FENWICK
ELLIOTT

The construction &
energy law specialists

Annual Review 2016/2017

A round-up of key developments in the construction, engineering and energy arena

Contents

October 2016

Fenwick Elliott
Aldwych House
71 - 79 Aldwych
London WC2B 4HN
T +44 (0)20 7421 1986

Office 1A (first floor)
Silver Tower, Cluster I
Jumeirah Lakes Towers
PO Box 283149
Dubai, UAE
T +971 (0)4 454 2355
www.fenwickelliott.com

Editor
Jeremy Glover, Partner
jglover@fenwickelliott.com

Published October 2016

Simon Tolson
Senior partner

It is my great pleasure to introduce the 20th edition of the Fenwick Elliott *Annual Review*. It is always a challenge to squeeze into one journal the nadirs of the legal year. Our purpose is always to be edifying and to flag to you areas of the law and practice that we hope are useful to your business enterprise. We recognise that while you need to make sure you avoid getting on the wrong side of a contract, keeping up with the latest points and vulpine like staying ahead of the hounds is just one thing on your punch list to cram in to your busy day.

Our *Review* allows you to grab a Flat White, sit down and "*catch-up*" – my intro is a skip through Fenwick Elliott's highlights, and gives you a résumé of some of our news.

What a year it has been. In the space of a month, Britain voted to leave the EU, the Prime Minister resigned and was replaced by a new one, Cabinet ministers were unexpectedly sacked or promoted, the Leader of the Opposition lost a vote of no confidence and, having being challenged for his position, has been re-elected. The pound is at a 31-year low against the USD but the stock market is at record levels.

Team GB's glittering success in Rio was the result of a brilliantly executed campaign that brought sustained success at these Olympics too and the product of a long-term commitment to a credible plan. I will not be alone in thinking Construction has much to learn from the investment needed to bring such rewards in the field of the built environment and infrastructure. The challenges of post-Brexit Britain, I am quite sure, will not bring us to our knees or anything like it.

The UK services sector grew 0.4% in July, much more strongly than expected, suggesting that consumers had carried on spending as normal after the Brexit vote. Other figures from the Office for National Statistics ("*ONS*") show economic growth accelerated quicker than thought in the run-up to the referendum. Gross Domestic Product ("*GDP*") grew by 0.7% in the three months to the end of June, up from the 0.6% first estimated. In September 2016, the OECD went back on its warning that the UK would suffer immediately from a Brexit vote and has revised its 2016 GDP growth forecasts for the UK slightly upwards from 1.7% to 1.8%.

Back at the ranch, I am pleased to say that, beside many of us staring at our screens in disbelief in the week immediately after 23 June 2016, it has been business as usual. August was one of our most hectic months work-wise ever; September matched it. Our new Dubai office is also surging ahead.

For our 2016 financial year, we are now our largest ever, a 19 partner business having this year made up Claire King and Jonathan Shaw in London and Ahmed Ibrahim and Heba Osman in Dubai.

On 3 October 2016, in London, we moved into our fabulous new offices on the fourth floor of Aldwych House, with everybody in an open plan office, with electric Herman Miller rising desks to ease long hours of screen work and a 21st century environment, with break-out spaces, quiet rooms, roof terrace, great IT connectivity everywhere, and modern art to reality check it all! At the front of house, you will find eight all singing and dancing client facing meeting rooms.

We also have reason to be proud as *The Legal 500 UK* ranks Fenwick Elliott in the First Tier in London Real Estate – Construction, with rankings in International Arbitration, Energy and Education too.

Of other news I am delighted we have two lady High Court Judges join the TCC in London this month and we congratulate Finola O'Farrell QC and Nerys Jefford QC on their appointments. Fenwick Elliott has instructed and enjoyed working with both many times over the years and is very proud that they join the TCC making it the first division of the High Court with an equal complement of male and female judges! No glass ceilings here or at Fenwick Elliott.

The type of work we undertake continues to cover construction and energy projects around the world, and includes every aspect of procurement within the transport, highways, power generation and infrastructure sectors of all types globally. You name it; we are on something exciting and/or muddy and legally messy. We are also working with pretty well every English language-based construction contract in use and quite a few international ones, and of course, most are bespoke.

Our work continues to cover dispute avoidance strategy, litigation, international arbitration, adjudication and all forms of ADR/mediation. Our projects team continues to grow. Fenwick Elliott intends to hold its leading central London position whether for our commercial legal work, or for dispute resolution with London as a global leader in commercial dispute resolution and as a world centre of business. As ever, but so importantly, I want to thank all of you for the opportunities your legal problems have given us to resolve this past year. Long may this continue and be to our common advantage!

Welcome to the 20th edition of our *Annual Review*. As always, our *Review* contains a round-up of some of the most important developments from the past 12 months including, from page 42, our customary summaries of some of the key legal cases and issues, taken from both our monthly newsletter *Dispatch* as well as the *Construction Industry Law Letter*.

Jeremy Glover
Partner, Editor

This year's *Review* begins with an article by Simon Tolson on pages 4-5 looking to the future and the impact of artificial intelligence and the digital big bang. Whilst robots will not be replacing judges and lawyers just yet (he says slightly more nervously than I might have done say two years ago), in my article on pages 10-13 reviewing the impact of the Jackson Reforms on the litigation process, I do look at the likely introduction of on-line courts for small value claims.

In a similar vein, Stacy Sinclair on pages 6-7 considers the continued march forward of BIM driven in-part by advances in machine learning. What contractual safeguards need to be put in place to work with BIM? Then Stacy together with Claire King, on pages 8-9, explains how these technological advances can assist in controlling the spiralling nature and costs of the e-disclosure process.

Our new office in Dubai has been open for over a year now. The office can be found at Cluster I, Jumeirah Lake Towers ("*JLT*"). Our team which is headed by Nicholas Gould, and includes partners Ahmed Ibrahim and Heba Osman, can offer a fully integrated specialist construction law and arbitration practice operating from the DMCC.
We have Arabic speakers with knowledge of local laws and practices, as well as international expertise in construction law.

Heba has written an interesting article on pages 23-24 about a recent decision of the Dubai courts about whether or not an Engineer's Decision under the FIDIC form is a contractual pre-condition to the right to bring an arbitration claim. Edward Colclough has looked at FIDIC too, discussing at pages 25-26 the extent to which the UK Unfair Contract Terms Act can be used when considering the reasonableness or otherwise of time bar clauses. Our *Review* ends, at page 52, with some suggestions as to what changes FIDIC might be making to their 1999 Suite of Contracts.

The concept of good faith is enshrined into the UAE Civil Code. On pages 20-22 Sana Mahmud looks at the extent to which the UK courts embrace similar concepts. Reyhan Yilmaz on pages 27-28 takes up the theme of contractual interpretation when she looks at whether or not a prohibition on oral variations can be overridden.

There have been a number of important decisions from the Supreme Court over the past 12 months, including other aspects of contract interpretation.

On pages 29-31 I look at what the Supreme Court Justices said, whilst Andrew Weston, at pages 32-34, looks at the outcome of the Supreme Court's review of the law about liquidated damages.

Guarantees always need to be considered carefully before signing. There is often little leeway when it comes to interpreting what obligation you have signed up to. Sarah Buckingham on pages 14-16 looks at how easy it is to sign up to personal guarantees, but how hard it is to try and extricate yourself from having done so.

In August 2016, two important new pieces of insurance legislation came into force. They were described by the Government as being the biggest reform to insurance contract law in more than a century.
Find out more on pages 38-41.

Last year, we noted that there had been one clear trend in adjudication enforcement cases over the preceding 12 months. In the words of Mr Justice Coulson, this was the large (and "*baleful*") increase in the number of cases before adjudicators and the TCC in which the claimant contractor argued that the defendant employer had failed to serve its notices on time, with the consequence that there was an automatic right to payment in full of the sum claimed. That trend has continued and Jonathan More distils once more what you need to know from these cases at pages 17-19.

We have had more cases on the perils of "*hopeless*" challenges to adjudication in the case of *AMD Environmental Ltd v Cumberland Construction Company Ltd*, Mr Justice Coulson reminded everyone that: *"The TCC is concerned that too many adjudication decisions are not being complied with, and that there are too many disputed enforcements where the grounds of challenge are without merit".*

There have also been a number of cases over the past 12 months that have looked at the impartiality of adjudicators and arbitrators. Lyndon Smith explains more on pages 35-37. In one of those cases, Mr Justice Fraser pointedly reminded everyone about conduct generally, noting that:

"*Adjudication is not the Wild West of dispute resolution*"

Our website (www.fenwickelliott.com) keeps track of our latest legal updates or you can follow us on Twitter or LinkedIn. As always, I'd welcome any comments you may have on this year's Review: just send me a message by email to jglover@fenwickelliott.com or on Twitter @jeremyrglover.

Artificial Intelligence and the law

Simon Tolson, in an edited version of an article that first appeared in the July 2016 Chartered Institution of Civil Engineering Surveyors *Construction Law Review*, discusses the rise of Artificial Intelligence within law.

Computer use and digital databases of any real practical use started in the legal profession coincidentally from about the time when I was an undergraduate law student in 1979. Back in those days one had an "*operator*" and paid line time by the minute; it was hit and miss even in a university faculty, it was slow progress, and it was all code input-based to search criteria.

By 1995 some lawyers like me became "*mobile*" with their legal data. I was using a Psion Organiser with a QWERTY keyboard with a comprehensive self-typed construction law database; no cut and paste then!

I would say that in or about 1996 (the year I sent my first email), Fenwick Elliott was one of the first law firms to use the internet in London and boy was it slow (no fast broadband then), but we had the "*big bang*" when the legal profession and how it accessed material began to change forever. It changed law in a way nothing else had for c.300 years. Simple memory typewriters were with us in 1983 and word processors in 1990, but processing power, the commercial emergence of email and personal computers and the internet have been the facilitators for what we see today; everything is digital and for many of us work is virtually paperless.

Artificial Intelligence today

Believe it or not law firms are really investing in Artificial Intelligence ("*AI*"), the capability of a machine(s) to imitate intelligent human behaviour. There has even been speculation that law is ripe for "*Uberisation*",[1] becoming the next target of technological transformation. The Millennials generation is pushing the changes hardest and law firms are making a dash to harness the power of cognitive computing and the natural language processing capabilities of computers, investing heavily in Artificial Intelligence to automate the mundane tasks that are part and parcel of the law and legal services. Professional services generally rely on a lot of data and information, and a relatively small amount of judgment, which means tasks can be speeded up considerably. However, robots are unlikely to replace lawyers in court, but they can prepare papers for hearings and do other "*clever*" things with massive data.

The recent media fever about AI has been inevitable. This vision has conceivably come a step closer with the arrival of IBM Watson and Professor Richard Susskind's latest book, *The Future of the Professions*, which predicts an internet society with greater virtual interaction with professional services such as doctors, teachers, accountants, architects and lawyers.

In transactional work LONald can, for example, send an enquiry to Companies House to check if the address in a document matches the company number. If the address is out of date, the computer will flag it for review. The team will then consider all flagged documents in one go at the review stage. It thus converts unstructured data (e.g. contracts, official copies) into structured output (e.g. a spreadsheet) in a fraction of the time (a few seconds) it takes a human and with a higher degree of accuracy! The lawyers then do the higher-level strategic review to make sure nothing is missed.

Professor Richard Susskind, who is also IT Adviser to the Lord Chief Justice, has predicted radical change in the legal sector, pointing out that intelligent search systems could now outperform junior lawyers and paralegals in reviewing large sets of documents and selecting the most relevant.

Susskind said at a conference in April 2016[2] that he believes the legal profession had five years to reinvent itself from being legal advisers to legal technologists and criticised law schools for "*churning out 20th century lawyers*". Over the course of

1 A recent study by Jomati, *Civilisation 2030: The Near Future for Law Firms*, points out that, after long incubation and experimentation, "*technology can suddenly race ahead at astonishing speed*"

2 Law Society's law management annual conference: http://communities.lawsociety.org.uk/law-management/events/law-management-section-events/law-management-section-annual-conference-27-april-2016-london/5052637.fullarticle

3 Lord Slynn memorial lecture, 15 June 2016: https://www.supremecourt.uk/docs/speech-160615.pdf

the next decade, AI would move forward so quickly that systems themselves would be able to assess, diagnose and respond to the legal problems posed by clients. But instead of suggesting that this was a threat to the profession, Susskind instead claimed that it was an opportunity to become engineers of knowledge, and to shape the future of the profession in a positive way.

Where next?

So where is all this headed? Well, for sure, away from where we are now. Much the same applies with how Building Information Modelling can expedite design improvement and best selection of materials to provide the opportunity of testing and assessing different design alternatives that may impact on the energy performance of buildings.

In the law, text analytics and machine learning can be incredibly helpful in enabling the data to tell its story, and what we are finding is that computers are learning and in large data cases can be better than human lawyers, particularly tired lawyers. Predictive coding enables users to sample data such as on a large project and identify what is relevant. Through sampling, the program is able to learn which documents are relevant. This process greatly reduces the time needed for e-discovery and document review because the program is searching for concepts as opposed to simple keywords.

The legal community, however, is often called too late. We are involved when our clients have reached crisis. We are called to fire fight, we are the A&E department. At this point, the role of the legal professional may be rather limited. Bright lawyers and astute law firms need to ask themselves, what are the common developing legal issues coming over the skyline? The impact of technology on the law is one such issue.

We live in a globalised world. The exponential growth of technology has created a new world order. It affects how we talk, how we learn, how we trade. The world is, quite simply, more interconnected than ever and using big data is key. The future is not desolate. The globalised world has also brought hope and opportunity.

Technology has already restructured the way we do business and significantly impacted the practice of law. We are already using technology to communicate with our clients more quickly, to manage their data and to make our businesses more efficient. Skype, instant messaging, WebEx online meetings and email are part of our everyday working lives.

AI will become more embedded in our lives. In many ways, it is already part of the way we interact with each other and with the world:

- When eBay suggests products you may like, that is AI;
- Siri on your iPhone, that's also AI;
- Anti-lock braking systems on cars and systems that wake you up as you nod off: AI.

It is already everywhere. But, what does this mean for lawyers? Many of our business clients google their legal problems before they come to see us. *Pro bono* portals are available, helping people to access legal advice early. Of course self-diagnosis can never be a replacement for legal professionals any more than it can for physicians. The functions we carry out as lawyers extend far beyond dispensing black-letter legal advice. Lawyers will, however, need to consider the ethical and legal dilemmas brought by AI in much the same way that architects and engineers are doing with Building Information Modelling and IP.

Ethical duties

Lord Neuberger, president of the Supreme Court, has called for a debate on the ethical implications of AI and for "*greater prominence*" for ethics in legal training.[3] Law schools will therefore need to pull up a sock or two. Lord Neuberger made a plea for "*greater prominence*" for ethics training both on university law courses and professional legal training courses. He said that the "*earlier and more effectively*" potential professional lawyers and advocates could be trained to "*appreciate and understand the importance and nature of their ethical duties, the stronger a legal profession we will have, and the stronger the rule of law will be*".

Back in 2013 the Judge had urged the legal profession not to lose sight of its fundamental principles in the rush for modernisation, warning about the risks of pressure from "*hard-nosed businessmen*" who may invest in law firms. The legal profession should be preparing for the problems and opportunities that may arise from such an enormous potential area of development, and one of the most difficult challenges will be to consider the potential ethical implications and challenges.

Whilst Neuberger does not fully embrace the Susskind view of future legal life, he does say that Susskind's point, that this potential development, has ethical as well as employment implications and that he rightly calls for a public debate on the issue. Neuberger likewise warned of increased potential for ethical conflicts where alternative business structures ("*ABSs*") were owned by non-lawyer investors who are "*ultimately only concerned with the bottom line*". The investors will often have no experience of, or interest in, the lawyers' ethical duties.

When it all goes wrong

As computers take on more and more responsibility, one also has to ask the question of where the liability lies when things go wrong. Volkswagen expects the first self-driving cars on the market by 2019. These self-driving systems may need to make split-second decisions that raise real legal questions:

- A child suddenly runs into the road and the car has to choose: hit the child or swerve into an oncoming truck;
- How does the vehicle decide? Who decides what the car decides?
- Ditto the JCB on a construction site: does it avoid the trench with a man in it or does it strike the building if it cannot avoid both?
- And who is liable if it chooses the wrong one, the plant owner or the programmer?

Responding to the technological realities of the 21st century is an imperative. These are questions for lawyers. It is for us, the legal experts, to answer these questions now. Lawyers should not be fire fighting.

What about now?

We must identify and solve the legal issues of tomorrow, now. And if we want to achieve this we must be:

- Explorers, not mere voyagers;
- Architects, not plain builders;
- On the front line, not in the purser's office.

We live in exciting times. The legal community must clinch this.

- We don't have to repeat the past;
- We don't have to relive the present;
- We can shape the future;
- If we don't others will.

The world will always be complicated, but if lawyers take the time to put their minds together, to learn from one another, they can fix pervasive problems like new technological solutions. For example, following Brexit, how do we manage best all the changes to domestic laws? If we are successful, we will make the legal profession worthy of this millennium, all the more so with regard to the construction industry.

Recognising your BIM obligations and limitations

We were all waiting for 2016: the year the UK government implemented and required BIM Level 2 on all of its projects. What a monumental step for technology and the future of construction. Whilst there are of course still sceptics amongst us and it is arguable whether all areas of the industry truly welcome it, as Stacy Sinclair explains, there nevertheless continues to be an energetic and vibrant interest in both the use of BIM Level 2 and the development and implementation of BIM Level 3. In a world which now is starting to embrace Artificial Intelligence and machine learning, there is no doubt that use of BIM, automation and big data will only increase.

"To look at how far we have come in four short years is to understand how far we can and need to go in the next four and beyond.

BIM is now very much business as usual. Our Level 2 programme is driving efficiency and creating a competitive supply sector with our businesses in demand internationally"

Mark Bew, MBE: Chair of the HM Government BIM Task Group

First, we must not forget the definition and purpose of BIM. As the NBS states:

"BIM is an acronym for Building Information Modelling. It describes the means by which everyone can understand a building through the use of a digital model. Modelling an asset in digital form enables those who interact with the building to optimise their actions, resulting in a greater whole life value for the asset... BIM is a way of working..."[1]

Fundamentally, BIM is a digital tool or *"way of working"* to optimise output, both in terms of working practices as well as the whole life value of the building or asset. As the NBS International BIM Survey 2016 found, 77% of the respondents (in the UK) agreed that *"BIM is the future of project information"*.[2]

To assist with project information and collaboration, the following set of core documents are now available:

(i) CIC BIM Protocol PAS 1192-2 : 2013

(Specification for Information Management – capital/delivery phase of projects)

(ii) PAS 1192-3 : 2014

(Specification for Information Management – operational phase of projects)

(iii) BS 1192-4 : 2014

(Collaborative Production of Information – COBie, Code of Practice)

(iv) PAS 1192-5 : 2015

(Specification for Security-minded BIM)

(v) Government Soft Landings Policy

(vi) The BIM Toolkit

(The Digital Plan of Work and Uniclass 2015 Classification Tables)

To what extent these documents are used on all BIM projects is a separate discussion, but nevertheless, when they are utilised, parties must be aware of the legal issues and liabilities which arise therein. By way of example, the following briefly looks at the CIC BIM Protocol and the Government Soft Landings Policy.

CIC BIM Protocol (*"Protocol"*)

The purpose of the Protocol is to integrate BIM Level 2 with standard form contracts and it has played an important role in advancing the use and awareness of BIM in the UK. Whilst the Protocol is well known in the UK, it is arguable to what extent the Protocol is used. Interestingly, in recent research carried out by King's College London, *"Enabling BIM Through Procurement and Contracts"*,[3] *"very few interviewees mentioned adoption of the CIC BIM Protocol"*. Nevertheless, if using the Protocol (or any other bespoke document which attempts to provide a similar role), it is important to understand what the Protocol attempts to do in terms of each party's contractual obligations, liabilities and associated limitations.

First, the Protocol is designed to take precedence in the event of conflict or discrepancy with any contract (clause 2.2). As such, there is a real risk that interpreting the wording of the Protocol alongside the contract provisions, in particular standard form contracts which are not amended, will be problematic. For example, JCT2011 suggests that a protocol (not necessarily the CIC Protocol) should be a Contract Document or included as part of the Employer's Requirements. If the CIC Protocol is employed, without amendment, clearly ambiguity immediately exists.

The recently released JCTDB 2016 provides a new entry for the identification of a BIM Protocol, if any are applicable, at clause 1.1 and the BIM Protocol is included within the definition of a Contract Document. Clause 1.3 states that the Conditions shall override any other Contract Document (i.e., the BIM Protocol) and clause 1.4.6 incorporates the BIM Protocol's information (in a form or medium conforming to that protocol) where *"documents"* are referred to throughout the contract. The JCTDB 2016 then integrates this defined term, BIM Protocol, throughout the contract.

In terms of any discrepancies, the JCTDB 2016 Guide states that the *"JCT considers that its contracts give sufficient latitude to BIM Protocols so that a conflict should not arise; in any event, it also considers that unqualified overriding provisions of this type are not appropriate in such protocols"*.[4] To what extent this standard form has eliminated ambiguities, only time will tell.

Secondly, parties should be aware that the Protocol includes limitations on a project team member's liability. Clause 5 provides that the project team member does not warrant the integrity of electronic data transmission, and clause 6.4 provides the right for a project team member to revoke or suspend a licence to use their models in the event of non-payment. Furthermore, clause 4.1.2 provides that the obligation on project team members to deliver models and comply with Information Requirements is limited to "*reasonable endeavours*". This duty of care is lower than the more typically accepted "*reasonable skill and care*".

Furthermore, clients/employers should note clause 3 of the Protocol which bestows the absolute obligation on them to secure protocols in substantially the same form from all project team members and to update the Information Requirements and the Model Production and Delivery Table.

Regardless of whether the Protocol or your own bespoke protocol is used, all parties need to understand where obligations and duties of care are either heightened or diluted from the industry norm. In addition, with numerous documents setting out the BIM procedures and standards for the project, parties need to ensure they are aware of their obligations within each document and understand how they all fit together, both in terms of priority as well as process. For example, time and deadlines in terms of model production and otherwise are not dealt with in the CIC BIM Protocol, but are left to the BIM Execution Plans.

Government Soft Landings ("*GSL*")

The GSL is the government's management approach to the specification and measurement of building performance and is based on the government's philosophy that the ongoing maintenance and operational cost of a building during its life cycle far outweighs the original capital construction cost: if this can be recognised during the design process, there will be greater scope to achieve cost savings and improved functionality.

The GSL's primary focus therefore is on functionality and effectiveness (buildings should be designed to meet the needs of their occupiers with effective, productive working environments); environmental factors (buildings should meet government performance targets in energy efficiency, water usage and waste production); facilities management (there should be a clear, cost-efficient strategy for managing the operations of buildings); and finally, commissioning, training and handover (projects should be delivered, handed over and supported such that they meet the needs of end-users).

From a legal perspective, the GSL is likely to create contractual issues since it raises a brand new concept of responsibility for the whole life cycle of buildings which involves the setting of targets and measuring performance against those targets in a new post-occupancy period. The post-occupancy period is intended to last for three years post-completion. In other words, the post-occupancy period is two years in excess of the traditional defects liability period and therefore amendments to the standard forms will be necessary to provide for the associated extended monitoring on site (which may or may not overlap with the defects liability period).

Amendments will also be necessary to provide for the precise maintenance and operational requirements and standard that needs to be met during the life cycle of a building. This may lead to a shift towards routine fitness for purpose obligations and absolute warranties – which are currently construed very narrowly by the courts in the absence of very clear words to the contrary.

Conclusion

No matter what contracts, protocols, guidance notes, or otherwise are required on a particular project, it is important to understand your obligations, liabilities and limitations within each document.

Unfortunately it is all too often the case that contract documents do not align with each other and/or are not considered sufficiently in detail, which can lead to ambiguity and problems of interpretation.

With regard to BIM, the devil is in the detail with these documents. All contract documents need to align obligations clearly. Introducing protocols which muddy the water should be avoided. In addition, any Levels of Detail, Execution Plans and Model Production and Delivery Tables should be well vetted and considered before agreement as, depending on the terms of your contract, these could be binding documents with obligations contained therein which you need to understand and be alert to.

1 https://www.thenbs.com/knowledge/what-is-building-information-modelling-bim
2 https://www.thenbs.com/knowledge/nbs-international-bim-report-2016
3 https://www.kcl.ac.uk/law/research/centres/construction/enabling-bim/ebimtpac-form.aspx
4 Paragraph 20 of JCT DB/G 2016

The Disclosure Menu in a world of big data

The volume of data that is potentially disclosable in construction disputes (and indeed disputes more generally) appears to increase exponentially with every year that passes. As Claire King and Stacy Sinclair explain, in that context choosing the right method for disclosure will not only enable a party to find and marshal the evidence they need to support their position, but also to ensure that the costs of disclosure do not become disproportionate to the value of the case or indeed the value that the exercise of disclosure brings to the table in the first place.

The English law concept of "*Standard Disclosure*" (where a party discloses those documents: (i) relied on by a party; (ii) adversely affecting that party's case; (iii) adversely affecting another party's case; (iv) supporting another party's case; (v) required by a Practice Direction to be disclosed)[1] sits somewhere between the very extensive and expensive discovery procedures found in the US and the much narrower civil law disclosure requirements where (broadly speaking) the parties only disclose what they are relying on.

However, parties increasingly need to consider options other than standard disclosure, as well as utilising the new technological tools available, in order to ensure that the costs of standard disclosure do not become totally disproportionate to the value of the claim.

In the case of paper disclosure, parties usually know what paper they have. Here, the problem is merely locating it physically and going through it to produce the documents required by the standard disclosure test. The problem with electronically stored information *("ESI")* is that parties often do not know how much ESI they have, or even the location of all the places where it might be found. This article examines a range of potential disclosure options available on big data cases, aside from traditional standard disclosure and manual review, including:

(i) Predictive coding: increasingly an option as the technology available for this continues to improve and was approved by the courts in the recent cases of *Pyrrho Investments Limited v MWB Property Ltd*[2] and *Brown v BCA Trading Ltd*;[3]

(ii) Reliance disclosure: the option favoured in international arbitrations and closely linked to the traditions of the civil law system; and

(iii) Keys to the warehouse: a lesser known option but one suggested by Lord Justice Jackson in his 2011 lecture on "*Controlling the Costs of Disclosure*"[4] and one which has been ordered in both an arbitration and a TCC claim Fenwick Elliott was involved with.

Before doing so, we briefly review why standard disclosure can be very expensive, and inefficient, especially in cases where there is a high volume of data.

Standard disclosure and manual review

Although solicitors (and indeed Judges and arbitrators) are becoming more and more aware of the options available on disclosure, some do remain attached to manual review and standard disclosure. The cost of carrying out such reviews can, however, be disproportional to the benefits of doing so, even when aided by electronic disclosure. A team of paralegals will still need to sift through the evidence assessing for relevance (albeit keywords may assist in getting rid of obviously irrelevant documents such as junk emails), their results will need to be checked and key documents filtered upwards for the benefit of the core legal team. The parties can try and reduce the data pool by agreeing key custodians and date ranges but in big claims with numerous custodians and terabytes of data, this can only get you so far.

The cost of reviewing data manually for standard disclosure can therefore be extremely high, inevitably involving a large team of paralegals at the coal face whose efficiency will naturally slip if they spend too long on such reviews on any given day. The Rand Review, *Where the Money Goes,* published in 2012 by a US not-for-profit organisation concluded that some 70% of the costs associated with the e-disclosure process concern this review function.[5]

> *The evidence establishes, that in discovery of large data sets, technology assisted review using predictive coding is at least as accurate as, and probably more accurate than, the manual or linear method in identifying relevant documents*[6]

Accordingly, parties need to think very hard about what benefits can be obtained from reviewing documents individually for the purposes of providing standard disclosure when compared against the costs of actually doing so.

Predictive coding

Predictive coding is a document review technology that allows computers to predict particular document classifications (e.g. relevant or privileged) based on coding decisions made by the lawyers running the claims in question. Broadly speaking a seed set of data is coded by a senior lawyer with in-depth knowledge of the case. The results are analysed by the predictive coding software and sample sets are generated which can also be coded to increase the level of accuracy and apply the coding across the whole data set.[7]

1 See CPR 31.10
2 [2016] EWHC 256 (Ch)
3 [2016]EWHC 1464 (Ch)
4 See Lord Justice Jackson's lecture on "*Controlling the Costs of Disclosure*", Seventh Lecture in the Implementation Programmes, the LexisNexis Conference on Avoiding and Resolving Constructions Disputes, 24 November 2011
5 See Nicholas Pace and Laura Zakaras, *Where the Money Goes: Understanding Litigant Expenditures for Producing Electronic Discovery* (the Rand Institute for Civil Justice), April 2012
6 Master Matthews, Pyrrho v MWB
7 See Kroll OnTrack, *Mastering Predictive Coding: The Ultimate Guide, key considerations and best practices to help you increase ediscovery efficiencies and save money with predictive coding 2014*
8 See *paragraph 33 (2) of Pyrrho Investments Ltd v MWB Property Ltd* [2016] EWHC 256 (Ch)
9 [2016] EWHC 256 (Ch)
10 See *Bank Resolution Corporation Limited and others v Sean Quinn and others* [2015] IEHC 175
11 See *paragraph 33 of Pyrrho Investments Limited v MWB Property Limited* [2016] EWHC 256 (Ch)
12 The IBA adopted new rules on 29 May 2010, which supersede the 1999 version http://www.ibanet.org/Document/Default.aspx?DocumentUid=68336C49-4106-46BF-A1C6-A8F0880444DC
13 https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Speeches/controlling-costs-disclosure.pdf
14 www.tesca.org.uk/e-disclosure

The system brings potentially massive costs savings given the high percentage of costs associated with the review function. However it has limitations. The results are only as good as the coding done on the seed sets of data which will need checking and there may also be limitations on very complex multi-issue cases where no one seed set will cover all the issues in dispute. Having said that, there is now some evidence that in fact predictive coding can lead to more accurate coding than manual review.[8]

In *Pyrrho Investments Ltd v MWB Property Ltd*[9] the English courts approved the use of predictive coding for the first time. Other jurisdictions have arguably been more ahead of the game in this respect, with the US in particular leading the way. Indeed, Ireland had already approved its use the year before.[10]

Master Matthews noted in approving its use that: experience in other jurisdictions has shown it can be useful in "*appropriate cases*"; there was some evidence to show predictive coding could be more accurate than manual review alone or manual review combined with keyword searches; the costs of full manual review of 3.1 million documents would be unreasonable; the claim was worth tens of millions and accordingly the cost of the software was proportionate and if the software did not work there was enough time to resolve the issues.[11]

In the more recent case of *David Brown v BCA Trading* (unreported) the court again approved the use of predictive coding, with the law firm pushing for predictive coding, estimating it would cost one third of what the manual review would be.

As technology continues to improve, the advantages of using predictive coding and the frequency of its use in cases which are fairly high value with big data sets are set to increase exponentially.

Reliance disclosure

Reliance disclosure is a favourite in international arbitration. Here, parties only disclose, in the first instance, those documents on which they rely. In other words, parties only disclose those documents which evidence their arguments and benefit their own case.

The IBA Rules on the Taking of Evidence in International Arbitration[12] are commonly used to supplement other institutional arbitration rules. In the IBA rules, the parties first submit those documents on which they rely, except for any documents which have already been submitted previously. Then, parties submit a "*Request to Procure*". In this request, the party sets out a description of each document, or a description of a category of documents, they are seeking from the other party, which they reasonably believe to exist. The request must include such statements as to how the documents (or category of documents) are relevant to the case and why it is assumed that the other party has possession of such documents. The arbitral tribunal then orders production of the requested documents or deals with any objections made.

Some swear by this method of disclosure, but it can cause additional costs as parties do tend to argue over the schedules of documents produced for the "*Request to Procure*" (otherwise known as Redfern schedules which are meant to collaboratively collect each party's position in respect of each document request). Parties might argue that a particular document request is unduly burdensome and/or is not relevant to the issues in the case. In addition, there may be repeated requests for disclosure of specific documents, causing the disclosure process to become protracted and costly, rather than a discrete, fixed period. Arguably, these disputes over the request for documents are not so dissimilar to those arguments over keywords in standard disclosure, which unfortunately are all too common.

Key to the warehouse

The keys to the warehouse is a lesser known option in disclosure and a term that was first coined by Lord Justice Jackson in his 2011 lecture on "*Controlling the Costs of Disclosure*".[13] In that lecture he stated:

"*4.7 One possible order under sub-para (f) – the key to the warehouse. One possible order which could be made under rule 31.5 (4) (f) is that each side (after removing privileged documents) should simply hand over the 'key to the warehouse'. In other words, each party hands over all its documents and the other side can choose which ones it wishes to use. This means that each party devotes its resources to selecting what it regards as helpful from the other side's store of documents. That is the opposite of standard disclosure, which requires each party to examine its own documents and (in effect) to pick out the ones that it thinks will help the other side. I am aware of one recent case in which a 'key to the warehouse' order was made by the Technology and Construction Court.*" [Emphasis added]

At its simplest then, keys to the warehouse involves handing over all of the documents potentially relevant to the dispute after having removed privileged information and, to the extent possible without a manual review, junk or completely irrelevant information. What constitutes the warehouse will obviously need to be clearly defined in order to avoid disputes between the parties at a later stage. Parties may, for example, want to agree a list of key custodians and apply date range filters to any collection as well.

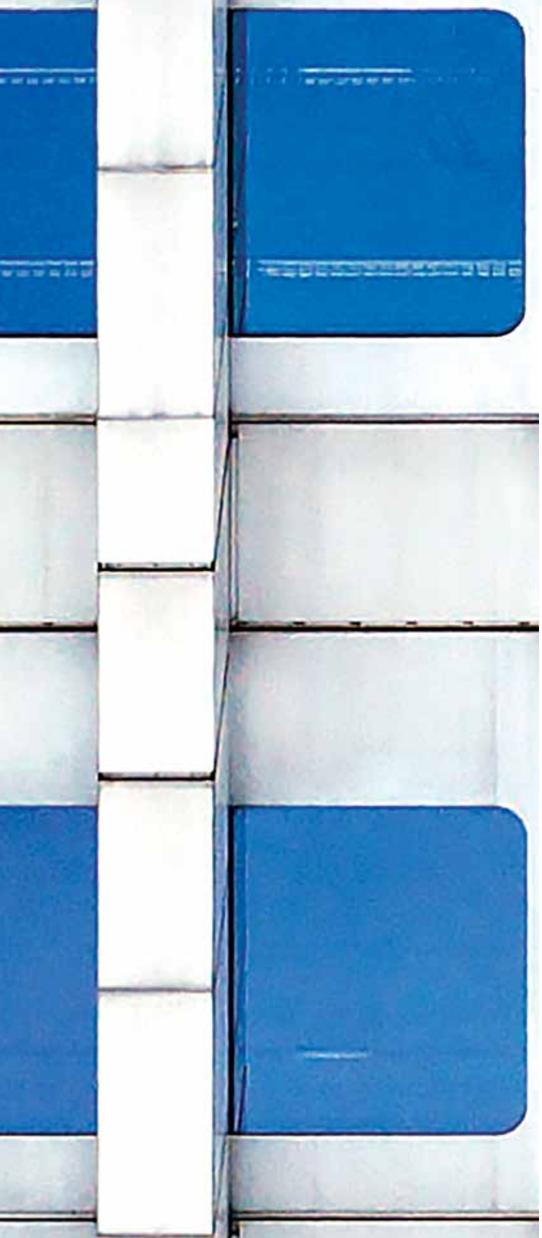
Keys to the warehouse may become a less useful option as predictive coding gets more advanced but it may be useful in disputes with high volumes of documents and extensive lists of issues which can make predictive coding very difficult. The parties obviously will need to ensure that there is clear agreement between them that if privileged documents are accidentally disclosed they will be returned without the other side having read them. (The wording in the TeCSA protocol is ideal in this respect.)[14]

The inherent issue some parties may have with this is the fear of handing over documents whose content has not been reviewed in detail before being disclosed. However, where the volumes of data are sufficiently large to make the costs of manual review significant and disproportionate, this is a very real alternative. Lawyers and paralegals can still carry out targeted searches to support their pleadings on their own documents and the ones they hand over. However, this option avoids the downsides of reliance disclosure (i.e. repeated applications for documents) and the costs of manual review.

Conclusion

Choosing which method of disclosure is right for any particular case, and subsequently reaching agreement with the other side, is never easy. Relevant factors include: complexity and the number of issues in dispute, the number of documents involved and the size of each party's database, the value of the dispute, the forum of the dispute (litigation/arbitration) and the openness and willingness of each party to use new technologies. Whatever method is employed, careful advanced consideration and planning is needed to ensure the process is reasonable, proportionate and efficient. In an age of Artificial Intelligence with technological advances constantly on the horizon, electronic disclosure is destined to continue to evolve in the near future.

Watch this space…



The Jackson Reforms to the litigation process: three years on

When the Jackson Reforms first came into force in April 2013, it was proclaimed they would lead to significant changes in the way in which civil litigation was conducted and would improve the culture of litigation for the good of all. Now some three and a half years on, Jeremy Glover (i) provides a reminder of the key aspects of the Jackson Reforms; (ii) reviews how they are working in practice; and (iii) takes a look at some of the latest developments.

"If access to justice is to have any real meaning, then the aim of keeping costs to the reasonable minimum must become paramount. Procedural squabbles must be banished and a culture of co-operative conduct introduced in their place. This will not prevent contentious issues from being tried fairly: on the contrary it should promote it."

Cost budgets

One of the key elements of the Jackson Reforms was the effective management of litigation costs through the introduction of cost budgeting. The basic idea behind cost budgeting is that cost budgets detailing a party's costs for the entire litigation must be filed and exchanged prior to the first Case Management Conference. Parties are encouraged to seek to agree cost budgets, in whole or in part, after they have been exchanged and the court will record any such agreed budget. Where the budgets are not agreed, the court has to review, make any appropriate revisions, approve the budget and make a costs management order. As will be clear from the *Mitchell* case, a party who fails to file a budget when required to do so will be treated as having filed a budget comprising only the applicable court fees, unless the court orders otherwise.

On 13 May 2015, Lord Justice Jackson gave the third annual Harbour Litigation Funding Lecture titled "*Confronting Costs Management*".[1] During that talk he highlighted what he saw as the key benefits of costs management:

(i) Both sides know where they stand financially; parties have clarity as to what they will recover if they win and what they will pay if they lose;

(ii) It encourages early settlement;

(iii) It controls costs from an early stage;

(iv) It focuses attention on costs at the beginning of litigation;

(v) Case management conferences are now more effective in that there is serious debate about what work is really necessary, what disclosure is required, what experts are needed;

(vi) "*Elementary fairness*": it gives the other side notice of what you are claiming; and

(vii) *"It protects losing parties… from being destroyed by costs."*

A party cannot recover costs simply because they are reasonably and were necessarily incurred. The costs incurred must be proportionate to the matters in issue. Mr Justice Coulson gave guidance as to the court's approach in the case of *Willis v MJR Rundell & Associates Ltd*.[2] Here, the total value of the claim was about £1.1 million.

1 See Courts and Tribunals Judiciary website: https://www.judiciary.gov.uk/announcements/harbour-lecture-by-lord-justice-jackson-confronting-costs-management/
2 [2013] EWHC 2923 (TCC)
3 One particular point to note is that the recoverable costs of budgeting itself are capped at 1 per cent of the approved budget for completing Precedent H and 2 per cent of that budget for all other costs, save in exceptional circumstances: PD3E 7.2
4 Something the TCC has done in the cases of *CIP Properties (AIPT) Ltd v Galliford Try Infrastructure Ltd* [2015] EWHC 481 (TCC) and *GSK Project Management Ltd (in liquidation) v QPR Holdings Ltd* [2015] EWHC 2274
5 However, the *CIP* and *GSK* cases make it clear that a court will take into account the amount of costs that has already been incurred
6 *The Board of Trustees of National Museums and Galleries on Merseyside v AEW Architects and Designers Ltd* [2013] EWHC 3025 (TCC)
7 [2016] EWHC 629 (Ch)
8 [2016] EWHC

The claimant's costs budget was £821k and the defendant's cost budget was £616k. The Judge held that the costs were disproportionate and unreasonable.[3] The key points to emerge from that judgment were:

(i) Where the aggregate of the cost budgets exceeds the maximum amount claimed, the court is likely to take the view that the cost budgets are disproportionate and unreasonable;[4]

(ii) It is essential that any cost budgets submitted are sufficiently detailed to enable the court to undertake a proper review and assessment;

(iii) If the court only gets to see the budgets by the time a substantial proportion of costs have already been incurred, this will undermine the effectiveness of the cost management regime and the court's ability to contain costs;[5]

(iv) The parties should aim to obtain approval for their cost budgets at an early stage and be prepared to make proactive and prompt applications to the court if budgets are exceeded; and

(v) If one party wishes to attack the other's cost budget, it should present the court with alternative figures for any items that are contested. In this case neither side offered substitute figures in respect of each other's cost budget. As a result, the Judge concluded that he did not have sufficient information to propose alternative figures and stated that it would be inappropriate for the court to do so without notice and without any necessary supporting detail.

In view of the Judge's criticisms in this case, the following should be avoided:

(i) large, rounded-up figures for which no breakdown is provided;

(ii) lump sum items which are not properly substantiated and explained. For example, it is not appropriate to include a single sum for *"contingent costs"* without further detail; and

(iii) describing components of the cost budget as *"incurred/estimated"*.

In short, it is now essential for parties to prepare accurate budgets and keep them up to date. Cost budgeting is here to stay and now applies to all cases with a value of under £10 million. The court will not allow a party to revise its approved budget if there was a simple error in the budget. However, the court may allow the costs budget to be revised if there has been a significant change to the course of the litigation since the budget was prepared. Significant reasons may include the addition of a party, substantial amendments and the increased complexity of the case.[6]

In the case of *Group Seven Ltd v Nasir*,[7] Mr Justice Nasir commented that:

"However, what is principally required in assessing a costs budget is to consider the proportionality of the amount of the budget so that the court feels that it would be appropriate to award the budgeted sum to the receiving party and require it to be paid by the paying party."

The position in 2016

In April 2016, the 83rd CPR update came into force. With it changes were introduced to the cost budgeting regime set out in CPR 3.12-18 to encourage parties to agree the budgets in advance of the Case Management Conference. Cost budgets must now be filed 21 days and not 7 days in advance of the CMC and parties must then file, 7 days before the CMC, an *"agreed budget discussion report"* setting out what is agreed and the reasons for any disagreement. The idea behind this change is to increase the opportunity for agreement, and parties are now required to cooperate and compromise regarding their budgets and have more time to reach an agreement.

> *"We think we should make it plain that it is wholly inappropriate for litigants or their lawyers to take advantage of mistakes made by opposing parties in the hope that relief from sanctions will be denied and that they will obtain a windfall strike out or other litigation advantage."*

The proportionality test applied

There have been a small number of cases where the courts have considered the approach to be taken in small value claims. In *May v Wavell Group plc*,[8] the successful claimants' costs of a claim which settled for £25,000 were reduced in two phases. First, on detailed assessment, from £208,000 to £99,655.74. Then, applying the proportionality test, they were further reduced to £35,000 plus VAT. Master Rowley said this:

"It seems to me to be clear that where the sums in issue are modest... The amount that can be recovered from the paying party is not the minimum sum necessary to bring or defend the case successfully. It is a sum which it is appropriate for the paying party to pay... It is not the amount required to achieve justice in the eyes of the receiving party but only a contribution to that receiving party's costs in many modest cases."

Changes to the court process and procedures

One of the headline features of the initial Jackson Reforms was the change in approach of the courts to breaches of the rules and court orders.

The *Denton* case: a reminder

In 2014, in the case of *Denton v TH White Ltd*,[9] the Court of Appeal outlined a new three-stage test for considering breaches:

(i) The court must consider whether the breach was *"serious or significant"*. In *Mitchell*, the test had been to say if the breach was minor or trivial. This would appear to give the courts a degree of flexibility. If the breach is neither serious nor significant, relief from sanctions will usually be granted;

(ii) The court must consider whether there was a good reason for the breach or why the breach occurred; and

(iii) The court must consider all the circumstances of the case so as to enable it to deal justly with the application. These circumstances include two of the factors set out in CPR r.3.9: (a) the need for litigation to be conducted efficiently and at proportionate cost; and (b) the need to enforce compliance with rules, practice directions and orders.

Lord Justice Vos referred to CPR r.1.3, which provides that *"the parties are required to help the court to further the overriding objective"*, noting that:

"We think we should make it plain that it is wholly inappropriate for litigants or their lawyers to take advantage of mistakes made by opposing parties in the hope that relief from sanctions will be denied and that they will obtain a windfall strike out or other litigation advantage. In a case where (a) the failure can be seen to be neither serious nor significant, (b) where a good reason is demonstrated, or (c) where it is otherwise obvious that relief from sanctions is appropriate, parties should agree that relief from sanctions be granted

without the need for further costs to be expended in satellite litigation. The parties should in any event be ready to agree limited but reasonable extensions of time up to 28 days as envisaged by the new rule 3.8(4)."

The approach of the courts in 2016

The approach of the courts is that the: "*rules exist to enable the court to resolve the matters in issue, not to throw up unnecessary technical obstacles*".[10]

It is fair to say that the *Denton* decision led to a slight relaxation of the approach by the courts, but only a slight one. There continue to be cases where the courts reinforce the importance of procedural discipline and compliance with court rules and orders.

In *British Gas Trading Ltd v Oak Cash & Carry Ltd*,[11] a defence was struck out following a two-day delay in filing a listing questionnaire in compliance with an unless order. Although the apparent delay was only two days, looking back, the Court of Appeal noted that in total the defendant's solicitors had had three months to comply with the relevant order, but failed to do so. Further, they were two days late in complying with an unless order. This breach was serious and significant. Then on top of this, the defendant delayed for over a month before seeking relief from sanction. Had it acted more promptly, then the late filing of the listing questionnaire might not have had any adverse impact on the overall conduct of the action. Lord Justice Jackson noted that if:

" the defendant had made an immediate application for relief at the same time as filing its PTC, or very soon after, I would have been strongly inclined to grant relief from the sanction of striking out. To debar a party from defending a £200,000 claim because it was somewhat late in filing a PTC is not in my view required by rule 3.9, even as interpreted by the majority in Denton."

A similar approach was taken in the case of *Gentry v Miller*.[12] This was a road traffic accident where, following judgment being entered in default of the service of an acknowledgement of service, insurers applied to set aside that judgment, alleging amongst other things that the claim was fraudulent. Lord Justice Vos took a similar view to Lord Justice Jackson:

"In my judgment, Mitchell and Denton represented a turning point in the need for litigation to be undertaken efficiently and at proportionate cost, and for the rules and orders of the court to be obeyed. Professional litigants are particularly qualified to respect this change and must do so. Allegations of fraud may in some cases excuse an insurer from taking steps to protect itself, but here this insurer missed every opportunity to do so... The insurer must in these circumstances face the consequences of its own actions."

Continued drive towards electronic working

Given that the aim of the Jackson Reforms was to lead to a decrease in costs, it is no surprise that the courts and parties are being encouraged to make use of a new electronic system to file documents.

Since 10 November 2014, an extended trial for a new online filing system has been operating. Found at www.ce-file.uk, the Courts Electronic Filing (or CE-File) system enables parties in the Technology and Construction Court, Chancery Division, Commercial and Admiralty Courts and Bankruptcy and Companies Courts to file claims and documents and pay fees electronically. The trial period was extended by a year in October 2016 and this increasing use of technology is undoubtedly bound to be a continuing feature of litigation as time goes by.

"In my judgment, Mitchell and Denton represented a turning point in the need for litigation to be undertaken efficiently and at proportionate cost, and for the rules and orders of the court to be obeyed."

The Pre-Action Protocol

TeCSA carried out a review[13] of the Construction and Engineering Pre-Action Protocol ("*PAP*"), which was published in January 2016. One reason the review was carried out was in response to suggestions that the PAP might be abandoned or heavily modified by the Court Rules Committee to make it voluntary. The review canvassed opinions from across the construction industry, including solicitors but also main contractors, specialist subcontractors, consultants and insurers.

Overall, 95% of respondents thought that the PAP was a valuable pre-action mechanism and 87% believed that it was creating access to justice. Based on the Report's findings, TeCSA said:

"there should be no doubt that the PAP ought to remain and that it should continue to be a compulsory step for those wishing to pursue a claim through the courts."

It is interesting to note that when asked to consider how the PAP could be amended, approximately 75% of respondents felt that access to and guidance from TCC Judges pre-action would be beneficial.

A new approach to trials and hearings

Since October 2015, the TCC, along with other courts that operate out of the Rolls Building in London, has been operating, under Practice Direction 51N, two new pilot schemes: the Shorter Trial Scheme ("*STS*") and the Flexible Trial Scheme ("*FTS*"). These pilot schemes were originally scheduled to last for two years but were extended by a year until 30 September 2018 in October of this year. Neither scheme is mandatory and a claimant must "*opt in*"; if a defendant wants to opt out it must apply to do so promptly. Both schemes potentially should allow for more streamlined court procedures and savings in terms of time and costs.

Under the STS, there is still a pre-action protocol process, albeit a much shorter one being based upon a 14-day notice of intention to issue proceedings under which the defendant has 14 days to reply. The aim is to have trials listed within 10 months from the issue of proceedings, with trials of no more than four days and a judgment delivered no later than six weeks after the hearing.

With the FTS, the aim is to enable parties by agreement to adapt the trial procedure to suit their particular case. The FTS is designed to encourage parties to limit disclosure and to confine oral evidence at trial to the minimum necessary for the fair resolution of their disputes. This is all consistent with its stated aim, namely to reduce costs, reduce the time required for trial and to enable earlier trial dates to be obtained.

As with all new processes, initial take-up has been slow. However, in the recent case of *Family Mosaic Home Ownership Ltd v Peer Real Estate Ltd*,[14] Mr Justice Birss noted that the STS is intended to involve tight control of the litigation process by the court, in order to resolve the dispute on a shorter more commercial timescale. The idea is that a case will be managed by the same Judge throughout. The Judge noted that:

"The initiative as a whole also seeks to foster a change in litigation culture: a recognition that comprehensive disclosure and a full, oral trial is often unnecessary for justice to be achieved. That in turn should improve access to justice by producing significant savings in the time and cost of litigation."

Cases that will not normally be suitable for this trial process include:

- cases including an allegation of fraud or dishonesty;
- cases which are likely to require extensive disclosure and/or reliance upon extensive witness or expert evidence;
- cases in the Intellectual Property Enterprise Court;
- cases involving multiple issues and multiple parties; and
- public procurement cases.

Looking forward

The courts are continuing to review potential reforms to the court process. On 27 July 2016, Lord Justice Briggs published a Report entitled *Civil Courts Structure Review*.[15] As well as looking into ways to reduce the delays in the Court of Appeal, one of the headline points arising from the final report was the idea of creating an "*Online Court*". The Judge recommended, and outlined an approach for, a phased introduction of the Online Court.

As a first stage, subject to substantial exclusions, he proposed that the Online Court deal with money claims up to £25,000. It is designed for litigants to settle disputes without lawyers. This may ease the administrative pressures on the county courts. Despite the processes name, it would not be entirely automated or online.

The three potential stages of the Online Court are outlined as:

(i) Stage 1 is mainly an automated process by which litigants are assisted in identifying their case (or defence) online without lawyers so that it can be understood by their opponents and resolved by the court, and required to upload the documents/evidence which the court will need to decide the claim;

(ii) Stage 2 will involve a mix of case management and conciliation, by a Case Officer. Rather than relying on on-line or telephone mediations, Case Officers are to be encouraged to consider the best option on a case-by-case basis;

(iii) Stage 3 will consist of determination by Judges, usually District Judges or their Deputies. This may not be through a traditional trial but could be carried out on the documents, on the telephone, or by video, or by combination of all three.

The proposals for the Online Court are based on a desire to use modern technologies to try and enhance the efficiency of the court systems as well as increase access to justice for all. They are not, despite the advances outlined by Simon Tolson in his article on Artificial Intelligence and the Law, a pre-cursor to the rise of "*Robot or AI-Judges*."

Whilst there is no doubt sufficient IT capacity and awareness to do this, this initiative cannot succeed unless properly financed resources are introduced both to help run the system and help educate those who use it. It is equally important that those resources are not diverted from an already over-burdened county court system.

Conclusions

The Jackson Reforms are, of course, not the only changes the court system is currently facing. Indeed there is a certain irony when the cornerstone of the Reforms, namely the reduction of costs, is compared and contrasted with the ever-increasing costs of court fees themselves (something which is not within the control of the Judges or courts).

However, culturally a change has come about and Mr Justice Edwards-Stuart succinctly summarised the approach that the courts are expecting to see in the case of *Gotch v Enelco Ltd*:

"If access to justice is to have any real meaning, then the aim of keeping costs to the reasonable minimum must become paramount. Procedural squabbles must be banished and a culture of co-operative conduct introduced in their place. This will not prevent contentious issues from being tried fairly: on the contrary it should promote it."

9 [2014] EWCA Civ 906
10 *Williams v Devon County Council* [2016] EWCA Civ 419, paragraph 31
11 [2016] EWCA Civ 153
12 [2016] EWCA Civ 141
13 *Report Evaluating the Perceived Value of the Construction and Engineering Pre-action Protocol*, available on the TeCSA website – www.tecsa.org.uk. The research included the examination of data records from 216 disputes
14 [2016] EWHC 257 (Ch)
15 An Interim Report had been published in January 2016 which foreshadowed many of the recommendations to be found in the Final Report. See Courts and Tribunals Judiciary website: https://www.judiciary.gov.uk/publications/civil-courts-structure-review-final-report/

Guaranteeing company obligations – don't let it get personal

We were recently approached by a client asking if we could help to extricate him from a personal guarantee – a guarantee which, prior to it being called on, he had not realised he had given. By signing the relevant box in a document entitled *"Application for Credit Account"*, our client thought that he was entering into an agreement pursuant to which his company would be granted credit terms by a supplier, an essential component to the smooth day-to-day running of the company. In fact, he and his fellow directors had also unwittingly agreed *"jointly and severally to guarantee payment of all the financial obligations (of the company) due to"* the supplier – in effect, a personal guarantee.

Therefore, without being provided with a document calling itself a *"Guarantee"* or even having his attention drawn by the use of the word *"personal"* within it, a director may find himself personally liable to pay his company's debts and if he does not do so when required, he may be taken to court and ultimately face enforcement of a judgment debt against his assets, including the family home. In our client's case, the devil was in the detail – or, rather, buried in the small print.

Is this commonplace?

It is not unusual in the construction industry for an employer to require a parent company guarantee in order to receive the benefit of some form of security in relation to a company's obligations. However, banks, landlords or even suppliers may agree to deal with smaller, owner-managed companies only if its obligations are backed up by a personal guarantee from the individuals behind it. This may be particularly pertinent, for example, where a new company is keen to get its business up and running.

If you have ever been asked to provide a personal guarantee by, for example, a bank, you will most likely have been provided with a separate guarantee document which clearly identifies itself as a *"Guarantee"*. You may also have been required to take independent legal advice on the guarantee.[1] In this way, individuals are (or should be) fully aware of what they are signing up to.

However, there is no reason why a guarantee may not be contained within another agreement. Further, if the creditor is not a financial institution subscribing to a particular lending code or adhering generally to best practice, he will not feel bound to comply with any of the *"protections"* potentially afforded to guarantors under such codes of practice, such as a commitment not to take an unlimited guarantee from an individual and ensuring an individual takes separate legal advice. He may instead require a personal guarantee as standard practice regardless of credit rating and just see if he can get away with it by documenting it in his credit agreement.

In the absence then of reading and fully understanding the implications of the small print, it may prove surprisingly easy to find yourself *"on the hook"* as a personal guarantor.

What constitutes a guarantee?

The law of guarantees is complicated and the purpose of this article is not to provide an in-depth study of that area of law. However, it is still helpful to have an understanding of what a guarantee is and how it can be given.

A guarantee is an undertaking by one party to another promising to be responsible for the payment of debt or performance of obligations by the person primarily liable. The liability of the guarantor is a secondary obligation which is contingent on the existence (and usually breach) of the primary obligations owed by the principal obligor to the creditor.

The basic requirements of a contract governed by English law apply to the formation of a guarantee: i.e. offer, acceptance, intention to create legal relations and consideration if not contained in a deed. The Statute of Frauds 1677[2] stipulates that a guarantee must be in writing and signed by the guarantor or a person authorised by it in order to be effective.

> *"The contractual text is very short. The Director is directed to read it. If he does not read it, he takes a certain chance. That is what happened in this case if he did not read it. The wording is clear beyond peradventure."*

Historically, this was to protect against liability attaching to informal communications which may be given without sufficient consideration or expressed ambiguously. Although guarantees are often executed as deeds to overcome any argument about this, recent court decisions have recognised that a series of documents (including emails) is now capable of forming a guarantee.

The name of the guarantor in an email, where there is both an intention that it is a signature and an intention to contract, will constitute a signature for this purpose.[3]

A guarantee can be either

(i) all monies – i.e. guaranteeing all the payment obligations (whether existing or future) of the principal obligor (this is the most beneficial position for the creditor);

or

(ii) for specific amounts – i.e. guaranteeing all the payment obligations in relation to a specific transaction only (better for the guarantor).

The effect of a personal guarantee

Exposure to an unlimited financial liability with all the consequences which naturally flow from that is a sobering prospect.
If the company breaches the underlying agreement and a claim is made by the creditor, the director will be liable to pay the company's debt. If he does not have sufficient assets (including the family home) to cover the debt, he may be made

bankrupt. The impact on his credit rating and the difficulty of obtaining financial services, insurance, etc. in the future barely need to be expressed. In addition, an undischarged bankrupt[4] may not act as company director without leave of the court.

Further, where several directors give a personal guarantee (or give a single guarantee jointly and severally, as in our client's case) to the same creditor, the creditor does not have to pursue all of them but can claim the whole amount from one guarantor. The stakes for each individual may prove to be very high.

Is there any way out of it?

Some comfort may be found in the knowledge that the courts have traditionally been very protective of guarantors and many events will reduce or release a guarantor's liability (unless, however, the guarantee provides otherwise). The courts have taken this approach following equitable principles. For example, if the creditor breaches the underlying agreement or (without the consent of the guarantor) alters the liability of the principal obligor under it by increasing the amount of credit or by granting more time for the principal to pay, the guarantor may be left in a worse position when the guarantee is eventually called.

This inequitable outcome provides the guarantor, at common law, with a defence to a claim under the guarantee. The effect of such protection could mean that the guarantee is released in full, reduced in part, extinguished or unenforceable.

However, not surprisingly, the creditor will actively seek to expressly exclude any such protections from the guarantee. In our client's case, the "*guarantee*" wording concluded as follows: "*including any financial obligations arising from any changes in credit limit made to the credit account granted by us from time to time*".

The creditor therefore sought to ensure that our client was still on the hook even if, without his specific knowledge, the underlying agreement was altered by increasing the credit limit.

Had the client signed in his personal capacity and was his attention sufficiently drawn to the offending clause?

As the signature boxes immediately underneath the "*guarantee*" wording (which constituted two lines of small print hidden within an A4-sized document) required the signatures of the directors, it could be argued that our client had not signed the guarantee in his personal capacity but in his capacity as director of the company only.

Consequently, the guarantee would not have been signed by the "*party to be charged*" and would not fulfil the requirements of the Statute of Frauds 1677.[5] Further, could he rely on the so-called "*red hand*" rule of contract law, which provides that the more onerous or unreasonable a clause is, the greater the notice which must be given of it (e.g. by writing it in red ink on the front page with a red hand pointing to it, to be sufficiently noticeable)?[6]

The court's assessment of the parties' intentions for entering into a contract, however, is an objective one – i.e. "*The question is what a reasonable person, circumstanced as the actual parties were, would have understood the parties to have meant by the use of specific language*".[7]

The court will therefore look to the parties' expressed rather than actual intention. Therefore, if the contract expressly refers to a director in his personal capacity giving commitments on behalf of the company, and that director has put his signature directly underneath such an unambiguous statement, it may be difficult to show that the Statute of Frauds' requirements had not been met. In a recent case on similar facts to our client's experience, the Court of Appeal made the following remarks in respect of the contract in question:

"*The contractual text is very short. The Director is directed to read it. If he does not read it, he takes a certain chance. That is what happened in this case if he did not read it. The wording is clear beyond peradventure.*"[8]

The Court of Appeal further held in the same case that even where the wording appears in smaller print than the rest of the contract, a director is still bound by his signature. The "*red hand*" rule may be helpful in arguments where the unreasonable term is contained in a separate document (e.g. the creditor's standard terms of business) but not where it is included in the document actually signed by the parties. Therefore, once you have put ink to paper (or the equivalent electronically), it is extremely difficult to back track from there.

Can you argue that the terms are unfair?

Despite its name, the Unfair Contract Terms Act 1977 ("*UCTA*") does not apply to all unfair terms. It only controls clauses that limit business liability, directly or indirectly, and does not examine whether a contract is generally unfair. Certain clauses in guarantees, because they are exclusion clauses (e.g. prohibiting set-off), may be held subject to UCTA and as such to be enforceable only to the extent they satisfy the reasonableness test. Section 11 provides that a clause must be:

"*a fair and reasonable one*" in the light of the "*circumstances which were, or ought reasonably to have been, known to… the parties when the contract was made*".

However, the courts have made clear that many standard form clauses in guarantees will not be regarded as unreasonable where the guarantor is an experienced business person.[9] In any event, in our client's case, UCTA would not apply as the "*guarantee*" wording was not attempting to limit liability and was therefore not an exclusion clause.

Could our client then argue that, as an individual, he was protected by the Unfair Terms in Consumer Contracts Regulations 1999 (the "*Regulations*")? In *Barclays Bank Plc v Kufner*[10] it was held that:

"*The Regulations would apply to a bank guarantee where the guarantor and the principal debtor each entered into their respective contracts as natural persons and were not acting in the course of their trade or profession.*"[11]

Under the Regulations, a contractual term:

"*which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations arising from the contract, to the detriment of the consumer.*"[12]

The Regulations further provide that a:

"*term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term.*"[13]

However, the Regulations were held not to apply in the Kufner case as the underlying loan agreement was not a consumer agreement (as it had been executed by a company). It was further held, however, that even if it was irrelevant that the company was not acting as a consumer, the Regulations would still not apply as it was clear that the guarantor, despite being an individual, was acting in a business capacity.

Similar facts applied to our client. It was irrelevant that the "*guarantee*" wording had not been individually negotiated with him or that the agreement was given to him on a "*take it or leave it basis*" – the Regulations did not apply. Credit was being extended to his company and so the credit agreement was not a consumer contract; his guarantee (albeit a personal one) was given by him acting in the course of and for the benefit of his business.

It follows that it would not be right for businesses to gain the benefits and protections of consumer legislation effectively by the back door. No matter how unfair it seems then, it is a hard case to actually argue.

Is there any hope?

It is unlikely that a guarantee hidden in the small print will provide the guarantor with an explicit right to terminate the guarantee. The general rule, however, is that a continuing (all monies) guarantee of all the principal's liabilities can be terminated by giving notice to the creditor. This is because the consideration given by the creditor can usually be divided into different instances over the life of the guarantee.

Therefore, if the credit agreement can be terminated by the creditor on notice and no new transactions entered into or further credit extended to the principal, the guarantor should be able to terminate the guarantee by giving notice. Note though that this will not affect any rights that have accrued before the notice is given – i.e. the guarantor will still be on the hook for existing liabilities but, thankfully, he will be free from all future ones.

So, it may be wise to dig out all of those supplier agreements that you may have signed over the years, dust them off and get out the magnifying glass. If you find that you have given any personal guarantees, pick up the phone or email the supplier to give them notice that you are revoking the guarantee.

When entering future contracts, always read the small print and if you are unsure of its implications, seek advice before you sign it. Just a few seemingly innocuous words can have far-reaching consequences.

Always try to avoid giving a personal guarantee but at the very least try to ensure that it relates only to specific amounts or transactions (rather than "*all monies*") or, alternatively, negotiate an overall cap.

Conclusion

The reality of the situation, unfortunately, is that if you have signed a personal guarantee it is extremely difficult to free yourself completely from your obligations under it.

If a creditor has called on a personal guarantee he will vigorously reject any challenges to it and will usually have standard methods of doing so. However, it is also worth noting that creditors will make every effort to receive money prior to going to court, as in many cases (particularly with banks) they do not wish to give the courts the opportunity to strike down a personal guarantee and in so doing set a precedent which would potentially devastate large numbers of similar guarantees held by them.

This can work in favour of a well-informed guarantor who argues his case well, as the creditor may be more willing to settle for a lower sum. This is precisely the route our client chose to take.

A contractual term:

"which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations arising from the contract, to the detriment of the consumer."

1 See, for example, *Barclays Bank Ltd v O'Brien* [1994] 1 AC 180 and *Royal Bank of Scotland v Etridge* (No 2) [2002] 2 AC 773 concerning the giving of guarantees and undue influence
2 Section 4, The Statute of Frauds 1677
3 *Golden Ocean Group Ltd v Salgaocar Mining Industries OVT Ltd* [2011]
4 An undischarged bankrupt is someone who is still going through the process of bankruptcy, which usually takes a year – i.e. usually the bankrupt is discharged on the first anniversary of the date the bankruptcy order was made
5 *"upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith or some other person thereunto by him lawfully authorised"*
6 See Lord Denning's statements in *J Spurling Ltd v Bradshaw* [1956] 2 All ER 121
7 Lord Steyn, *Sirius International Insurance Co v FAI General Insurance Ltd* [2004] 1WLR 3251
8 *Stephen Barrett v Brandon Hire Ltd* [2014] EWCA Civ 164
9 *Barclays Bank plc v Alfons Kufner* [2008] EWHC 2319 (Comm)
10 [2008] EWHC 2319 (Comm)
11 It was held that Bayerische Hypotheken- und Wechselbank AG v Dietzinger (C-45/96) [1998] 1 W.L.R. 1035 applied
12 Section 5(1), The Unfair Terms in Consumer Contracts Regulations 1999 No. 2083
13 Section 5(2), The Unfair Terms in Consumer Contracts Regulations 1999 No. 2083

Payment provisions in construction contracts: another year on

In the last *Annual Review* Jonathan More reviewed the key cases that had been reported in respect of the amendments to the Housing Grants (Construction and Regeneration) Act 1996 (*"the Construction Act"*) as introduced by Part 8 of the Local Democracy, Economic Development and Construction Act 2009 (*"the New Act"*). This first wave of cases included: *ISG Construction Ltd v Seevic College*,[1] *Galliford Try Building Ltd v Estura Ltd*,[2] *Caledonian Modular Ltd v Mar City Developments Ltd*,[3] and *Henia Investments Inc v Beck Interiors Ltd*.[4] Since then further case law has helped clarify the conclusions drawn from those cases. Jonathan More discusses these developments further.

The first wave of case law

Mr Justice Coulson, in the case of *Severfield (UK) Ltd v Duro Felgura UK Ltd*[5] provided a summary of where we stood in 2015:

"Over the course of the last year there has been a flurry of cases in which Edwards-Stuart J has considered the situation in which a contractor has notified the sum due in a payment notice, and the employer has failed to serve either its own payment notice or a payless notice... In essence, these [cases] are authority for the proposition that, if there is a valid payment notice from the contractor, and no employer's payment notice and/or payless notice, then the employer is liable to the contractor for the amount notified and the employer is not entitled to start a second adjudication to deal with the interim valuation itself...

All of these cases concern the situation where the contractor is seeking to take advantage of the absence of any notices from the employer to claim, as of right, the sum originally notified. That approach is in accordance with the amended provisions of the 1996 Act. But because of the potentially draconian consequences, the TCC has made it plain that the contractor's original payment notice, from which its entitlement springs, must be clear and unambiguous. Thus:

(i) In Caledonian Modular Limited v Mar City Developments Limited... I said:

'... if contractors want the benefit of these provisions, they are obliged, in return, to set out their interim payment claims with proper clarity. If the employer is to be put at risk that a failure to serve a payless notice at the appropriate time during the payment period will render him liable in full for the amount claimed, he must be given reasonable notice that the payment period has been triggered in the first place.';

(ii) In Henia Investments v Beck Interiors Limited... Akenhead J said:

'... the document relied upon as an Interim Application... must be in substance, form and intent an Interim Application stating the sum considered by the Contractor as due at the relevant due date and it must be free from ambiguity... If there are to be potentially serious consequences flowing from it being an Interim Application, it must be clear that it is what it purports to be so that the parties know what to do about it and when.'"

Clear and concise.

The second wave of case law

The second wave of case law by and large focuses on the application of the key principles established by the above cases. What can be said as a consequence of the newer case law, reviewed in more detail below, is that the following principles will be applied to payment provisions in construction contracts:

(i) A contractor relying on the noncompliance of the employer in respect of Payment and Payless Notices must itself have complied with its contractual obligations in respect of applications for payment.

(ii) In particular the contractor must:

  (a) issue its interim applications on the dates required by the relevant contract;

  (b) ensure that what it issues as its interim application complies with the contract and clearly constitutes an application in accordance with the process in place between the parties;

  (c) recognise that a schedule of application/payment dates may replace or supersede dates otherwise agreed in the body of the contract particulars and/or conditions of contract dependent upon the wording.

The principles of the *Estura* case will only be relevant in exceptional circumstances and are an enforcement issue rather than one which impacts the principles of whether a sum should be awarded at adjudication.

It is clear that in circumstances where the employer and/or administrative team on a construction project have failed to properly issue the notices required, the focus of the attack has been twofold. First, from our experience, there are often numerous references to the *"smash and grab"* and *"baleful"* actions of the contractor in raising such a claim, which arguments have not gained any traction with adjudicators. A second and more fruitful approach has been to focus on the contractor's interim applications, in particular:

- the date of issue of such applications with reference to either the contractual due dates, or
- Schedules of Interim Payments which can also unwittingly amend the contract terms as a result.

Leeds City Council v Waco UK Ltd[6]

This case challenged an adjudicator's decision for Leeds City Council (*"LCC"*) to pay Waco UK Ltd (*"Waco"*) just under £500,000 as LCC mechanisms for the submission of applications had refused to serve the relevant notices in response to Waco's interim application no. 21. This application had been made after practical completion, where the JCT mechanisms[7] for the timing of submission for applications had changed from monthly to every two months.

It is fair to say that post-practical completion the timing of Waco's applications was somewhat ad hoc However, the contract administrator had shown some pragmatism in dealing with these applications. Submissions and assessments were made if applications were only two or three days late with reference to the agreed monthly date, or where the sums involved were relatively modest.

The legal principles discussed in this case focused more on matters such as the course of dealings and conduct of the parties as to whether there was waiver or estoppel in play. However, one point made clear by Justice Edwards-Stuart at paragraph 36 of the judgment was the following:

"I consider that the employer needs to have some idea of when an interim application is likely to be received so that he can ensure that he has the resources available in order to respond to it within the limited time that the contract allows – in particular, to consider and prepare any payment notice."

In the decision it was held that interim application 21 had been issued prematurely in accordance with the contractual dates (it was issued on the 22nd of the month, six days ahead of the agreed 28th of the month submission date) and was not a valid application, as it did not fall within the more narrow margins of flexibility that the contract was being administered to.

Grove Developments Ltd v Balfour Beatty Regional Construction Ltd[8]

A similar theme was adopted here to that in *Waco*. Balfour Beatty Regional Construction Ltd (*"BB"*) had issued an interim application no. 24 in respect of which it argued that Grove Developments Ltd (*"GDL"*) had failed to issue either a Payment Notice or a Payless Notice within the applicable time limits. Although GDL denied that it had missed the required dates, it argued that in any event the parties, by virtue of an agreed schedule of interim payment dates, had agreed to only 23 interim payments. BB, therefore, had no entitlement to be paid a 24th interim payment.

The contract here was the JCT Design and Build 2011 standard form, with amendments. The parties had agreed that interim payments would be made in accordance with Alternative A – stage payments *"to be agreed within 2 weeks from date of contract"*. It was common ground between the parties that a schedule was agreed which regulated the interim payment process from September 2013 to July 2015. The last interim payment on the schedule was no. 23, to be issued on 16 July 2015. It was after this date that BB issued its application no. 24.

At first instance, the court held that:

(i) The effect of the agreed schedule was to act as a specific amendment to the Contract.

(ii) Where parties have agreed intervals at which, or circumstances in which, interim payments become due, the fact that the agreement does not provide for interim payments covering all of the work under the contract is no reason to import the provisions of the Scheme.[9]

(iii) Accordingly BB had no entitlement to make or be paid in respect of interim application 24 (or any subsequent application).

Just nine months later, this decision was upheld by a majority decision on appeal. BB argued that for the parties could not have intended that if practical completion were delayed, BB would have to wait for payment until the final payment date. In order to make commercial sense, the contract could only be interpreted in such a way as provide for further interim payments.

This argument was rejected for the following reasons:

- The express words used by the parties made it clear the parties only agreed interim payments up to the contractual date for completion i.e. application no. 23;
- It was impossible to deduce from what was said to be the hybrid agreement what the dates for valuations, payment notices, Pay Less notices and payments would be; and
- This was a classic case of a party making a bad deal Lord Justice Vos disagreed. In allowing the appeal he held that the Contract agreed between the parties was ambiguous as the Schedule of Payments was not clear enough to be construed as meaning, when read with the JCT contract, that the parties must have intended that there would be no interim payments after interim payment 23. This being the case the intention of the parties could be considered, and having considered the submissions of the parties Lord Justice Vos found that the parties must have intended the monthly interim payments to continue.

It is clear, therefore, (although the 2 to 1 decision in the appeal might increase the prospects of further appeal) that contractors will be expected to have administered their payment processes strictly (with only small margins of error) in accordance with the agreed contract process. Where any schedule of application dates have been agreed care needs taken to provide for interim payments in the event of delay to the works.

RMC Building & Civil Engineering Ltd v UK Construction Ltd[10]

The claimant, RMC Building & Civil Engineering Ltd (*"RMC"*), applied for summary judgment in proceedings to enforce an adjudicator's decision. UK Construction Ltd (*"UKC"*) challenged the enforcement proceedings arguing that it would cause manifest injustice. Edwards-Stuart J enforced the adjudicator's decision and refused to grant a stay pending the defendant's Part 8 application for declaratory relief.

The enforcement of the adjudicator's decision was primarily challenged on the basis that the adjudicator had not had jurisdiction to decide the referral.

The more relevant part of this decision for the purposes of this *Review* related to the reference made by UKC to the *Estura* case as part of its contention that enforcement of the decision should be stayed. A preliminary comment made by Mr Justice Edwards-Stuart on such arguments is found at paragraph 56:

"The provisions introduced by the Act and the Scheme are all about maintaining cash flow. That purpose is not achieved by simply giving judgment for a sum then staying enforcement; interest is often no compensation for a lack of cash flow."

A stay of enforcement of the decision of the adjudicator, either in whole or in part, was rejected by Edwards-Stuart J as the defendant had failed to demonstrate that it would suffer financial hardship or beunable to recover any overpayment from the claimant when the dispute was finally resolved, further emphasising that a manifest injustice argument will only be successful in rare cases similar to *Estura*.

Finally, it is clear that when one party is basing a claim on due contractual process being ignored as regards the content of a notice being invalid, that party's own proficiency, or otherwise, in completing the contents of its notices will come under sharp focus. This was the situation in the following case.

Jawaby Property Investment Ltd v The Interiors Group Ltd and another[11]

This dispute related to construction works at Holborn Tower, High Holborn, London. The Contract was an amended JCT 2011 Design and Build form. Jawaby Property Investment Ltd (*"Jawaby"*) sought declaratory relief against The Interiors Group Ltd and another (*"TIG"*) in relation to certain payment obligations under the Contract and a related Escrow Agreement.

Under the terms of the Contract, TIG was to submit interim applications for payment on or before the due date, the eighth of each month. TIG's first six interim applications were submitted to Jawaby in the form of a valuation attaching Excel spreadsheets and setting out a statement of the final sum applied for (or total work done) at the conclusion. Each of Valuations 1 to 6 valued TIG's works up to the relevant due date. From Valuation 5 onwards, there was a summary sheet followed by detailed backup sheets. Upon receipt of these documents, Jawaby's agent would *"walk the job"* with TIG to assess and check that the work was done, following which it would issue a Certificate of Payment accompanied by detailed Excel spreadsheets showing how the assessment had been made.

On 7 January 2016, TIG submitted, by email, Valuation 7 which was marked as an *"initial assessment"*. On 11 January 2016, Jawaby *"walked the job"* and, then on 15 January 2016, issued a Certificate of Payment for a negative value. On 18 January 2016 Jawaby provided markedup documentation explaining how they had reached a negative valuation. Both the Payment Certificate of 15 January 2016 and the supporting documents of 18 January 2016 were out of time to constitute Payment Notices under the Contract. TIG issued proceedings on this basis.

Jawaby argued both that it had served a valid Payless Notice by virtue of the documents issued on 18 January 2016 and that TIG had failed to serve a valid interim application because Valuation 7 did not describe itself as such. TIG stated that there was no requirement for the document to be expressly described as an interim application. The Judge concluded that Valuation 7 was not a valid application because:

(i) it was materially different from TIG's previous applications and failed to comply with the provisions of the Contract;

(ii) it was described as an *"initial assessment"*;

(iii) the valuation summary sheet had been erroneously marked as Valuation 6; and

(iv) unlike TIG's previous applications, the value did not include works up to the contractual due date.

Stop press – final accounts and payment notices

In *Kilker Project Ltd v Purton*, Purton argued that the effect of a failure by a party to issue a payment notice and/or a pay less notice is that the payer has agreed the valuation of the payee for that payment and must pay the application sum in full. This meant that in the case of an application for final payment, the effect of a failure by a party to issue a payment notice and/or a pay less notice is that the final account is agreed. It remains open to the payer to challenge the valuation in litigation or arbitration, for example by way of restitution, but the agreed valuation cannot be re-opened in a subsequent adjudication. Deputy Judge O'Farrell QC disagreed, noting that:

"where the "notified sum" determined in adjudication is in respect of a final payment, unless the contract provides that such payment is conclusive as to the contract sum due, although the "notified sum" must be paid, either party is entitled to have the ultimate value of the contract sum determined in a subsequent adjudication, litigation or other form of dispute resolution… It is not necessary for the contract to set out any specific mechanism for that final accounting exercise; payment of any final sum due to either party is based on enforcement of the contractual bargain."

Here, an adjudicator had determined the *"notified sum"* payable in respect of the contractor's final account application but did not determine the proper value of the final account. Kilker was obliged to pay that sum in full. However, there was no agreement that the final account would be conclusive as to the final sum due under the contract and the Judge held that the statutory payment provisions do not have such effect. Therefore, Kilker was entitled to refer the final account valuation to a second adjudicator.

Commentary

The key principles that evolved in 2014/15 in respect of the New Act, clearly created an environment within which the so called *"smash and grab"* adjudication could thrive. It is apparent from the case law that has followed thereafter that, whilst not departing from the key principles, a contractor will be expected to have followed the contract very closely to benefit from any lapses on the part of employers. To this end, the courts have quite properly applied the checks and balances you would expect to ensure that *"draconian"* rules do not readily result in *"baleful"* decisions.

Although apparently straightforward, administrating a construction contract can be difficult and can easily become derailed. The employer will often be on more sound footing on administrative matters as it will likely have employed a consultant specifically to administer such matters. Contractors are well advised to make sure their own administrative functions are well trained and work properly and efficiently in line with specific contractual requirements.

Working collaboratively between administrative functions also needs to be handled with care, as discussions and negotiations at each payment cycle whereby a contractor might try and squeeze an increased payment out of a cycle may mean that the application and response dates become out of sync and confused.

1 [2014] EWHC 4007 (TCC)
2 [2015] EWHC 412 (TCC)
3 [2015] EWHC 1855 (TCC) 29 June 2015
4 [2015] EWHC 2433 (TCC)
5 [2015] EWHC 3352 (TCC)
6 [2015] EWHC 1400 (TCC)
7 The contract was the JCT Design and Build Contract, 2005 edition, revision 2, 2009
8 [2016] EWHC 168 (TCC)
9 The Scheme for Construction Contracts
10 [2016] EWHC 241 (TCC)
11 [2016] EWHC 557 (TCC)

Is there a general principle of good faith under English law?[1]

Many jurisdictions[2] expressly include in their civil codes references to the concept of good faith in commercial dealings. In that context, an obligation to act in good faith in the making and performance of a contract becomes an express obligation on all parties. It also should be noted that the recognition of a general doctrine of good faith is not limited to just civil law jurisdictions. For example, Australian courts have been known to imply broad duties of good faith into commercial contracts, and the Supreme Court of Canada recently recognised a new common law duty of honest performance.[3] Yet, as Sana Mahmud asks, to what extent do the English Courts recognise the concept of good faith?

Good faith under English law – to what extent is this a recognised concept?

Those working in the construction industry will be aware that many standard forms of contract used domestically include obligations that could be commonly construed as good faith-type obligations. Examples are perhaps most obviously apparent in partnering contracts and in clause 10.1 of the NEC3, which states that the parties should act in accordance with the Contract and in a spirit of mutual trust and cooperation. Whilst it is accepted that broad concepts of fair dealing can be reflected in the English court's response to questions of construction and the implication of terms, the long-standing position under English contract law is that courts have been reluctant to recognise any general pervasive duty of good faith.[4]

The historical reluctance of the courts to imply a general duty of good faith is due in part to concerns that doing so would likely undermine contractual certainty. Instead, the English courts have, as Lord Justice Bingham put it in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*,[5] preferred to develop "*piecemeal solutions in response to demonstrated problems of unfairness*". There is no generally accepted definition of the concept under English law, but in the same judgment, Lord Justice Bingham described good faith as being most aptly conveyed by colloquialisms such as "*playing fair*", "*coming clean*" or "*putting one's cards face upwards on the table*", concluding that it "*is in essence a principle of fair and open dealing*".

If the term is not expressly defined in a contract, parties will have scope for argument about what an obligation of good faith in a particular context means. Where parties have expressly included good faith obligations in their contract, the general approach is that the courts will seek to give effect to those express provisions which relate to the actual performance of a particular obligation. However, whether a party can successfully rely on such a provision will depend to a great degree on the specific wording of the particular clause. The usual principles of contractual interpretation will apply.[6]

Often in cases where there is an express clause incorporating an obligation of good faith, parties seeking to rely on the clause have attempted to argue that the duty is a general one that can apply across other provisions of the contract. The courts have generally favoured a narrow interpretation of express contractual obligations of good faith, and in cases where the duty relates to a specific provision, they have been hesitant to imply a wider overarching contractual duty.

The judgment in the 2013 case of *Yam Seng Pte Ltd v International Trade Corporation Ltd*,[7] however, briefly raised expectations that the courts were open to a pervasive duty of good faith being implied more commonly in commercial contracts. A number of subsequent cases, including the first instance decision in *MSC*, followed the approach in *Yam Seng*.[8] The Court of Appeal has, however, recently overturned the *MSC* decision at first instance, reverting to the traditional position that English contract law does not recognise a general duty of good faith.

Some recent cases

Yam Seng Pte Ltd v International Trade Corporation Ltd

As mentioned above, in 2013 the issue of whether a duty of good faith could be implied into a contract was examined in the case of *Yam Seng Pte Ltd v International Trade Corporation Ltd*. Here, Mr Justice Leggatt, who also sat as the Judge at first instance in *MSC*,[9] adopted a relatively broad (and some might say novel) approach regarding the circumstances in which good faith obligations could be implied into ordinary commercial contracts. In his judgment, he expressed the view that:

"*the traditional English hostility towards a doctrine of good faith in the performance of contracts, to the extent that it still persists, is misplaced*".

The reasoning behind this view was that an obligation of good faith could be implied by reference to the established approach for the implication of terms into a contract – in this case, whether the term is so obvious that it goes without saying, or is necessary to give business efficacy to the contract.

The dispute arose out of a long-term international distribution agreement between the parties under which ITC granted Yam Seng exclusive rights to distribute Manchester United branded fragrances.

> *"recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences"*

The relationship broke down and Yam Seng alleged a number of breaches of contract by ITC and sought to argue that an obligation of good faith should be implied into the agreement.

Specifically, Yam Seng argued that ITC had:

(i) failed to act with an implied obligation of good faith in prejudicing Yam Seng's sales by offering the same products for domestic sale below the duty free prices that Yam Seng was permitted to offer;

(ii) instructed or encouraged Yam Seng to incur marketing expenses for products that ITC was unable or unwilling to supply; and

(iii) offered false information upon which Yam Seng relied to its detriment. There were no express terms in the agreement dealing with these points.

In this particular case, the two obligations implied by the court were:

(i) to not knowingly provide false information on which the other party would rely, and

(ii) a fact-specific obligation not to undercut duty free prices.

A duty of good faith was implied in both these respects. The first obligation was contrary to usual standards of commercial dealing and the second was implied into the agreement between the parties as a matter of fact.

There were certain circumstances specific to this case which led the court to conclude that an obligation of good faith could be implied. The agreement was "*skeletal*" and had not been drafted by lawyers. In the view of the court, it would be more difficult to imply a term into a detailed and professionally drafted document.

Furthermore, the contract was a long-term distributorship agreement which, the court noted, required the parties to communicate effectively and cooperate with each other in its performance. Mr Justice Leggatt classed this type of agreement as a "*relational contract*" and the case appeared to provide authority for the position that a general duty of good faith could be implied into these kinds of contracts. The examples he cited as falling within the definition of a "*relational contract*" included joint venture agreements, franchise agreements and the type of long-term distributorship that was the subject of this dispute. Other examples, though not mentioned specifically, would also likely have included certain types of construction and engineering contracts.

Following the decision in *Mid Essex Hospital Services*[10] and more recently the Court of Appeal judgment in *MSC*,[11] both discussed below, *Yam Seng* should be treated with caution.

In another very recent case concerning a long-term contract, *Globe Motors Inc v TRW Lucas Variety Electric Steering Ltd*,[12] the Court of Appeal rejected the concept that "*relational contracts*" are likely to be subject to duties of good faith. Instead, the court confirmed that:

"*the implication of a duty of good faith will only be possible where the language of the contract, viewed against its context, permits it. It is thus not a reflection of a special rule of interpretation for this category of contract.*"

Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd[13]

Shortly after the judgment in *Yam Seng*, however, the Court of Appeal took a much more narrow and restrictive approach in *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd*. Here, the court made clear that the obligation to act in good faith under a particular provision did not extend to all conduct under the contract.

The factual background to the case was that the respondent, Compass, agreed to provide cleaning catering services to the appellant Trust under a substantial commercial contract. Under this contract, Compass was required to meet certain agreed performance levels and criteria. Failure to meet the agreed performance levels or criteria by Compass would result in the levying of certain deductions. The dispute concerned the levying of those deductions, and a question of whether the Trust had been entitled to terminate the contract on the basis that Compass had exceeded the number of service failure points permitted in any given six-month rolling period.

Clause 3.5 of the contract, which contained an express duty to cooperate in good faith, read as follows:

"*The Trust and the Contractor will co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract.*"

The court was asked to decide whether this clause provided an overarching obligation on the parties to cooperate with each other in good faith. Compass relied heavily on the decision in *Yam Seng*, arguing that the good faith obligation in clause 3.5 should be construed widely so as to apply to the contractual provisions relating to performance level failures and/or that a general duty of good faith should be implied into the contract.

> *"the traditional English hostility towards a doctrine of good faith in the performance of contracts, to the extent that it still persists, is misplaced."*

Reversing the decision of the High Court at first instance, the Court of Appeal held that the obligation to act in good faith was limited to the purposes identified in the clause: to transmit information and provide full benefit of the contract to the customer. The court found that commercial common sense did not favour the addition of an overarching duty to cooperate in good faith in circumstances where good faith had been provided for in the contract in such a precise manner at clause 3.5. The Court of Appeal emphasised that

"*if the parties want to impose a duty they must do so expressly.*"

The position in 2016

The Court of Appeal's decision in *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt*

The case concerned a dispute between a carrier, MSC, and a shipper, Cottonex, in respect of demurrage on 35 containers used for the carriage of raw cotton from Bandar Abbas and Jebel Ali to Chittagong. Cottonex engaged MSC to transport the cotton in three consignments under five bills of lading. Each of these bills of lading contained a clause providing for a period of free time for the use of the containers at their destination, after which demurrage became payable at a daily rate.

In the time it took to ship the consignments to their destination, the price of cotton collapsed and the consignee refused to accept the goods. Cottonex received payment for the consignments by presenting its documents to a bank which had opened a letter of credit in its favour and subsequently argued that it had no right to deal with the goods as property in them had passed to the consignee.

The bills of lading contained terms which under certain circumstances gave MSC the right to unpack the goods and dispose of them. However, the customs authorities at Chittagong refused to allow anybody to deal with the containers without permission from the court. Consequently, nobody was able to take delivery of the goods or dispose of them. At the time of the Court of Appeal judgment, it was understood that the cotton was still at the dock.

Under the terms of the bills of lading, demurrage would become payable at a daily rate of US$840 a day upon the expiry of the period of free time for the use of the containers. The continued impasse meant that the period expired, and MSC claimed demurrage of US$577,184, which was said to be still accruing at the daily rate during the appeal.

The case mostly dealt with the right to affirm in the context of repudiatory breach. However, in its decision the Court of Appeal took the opportunity to make some observations on remarks made by Mr Justice Leggatt in deciding the case at first instance.

The High Court had held that MSC was not entitled to keep a contract alive indefinitely for the purpose of claiming ongoing demurrage following Cottonex's repudiatory breach. The High Court had further held that an innocent party's decision to terminate or affirm a contract after a counterparty's repudiatory breach, akin to a contractual discretion, must be exercised in good faith and must not be exercised arbitrarily, capriciously or unreasonably.

In his Court of Appeal judgment, Lord Justice Moore-Bick stated that he did not believe there was any justification in applying principles of good faith when considering whether an innocent party had a legitimate interest in affirming a contract following a repudiatory breach. He noted that the:

"recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences"

He continued that in his view:

"the better course is for the law to develop along established lines than to encourage judges to look for what the judge called in this case 'some general organising principle' drawn from cases of disparate kinds".

The Judge concluded with the warning that there was:

"a real danger that if a general principle of good faith were established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement".

The approach taken by the Court of Appeal appears to be one that seeks to limit what Lord Justice Moore-Bick fears might otherwise be an opening of floodgates to claims which undermine express terms agreed between parties.

The judgment makes it clear that there is no general organising principle of good faith in English law and effectively curtails the line of authority that began with the decision in *Yam Seng*.

Conclusion

In circumstances where a party argues that an implied term based on the concept of good faith applies, the term would still need to meet strict implications tests.[14] In practice this means that a term of this nature would be unlikely to be implied unless a party could properly demonstrate that the contract would lack commercial or practical coherence without it.

In light of the above, if a party wants to rely on a good faith obligation in a contract, it should expressly provide for one. Where a party chooses to do this, it is important that the scope and substance of that obligation is made clear to avoid any ambiguity as to what it means or to which provisions of the contract it applies. Certainty is key. Parties should remember that good faith will not trump an absolute contractual right.

"the implication of a duty of good faith will only be possible where the language of the contract, viewed against its context, permits it"

1 The Court of Appeal's decision in *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2016] EWCA Civ 789
2 For example, French, German and UAE Civil Codes
3 *Bhasin v Hrynew* 2014 SCC 71
4 *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* (trading as Medirest) [2013] EWCA Civ 200. It should be noted that duties of good faith are relevant in the context of certain kinds of contracts, such as contracts of agency, insurance, employment and contracts with consumers; however, these are beyond the scope of this article
5 [1989] QB 433
6 *Marks and Spencer Plc v BNP Paribas Security Services Trust Company* (Jersey) Limited [2015] UKSC 72
7 [2013] EWHC 111 (QB)
8 *Bristol Groundschool Limited v Whittingham* [2014] EWHC 2145 (Ch); D&G Cars Ltd v Essex Police Authority [2015] EWHC 226 (QB)
9 *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2015] EWHC 283 (Comm)
10 *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* (trading as Medirest) [2013] EWCA Civ 200
11 *MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2016] EWCA Civ 789
12 [2016] EWCA Civ 396
13 [2013] EWCA Civ 200
14 *Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72

Contractual preconditions to arbitration under FIDIC: Dubai 2016

The Dubai Court of First Instance in a recent ruling (Commercial Case 757 dated 15 August 2016) has confirmed the principle that recourse to the Engineer for a decision under clause 67 FIDIC is a pre-condition to the validity of the arbitration. The judgment does not appear to specify which FIDIC Standard Form; however, from reading it appears to be the modified version of the FIDIC Red Book fourth edition.

Heba Osman explains more.

Summary of facts

The Claimant in this case was a contractor who entered into a construction contract (most likely a FIDIC Red Book fourth edition) with the Respondent for the construction of a factory and its associated buildings (the "*Project*"). The value of the contract was approximately AED 48 million and the Claimant submitted a performance bond amounting to 10% of the value of the contract. Limited information is currently available from the judgment however it is understood that the Claimant completed the works and handed over the Project to the Respondent.

It is also understood that the Respondent failed to make certain payments to the Claimant and refused to release the performance bond as required under the terms of their contract. However, the judgment does not state the reasons or the grounds on the basis of which the Respondent refused to make the payments to the Claimant and/or release the performance bond.

However, on the basis of the Respondent's failure, the Claimant filed an arbitration case in accordance with clause 67 of the FIDIC contract before the Dubai International Arbitration Centre ("*DIAC*"), which appointed the arbitrator. The parties and the arbitrator then signed Terms of Reference. It is understood that the Terms of Reference did not contain any provision indicating that the Respondent waived its right to challenge the arbitral award on the basis that the dispute was not referred to the Engineer; on the contrary, it appears that the Respondent did raise a jurisdictional objection due to the lack of referral to the Engineer.

The arbitral award was issued on 9 March 2016 obliging the Respondent to pay the Claimant an amount of AED 7.3 million along with interest, arbitration costs and legal fees.

The Claimant then filed a case before the Dubai Court of the First Instance seeking, inter alia, the enforcement of the arbitral award. The Respondent filed a counterclaim seeking the annulment of the arbitral award.

The Respondent's grounds for the annulment of the arbitral award included the Claimant's failure to refer the dispute for the Engineer's decision in accordance with clause 67. As a consequence of this, the Respondent submitted that the arbitration had been filed prematurely.

In particular, the Respondent submitted that clause 67 had set a mechanism, (which the Claimant had failed to follow) for the settlement of disputes prior to an arbitration which required that:

(i) there be a dispute between the parties;

(ii) the dispute had not been resolved amicably; and

(iii) the dispute had been referred to the Engineer for a decision to be issued within 84 days from its referral.

The court decision

Before making its decision, the Dubai court recited the following principles:

(i) In accordance with the general principles of contract, arbitration is a contract between the parties and therefore it is permissible for the parties to this contract to include pre-conditions that must be fulfilled prior to arbitration being commenced.

As such, if any of these conditions are not satisfied or fulfilled then it is not possible to resort to arbitration. This is in line with the established legal principle that the contract is the law of the parties.

(ii) The principle that the contract is the law of the parties does not prevent these same parties, either after entering into the agreement or at any time, from expressly or impliedly amending the terms of their arbitration agreement as these agreements are not part of the public order.

(iii) It is an established principle that the parties to a contract are entitled to decide on the types of disputes in respect of which recourse to arbitration can be made.

The parties are not obliged to utilise arbitration for all disputes that may arise between them. Moreover, since arbitration is an exception to the original jurisdiction of the courts, arbitration agreements must be narrowly construed in a manner that does not exceed the intent of the parties.

Applying these principles, the Dubai Court of First Instance was of the view that the parties had agreed that certain disputes arising between them may be referred to arbitration.

These disputes were the disputes which had been (i) referred to the Engineer for a decision but had not become final and binding (clause 67.1) or (ii) referred to the Engineer for a decision and have become final and binding but one of the parties failed to comply with the Engineer's decision (clause 67.4).

The Court, therefore, concluded that the parties' agreement was that it was essential that a dispute be first referred to the Engineer before the parties can proceed to arbitration.

The Court then ordered the annulment of the arbitral award on the basis that the Claimant had produced no evidence showing that the dispute was ever referred for the Engineer's decision under clause 67.

Commentary

This is a decision from the Dubai Court of First Instance and is therefore still subject to appeal. However, this decision shows a consistency in the Dubai Court's position that clear pre-conditions contained in multi-tier dispute resolution clauses must be respected by the parties.

This position, nonetheless, is to be contrasted with a decision from the Dubai Court of Cassation last year in which that Court did not accept a provision requiring amicable settlement to be attempted prior to resorting to arbitration as a pre-condition.

In particular, the Dubai Court of Cassation found that if the agreement does not offer guidance as to how this amicable settlement should be approached or set out any specific steps for this amicable settlement, and a party proceeds to arbitration, then it is deemed that the amicable settlement attempts have failed.

The importance of considering the specific requirements of an arbitration clause cannot be overemphasised. It is not in any claimant's interest to commence arbitration proceedings and expend time and money to end up with an annulled arbitration award due to the failure to follow a procedural step, especially when this could have been avoided from the start.

Parties contemplating arbitration should, before commencing any arbitration proceedings, carefully review the wording of the full dispute settlement or arbitration provision contained in their agreement.

In particular, a simple check-list would include:

- Ensure that the arbitration agreement itself is binding (i.e. signed by the authorised persons);
- Check if the arbitration agreement can in fact be applied (for example: it actually refers to arbitration rather than to the court);
- Consider carefully the pre-conditions contained in the provision. Is there a requirement to submit the dispute to an Engineer or a Dispute Adjudication Board ("*DAB*")?
- Is there a time limit for submitting the dispute? When can arbitration be commenced?
- Is there a requirement for amicable settlement or referral to senior management following the Engineer's or DAB's decision?
- Is the other party a governmental entity or some other entity subject to a special law that sets specific requirements prior to commencing arbitration?

Whatever the requirements of the arbitration clause, it is important to comply with these provisions even if the other party is uncooperative. The central question before a court enforcing the arbitral award (or a tribunal considering whether it has jurisdiction or not) will be whether or not the party has attempted to comply with the requirements of the arbitration agreement.

An example of a party failing to do this came about in 2014 in the Swiss courts:

> *"In this respect, considering the circumstances germane to the case at hand... they cannot be criticized for failing to denounce the Respondent's failure to sign the DAA from the point of view of the rules of good faith. Pursuant to these rules and considering the process of constitution of the DAB, it is indeed impossible to blame the Respondent for losing patience and finally skipping the DAB phase despite its mandatory nature in order to submit the matter to arbitration"* [1]

1 Decision 4A_124/2014 of the Swiss Supreme Court

Formation of subcontracts and time bar clauses

Today, notices and time bar provisions are found in most construction contracts. As Edward Colclough highlights, the 2016 case of *Commercial Management (Investments) Ltd v Mitchell Design and Construct Ltd & Anor*[1] provides a useful insight into the enforceability of time bar provisions and highlights the confusion that can often exist when trying to identifying the applicable terms and conditions to a subcontract.

Here, the main contractor ("*Mitchell*") was engaged to design and build a warehouse in Erith, Kent. Mitchell appointed a ground works subcontractor ("*Regorco*") to carry out certain ground treatment works, known as vibro compaction, at the site. Ten years following practical completion, the tenant of the warehouse complained of settlement of the slab beneath the warehouse production area.

When the claims came to court, as a preliminary issue, the court had to determine:

(i) which terms and conditions formed the subcontract between the parties; and

(ii) if Regorco's time barring clause, contained within its standard terms and conditions, complied with the Unfair Contract Terms Act 1977 ("*UCTA*").

Terms and Conditions of the subcontract

Mitchell stated in its invitation to tender that the subcontract terms were to be the JCT Standard Form of Contract (DOM/2). In response, Regorco provided an estimate for carrying out the subcontract works stating that such works would be undertaken on its own standard terms – which included a time barring clause. Mitchell later issued Regorco with a letter of intent instructing them to proceed to keep the project on programme.

The letter made no reference to the terms governing the subcontract. Following completion of the works, Mitchell issued a purchase order to Regorco to finalise the contractual paperwork. This purchase order now sought to incorporate Mitchell's own standard terms and conditions to govern the subcontract. Regorco returned and counter-signed the purchase order, but only after having made various manuscript amendments to the document. The key amendment was that Regorco accepted that Mitchell's terms and conditions governed the subcontract "*where applicable otherwise [Regorco's standard terms and conditions] apply*".

The Judge took particular note of the fact the director of Regorco had required his own company's terms and conditions to be blown up in A3 for ease of reference at the hearing. The clause clearly formed part of the "small print".

In assessing the many conflicting provisions between the parties, Mr Justice Edwards-Stuart applied the established principle of the "*battle of the forms*" (i.e. the last party to put forward terms and conditions that are not explicitly rejected wins). In doing so, he found that the purchase order issued by Mitchell was not an acceptance of Regorco's estimate, not least because it sought to introduce Mitchell's standard terms and conditions into the subcontract.

The subcontract terms were only considered to be agreed between the parties once the purchase order was counter-signed and returned with the manuscript amendments and the manuscript amendments were reviewed by Mitchell who decided to take no further action.

Although Regorco's manuscript amendments formed part of the subcontract, the time bar clause could not be read alongside Mitchell's standard terms and conditions as it attempted to curtail the indemnities given by Regorco under Mitchell's terms and conditions.

Conclusion

Having spent time and money negotiating a main contract with an employer, it is surprising how contractors can treat agreeing the subcontract terms as an afterthought. This case is a prime example.

The subcontract was finalised after the works were completed, there were numerous conflicting standard terms, purchase orders, letters of intent, correspondence and contract documents exchanged between the parties that provided little clarity as to what formed the subcontract between the parties. This contractual uncertainty was no doubt assisted by the fact the contractor and subcontractor had previously worked together and were probably working under the expectation that "*everything would work out like last time*".

It would have been in the interests of both parties to have had the contractual terms agreed and clearly documented at the outset. The Judge noted that the contractor was put in a difficult position by having to negotiate the subcontract after practical completion. This forced it to make concessions it would not have done, had the subcontract been agreed early on.

The case serves as a reminder of the importance of ensuring parties are aware of the applicable contractual terms and conditions in play between them. It also provides a warning to carefully review any last minute amendments to contractual

1 [2016] EWHC 76 (TCC)

documents. As seen, the last amendments made and not expressly rejected were deemed to be incorporated.

Time barring clause

Time barring clauses can provide a party with a complete defence to what would otherwise be a perfectly valid claim. The clause Regorco sought to incorporate through its standard terms and conditions looked to provide such a defence to the claim against it:

"All claims under or in connection with this Contract must in order to be considered as valid be notified to us in writing within 28 days of the appearance of any alleged defect or of the occurrence (or non occurrence as the case may be) of the event complained of and shall in any event be deemed to be waived and absolutely barred unless so notified within one calendar year of the date of completion of the works."

The clause required the notification of any claim for defective works to be made in writing within 28 days of the appearance of the defect, and in any event, to be notified within one calendar year of completion of the works. The clause expressly noted that failure to do so would result in any claim being time barred.

Did UCTA apply?

Section 1 of UCTA provides that a person cannot restrict his liability for negligence "*except in so far as the term or notice satisfies the requirement of reasonableness*". Liability for death or personal insuring resulting from negligence can never be excluded.

Here, the court considered whether the above clause might have been subject to the provisions of UCTA on the basis it formed part of the written standard terms of business of one of the parties. The court concluded that it did and UCTA applied. In reaching its decision, it found the time bar clause was part of Regorco's standard terms of business even though the clause was only ever intended to be partially incorporated into the subcontract.

UCTA is intended to govern the practice of companies offering and relying on terms and conditions in the hope that the other party will not take any notice of them or regard them as non-negotiable. The time bar clause was found to be part of Regorco's standard terms of business and therefore subject to the provisions of UCTA.

The Judge took particular note of the fact that the director of Regorco had required his own company's terms and conditions to be blown up in A3 for ease of reference at the hearing. The clause clearly formed part of the *"small print"*.

UCTA – Reasonableness Test?

Having found that the clause would have been subject to UCTA, the Judge went on to provide some useful observations on the requirement of reasonableness as defined under section 3(2) of UCTA which states that:

"(2) As against that party, the other cannot by reference to any contract term—

(a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or

(b) claim to be entitled—

(i) to render a contractual performance substantially different from that which was reasonably expected of him, or

(ii) in respect of the whole or any part of his contractual obligation, to render no performance at all, except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness."

The clause was distinguished from the time bar imposed by the FIDIC Red Book on the basis that FIDIC drafting requires a contractor, who wishes to claim an extension of time or additional payment, to give notice as soon as practicable, and not later than 28 days after he becomes aware, or should have become aware, of the event or circumstance giving rise to the entitlement. The FIDIC drafting was reasonable on the basis that:

(i) contractors generally know when a contract is in delay or whether the work has been disrupted and so giving notice of the relevant event within 28 days should not be unduly onerous; and

(ii) time starts running from when the contractor knew or ought to have known about the event.

In contrast, Regorco's time bar clause:

(i) applied to events after the parties were off site and to concealed works; and

(ii) time started to run from the date the defect appeared and not from when the other party knew or ought to have known about it.

Mr Justice Edwards-Stuart concluded that the clause was not reasonable given the nature of groundworks undertaken by Regorco:

"It is, in my experience at least, rare for a failure of ground or piles to manifest itself in a period measured in months, rather than in years. Of course, there may be exceptional cases when the design or construction is so poor that failure occurs almost immediately upon loading, but I cannot recall such a case. In this case, the lapse of time was in excess of 10 years: whilst I would not suggest that such a long period is normal, it is more of the order that one would expect."

In these circumstances, it was concluded that it would not be reasonable to expect that the contractor should comply with the 28 day time limit, or one year long stop, imposed for bringing a claim for such defects. As a result, the clause would have been struck out under UCTA.

Conclusion

The case is a useful reminder that standard terms in a business to business contract will be subject to UCTA's reasonableness requirement, even if such terms are dissected or incorporated only in part by parties. Any limitations or exclusions contained within a business's standard terms must be reasonable in the circumstances to be enforceable under UCTA.

A time bar which ran from the date of an event (not knowledge of the other party) and provided a short timeframe to bring a claim in relation to concealed works (i.e. groundworks) was found, in the circumstances, not to be reasonable.

Mr Justice Edwards-Stuart concluded that:

"the parties would not reasonably have expected – if they had thought about it – that compliance with both the 28 day time limit and the requirement to make a claim within a year would be achievable, let alone practicable, save in rare cases."

Anti-oral variation clauses: are they enforceable?

Anti-oral variation clauses are often found in contracts. The idea behind them is to prevent the parties to that contract from making any subsequent changes to the agreement unless those changes are mutually agreed in writing and signed by the parties. In other words, those parties are trying to prevent themselves from becoming bound by informal ad hoc verbal (or even email) exchanges.

As Reyhan Yilmaz explains, these clauses have been the subject of a number of Court decisions in 2016, where the Court of Appeal had to weigh the apparent certainty given by these clauses against more traditional freedom of contract principles.

Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd[1]

Here, the appellants, TRW Lucas Varity Electric Steering Ltd ("*Lucas*"), produced electric power-assisted steering systems ("*EPAS*") for cars. The first respondent, Globe Motors ("*Globe*"), designed and manufactured component parts of the EPAS system.

In June 2001, Lucas entered into a long term contract with Globe to purchase electrical motors ("*Agreement*"). The Agreement applied not only to the products identified in it, but also to products that "*could and would have been produced by Globe making 'Engineering Changes' to the Products identified in the Agreement and detailed specification*". Globe Motors Portugal, the second respondent, was not a named party to the Agreement but supplied Gen 1 motors to Lucas.

On 23 February 2003, Lucas appointed a third party, Emerson, as the sole supplier for the development and production of second generation motors, known as Gen 2 motors. From around 2005, Lucas purchased around three million Gen 2 motors from Emerson. Globe commenced proceedings for breach of contract against Lucas on 1 June 2011.

Decision at first instance

In 2014, HHJ Mackie QC in the High Court considered that Lucas's purchase of Gen 2 motors from another manufacturer was a breach of the exclusivity agreement between Lucas and Globe. Six issues were raised by Lucas on appeal, of which two are important:

- Whether the Agreement covered not only the products identified in it, but also the Gen 2 motors bought from Emerson to the extent that they "*could and would have been produced by Globe...*"
- Whether the Agreement was varied by conduct so that Globe Motors Portugal became a party to the Agreement (and therefore had a right of action against Lucas) in circumstances where Article 6.3 of the Agreement expressly required that any agreement had to be recorded in writing and signed by the parties:

Article 6.3 of the Agreement provided that:

"6.3 Entire Agreement; Amendment: This Agreement, which includes the Appendices hereto, is the only agreement between the Parties relating to the subject matter hereof. It can only be amended by a written document which (i) specifically refers to the provision of this Agreement to be amended and (ii) is signed by both Parties."

> *"What is excluded by one act, is restored by another. You may put it out by the door, it is back through the window. Whenever two men contract, no limitation self-imposed can destroy their power to contract again..."*

Arguments before the Court of Appeal

The Court of Appeal held that the first instance had erred in finding that the term "*Products*" extended to improved second generation motors that "*could have would have been produced by Globe making 'Engineering Changes' to Products that were within the Agreement*". Accordingly, Lucas was not in breach of contract for buying such motors from a third party. Therefore, strictly the question as to whether Globe Motors Portugal became a party to the Agreement became irrelevant. However, due to the importance of this issue, the Court of Appeal went on address this point.

Lucas argued that the requirement in Article 6.3 meant that any amendment had to be in writing and signed by both parties and it was not open to the parties to amend the agreement orally. It relied on the Court of Appeal's decision in *United Bank Ltd v Asif*.[2] Lucas submitted that an anti-oral variation clause "*promotes certainty and avoids false or frivolous claims*" of an oral agreement and that such clauses can prevent parties from producing evidential documents that is inconsistent with such a clause and that it sets an evidential threshold.

Lucas, however, was unable to point to a common law principle that restricted the freedom of the parties to agree the terms of a contract and/or one which precluded an oral agreement where it was subject to another agreement which contains an anti-oral variation clause.

The Court of Appeal also had to consider the approach in a conflicting appellate Court decision in *World Online Telecom v I-Way Ltd*[3] where it was decided that notwithstanding an anti-oral variation clause, the conditions in the contract in that case had been varied by oral agreement. The reasoning here was fuller reasoning than the United Bank case and the unsuccessful respondent in the World Online case had accepted that the purpose of an anti-oral variation clause "*is not to prevent recognition of oral variations*" but only to prevent "*casual and unfounded allegations*" of variation.

The Court of Appeal decision

The Court of Appeal, albeit with some hesitation, decided to adopt the approach in the World Online Telecom case which recognised that a contract can be varied by oral agreement or by conduct notwithstanding the existence of an anti-oral variation clause.

Article 6.3 did not prevent the parties from varying the Agreement orally in any other informal manner. The principle of freedom of contract entitled the parties to freely agree the terms subject to public policy restrictions. The Court of Appeal found that Article 6.3 was waived as it was "*overwhelmingly clear*" on the basis of *"open, obvious and consistent*" dealings that the parties acted for a long period of time as if Porto was a contracting party to the Agreement. Whether or not it is possible for parties to vary an agreement without a requirement such as that in Article 6.3 depends on the facts of each case, and "*to decide so otherwise would be inconsistent with the principles of freedom of contract*".

The Court of Appeal, however, took pains to emphase that it does not follow that clauses like Article 6.3 have no value at all. In many cases, parties would be unable to rely on informal communications or course of dealings in order to modify their obligations.

Further Cases

Like London buses, you wait 15 years for a case on anti-oral variations and then three come along at once. Shortly after the Globe decision, the same issue came up before the Court of Appeal in the case of *MWB Business Exchange Centres Ltd v Rock Advertising Ltd.*[4] Here the Court also considered whether the variation was supported by consideration for a variation to be valid and found that it had. Lord Justice Kitchen in his judgment referred to the words of Cardozo J nearly 100 years ago in the New York Court of Appeal in *Alfred C Beatty v Guggenheim Exploration Company* (1919) 225 NY 380 where he said that:

"Those who make a contract, may unmake it. The clause which forbids a change, may be changed like any other. The prohibition of oral waiver, may itself be waived... What is excluded by one act, is restored by another. You may put it out by the door, it is back through the window. Whenever two men contract, no limitation self-imposed can destroy their power to contract again..."

The Court of Appeal decisions were then followed in the TCC case of *ZVI Construction v The University of Notre Dame*[5] where there was also a clause in the contract stating that it could not be varied unless the agreement to vary was in writing and signed. Following the Globe and MWB cases, the Judge simply accepted that the parties could vary the contract in other ways.

Conclusion

These decisions are welcome as they clarify the two substantially inconsistent Court of Appeal authorities on this topic. The cases serve to reduce uncertainty about the enforceability of agreements varied orally or by conduct. They further reaffirm the long-standing freedom of contract principle that parties have a continuing liberty to agree what they like. Therefore, where there is an anti-oral variation clause that is designed to stop parties from varying it other than in writing in accordance with the contract, the parties are still free to vary that particular term either orally or by conduct.

Practical tips

It is important to note that the Court of Appeal in the *Globe* case did acknowledge that anti-oral variation clauses have practical benefit and promote certainty between the parties and that it did not follow that anti-oral variation clauses had no value at all. Indeed, Lord Justice Underhill commented that:

"In many cases, parties intending to rely on informal communications and/or a course of conduct to modify their obligations under a formally agreed contract will encounter difficulties in showing that both parties intended that what was said or done should alter their legal relations; and there may also be problems about authority. Those difficulties may be significantly greater if they have agreed to a provision requiring formal variation."

Parties should therefore still be take care to ensure they set out, sign and document any variation in order to avoid any dispute about what was agreed and not agreed to be varied.

1 [2016] EWCA Civ 396
2 11 February 2000
3 [2002] EWCA Civ 413
4 [2002] EWCA Civ 413
5 [2016] EWHC 1924 (TCC)

Interpreting contracts and implying terms: the approach of the Supreme Court

In the preceding article, Reyhan Yilmaz looked at anti-oral variation clauses, which are designed to limit the ability of parties to make subsequent changes to their agreement. Lord Justice Beatson had said in the *Globe Motors*[1] case highlighted by Reyhan that:

"The professed object of a common law court in interpreting or construing a written contract is to discover the mutual intention of the parties."

Jeremy Glover takes a look at what the Supreme Court has said about how parties should go about interpreting their contract.

"there is no principle of interpretation which entitles a court to re-write a contractual provision simply because the factor which the parties catered for does not seem to be developing in the way in which the parties may well have expected."

The seven principles for contract interpretation

At the end of 2015, the Supreme Court, in the case of *Arnold v Britton*,[2] considered the court's approach to the principles of contract interpretation. Lord Neuberger emphasised seven issues which were key to interpreting the contract in question. The seven factors were:

(i) the reliance placed on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed;

(ii) the less clear the relevant words are, or the worse their drafting, the more ready the court can properly be to depart from their natural meaning;

(iii) commercial common sense is not to be invoked retrospectively;

(iv) a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight;

(v) when interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties;

(vi) in some cases, an event subsequently occurs which was plainly not intended or contemplated by the parties, judging from the language of their contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention; and

(vii) service charges are not subject to any special rules of interpretation.[3]

Previously, in the case of *Kookmin Bank v Rainy Sky SA*,[4] the Supreme Court had had to consider how to interpret a bond. Should it adopt a literal or common sense approach? Lord Clarke quoted with approval from the dissenting Court of Appeal judgment of Sir Simon Tuckey:

"As the Judge said, insolvency of the Builder was the situation for which the security of an advance payment bond was most likely to be needed. The importance attached in these contracts to the obligation to refund in the event of insolvency can be seen from the fact that they required the refund to be made immediately. It defies commercial common sense to think that this, among all other such obligations, was the only one which the parties intended should not be secured. Had the parties intended this surprising result I would have expected the contracts and the bonds to have spelt this out clearly but they do not do so."

Therefore, the buyer's construction was to be preferred because it was consistent with the commercial purpose of the bonds in a way in which the bank's construction was not. However, parties must take care not to place too much emphasis on "*commercial common sense*" at the expense of the actual words used. Lord Neuberger noted at item four of his list of seven principles that:

"while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a Judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party."

Therefore, whilst the *Arnold* case should not be taken as signalling any change in the approach of the courts, it does confirm that the starting point for contract interpretation is always the plain words of the contract in question. Lord Neuberger held that the court was:

"concerned to identify the intention of the parties by reference to 'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean'... and it does so by focussing on the meaning of the relevant words... in their documentary, factual and commercial context."

Implied terms of contract

Terms can be implied into a contract as a matter of law (for example through statute, say the Supply of Goods and Services Act) and as a matter of fact. The second approach includes terms implied by the "*business efficacy*" or "*officious bystander*" tests. In 1977 in the case of *Liverpool City Council v Irwin*[5] Lord Wilberforce had noted that ultimately the test was one of necessity: is the implied term necessary to make the contract work? Lord Neuberger also made a number of interesting comments in the case of *Marks & Spencer v BNP Paribas* where he considered the test for the implication of terms. Unsurprisingly, he adopted a similar approach to the *Arnold v Britton* case.

The *Marks & Spencer* case related to a claim by a tenant who argued that a term should be implied into a lease to the effect that certain advance payments relating to a period after the lease ended should be refunded. It is important because the Supreme Court took the opportunity to clarify the legal test for implying terms into contracts and also to comment upon what the following words of Lord Hoffman in the 2009 case of *Attorney General of Belize v Belize Telecom* actually meant:

"There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"

Whilst the Supreme Court confirmed that the judgment was not to be read as involving any relaxation of the traditional, highly restrictive approach to the implication of terms, Lord Neuberger stressed that these words did not mean that Lord Hoffman was suggesting that reasonableness alone was a sufficient ground for implying a term. Indeed, because the Supreme Court considered that some had wrongly suggested that this was what Lord Hoffman had meant, Lord Neuberger noted that these words should be treated as observations and:

"characteristically inspired discussion rather than authoritative guidance on the law of implied terms".

This led the Supreme Court to restate the law on the implication of terms. There are two types of contractual implied term. The first, with which this case was concerned, is a term which is implied into a particular contract, in the light of the express terms, commercial common sense, and the facts known to both parties at the time the contract was made. The second type arises because, unless such a term is expressly excluded, certain statutes can impose certain terms into contracts – for example through the Supply of Goods & Services Act 1982.

In relation to the first type of implied term, the Supreme Court went back to the 1977 Privy Council case of *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings*,[6] where Lord Simon said that for a term to be implied, the following five conditions must be satisfied:

"(i) it must be reasonable and equitable;

(ii) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;

(iii) it must be so obvious that 'it goes without saying';

(iv) it must be capable of clear expression; and

(v) it must not contradict any express term of the contract."

Lord Neuberger added six comments to those principles:

(i) The implication of a term was "*not critically dependent on proof of an actual intention of the parties*" when negotiating the contract. If you approach the question by reference to what the parties would have agreed, what matters is not the hypothetical answer of the actual parties, but the answer of notional reasonable people in the position of the parties at the time at which they were contracting.

(ii) A term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary but not sufficient grounds alone for including a term.

(iii) It was questionable whether Lord Simon's first requirement (reasonableness and equitableness) will usually, if ever, add anything. If a term satisfied the other requirements, it was hard to think that it would not be reasonable and equitable.

(iv) Business necessity and obviousness can be alternatives in the sense that only one of them needs to be satisfied, although the Judge suspected that in practice it would be a rare case where only one of those two requirements would be satisfied.

(v) If one approaches the issue by reference to the officious bystander, it is vital to formulate the question to be posed by that bystander with "*the utmost care*".

(vi) The necessity for business efficacy involves a value Judgement. A more helpful test would be that a term can only be implied if, without the term, the contract would lack commercial or practical coherence.

The Supreme Court said that in most, possibly all, disputes about whether a term should be implied into a contract, it is only after the process of construing the express words is complete that the issue of an implied term falls to be considered. Until you have decided what the parties have expressly agreed, it is difficult to see how you can decide whether or not a term should be implied and, if so, what term. Remember that no term can be implied into a contract if it contradicts an express term.

Therefore when deciding whether or not a term can be implied as a logical starting point, you cannot proceed to decide whether a term should be implied until the express terms of a contract have been considered and understood.

"it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice"

Applying the *Marks & Spencer* case to adjudication

Mr Justice Edwards-Stuart applied this decision in the case of *Manor Asset Ltd v Demolition Services Ltd*[7] when he had to consider when the final date for payment was. As part of the contract arrangements, the parties had agreed that the contractor's invoice (which would stand as payment notice) had to be served immediately after reaching the corresponding milestone, and the final date for payment was only 72 hours after the invoice was served. The problem was that the contract also required that any payless notice was served up to five days before the final date for payment, in other words before the invoice was served. This was not only technically impossible but also understandably prohibited by the HGCRA. The same problem would arise if the Scheme was said to apply. The Judge began by noting that:

"I shall therefore approach Lord Hoffman's observations in Belize Telecom in the light of the qualifications made by Lord Neuberger in Marks & Spencer. However, the overriding point to be borne in mind is that before implying any term the court must conclude that the implication of that term is necessary in order to give business efficacy to the contract or, to put it another way, it is necessary to imply the term in order to make the contract work as the parties must have intended."

When considering the true construction of the amendment to the contract, he said:

"65. The only solution to this problem that I can identify is the one that I mentioned to counsel both at and following the hearing, namely that when making the amendment the parties impliedly agreed that the prescribed period was to be reduced to nil. Thus MAL could issue a payless notice at any time before the final date for payment: that is to say, within the 72 hour period between receipt of the invoice and the final date for payment 72 hours later.

…

71. Faced with a stark choice between rendering the amendment wholly ineffective or enabling it to work, the parties must surely have intended the latter... The only way in which it can be made to work, whether by so construing the contract or implying a term, is to say the prescribed period was to be nil – thus enabling MAL to serve a payless notice at any time within 72 hours after receipt of the invoice. In my judgment such an agreement is necessary and it is not inequitable...

72. I therefore declare that, as a result of the amendment, the final date for payment is 72 hours after receipt by MAL of [Demolition Services] invoice following achievement of a milestone."

The Judge concluded that the decision reached by the adjudicator that MAL's notice of 28 October 2015 was not a valid payless notice was correct, albeit for the wrong reasons, and accordingly the breach of natural justice had not had a material effect on the outcome of the adjudication.

Whilst it is tempting to suggest that this case may well give rise to more arguments in the future about implied terms in contractual payment mechanisms, that is unlikely. This case was an unusual one, and the solution proposed by the Judge was itself an unusual one as it was not one considered previously by the parties.

Conclusions

The Supreme Court in the *Marks & Spencer* case effectively endorsed the traditional approach to the implication of terms. What matters, as Mr Justice Edwards-Stuart said, is whether or not it is necessary to imply the term in order to make the contract work as the parties must have intended. This means that a term will not be implied into a detailed construction contract simply because it appears fair or because the court considers that the parties would have agreed it, had it been suggested to them.

And you cannot begin to consider whether or not to imply a term into a contract until the express terms of the contract have been construed or interpreted. One of the key points to come out of the decision of more or less the same panel of Supreme Court Judges in the *Arnold* case was that where the contractual wording is clear, the courts are reluctant to depart from that clear and plain meaning and consider principles of commercial good sense. Lord Neuberger said:

"there is no principle of interpretation which entitles a court to re-write a contractual provision simply because the factor which the parties catered for does not seem to be developing in the way in which the parties may well have expected."

"while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight."

1 *Globe Motors Inc and others v TRW Lucas Varity Electric Steering Ltd and others* [2016] EWCA Civ 396
2 [2015] UKSC 35
3 The dispute in question was over the construction of a lease
4 [2011] UKSC 50
5 [1977] A.C. 239
6 [1977] UKPC 13, 26
7 [2016] EWHC 222 (TCC)

Liquidated damages following *Cavendish*

On 4 November 2015, the Supreme Court handed down judgment in joint appeals relating to *Cavendish Square Holdings Ltd v Talal El Makdessi* (the "*Cavendish Appeal*") and *ParkingEye Ltd v Beavis* (the "*Beavis Appeal*")[1]. These appeals provided the first opportunity for the Supreme Court, or the House of Lords, to consider the law concerning penalty clauses in approximately 100 years.

The two appeals related to non-construction-related disputes. The *Cavendish* Appeal concerned the effect of two clauses related to non-compete covenants in an agreement regarding the sale of a controlling stake in business. The *Beavis* Appeal concerned the enforceability of a parking fine.

As Andrew Weston sets out below, the Supreme Court judgment is relevant to construction contracts as it impacts upon the law relating to liquidated damages.

The most important proposition of law impacting on liquidated damages provisions typically found in construction contracts is derived from the leading judgment of Lord Dunedin in *Dunlop Pneumatic Tyre Company Ltd v New Garage Motor Co Ltd* (1915).[2]

Following *Dunlop* the test commonly applied was: are the liquidated damages a genuine pre-estimate of the loss (rendering the clause compensatory)? If so, the clause was unlikely to be regarded as a penalty. However, if the amount of liquidated damages bore absolutely no resemblance to the loss, was extravagant and unconscionable, and was intended to deter a breach of contract, the court would be more willing to construe it as an unenforceable penalty.

As a consequence, an employer did not need to prove that it had actually suffered the loss covered by the liquidated damages provision. The liquidated damages could be recovered even if its actual loss was lower, providing they represented a genuine pre-estimate of the loss. If not, the provision was open to challenge on the basis it was a penalty clause, and not recoverable as a matter of law.

The *Cavendish* Appeal

Mr Makdessi agreed to sell a controlling stake in the largest advertising group in the Middle East to Cavendish. The terms of a share sale agreement ("*the Agreement*") contained restrictive covenants requiring Mr Makdessi not to become involved in a competing business. The sanctions for default were that Mr Makdessi would:

(i) forfeit the balance of price payable by Cavendish for his shares; and

(ii) be required to transfer all his remaining shares to Cavendish at a price which excluded any goodwill value.

Mr Makdessi accepted he had breached the restrictive covenants, but he denied the clauses were enforceable on the basis they were penalties.

At first instance, Mr Justice Burton found that the purpose of the restrictive covenants was not to deter a breach of contract, but to adjust the consideration between the parties. Cavendish was entitled to assess the value of a breach of the restrictive covenants by reference to the greatest loss that could conceivably be proved to have followed from the breach, given the potential for a substantial impact on the goodwill of Cavendish's business. Accordingly, the clauses were not

1 [2015] UKSC 67
2 AC 79 ("*Dunlop*")

found to be penalty clauses. Mr Makdessi appealed.

The Court of Appeal reviewed the law on penalties. It noted that the purpose of a penalty clause was to deter breaches of contract, and a clause would only be a penalty if it was "*extravagant*" and "*unconscionable*". Reference was also made to the more flexible approach taken in cases since *Dunlop* and focused on the dominant purpose of such clauses. It concluded that if the dominant purpose of a clause was to deter a breach of contract, and the amount of the sanction was commercially justified, then it was not a penalty clause.

Is it still the case that a liquidated damages clause will only be a penalty if it is "extravagant" or "unconscionable"?

The Court of Appeal upheld the appeal, finding that the two clauses were unenforceable penalty clauses intended to deter a breach of contract. It was found the provisions did not reflect a genuine pre-estimate of loss, were extravagant and unreasonable compared with the likely damage arising from the breach, and had no commercial justification. As a result, they were unconscionable. Cavendish appealed to the Supreme Court.

The *Beavis* Appeal

Mr Beavis parked his car at the Riverside Retail Park car park, Chelmsford, a car park operated by ParkingEye. Prominent signs were displayed around the car park advising that the maximum stay was two hours, after which time a parking charge of £85 would apply. Mr Beavis overstayed the maximum stay by one hour, as a result of which he was charged £85. He refused to pay on the basis that the clause was a penalty and was therefore unenforceable.

At first instance HHJ Moloney QC found in favour of ParkingEye. The Judge held that a motorist who parked in the car park did so on the terms and conditions at the entrance and on the noticeboards, which represented the contract between ParkingEye and Mr Beavis. The contract included an obligation to leave within two hours, in default of which there was an agreement to pay the £85 charge. The Judge acknowledged that the charge had the characteristics of a penalty as ParkingEye did not suffer any identifiable financial loss as a result of Mr Beavis' breach.

The Judge found that the predominant purpose of the £85 charge was to deter motorists from breaching the maximum two-hour free stay period (and therefore the contract), which would at first glance render it a penalty. However, the Judge found that the charge was commercially justifiable, was not improper or excessive in amount in the circumstances, and was not unfair pursuant to the Unfair Terms in Consumer Contract Regulations 1999 ("*UTCCR*"). Accordingly, the charge was enforced. Mr Beavis appealed.

The Court of Appeal considered:

(i) whether the £85 charge was unenforceable at common law on the basis it was a penalty; and

(ii) whether the charge was unfair (and therefore unenforceable) under the UTCCR.

In relation to the penalty issue and deciding whether the charge was extravagant and unconscionable under *Dunlop*, the Court of Appeal followed Judge Moloney QC's approach of considering the charge having regard to the actual loss suffered, the deterrent effect of the clause, and whether it was justifiable commercially.

The court held that the charge was not a genuine pre-estimate of loss; it was aimed at deterring motorists from overstaying the permitted period; was not extravagant or unconscionable; and crucially, was justifiable for both commercial and social reasons. The £85 charge was therefore upheld. Mr Beavis appealed to the Supreme Court.

Decision of the Supreme Court

The Supreme Court considered the development of the law in relation to penalty clauses. It noted that the distinction between a clause providing for a genuine pre-estimate of damages and a penalty clause had remained fundamental to the modern law as it was understood.

Two questions were posed:

(i) in what circumstances is the penalty rule engaged at all: and

(ii) what makes a contractual provision penal?

In relation to the circumstances in which the rule is engaged, it is necessary to consider how the obligation is framed, i.e., whether it is a conditional primary obligation or a secondary obligation providing an alternative to damages.

This is fundamental as "*where a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty*".

Conversely, *"if the contract does not impose... an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum, the obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty."*

In relation to the question as to what makes a contractual provision penal, reference was made to the four tests formulated by Lord Dunedin in *Dunlop* and to the essential question as to whether the agreement was "*unconscionable*" or "*extravagant*".

It was acknowledged that Lord Dunedin's four tests were useful tools for deciding whether a provision was unconscionable or extravagant where there were simple damages clauses in standard contracts. They were not easily applied to more complex cases. Lord Neuberger and Lord Sumption also noted that the assumption that a provision cannot have a deterrent purpose if there is commercial justification seemed to be questionable.

The Supreme Court was unanimous that the doctrine of penalties should not be abolished. However, the traditional test set down in *Dunlop* that a clause will be a penalty if it is not a genuine pre-estimate of loss and is found to be extravagant or unconscionable, or if its purpose is to deter a breach of contract, was rejected. The majority held that the correct approach in commercial cases was to have regard to the nature and extent of the innocent party's interest in the performance of the obligation that was breached as a matter of construction of the contract.

The test, formulated by the majority and set out at paragraph 32 of the Judgment, is whether:

"... the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation."

They went on to note:

"The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some

appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity. But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations."

Application of the test – the *Cavendish* Appeal

Applying this test to the facts in the *Cavendish* Appeal, the Supreme Court unanimously held that the two clauses in question were not penal in nature. The majority held that the clauses were primary obligations under the contract, as they provided for an adjustment to the purchase price that was equivalent to other primary price calculation clauses in the contract which meant the penalty rule was not engaged. This was distinct from secondary obligations that only come into play once a breach of contract occurs (such as an obligation to pay liquidated damages if the works are delayed). Further, the clauses were justified commercially by Cavendish's legitimate interest in protecting the goodwill of the business, and the parties were the best Judges of how that interest should be reflected in the contract.

Application of the test – the *Beavis* Appeal

In the *Beavis* Appeal the Supreme Court held that whilst the £85 charge was a secondary obligation, intended to deter motorists from a breach of contract (i.e. overstaying), it was not a penalty. This was so because ParkingEye, and also the car park owner, had a legitimate commercial interest in deterring motorists from overstaying by imposing a charge on them. The interest of the car park owner was the provision and efficient management of customer parking for the retail outlets. The interest of ParkingEye was income from the £85 charge which met the running costs of what was considered by the Supreme Court to be a legitimate commercial scheme, plus a profit margin. The reasoning behind the imposition of the charge was entirely reasonable, and proportional to the commercial interests of ParkingEye and the car park owners. Accordingly, it was not penal.

Why is this case important to the construction industry?

A number of points arise out of the judgment:

- Liquidated damages are secondary obligations and are in principle caught by the new rule for penalties.
- As a general rule, there will be a strong presumption that the clause is not out of all proportion with the innocent party's legitimate interests if a commercial contract has been negotiated between two parties of comparable bargaining strength, and survived advisors' scrutiny. This is the case even if it is penal in nature, is intended to deter a breach of contract, and is not representative of any actual financial loss the innocent party would suffer.
- Losses that cannot be easily quantified, such as reputational issues, goodwill and third party interests (i.e. other commercial *"interests"*) may fall to be considered in determining the level of liquidated damages.
- It is important to challenge liquidated damages that appear not to be commensurate with the commercial impact of delayed completion before the contract is executed.

Conclusion

The decision of the Supreme Court in the *Cavendish* and *Beavis* Appeals has replaced the century-old test in *Dunlop* with a more modern and flexible test. The test reflects the fact that parties may have a legitimate commercial interest to protect in enforcing the performance of contractual obligations which may extend beyond compensation for any identifiable commercial losses that breach may cause, or the deterrence of a breach of contract.

In the context of construction projects this new test will require consideration of the commercial justification for the liquidated damages clause at the time the contract was entered into; and whether the amount of liquidated damages is out of all proportion to the employer's legitimate commercial interest in deterring late completion of the works.

> *"In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach... But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations."*

Conflict of interest – apparent bias of arbitrators

As Lyndon Smith explains, there have been two noteworthy judgments by the Commercial Court this year on the subject of apparent bias of arbitrators. These decisions potentially have a wider application because, whilst they give guidance as to how the English courts will treat conflicts of interest of an arbitrator, the principles discussed, as a third case in the TCC has already demonstrated, apply equally to the appointment of adjudicators.

Both cases considered the apparent bias of a sole arbitrator based on an alleged conflict of interest.

In *Cofely Ltd v Bingham & Knowles Ltd*,[1] the claimant's application was for the removal of the arbitrator during the course of the arbitration under section 24 (power of the court to remove an arbitrator) of the Arbitration Act 1996.

W Ltd v M SDN BHD[2] followed soon afterwards in which the claimant challenged two awards by alleging serious irregularity under section 68(2) (challenging the award: serious irregularity) of the Arbitration Act 1996. In this case, the claimant also relied on the new *IBA Guidelines* to support its position.

In September 2016, the *Cofely* case was referred to in an adjudication enforcement case, *Beumer Group UK Ltd v Vinci Construction UK Ltd.*[3]

Despite all the discussion and developments surrounding these cases, both cases ultimately reconfirmed the well established common law position as to the basic test for establishing bias as set out in *Porter v Magill*.[4] That is, whether:

"a fair minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased."

Cofely Ltd v Bingham & Knowles Ltd

Background

Cofely Ltd (a major construction company) applied to have the arbitrator removed under section 24 of the Arbitration Act 1996 alleging apparent bias. The dispute related to the alleged breach of an agreement by Cofely to pay a success fee to Knowles (claims consultants) of £3.5m.

Knowles had been appointed by Cofely to advise upon and then progress its claims for an extension of time and associated additional costs relating to Cofely's contract with Stratford City Developments Ltd and the Olympic Delivery Authority to design, build, maintain and operate district energy services to the Olympic Park and Westfield Shopping Centre in Stratford, London.

Section 24(1)(a) of the Arbitration Act enables a party to apply to the Court to remove an arbitrator on the grounds that circumstances exist that give rise to justifiable doubts as to his impartiality.

Cofely's concerns surrounded Knowles' request for the appointment of this particular Arbitrator. On his acceptance of nomination form, he had failed to disclose any prior involvement with Knowles and subsequent to the commencement of the arbitration and following the first award, the judgment of *Eurocom Ltd v Siemens Plc*[5] was handed down in the Technology & Construction Court.

"Adjudication is not the Wild West of dispute resolution"

The *Eurocom* case concerned a summary judgment application made by Eurocom against Siemens in respect of an adjudication decision made by this arbitrator. The application failed on the grounds that Siemens had real prospects of successfully defending the claim on the basis that the adjudicator had no jurisdiction because of a fraudulent misrepresentation allegedly made by one of Knowles' employees when applying for the appointment of the adjudicator on Eurocom's behalf. It turned out that the adjudicator appointed (who was also the arbitrator in the Cofely arbitration) had regularly been appointed by Knowles.

This was clearly of great interest to Cofely as they wrote to the arbitrator requesting information on his previous dealings with Knowles in light of the *Eurocom* judgment. The arbitrator did not answer Cofely's questions in detail but called a hearing at which he ruled that there was no conflict or apparent bias. It was after this hearing that Cofely decided to make its section 24 of the Arbitration Act 1996 application.

Cofely also relied upon Rule 3 of the *CIArb Code of Professional and Ethical Conduct for Members (October 2000)* which states that:

"Both before and throughout the dispute resolution process, a member shall disclose all interests, relationships and matters likely to affect the member's independence or impartiality or which might reasonably be perceived as likely to do so."

Cofely contended that the disclosure obligation should be followed where there is any doubt as to the relevance of the information and the manner in which an arbitrator discharges this obligation can be relevant to the issue of apparent bias. In this case, no disclosure had been made at the outset of the arbitration, although as the case progressed, it was the attitude of the arbitrator which took on a bigger focus.

The Decision

In coming to his decision, Mr Justice Hamblen concluded that five of the grounds relied upon by Cofely gave rise to a real possibility of apparent bias. These were:

(i) The facts of the *Eurocom* case, i.e. the adjudicator in that case (i.e. Cofely's arbitrator in their arbitration) was clearly someone that Knowles was keen to see appointed, and they sought to influence appointments by trying to exclude many other potential adjudicators from acting;

(ii) The arbitrator's evasive and defensive responses to Cofely's questioning about the nature and extent of the professional relationship between himself and Knowles;

"Adjudicators are not arbitrators, but in my judgment are governed broadly by the same principles so far as disclosure is concerned."

(iii) The arbitrator's defensive approach in providing the requested information. His calling of a hearing, which had not been requested, to consider Cofely's questions, the way the hearing was then conducted and the way the "*ruling*" was handed down purporting to deal with the apparent bias;

(iv) The information that eventually became available of the professional relationship between the arbitrator and Knowles showed that over the past three years he had acted as adjudicator or arbitrator 25 times (out of a total of 137) on cases involving Knowles as either a party or the representative of a party. This represented 18% of his appointments and 25% of his income. It was also found that he had held in favour of Knowles, or the party with which Knowles was involved, on 18 of the 25 occasions (i.e. 72%); and

(v) The arbitrator was aggressive and unapologetic in his witness statement. Rather than stay neutral, he saw fit to make positive statements in opposition to Cofely's application. This could not but leave the impression that on any view, he had taken sides in the application.

For these reasons, Mr Justice Hamblen found that Cofely had established the requisite grounds for the removal of the arbitrator under section 24(1)(a) of the Arbitration Act.

The case for apparent bias had been made out.

It is worth noting that the Cofely case was then cited in the adjudication enforcement case of *Beumer Group UK Ltd v Vinci Construction UK Ltd* – judgment was handed down on 13 September 2016.

Here, Beumer had been successful in an adjudication against Vinci and had applied for summary judgment. However, Vinci opposed enforcement relying on breaches of natural justice. The facts were that on the same day that Beumer commenced an adjudication against Vinci, it had also commenced a second adjudication, before the same adjudicator, against its sub-subcontractor. Beumer also went on to take differing positions on the same issues in the two different adjudications.

This was not disclosed by either Beumer or the adjudicator and it was only some time later that Vinci found out about the second adjudication.

Mr Justice Fraser in the Technology and Construction Court commented that:

"Adjudication is not the Wild West of dispute resolution"

The Judge then went on to say that he took:

"a very dim view of the propriety of behaviour where Party A says in one set of adjudication proceedings with Party B "the works were complete on 16 December 2015" and, in relation to the very same works (or at least a sub-set of the works) on the very same project states in another set of adjudication proceedings with Party C "the works are not yet complete, you are liable to pay liquidated damages". They are *wholly inconsistent."*

The Judge then held that the adjudicator's failure to disclose his involvement in a simultaneous adjudication involving Beumer was a material breach of the rules of natural justice and, therefore, he did not enforce the adjudicator's decision. He referred to Cofely and Mr Justice Hamblen's reference to the *CIArb Code of Professional and Ethical Conduct* for Members and the requirement to disclose all interests, relationships and matters likely to affect the member's independence or impartiality.

Mr Justice Fraser stated that:

"Adjudicators are not arbitrators, but in my judgment are governed broadly by the same principles so far as disclosure is concerned."

W Ltd v M SDN BHD

Background

Following an arbitration between *M SDN BHD and W Ltd*, relating to a project in Iraq, W Ltd applied to have two awards set aside pursuant to s.68 of the Arbitration Act 1996 on the grounds of apparent bias on the part of the arbitrator. W Ltd's application was based on an alleged conflict of interest.

The sole arbitrator had been appointed in May 2012. He was a partner in a medium-sized Canadian law firm although had worked almost exclusively as an international arbitrator for a number of years with virtually no involvement in the running of the firm. For instance, he had not attended partnership meetings for the previous six or so years.

At the time of his appointment, a company ("Q") was a client of the firm. M SDN BHD was a subsidiary of another company ("P") and, following an announcement in June 2012, P acquired Q, meaning that Q (as with M SDN BHD) became a subsidiary of P. This resulted in Q and M SDN BHD becoming affiliates. Following the acquisition, the law firm continued to provide substantial legal services to Q.

The arbitrator carried out conflict checks at the time of his appointment and made various disclosures to the parties but the conflict checks did not identify that Q was a client of the law firm.

It was not until the arbitrator handed down his final award on costs that the potential conflict was actually raised by W Ltd in correspondence with the arbitrator. The arbitrator then responded promptly stating that he had no knowledge of his firm's work for Q, and further confirming that had he known, he would have disclosed the potential conflict to the parties.

The parties were agreed that the common law test for apparent bias was that set out in the Porter v Magill case: i.e. whether *"a fair minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased"*.

W Ltd argued that, given the facts of the case, the fair minded and informed observer would conclude that there was a real possibility that the tribunal was biased or lacked independence or impartiality.

W Ltd also relied on the fact that the position with the arbitrator's law firm acting for Q meant that this conflict was caught by paragraph 1.4 of the Non-Waivable Red List of the *IBA Guidelines* which states:

"The Arbitrator or his or her firm regularly advises the party, or an affiliate of the party, and the arbitrator or his or her firm derives significant financial income therefrom."

The Decision

In considering whether there was apparent bias, Mr Justice Knowles concluded that a fair minded and informed observer would not conclude that there was any real possibility of bias and dismissed the application accordingly. He was of the view that the arbitrator, although a partner, operated effectively as a sole practitioner, using the firm for secretarial and administrative assistance.

The arbitrator had made other disclosures where, after checking, he had knowledge of his firm's involvement with the parties. Given this commitment to transparency, the Judge was of the view that the arbitrator would have made a disclosure in this case had he been alerted to the situation. This would be relevant in the mind of the fair minded and informed observer. It also showed that the arbitrator could not have been biased by reason of the firm's work for the client. In fact, that work was not in his mind at all; had it been he would have disclosed it.

Mr Justice Knowles went on to comment that the 2014 *IBA Guidelines* make a distinguished contribution in the field of international arbitration:

"Their objective, to assist in assessing impartiality and independence, is to be commended."

However, the Judge went on to say that in this case, the Guidelines had perhaps led to some uncertainty which was at the forefront of W Ltd's case. With regard to W Ltd's reliance on the *IBA Guidelines*, the Judge acknowledged that the conflict fell within the description given in paragraph 1.4 but this did not result in him altering his decision as he identified two weaknesses in the guidelines.

First, it was only in 2014 that paragraph 1.4 of the *IBA Guidelines* was amended to include scenarios where advice was provided to an affiliate without the arbitrator's involvement or knowledge. The Judge found it hard to understand why this situation should now warrant inclusion in the Non-Waivable Red List.

Secondly, including such a situation in the Non-Waivable Red List meant that there was no consideration of whether the particular facts could realistically have any effect on impartiality or independence (including where the facts were not known to the arbitrator).

W Ltd sought permission to appeal but this was refused on the basis that the proper forum for the determination of the wording of the *IBA Guidelines* was the International Bar Association and not the Court of Appeal.

Conclusions

Whilst all cases must be Judged on their specific facts, the judgments here all serve to confirm the English law position of the fair observer test when deciding on claims of apparent bias.

> *Arbitrators and adjudicators must disclose all interests, relationships and matters likely to affect their independence or impartiality. And in making that disclosure, it might be better to err on the side of caution.*

The lesson for arbitrators is to be transparent and honest in the conflict process. If in doubt, disclose. Common sense should prevail. In Cofely, the arbitrator's failure to acknowledge the relevance of his relation with Knowles and his refusal to disclose information about that relationship led the Court to conclude a lack of impartiality. This was in contrast to the arbitrator in *W Ltd v M SDN BHD* who was willing to disclose possible conflicts of interest.

With regard to the *IBA Guidelines*, paragraph six makes it clear that the guidelines are not legal provisions and do not override any applicable national law or arbitral rules chosen by the parties. *W Ltd v M SDN BHD* confirms the position that the English Courts will not be bound by the *IBA Guidelines*.

Even given this judgment, the international arbitration community will, no doubt, continue to use the *IBA Guidelines* but the point has now been made that a strict approach to the guidelines when determining conflict is not necessarily the right approach to be taken in every case.

1 [2016] EWHC 240
2 [2016] EWHC 422
3 [2016] EWHC 2283 (TCC)
4 [2002] AC 357 at 102
5 [2014] EWHC 3710 (TCC)

The new Insurance Act

On 12 August 2016 the Insurance Act 2015 (the "*Insurance Act*")[1] came into force bringing with it a new default regime for business insurance in the UK.

As Jeremy Glover explains, it represents the most significant statutory change to UK commercial insurance law in over 100 years, and it will have a substantial impact on insurance practice and procedures, as it will apply to every insurance policy and reinsurance policy that is written in England and Wales, Scotland and Northern Ireland, as well as any renewals and endorsements.

Just a few days earlier, on 1 August 2016, the Third Parties (Rights against Insurers) Act 2010 had also come into force. The essential idea behind this Act is to try and make it easier for a third party to pursue a claim directly against liability insurers where the insured is or becomes insolvent.

"the biggest reform to insurance contract law in more than a century"

Andrea Leadsom, 3 February 2015

The Insurance Act sets out new industry standards for commercial insurance contracts, which are the product of an extensive industry review and consultation. It is designed to complement the other relatively recent but significant change to the insurance industry, the Consumer Insurance (Disclosure and Representations) Act 2012 (the "*Consumer Insurance Act*"), which implemented a number of reforms for consumer insurance contracts.

Why the need for change?

Insurance law in the United Kingdom was previously based on a mix of a lengthy history (Lloyds of London began life as a coffee shop in London in the seventeenth century) and the old statutory framework of the Marine Insurance Act 1906. It was felt that many aspects of the old legislation were outdated and no longer reflective of commercial reality and practice. The new replacement, the Insurance Act, has been introduced to modernise and simplify the law, to balance more fairly the interests of insurers and the insured, and to provide a new framework for an effective and competitive insurance market that is more sensitive to the needs of business.

The Insurance Act is designed to encourage cooperation between the insured and insurer during the pre-contract negotiation stage.

Insurance Act: key points

What does the Insurance Act cover?

The Insurance Act will apply to all new commercial (but not consumer[1]) insurance contracts, as well as any variations of existing insurance contracts entered into on or after 12 August 2016. The rule about variations is subject to one exception: parts 3 and 4 of the Insurance Act which deal with warranties and fraudulent claims will not be applicable to variations of insurance contracts entered into before 12 August 2016.

Duty to make a *"fair presentation"* of the risk

The duty to make a fair presentation of the risk is probably the most substantial change to be brought in by the Insurance Act.

All insurance policies depend on the disclosure of material information by the party seeking insurance which enables insurers to assess and therefore price the risk correctly. Currently under the common law, a party seeking insurance has a pre-contractual duty of utmost good faith

1 An insurance contract entered into by an individual mainly for purposes unrelated to the individual's trade, business or profession
2 "*Risk*" is defined as any information that "*would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms*"
3 See section 3(4) of the Act
4 See section 3(3)(b) of the Act
5 See section 5(6) of the Insurance Act
6 See section 5(2) of the Insurance Act

to disclose all relevant facts to the insurer free of any misrepresentation. The Act codifies and builds upon this duty as a "*duty of fair presentation*". Prospective insured parties must now disclose to the insurer all relevant "*risks*"[2] and every material representation must be made in good faith.

The new duty[3] requires the insured to either:

(i) disclose every material circumstance which he knows or ought to have known; or, failing that,

(ii) disclose sufficient information to put a prudent insurer on notice of the fact that it needs to make further enquiries for the purposes of revealing those material circumstances.

Some might say that in reality little has changed, which is why we said that the duty to make fair presentation was probably the most substantial change. Under the Insurance Act a party must still make full disclosure of everything that is material to the risk.

The disclosure has to be given in a manner that would be reasonably clear and accessible to a prudent insurer.[4] Every material representation as to a matter of fact must be substantially correct, and every material representation as to a matter of expectation or belief must be made in good faith. It will no longer be possible to dump large amounts of data on insurers indiscriminately without highlighting the key aspects, and insurers will have a new obligation to follow up on any unanswered questions. This might become burdensome if that party is involved in a large number of construction projects.

The use of the words "*ought to know*" is important. Currently, the requirement is limited to what a firm knows in the ordinary course of business. The Insurance Act states that what the insurer ought to know is information that should be reasonably obtainable through "*reasonable search of information available to the insured*".[5] This will include information that is "*held within the insured's organisation or by any other person (such as the insured's agent or a person for whom cover is provided by the contract of insurance)*."

This wide-ranging definition is likely to increase the level of disclosure required. It may cover information held by other parties in construction projects such as designers who can be "*any other person*" and covered by "*reasonable search*".

What are "*material circumstances*"?

The Act provides details of what constitutes "*material circumstances*" which need to be disclosed. These include a catch-all category covering "*anything which those concerned with the class of insurance and field of activity in question would generally understand*". Again this might be quite wide-ranging. It may also be difficult to apply when it comes to construction all risks ("*CAR*") insurance as it may require disclosure of a broader range of information (including about subsidiaries but also subcontractors, sub-consultants and designers).

Who has relevant knowledge?

Where the insured is an organisation, the relevant knowledge will be the knowledge of anyone who is part of the senior management of the insured (this will include the Board, the Risk Manager and anyone who plays a significant role in the making of decisions about how the activities of the insured are to be managed and/or organised), as well as anyone who is responsible for insurance. The knowledge of the insured is defined having regard to information that could be expected to be found by a reasonable search of information held by the insured, its agent(s), or co-insured.

In practice, it is likely that the search will extend beyond senior management to those who perform a management role, or who otherwise possess relevant information or knowledge about the risk to be insured. This is particularly the case for large companies and organisations, but much will depend upon the structure and management arrangements of the insured.

As far as insurers are concerned, they will be deemed to have knowledge of anything that is known to them or any individual who participates on their behalf in the decision whether to take the risk and, if so, on what terms. In practice, this will be the knowledge of the underwriters, or insurers' claims staff if they are involved in the renewal process.

Under the Insurance Act a party must still make full disclosure of everything that is material to the risk.

Insurers are "*presumed*" to know anything that is common knowledge, and anything that an insurer offering insurance of the class in question to the insured in the field in question would reasonably be expected to know in the ordinary course of its business.

The Insurance Act refers to information that is "*readily available*".[6] This may include their own surveyor's report assessing the risks associated with the construction project as it is information that ought to have been provided to the underwriter, held by the insurer, or available to the underwriter. Further, the definition "*readily available*" may well cover the insurer's archive of claim reports and the insured's past performances.

Warranties

The Insurance Act makes three changes to the way in which warranties (i.e. terms of the insurance policy) are dealt with. Under the existing law, as a general rule, insurers are discharged from all liability under an insurance policy following a breach of warranty of the insured, regardless of the subject matter or relevance to the actual loss suffered.

Under the new regime, first, warranties will operate as suspensive conditions, which means that insurers' liability to make payment will remain suspended until such time as any breach of warranty has been remedied, and insurers will remain liable for any losses prior to the breach of warranty.

For any warranties that are subject to deadlines, if the deadline is missed, the insured will remain, and cannot cease to be, in breach, given that the critical time for compliance has passed, and insurers will therefore not be obliged to provide an indemnity in such cases.

Second, insurers will no longer be able to rely on a breach of warranty, condition precedent, exclusion clause, or any other term which did not increase the risk of, and was irrelevant to, the loss that occurred. So if, for example, there were a failure to put in place adequate measures for site safety, and the site was then subject to theft, insurers will still be obliged to make payment under the policy, whereas they currently have no such liability.

Finally, "*basis of the contract*" clauses, which can turn any pre-contractual statement from a policyholder into a warranty, will be abolished.

This means that it will no longer be possible for insurers to avoid a claim on the basis of the insured's breach of a contract term in circumstances where the breach is completely irrelevant to the loss suffered by the policyholder.

Insurers' remedies[7]

This, in fact, might constitute the biggest change.

In the event that the insured fails to make a fair presentation of the risk, the Insurance Act offers a much more flexible and commercial approach than the existing regime. From August 2016, if an insured innocently fails to make a fair presentation of the risk, insurers will only be able to avoid policies if, but for the breach of duty to make a fair presentation, they would not have entered into the insurance contract at all. In such cases, insurers will have a new right to return the premium, avoid the contract and refuse all claims.

Alternatively, if fair presentation would have changed the insurance contract, when the breach was neither deliberate nor reckless, the contract will be treated as if it had been entered into on those different terms. For example, if insurers would have entered into the contract, but charged a higher premium, then insurers may reduce the amount they pay out, or apply different terms that would have applied had a fair presentation of the risk been made. However, the insurer has to prove with evidence that it would not have been willing to write it at all if there were fair presentation.

If you have a liability claim against a third party that is insolvent but has liability insurance, it is now easier for you to make a direct claim in respect of the third party's liability against its insurers under the Third Parties Act.

Insurers do, however, retain the right of avoidance in circumstances where the insured has not been entirely truthful. If the insured knew it did not make a fair presentation, or did not care whether it had made a fair presentation, then it will be open to insurers to avoid the policy without returning the premium.

In the case of outright fraud, insurers will now have the option to notify the insured that the insurance policy is terminated from the time of the fraudulent act (which renders the claim fraudulent), and can refuse liability in respect of a relevant event taking place after the fraudulent act. Valid claims made before any fraudulent act will, however, be unaffected.

Contracting out

With the exception of basis of contract clauses, insurers may contract out of the Insurance Act provided:

(i) they take sufficient steps to draw any disadvantageous terms to the attention of the insured or its agent before the contract is entered into or any variation is agreed; and

(ii) the disadvantageous term is clear and unambiguous, having regard to the characteristics of the insured and the circumstances of the transaction. The Act defines such terms as disadvantageous if they "*would put the insured in a worse position*".[8] This is potentially a very wide test.

The term "*sufficient steps*" will depend upon the characteristics of the insured and the circumstances of the transaction. Steps that are sufficient for one insured may not necessarily be sufficient for another, and the extent to which insurers will need to spell out the consequences of a disadvantageous term will depend on the insured, and the extent to which it could be expected to understand the consequences of the provision. Contracting out of the Insurance Act is therefore likely to be an area ripe for dispute.

Third Parties Act

The Third Parties Act is of particular importance in the context of professional indemnity policies, which often contain an exclusion clause providing that insurers will not have any liability directly arising out of the insolvency or bankruptcy of the insured and/or that the policy will automatically be cancelled on the insolvency of the insured. Such exclusions are usually triggered in relation to, for example, a claim for unpaid fees by the supply chain during the course of the works against an insolvent contractor.

At common law, if a person who is insured under a liability policy incurs a liability to a third party but then goes into liquidation, any money subsequently paid out under the policy will form part of the insured's assets and will ultimately be distributed to creditors, leaving the party to whom the liability is owed with nothing.

The Third Parties Act will provide those with a liability claim against an insolvent insured with a recovery, by altering the position at common law and making it easier for parties with liability claims to bring a claim directly against the insurers of the insolvent insured.

From 1 August 2016, it will be possible to join insurers as a joint defendant with the insolvent insured, without having to first establish a legal liability as against the insured in separate proceedings by a declaration or judgment of the court, arbitration award or settlement,[9] as was the position under the Third Parties (Rights against Insurers) Act 1930.

It is very important to note, however, that the ability to make a direct claim against insurers will be subject to any coverage issues that might arise.[10] This makes it all the more important for those with liability claims against insolvent insured to be fully aware of the provisions of the Insurance Act that are discussed above.

Finally, in addition to making a direct claim against insurers possible, the Third Parties Act will also make it easier for parties with liability claims against insolvent insured to obtain information from the insurers or the broker on a pre-action basis. It will be possible to seek information about:

(i) the identity of the insurer;

(ii) whether there is a policy in place that might cover the alleged liability;

(iii) the terms of the policy;

(iv) whether the insurer has denied liability;

(v) whether proceedings have been issued by the insured in respect of the cover;

(vi) whether there is an aggregate limit of indemnity, and, if so, how much if anything has been paid out on other claims; and

(vii) whether there are any fixed charges that would apply to any sums that might be paid out.

The insurer or broker is under an obligation to provide the information requested within 28 days and, in circumstances where information is not available, explain why it cannot be provided and who else might have it. If the insurer or broker fails to comply, then the party with the liability claim may seek a court order requiring the information (or documents) to be provided.

Some practice points

- It is open to insurers to contract out of most of the provisions of the Insurance Act, and this contracting out may affect the rules against which you will be measured when you present your risk. Review any new policy in detail so that you understand how the policy will operate and what is required of you.

- Review your disclosure process. Build in enough time to deal with the reporting requirements.
- Ascertain who needs to be consulted, both within your company or organisation and also externally, to ensure you have the right information from the right people so that you may fairly present your risk to insurers. Who are your senior management? Who is responsible for insurance within your business?
- If possible, try to contract out of the knowledge provisions in the Insurance Act and replace them with something that is tailored to fit the management structure of your company or organisation. Ideally, you should generically define who the knowledge-holders are for the purposes of the information obligations under the policy so that your obligations are clear.
- For the first time, the Insurance Act provides guidance on the placement process and you must present information (including complex information) in a manner that is clear, accessible and meaningful to a third party who may have no technical knowledge. Do not "*data dump*" on insurers indiscriminately, or overwhelm them with lots of irrelevant material.
- As always with insurance, engage with your brokers and/or insurers to make sure you understand their requirements.
- If you have a liability claim against a third party that is insolvent but has liability insurance, it is now easier for you to make a direct claim in respect of the third party's liability against its insurers under the Third Parties Act. You will be able to claim provided that (i) the insolvent insured meets the definition of "*insolvent*" under the Third Parties Act, and (ii) you have a valid liability claim against the insured.
- Prior to presenting a claim under the Third Parties Act, you should approach the insolvent party's insurers to request a copy of the policy to check whether there is liability cover, and ask for their confirmation that the policy will respond to your claim, if appropriate. If insurers confirm that cover has been declined, or proceed under a reservation of rights in relation to coverage, they are not obliged to communicate their reasons for not confirming an indemnity as this information will be confidential. Insurers may, however, be prepared to provide the information you seek and provide you with a copy of the policy on a voluntary basis if the declinature is valid in order to avoid the issue of legal proceedings. An informal approach to insurers in correspondence is therefore worthwhile prior to issuing proceedings.

Conclusion

There was a fairly lengthy lead-in period in respect of both Acts. The intention behind this was to give Insurers time to review their existing policy wordings; and no doubt underwriters will have been amending their underwriting policies and procedures. Brokers may start to ask different questions at renewal time.

The insured will now need to change the way they present risks, understand how warranties will operate under the new regime, and appreciate the new remedies that will be available to insurers in respect of fraud and in the event that the presentation of risk is unfair.

Much is set to change and only time will tell whether the Insurance Act will achieve its stated aims of modernising and simplifying insurance law. If its provisions are not commercially feasible, contracting out of the Insurance Act will likely become widespread, in which case extensive case law is likely to follow.

From August 2016, if an insured innocently fails to make a fair presentation of the risk, insurers will only be able to avoid policies if, but for the breach of duty to make a fair presentation, they would not have entered into the insurance contract at all.

7 Sections 16 and 17 of the Insurance Act
8 See section 16(2) of the Act
9 Albeit many liability policies specifically exclude liability claims that have arisen purely as a result of agreement between the parties, in which case a declaration would be preferable to ensure that the Third Parties Act will bite
10 If, for example, the insolvent insured failed to make a fair presentation of the risk (as to which, see above) when taking out the cover, then insurers may decline the cover, or make a reduced payment

Case law update

Our usual case round-up comes rom two different sources. As always we highlight here some of the more important cases which may not be covered in detail elsewhere in the *Review*. First, there is the *Construction Industry Law Letter* (CILL), edited by Fenwick Elliott's Karen Gidwani. CILL is published by Informa Professional. For further information on subscribing to the *Construction Industry Law Letter,* please contact Kate Clifton by telephone on +44 (0)20 7017 7974 or by email: kate.clifton@informa.com.

Second, there is our long-running monthly bulletin entitled *Dispatch*. This summarises the recent legal and other relevant developments. If you would like to look at recent editions, please go to www.fenwickelliott.com. If you would like to receive a copy every month, please contact Jeremy Glover or sign up online http://www.fenwickelliott.com/research-insight/newsletters/dispatch. We begin by setting out some of the most important adjudication cases as taken from *Dispatch*.

Adjudication: Cases from *Dispatch*

Paying the adjudicator's fees

Science and Technology Facilities Council v MW High Tech Projects UK Ltd

If you have reserved your position as to jurisdiction, does the fact that you have paid the adjudicator's fees mean that you are treating the adjudicator's decision as binding and have waived or lost the right to maintain that objection? In the case here, the adjudicator's terms and conditions said this:

"1. Each party to the reference shall be liable for my fees on a joint and several basis save that if, in my sole discretion, I consider that I have no jurisdiction to proceed with the reference my fees shall be payable solely by the Referring Party.

…

3. My fees will be payable notwithstanding that my decision is subsequently found by a court to be unenforceable by reason of lack of jurisdiction."

The Claimant here said that neither party had expressly accepted the adjudicator's terms during the adjudication. Silence cannot amount to acceptance and so the terms and conditions were not agreed. Mr Justice Fraser noted that the agreement of the Defendant to the adjudicator was done following a full reservation of right. Further, it is possible to signify acceptance of proposed contract terms by conduct and this is what the Defendant did.

Whilst there are cases where, by paying the adjudicator's fees, a party has lost the right to object to a decision, this was not the case here. Taken together, the express terms of the letter reserving the Defendant's rights and clause 3 of the adjudicator's terms and conditions were "*compelling*" evidence to allow the Defendant to challenge jurisdiction on enforcement, regardless of the payment by the Defendant of the adjudicator's fees.

Payment provisions

Severfield (UK) Ltd v Duro Felguera UK Ltd

This was a claim for summary judgment which, although it was not an adjudication enforcement case, included discussion of the payment principles under the Housing Grants Act ("*HGCRA*"). Mr Justice Coulson provided a useful summary of the recent case law:

"Over the course of the last year there has been a flurry of cases in which Edwards-Stuart J has considered the situation in which a contractor has notified the sum due in a payment notice, and the employer has failed to serve either its own payment notice or a payless notice. Those cases… are authority for the proposition that, if there is a valid payment notice from the contractor, and no employer's payment notice and/or payless notice, then the employer is liable to the contractor for the amount notified and the employer is not entitled to start a second adjudication to deal with the interim valuation itself.

All of these cases concern the situation where the contractor is seeking to take advantage of the absence of any notices from the employer to claim, as of right, the sum originally notified. That approach is in accordance with the amended provisions of the 1996 Act. But because of the potentially draconian consequences, the TCC has made it plain that the contractor's original payment notice, from which its entitlement springs, must be clear and unambiguous."

> *"But because of the potentially draconian consequences, the TCC has made it plain that the contractor's original payment notice, from which its entitlement springs, must be clear and unambiguous."*

The Judge then reminded the parties of the words of Mr Justice Akenhead in the *Henia v Beck* case:

"If there are to be potentially serious consequences flowing from it being an Interim Application, it must be clear that it is what it purports to be so that the parties know what to do about it and when."

Here the contract between the parties was for the design, supply and erection of steel structures on a site in Manchester. The project involved the construction of two power generation plants, each comprising several different structures. In the terms of the HGCRA, it was a "*hybrid*" contract. Some parts fell under the provisions of the HGCRA, other parts did not. The court had to decide how to treat payment applications made under the contract.

Mr Justice Coulson rejected the suggestion that the provisions of the HGCRA ought to be incorporated wholesale, even in a hybrid contract, to apply to all the works. In the Judge's view, the court must uphold that different regime in respect of all claims to payment with regard to the works which were excluded by the 1996 Act. Although it was "*uncommercial, unsatisfactory and a recipe for confusion*", the result of Parliament excluding certain construction operations from the HGCRA was that in situations as the one here there would be two very different payment regimes.

The payment notice relied upon here was for some £3.7 million, of which £1.4 million related to works under the HGCRA element of the contract. However, the notice of December 2014 identified the sum due as £3,782,591.12. The £1.4 million now claimed was not said to be the sum due, and was not the notified sum. There was no reference in the payment notice to the sum of £1.4 million. It was not therefore a payment notice in respect of that claim. You cannot *"convert the sum notified by refining it later on"*.

It was not sufficient to say that because the application was supported by a spreadsheet with a number of line items, the "*notified sum*" consisted of each of the sums in each line item. In the view of the Judge, this was not the purpose or intention of the payment provisions of the HGCRA. It would make for unnecessary complexity to say that the notified sum was not the net total claimed, but each (or just some) of its individual components. In order to be a payment notice, the notice has to set out the basis on which the sum claimed has been calculated.

The December 2014 notice and the accompanying spreadsheet did not begin to address the complexities of what were and were not construction operations. It was not at all clear or unambiguous from either the notice or the accompanying spreadsheet that £1.4 million was the minimum due in respect of construction operations within the HGCRA. All of which led the Judge to conclude that:

"Adjudication, both as proposed in the Bill and as something that has now been in operation for almost 20 years, is an effective and efficient dispute resolution process. Far from being a 'punishment', it has been generally regarded as a blessing by the construction industry. Furthermore, it is a blessing which needed then – and certainly needs now – to be conferred on all those industries (such as power generation) which are currently exempt. As this case demonstrates only too clearly, they too would benefit from the clarity and certainty brought by the 1996 Act."

Contract formation *RMP Construction Services Ltd v Chalcroft Ltd*

This was an adjudication enforcement case where it was agreed that RMP had worked pursuant to a construction contract, but there was disagreement about how that contract was formed. RMP said it was formed by an email sent to RMP by Chalcroft on 5 December 2014, which accepted an offer made by RMP. Chalcroft said that if the contract was formed by (or included) the Letter of Intent or by (or included) the subcontract order, the contract incorporated a standard form of JCT contract wording. Mr Justice Stuart-Smith noted that whatever route you took, the Scheme applied and no adjudicator nominating body was specified by the parties. Thus, whichever the correct contractual analysis was, the procedure for appointing the adjudicator was the same: being that laid down by the Scheme.

Further, it was agreed that if RMP's interpretation was correct, then Chalcroft did not serve a payless notice in time, with the result that the adjudicator's conclusion on RMP's entitlement would have been correct. However, it was also agreed that if one of Chalcroft's interpretations of the substantive obligations imposed by the applicable contract was right, it was at least reasonably arguable that a payless notice sent on 26 August 2015 was valid and in time, and the adjudicator's conclusions would have been wrong.

The Judge noted that the distinction between jurisdictional challenges to enforcement and challenges alleging substantive error should be approached in two separate stages. The first question is whether the adjudicator had jurisdiction. The answer to that question here was that he did, on any contractual route being proposed by either party. He had jurisdiction and was to be appointed under the Scheme. Chalcroft's only point on jurisdiction was that RMP had not properly identified the contract that gave rise to the Scheme route to jurisdiction.

Whilst the Judge noted that it may be "*linguistically and even technically correct*" to describe Chalcroft's various alternative formulations as different contracts from the contract alleged by RMP, that difference should not be determinative when it was remembered that the Court was concerned with one contracting process, with the only question being which party has correctly identified where in that process the relevantly binding contract was formed. Where it is agreed that each of the alternatives was sufficient to found jurisdiction under the identical route of the Scheme, it seemed to the Judge that to rule RMP "*out of court*" because it may have misidentified the contractual provisions that would give the adjudicator jurisdiction under the Scheme was a "*return to the formalistic obstacle course*". The Judge noted that:

"*the adjudication system was and is meant to provide quick and effective remedies to parties, equally accessible to those who are legally represented as to those who are not; and I bear in mind that the system now covers not only written contracts but also oral contracts which increases the likelihood that they may be mis-described*".

Therefore the adjudicator had jurisdiction because, however the contractual arrangements between the parties were correctly to be described, they mandated the use of the Scheme and he was properly appointed by the Scheme's procedure. The Judge made it clear that he was not ignoring the possible difference in substantive outcome that could arise from identifying the contract correctly.

> *Adjudication is a blessing which needed then – and certainly needs now – to be conferred on all those industries (such as power generation) which are currently exempt*

The important point to note was that these substantive differences went not to jurisdiction but to substantive outcome only. Once that approach was adopted, the present case was to be treated as one where the adjudicator had jurisdiction to resolve the dispute that was referred to him (namely, how much was owing under interim application number 8) and addressed the correct question without bias, breach of natural justice or any other vice that would justify overturning his decision. The Judge concluded that:

"If, which cannot be resolved now, he has made an error of law in referring to the wrong contractual provisions when deciding the substantive question that was referred to him, that falls within the category of errors of procedure, fact or law which the Court of Appeal has repeatedly emphasised should not prevent enforcement."

No dispute & applicable interest rates

AMD Environmental Ltd v Cumberland Construction Company Ltd

In this adjudication enforcement case, two issues arose. The first was the alleged absence of a crystallised dispute at the time of the notice of adjudication, the second the failure of the adjudicator to address the matters at issue. The adjudicator rejected the "*no dispute*" point, noting that there had been a five-month gap between the application for payment on 31 March 2015, and the notice of adjudication on 2 September 2015. Mr Justice Coulson agreed, noting that he had observed before that "*this argument is frequently advanced and almost as frequently rejected by the courts*".

Cumberland said that they had been asking for particulars of parts of AMD's claim which were not always forthcoming. Mr Justice Coulson said that he considered that it was "*wrong in principle*" to suggest that a dispute had not arisen until every last particular of every last element of the claim had been provided:

"When a contractor or a sub-contractor makes a claim, it is for the paying party to evaluate that claim promptly, and form a view as to its likely valuation, whatever points may arise as to particularisation. Efforts to acquire further particularisation should proceed in tandem with that valuation process... In an ordinary case, a paying party cannot put off paying up on a claim forever by repeatedly requesting further information... Any other conclusion would allow a paying party limitless time, either to avoid an adjudication altogether, or at least to avoid the enforcement of any adverse decision. It would deprive the payee of its statutory right to adjudicate."

The Judge also noted that Cumberland replied to the adjudicator's ruling on 17 September 2015, that there was a crystallised dispute, by requesting that same day an extension of time to serve its response. Cumberland wrote again, expressly acknowledging the adjudicator's decision "*to overrule our barrister's objections to an adjudication*". There was no reference in either letter to any reservation of the right to challenge the decision subsequently on this same ground. Cumberland had therefore accepted the adjudicator's ruling and were treating him as having the necessary jurisdiction to proceed.

In an ordinary case, a paying party cannot put off paying up on a claim forever by repeatedly requesting further information...

Cumberland also suggested that the adjudicator's request for further information, and AMD's compliance with that request, constituted a breach of natural justice. The Judge rejected the submission that it was somehow unfair if the adjudicator was given information during the adjudication which had not previously been available (whether or not it had been previously requested). If an adjudicator asks for more information, it was "*obviously wise*" for the claiming party to provide that information, regardless of their own view as to its materiality. It would be contrary to the Scheme for Construction Contracts and the basic principles of adjudication not to allow the adjudicator a wide leeway to seek information that they believed to be important.

AMD sought interest at 8.5% pursuant to the Late Payment of Commercial Debts (Interest) Act 1998. Cumberland suggested 2.5%. The Judge decided that the right figure was 6%:

"That is because this adjudication decision should have been honoured some time ago, and the arguments in support of the defendant's position were properly categorised as hopeless. The TCC is concerned that too many adjudication decisions are not being complied with, and that there are too many disputed enforcements where the grounds of

challenge are without merit. Thus a high interest rate under the Act will be awarded in such cases."

Natural justice
Stellite Construction Ltd v Vascroft Contractors Ltd

Stellite engaged Vascroft to carry out shell and core works at a substantial house in Hampstead. The contract was based on the JCT SBC Without Quantities 2011 form. Completion of the works was delayed. Stellite claimed liquidated damages and when Vascroft did not pay, referred its claims to adjudication. The adjudicator decided that time for completion had been set at large and that no liquidated damages were due. Stellite maintained that the Decision was unenforceable as a result of a breach of the rules of natural justice. Stellite said that Vascroft had not argued that time for completion of the Works was at large and the adjudicator had not given the parties a fair opportunity to comment on this proposition. The breach was of fundamental importance to the outcome of the Decision. Having decided that time was at large, the adjudicator went on to decide that a reasonable date for completion was 5 March 2016. Stellite said that neither party had asked for a decision on the reasonable date for completion, nor had the parties' submissions addressed the issue. Therefore the Decision as to a reasonable date for completion was also outside the adjudicator's jurisdiction and/or in breach of the rules of natural justice.

Therefore, Mrs Justice Carr found herself in the unusual position of having to deal with a claim by the Referring Party for declaratory relief that the adjudicator's decision had been made in breach of natural justice. The first issue was whether or not the parties had had a fair opportunity to set out their respective positions in relation to the question of whether or not time was at large.

As the Judge said, what is and is not fair will depend upon all the circumstances: circumstances that need to recognise the compressed and limited context in which the decision was delivered. In deciding that there was no breach of natural justice, Mrs Justice Carr analysed the submissions made during the adjudication and came to the conclusion that the issue of whether time was at large was obviously "*in play between the parties*". The parties were each aware of the relevant material and the issues had been canvassed fairly before the adjudicator.

The adjudicator had decided the case, not by accepting the precise submissions of one party or another, but rather by reaching a decision on a point of importance on the material before him. The Judge concluded by reminding the parties that it would be "*a rare case where there has been a breach of the rules of natural justice*". The second issue arose out of the first. The adjudicator, having found that time was at large, went on to consider what the reasonable completion date was. Whilst to all intents and purposes, this may have seemed like the next logical step, the problem was that in proceeding to consider the issue, the adjudicator had exceeded his jurisdiction. As the Judge noted:

"*It is important not to confuse the fact that the Adjudicator may have had material with which to decide an issue with having the jurisdiction to resolve it. The two are not the same.*"

Here, the Notice of Intention to Refer did not confer jurisdiction on the adjudicator to consider alternative claims that did not affect the sums that might be due to Stellite in liquidated damages. The Judge did not consider that even allowing for some latitude, the words "*or such other amount that the Adjudicator deems appropriate*" could be stretched to encompass a claim for unliquidated damages (or any other amount brought in any claim for money under the contract).

As far as Mrs Justice Carr was concerned, those words simply allowed for the awarding of a lesser sum than Stellite had claimed if, for example, Vascroft had established an entitlement to an extension of time under the contract. What those words did not do was confer jurisdiction on the adjudicator to determine a reasonable time for completion, which could only be relevant to a claim for unliquidated damages. To reinforce the point, the Judge noted that the parties had not actually made reference to any claim for unliquidated damages (or a reasonable time for completion outside the context of a claim for liquidated damages).

It would be "a rare case where there has been a breach of the rules of natural justice".

Whilst Vascroft had raised a claim for extensions of time by way of defence to Stellite's claim for liquidated damages, the question of whether or not Vascroft was entitled to an extension of time under the contractual provisions was quite separate and distinct from the question of what would be a reasonable date for completion in the event that time was at large.

What was the result of the Judge finding that the adjudicator did not have jurisdiction to determine the reasonable time for completion? It was not that the whole Decision could not be enforced. Instead, as the two parts of the Decision were separate, the Judge was able (and this was common ground between the parties) to sever that part of the Decision, which had been made in excess of jurisdiction, from the balance of the Decision, which the adjudicator did have proper jurisdiction to make.

Adjudication: residential occupier & contract formation
Goldsworthy & Others v Harrison & Anr

This was an application to enforce an adjudication decision that the defendant homeowners, Harrison, pay the claimant builders £72k. Harrison was a residential occupier, therefore statutory adjudication did not apply. The primary issue was whether they had agreed contract terms containing an adjudication clause. As Deputy Judge Bartlett QC made clear, he could only decide the application in Goldsworthy's favour if Harrison had no real prospect of successfully defending the enforcement claim.

Goldsworthy said that the parties agreed, and proceeded on the basis that, the JCT Minor Works (MW) terms applied. These terms contain a provision for adjudication. Harrison said that although the parties expressed an intention that they would enter into a MW form of contract, the parties did not do so because they never reached final agreement on the terms of such a contract. Further, the parties' conduct was not consistent with a concluded agreement.

As the Judge noted, the principal difficulty here was that the parties had proceeded with works without fully formalising the terms of their legal relationship, even though a Final Certificate had been issued.

Thus the court had to make the best sense possible of unclear expressions. The Judge referred to the Supreme Court case of *RTS Flexible Systems Ltd v Molkerei* which said that:

"(i) It is possible that parties may agree to be contractually bound by agreed terms even though they defer other important matters to be agreed later.

(ii) Contracts may come into existence, not as a result of offer and acceptance, but during and as a result of performance."

The parties may take the view that a better course, to avoid the risk of legal costs escalating on both sides in a manner disproportionate to the amount truly in dispute, would be to sit down and arrive at a fair figure for payment to resolve all their differences.

Further, the Judge noted that the provisions of the Minor Works form constitute a carefully designed package which, when properly filled in, sets an agreed balance of costs, liabilities and risks. He continued:

"This feature needs to be kept in mind when considering whether an incomplete Minor Works form constitutes a binding contract. When parties intend that they will contract on a Minor Works form, but fail to complete it, the Court needs to be wary of imposing on them a less complete contract, with a different balance of risks partly reflecting the Minor Works form and partly inconsistent with it: a contract which, if asked, they would not have agreed to."

Having considered the facts carefully, Deputy Judge Bartlett QC commented that it was ironic that:

"the defendants, who for most of the period from October 2012 onwards envisaged and desired that the full works would be done under a Minor Works contract, now contend that this intent was never contractually agreed or implemented, whereas the claimants, who resisted signing the Minor Works form when it was offered and did not revert with any altered version said to reflect the parties' agreement, now contend that the Minor Works terms were contractually agreed…"

He said that the fact that the use of the MW form was envisaged for the full works did not amount to a finding that there was a contractual agreement by the parties at that stage to use the MW form and bind themselves to the MW terms.

Goldsworthy's case on offer and acceptance was that the relevant offer was their quotation in February 2013 and the contractual acceptance was given in an instruction to commence works in its email of 28 March 2013. But that offer was made against the invitation in the email of 4 January 2013, which expressly referred to the need to fill in a MW contract.

However, as the Judge made clear, without knowing what was said between the parties in March 2013, and this was only a summary judgment application, he could not make a definitive finding that the email of 28 March 2013 concluded a contract for the carrying out of the full works on MW terms. Neither the fact that the certificates referred to the "*correct*" MW clauses, nor that the parties agreed terms of payment inconsistent with the MW terms and that they made no agreement on completion date and liquidated damages, established conclusively that the MW terms did not apply. The position was simply not clear.

The problem for the Judge was that in all the circumstances, without fuller evidence from both sides, in particular of the discussions lying behind the emails, he found it impossible to say whether the parties did or did not reach a stage where they agreed with contractual effect to the application of the Minor Works terms, with gaps where particular options were not filled in or agreed. Given that it could not be confidently decided without the full evidential picture, he was not in a position to grant summary judgment to the claimants for enforcement of the adjudicator's decision. However, the Judge concluded:

"I reach this conclusion with a degree of regret. So far as the present evidence goes, the reasons given by the defendants for not paying the claimants' invoices do not appear to justify particularly large reductions, and it is common ground that there is an outstanding balance due to the claimants in respect of the works. In theory the next step would be to proceed to a full trial of the issue of whether the parties' contract included the adjudication clause. Such a trial would determine only the enforceability of the adjudicator's decision. It would not finally determine how much money is owing from the defendants to the claimants in respect of the works. The parties may take the view that a better course, to avoid the risk of legal costs escalating on both sides in a manner disproportionate to the amount truly in dispute, would be to sit down and arrive at a fair figure for payment to resolve all their differences."

Debt Recovery costs *Lulu Construction Ltd v Mulalley & Co Ltd*

The question for Deputy Judge Acton-Davies QC was whether or not the adjudicator had jurisdiction to make an award in favour of Lulu of what were described as "*debt recovery costs*" of £48k. The reason this was an issue was because the claim was not specifically referred to in the Notice of Adjudication, or in the Referral Notice, or in the Response. It was only pleaded, for the first time, in the Rejoinder. The reason for this somewhat unusual state of affairs was that the adjudication was brought by Mulalley, effectively the paying party who wanted to resolve the value of Lulu's claim under the subcontract. As the Judge noted, it was therefore "*hardly surprising*" that the claim for debt recovery costs was not referred to in the Notice of Adjudication. Mulalley's position was that the head of claim was not within the scope of the Referral and the claim was not something which could be run as what might be called a defence.

The Judge considered that the costs claimed were clearly connected with and ancillary to the referred dispute and therefore must properly be considered part of it. This meant that the Adjudicator was correct to say that he had jurisdiction to decide this element of the dispute; although it was not within the scope of the referral, it was something which was connected with and ancillary to that referred dispute. To be clear, the Judge did not say that the Adjudicator was correct, simply that he had jurisdiction to consider the claim and make a decision on it. Given the unusual nature of this adjudication, it was possible for a claim which was not part of the Adjudication Notice to fall within the issues which the adjudicator had jurisdiction to decide.

Other cases: *Construction Industry Law Letter*

Interpretation – payment provisions
Bouygues (UK) Ltd v Febrey Structures Ltd

Technology and Construction Court; before Deputy High Court Judge Mr Jonathan Acton Davis QC; judgment delivered 10 June 2016

The facts

By a subcontract dated 28 May 2015, Bouygues (UK) Ltd ("*the Claimant*") engaged Febrey Structures Ltd ("*the Defendant*") as subcontractor to construct an in situ concrete frame and structural topping for a new building at the University of Bath. The subcontract sum was £626,315.79. The subcontract order incorporated the terms of the GC/Works subcontract, as amended by the parties. Appendix 10 set out a payment schedule which provided for the following in respect of the application for payment to be made on 23 October 2015:

- The due date for payment was 16 November 2015.
- The final date for payment for 60% of the payment was 23 November 2015.
- The date for the Claimant to serve its Payment Notice for the whole of the application was 23 November 2015.
- The date for the Claimant to serve its Payless Notice for the 60% payment was 20 November 2015.

This part of Appendix 10 did not comply with the HGCRA1996 (as amended), in that (i) the Payment Notice date was more than five days after the due date; and (ii) the Payless Notice deadline was before the Payment Notice deadline. The Defendant issued its application for payment on 23 October 2015 and the Claimant issued its Payment Notice on 23 November 2015, valuing the Defendant's entitlement as –£2,041.27.

Was the Payment Notice served by the Defendant invalid?

Yes. On an objective interpretation of the subcontract, including consideration of the other dates in Appendix 10, there was an obvious error in the subcontract.

The Defendant argued that the date in Appendix 10 for the Claimant to serve its Payment Notice was an obvious error, and that on an objective construction of the subcontract, that date should have read 20 November 2016. Accordingly, the Defendant argued that the Payment Notice served by the Claimant was invalid and that it was entitled to be paid the full amount of its application.

The Claimant disagreed and refused to pay the Defendant. The Claimant referred the matter to the court, seeking declarations as to the date for Payless Notices to be served against the Defendant's October application and that its Notice of 23 November 2015 was a valid Payless Notice.

Issues and findings

Was the Payment Notice served by the Defendant invalid?

Yes. On an objective interpretation of the subcontract, including consideration of the other dates in Appendix 10, there was an obvious error in the subcontract. The Payment Notice and the Payless Notice should have been served by 20 November 2016 to be effective.

Commentary

In this case, the court considered in detail the other dates for notices in the payment schedule and concluded that this was a case where there was a clear and obvious error; in other words, this was a case where something had gone wrong with the language in the contract.

The Judge distinguished this case from the recent judgment in *Manor Asset Ltd v Demolition Services*, where Edwards-Stuart J concluded that a situation which resulted in the date for a Payless Notice being before the date for a Payment Notice was acceptable and that the correct approach was to treat the prescribed period for the issue of the Payless Notice as "*nil*". Here,

the Judge stated that he was led by the schedule of dates attached to the subcontract to construe the subcontract in a particular way and he could not then imply a term as this would be contrary to his express construction of the subcontract.

Interpretation – JCT contracts – application of extension of time provisions *Carillion Construction Ltd v (1) Woods Bagot Europe Ltd (2) Aecom Ltd (3) Emcor Engineering Services Ltd (4) Emcor (UK) Ltd*

Technology and Construction Court; before Miss Recorder Nerys Jeff ord QC; judgment delivered 28 April 2016

The facts

By a contract dated 14 June 2007 ("*the Main Contract*"), Rolls Development UK Ltd ("*Rolls*") engaged Carillion Construction Ltd ("*Carillion*") to design and construct the Rolls Building, a court building in central London built to house various commercial courts including the Technology and Construction Court. The Main Contract incorporated the JCT Standard Form of Building Contract with Contractor's Design, 1998 edition, with amendments.

Carillion subsequently entered into two subcontracts for the provision of various mechanical and electrical ("*M&E*") services, one with Aecom Ltd ("*Aecom*") and the other with Emcor Engineering Services Ltd. In respect of that latter subcontract, Emcor's parent company, Emcor (UK) Ltd, provided Carillion with a parent company guarantee. Both Emcor companies are referred to in this report without distinction as "*Emcor*".

The Emcor subcontract incorporated the JCT standard form of subcontract conditions for use with the Domestic Sub-Contract DOM/2, 1981 edition ("*DOM/2*"). Clause 11.3 of the Emcor subcontract provided for Carillion to grant Emcor an extension of time on the occurrence of certain events and if "*the completion of the Sub-Contract Works is likely to be delayed thereby beyond the period or periods stated in the Appendix, pt 4, or any revised such period or periods*". In this event then Carillion was to fix such revised or further revised period or periods for the completion of the Subcontract Works as Carillion estimated to be reasonable. The Appendix, pt 4 set out dates and time periods for the commencement and completion of the Subcontract Works.

It is relevant to consider the distinction between responsibility for delay and contractual liability. Under the subcontract, Emcor was only contractually liable for delay if it failed to complete the subcontract works within the period or periods for completion

The works were delayed and Rolls claimed liquidated damages from Carillion under the Main Contract. In turn, Carillion claimed against Aecom and Emcor damages it alleged were caused by delay to the carrying out and completion of both Aecom's and Emcor's subcontract works.

Emcor denied Carillion's claim on the basis that it was entitled to an extension of time for completion of the subcontract works. Both Emcor and Aecom also argued that Carillion did not have any liability to Rolls for liquidated damages and/or had not paid those liquidated damages to Rolls.

Carillion issued proceedings against Aecom and Emcor. At the first case management conference, certain preliminary issues were ordered to be heard and a question arose as to the proper treatment of extension of time awards under the Emcor Subcontract.

Emcor argued that if it was entitled to an extension of time then such extension of time should be given by adding the time awarded to the end of the period or periods set out in the Appendix pt 4 as amended or revised ("*adding a further period contiguously to a previously fixed period*"). Carillion argued that Emcor's interpretation was correct with regard to matters giving rise to an entitlement to an extension of time which occurred before the date for practical completion.

However, with regard to matters arising after the date for practical completion, Carillion argued that consideration should be given to the effect of the matter relied upon at the time it occurred and that this might result in a further period of time for completion being given to Emcor which need not be added to a previous fixed period. Instead, the extension of time would be a discontinuous period of time.

Issues and findings

When considering the effect of an award of an extension of time, should the further time period awarded be added contiguously to the previous fixed period or can such period be treated as discontinuous?

Under the present subcontract, an award of an extension of time should be added contiguously to the previous fixed period.

Commentary

In the Judge's opinion it was clear that the natural meaning of the clause in question was that extensions of time should be awarded on a contiguous basis.

The issue in question is still a matter for debate within construction law circles and the Judge in this case made clear that her decision was made expressly on the basis of the drafting of the relevant clause. She did not rule out that there were circumstances where Carillion's argument could be successful.

The Judge said that Carillion's argument was "*well made*" and acknowledged that there were factual scenarios in which the addition of a further period of time to the existing period of time set for completion may have the effect of relieving a subcontractor of liability to an extent that does not truly reflect the consequences of his breach in failing to complete within the original period for completion.

The Judge also observed that it is relevant to consider the distinction between responsibility for delay and contractual liability. Under the subcontract, Emcor was only contractually liable for delay if it failed to complete the subcontract works within the period or periods for completion. This, in the Judge's view, was narrower than an obligation to be generally responsible for delay, which would be the effect of the interpretation argued for by Carillion.

Shorter Trials Scheme *Family Mosaic Home Ownership Ltd v Peer Real Estate Ltd*

Chancery Division; before Mr Justice Birss; judgment delivered 16 February 2016

The facts

Family Mosaic Home Ownership Ltd ("*Family Mosaic*") issued proceedings against Peer Real Estate Ltd ("*Peer*") in the Chancery Division.

The parties agreed that the case was suitable for transfer to the Shorter Trials Scheme and an application was made to the court accordingly. The application was made on paper. Ordinarily, no judgment would be necessary for the court to make an order of this kind but as this was, to the Judge's knowledge, the first time such an application had been made, he believed certain issues needed consideration in light of this. The Judge therefore issued a judgment covering in particular:

- whether the court had jurisdiction to transfer a pending case into the Shorter Trials Scheme;
- whether the case in question fell within the class of cases which the Scheme was for;
- whether the case was an appropriate case to transfer in any event; and
- the procedure to be followed on transfer.

Issues and findings

Does the court have jurisdiction to transfer a pending case into the Shorter Trials Scheme?

Yes. Whilst this is not expressly stated in the relevant Practice Direction, that the court has such jurisdiction is implicit in the relevant provisions. Further, the court having such jurisdiction is in line with the overriding objective.

Did the case in question fall with the class of cases which the Scheme was for?

Yes.

Was the case an appropriate case to transfer in any event?

Yes.

What is the procedure on transfer?

The case would be allocated a Judge and, in the present case, the parties were to take steps to fix a case management conference.

Commentary

The Shorter Trials Scheme was introduced in October 2015 with the purpose of allowing more efficient conduct of business cases. The Scheme is applicable to all the courts that operate out of the Rolls Building, other than the Intellectual Property Enterprise Court. The Shorter Trials Scheme is therefore applicable to the Technology and Construction Court.

The Judge noted that this was only the second case to use the Scheme. Whilst the Scheme is due to run for two years, there does appear to be a slow uptake given that five months had passed since commencement of the Scheme when this judgment was issued.

Notwithstanding, it is helpful to receive guidance from the court with regard to jurisdiction and procedure for the transfer of cases into the Scheme and also in respect of the suitability of cases for the Scheme.

Conduct of parties in TCC – approach to TCC litigation – costs *Gotch and Another v Enelco Ltd*

Technology and Construction Court; before Mr Justice Edwards-Stuart; judgment delivered 3 July 2015.

The facts

The claimants engaged Enelco Ltd ("*the defendant*") under a contract ("*the Contract*") to undertake work on two properties. Disputes arose between the parties. In particular, the defendant alleged that in May 2014 the claimants repudiated the Contract by withdrawing part of the work from the defendant and instructing others to carry out that work. The defendant accordingly claimed damages for breach of contract. The claimants alleged that even if there were a breach of contract (which they denied) the defendant affirmed the Contract and therefore it remained in force.

On 20 March 2015, the defendant's solicitors suggested that the dispute should be referred to adjudication. This was resisted by the claimants on the basis that there was no adjudication provision in the Contract and that, in any event, the claimants were residential occupiers and therefore the adjudication provisions of the Housing Grants, Construction and Regeneration Act 1996, as amended, did not apply to them ("*the jurisdiction issue*").

> *Given the overriding objective of the CPR (including the requirement that the parties deal with cases at proportionate cost), it is not acceptable for parties to pursue applications that have no real impact on issues that are central to the dispute or to carry on a war of attrition by correspondence, even if instructed to do so.*

There then followed correspondence between the parties' respective solicitors where the claimants indicated that they would issue Part 8 proceedings to obtain declarations with regard to the jurisdiction issue and the defendant stated that such proceedings would be premature, but did not withdraw the threat to adjudicate.

On 9 April 2015, by a telephone conversation between solicitors, the defendant indicated for the first time that it did not intend to adjudicate, but reserved its position in this regard. By a letter dated 13 April 2015, the defendant's solicitors stated in terms that the defendant had no current intention to adjudicate and suggested that there be a Part 8 determination on the repudiatory breach issue followed by mediation on quantum if necessary.

The claimants were seeking an unequivocal indication from the defendant that it would not adjudicate. As this did not occur, on 16 April 2015 the claimants issued Part 8 proceedings in the TCC to obtain declarations with regard to the jurisdiction issue.

The application for directions was considered on the papers by the Judge in the TCC. The Judge was concerned by the application because there appeared to be no imminent threat of adjudication proceedings, the defendant had indicated that it did not intend to take part in the proceedings and there was a potential issue on the facts. The Judge therefore directed that a case management conference be held to give directions for the future conduct of the action and that by 7 May 2015 the parties discuss and agree directions if possible in relation to the repudiatory breach issue. The Judge gave reasons as to why he did not consider an order for directions in relation to the jurisdiction issue to be appropriate.

Following receipt of the Order, the claimants' solicitors wrote to the court stating that the claimants would not seek to agree directions as ordered by the Judge as they had asked the court to deal with the jurisdiction issue and not the repudiatory breach issue. At the case management conference, the Judge considered the refusal to comply with a court order, the costs consequences arising from the conduct of the parties and the correct approach to litigation in the TCC.

Issues and findings

Should the court hear the application in respect of the jurisdiction issue?

No.

What is the appropriate approach to the order on costs?

The failure by the claimants to comply with the Order was inexcusable. The Judge set out a series of principles as to the proper approach to costs and conduct in this type of litigation.

Commentary

The Judge in this case made plain his displeasure at the conduct of the claimants in refusing to comply with the case management order, and the indemnity costs order made against the claimants for the period 17 April 2015 to 21 May 2015 reflects that. Of wider interest to practitioners is the clear enunciation of how the TCC considers cases should be managed by the parties.

In particular the Judge emphasised that, given the overriding objective of the CPR (including the requirement that the parties deal with cases at proportionate cost), it is not acceptable for parties to pursue applications that have no real impact on issues that are central to the dispute or to carry on a war of attrition by correspondence, even if instructed to do so.

The Judge went on to say that "*procedural squabbles must be banished and a culture of cooperative conduct introduced in their place*". This, it is submitted, is the logical conclusion of the principles set out in the CPR but may be difficult for some practitioners to embrace in cases of hard-fought litigation. It is also an approach that diverges from practice that might take place in other forums, such as adjudication and arbitration.

Notwithstanding, it is clear that the TCC will penalise such behaviour and will expect both counsel and parties to adhere to these principles in the conduct of litigation in the TCC.

Injunction to restrain winding up petition – JCT contract provisions providing substantial grounds to dispute petition debt – serious and genuine cross-claims

Wilson and Sharp Investments Ltd v. Harbour View Developments Ltd

Court of Appeal, Before Lord Justice McCombe, Lady Justice Gloster and Sir Colin Rimer

Judgment delivered 13 October 2015

The facts

Wilson and Sharp Investments Ltd ("*the appellant*") was a property developer and Harbour View Developments Ltd ("*the respondent*") was a building contractor. In 2012 and 2013 the appellant engaged the respondent to carry out works in respect of two developments for student accommodation in Bournemouth. Both contracts incorporated the JCT Standard Form of Building Contract Intermediate with Contractor's Design, 2011 edition.

Clause 8 of the contracts deals with insolvency. Clause 8.5 states that if a Contractor is insolvent (as defined by the contract) then the employer may at any time by notice terminate the Contractor's employment. Clause 8.7.3 provides that in the event that the Contractor is insolvent then, amongst other things, the employer need not pay any sum that has already become due.

It is not an absolute rule that summary judgment on an adjudication will be refused simply because the employer is able to show that the contractor is insolvent

By August 2013, the appellant had begun to be concerned about the performance of the respondent and also the Contract Administrator and believed that interim payment certificates had been overvalued.

By 12 November 2013, an unpaid amount of £1,202,506.55 was due from the appellant to the respondent in respect of three unpaid interim payment certificates.

Following negotiations between the parties, a payment of £200,000 was made by the appellant to the respondent but matters deteriorated and in January 2014 the respondent gave notice of its intention to terminate the contracts for non-payment of the interim payment certificates. In response, the appellant claimed that the respondent was in repudiatory breach of contract and stated that it accepted the repudiation. Following discussions between the parties, a further payment of £100,000 was made by the appellant to the respondent in February 2014.

On 6 February 2014, the appellant's new Contract Administrator produced an interim valuation of the respondent's works, showing that the interim payment certificates had overvalued the respondent's works to the extent that no further payment was due to the respondent.

On 27 February 2014, the respondent notified the appellant that it would present a winding-up petition if the interim payment certificates were not paid by 7 April 2014.

On 3 April 2014, the appellant's solicitors wrote to the respondent's solicitors setting out the detail of its cross-claims, as then valued. The letter concluded that the interim payment certificates had been overvalued by £1,169,762.96 (thus exceeding the amount otherwise due) and that there were other claims for damages.

On 21 May 2014, the respondent obtained a moratorium to enable it to put forward to its creditors proposals for a company voluntary arrangement ("*CVA*"). The proposals showed that the respondent was insolvent even if it recovered all sums alleged as due from the appellant. The moratorium stayed in place until 30 June 2014, when the proposals for the CVA were rejected by the respondent's creditors.

On 30 June 2014, the appellant's Contract Administrator issued a revised valuation across both contracts, taking into account various planning matters that had occurred. He concluded that the respondent had been overpaid by £240,550.36 across both contracts.

At a hearing on 10 July 2014, the appellant argued that the court should restrain the presentation of the winding-up petition by the respondent.

The appellant argued first that the proposed petition debt was disputed on substantial grounds. In this regard the appellant relied on clause 8.7.3 of the contracts. The Judge found that clause 8.7.3 was not effective given that termination had already taken place prior to the insolvency of the respondent.

Secondly, the appellant argued that it had serious and genuine cross-claims which exceeded the sums alleged to be outstanding in the interim payment certificates. The Judge rejected this argument.

Accordingly, the Judge refused to grant an injunction restraining the presentation of the winding-up petition. The appellant appealed, relying on the arguments raised at first instance. In addition, the appellant argued that, in permitting the respondent to present a petition, the Judge had acted inconsistently with the established practice of the TCC not to enforce interim payment obligations in favour of insolvent contractors.

Issues and findings

Did the appellant have substantial grounds to dispute the proposed petition debt?

Yes. The Judge had erred in his construction of the relevant clauses in the contracts. The correct construction is that an employer can cease making payments to a contractor in CVL, even if the contract had been terminated prior to the insolvency.

Did the appellant have serious and genuine cross-claims?

Yes.

Was it established practice in the TCC not to enforce interim payment obligations in favour of insolvent contractors?

It is not an absolute rule that summary judgment on an adjudication will be refused simply because the employer is able to show that the contractor is insolvent. In deciding whether to refuse summary judgment in such cases, the TCC looks at all the circumstances including whether the employer's counterclaim has sufficient merit to justify such a course and/or has sufficient mutuality to lead to compulsory set-off in an insolvency.

Commentary

This case raises and clarifies a number of issues.

First, it clarifies the meaning of the particular JCT provisions concerning the obligation on the part of an employer to pay a contractor sums due in respect of interim certificates in the event of insolvency. The Court of Appeal made clear that even if the contract has been terminated for a reason not related to insolvency and prior to the insolvency, there is no obligation to pay the contractor if it is insolvent.

Secondly, the Court of Appeal also confirmed that this is in itself a "*substantial ground*" on which to dispute a petition debt in circumstances where the insolvent contractor wishes to present a winding-up petition. On this basis, a permanent injunction restraining the presentation of the respondent's winding-up petition was granted.

Thirdly, the Court of Appeal set out its view as to the practice in the TCC in not always enforcing adjudicators' decisions where the receiving party is insolvent.

Finally, guidance was given with regard to what might constitute a genuine cross-claim for the purposes of obtaining an injunction to restrain a winding-up petition.

Ps – Changes to the FIDIC Form of Contract

Our *Annual Review* goes to press in October 2016. This is just before FIDIC finally announces what changes it is making to the 1999 Suite of Contracts. We understand that FIDIC will be releasing a details of the Yellow Book draft amendments in December 2016 and then revised draft Yellow, Red and Silver Books in the Spring of 2017.

We thought we might take out our crystal ball and try and predict what FIDIC might do.

Introduction

Understandably, FIDIC have kept a fairly close lid on what they are intending to do. However, it is likely that guidance can be found in the 2008 Gold Book, and perhaps the 2011 Red Book Sub-contract. It is also likely that, in keeping with the general contract trends, there will be an added focus on dispute avoidance.

Claims and disputes

This is a relatively easy one as FIDIC themselves have made it clear, in talks given at conferences, that they are going to split Clause 20 in two. The reason for this is to try and make clear that making a Claim is not the same as a Dispute. To put forward a claim is to make a request for an entitlement under the Contract. A Dispute arises if that Claim is rejected (in whole or in part) or ignored.

Clause 20 will deal with Claims and Clause 21 with Disputes.

The Claims Procedure and the Sub-clause 20.1 Condition Precedent

The FIDIC Form currently requires both the Employer and Contractor to submit claims. This will continue. It may be that the process for both parties to submit claims will become more closely aligned. If there is a clearly defined process, that can help maintain relationships as both parties will know exactly where they stand and why the other is taking the steps they are to submit their claim.

It is also very likely that the condition precedent, the timebar or deadline for making claims and providing detailed particulars of those claims, will apply to both Contractor and Employer claims. This change, whilst potentially controversial (and possibly likely to be subject to frequent deletion) will be justified on the grounds of balance.

In doing this, FIDIC might be thought to be reflecting recent caselaw, as the Privy Council in the 2015 case of *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)*,[1] to many people's surprise, held that Sub-clause 2.5 of the 1999 FIDIC Form was actually a condition precedent. The change FIDIC are likely to introduce is to ensure that the timebar is set out in a clearly defined period, presumably 28 days.

Dispute Adjudication Boards ("*DABs*")

FIDIC will undoubtedly look to extend the dispute avoidance role of the DAB.

In Clause 21, all DABs will be standing DABs, although the Guidance Notes will include an option for the use of an ad hoc DAB, as and when a dispute arises.

Although FIDIC did give serious consideration to adopting the updated ICC Dispute Board Rules, they have, we understand, decided to retain the FIDIC DAB Rules. Again, these are likely to follow the Rules to be found in the FIDIC Gold Book, albeit with added focus on dispute avoidance.

It is therefore likely that the Parties to the Contract will be given the power found in Sub-clause 20.5 of the Gold Book to:

"jointly refer a matter to the DAB in writing with a request to provide assistance and/or informally discuss and attempt to resolve any disagreement that may have arisen between the Parties during the performance of the Contract."

It is important to note that both the Contractor and Employer must agree to do this but it is a helpful recognition of the fact that, with a standing DAB, the role of that DAB can be to endeavour to prevent potential problems or claims from becoming disputes.

The Engineer

It would be in keeping with the increased importance of dispute avoidance for FIDIC to try and expand the role of the Engineer. Currently under Sub-clause 3.5, before making a determination, the Engineer is required to consult with each Party in an endeavour to reach an agreement. Only if agreement is not achieved is the Engineer supposed to go on to make a fair determination. It may be that this feature is enhanced.

Equally, given FIDIC's desire for clarity, it might be the case that a clearer timeline is set out for the making of Engineer's determinations.

Advance warning

Another feature of dispute avoidance is the concept of advance warning, giving early notice of a potential problem. By encouraging the parties to do this, it is hoped that they can then work together to resolve the potential difficulty at an early stage when it is relatively minor and thereby prevent it from escalating into something altogether more serious.

Currently Sub-clause 8.4 of the Gold Book provides that each Party shall endeavour to advise the other Party in advance of any known or probable future events or circumstances which may adversely affect the work.

BIM

None of the FIDIC forms currently mention BIM. That will change. However, the adoption and use of BIM is perhaps something that is more likely to be dealt with in the Guidance Notes rather than being dealt with formally within the main 21 Clauses.

Force majeure and exceptional risks

Again, FIDIC here is likely to follow the Gold Book which is considered to represent a more collaborative, risk sharing approach than the 1999 suite of contracts. The Gold Book does not follow the 1999 Clause 19 force majeure provisions. Instead, it drops Clause 19 completely in favour of a new Clause 18 that is headed *"exceptional risks"*, and Clause 17 (which was formerly risk and responsibility) has been re-named *"risk allocation"*. The definition of exceptional risks is very similar to the force majeure definition at Clause 19.

However Clause 17 is rather different, setting out the risks that the Employer and Contractor are to bear in a very detailed manner with the Contractor being entitled to an extension of time and its costs if there are any exceptional risks or Employer risks during the Design/Build Period.

1 [2015] UKPC 37. The Privy Council is effectively the Supreme Court for many Caribbean countries

Fenwick Elliott LLP
Aldwych House
71 - 91 Aldwych
London WC2B 4HN

Office 1A (first floor)
Silver Tower, Cluster I
Jumeirah Lakes Towers
PO Box 283149
Dubai, UAE

www.fenwickelliott.com