contract at a cost of €6.9m. LCC added that if the contract was terminated, there was no doubt but that UCL would seek arbitration or some other legal recourse. However, if UCL were unsuccessful, their bond of €2.2m would be forfeited. LCC stated that the appointment of a new contractor would cost an additional €3.8m over present costs, but overall this would be the most attractive financial option.

LCC told the Department that, having discussed the matter with their consultants and solicitors, they were of the view that it was time to consider early termination of the contract.

These matters were discussed at meetings held in the consultant engineer's office, at the Department's offices and at the LCC's legal advisers' office in Dublin on 21 May 2001.

The legal advice was that the Engineer should clarify a previous warning. The Engineer warned UCL, in writing, that it was failing to proceed with due diligence on 29 May 2001.

On 12 June 2001 UCL wrote, denying that they were failing to proceed with the works with due diligence. They accepted that a serious delay had occurred with the tunnelling operation, but asserted that this was because of unforeseen physical conditions encountered. They suggested that they would seek to resolve the matter with the assistance of an independent third party, who would be a professional engineer, rather than embarking on the lengthy and expensive dispute resolution process which would inevitably follow the formal termination of the contract.

The Engineer issued a further written warning on 20 June 2001.

In early July, UCL provided a 39 page statement of the methodology for the next extended stage of tunnelling which was discussed at meetings over the following weeks. Approval was given on 2 August for the next section only. Tunnelling recommenced on 9 August, but had to be aborted almost immediately as the tunnelling machine could not be kept on line or level.

Pre-Termination Consultations with the Department

On 17 September 2001 the Minister was made aware of the situation. The key points made were that

- The City Manager had been advised that UCL should be given 7 days notice that they were being expelled from the contract.
- The contract was worth about €9.5m of the overall €188m tendered for the scheme.
- There had been discussions with the contractor over a number of months.
- The procedure being followed was in accordance with the General Conditions of Contract.
- It was now a decision for the City Manager. The matter was a contractual/legal one involving LCC, their consultants and UCL.
- The Department did not have a role in the termination process, and any approach to the Department would be responded to on that basis.
- If UCL were expelled, the bondsman would become responsible for putting another contractor in to complete the job. Any costs arising from consequent delays would also be the responsibility of the bondsman. Delays, should they arise, would not hold up other aspects of the scheme, as this part of the work was not on any critical path.

The file was noted as seen by the Minister.

Department's Evaluation of the Position

I asked the Accounting Officer if her Department considered the possibility that the UCL position had merit, and what independent consideration had it given to the question as to how LCC should seek to resolve its differences with UCL.

In her reply, the Accounting Officer said the Department's experienced Water Inspectorate reviewed the engineering and contractual advice received by LCC, and all proposals made by LCC on foot of professional advice at all stages leading up to termination, and during the entire conciliation and arbitration processes. The Engineering Inspectors, Senior Advisers and Principal Advisers in the Water Inspectorate involved during the entire course of this dispute, have each many years of experience in water services projects, preparation of contract documents, forms of contracts, construction methods, and conciliation and arbitration procedures, both in the public and private sectors, to an extent that would not be matched in the local authorities. Prior to termination, the advice and recommendations of LCC's

engineering advisers and specialist tunnelling and geotechnical advisers were critically examined through extensive review and questioning by the Engineering Inspector, in particular at meetings in May and September 2001.

As I was concerned by the apparent lack of clarity in the Department's role, I asked the Accounting Officer what part her Department had played in the decision to terminate the contract, and had the financial risks of termination been assessed.

In reply, she said that the Department was not a party to the contract, but that the Department's Engineering Inspector attended the meeting of 11 September 2001 between LCC and their consultant engineers, which concluded in the latter's recommendation to LCC to terminate the contract. The Inspector was satisfied that LCC was acting on the basis of expert engineering and legal advice, and that the decision reached was supported by a rigorous assessment of all the circumstances associated with the contract, and he reported accordingly.

A risk assessment of the financial consequences of contract termination carried out by LCC's legal and engineering advisers, was presented at the meeting of 11 September. The risk assessment addressed both the principle of the contractor's claims, and the quantum of the claims. The Department was satisfied that the rationale used was appropriate, and that the risk assessment findings were supported by the necessary analysis of the risks involved.

I also asked the Accounting Officer what was the Department's experience of contract terminations at that time, and was there a prescribed format for the evaluation of the risks involved.

She said that contract termination, by reason of contractor default or non-performance, is a very rare occurrence on water services projects, with no other case occurring since the mid-1970s. Other contract terminations have occurred, but these have all been as a result of the contractor going into liquidation or receivership. She also said that there was no prescribed format for the evaluation of risks in relation to termination of civil works contracts.

LCC Terminates Contract

LCC and its engineering and legal advisers met and corresponded with UCL and its advisers during September 2001, but these exchanges did not resolve matters, and the contract was formally terminated by the end of the month.

In a memo to the Minister, dated 19 October, it was stated that the Inspector had been in close touch with the Limerick Project from its inception, and was satisfied that neither the City Council nor its consultants had acted unreasonably or outside of contractual norms.

The Minister wrote to the contractor on 22 October, stating that, while the Department was the managing authority for the National Water Services Investment Programme, its function in relation to procurement of individual contracts was limited to ensuring that the contract process fully accords with national and EU procurement requirements. The Department was not a party to the contract, and it had no role or powers of intervention in relation to post-contract dispute resolution.

Following "without prejudice" discussions with the contractor in the hope of finding a resolution, LCC entered the site and expelled the contractor on 5 November 2001.

LCC also called in UCL's bond, which amounted to €2,392,649, at this time. When the bond was called in, the bondsman indicated that he was withholding payment pending the outcome of the arbitration. Now that the arbitrator has found that the contractor was wrongfully dismissed, the bondsman has contended that there is no case for paying the bond.

I asked the Accounting Officer whether the Department could have prevented LCC from terminating the contract, and she said that her Department could have advised LCC against terminating the contract, or that LCC were terminating the contract entirely at their own risk, but the Department could not have prevented LCC from legally terminating the contract. The Department, from its own review of all aspects of the history of the contract, did not form a view that would have warranted such advice to be given.

In reply to whether the Department considered making LCC liable for the financial outcomes of termination, the Accounting Officer said that she was at all times satisfied that LCC was acting in accordance with the best engineering and legal advice available to them. On that basis, there would not have been grounds for exposing LCC to the potential financial consequences of the termination.

Conciliation

In November 2001 UCL, through its solicitor, asked for immediate agreement to arbitration, conciliation/mediation, or another alternative dispute resolution procedure. Solicitors for LCC responded in February 2002, broadly welcoming this approach, notwithstanding that the contract did not provide for conciliation as such. In April, the UCL's solicitors put forward the names of 6 experts, any of whom might act as conciliator. LCC accepted the first of these, and on 28 June 2002 an agreement to conciliation between LCC and UCL was signed.

A key requirement of the conciliation agreement was that “ the conciliator’s recommendation shall state his opinion as to the entitlements of the parties and in this regard shall state his opinion as to what he considers an arbitrator, if appointed, is likely to find (including a finding as to the amount of compensation payable to any party by the other) based on the application of the terms of the contract and applicable principles of law.” As is common with its use in the construction sector, the conciliation procedure was non-binding on the parties, and either party could refer the dispute to arbitration when the conciliation was concluded.

Conciliator’s Recommendation Part 1

On 27 January 2003, the conciliator issued his Recommendation Part 1. He stated that, in his opinion, an arbitrator would find that the termination of the contract was wrongful and should be set aside. He was also of the opinion that an arbitrator would find LCC liable to pay damages to UCL. He had not estimated an amount yet, but it would be an amount which would put UCL in the same position as if the contract had not been terminated. UCL would be entitled to payment for all works carried out before termination. During the course of outlining the reasons for his recommendation, he stated that in his opinion an arbitrator would find that

- There had not been any improper or incompetent operation of the micro-tunnelling boring machine
- Ground stabilisation (or alternative enabling work) was necessary
- UCL was not guilty of any failure to progress work with due diligence
- Work was proceeding well and expeditiously at the time the contract was terminated.

In a report dated 11 February the city engineer summarised “Post Recommendation Events” as follows

- At a meeting on 30 January 2003 UCL noted that its claims amounted to €22.8m, but was prepared to accept an immediate settlement of €12.4m, to be accepted by noon the following day, or the amount would have to be increased to €15.9m.

- LCC had not changed its position regarding the termination, but acknowledged that it would be prudent to consider the offer. However, the €12.4m compared with a contract of €9.5m and LCC's valuation of completed works of €3.6m.

Rejection of Conciliator's Recommendation Part 1

On 12 February 2003 LCC City Manager wrote to the Department notifying them that LCC proposed

- Rejecting the conciliator's recommendations Part 1
- Advising the conciliator that there was no point in him proceeding with the remaining part of the recommendations
- Making a sealed offer following a financial and legal risk assessment in the likely event of arbitration.

On 14 February 2003 LCC issued formal notice of rejection of conciliator's recommendation to the Conciliator and UCL.

I asked the Accounting Officer how her Department had responded to LCC's proposal to reject the conciliation findings, and she said that it had considered the matter fully and raised no objection. She said that the Department was satisfied that due process, as provided for in the contract, should be followed so that, in accordance with the rigours of the arbitration procedure, UCL's claims would be tested in evidence and by cross-examination of witnesses. Conciliation was not provided for in the contract but was agreed to by LCC on the basis that it might lead to a speedier resolution.

On 10 June 2003 the contractor wrote to LCC City Manager summarising events to date and asserting that

- LCC had immediately rejected the conciliator's recommendation
- The contractor had sought to reach an amicable settlement but LCC had rejected all proposals
- The contractor was suffering serious and continuing losses
- UCL had no wish to be involved in litigation.

UCL copied this letter to the Secretary General of the Department.

The Secretary General, having consulted the Minister, replied on 20 June, indicating that LCC's decision to reject the conciliator's findings had activated the arbitration process, and noting his understanding that this decision was based on a thorough assessment of the issues, including the financial risks of the various courses open to LCC, taking account of relevant legal and technical advice. He concluded that, in these circumstances, it would not be feasible or appropriate for the Department to intervene in the process.

The Accounting Officer informed me that the Department had at that time received a copy of the Risk Assessment (February 2003) prepared by LCC and their advisers. This assessment had been prepared at the Department's request, and the Department had satisfied itself that the rationale used was appropriate, and the assessments made were based on proper analysis of risks.

New Contract

In June 2003, LCC sought tenders for completion of the outstanding works. Three tenders were received by the closing date, 21 August 2003. One was deemed non-compliant, and the amounts of the others were €20,376,218 and €22,695,981. The contract was awarded for the lower amount in February 2004, and was completed in July 2005, without difficulties at a final cost of c. €27m.

I asked the Accounting Officer how did the new contractor deal with the difficulties alleged by UCL and in particular

- Were ground consolidation measures of the kind said to be required by UCL undertaken?
- Was the tunnelling level and/or route changed from that originally specified?

In her reply, the Accounting Officer said that the new contractor carried out only a very limited proportion of the ground stabilisation measures that UCL claimed were necessary. It was also the case that the new contractor used the same tunnelling boring machine that UCL had been unable to use in a satisfactory manner. Ground stabilisation was carried out over a total length of 275 metres costing €800,000 plus VAT, as compared to the 945 metres claimed by UCL at an estimated cost of €5,853,267 plus VAT. This was at the contractor's risk under the completion contract, in the same way as LCC maintained it was on the UCL contract. This amounts to just 13.66% of the expenditure on ground stabilisation, which UCL claimed was necessary. She also said that the new contractor did not encounter any major difficulties, additional to those asserted by UCL, and the tunnelled sewer was constructed in accordance with the contract documents, on the same route and at the same level as originally specified in UCL's contract.

Conclusion of Conciliation and Start of Arbitration

Late in June 2003 the City Manager wrote to UCL, referring to the deep-rooted differences between the parties, and the very significant degree of dispute regarding the valuation of the claim. He suggested that arbitration seemed the best mechanism to resolve the differences. The President of the Institute of Engineers in Ireland (IEI) nominated an arbitrator on 10 July 2003, and the arbitrator was informed on 8 August 2003 that the parties had agreed that conciliation would have to be completed before arbitration could commence.

Conciliator's Final Findings

In the second and final part of his recommendation, dated 9 November 2003, the Conciliator found in favour of UCL, and stated that an arbitrator would be likely to award €25,423,263 (exclusive of VAT) being

- €5,548,712²⁹ in respect of works completed to the date of termination, in addition to €4,163,547 already paid by LCC
- €19,874,551 in respect of damages for wrongful termination of contract.

I asked the Accounting Officer how she satisfied herself that the Department had at all times monitored and given appropriate advice to LCC in respect of the conciliation proceedings, and in particular, was she satisfied with LCC's rejection of the conciliator's findings.

In reply, the Accounting Officer said that the Department had not raised any objection to the dispute being referred to non-binding Conciliation, with a view to an early resolution being achieved. Conciliation was not a provision in the contract at the time of award of the UCL contract, but had been introduced by the Department of Finance on Public Works contracts in January 2001. The Department, on learning of the Conciliator's recommendation, requested LCC to prepare an updated risk assessment. The Risk Assessment in November 2003 verified, to the Department's satisfaction, that there was no reasonable basis for accepting the Conciliator's Recommendation. The wider implications of the Conciliator's interpretation of certain contractual provisions for public works contracting generally were also factors that influenced the Department to raise no objection.

²⁹ This overall assessment totalling €9.7m was €6.1m greater than the LCC valuation of completed works of €3.6m.

Arbitration Hearings

A preliminary meeting of the parties took place in Dublin on 10 December 2003. Hearings occurred in 3 sessions: 19 July to 10 September 2004, 8 to 19 November and 7 December to 17 December 2004. The parties submitted their closing statements in writing around 20 January 2005, and replies to these statements on 14 February 2005.

Within their rebuttal to UCL's closing statement, LCC proposed a number of issues of law that should be subject to the Case Stated procedure. By letter dated 22 March 2005, LCC's solicitors submitted a list of issues that could be dealt with, without requiring alternative findings dependent upon the outcome of a Case Stated, and by letter dated 24 March 2005 solicitors on behalf of UCL submitted their list of such questions.

In June 2005, after considering the matters raised in this reference, the arbitrator sought guidance from the representatives of the parties, on his obligation to draft any part of the award as a Case Stated. The representatives of the parties responded, and the Arbitrator decided to issue a first interim award, confined to issues of fact previously sent to him.

Arbitrator's First Interim Award June 2005

The Arbitrator's findings covering liability and measurement issues ran to over 130 pages and found substantially in favour of UCL and found against LCC in the manner of its termination of the contract. He concluded that

- On the evidence, UCL had carried out its tunnelling operations in a competent manner
- From the evidence of experts, ground conditions necessitating treatment had been encountered and that those conditions could not have been reasonably foreseen by an experienced contractor
- At the time of the termination UCL was proceeding with all sections of the works with due diligence and that UCL was not either persistently or fundamentally in breach of contract.

He determined the value of measured works at the time of termination at €6,304,040³⁰ (exclusive of VAT). Consideration of damages for wrongful termination was left to the final award.

High Court Appeal

In July 2005, the Department notified the Office of the Attorney General of the Arbitrator's Interim Award, and sought independent legal advice on LCC's consideration of an appeal of the Arbitrator's findings to the High Court. The Department was concerned by the financial implications of the findings, the Arbitrator's interpretation of the contract, not only in this case, but also its general implications, given that this form of contract was widely used throughout the Public Sector, and the extent of the Arbitrator's criticism of LCC and its technical and legal advisers.

In reply the Office of the Attorney General indicated in August 2005 that

- It was doubtful if it would be possible to impugn the findings of the Arbitrator
- The grounds on which an Arbitrator's findings would be set aside or remitted by the Court would be very limited
- The findings of an Arbitrator are not public and therefore did not represent a precedent.

³⁰ This was over €3.4m less than the Conciliator's total valuation in respect of completed works.

LCC appealed the Arbitrator's award to the High Court on a number of points of law, but the Court ruled on 1 November 2005 that there were insufficient grounds to merit its intervention.

I asked the Accounting Officer why the advice of the Attorney General had not been sought at a much earlier stage.

She told me that the Department did not consider it necessary to involve the Attorney General up to that time, as LCC were being advised by one of the main construction law firms in the State, supplemented by experienced Counsel from the U.K. The Attorney General was subsequently consulted, because the Arbitrator's award had wider implications for other contracts, by virtue of some of his interpretations of the contractual provisions. It was also the case that the Department's inspectorate had a considerable body of knowledge of matters relating to contract conditions and dispute resolution, based on many years experience in capital project appraisal.

I also asked the Accounting Officer what advice her Department gave LCC in the light of its approach to the Office of the Attorney General. She informed me that LCC had been told that the advice of the Attorney General was being sought, and that the advice received had, with the agreement of the Attorney General, been communicated in full to LCC and their legal advisers. She further indicated that her Department sought an updated Risk Assessment (June 2005) from LCC, and agreed with the LCC assessment that such were the consequences of the award, and the unprecedented interpretation of contractual provisions in the award, that an appeal to the High Court was appropriate. A copy of the Arbitrator's Interim Award was also forwarded to the Chair of the Government Construction Contracts Committee.

Final Arbitration Award Excluding Costs

Arbitration hearings resumed on 2 November 2005 to consider the UCL claim for the recovery of damages for wrongful termination, and further hearings took place from 6 March 2006 to 23 March 2006. UCL had initially sought €82m at the commencement of the arbitration, but reduced this to €77m at the resumption of hearings in November 2005.

On 8 September 2006 the arbitrator published his final Award excluding costs.

He ruled that LCC was liable to pay €32,336,702³¹ (inclusive of VAT) to UCL consisting of

- Loss of profit on the contract – €0.589m
- Consequential trading losses on two other contracts – €17.441m
- Loss of profits due to lost revenues between 2003 and 2010 – €10.417m
- Interest and financing costs – €3.89m.

New Forms of Contract

The matter was brought to the attention of the Government on 12 September 2006, and subsequently further advice from the Attorney General concluded that

- The extensive jurisprudence governing challenges to arbitral awards points very firmly to the view that the courts are reluctant to uphold a challenge save in the most manifest of cases.
- There is no prospect of any successful challenge to the preponderance of the award in this case.

³¹ The Conciliator's award of €25.4m was **exclusive** of VAT.

The Minister again brought the matter to Government on 23 October 2006, indicating his intention to instruct LCC to explore the possibility of a negotiated all-in settlement, or failing this, to lodge €22m, which the Attorney General advised was the amount of the uncontested liability, with UCL's legal representatives. His Department would provide capital funding to LCC to pay the undisputed element of the award, to the extent that such funding could not otherwise be recouped by LCC from the professional insurances of its engineering consultants and legal advisers. The Minister also noted that the new Forms of Contract for civil buildings works, which were about to be launched by the Minister for Finance, also provided for termination, conciliation and arbitration. These provisions limited recovery, in a case of wrongful termination, to those amounts arising from the contract itself.

The Minister also proposed an early examination, by an independent qualified person, of the management of this case, to identify lessons for civil engineering management, and to recommend on how best to minimise risk of adverse outcomes in future cases.

I asked the Accounting Officer to outline the ways in which the new Forms of Contract differed from those governing the Limerick case with particular reference to

- Conciliation
- Arbitration
- The admissibility of claims for compensation on termination distinguishing between losses arising directly from the contract in question and consequential trading losses.

In reply, the Accounting Officer said that conciliation is now mandatory before a dispute can proceed to arbitration, and the Conciliator has to base his recommendation on the parties' rights and obligations under the contract. Conciliation remains non-binding, in that either party may still reject the Conciliator's recommendation and refer the dispute to arbitration.

Similar arbitration provisions apply, but new Arbitration Rules for the conduct of proceedings were published by the Department of Finance at the end of April 2007. While the rules are essentially identical to the IEI Arbitration Procedure 2000, which applied in the Limerick case, the new rules set more specific and shorter timeframes for the conduct of the proceedings. In relation to compensation, she said that were similar circumstances, as occurred in Limerick, to arise under the new form of contract *i.e.* a finding by an arbitrator of wrongful termination, the Contractor would only be entitled to recover costs, but not damages.

In her reply, the Accounting Officer also said that should a similar case arise again, there were a number of safeguards to address the situation in the new Forms of Contract. Firstly, risk allocation is more clearly defined, with the contractor carrying ground conditions risk. Secondly, prior to terminating a Contract, the Employer may seek an opinion from a Conciliator as to whether he has sufficient grounds for termination. Lastly, as referred to above, in the event of an arbitrator subsequently finding that the termination was wrongful, the contractor is entitled to his costs, but not damages.

She also indicated that the Department would appoint an independent examiner to review the history of the case, and make any necessary recommendations now that the report of the independent legal and engineering review, commissioned by LCC at the behest of the Department, is available.

Costs to July 2007

On 21 November 2006 LCC paid €22,100,420 which was funded by the Department to UCL. A further payment on 11 January 2007 was sought by LCC from the Department, for the balance of the award of €10,081,675. An amount of €6,081,675 was paid to LCC on that date pending LCC review of any

potential for recovery from consulting engineers and legal advisers. These payments brought VAT inclusive expenditure by the Department to date to €63,898,142³² being

- Payments under the original contract €7,174,961
- Payments of LCC/Department expert/legal/witness expenses, etc. €11,161,288
- Payments under the arbitration award €28,182,095
- Payments under the completion contract €17,379,798

In response to my inquiries about the estimated final cost, the Accounting Officer said that costs had not been awarded by the arbitrator to-date. The final outturn cost of these events (costs incurred by LCC including the cost of the works carried out by UCL but excluding the cost of completion of the works by the new contractor) amount to c. €56m. The cost of the completion contract is a further c. €27m bringing the estimated total cost to c. €83m.

I asked the Accounting Officer what, if any, steps were the Department and/or LCC taking to seek recovery of awards from engineering or legal advisers or their insurers.

In reply she said that the Department has withheld €4m from LCC pending consideration by LCC as to whether they should pursue their engineering and legal advisers and their insurers arising from the outcome of this case. This matter is ongoing at the present time. LCC were advised by the Department to engage independent legal and engineering advisers to review the basis for the decision to terminate, whether the consequences of the decision to terminate were sufficiently considered, the conduct of the arbitration proceedings on LCC's behalf and whether any different steps should be taken when considering termination of future contracts in light of the arbitrator's award.

She also said that LCC engaged a solicitor and a consultant engineer, both widely experienced in construction contract law and disputes, to review the matter. Their independent review, which is now under consideration in relation to its conclusions, found that

- The engineer had grounds to find on 18 September 2001 that the contractor was not proceeding with due diligence and that, in the circumstances, the decision to terminate was a reasonable one to make and “even in hindsight may have been correct.”
- LCC had made the decision to terminate carefully and had considered the serious consequences of termination for the contractor before making the decision and it would have been difficult to foresee that it was exposing itself to liability to the contractor by pursuing its claim on the bond.
- To have released the bond would have been a strange thing to do and would have exposed the employer to the risk that its claims would not have been met.
- At the time of termination there were, and still are, grounds for the view that an employer is not in breach of contract by terminating on a clause 63 notice that is subsequently reversed in arbitration. However, the Arbitrator did not discuss this argument in his award but obviously rejected it.
- The manner in which the Employer's case was advanced was well-founded, thorough, robust, well thought out and more than competent and that the pleadings and submissions made on the Employer's behalf were of a much higher standard than those made for the contractor.
- The arbitrator, in considering “due diligence”, had given very little consideration to the 11 July programme, had not considered work on the shafts and that the arbitrator's decision to hold the

³² This excludes UCL costs which have not yet been awarded, €4m withheld by the Department from LCC and final payment in respect of the completion contract.

employer responsible for the contractor's loss of bonding facility was questionable as the denial of further bonding facilities was an independent decision of the bondsman.

- The arbitrator should have applied (but did not) the rationale based on *Matheson v. Canada* case where the Courts (both at first instance and on appeal) rejected as too remote a contractor's claim for loss of profits on future contracts as a result of an unjustified termination and bond claim.
- LCC were fully justified in referring the arbitrator's decision to the High Court. However, the Court was confined under the Arbitration Act to reviewing how the arbitrator conducted the arbitration and that there was no manifest error in the award itself but the Court was not entitled to open up or review the case itself due to limitations imposed by the Arbitration Act.

Department's Policy on Dispute Resolution

Given the difficulties that arose in this case I asked the Accounting Officer to outline the Department's experience of, and policy in respect of, significant disputes (exceeding €5m) since 2000.

The Accounting Officer said that two cases relating to Cork Main Drainage had gone to Arbitration. The first involving three contracts, all with one contractor, was settled, following a risk assessment, for a total of €11.24m including VAT in respect of claims in dispute totalling €52.8m including VAT. The second concerned the Waste Water Treatment Plant Design Build Operate contract, where the contractor had submitted a claim for €24.83m. The arbitrator awarded the contractor nothing and awarded Cork City Council all costs in this case.

At present two other cases are at arbitration. The first concerns the Dublin Bay Submarine Pipeline where the contractor is seeking €40m in claims while the second relates to a social housing contract in Naas where the contractor is seeking in excess of €5m in claims.

As regards monitoring of such cases the Department had, since September 2002, required local authorities to prepare risk assessments at the outset and to update these risk assessments as proceedings progressed and any new factor or outcome had to be taken into consideration.

I also asked the Accounting Officer how the Department monitored the settlement of disputes, which did not proceed to formal conciliation or arbitration to ensure such settlements were cost effective and if guidelines had been issued on dispute resolution.

The Accounting Officer said that where settlements are within the terms of the contract (*i.e.* where claims relate to quantum only) and the project remains within the approved budget, the cost of any such settlement will be included in the final account report submitted to the Department for approval. At this stage the Department will decide whether the settlement is eligible for recoupment to the local authority or whether the local authority should bear the cost. The cost of such settlements cannot be readily extracted from the final accounts.

The Department had not issued guidelines with regard to resolution of disputes as the circumstances of disputes are distinctively different, and it not possible to provide generic guidelines to cover every situation.

Since September 2002 the Department limited the Exchequer's financial exposure by requiring the local authority to first notify the Department of the existence of a dispute and to prepare a risk assessment. If a potential escalation of legal and other costs incurring at conciliation and arbitration is identified, the local authority is requested to consider seeking a commercial settlement within the scope of the risk assessment so as to minimise the cost to the Exchequer. In addition, where a dispute proceeds to arbitration, a "sealed offer" is recommended to mitigate exposure to the costs the contractor incurs.

In regard to its oversight role as the overall sponsor, manager and provider of funding for the Water Services Programme, the Accounting Officer stated that the Department oversees projects throughout their lifecycles. In this respect it monitors progress and costs relative to approved project budgets and maintains close liaison with local authorities where any project is not progressing satisfactorily or where a problem has arisen such as a contractual dispute. The Department of Finance had in recent months published the new Forms of Contract for Public Works which will provide further general safeguards for the Exchequer and the Department.

Current Developments

The Department does not believe that there were failures by management in either LCC or the Department in this case or that the arbitrator's award could have reasonably been anticipated having regard to the robustness of the Employer's case. The independent review carried out by LCC at the Department's request has confirmed that it would have been difficult to foresee this outcome. The planned independent examination of this case will further consider and report on the lessons to be learned from the case. All necessary lessons from this case are being, and will be, taken into account by the Department in relation to its management procedures, guidelines and input into contract terms and dispute procedures.

The Department's position is to ensure that capital programmes are implemented in accordance with the Government's National Development Plans in a cost effective manner and to protect the Exchequer from any unnecessary financial risk. The new Capital Management Works Framework being developed and introduced by the Department of Finance contains an integrated set of contractual provisions, guidance material and technical procedures covering the public works project lifecycle from inception to final project delivery and review. The structure of this strategic framework is closely aligned with the Capital Appraisal Guidelines issued by Department of Finance. The framework is intended to encourage more cost-effective procurement and delivery of public works projects by sponsoring authorities and sanctioning authorities through the introduction of a more systematic approach to planning, capital budgeting, design cost control, construction contract management, construction cost control and dispute resolution. It is expected that the completed framework, which is in the course of development by the Government Construction Contracts Committee, will be published before the end of 2007.

