

CONSTRUCTION : BULLETIN



The Role of the Project Monitor and the Importance of Checking Vesting Certificates

Financial institutions which provide funding for construction projects often appoint a project monitor (also known as a monitoring surveyor) to provide them with independent advice on the project and the risks associated with it. This allows the funder to make informed decisions, reduce and manage risk exposure and protect its financial interests.

However, as demonstrated in the recent case of *The Governor And Company of the Bank of Ireland v Faithful & Gould Ltd*, appointing a project monitor does not necessarily prevent a construction project from going horribly wrong.

Background

During 2006 and 2007, the Bank of Ireland (the "Bank") provided funding of more than £13m to a developer, Issa Developments Limited ("Issa"), for the construction of an apartment block in Manchester. The Bank appointed Faithful & Gould Limited ("F&G") as project monitor.

Unfortunately, in 2008, both Issa and its main contractor, BS Construction Limited ("BSC"), went into administration. The Bank was unable to recover £8m of the money it had loaned to Issa for the development.

The Bank sued F&G for the £8m, alleging that F&G had failed to properly perform its role as project monitor.

F&G ultimately settled the Bank's claim for £3.35 million. The reason the dispute came before the court was that F&G then pursued CBRE Limited

("CBRE"), who had been appointed as the Bank's valuer, for payment of a contribution towards the damages paid to the Bank by F&G. F&G argued that CBRE's valuations of the gross development value and market value of the site were negligent and therefore the Bank's security was far less than it had been led to believe.

F&G's claim against CBRE was ultimately unsuccessful because F&G was unable to prove that a negligent valuation had caused the Bank's loss. However, the main point of interest in this case was the court's comments on how the role of project monitor should be performed.

The role of the project monitor

All parties involved in the litigation agreed that when carrying out its duties under its letter of engagement, F&G was required to exercise the degree of care and skill to be expected of a reasonably competent project monitor.

The Bank had alleged that F&G had failed to comply with this duty in 3 different ways.

The first allegation was that F&G had not advised the Bank that Issa did not have sufficient experience of carrying out developments of this nature and did not have the resources to carry out the development on time and on budget. The court did not consider there was much merit in this allegation, as it was clear that the Bank had made its own investigations into Issa and was well aware that Issa had no experience of substantial developments.

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The second allegation was that F&G had not drawn the Bank's attention to the fact that there was no formal building contract between Issa and BSC, or informed the Bank that this could have led to problems relating to the ownership of materials if BSC became insolvent. The court was unimpressed by this allegation, since the Bank had clearly been aware of the situation and was apparently untroubled by it. The court also noted that the Bank was being advised by solicitors, as well as by F&G, and did not appear to have received any advice from its solicitors that the contractual arrangements were unsatisfactory.

Vesting certificates and the role of the project monitor

F&G's appointment required it to verify Issa's drawdown requests to verify that the funds requested were justified and had been properly incurred. The Bank's most serious allegation was that F&G had failed to competently quantify the expenditure incurred by Issa, with the result that Issa was allowed to draw down funds earlier than it should have been.

Specifically, the Bank alleged that:

- F&G had advised it that Issa's development costs included off-site materials worth £4.5m. However, materials to this value either did not exist, or were not stored in the UK.
- The vesting agreement for off-site materials submitted by Issa was not in the form that F&G and the Bank's solicitors had advised.
- F&G had not properly inspected the premises where off-site materials were stored in order to satisfy itself that the materials existed and had been properly set aside for the project.
- F&G had not explained to the Bank why Issa was procuring materials so far in advance of the need for them to be on site.

The court found that F&G had told Issa that any applications for drawdown of funds which included a claim for off-site materials had to be accompanied by a vesting certificate in the form approved by the Bank's solicitors. However, Issa did not comply with this

requirement. The vesting certificate should have been given by the material supplier to BSC, but it was actually both provided by and addressed to BSC. The vesting certificate was therefore essentially a letter from the main contractor to itself, which made it almost worthless to the Bank.

In addition, the vesting certificate did not properly describe and identify the off-site materials. The court stated that F&G "*should have drawn this to the attention of the Bank and advised it to check with its solicitors whether or not the proffered certificate was acceptable*". F&G did not do so. This failure was made all the more unfortunate by the fact that the Bank's approved form of vesting certificate had originally been drafted by F&G.

Furthermore, although F&G had submitted a report to the Bank confirming that F&G had verified that the materials were being stored in the stated locations, it emerged during cross-examination that this was not the case. The F&G employee that provided the project monitoring services admitted that the warehouse where the materials were stored was in such a mess that he had not been able to carry out a proper inspection to confirm that the materials claimed by Issa were actually stored there.

The court found that F&G should have advised the Bank that the warehouse was in too much of a mess for F&G to be sure that the materials were all present. In failing to do this, F&G's advice to the Bank "*fell below the standard that could reasonably be expected from a competent project monitor*".

The court was also surprised that F&G had advised the Bank to advance such a large sum of money to Issa without offering any explanation why Issa had chosen to tie up so much cash in the advance purchase of materials.

In summary, the court noted that if F&G had given the Bank proper advice, F&G would have told the Bank to allow no more than 50% of the claimed cost of the off-site materials at that stage.

Analysis

Whilst this case is of particular interest to project monitors and funders because of the guidance it provides on the standard of advice to be expected from a project monitor, it also contains very important lessons for anyone who is responsible for checking the validity of a vesting certificate.

As this case shows, it is crucial that payment for off-site materials is not made against a vesting certificate unless the vesting certificate has been thoroughly checked to ensure it provides the intended protection and clearly describes the materials in question. This is particularly important when large sums of money are at stake, or where there are concerns about the financial situation of the party seeking payment.

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