

**SUMMARY PAPER ON SDS LIABILITY FOR:
DELAY IN DESIGN PRODUCTION AND POOR QUALITY DESIGN AND
DELIVERABLES**

This summary paper (revised from the paper released in April 09) sets out the contractual position governing the liabilities of the SDS Provider under the SDS Agreement, SDS Novation Agreement, **tie** Collateral Warranty and Infraco Contract. The fundamental position is that the SDS Provider is responsible for all services to produce a design which enables the ETN to be constructed, operated and maintained in accordance with the Employer's Requirements and the Infraco Proposals and in a cost efficient manner. The Design Delivery Programme for the completion of SDS Provider design deliverables was aligned with the Infraco's Construction Programme at Infraco Contract signature.

The SDS Agreement was concluded in October 2005, following procurement under the Restricted Procedure.

UNDER THE SDS NOVATION AGREEMENT

tie releases the SDS Provider from all rights of action and remedies pursuant to the SDS Agreement, and the SDS Provider accepts the Infraco in place of **tie** in terms of the vesting of all such rights and remedies, together with all relevant obligations and liabilities. The only scope of work not novated to the Infraco is in relation to services regarding the utility diversions which are to be performed by SDS Provider for **tie** under the original terms and conditions.

The SDS Provider provides a warranty to the Infraco (*SDS Novation at 4.2.2 (d)(i) and (ii)*) that the designs and Deliverables completed by SDS Provider prior to and after the date of the novation comply with the Employers requirements and that it shall be liable for any loss or damage suffered by the Infraco arising from the poor performance by the SDS Provider of its obligations prior to the date of novation. This is consistent with the Infraco taking on contractual responsibility for all SDS design and Deliverables at the date of Infraco Contract signature. If there were not the case, there would be no need for this warranty for the benefit of the Infraco and no need for language here that liability attaches even though **tie**, as former Client, might not have suffered loss by SDS Provider's performance

Clause 4.4 provides that the SDS Provider's liability to the Infraco pursuant to the SDS Agreement is unaffected by the Infraco's assumption of design liability under the Infraco Contract.

tie provides a warranty to the Infraco that there is no dispute or claim subsisting at the date of novation, nor any circumstances existing which might give rise to any dispute or claim by the SDS Provider against **tie**. In order to preserve **tie**'s recourse against SDS Provider under the Collateral Warranty given to **tie**, this warranty does not include a limb in respect of circumstances which might give rise to a claim by **tie** against the SDS Provider, but any action or remedy will be for the Infraco to pursue. **tie** released the retention bond provided by the SDS Provider as a condition to the novation.

The Incentivisation Payment (to complete the design commission timeously) payable by **tie** to the SDS Provider (*SDS Novation at 8.8*) is reduced by just under £9,000 as liquidated damages for each failure in achieving the relevant date for provision of an Issued for Construction Drawing. No reductions can be made to that payment by way of counterclaim. In order to have the relevant dates extended, any claim for an extension of time must also entitle the Infraco to an extension of time under the Infraco Contract, and it must also be in circumstances which constitute a **tie** Change.

VARIATIONS TO THE SDS AGREEMENT

As part of the SDS Novation, amendments to the SDS Agreement were made and listed in Appendix Part 1 to the SDS Novation. These include an undertaking by the SDS Provider not to cause the Infraco to be in breach of the provisions of the Infraco Contract and an acknowledgement of full awareness of the relevant obligations of the Infraco. These provisions enhance the Infraco's position on SDS liability vis-à-vis any breaches of the Infraco Contract by the Infraco which are due to failures of the SDS Provider. The SDS Provider agrees to indemnify the Infraco against any such losses.

The amendments also included the substitution of a new extension of time clause into the SDS Agreement. The replacement clause fits with the Infraco Contract drafting and specifically includes circumstances which entitle the Infraco to an extension of time. This means that the SDS Provider will have a prima facie extension of time claim, whenever the Infraco has a valid extension of time claim.

The SDS Provider should notify the Infraco in writing within 10 Business Days of becoming aware of any circumstances likely to cause an extension of time, and must adhere to those timescales to avoid losing the entitlement. The SDS Provider must also inform the Infraco at the earliest opportunity of any delay to the design services which do not entitle the SDS Provider to an extension of time. In the latter case the SDS Provider must, at its own expense, take such acceleration measures as are necessary to achieve the programme dates.

A valid extension of time or compensation event claim requires the SDS Provider to not have been at fault, whether in managing the interface with CEC and other Approval Bodies, identifying when instructions are required, or using reasonable endeavours to adjust the order or sequence of the design services. Following novation, the SDS Provider must satisfy the Infraco that these obligations have been satisfied, rather than **tie** having any oversight.

Failure to agree an extension of time or compensation event entitles either party to refer to DRP, and the SDS Provider must continue to provide the Services notwithstanding any event being identified.

The liquidated damages drafting was also introduced into the SDS Agreement as part of the novation amendments, and mirrors the incentivisation wording in a number of ways. Each failure to hit an Issued for Construction Drawing delivery date results in SDS Provider liability to the Infraco of just under £9,000, matching the figure subtracted from Incentivisation payable by **tie**. The SDS Provider's liability is limited to a maximum of £1 million and is reduced to the extent that the failure to achieve the requisite date is brought about by the failure of **tie** or CEC to approve an SDS submission in the timescales required by the programme.

However, the amended clause clearly states that if it is agreed or determined by DRP that the Deliverable which was submitted by the SDS Provider was not submitted in accordance with the SDS Agreement in terms of packaging, process, or its content or quality was inadequate or insufficient, the liquidated damages limits will not apply. Here, SDS Provider will be liable up to the SDS Agreement contractual liability cap of 10 million pounds for each and every event.

LIABILITY CLAUSES IN THE SDS AGREEMENT

Under the original SDS Agreement drafting which has been retained, the following summarises the operation of Clause 27 (*Indemnity by SDS Provider, Liability and Sole Remedy*):

- The SDS Provider has given a general indemnity to the Infraco for any acts, omissions, breach, non-performance or delay in the performance of the SDS Provider's obligations;

- This liability is limited to a sum of £10 million in respect of each and every claim and, for pollution or contamination claims, £10 million in the aggregate;
- No limits are applicable to liability for death, personal injury, fraud, breach of warranty on specific topics or, in the case of the SDS Provider, for breach, delict or other liability arising prior to termination of the SDS Agreement.

These remedies provide a wide-ranging ability for the Infraco to recover monies from the SDS Provider for delays and poor quality of design. It is likely that the Infraco may choose not to pursue the SDS Provider unless it is suffering losses which it cannot recover from **tie**. It appeared at informal mediation that Infraco as either elected or forgotten to apply any liquidated damages to SDS Provider for late IFC Drawings despite clear contractual entitlement to do so.

Therefore it follows that **tie** should act against the Infraco for failures in design, whether due to quality or delay, so that the Infraco is then required to act against the SDS Provider as its subcontractor.

SDS COLLATERAL WARRANTY TO TIE

In the event that **tie** wish to consider direct action against the SDS Provider, the terms of the collateral warranty in favour of **tie** which the SDS Provider signed at novation are relevant.

This agreement includes a warranty from the SDS Provider to **tie** that it will exercise a reasonable level of professional skill, care and diligence. The SDS Provider acknowledges that it owes a continuing duty of care to **tie** in carrying out its obligations under the SDS Agreement.

In terms of liability, the collateral warranty drafting provides that the SDS Agreement shall determine the liability of the SDS Provider in all respects and that, if **tie** to choose to make a claim under the collateral warranty, the SDS Provider shall be entitled to rely upon any defence, right, limitation or exclusion in the SDS Agreement. The SDS Provider's liability under the collateral warranty cannot exceed its liability under the SDS Agreement.

The rights and benefits of **tie** under the collateral warranty are in addition to any other remedies that **tie** may have against the SDS Provider, such as delictual claims.

The collateral warranty's objective was to create a contractual link if **tie** were to require to step into the role of Client SDS Agreement following an Infraco termination or to be used directly for **tie** claims against the SDS Provider in respect of the utilities diversion design works. It would be unusual for **tie** to act directly against the SDS Provider in respect of deficient performance on infrastructure design, rather than against the Infraco due to the relationship of Client and subcontractor that was established at novation of the SDS Agreement. However, there is nothing in the Infraco Contract or the Collateral Warranty itself which preclude **tie** from pursuing remedies against SDS Provider if Infraco is not enforcing its rights to **tie**'s detriment.

The key points which arise are therefore:

- **tie** needs to establish whether there have been breaches of the design and Deliverables obligations contained in Infraco Contract which may or may not have been as a result of a failure by the SDS Provider. Taking action against the Infraco should relieve **tie** from having to establish fault as between **tie** and the SDS Provider and the Infraco's management of the SDS Provider as its subcontractor will be in focus.

- The SDS Provider liability levels in respect of late delivery of the specified Issued for Construction Drawings and for general poor performance are clear.
- The Infraco has a significant benefits and protection under the drafting of the SDS Agreement which allow it to recover from the SDS Provider. Limits on liability of £10 million will apply in most cases.
- The Collateral Warranty can be used by **tie** to claim directly against the SDS Provider for deficient performance in relation to utilities diversion design. The general limit on liability (as opposed to the IFC specific limit) applies.
- In the absence of a **tie** step-in, it would be unusual for **tie** to mount a direct contractual claim against the SDS Provider under the Collateral Warranty, rather than acting against the Infraco as the lead contractor in the contractual structure. However, if Infraco has simply not exercised its rights against SDS Provider to **tie**'s detriment, there is no contractual obstacle to **tie** pursuing SDS Provider direct for its breach of warranty.
- The SDS Agreement and the Novation Agreement contain DRP provisions which are similar to the Infraco Contract, but with an important exception. The SDS Agreement and Novation Agreement contain a provision which sets a 3 month time limit by which a party (having been aware of the circumstances giving rise to the claim) must raise a dispute, failing which there is a bar on bringing any claim.

LIKELY OPPOSING ARGUMENTS

The crux of any Dispute is likely to revolve around (a) whether the SDS Provider is entitled to an extension of time in respect of delayed IFCs and whether, and to what extent, other parties have contributed to these delays (b) whether, irrespective of IFC issue dates, SDS design and Deliverables have been materially deficient so as to cause Infraco to be in breach of its design production and service delivery obligations.

Where the Infraco have managed to obtain an extension of time (whether contractually or otherwise), it will be difficult for **tie** to act independently against the SDS Provider, as the Infraco are likely to have passed down any concessions to the SDS Provider as their subcontractor.

Given the attitudes demonstrated to date, it is certain that any claim against the Infraco will be fought, rather than swiftly passed down to the SDS Provider through the subcontracting structure as the contract drafting envisages. This is especially likely to be the case where the Infraco anticipates that the SDS Provider might argue that the Infraco is responsible for failures that have contributed to the delay or poor quality, even if the **tie** claim were clearly directed at SDS Provider fault.

DLA Piper

28th September 2009 (revised from 9 April 2009)