

The Thin End of the Wedge: ABB Zantingh Ltd –v- Zedal Building Services Ltd Redefines the “Power Generation” Exclusion under the Construction Act 1996, Section 105(2)(c). Part 1- The Law and the Case

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S.105(2)(c) of the Construction Act 1996¹ (the “Act”) provides that the Act does not apply to contracts for the installation of plant where the “primary activity on site” is power generation. The scope and meaning of this provision is ambiguous. In ABB Zantingh –v- Zedal Building Services the High Court decided that the installation of plant whose purpose was power generation on a site where the primary activity was “printing” was not exempt. This interpretation of the word “site” raises some serious practical and commercial issues. Are contracts for the installation of plant on CHP, co-generation, UPS, captive, and waste to energy power generation sites subject to the Act? In Part 1 of this article we consider the application of the Act and the import of the ABB case. In part 2 Jeff Delmon of Allen & Overy addresses the implications for sponsors, lenders and contractors by reference to specific projects.

1. The Act

The Act (supplemented by the Scheme for Construction Contracts)² provides specific rights to the parties to a qualifying contract for construction operations. For example, qualifying contracts must provide for: mandatory referral of disputes arising thereunder to adjudication (with interim binding effect); periodic payments, with an “adequate mechanism” for determining what is due under a contract (where parties are unable to agree upon an “adequate payment mechanism” the Scheme imposes its own); and a procedure for ensuring that unless an appropriate notice is given within a prescribed time, moneys may not be withheld. Crucially it confers a right to suspend performance for non-payment. It also partially prohibits conditional payment provisions.

Adjudication raises particular issues for lenders and for employers. They must consider claims in a very short time frame and do not have any control over preliminary dispute resolution. Adjudication operates at speed. A party may refer a dispute to adjudication at any time. The appointment of an adjudicator and the referral of the dispute to him must occur within 7 days of the referral notice. The adjudicator must then reach his decision within 28 days (unless an extension is agreed by the parties or the adjudicator extends this time by 14 days). The decision of the adjudicator is binding until the dispute is finally determined by legal proceedings, arbitration or agreement. Where a qualifying

¹ The full title of the Construction Act is the Housing Grants Construction & Regeneration Act 1996.

² The Scheme for Construction Contracts (England and Wales) Regulations 1998 SI 1998/649 introduced on 6 March 1998.

contract does not contain a compliant adjudication procedure the Scheme imposes a regime in default.

2. General application of the Act

The Act applies to all “*construction contracts*” in writing entered into after 1st May 1998. Section 104 (1) defines a construction contract as an “*agreement*” with a person for the “*carrying out of construction operations*” in England, Scotland, or Wales. Section 105(1) provides that “*construction operations*” include “*construction*”, “*alteration*”, “*repair*”, “*maintainance*”, and “*extension*”, of any “*structures*”, or “*works*” – “*forming, or to form, part of the land (whether permanent or not)*”, and “*operations which form an integral part of, or are preparatory to, or are for rendering complete*” the same, including “*earth-moving*”, “*excavation*”, and the “*laying of foundations*”. However the “*construction operations*” described in S.105(2), and PFI concession agreements³ are excluded from the application of the Act.

Whilst avoidance devices have been developed, parties cannot contract out of the Act.

Contracts for the manufacture and erection of machinery and equipment, and contracts for repair or maintainance, are each subject to the Act.

This is because they would constitute agreements for the “*construction*” (which is synonymous with assembly/erection), “*repair*”, or “*maintenance*” of either “*structures forming, or to form, part of the land,*” or of “*works forming, or to form part of the land*” - which are “*construction operations*” caught by the Act⁴.

Where a contract includes activities considered by the Act to be “*construction operations*” (such as civil engineering) as well as activities that are not subject to the Act, the contract as a whole will be subject to the Act, since the agreement involves the carrying out of construction operations. Therefore most turnkey construction contracts, though they involve certain activities, which are not considered by the Act to be “*construction operations*”, will include civil and other construction activities and will be subject to the Act.

The Act will also apply “*to a supply-only contract to the extent that the supplier is also engaged in a construction operation . For example, if a supplier of a boiler also agrees as part of his contract to test and commission it on installation, this would be for rendering complete [a construction operation].*”⁵

The Section 105(2)(c) exclusion

³ The Construction Contracts (England & Wales) Exclusion Order 1998, SI 1998/648.

⁴ Sections 104(1) and 105(1)(a) and (b).

⁵ See Footnote 4 and Current Law Statutes 1996 , 53/106.

Section 105(2)(c) excludes the following activities from the definition of “construction operations”⁶ :

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

- (i) nuclear processing, power generation, or water or effluent treatment, or*
- (ii) the production, transmission, processing or bulk storage (other than warehousing) of chemicals, pharmaceuticals, oil, gas, steel or food and drink.”*

Section 105(2)(c) is difficult to understand. Its drafting is unclear and its purpose has never been properly expressed. Various sources give some indication of the interpretation of this exclusion from the Act.

In **Norwest Holst**⁷ the Judge stated that *“it was the intention of Parliament that exemption should be given by applying an additional and different test: was the object of the “construction operation” to further the activities described in section 105(2)(c) (and in paragraphs (a) and (b)) since in those industries or commercial activities it was not thought necessary)... Paragraph (c) makes explicit the need to identify the site or location of the activity and to ensure that it is the primary or dominant activity since of course the activities listed may be ancillary to the principal activity.”*

The Judge opined that *“installing plant for.. power generation ... is excluded”*.⁸ He assumed that this was Parliament’s intention following: informed debate; consultation within *“the industry”*; enquiries and soundings by the DOE [now the DETR]; and *“a most thorough investigation ...evidently carried out”* by the DOE.

What did Parliament intend?

“We undertook to amend [Section 105(2)] to achieve two particular effects. The first of these was to ensure that the exclusion of work on plant and machinery on a process plant site should extend only to steel work that was necessarily connected to it in some way, and that all other steel work on such

⁶ Section 105(2)(d) also excludes the *“manufacture”* or *“delivery to site”* of: (1) building or engineering components or equipment;(2) materials, plant or machinery, or (3) components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply, or fire protection, or for security or communications systems. *“Except under a contract which also provides for their installation.”*

⁷ ABB Power Construction Ltd –v- Norwest Holst Engineering Ltd (2000) LTL 24.8.2000 (Court Transcript) line 13, page 8.

⁸ ABB Power Construction Ltd –v- Norwest Holst Engineering Ltd (2000) LTL 24.8.2000 (Court Transcript) line 1, page8, and line 16 page 7.

*site – in common with all other construction work – should be subject to the Bill’s provisions”*⁹ .

Robert Jones MP who was Construction Minister during the final stages of the debate on Section 105(2)(c) by Standing Committee F in the House of Commons¹⁰ categorically stated, “*we do not intend all work on a process engineering site to be excluded...we have.. excluded an industry that has made it clear that it has not had the same history of disputes as the construction industry*”.

“Subsection 2(c) was achieved through persistent lobbying by...[the] Process Industries Latham Group [“PILG”] [who] represented the interests of clients in the process industries”.¹¹

The sole impetus behind PILG’s lobbying was the singular wish of the process industry to be excluded from statutory interference in their business relationships. This stems from a “*fundamental belief in the Process Industries Group that there should not be resort to litigation. The ... industry’s clients are generally the sort of people who continuously place business, so there is the prospect of repeat business. One does not take one’s customer to court if one expects to receive more business from him*”.¹²

“*BEAMA co-ordinated the views of power generation members with the Institution of Electrical Engineers*”¹³ who were represented on PILG, as were the Engineering Construction Industry Association who represented major power contractors including at that time: ABB Power Generation Ltd, GEC Alstom Power Plants Group, Kvaerner Energy, and Siemens .

PILG, apparently, do not draw a distinction with regard to the site specificity of power plant construction.

During the debates on Section105(2)(c) Parliament unquestionably regarded *power plant* as being a type of process plant. “*That [power generation] plant is excluded from the Bill; nobody argues about...[but] there is no possible argument for excluding the civil engineering works concerned with ..[any]...power station.*”¹⁴

⁹ Lord Lucas, Minister leading the Government during the relevant debates in the House of Lords on Section 104(2)(c) (which subsequently became Section 105(2)(c) , HL Hansard 23 July 1996 , at Column 1335).

¹⁰ House of Commons, Official Report. Standing committee F: 13 June 1996, at Column 301.

¹¹ Current Law Statutes 1996 , 53/106; and speech of Lord Williams of Elvel, 28 March 1996, HL Hansard, at Column 901.

¹² House of Commons Official Report –Standing Committee F: 13 June 1996, at Column 305.

¹³ Andrew Willman – Legal Advisor BEAMA.

¹⁴ Lord Howie of Troon, HL Hansard 22 April 1996, at Column 934, see also the speeches of Earl Ferrers, 28 March 1996, HL Hansard , at column 1847; and Lord Berkeley, 22 April 1996 HL Hansard , at Column 1438.

ABB ZANTINGH¹⁵

The ABB case provides the most recent authority on the application of the Section 105(2)(c) exclusion. It concerned the installation of plant forming part of two diesel powered electricity generation stations on land owned by Mirror Colour Print Group (MCP) at sites where MCP printed colour magazines.

Zedal were a sub-contractor to ABB who had contracted with Scottish and Southern Energy plc (SSE) to design, build, and maintain these stations.

SSE leased the generators to MCP who were free to control the power output and destination of electricity which were to be used to supply stand-by power over the new year to deal with anticipated power-failure caused by the “Millennium Bug”.

The Judge ruled “*what has to be examined is not the primary activity of MCP but the primary activity of a site.*”¹⁶

In order to determine this question, he first had to define “*the site*”.

*“If the site is defined as a small area on which the generators stood ... surrounded by a security fence, then the primary activity of the sites must be power generation, because the only activity of those sites is power generation...If the site is defined as whole areas occupied by MCP ... then it cannot conceivably be said that the primary activity of those sites is power generation. Taking those sites as a whole, power generation can only be regarded as ancillary to the activity of printing colour magazines whether or not excess power might be sold to others.”*¹⁷

*When parliament refers in section 105(2) to “a site where the primary activity is ... the reference must be to a place broader than a generator surrounded by a security fence. To make any sense of the Act, one has to look to the nature of the whole site and ask what is the primary purpose of the whole site? Is the primary purpose power generation, or, is this printing?”*¹⁸

The Judge held that the primary activity on the whole of the site where the power plant was located was “*printing*”.

The Judge adopted a pragmatic view as to what the “*primary activity*” on the “*site*” was.

He did not employ any qualitative or quantitative techniques to compare and evaluate the prime “*site*” activity in terms of for example proportion of site area occupied for the carrying out of each activity, relative manpower, output, or by reference to the proportion of power generated for use on the site in

¹⁵ ABB Zantingh Limited –v- Zedal Building Services Limited [2001]BLR 66.

¹⁶ ABB Zantingh Limited –v- Zedal Building Services Limited [2001]BLR 66 at Para 16.

¹⁷ ABB Zantingh Limited –v- Zedal Building Services Limited [2001]BLR 66 at Para 28.

¹⁸ ABB Zantingh Limited –v- Zedal Building Services Limited [2001]BLR 66 at Para 3.

connection with the printing activity as compared with the proportion of surplus power which might have been sold to the National Grid.¹⁹

How else in a short time frame can even a TCC Judge be expected to decide such a multi-faceted issue?

Conclusion

The Act potentially applies to contracts for all major power plant work-packages which involve supply, and erection / testing and commissioning, or maintenance or repair, and to all turnkey contracts which require the execution of civils work or other construction operations.

Section 105(2)(c) only appears to exclude contracts which are for the installation of plant on a site, which considered as a whole, is one of those listed in section 105(2)(c).

However it should be noted that the cases referred to in this article are all first instance decisions and therefore do not constitute a unifying body of precedent on the meaning and scope of Section 105(2).²⁰

The interpretation and the application of Section 105(2)(c) of the Act remains a minefield for contractors and a fertile ground for litigation – which is not what Parliament intended.

Compounding the problem “there is no clear-cut division... between construction industry and process engineering contracts.”²¹

“The distinction between that which constitutes plant and construction can become fairly blurred. Thus for example it has been held that expenditure on an underground sub-station for transforming electricity was not expenditure on plant. The test appears to be whether the structure in question is performing a plant like function”.²²

In June 2000 the CLG recommended the wholesale removal of Section 105(2)(c) because there was no longer “any logical reason” for the “process plant exemption”, and because of the litigation, which has arisen out of its manifest anomalies.²³

¹⁹ However in this case the Judge was satisfied that there was no evidence of any arrangement for the supply of electricity by MCP back to the National Grid.

²⁰ see also *Palmer's Limited –v- ABB Power Construction Limited* 68 CLR 52; [1999] BLR 426.

²¹ Sir Sydney Chapman HC Hansard 7 May 1996 at Column 70.

²² *Current Law Statutes 1996*, 53/106, and *Bradley (Inspector of Taxes) –v- London Electricity*, *The Times*, August 1, 1996.

²³ Report on the Operation of the Act by the Constructors Liaison Group submitted to the Construction Minister June 2000.

Since any future decisions are less likely to be appealed due to the interim-binding nature of adjudication decisions – should the Government redefine Section 105(2)(c) to remove the anomalies it contains?

Nick Raynsford MP in his letter of 3rd April 2001 to Chris Vickers²⁴ makes it clear that the DETR will maintain a watching brief on Section 105(2), and that at present there are no plans for reform,

“The boundary of the exclusions [is] still giving rise to litigation. I suspect that as a result, we will see further refinements in the definitions over the next year or two. If problems persist, I certainly do not exclude returning to these issues, but we should be under no illusion that to make significant changes could be both controversial and perhaps technically quite difficult.”

The ABB case may well prove to be the thin end of the wedge in the narrowing down by the courts of the specific circumstances in which Section 105(2)(c) exempts power plant contracts from the full rigour of the Act.

²⁴ The Construction Minister’s letter to the Chairman of the CIB in response to the final report and recommendations of the CIB Task Force “Review of the Scheme for Construction Contracts.” The DETR has issued a consultation paper “Improving adjudication in the Construction Industry” which seeks comments on the Government’s proposed changes to the legislation on adjudication in the construction industry, which is available on the DETR web site: www.detr.gov.uk/bregs/contract. The DETR has stated that it welcomes all responses to the proposals contained in the paper and will take note of additional comments and proposals on changes to Section 105(2)(c). Responses must arrive at the DETR by Monday 18th June.