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Construction and development

Legal Update

Winter 2008

"Cameron McKenna is a leading firm with a serious construction unit. Sources admire team members' diligence and willingness to get their hands dirty when the situation dictates"
Chambers 2007

"In conclusion, CMS Cameron McKenna is providing its clients with expert, commercially focused advice - something which most firms claim to do but many fail to deliver."
External industry report

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The threat of recession has led some commentators to predict a shift for lawyers and clients from transactional work to disputes resolution, particularly in the financial sector. Certainly, when in the past there has been a slow down in development and construction, clients have been seen to re-direct their energies into the recovery of losses due to breach of contract and monies due but not paid.

Our bulletin contains a number of articles to update readers on the current state of play in dispute resolution. The Commercial Court is leading the charge on improving practice for large cases – an initiative which was necessary following the collapse of the BCCI case in November 2005. In a similar vein, the Court's Rule Committee is considering whether cost capping should be used more widely as a case management tool. There has been a shift in the application of court fees so that filing fees are reduced but higher fees are paid if the case is listed for trial – further evidence of the court encouraging parties to settle at an earlier stage in the proceedings.

If disputes do proliferate, there may be further claims under collateral warranties. So far claims under standard form warranties have not been considered in great detail by the courts. In 2007 however there was a case where it was held that liability for "costs" in a collateral warranty covered not only the costs of repair, renewal and/or reinstatement but also (since it was not expressly excluded) consequential loss.

If a claim is to be made against a design professional with a skill and care obligation, it is worth reminding oneself that this does not imply a fitness for purpose obligation. This issue has been reconsidered recently in a case before the TCC, where it was held that a consultant was not in breach of reasonable skill and care despite making a mistake in his assumptions in the course of design.

If you are the victim of a breach of contract, you may expect to recover damages. The payment of damages can be rather a complicated matter, as our article on the compensation rule in damages claims explains. Another article updates you on the current state of play as regards recovery of wasted management costs and compound interest: there have been welcome developments in these areas (for Claimants). We also review a recent adjudication (in which we were involved) in which a "no dispute" argument was run (unsuccessfully) and list the other circumstances in which there is potential to raise this defence in enforcement proceedings.

As regards insurance, employers and contractors might assume that, if something catastrophic happens during construction and a third party brings a claim, this will be picked up under the public liability (PL) section of the project policy or annual PL. The recent High Court decision in *Tesco v Constable* shows that this is not necessarily the case. Our article explains.

There have also been a number of recent cases where the Courts have supported agreements for private dispute resolution, namely arbitration. In particular it is now clear that UK Courts will interpret arbitration clauses widely, thus obliging parties with arbitration clauses to submit any disputes arising under or in connection with the contract to arbitration rather than to the jurisdiction of the court.

We include, as our leading article, a note on the latest guidance on the proposed Community Infrastructure Levy (or planning gain supplement as it used to be called). We also have our usual cases round up.

Caroline Cummins
February 2008

On 24 January 2008 the Department for Communities and Local Government issued its latest guidance looking in more detail at the proposed Community Infrastructure Levy (CIL) or planning gain supplement as it used to be called.

"This new guidance focuses on how CIL will actually operate in practice."

Community Infrastructure Levy: the latest guidance

This new guidance focuses on how CIL will actually operate in practice. The guidance looks at issues such as how the levy will be set, how will authorities spend it, payment arrangements and the relationship between the levy and section 106 agreements.

In terms of some of the headline points:

- In setting the levy authorities will need to follow two steps. The first is identifying what infrastructure is needed and how much it will cost. The second is working out what contribution each development should make to that cost. Arrangements will be put in place for independent testing of the proposed levy.

- It is accepted that an authority may want to impose different levels of charges because of specific local conditions so there may be different levies charged by an authority in respect of different parts of a town or district.

- Initially the intention is "affordable housing" should also be included in the definition of "Infrastructure" although it is not the intention that the levy will be used to fund affordable housing at this stage. This is just a fall back which can be used in the future in case there is a reduction in affordable housing contributions as a result of the introduction of the levy.

- The levy might be used to off set expenditure which has already been incurred (for example where an authority has funded in advance infrastructure costs in anticipation of the levy being paid). Also possibly the levy may be reserved for future expenditure.

- The guidance recognises that some infrastructure (for example hospitals and large transport projects) are actually undertaken on a sub-regional basis and involve a number of different charging authorities. There are no specific proposals in how to ensure that CIL can effectively contribute towards this sub-regional infrastructure and views from the industry are invited.

- The levy is expected to complement the existing section 106 arrangements. Also for those authorities who choose not to implement the levy, section 106 obligations will continue to be used as a way of securing contributions. The intention is that otherwise the section 106 agreements should (once the levy is implemented) focus on only three areas. The first is affordable housing. The second are non-financial and technical operation matters which can only really be covered by way of planning obligations. The third is dealing with site specific impact arising from the development (for example on site archaeology or an access road to the development).

- The levy will be payable on commencement of the development. The levy will be determined when planning permission first becomes fully effective. This is likely to mean that the levy will not be fully ascertainable at outline planning stage only.

- Because of potential difficulties associated with enforcing against the "land owner" at the time of implementation, it is proposed that developers should also be liable to pay the levy.

- The levy may be paid by instalments and failure to pay could result in works having to stop on site. The intention is that failure to pay will also be a criminal offence.

The intention is to formally consult on draft regulations in Autumn this year with a view to regulations being finalised in Spring 2009.

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"The levy is expected to complement the existing section 106 arrangements."

Developments in civil procedure

The past year has seen some interesting developments in civil procedure which hold relevance for cases in the Technology and Construction Court (TCC).

Pilot rules for large cases in the Commercial Court

A six-month pilot of new rules for large cases began in the Commercial Court on 1 February 2008. The new rules flow from the report of the Commercial Court Long Trials Working Party released in December 2007. Major changes include:

- minimising the importance of Statements of Case in the conduct of proceedings. Once Statements of Case have been exchanged, the Court itself is to settle a "List of Issues" for the proceedings. This list will then be the reference point for disclosure, expert reports, witness statements and the trial
- disclosure is to be more targeted, with each party setting out the disclosure it proposes for each of the issues in the List of Issues. The Court will then consider the disclosure appropriate to each issue.
- early applications for summary judgment and/or striking out are to be encouraged, again by reference to the List of Issues.
- limits on the length of witness statements, expert reports, submissions and opening/closing statements are to be enforced.
- the Court is to take a more robust approach to the making of costs orders, including making summary assessment the norm where the amount sought is less than £250,000.

"...the Court...is to settle a 'List of Issues'."

It remains to be seen whether these changes will find their way into the TCC, however one might expect them to be adopted in some form or another if the Commercial Court pilot proves a success. Watch this space!

Cost capping

The Court has power under the CPR to order that the recoverable costs of a party be capped in advance. Such an order is intended to avoid the incurring of unwarranted costs and avoid surprise and argument when a case proceeds to a detailed costs assessment after judgment. To date, differing opinions have been expressed as to the Court's readiness to make such orders and the circumstances in which they will be granted. Some judges think they should be used only in rare cases, whereas others feel they ought to be used proactively as a case management tool. The Court of Appeal has recently refrained from addressing the disparity of views and has instead referred the matter to the Rules Committee for consultation and guidance. It is hoped that the Rules Committee will consider the issue in 2008.

Court fees

New Court fees were introduced on 1 October 2007. Notable changes are:

- filing fees on commencing a claim have been reduced by 10%
- the total fee payable for listing a TCC trial has increased from £600 to £1,100
- the fees for a detailed costs assessment have increased significantly from a flat rate of £600 to a sliding scale varying between £300 to £5,000.

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Arbitration clauses: an end to the wrangling

Building and engineering contracts have historically used commercial arbitration as a means for resolving disputes. It is, however, not unusual for a party to seek to avoid arbitrating a dispute on the basis that the dispute is not caught by the relevant arbitration clause...

Arbitration clauses vary widely in their language, but generally they sound very similar. Wording such as *"any dispute arising under this contract shall be referred to arbitration"* is typical. So if a dispute arises "under" the contract, it goes to arbitration. In most cases, the operation of such a clause would be straightforward. Let's say a contractor wishes to claim money which is owing "under the contract", for work performed. A claim like that would be referred to arbitration. If the contractor were to start court proceedings to recover the money, the employer could have the proceedings stopped on the basis that the contractor should have referred the dispute to arbitration.

But, as you might expect, there are other cases where the position is not as clear-cut, and there is room for arguing that a particular dispute is not one arising "under the contract". Suppose the contractor wishes to claim damages on the basis that the employer made misrepresentations to the contractor *before* the contract was entered into. Is that a claim "*under the contract*"? Arguably yes, arguably no. What if an agreement requires disputes "*arising out of or in connection with*" the contract to be referred to arbitration – is the position any different? There are many other variants of the wording that is used, hence a variety of possible arguments that can be made about whether a particular dispute is caught by an arbitration clause.

"The modern trend...is almost to shut the door on arguments that a dispute...is not caught by an arbitration clause."

Historically, parties who wanted to find a way out of an arbitration would get some mileage from arguments that a particular dispute is not caught by an arbitration clause, and that the only way of resolving the dispute is to go to court. Not that going to court is necessarily a bad thing, compared to arbitration. But parties usually choose to resolve their disputes by arbitration for good reasons, including the fact that:

- arbitrations are conducted in private, on a confidential basis
- in international commerce, arbitration provides a vital means of resolving disputes in a forum that is acceptable to the parties, producing an award that is readily enforceable around the world.

The latter aspect is particularly important where the alternative to arbitration would be pursuing a claim in the courts of country X, where this could take years, and the integrity or reputation of the legal system of country X is not good. The other consequence of saying that a particular dispute between two parties is not caught by an arbitration clause is that some disputes will be resolved under the arbitration agreement, whereas others will not. If an arbitration clause operated in this way, it could lead to the absurd and expensive position of the parties being involved in both arbitration (for issues caught by the arbitration clause) and litigation (for those issues which are not caught by the clause).

The modern trend in interpreting arbitration clauses, as was recently affirmed by the House of Lords in *Premium Nafta Products Ltd v Fili Shipping Co Ltd* [2007] UKHL 40, is almost to shut the door on arguments that a dispute between contracting parties is not caught by an arbitration clause. As Lord Hoffmann held in the *Premium Nafta* case:

"In my opinion the construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal. The clause should be construed in accordance with this presumption unless the language makes it clear that certain questions were intended to be excluded from the arbitrator's jurisdiction".

The implications of this decision are clear. If an arbitration clause in project documents is drafted in familiar language, e.g. "*all disputes arising under this contract shall be referred to arbitration*", the presumption is that this clause catches *all* disputes that may arise between the parties concerning the project, including claims based on negligence, fraud, pre-contractual misrepresentation, illegality, restitution and other legal grounds. There may be circumstances where the parties only intended *certain* disputes to go to arbitration, and not others, but these cases will be uncommon, and a party may have difficulty in persuading a court that an arbitration clause is to be read narrowly.

The approach taken by the English courts should be gratifying to users of arbitration. It leaves little room, save in exceptional or unusual cases, for wrangling over the semantics of an arbitration clause. It also affirms the support that the English courts will give to the arbitral process itself, to ensure that it operates effectively, without being scuppered or disrupted by technical or unmeritorious legal points.

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"The approach taken by the English courts...leaves little room...for wrangling."

If you are the victim of a breach of contract, but through a combination of circumstances a third party rather than you will suffer pecuniary loss as a result, will the contract breaker get off scot free

The compensation rule in damages claims

In any company structure it is often convenient for one of the group companies to hold the freehold in a property while another company in the group with the relevant project management expertise enters into a construction contract to develop the property. So long as there is (ideally) a back-to-back agreement between these two companies, which passes on the obligations under the construction contract, this is fine. Often such an agreement is missing, potentially creating a legal "black hole". The black hole arises because the contract maker suffers no pecuniary loss if the contract is breached – because he has no interest in the property and no legal obligation to develop the property to the standard required under the construction contract or otherwise. Indeed, the black hole arises in numerous other situations where the cause of action is divorced from the loss suffered as a result of the beach of contract.

As a rule of thumb, if there has been a breach of contract, only the injured party under the contract may sue for damages and those damages will be limited to the loss actually suffered by the injured party. But that is not the whole story.

"The black hole arises because the contract maker suffers no pecuniary loss if the contract is breached..."

The privity rule (which provides that only the parties to the contract may enforce it) was torn asunder when the *Contract (Rights of Third Parties) Act 1999* was enacted, which provides that a third party may enforce a term of a contract if the contract expressly says that he may, or the term purports to confer a benefit on him. Thus it is now possible to give the owner of the property an express right to enforce the terms of a construction contract.

The rule that an injured party may only recover damages that he himself has suffered (the "compensation rule") has also been eroded over time by the application of clever judicial reasoning and the desire to give a just result. In *Technotrade v Larkstore Ltd* (2006) Lord Justice Rix put it like this:

> *"The authorities in this area demonstrate the courts' striving to ensure that wrongdoers do not escape from their liabilities by reference to the general principle that a person can only recover for his own loss because of the happenstance that a cause of action lies in the hands of someone other than the person who has suffered the loss. The courts are concerned to see that justice is done between the parties."*

The *George Fischer* case in 1994 is authority for the proposition that a parent company may claim for loss caused to a subsidiary. Losses suffered by a sister company in the same group may not be so safe, although they might take comfort from what Lord Clyde said in *Alfred McAlpine v Panatown* (2000):

> *"Where for its own purposes a group of companies decides which of its members is to be the contracting party in a project which is of concern and interest to the whole group I should be reluctant to refuse an entitlement to sue on the contract on the ground simply that the member who entered the contract was not the party who suffered the loss on a breach of the contract."*

In fact the biggest inroad into the compensation rule was expressed by Lord Griffiths in the *St Martin's* case in 1994 (referred to as "the broader ground[1]") - although

[1]The narrower ground allows a party to a contract to recover a third party's loss on its behalf when it was in the contemplation of both parties to the contract that the third party might suffer loss in the event of a breach of contract because the ownership of the property (the subject matter of the contract) might be transferred to the third party before the conclusion of the contract.

some judges have described this as an application of the compensation rule rather than an exception to it. Lord Griffiths argued that, in a contract for work, labour and the supply of materials (such as a building or engineering contract) the original contracting party suffers compensable loss if he does not receive the bargain for which he contracted. The measure of damages is the cost of securing the contract.

So, in a contract for work, labour and the supply of materials and under the broader ground, a Claimant may recover damages even where he has suffered no pecuniary loss himself as a result of the breach.

As debated by their Lordships in the *Panatown* case, the broader ground gives rise to tricky questions especially where the contracting party has no desire or obligation to spend his damages on actually securing the contract – for example, putting right defects. If in fact a third party has suffered loss as a result of the breach (for example because, although it was not a contracting party, it is the owner of the land or the property which is the subject matter of the contract) the receiver of the damages has no obligation to pay the damages to the third party. What is being compensated is a "loss of expectation interest" rather than a hole in the pocket.

However, if the Claimant has no intention of spending the damages on the repair or accounting to the third party to allow him to do so, this may well be relevant to the reasonableness of his claim and he may find himself recovering only nominal damages. Similarly, if the third party has an independent cause of action against the contract breaker (for example, the benefit of a collateral warranty), this may well cancel out the Claimant's claim for loss of expectation interest, since the contract may be secured through another route, albeit different. Finally, it is not at all clear from their Lordships' discussion in *Panatown* that a Claimant may recover damages for delay in performance of the contract under the broader ground.

There has been a recent application of the broader ground in the well-known case of *Mirant v Ove Arup* (2007).

"...the original contracting party suffers compensable loss if he does not receive the bargain for which he contracted."

The *Mirant* case was a dispute about the failure of two of the main foundations to a power station in the Philippines. Arup was found liable for the failure of the foundations. A third trial in the Technology and Construction Court assessed the damages to be paid by Arup arising from the findings on liability.

The contractual arrangements for the project to build the power station were very complicated. The agreement entered into by Arup for the design of the power plant was made between Arup and a company called CEPAS in 1995. CEPAS's shares were purchased in 1997 and in 2001 the purchasing company demerged out of which demerger Mirant, the Claimant, was created. CEPAS was part of a consortium that entered into a contract to design, procure, construct and commission the power station. In the action against Arup, Mirant sought to recover CEPAS's loss and also time and acceleration related costs suffered by another member of the consortium (SCC), who had no independent cause of action against Arup, thus raising as an issue the compensation rule.

In summary, the Judge found in *Mirant* that, as a matter of principle and based on the broader ground, Mirant would be entitled to recover damages suffered by SCC (the costs arising from delay) if it could shown as a matter of fact that Arup's breach had caused the relevant loss.

On the facts, the Judge decided that the delay losses (suffered by SCC) did not arise as a result of Arup's breach of contract so, despite the finding of principle on the broader ground, no recovery was made by Mirant for this head of claim. Nevertheless, the door has been pushed wider open, albeit for others to pass through.

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Collateral warranties: the meaning of "costs"

Collateral warranties are still a major feature of the legal landscape of the construction industry, despite the advent of the Contracts (Rights of Third Parties) Act 1999. Yet there is surprisingly little case law on how the courts will interpret them, although a recent Scottish case gives us some guidance…

Glasgow Airport Ltd v Kirkman & Bradford [2007] CSIH 47 concerned the construction of a building at a cargo centre at Glasgow airport. The employer (GAL) engaged a contractor to perform the works. The contractor, in turn, engaged consulting engineers to design the building. The consulting engineers (K&B) gave a collateral warranty to the employer in respect of the adequacy of their design.

After the cargo building was completed, GAL discovered that the floor slab of the building was defective, and needed replacement. GAL alleged that the slab was defective due to errors made in K&B's design, for which K&B were responsible to GAL under the collateral warranty. The employer sought to recover under the collateral warranty not only the cost of replacing the slab, but other losses to its business (including costs from claims by tenants) flowing from the need to replace the slab. The contractor who performed the building work was insolvent, and not worth suing.

The terms of the collateral warranty

The collateral warranty was drafted in familiar language, i.e. K&B warranted among other things that it had and would continue to exercise reasonable skill, care and diligence in the provision of its services. There was also a net contribution clause, which stated that:

> *"[K&B's] liability for costs under this Agreement shall be limited to that proportion of such costs which it would be just and equitable to require [K&B] to pay having regard to the extent of [K&B's] responsibility for the same and on the basis that the Contractor and its sub-consultants and sub-contractors shall be deemed to have provided contractual undertakings on terms no less onerous than this clause 1 to the Employer in respect of the performance of their obligations in connection with the Works (other than those obligations which relate to the Services) and shall be deemed to have paid the Employer such proportion which it would be just and equitable to pay having regard to the extent of their responsibility."*

"The employer sought to recover...losses to its business (including costs from claims by tenants) flowing from the need to replace the slab."

The issue

The issue before the court was the operation of the net contribution clause, especially in relation to meaning of "costs". K&B argued that the purpose of the clause was to define or limit not only the *extent* of K&B's liability, but the *type* of loss or damage for which it could be liable to the employer. In essence, K&B's argument was that references to "cost" were to the cost of reinstatement of the affected work, and not costs or losses that were *consequential* upon any breach of the collateral warranty, including costs that the employer may have to meet as a result of tenants making claims against the employer due to interruption to their businesses.

The employer argued that the net contribution clause did not place any limitation on the meaning of "costs", and that "costs" could include amounts that the employer would be required to pay to third-parties (including tenants) as damages arising as a consequence of a breach of the collateral warranty. What the net contribution clause did was to limit the *extent* of K&B's liability to a "just and equitable proportion" of the employer's increased costs.

The Court's decision

The court accepted the employer's argument, holding that the reference to "costs" was not restricted to the cost of reinstating the defective work. The court said that the collateral warranty:

> *"is granted in general and unqualified terms and would, unless clearly restricted, entitle [GAL] to recover all losses directly caused by its breach, subject always to ordinary common law rules of remoteness of damage…"*

The potential consequence of this decision (although the court did not have to decide the matter) was that the engineers could be liable to meet some portion of the tenants' claims against the employer for losses flowing from business interruption.

Lessons

The purpose of a net contribution clause is to limit the *proportion* of a person's liability for breach of contract, so that they are not liable for all of the loss suffered where there were other parties who were also at fault. The engineers in the *Glasgow Airport* argued unsuccessfully that the net contribution clause limited not only the *proportion* of a loss for which the engineers might by liable, but that it restricted the *types* of loss for which the engineers could be held liable under their collateral warranty. What this suggests is that if a party giving a collateral warranty wishes to limit its liability to certain types of "costs" (e.g. the cost of rectifying defects) or other losses, the collateral warranty must identify those costs in clear terms.

Sadly, the question of the impact of the net contribution clause on K&B's liability was not argued or addressed by the Court. We wait with interest to see how the Courts will grapple with the issues arising from such clauses, particularly where one party potentially at fault is insolvent.

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"The court accepted the employer's argument, holding that the reference to "costs" was not restricted to the cost of reinstating the defective work."

A ring of fire: fitness for purpose revisited

A recent decision of the Technology and Construction Court has examined the meaning of reasonable skill and care. The context was a consultant designing a fire training facility that actually caught fire (and was therefore not fit for its intended purpose).

Background
The term that may be implied into construction contracts that works performed by a design and build contractor should be fit for their intended purpose is generally well known.

Fitness for purpose under design and build contracts can be contrasted with the general obligations owed by a designer who undertakes to use reasonable skill and care. The test of reasonable skill and care was set out in *Bolam v Friern Hospital Management Committee*[1] as follows:

> *"the standard of a skilled man exercising and professing to have that special skill …A man need not possess the highest expert skill; it is well established that it is sufficient if he exercises the ordinary skill of an ordinary competent man exercising that particular art."*

In the recent case of *London Fire and Emergency Planning Authority v Halcrow Gilbert Associates Limited*[2], His Honour Judge Toulmin CMG QC considered a professional's obligations of reasonable skill and care as distinct from fitness for purpose.

The facts
The London Fire Authority contracted with an international multi-disciplinary engineering consultant (the Consultant) to design a training facility for fire fighters in Southwark. The training facility was supposed to provide simulated and realistic conditions of a fire, such as heat, smoke and fire, using a novel design. Unfortunately it actually caught on fire on two occasions causing some limited damage. As is common for a professional providing design services, the contract required the Consultant to perform its obligations using reasonable skill, care and diligence.

"…it is sufficient if he exercises the ordinary skill of an ordinary competent man exercising that particular art."

The Fire Authority claimed that as a result of the fires it was not possible to use the centre, and relocated training at significant additional cost. The Authority brought a claim for breach of contract and professional negligence against the Consultant. Two of the allegations were that the Consultant

- had failed to produce a satisfactory design
- had failed to review its design.

The issue
A key question in the case was whether the Consultant should have appreciated when designing the facility that the oil used to form the smoke to simulate the conditions of a fire, rather than forming a film in the ductwork, would collect and form small globules which would leak and saturate the insulation, creating a fire risk. In failing to appreciate this, did the Consultant's performance fall beneath the required professional standard?

The Fire Authority submitted that as the design was innovative and that it was not clear how much smoke oil would be deposited in the ductwork, a reasonably competent and prudent consultant would have carried out investigations and risk assessments to ascertain the amount of smoke oil and design the facility accordingly.

[1] [1957] 1 WLR 582 at 586
[2] [2007] EWHC 2546 (TCC)

The evidence of both of the Consultant's expert engineers was that they had expected a fine film of oil to form which you would be able to feel if you rubbed your hand on it but would not be visible. They did not expect globules of oil to form and there was no literature to contradict these conclusions.

The decision

In his brief review of the law of negligence, HHJ Toulmin CMG QC said that he thought Bolam set out the best articulation of the test to be applied when considering the obligations of a designer carrying out its obligations of reasonable skill and care.

Turning then to the issue of whether the Consultant had failed to give due consideration to the effect of smoke oil in the ductwork, HHJ Toulmin CMG QC rejected the Fire Authority's submission. He concluded that the Consultant did consider what would happen in the ductwork and had reached the reasonable (although mistaken) conclusion that a fine film would form. It followed that the Consultant could not have been expected to ensure that the oil would leak from the ductwork. He emphasised that the Consultant did not fall below the standard expected of them in their profession in any way. However, the Consultant was found to have been negligent in failing to conduct a limited review of their design after the first fire.

Conclusion

This case reminds us that the obligation on a designer to exercise reasonable skill and care when undertaking their services is far less onerous than an obligation which guarantees a particular result. Whilst fitness for purpose did not need to be examined specifically by the court in this case, the facts seem to speak for themselves, as the facility caught fire when it was being used for the intended purpose.

Designers will take comfort from this case that "reasonable skill and care" has the meaning they had understood it to and that wording along these lines does not import any fitness for purpose obligations. Designers should of course still be vigilant to avoid any attempted inclusion of any express fitness for purpose obligations in their appointments.

For employers, this case provides a useful reminder that, even when they appoint a well known specialist to design a project, the specialist is not guaranteeing the result; there are circumstances in which the intended result is not achieved but the specialist will not be liable.

"...the Consultant...had reached the reasonable (although mistaken) conclusion that a fine film would form."

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There seem to be fewer "no dispute" arguments now in adjudication but they still occasionally rear their heads. However, similar jurisdictional challenges to adjudicators continue to raise byzantine issues

"No dispute" arguments in adjudication

A bit of "no disputes" history

Until relatively recently adjudication was plagued by "no dispute" arguments. It seemed that hardly a week would go by without a new court case in which a party argued that the adjudicator lacked jurisdiction to make a decision because the claim referred to him had not crystallized into a dispute at the time the adjudication began - the adjudicator only being able to decide a "dispute"[1]. When this defence worked it rendered any decision on the merits of the claim void and the adjudication, therefore, a waste of time and money.

The defence was criticised by many as legalistic. Respondents to claims delayed answering them or asked for further details to try to defer a dispute crystallizing. The responding party might then say that no dispute existed at the time the adjudication started while (and not inconsistently) fighting the claim tooth and nail.

Analysis of our adjudication case database

A search of our database of over 250 adjudication case summaries (which is freely accessible through our Law-Now website) suggests a significant drop in "no dispute" cases since the courts sought to clarify when a dispute crystallizes in late 2004. This is despite the fact that the clarification was by no means definitive with senior judges disagreeing as to whether it should be easier or harder for a dispute to crystallize for the purposes of adjudication than it is for arbitration, where similar issues arise.

"A search of our database...suggests a significant drop in "no dispute" cases."

While the clarification did, however, help it appears that claimants are still cautious about ensuring that the dispute they want decided crystallizes before they commence adjudication. This is often achieved by sending the responding party a draft of the claim and giving them a reasonable opportunity to respond. The time sought (if not allowed) for the opportunity to respond is often longer than the 28 days that an adjudication over the dispute (once it has crystallized) is supposed to run for.

The latest "no dispute" case

A case in October last year raised an interesting "no dispute" defence. In one of his first judgments since becoming a High Court Judge in the specialist Technology and Construction Court, Mr Justice Akenhead followed the trend of recent authorities. His judgment in *Ringway Infrastructure Services Limited v Vauxhall Motors Limited* [2007] EWHC 2421 (TCC) adopted a common sense application of the now established case law on when a dispute crystallizes.

A JCT interlude

In this case, a contractor referred to adjudication a dispute about its entitlement to payment under an amended JCT 1998 With Contractor's Design form. Its claim was based on an application for payment and the employer's failure to issue a payment notice. While section 110 of the Construction Act specifies no sanction for not giving a payment notice, the JCT 1998 WCD form does by requiring the amount applied for to be due. (The equivalent form in the JCT 2005 suite also requires payment notices - which is critical for current purposes - but provides no sanction for their non-issue.)

[1] Some contracts give adjudicators jurisdiction to decide a "difference" as well as a "dispute". A "difference", strictly speaking, embraces a broader range of situations than a "dispute" although its precise scope is yet to be fully defined. In any case, for the purposes of the Construction Act, section 108(1) says that a "dispute" includes any "difference".

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The case continued...

As the employer gave no payment notice, the adjudicator awarded the contractor the sum stated in its application for payment. The employer sought to resist enforcement of the adjudicator's decision, claiming that the adjudicator lacked jurisdiction because the referred dispute had not crystallized before the adjudication began. The court disagreed. The contractor's application for payment was a claim for payment in respect of the sum therein stated. That amount fell due immediately after the employer failed to give its payment notice. It did not matter that the contractor did not expressly raise a claim based on the lack of a payment notice before the adjudication. Such a claim was encompassed by the claim made under the application for payment.

The dispute arguably arose as early as when the payment notice was not given. However, the precise timing of when the dispute arose did not have to be decided because the value of the contractor's entitlement under the application for payment was clearly disputed before the adjudication by a (late) withholding notice.

Implications

Had the employer's argument succeeded it would have placed an unwelcome additional hurdle in the way of a payee's right to adjudicate. Helpfully the judge also indicated that there is no good reason in principle to distinguish between a "dispute" for the purposes of adjudication and for arbitration.

However, this case by no means heralds the end of "no dispute" arguments. For instance, one case (*Durtnell v Kaduna*) suggests that a claim cannot become a dispute until it has passed through any applicable contractual mechanism requiring a determination by a third party. Some JCT forms give an architect or contract administrator 12 weeks to determine extension of time claims before practical completion. It is said that for any such claim, until the determination or the passing of the 12 weeks, a dispute cannot arise. The 12 weeks may not begin to run until after the contractor provides "reasonably sufficient particulars and estimate" or "the required particulars". Many regard *Durtnell* as dubious authority.

"Its claim was based on...the employer's failure to issue a payment notice."

A similar line of argument is that a dispute over payment cannot arise until after the final date for payment has passed. However, it seems that a distinction should be drawn between the date for payment and an entitlement to payment; before the former passes the latter may be disputed and referred to adjudication (see *All In One v Makers*).

Other close relatives of the "no dispute" argument that sometimes succeed include the following:

- The dispute referred to adjudication does not fall within the adjudication agreement as either implied by the Construction Act into the parties' contract or as the parties have otherwise agreed. For instance, this may mean that an adjudicator lacks jurisdiction to decide more than one dispute (*Bothma v Mayhaven*). The question of whether more than one dispute has been referred raises difficult issues.

- The dispute set out in the adjudication notice differs substantially from that which crystallized (*Fastrack v Morrison*) or the adjudication notice is "unduly broad or optimistic" when compared with the crystallized dispute (*Multiplex v Mott MacDonald)*.

- The dispute decided by the adjudicator differs from that set out in the adjudication notice (*Edmund Nuttall v Carter*).

- The decided dispute does not fall within the terms of the adjudicator's appointment (*Fastrack v Morrison*).

- No dispute arises under the contract (or out of it, in connection with it, in respect of it, etc., as the adjudication agreement may provide) (*Shepherd v Mecright*). The scope for this line is now much reduced following a recent House of Lords case (*Premium Nafta Products*, which is the subject of Julian Bailey's article in this bulletin on pages 7-8).

- A settlement supersedes the adjudication agreement in the contract to which it relates and the settlement itself is not governed by any adjudication agreement (such that there is no applicable adjudication agreement) (*McConnell v National Grid*).

It should be apparent from the above just how technical this area is. It is clear, though, from the *Ringway* judgment that when mounting a jurisdictional challenge you are always starting on the back foot.

This is an extended version of an article that first appeared in Contract Journal.

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"That amount fell due immediately after the employer failed to give its payment notice."

Management costs and compound interest

Ever felt aggrieved by having to spend time dealing with another's breach of contract, or that you should be entitled to compound interest on the recovery of a debt or damages? We review the recent case law.

Wasted management costs

Since the case of *Tate & Lyle v GLC*[1] in 1982 it has been recognised that, at least in theory, it is possible to be compensated in damages for the cost of wasted management time incurred as a result of a breach of contract. A claimant will therefore usually include as part of its claim, the costs that its senior staff have incurred in investigating and dealing with the issues.

Historically the courts were reluctant to permit recovery without seeing evidence that the staff had been distracted from their (profit making) day jobs. This often presents a problem as adequate records are rarely kept.

Further guidance on when wasted management costs are recoverable was provided in January last year when the Court of Appeal set out a three stage test as part of its judgment in *Aerospace Publishing v Thames Water Utilities*[2]. It said that:

- The diversion of staff time has to be properly established. A claimant is at risk of failing to establish the diversion if it does not adduce evidence that it would be reasonable to adduce
- The claimant must establish that the diversion caused significant disruption to its business.
- It is reasonable for a court to infer from the disruption that, had the staff's time not been diverted, they would have applied it to activities that would have generated revenue in an amount at least equal to the costs of employing them during that time.

"The claimant must establish ...significant disruption to its business."

Whilst clarifying the law that wasted management costs were recoverable in certain circumstances, the Aerospace Publishing case did nothing to address the practical problem in the construction industry that detailed records were seldom available to be adduced as evidence.

The Technology and Construction Court took a more pragmatic view last April in the case of *Bridge UK.Com v Abbey Pynford*[3]. It held that:

- although actual records did not exist, a schedule of time spent in dealing with the claim (that had been prepared retrospectively by looking through various documents that recorded what happened) was satisfactory evidence of loss
- a 20% discount should be applied to the costs claimed to recognise the inherent uncertainty of such a retrospective assessment.

Despite the apparent relaxation in the case of *Bridge* of the rules regarding evidence, it remains good practice to make and keep contemporaneous records of management time spent in dealing with any claims. These records should include details of the diversion of staff time and also demonstrate where possible that the diversion caused significant disruption to the business.

[1] Tate & Lyle Industries Ltd v Greater London Council [1982] 1 WLR 149.

[2] Aerospace Publishing Ltd v Thames Water Utilities Ltd [2007] EWCA Civ 3

[3] Bridge UK.Com Limited v Abbey Pynford plc [2007] EWHC 728 (TCC).

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Recovery of compound interest

The High Court has a statutory power to award simple interest at such rate as the court thinks fit in cases concerning the recovery of a debt or damages (section 35A of the Supreme Court Act 1981). The fact that the power is limited to the award of simple interest has been criticised as not representing commercial reality as claimants in long-running cases may be under-compensated. It is also an anomaly with arbitration and adjudication where arbitrators and adjudicators have the power to award either simple or compound interest[4]. There is no obvious justification for such a distinction.

Along with others, it is for these reasons that the Law Commission recommended in February 2004[5] that the courts should have the power to award compound interest in certain circumstances (the presumption being where the claim for debts or damages was worth £15,000 or more). The recommendation has not been implemented to date.

This is perhaps why in the case of *Sempra v IRC*[6] the House of Lords expanded the circumstances in which a claimant could be awarded compound interest.

Whilst previously the court had only an equitable discretion to award compound interest in certain circumstances, it seems likely that the effect of the judgment in *Sempra* is that compound interest can now be awarded as damages under common law where it was thought previously that there was no entitlement to do so.

In its judgment, the House of Lords said that the Supreme Court Act 1981 was not intended to be an exhaustive code and that section 35 did not displace any jurisdiction the courts themselves had to award interest. Lord Nicholls said that the court had a "*common law jurisdiction to award interest, simple and compound, as damages on claims for non-payment of debts as well as on other claims for breach of contract and in tort.*"

"...compound interest can now be awarded as damages... "

The effect of this judgment appears to be that a claimant should now be properly compensated for a breach of contract. A practical example of the operation of this principle would be where the defendant's non-payment causes the claimant to draw down on an overdraft facility thus incurring interest charges (which are often compounded).

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[4] Section 49(3) of the Arbitration Act 1996 and paragraph 20(c) of the Scheme for Construction Contracts (England and Wales) Regulations 1998.
[5] The Law Commission No 287, Pre-judgment Interest on Debts and Damages, 24 February 2004.
[6] *Sempra Metals Limited v Her Majesty's Commissioners of Inland Revenue* [2007] UKHL 34.

Are your liabilities covered?

Employers and contractors might assume that, if something catastrophic happens during construction and a third party brings a claim, this will be picked up under the public liability (PL) section of the project policy or annual PL. The recent High Court decision in *Tesco v Constable* [2007] EWHC 2088 (Comm) shows that this is not necessarily the case.

The facts
Tesco's claim for indemnity under the public liability section of the project policy arose out of the collapse of a tunnel under construction outside Gerrard's Cross station, which led to the railway line through Gerrard's Cross being closed for 51 days. Chiltern Railways, who operate on the line through Gerrard's Cross, made a claim against Tesco under a contractual Deed of Covenant. The claim was settled in June 2007 and the settlement included amounts for lost revenue suffered as a consequence of the tunnel collapse after the line had re-opened. Tesco sought reimbursement from the PL insurers.

The Policy
The insuring clause of the PL section provided that:

> *"The Insurers will indemnify the Insured against all sums for which the Insured shall be liable at law for damages in respect of (a) death of or bodily injury to or illness or disease of any person (b) loss or damage to material property…(c) obstruction, loss of amenities, trespass, nuisance or any like cause…"*

There was also a Contractual Liability Extension, which provided that liability assumed by the insured under contract which would not have attached in the absence of such contract would be the subject of indemnity under the PL section of the policy only if the conduct of the claim were to be vested in the Insurers.

"...the settlement included amounts for lost revenue suffered as a consequence of the tunnel collapse after the line had re-opened."

The decision
Tesco argued that the amounts paid to Chiltern in settlement represented sums which Tesco was "liable at law" to pay, and that the liability arose out of "obstruction, loss of amenities, trespass, nuisance or any like cause", because the line closure following the tunnel collapse should be understood as "obstruction or loss of amenity". Alternatively, the Contractual Liability Extension should respond, because the liability to Chiltern arose out of the terms of the contractual Deed of Covenant.

The judge rejected Tesco's submissions. Agreeing with the position argued by the insurers, he found that:

- the starting point for analysing the policy was to look at the type of policy; in this case, it was a public liability policy, which was (per Mr Justice Field) generally understood to be intended to cover tortious, rather than contractual, losses

- the Insuring clause clearly listed well-known torts, albeit using the typical shorthand language of a public liability policy. Obstruction, loss of amenity etc are torts which require an interest in the property affected. As Chiltern had no interest in the railway line, they could not have a claim in tort against Tesco (hence the reliance on the Deed of Covenant) and so Tesco could not be "liable at law" in tort

- the Contractual Liability Extension was subject to the main insuring clause and operated only to extend the cover to co-existent liability in contract; it did not extend the policy further to cover all contractual legal liabilities

- the judge distinguished between public liability, a term which he said was intended to describe claims in tort which could be brought by the public at large, and "private liabilities", which only arise (as here) as a result of some private agreement between the parties

Conclusion

The judge took a narrow approach to the construction of wording, and the Contractual Liabilities Extension in particular, which could, on the face of it, have significantly extended the scope of the operative clause of the policy. If employers and contractors want cover under a PL policy for pure contractual liability outside the scope of the tortious-type losses described by the judge in *Tesco*, very clear wording will be needed in the policy, and full disclosure to Insurers of the potential contractual liabilities will be required. Tesco is understood to be seeking leave to appeal the decision, so watch this space.

CMS Cameron McKenna LLP acted for the Chiltern Railway Company in the underlying claims under the Deed of Covenant.

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"...Tesco could not be "liable at law" in tort."

Caselaw roundup

Treasure & Son Ltd v Dawes [2007] EWHC 2420 (TCC)
The Technology and Construction Court found in this case that, where there was a contractual agreement to adjudicate (the HGCRA did not apply because it related to a residential development), the adjudication process was not undermined by the fact that terms of the original contract had been orally varied; unless it was an express term of the contract that oral variations would only be valid if recorded in writing, an oral variation would not compromise the adjudicator's jurisdiction to decide the dispute.

This part of the judgment highlights the long running debate in the industry as to whether the adjudication provisions of the HGCRA should *only* apply to contracts that are wholly in writing (as opposed to oral or implied contracts). This issue does not arise in situations such as the present, where the parties have expressly provided that adjudication shall apply. In these circumstances, adjudication will apply to both written and oral contracts, which would probably include oral variations to a contract.

Harris Calnan Construction Co. Ltd v Ridgewood (Kensington) Ltd [2007] EWHC 2738 (TCC)
Until recently, it had appeared clear that, as long as a party makes a jurisdictional challenge before an adjudicator, and does not consent to the adjudicator deciding his own jurisdiction, that party will be permitted to challenge the jurisdiction of the adjudicator in court (i.e. in opposing enforcement proceedings). However, the recent *Harris Calnan* case has muddied the waters somewhat.

His Honour Judge Coulson QC held that if the challenger had expressly reserved its position, the adjudicator's decision on jurisdiction would not be binding. However, the Defendant had not reserved its position. This was tantamount to saying that he was content to be bound by the adjudicator's decision on jurisdiction. Furthermore, given that there was, on the facts, a contract in writing, the adjudicator did have jurisdiction to make a binding decision on jurisdiction in any event.

"...where there was a contractual agreement to adjudicate...an oral variation would not compromise the adjudicator's jurisdiction..."

It should however be noted that the judge was apparently not referred to a higher authority which goes against this approach. The Court of Appeal held (in *Rhodia Chirex,* 2003) that, in order to succeed with such an argument, a claimant would have show that the silence of the defendant constituted a clear submission to the jurisdiction. A submission to an adjudicator's jurisdiction would not usually be founded on the fact that a respondent had failed to make it clear that it was not abandoning a jurisdictional point.

Nigel Witham Ltd v Smith (No.2) [2008] EWHC 12 (TCC)
In this case the Technology and Construction Court decided a novel point, namely that a successful party in litigation might not recover some of its costs if it had delayed mediation. To date cases have focused on punishing successful parties who failed to engage in mediation at all. This case pushes parties not just to mediate but to mediate as soon as the time is right. No such order was actually made in this case because:

- There was nothing to show that the defendants had unreasonably delayed in consenting to the mediation. Both sides had missed the critical moment to mediate if it had ever existed and, by the time they did mediate (two months before trial), extensive costs had already been incurred and attitudes had hardened.

- Even if there had been an earlier mediation, it would not have had a reasonable prospect of success given the claimant's uncompromising attitude.

The "successful" defendants (who incurred costs of over £123,000 in winning a judgment for £1,683) did, however, have a proportion of their costs disallowed to reflect the late abandonment of part of their case.

Discerning when the time is right to mediate may be hard: the judge suggested that in many cases the appropriate time to mediate was likely to be when the detail of the claim and response were known to the parties, but before significant costs had been incurred such that settlement was no longer possible. It will therefore often be hard to show that a successful party unreasonably delayed in consenting to mediation. Only in the plainest cases will the courts punish successful parties who delay mediation. However, the message to those to whom mediation is suggested is clear: delay at your peril.

Petromec Inc v Petroleo Brasileiro S.A. Petrobras [2007] EWCA Civ 1371

In this case the Court of Appeal addressed the issue of whether a contractor can claim additional costs arising from a change in works specification on the basis of a global or total costs claim.

The parties entered into a contract for the upgrade of an offshore oil production platform. Subsequently, the parties agreed amendments to the original upgrade specification. The funding of the revised upgrade was governed by a supervision agreement which provided for operator Petrobras to pay contractor Petromec the reasonable extra cost of upgrading the vessel in accordance with the amended specification over and above the cost that Petromec might reasonably have incurred in upgrading the vessel in accordance with the original specification

The High Court had decided that Petromec was entitled under the supervision agreement to recover the additional costs attributed to the revised upgrade, including costs of financing administration and general overheads, but not any additional profit.

"This decision reinforces the difficulties of making a claim using a "total cost" or "global claim" approach."

In this appeal, Petromec argued that it was entitled to recover the difference between the total cost of upgrading the vessel in accordance with the amended specification and the estimated cost that it would have incurred in upgrading it to the original specification. The Court of Appeal suggested otherwise, indicating that at the very least Petromec needed (i) to identify the particulars of the additional work required to fulfil the amended specification and the extra costs of such work; and (ii) to demonstrate that the costs in question were reasonably incurred. This decision reinforces the difficulties of making a claim using a "total cost" or "global claim" approach.

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