Construction newsletter

July 2018

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Any comments or queries?

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Trends and developments in the construction industry

The annual rate of house price growth has continued to slow. Nationwide reported that house prices in London fell by a further 1.9% in Quarter 2. If this trend continues, a likely outcome will be a rise in the number of overvaluation claims against surveyors. To help protect against such claims, surveyors carrying out valuations would be well advised to make the scope of those valuations clear. This includes expressly stating who can rely upon the valuation, on what it is based and for how long it is valid.

The Committee on Climate Change's annual report, published on 28 June 2018, asked Government to support unrealised cost-effective options, including utilising onshore wind and solar energy and improving energy efficiency in buildings. The proposed actions include strengthening new build standards, using heat pumps in new build homes and insulating properties.

We have previously reported an increasing number of claims based on allegations that cavity wall insulation has been installed in properties for which it is not suitable. Claimant solicitors are likely to be watching out for other wide-spread energy saving measures that may work in some properties and not others. Whilst a renewed focus on the energy sector could be an area of growth and opportunity for the construction industry, it is important that only those with the appropriate expertise provide advice. Contractors and insurers will want to be vigilant to the possibility that new entrants to the market may not have sufficient expertise and that new technologies often pose a higher risk of failure.

The Court has heard a couple of key cases that focus on oral construction contracts. These are further discussed in the newsletter below. On a practical note, we often see claims stemming from unclear terms of engagement or a lack of written terms. Both contractors and consultants would be prudent to ensure that their contracts are unambiguous, fully recorded in writing and based on an appropriate level of legal advice.

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In the news

Contribution claims – a tip for the future

Accept certain inalienable truths: prices will rise, politicians will philander and contribution claims will continue to crop up in construction litigation[1].

As such, I thought it would be worth recapping a key principle of contribution claims: same damage.

Section 1(1) of the Civil Liability (Contribution) Act 1978 provides that, in to recover a contribution from another party, that party must be liable for the same damage:

"...any person liable in respect of any damage suffered by another person may recover contribution from any other person liable **in respect of the same damage** (whether jointly with him or otherwise)."

You might think that the term "same damage" is obvious and not worthy of its own blog, let alone judicial ink. But you would be wrong.

Considering situations where the claim is **not** for the same damage may help illustrate the differences in damage that can arise, and what to look out for:

- **Different kinds of harm**: delay caused by a contractor and an extension of time wrongly given by a contract administrator are not the same damage: *Royal Brompton Hospital NHS Trust v Hammond*[2].
- **Physical defects as opposed to financial loss**: *Birse Construction Ltd v Haiste*[3]. In this case, the two (different) types of damage suffered were physical defects in a reservoir and the financial loss of having to construct a second reservoir. Roch LJ summarised his reasoning and conclusion:"The word 'damage' in the phrase 'the same damage' in section 1(1) does not mean 'damages'."
- A building contractor who builds a defective building is not liable for the same damage as an insurer. The former was liable for the damage suffered as a result of the defects, whereas the insurer could only be liable for financial loss under the policy: *Bovis Construction Ltd v Commercial Union*[4].

It is worth noting that one party may be liable for only some of the damage suffered, whilst the other may be responsible for the whole. This part can still be the same damage. And there are many situations where the parties are responsible for the same damage.

That said, if your client is facing a contribution claim, my advice would be to check whether it really is for the same damage.

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1. Thank you Baz Luhrmann.
2. *Royal Brompton Hospital NHS Trust v Hammond* [2002] UKHL 14.
3. *Birse Construction Ltd v Haiste* [1996] 1 WLR 675.
4. *Bovis Construction Ltd v Commercial Union Assurance Co Plc* [2001] 1 Lloyd's Rep 416, David Steel J.

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Oral variations can leave you between a Rock and a hard place

Variations to contracts, whether the scope of the works or services to be performed or the terms under which those works/services are provided, are common place in the construction industry. Often these variations are agreed on site, in a hurry and with little regard to any formalities that might be contained within the parties' contract. The recent case of *Rock Advertising Limited v MWB Business Exchange Centres Ltd* provides an important reminder that the contract shouldn't be ignored.

In Rock, the Supreme Court held that a "no oral modification" clause (or NOM clause) is effective to invalidate a variation to a contract made by oral agreement or by conduct. Whilst this ostensibly removes an all-too-common cause of dispute, the practical effects may be significant (particularly in the construction industry but by no means exclusively).

NOM clauses are contained in many construction contracts and are often added to standard forms by way of bespoke amendments (sometimes as a matter of course in the "boilerplate" section). Standard and bespoke forms often also contain prescriptive provisions for instruction to be issued changing the works/services. They are intended to obviate disputes which may arise from alleged oral variations to a contract, notably when a party embarks on work in the belief they have been instructed to undertake such, only to find that the terms are in dispute or that such an "agreed" variation was never agreed at all.

The matter of whether an oral variation was formally agreed between the parties formed the basis of the dispute in Rock. Rock Advertising Limited (Rock) had entered into a contractual licence with MWB Business Exchange Centres Limited (MWB) to occupy office space but soon fell into arrears with payment of its licence fee. Rock subsequently proposed a revised schedule of payments to MWB. Following a telephone discussion between the parties, Rock treated the revised schedule of payments as accepted. However, MWB later formally rejected the offer and, a month later, locked Rock out of the premises and terminated the licence for non-payment. MWB sued for the arrears and Rock counterclaimed for wrongful exclusion from the premises. The matter turned on the effect of the NOM clause contained in the licence.

The Court of Appeal found on the evidence that the telephone discussion between the parties' representatives had constituted not only an oral agreement to revise the schedule of payments but also an agreement to dispense with the NOM clause. The Supreme Court disagreed and provided clarity on the effectiveness of NOM clauses, with the Court endorsing a view that parties are entitled to agree whatever terms they wish (within the boundaries set by common law and statute) at the outset of a contract. Thereafter, the parties should follow what they have agreed and inserting a NOM clause has the effect of invalidating any later attempt to vary those terms orally (including the NOM clause itself).

As justification, the Court set out three key practical reasons for upholding NOM clauses:

- to prevent attempts to undermine written agreements by informal means
- to prevent misunderstandings as to whether a variation is intended, and its terms, and
- to provide a measure of formality which makes it easier for corporations to police internal rules, restricting who has authority to agree variations.

Nevertheless, as touched upon in the judgment, such a position causes difficulties for a party that carries out work it has been instructed verbally to undertake, only to subsequently find that this does not alter the contractual basis on which it is entitled to be paid. As set out at the outset of this note, despite inclusion of NOM provisions in the construction contracts governing parties' conduct, oral variations are still a common feature of the majority of construction projects.

Whilst Lord Sumption noted that "the safeguard against injustice lies in the various doctrines of estoppel" he declined to explore the circumstances in which such doctrines would be applicable and estoppel can only even be used as a "shield" rather than a "sword" to bring a claim.

The impact of the judgment and how adjudicators and the courts, might interpret arguments over estoppel remains to be seen. Whilst Rock ostensibly provides welcome clarification of the law, it may open a Pandora's box of new disputes (or newly framed disputes) in the construction industry if parties fail to alter their conduct. In the meantime, the advice remains check your contract and comply with the agreed variation procedure. Parties who complain about the other being "overly contractual" should be reminded of the procedure they have either set or consented to.

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Talk isn't always cheap: oral contracts in the construction industry

The recent case of *Dacy Building Services Limited v IDM Properties LLP* [2018] EWHC 178 (TCC) highlights how the TCC dealt with the issue of an oral construction contract.

Since the Local Democracy Economic Development and Construction Act 2009 removed the requirement for construction contracts to be in writing, an oral construction contract is sufficient for disputes to be governed by the statutory adjudication provisions.

The case of *Dacy v IDM* originally started as an application by Dacy to enforce the decision of an Adjudicator who decided: (i) that an oral contract existed between Dacy and IDM; and (ii) IDM owed Dacy the sum of £247,250 pursuant to that contract.

Dacy applied, in the usual way, to enforce the Adjudicator's award by way of summary judgment. IDM resisted enforcement as it alleged there was no contract between Dacy and IDM but instead Dacy had contracted with a third party, who subsequently entered into administration. Accordingly, IDM contended the Adjudicator had no jurisdiction to make his decision.

At the summary judgment hearing the Court held that IDM had a "realistic prospect of succeeding" in its defence that there was no contract between Dacy and IDM. Therefore a one day trial was ordered which, naturally, relied on oral evidence between the parties involved to consider whether an oral contract was agreed.

The Court commented that IDM's key witness was "very capable of glossing over contractual precision when it suits him" and ultimately preferred the evidence of Dacy's witnesses. The Court decided a contract was concluded between Dacy and IDM and the Adjudicator's decision was enforced.

In delivering its judgment the Court made and drew on previous comments about the difficulties with oral evidence commenting that "reliance on recollection alone should not be the sole tool for assessing credibility of witnesses" and "In a case such as this, with the central issue being what was agreed orally at a particular meeting, there are inferences (which is to say common sense conclusions) that can be drawn from certain other matters, not only documents, but also circumstances".

The case highlights the obvious difficulties that arise when contracts are not concluded in writing and (despite the Court's efforts) it took 17 months – and one would expect considerable cost – before Dacy was able to enforce the Adjudicator's decision.

The Court however seemed keen to emphasise the trial could have taken place much earlier and the issue resolved a year before. It also noted that it was only in very rare cases that adjudication enforcement applications will result in trials of issues thus highlighting that disputes (even involving oral contracts) will usually be dealt with speedily.

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Cases

SSE Generation Ltd v Hochtief Solutions AG and another [2018] CSIH 26

This recent case considered the principles in the Supreme Court case of *MT Højgaard A/S (Respondent) v E.On Climate & Renewables UK Robin Rigg East Limited and another (Appellants)* and saw the courts once again opine upon the complex issues arising in respect of a contractor's fitness for purpose contractual obligation and the duty a professional owes in common law to exercise reasonable and care when providing design services. The case also looked at the often grey area between what is design and what is workmanship (or "design implementation").

Background

The case involved the collapse of a tunnel in Scotland that formed part of an hydro-electric scheme that had been design and built by Hochtief Solutions AG and Hochtief (UK) Constructions Ltd (the Contractor) for the SSE Generation Ltd (the Employer) under a NEC contract. The contract contained a fitness for purpose obligation on the Contractor to build a tunnel that would not collapse for 75 years. It also included Option M which limits the Contractor's design duties to those of reasonable skill and care.

The tunnel collapsed six months after construction and a dispute arose as to whether the Employer or the Contractor was liable for the remedial costs which amounted to around £107m.

Many issues were debated, including what caused the collapse of the tunnel and what constituted a defect under the terms of the contract. Of particular interest, however, was the further debate as to how the courts may interpret a contract containing both a duty to undertake the design element of a project with reasonable skill and care as well as a fitness for purpose obligation.

In this case, the court held that the defect that caused the collapse of the tunnel was not design related and that the Contractor had complied with its reasonable skill and care duties in that respect. Instead, the defect was found to be linked to the implementation of the design – the workmanship element of the services. As a result, the fact that the Contractor had complied with its design duties was not enough to provide a defence since the contract contained a fitness for purpose obligation on the Contractor to build a tunnel that would not collapse for 75 years.

Conclusion

Contactors often seek to limit their duties in respect of the design element of a project with clauses similar to the Option M clause in the NEC Contract. In doing so, they seek to differentiate their design duties from their contractual obligation to provide a product that is fit for purpose. The issues in this case, therefore, extend beyond NEC contracts and are of potential relevance to all contractors operating under design and build contracts.

This decision serves to remind us how fact specific and complicated the debate around fitness for purpose vs. reasonable skill and care remains when considering design and build contracts. While it is hard to draw any firm conclusions at this stage, the decision suggests that, when interpreting contracts, the Courts are becoming more willing to favour and emphasise a contractor's fitness for purpose obligation over any less onerous duties of reasonable skill and care.

While the case was heard in the Scottish courts, it is anticipated that the case will go to the Supreme Court given the principles and the sums at stake.

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R.G. Carter Buildings Limited v Kier Business Services Limited [2018] EWHC 729 (TCC)

The Court has given guidance on when time starts to run for contribution claims. In short, pursuant to s.10(4) Limitation Act 1980, limitation on claims in contribution will run from the date on which the parties conclude a binding agreement for damages to be paid. Agreements reached "in principle", or said to be "subject to contract" or similar, could not be binding agreements, and therefore time could not cause time to begin to run.

The facts of the case were as follows: In 2002, RG Carter built a new science block for Lincolnshire County Council at Boston Grammar School. Unfortunately, the block, which had been designed by Kier, suffered water ingress problems. The Council brought arbitration proceedings against Carter in 2015.

Alongside the arbitration, between March and April 2015, Carter and the Council entered into settlement negotiations. At that stage, it was agreed that Carter would carry out remedial works, some at its own cost and some with the costs shared with the Council. The Council distilled the proposal on 16 April 2015 in correspondence marked "WITHOUT PREJUDICE SAVE AS TO COSTS" and. "SUBJECT TO CONTRACT". Further correspondence followed clarifying the precise scope of the remedial works. Carter conducted investigatory surveys in May, and carried out preparatory work in June.

Eventually, a final agreement was signed on 29 June 2015. Carter decided to seek a contribution from Kier in respect of the c£200k costs it had incurred as a result of the settlement. Carter and Kier entered into a standstill agreement on 28 April 2017, before Carter issued proceedings on 20 September 2017. Kier asserted that the proceedings were out of time, since under s.10 Limitation Act; proceedings had to be brought within two years of the date on which a right of action accrued. Kier's position was that the remedial works had been agreed in principle by 16 April, meaning that time began to run from that date. On that basis, Kier considered that time had already expired by the date of the standstill agreement.

The issue for the court was whether time ran under s.10(4) only once parties have entered into a binding agreement for the payment of compensation, or whether something short of a binding agreement is sufficient to start time running.

The court considered that the most logical way to test Kier's proposition was to consider what the outcome would be if the parties reached an agreement in principle, but the talks then broke down and did not result in a binding settlement agreement. Under Kier's construction, once the talks failed, then the case would revert to be determined under s.10(3), ie from the

date of judgment or award where the matter is litigated or arbitrated. That was not a sensible construction of the Act.

The court considered it important to approach the legislation on the basis that Sections 10(3) and 10(4) are intended to be mutually exclusive. As such, there could only be one trigger date to start time running under s.10: either (i) the date of the judgment or award requiring a payment; or (ii) the date of the agreement to make payment where the issue is compromised. On that analysis, and since there can only be one trigger event, it follows that time cannot start to run where the parties reach an unenforceable agreement as to payment. In such a case, the proceedings remain on foot and time will only start to run under s. 10(4) from the date of the formal binding agreement as to the amount of the compensation payment.

As a sense check, the court concluded that its findings were "obviously right" when the interplay between s.1(4) Civil Liability (Contribution) Act 1978 and s.10(4) Limitation Act 1980 was considered. Since the cause of action for a contribution only arose under the 1978 Act on settlement of the underlying dispute, time could not start to run under the 1980 Act from the date of some earlier, non-binding agreement.

The negotiations during April 2015 were expressly conducted on a "subject to contract" basis and it was common ground that no binding agreement was reached until 29 June 2015. The parties had not intended to be bound until that date. The contribution claim was therefore in time and the limitation defence failed.

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Redbourn Group Ltd v Fairgate Developments Ltd [2018] EWHC 658 (TCC)

The Technology and Construction Court has considered issues of causation and loss in a decision arising out of the wrongful repudiation of a consultant's contract. The decision highlights the need for consultancy appointments to contain clear termination provisions and reveals the consequences for a consultant in circumstances in which its consultancy agreement contains a discretion, on the part of a developer, to (or not to) proceed.

Facts

The consultant, Redbourn Group Limited (RGL), was appointed development and project manager in relation to the development of land in Wembley. RGL's appointment included a staged payment-plan. The developer, Fairgate Developments Limited (FDL), terminated the appointment by serving a breach of notice midway through stage 3 of 5. RGL sought damages for breach of contract. Having first found that RGL's contract had been wrongfully repudiated, the Court had to determine the amount of any damages to award.

RGL claimed that it was entitled to all the fees that would have been payable to it had it carried out all the services under its appointment for all stages of the project, save for a discretionary performance fee. In the alternative, RGL claimed damages for the alleged loss of a chance to earn those fees. Credit was given for costs that it would have incurred in any event.

Decision

Part of RGL's role was to obtain planning permission for the development. The planning application was subject to approval by FDL. Planning permission had not been obtained by RGL at the time of its dismissal and the Court considered that, even if RGL had not been dismissed, consent would likely not have been given for the proposed scheme.

The Court considered whether, pursuant to the terms of RGL's appointment, FDL was legally entitled to pull out of the contract or whether it owed a contractual obligation to proceed and, therefore, pay RGL. The Court concluded that the fact that FDL retained discretion (relating to whether to approve an application for planning permission) – albeit not unfettered - indicated that FDL was not contractually obliged to proceed with the scheme. There was, therefore, no guarantee that RGL would be employed, and paid, for every stage.

Further, the Court concluded that the project was unrealistic and commercially unviable on the facts. RGL's alternative case also failed, with the Judge likening the claim to awarding damages to a wrongfully dismissed employee based on the chance that their employer might have continued their employment longer than obliged to do so.

Ultimately, the TCC found that RGL could only claim the fees payable up to the point that the appointment could have been lawfully terminated. As all fees up to that point had been paid (save for an outstanding sum that FDL had admitted), even though FDL was found to have repudiated the contract, RGL was not entitled to damages.

FDL's small contractual discretion, not contained within the contractual termination clauses, as to whether to proceed with the development ultimately limited its liability to RGL and saved it from a substantial order to pay damages. Consultants should be aware of the limiting effect these types of clauses can have on their ability to recover lost fees following termination and the need to ensure that their consultancy appointments contain clear termination provisions setting out what fees a developer will be liable for in the event of termination.

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Haberdashers' Aske's Federation Trust v Lakehouse Contracts [2018] EWHC 588 (TCC)

This article discusses the recent TCC judgment in which the High Court gave valuable guidance on the application of project-wide insurance cover. To what extent does a subcontractor become a party to a Contractors' All Risks insurance policy which is in place before the subcontractor is engaged and what right do Insurers have to pursue subrogation claims against sub-contractors on a project?

Background/issues

The Claimants owned and operated a School. The First Defendant (Lakehouse) was appointed as the main contractor for an extension project and the Second Defendant (Cambridge Polymer Roofing) was their appointed roofing sub-contractor. A fire occurred at the project site which

caused extensive damage to the buildings. The Claimants brought proceedings for damages against the First Defendant and the claim was settled for £8.75m, paid by a project-wide insurance policy which covered a list of insureds, including the First Defendant contractor and its sub-contractors.

The Second Defendant had also expressly agreed in its sub-contract with the First Defendant that it would obtain its own insurance cover in respect of its construction works in the sum of £5m (which it had done). The project insurers sought a contribution/indemnity from the Second Defendant's insurers. The Second Defendant argued that, notwithstanding the express term in the sub-contract that it obtain its own insurance, the project insurance had been intended to, and did, include it as an insured party and sought a declaration to that effect.

Issues to be determined
To what extent did the Second Defendant sub-contractor have the benefit of the project-wide insurance policy and could the project insurers pursue a subrogated recovery from the Second Defendant's insurers?

Held
The Court held that the Second Defendant was not entitled to the benefit of the project wide policy, to the extent that it had its own insurance. Recovery from the Second Defendant's insurance policy was therefore allowed.

In deciding the issues, Mr Justice Fraser helpfully discussed the question of how subcontractors in the construction industry come to participate in project insurance policies and provided useful guidance. Three ways were discussed – Agency and ratification, Standing offer, Implied conduct.

- **Agency** – The theory that the contractor was an agent of the sub-contractor when procuring project insurance was deemed to be stretching the principles of agency and posed a problem for subsequent subcontractors as they would not have been identifiable at the time the insurance was procured and therefore could not ratify the procurement of the insurance under the principles of agency. The Court did not favour this theory.
- **Standing offer** – The favoured method was by acceptance of what could be deemed a standing offer of insurance to all those persons who are subsequently identified as members of a defined grouping, namely the First Defendant's sub-contractors. The offer is accepted by the execution of the sub-contract. However, in this instance the express term in the Second Defendant's sub-contract for them to obtain their own insurance meant that they never joined the "defined grouping" to which the offer was being extended (at least not to the extent that it had its own insurance cover), and therefore the act that would have included the Second Defendant in the project insurance, namely entering into the sub-contract, did not constitute acceptance, where the agreement expressly stated that the sub-contractor should have its own insurance.
- **Implied conduct** – It was considered that a sub-contractor could be deemed included in the project insurance from their conduct, negating the need for offer and acceptance as required for a standing offer. The Judge did not comment on whether this was a correct method but excluded it as a possibility on these facts as it was determined that the parties' intention on the face of it was for the Second Defendant to obtain their own insurance. This express term in the contract prevented the possibility of implying a term to the contrary and to say that the sub-contractors insurance would never be called on in such circumstances would be to go against the express intention of the contract.

Summary/conclusion

To the extent that the Second Defendant had expressly agreed to have insurance in place, the Second Defendant was not entitled to the protection of the project insurance. The express agreement in the sub-contract negated any standing offer, over-rode any implied conduct and prevented any implied contractual terms to the contrary. Therefore, the project insurers were entitled to bring a subrogated recovery claim and could recover the full amount of the insurance cover that the Second Defendant had agreed to obtain, as a contribution/indemnity.

Practical points

This case does not provide definitive guidance. The Court did not go so far as to say the agency theory is completely wrong, or that the only correct approach is the standing offer theory. However, this seems the most plausible scenario from the useful guidance that is given. Contractual parties should be mindful of the primacy of any express agreements in sub-contracts which will over-ride any informal intention or implied conduct in relation to project wide insurance cover and the right of subrogated recovery from a sub-contractor's insurer.

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Roundup

What's on the horizon?

It's been a couple of years but we are still waiting for the implementation of **BIM Level 3**. The next level of BIM, which is intended to address the flaws in BIM Level 2, was launched by the government in March 2015, and the plan was to have five years of preparation followed by five of implementation, with early adopter projects beginning in 2017/18. Indeed, government projects were supposed to start using BIM Level 3 in January 2017. However, there is no update as to how its development is going and the proposals for industry-wide implementation are still unknown.

Meanwhile, the government has extended the deadline for **the Shorter Trials Scheme and the Flexible Trials Scheme** pilots to 30 September 2018. The government introduced these pilot schemes in October 2015 with the intention that they will lead to shorter trials at the High Court in London, at a more reasonable and proportionate cost than usual litigation. In summary, the Shorter Trials Scheme applies to simple cases where no extensive disclosure is required, particulars are less than 20 pages, and trial is no more than four days long whilst the Flexible Trials Scheme requires parties to agree to a truncated procedure which limits disclosure and oral evidence, and focuses on written evidence and submissions. Uptake on either Scheme has been limited – only a small number of cases have been issued or transferred to the Shorter Trials Scheme and fewer have used the Flexible Trials Scheme. It is not clear whether this slow uptake is due to lack of public awareness, caution of parties, or perhaps some other factor, but the deadline for the Schemes has been extended as a result. More information on the Schemes can be found here.

From 18 October 2018, all contracting authorities will be required to permit the submission of electronic tenders. This extends to all communication and information exchanged in the tender process. It has been implemented through the **Public Contracts Regulations 2015** and applies to contracts that are above £164,176 in value. The Regulation is intended to promote traceability, transparency and auditability in the procurement process.

Finally, the government is due to unveil new legislation that works to **reverse charge VAT** in the construction sector. The new reverse charge VAT scheme will transfer the burden of liability for VAT from the supplier to the recipient, where it will be the supplier who has to account for VAT that is due. The new regime works to combat a common issue of fraud in the construction industry whereby supply chains are artificially extended in order to avoid paying VAT. By requiring the recipient to pay VAT directly to HMRC, it avoids the need for VAT being collected at a later date and risking exposure to fraud.

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For full details of our international construction team click here.

About RPC

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- **Winner – Law Firm of the Year – The Lawyer Awards 2014**
- **Winner – Law Firm of the Year – Halsbury Legal Awards 2014**
- **Winner – Commercial Team of the Year – The British Legal Awards 2014**
- **Winner – Competition Team of the Year – Legal Business Awards 2014**

Areas of expertise

- Competition
- Construction & Engineering
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- Dispute Resolution
- Employment
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- Media
- Pensions
- Professional Negligence
- Projects & Outsourcing
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Technology

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