CONTRACT ADMINISTRATORS— THE OBLIGATION OF IMPARTIALITY AND LIABILITY FOR INCORRECT CERTIFICATION

Tim Elliott, QC

Keating Chambers, London

INTRODUCTION

For well over a hundred years it has been standard practice for contract administrators to be used on construction contracts. Architects have been engaged to supervise and manage building contracts and engineers engineering contracts. More recently, project managers and construction managers have undertaken similar roles under new forms of contract.

Contract administrators are engaged by employers. Some of what they have to do entails them acting as the agent of the employer. However, in carrying out other tasks, they have to act impartially and fairly between employer and contractor. These dual roles have given rise to difficult questions. What exactly is required from the administrator when acting fairly and impartially? Can the administrator be liable to either contractor or employer if he makes mistakes when acting impartially? Can the employer, who pays the administrator, be liable to the contractor for his mistakes?

TRADITIONAL PROCUREMENT

The employer and the contractor make their contract on the understanding that in all matters where the architect has to apply his professional skill he will act in a fair and unbiased manner in applying the terms of the contract. (Keating on Construction Contracts, 2006, quoting from Sutcliffe v Thackrah [1974] AC 727)

The architect, or administrator, has to exercise his professional skill in a fair and unbiased manner when, for example, issuing payment certificates or deciding upon and granting extensions of time. Traditionally payment to the contractor is dependant on the issue of a certificate by the contract administrator and the obligation as to the time for completion of the works will be contingent on extensions of time which the administrator may or may not grant.

It is now well established that if the employer exerts pressure on the administrator when performing these functions with the result that the administrator allows his judgment to be influenced, his decision may be held invalid and set aside.

In Page v Llandaff and Dinas Powis Rural District Council (1901) Hudson's BC (4th ed.) Vol. 2 at 316, the contract provided that the decision of the surveyor as to the value of the works was to be final and not subject to appeal. The surveyor issued a final certificate in accordance with the instruction of the Council (the employer) that he should value part of the work by estimating quantities and applying a measured rate and that he should not value on a day–work basis. This was held to be improper interference by the Council with the surveyor's function of certifying impartially as between owner and contractor. The result was that his certification was held not to be final and binding on the contractor.

Hickman & Co. v Roberts (1913) AC 229 is another example. The contract provided that the decision of the architect as to payment due to the contractor was to be final and that payment was to be made to the contractor on the basis of the architect's certificates. The contractor claimed that he was owed certain sums but the architect had failed to issue a certificate in his favour. When challenged by the contractor the architect's reply was that his clients, the owners, would not allow it: 'in the face of their instructions to me I cannot issue a certificate

whatever my own private opinion in the matter'. The House of Lords held that he had improperly allowed the owners to influence him: the owners could not rely on the absence of a certificate as a reason not to pay the contractor.

The need for the contract administrator to maintain his impartiality and independence was well expressed by Megarry J. in London Borough of Hounslow v Twickenham Garden Developments Ltd [1971] 1 Ch. 233, often regarded as a classic statement of the position:

... under a building contract the architect has to discharge a large number of functions, both great and small, which call for the exercise of his skilled professional judgment. He must throughout retain his independence in exercising that judgment ... it is the position of independence and skill that affords the parties the proper safeguards and not the imposition of rules requiring something in the nature of a hearing.

ERRORS BY THE ADMINISTRATOR IN CERTIFYING—CAN THE ADMINISTRATOR BE LIABLE TO THE CONTRACTOR?

If the contract administrator erroneously certifies less than the contractor is entitled to, the contractor is likely to suffer economic loss. Equally if the administrator wrongly fails to grant an extension of time, the contractor may suffer loss. Since the cause of any such loss is the erroneous certification the question arises whether the contractor can recover from the administrator.

It is now regarded as established in most common law jurisdictions that the contract administrator would not be in breach of a duty of care owed to contractors if he improperly disallowed claims or failed to certify according to their entitlement. In Pacific Associates v Baxter [1990] 1 QB 993 the Court of Appeal rejected the existence of such a duty of care as between the engineers, the partners of Halcrow International, and the contractors, in respect of alleged improper rejection of the contractors' claims and refusal to certify in their favour. In order to succeed in such a claim a duty would have to be imposed on the contract administrator to take care to prevent the contractor suffering economic loss. The court rejected the imposition of any such obligation in Pacific Associates relying on the contractual relationship between employer, contractor and engineer. The engineer was engaged by the employer and the contractor could arbitrate against the employer to recover the sums which should (allegedly) have been certified. In these circumstances the court refused to impose on the engineer a duty of care to avoid economic loss being suffered by the contractor.

In Hong Kong the court followed Pacific Associates v Baxter in Leon Engineering and Construction Co Ltd v Ka Duk Investment Co [1989] 47 BLR 139 in refusing an application to join architects as defendants in an action brought by a contractor on a project in Shatin. The contractor alleged that the architects' failure to certify promptly and impartially was a breach of its duty of care. The court held that no such duty of care was owed.

In the Australian case of John Holland Construction v Majorca Projects [2000] 16 Const. LJ 114, Byrne J also followed Pacific Associates. The contractor alleged that it had been substantially underpaid and sued both employer and architect. The employer went into liquidation leaving only the architect as a defendant. The contractor asserted that the architect owed it of a duty of care in tort to act fairly and impartially in carrying out the duty of certifier under the contract. It alleged that this duty was breached in that the architect had received representations from the employer without giving the contractor a chance to answer them, with the result that it suffered economic loss. The judge held that the architect owed no duty to avoid the contractor suffering economic loss. There was no reliance by the contractor or assumption of responsibility by the architect which would justify grafting an obligation on the certifier in tort.

Special circumstances may arise which render the administrator liable to the contractor in tort. An example is the New Zealand Court of Appeal decision of Day v Ost [1973] 2 NZLR 385. A subcontractor stopped work because he had not been paid by the main contractor. The architect, employed by the owners, asked the subcontractor to re–start work assuring him that he would be paid and that the main contractor had ample funds. The subcontractor carried on but the main contractor went into liquidation leaving the subcontractor underpaid for his work. The court held that the architect was liable for negligent misstatement under the rule in Hedley Byrne v Heller . The architect was in a position to know that the client was in financial difficulties and by his gratuitous advice assumed a responsibility to the subcontractor. Another, albeit rather unlikely, possibility is a claim for deceit against employer and administrator if there has been collusion between them to deprive the contractor of sums due to him. However the chances of such circumstances arising must be remote and in addition,

deceit requires a high standard of proof. Indeed both of the examples above must be regarded as exceptions. Under the normal contractual relationships between contractor, employer and contract administrator, the administrator will not owe a duty of care to the contractor with regard to certification.

ERRORS BY THE ADMINISTRATOR IN CERTIFYING—CAN THE EMPLOYER BE LIABLE TO THE CONTRACTOR?

If the administrator erroneously certifies less money than the contractor is entitled to or if he carelessly fails to grant a fair extension of time, can the contractor hold the employer liable for his failure? In general terms the employer will not be liable for the faults of his administrator when he is carrying out his independent and impartial role, unless he is aware of the administrator's error and does nothing about it.

The genesis of this approach is found in the shipping case, Panamena Europea Navigacion v Leyland [1943] 76 Lloyd's Reports 113. A contract for the repair of a ship provided that the owners should pay the repairers on the basis of certificates of the owners' surveyor which were to be final and binding. The Court of Appeal found that the surveyor had misunderstood what he was empowered to do and that the certificate issued by him was invalid as a result. The further question arose as to whether the shipowners were in breach of contract as a result of the incorrect certification of their surveyor. Scott LJ said as follows:

It seems to me plain that if the shipowners had known that he was departing from his proper function under the contract, it would have been their duty to stop him and tell him what the function was for which the contract provided. In those circumstances I think that the court ought to imply an undertaking by the owners that in the event of its becoming known to them that their surveyor was departing from the function which both parties had agreed he was to perform, they would call him to book, and tell him what his real function was.

In the Australian case of Perini Corporation v Commonwealth of Australia [1969] 2 NSWR 350, Macfarlan J adopted the approach of the Court of Appeal in Panamena. The court had to decide the correct approach to be followed by an employer (a Government department) whose employee was acting as the independent certifier on a construction contract. It was alleged that the certifier had given the departmental policy of the employer as the reason for not granting an extension of time rather than his own opinion. The judge held that there was not only a duty on the employer, in the negative sense, not to interfere with the proper performance of the certifier' duties when considering extensions of time but also, in the positive sense, a duty to ensure that the certifier was properly exercising his duty if it became aware that he was proposing to act improperly. The employer has 'an obligation to require the Director to act in accordance with his mandate if [it] is aware that he is proposing to act beyond it.'

The English Technology and Construction Court has also followed this approach. In Penwith District Council v VP Development Ltd (1999) (unreported), the court found the owner not to be in breach of contract in respect of the defaults of its certifier, despite the existence of a duty upon the Council regarding his conduct. Crucially the existence of this duty required express knowledge of the situation on the part of the Council:

Penwith was the party who could control (the certifier) if he failed to do what the contract required. Since the contract is not commercially workable unless the certifier does what is required of him, Penwith, as part of the ordinary implied obligation of co–operation, was under a duty to call (the certifier) to book (to use Scott LJ's phrase) if it knew that he was not acting in accordance with the contract. Both Scott LJ and Macfarlan J make it clear that the duty does not arise until the employer is aware of the need to remind the certifier of his obligations .... A mere failure by the certifier to act in accordance with the contractual timetable is not a failure on the part of the employer to discharge an implied obligation positively to co–operate and cannot be a breach of contract by the party whose employee is the certifier.

The topic also arose in the Singaporean case of Hiap Hong and Co (Pte) Ltd v Hong Huat Development Co (Pte) Ltd [2001] 2 SLR 458. This was another case in which it was alleged that the contract administrator had gone seriously wrong when issuing payment certificates. The court was faced with the question what, if any, were the obligations of the employer in relation to the certifying functions of its architect. It held that the employer was under a negative duty not to interfere with the discharge of the architect's duty but that it was not under any obligation to tell the architect what to do. It held that, even if aware of the architect's defaults, it was not liable for those defaults. Chao Hick Tin JA put it 'there is no justification for such a wide–ranging term to be implied, bearing in mind the independent nature of the

certification function of the architect postulated under a building contract. It is not the duty of an owner/employer to oversee the architect in the discharge of that function'. This case has been the subject of some criticism, notably from the late Ian Duncan Wallace QC. Firstly the express language of the contract in question actually imposed a duty on the employer to provide an architect ready and willing to give a certificate which does not appear to have been given much if any weight. Secondly the views of the Singaporean court certainly appear wider than, and at variance with, the approach followed in Panamena, Perini and Penwith; namely that if the employer becomes aware that the administrator is not correctly carrying out his functions, he is obliged to take steps to correct the position.

It is suggested that a correct summary of the modern position was set out by the Technology and Construction Court in BR and EP Cantrell v Wright and Fuller [2003] BLR 412.

In undertaking these (contract administration) functions, the Architect does not act as the agent of the Employer but, since he is engaged by the Employer, he has a contractual obligation to act fairly, impartially and in accordance with the powers given to him by the conditions. The Employer may not interfere in the timing of the issue of any certificate but is not himself in breach of contract if a particular certificate is not issued or is erroneous unless he is directly responsible for that failure. However, if and when it comes to his notice that the Architect has failed to comply with his administrative obligations, by for example failing to issue a certificate required by the contract, the Employer has an implied duty to instruct the Architect to perform that function in so far as it remains within the power of the Architect to perform it and the Employer is in breach of the contract with the Contractor to the extent that he does not intervene to arrange for the correct or a correcting step to be taken by the Architect.

LIABILITY FOR OVER–CERTIFICATION

If the contract administrator carelessly certifies too much money to the contractor or carelessly grants too great an extension of time, can he be liable to the employer who has engaged him? This topic was the subject of considerable attention by the courts some thirty years ago. The leading case of Sutcliffe v Thackrah [1974] AC 727 settled the debate.

Prior to 1974, under English Law, it was not possible for a client to sue in respect of the deficient contract administration of its architect or engineer. The Court of Appeal authority of Chambers v Goldthorpe [1901] 1 KB 624 and other case law established that in certification, specifically, the contract administrator was acting in an arbitral role and should be protected against civil suit by a form of quasi–judicial immunity.

In 1974, the House of Lords in Sutcliffe v Thackrah overruled this decision and established that an architect owes a duty of care towards his client in the performance of all duties, including contract administration, and specifically certification, and could be liable for negligence in the performances of those duties. Negligent over–certification would be an obvious example. This extends to both interim and final certificates—see Merton LBC v Lowe [1981] 18 BLR 130. Obviously, in many cases of over–certification in interim certificates (and under–certification for that matter) it will be possible to avoid any lasting harm to anyone by correcting the position in a subsequent certificate. However where a contractor has gone into insolvency rendering recovery from that source impossible, the employer may well look to his negligent contract administrator for recompense in the case of over certification.

An interesting variation on liability for over–certification can be observed in the Malaysian case of Chin Sin Motor Works Sdn Bhd v Arosa Development Sdn Bhd [1992], 1 MLJ 23, where purchasers had agreed to buy a house from developers. Money was to be advanced to the developers on behalf of the purchasers by a lending institution on the basis of interim certificates shown to it. On the developer's insolvency, it was discovered that sums had been advanced on a certificate that water and electricity supplies were connected; the latter had not been done. The certifying architect was held to owe a duty of care to both purchaser and lender and was held liable on the basis of negligent misrepresentation. It is suggested that the position would be the same in other common law jurisdictions.

RECENT JUDICIAL CONSIDERATION OF THE DUTY OF IMPARTIALITY

In speaking of the contract administrator's duty, courts and commentators have referred to a variety of qualities. These include 'impartiality', 'independence', 'fairness', even–handedness' and 'holding the scales fairly or evenly'. From time to time, there have been attempts to analyse more exactly the meaning and relationship of these terms. In the classic London Borough of Hounslow case referred to above, Mr. Justice Megarry was certain that there was no general

obligation to 'observe the rules of natural justice, giving due notice of all complaints and affording both parties a hearing'. But his formulation of the duty included the requirement that the architect 'must throughout retain his independence' in exercising his professional judgment. Nearly 30 years later, the emphasis had changed, some might say in favour of greater realism. Lord Hoffmann in Beaufort Developments Ltd v Gilbert Ash NI Ltd [1999] AC 266 observed that:

... the architect is the agent of the employer. He is a professional man but can hardly be called independent. One would not readily assume that the contractor would submit himself to be bound by his decisions subject only to a challenge on the grounds of bad faith or excess of power. It must be said that there are instances in the nineteenth century and the early part of this one in which contracts were construed as doing precisely this … But the notion of what amounted to a conflict of interest was not then as well understood as it is now … today one should require very clear words before construing a contract as giving an architect such powers.

In Amec Civil Engineering Ltd v Secretary of State for Transport [2005] BLR 227 the Court of Appeal had to consider the ambit of the duty of an engineer in making a decision over a dispute referred to him under Clause 66 of the ICE Conditions. Amec were responsible for renovation works to the M6 motorway. Defects were found in roller bearings used and the employer wrote to Amec asking them to accept liability. When Amec did not do so, the employer referred the dispute to the engineer for determination. This was a necessary step as under Clause 66 a decision of the engineer is required before the commencement of an arbitration. Time was extremely short as the limitation period was about to expire. The engineer decided in a matter of days that Amec was liable for the defects. Amec refused to accept this decision and an arbitration was commenced. Amec contended that the arbitrator had no jurisdiction because the engineer's decision was invalid in that it had not been reached by a fair process—in particular the engineer had reached his decision without giving Amec the opportunity to make submissions. The Court of Appeal (with May LJ giving the leading judgment) held that there was no difference between the engineer's duty under Clause 66 and his duty when carrying out his other independent functions. He had to act independently, honestly and fairly—but he did not have to apply the rules of natural justice. Rix LJ disagreed with this analysis. He said that the engineer's role under Clause 66 did differ from his other roles and that he had been wrong not to have heard both sides before reaching his decision on the dispute. In effect he was of the view that the engineer was obliged to comply with the rules of natural justice when determining a dispute under Clause 66. In the event this disagreement between May LJ and Rix LJ did not affect the outcome of the appeal.

Further consideration of the duties of a contract administrator was given in Costain Ltd v Bechtel Ltd [2005] EWHC 1018, a decision of Jackson J in the English Technology and Construction Court. The contractor on the Channel Tunnel High–Speed Rail Link Project applied for interim injunctions to prevent interference in the process of contract administration, specifically in deciding on contractor's claims. Under the contract the project manager was responsible for determining how much the contractor should and should not be paid. The project manager was a consortium of which Bechtel was the major player. At an emergency meeting of the project management team concerning budget overruns, Mr Bassily, an employee of Bechtel and the Executive Chairman of the project manager consortium, addressed the staff involved in determining what was due to the contractor. The contractor's case, in effect, was that Mr Bassily had advocated a policy that would have the effect of denying the contractor its due entitlements. It pointed among other things to the fact that following the meeting the incidence of refusal of contractor's claims had increased measurably. The contract was an amended version of the New Engineering Contract. This added somewhat to the piquancy of the proceedings in that the Recitals included the provision/hope/aspiration that 'The Employer, the Contractor and the Project Manager act in the spirit of mutual trust and co–operation and so as not to prevent compliance by any of them with the obligations each is to perform under the Contract'.

The contractor in the proceedings described the Bechtel approach as 'a policy adopted by Bechtel … to reduce its own risk rather than as a result of an impartial and genuine application of the Contract'. One of the questions which counsel addressed in the proceedings was characterised by the judge as 'When assessing sums payable to (the contractors) … is it (the contract administrators') duty (a) to act impartially as between employer and contractor or (b) to act in the interests of the employer?'

Mr. Justice Jackson observed at the outset that this issue 'has significance extending beyond

the boundaries of the present litigation'.

Counsel for the project managers argued that the contract in question should be distinguished from the 'conventional contracts' (where Jackson J indicated that a straightforward Sutcliffe v Thackrah approach would apply) because:

(i) the project manager was here given no broad discretion but his duties were very specific and detailed; so there was 'no need, and indeed no room for an implied term of impartiality';

(ii) the availability to the contractor of the dispute resolution procedures under the contract would have 'the effect of excluding any implied term that the project manager would act impartially';

(iii) the project manager's role under this contract was 'not analogous to an architect or other certifier under conventional contracts'. The project manager was specifically employed to act in the interests of the employer;

(iv) the contractual terms excluding any term implied by custom would 'prevent any implied term arising that the project manager will act impartially'.

Jackson J said that, although the NEC is more specific and objective than 'conventional' construction contracts, 'there are still many instances where the project manager has to exercise his own independent judgment …. When the project manager comes to exercise his discretion in those residual areas, I do not understand how it can be said that the principles stated in Sutcliffe do not apply. It would be a most unusual basis for any building contract to postulate that every doubt shall be resolved in favour of the employer and every discretion shall be exercised against the contractor.'

In the provisions of the contract the judge was 'unable to find anything which militates against the existence of a duty upon the project manager to act impartially in matters of assessment and certification'.

He did not accept the argument that the inclusion of a dispute resolution procedure militated against the existence of a duty on the project manager to act impartially in matters of certification. Virtually every construction contract had such provisions

He accepted that 'in discharging many of its functions under the contract, the project manager acts solely in the interests of the employer … Nevertheless, I do not see how this circumstance detracts from the normal duty which any certifier has on these occasions when the project manager is holding a balance between employer and contractor'. He could not see how a clause excluding any term implied by custom could be relevant: 'The implied obligation of a certifier to act fairly, if it exists, arises by operation of law not as a consequence of custom'.

In the result, the court's decision did not hinge on these findings. Jackson J held that damages would be an adequate remedy if the case proved to be successful and the 'balance of convenience' test was not satisfied. These findings were fatal to the application for an interim injunction.

Mr. Justice Jackson concluded with observations on yet another attempted formulation of the duty; the phrase 'in good faith': 'Sometimes it is used as a synonym for 'impartiality'. Sometimes, it is used as a synonym for 'honestly''. Criticising the term as 'ambiguous', Jackson J observed that 'A semantic debate about the precise meaning of the phrase 'in good faith' in the context of certification seems to me to serve no useful purpose. I have therefore concentrated on the question whether there was a duty of impartiality and whether, arguably, that duty was breached.'

The most recent relevant case is Scheldebouw v St. James Homes (Grosvenor Dock) Ltd [2006] BLR 113. Again the judge was Jackson J in the TCC. The employer, St. James, had removed Mace, their construction managers, and proposed themselves as the replacement. Scheldebouw objected and were met with a trenchant reply from St. James: 'There is no reason why we cannot appoint ourselves as the construction manager. This is a construction management contract whereby the construction manager, whoever that is, acts on our behalf to manage the works in relation to the contracts entered into between us and the trade contractors. Under construction management, as opposed to management contracting, the construction manager acts entirely as our agent to protect our interests. The construction manager is not appointed as some quasi independent certifier, as you imply, such as is the position of an architect, for instance, under a JCT contract … there is no obligation on us to act independently and impartially as there was not on Mace'.

The contractor took the matter to court for a ruling on whether the employer was entitled to act in this way under the contract in question. The judge found that the construction manager fulfilled two different functions which could be described as the 'agency function' (as in instructing variations) and the 'decision–making function' (as in ascertaining loss and expense and granting extensions of time). The same of course is true of architects and engineers in most

standard forms of contract. After referring to the cases of Panamena, Perini, Hounslow, Sutcliffe and Amec (see above) the judge reached the following conclusions:

• The precise role and duties of the decision–maker will be determined by the terms of the contract in question.

• Generally the decision–maker is not and cannot be regarded as an entity wholly independent of the employer.

• When performing his decision–making function, the administrator (in this case a construction manager) is required to act in a manner which has variously been described as independent, impartial, fair and honest. These words connote that the decision–maker must use his skill and best endeavours to reach the right decision as opposed to a decision which favours the interests of the employer.

• The contract did not allow the employer to appoint himself as construction manager. It was not envisaged that the role of the decision–maker should be exercised by the employer himself. The whole structure of the contract was that the decision–maker should be a separate entity from the employer.

• The concept of the employer carrying out the functions of the independent decision–maker were so unusual that it would require express words in the contract to bring this about (as was the case in Balfour Beatty Civil Engineering v Docklands Light Railway [1996] 78 BLR 42). There were no such words in this contract.

CONCLUSIONS

Traditionally employers have engaged professionals to manage construction and engineering contracts. While the scope of their duties depends on the terms of the particular contract, usually they perform two distinct roles. The first is as agent of the employer—for example in issuing instructions and ordering variations. The second is as a decision–maker—for example in certifying payments, assessing claims for loss and expense and in awarding extensions of time.

A contract administrator acting as a decision–maker has to act independently, impartially, honestly and fairly. He must not favour either contractor or employer. However he does not have to apply the rules of natural justice when making his decisions.

If the administrator negligently over–certifies in the contractor's favour he can be held liable to the employer who engages him. In special circumstances he might also be liable to third parties, such as institutions lending money to the employer.

In normal circumstances an administrator who under–certifies will not be liable to the contractor. However if, for example, he makes gratuitous representations to the contractor he may be found to have assumed a responsibility to him and be liable in negligence.

If the employer exerts pressure on the administrator so that he loses his impartiality and independence then the administrator's certificate may be invalid and his decision ignored. Furthermore if the employer knows that the administrator is not carrying out his functions properly then he may himself be liable to the contractor for breach of contract if he does not take steps to correct the position.

Contractors and employers are entitled to expect that contract administrators will be fair in their decision–making. They cannot be independent in the (common) situation where they are engaged by the employer, but they can be expected to act impartially as between contractor and employer in their decision–making role, in the sense of favouring neither. The concept of acting independently is still relevant.

In principle, there is nothing to stop parties agreeing that the contract administrator should be an employee of the client/employer. In theory the employer itself could act as contract administrator but this is unusual and potentially fraught with difficulty. The clearest express terms are needed to bring this about.

These principles have long been applied to 'traditional' construction and engineering contracts. Recent attempts to argue that they do not apply to decision–makers under new forms of contract have been rejected by the courts.

The principles outlined above concern the duties of an administrator in relation to the economic well–being of either contractor or employer. When physical damage to person or property is the issue then the administrator will be subject to the usual rules for the imposition of a duty of care founded on the well known case of Donoghue v Stevenson.

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