Nuts and bolts

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A very serious offence – take note for 2008

On 6 April 2008 The Corporate Manslaughter and Corporate Homicide Act 2007 will create the new offence of corporate manslaughter. The Act will make it possible for companies rather than individuals to be punished where there has been a gross failing throughout the organisation in the management of health and safety with fatal consequences. The Act will affect all businesses and construction organisations need to be aware of the following key points:

The Offence
An organisation will be guilty of an offence under the new Act if the way in which any of its activities are managed or organised by ‘senior managers’ causes a person’s death and amounts to a gross breach of a relevant duty of care owed by the organisation to the deceased.

The question of whether a duty of care exists is a matter of law but at the very least a duty of care is owed to employees and others working for the organisation, workers whom it supervises, all those engaged by it to carry out construction works and those visiting its sites.

Penalties
If convicted under the Act the risk is an unlimited fine. The Court can also make a remedial order requiring the working practices/defects which led to the death to be changed. If the offender fails to comply with such an order it will be guilty of another offence liable to an unlimited fine.

The Court can also require publication of details of the conviction stating the particulars of the offence, amount of the fine and terms of any remedial order. Failure to comply with a publicity order is also an offence and liable to an unlimited fine.

What should be done?
Some suggestions:

Promote a health and safety culture. Allow employees to report any concerns on a confidential basis;

Consider who in your organisation would be considered as ‘senior management’. Are you satisfied that they are competent? Make sure they are well aware of the Act and the implications of their actions;

Review how you currently deal with health and safety breaches when they occur – are they well documented and are relevant steps taken to prevent repeat breaches?

Remember: You will not fall foul of the Act if you comply with all relevant health and safety legislation and guidance.

Finally, a goodbye to collateral warranties?

Background
Provision of collateral warranties to third parties (including funders, purchasers and tenants) has long been a feature of development projects. On larger projects this can result in a huge number of separate collateral warranty documents having to be prepared and executed. This can be time consuming and sometimes causes problems with funding drawdowns where, for example, provision of certain collateral warranties is a condition precedent.

The direct alternative to preparing and executing separate collateral warranty documents is providing rights to third parties in the principal contract through the use of the Contracts (Rights of Third Parties) Act 1999 ("Act"). Although the Act has been in force for seven years it is only relatively recently that wider and more frequent use of the provisions of the Act has been experienced in development projects.
The slow take up has been due to a number of factors including:

- resistance to change, particularly by some banks involved in providing finance;
- various drafting bodies taking their time to include them in standard form contracts;
- lack of confidence about enforcement;
- uncertainty on how to deal with ‘step-in’ rights;
- lack of confidence in dealing with the imposition of third party rights on sub-contractors, where required.

Many of the above factors have been resolved over time. Within the last two years:

- key participants in development projects have become far more comfortable with the formulation and use of third party rights schedules;
- third party rights schedules were included as an option under the revised suite of JCT standard form contracts that were first published in the latter half of 2005;
- enforceability is not an issue provided the rights are properly drafted and, of course, the principal contract (containing the third party rights) is executed by the parties;
- many banks have now become comfortable with step-in rights in third party rights schedules;
- where third party rights are required from sub-contractors the obligation to procure them can be imposed on the principal contractor and then contained in the subcontract.

Some advantages of using third party rights under the Act

- It reduces the number of documents to be prepared and executed and therefore time and cost;
- Only one contract document is needed to contain all the relevant rights instead of the principal contract and the relevant collateral warranty which can easily become separated over the years and difficult to find;
- Once the relevant contract is executed the third party rights are effective (subject to any specific terms in the third party rights schedule, e.g., written notices).

We believe that the Act will be used more frequently in the future and we would certainly encourage our clients to make use of the provisions of the Act. It will be some time before we can say that collateral warranties are a thing of the past but we expect that their use will and should diminish.

**Adjudication cases 2007**

**Steve Domsalla (t/a Domsalla Building Services) v Kenneth Dyason:** The court held that notwithstanding the usual exclusion a residential occupier who is a party to a JCT Minor Works 2005 Contract is bound by the contract’s adjudication provisions. We consider that this will apply equally to other JCT and standard form contracts. It was also held that the doctrine of unreviewable error of an adjudication award only applies to statutory adjudication (i.e. ones where the parties are subject to the provisions of the Construction Act) and not to contractual adjudication (i.e. where parties agree to submit to adjudication when otherwise they would be outside the Act as when they enter into a JCT Contract which contains adjudication provisions). Further, that the Unfair Terms in Consumer Contracts Regulations do not apply to the adjudication provisions in the JCT Minor Works 2005 Contract even when it may be procedurally unfair for the contractor to rely on them against a residential occupier. However, the withholding provisions in the same contract were held to be unfair on the facts of this particular case.

**AC Yule & Son Ltd v Speedwell Roofing & Cladding Ltd** [2007] EWHC 1360 (TCC); [2007] B.L.R. 499 Where a party has not expressly agreed to an adjudicator’s request for an extension of time for giving his decision, the Court may infer agreement from the party’s conduct, so that the party may be prevented from challenging the decision on the basis it was “out of time”.

**Mott MacDonald Ltd v London & Regional Properties Ltd** [2007] EWHC 1055 (TCC); 113 Con. L.R. 33 The court will not tolerate adjudicators imposing liens on their decisions subject to payment of their fees – in this case the judge went as far as to say that the fact the adjudicator required his fees had to be paid by the referring party before he would publish his award gave the appearance of bias to his appointment.

**Multiplex Construction (UK) Ltd v Mott Macdonald Ltd** [2007] EWHC 20 (TCC); 110 Con. L.R. 63 Unusually, the remedy granted by the adjudicator which the claimant was seeking to enforce was specific performance for delivery of certain documents. The court held that the adjudicator had acted within his jurisdiction when he allowed the claimant access to certain documents of the defendant and that to enforce
Can you withhold payment without serving a withholding notice?

The short answer to this is yes... in limited circumstances. This question was the main issue considered in *Melville Dundas Limited v George Wimpey (UK) Limited*, a case which hit the headlines in April 2006 as it was the first time that the Housing Grants Construction and Regeneration Act 1996 had been considered in the House of Lords.

Melville had applied for an interim payment on 2 May with the final date for payment falling on 16 May. Wimpey failed to pay by 16 May and failed to serve a withholding notice. On 22 May, Melville went into administration and on 30 May, Wimpey terminated the building contract. Melville’s receivers brought proceedings against Wimpey to recover the sum applied for by Melville on 2 May.

Melville relied on s.111 of the HGCRA: “A party to a construction contract may not withhold payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to withhold payment”.

Wimpey, however, relied on clause 27.6.5.1 of the building contract (JCT 1998 With Contractor’s Design) which provided that where the employer determined the employment of the contractor as a result of a default on the contractor’s part or the appointment of administrative receivers, “…the provisions of the contract which require any further payment…to the contractor shall not apply”.

The Court dealt with this apparent conflict between s.111 and the JCT clause by stating that s.111 “should be construed as not applying to a lawful ground for withholding payment of which it was...not possible for a notice to have been given in the statutory time frame.” The House of Lords held (albeit not unanimously) that Wimpey had been entitled to withhold the money from Melville.

At the time, this decision gave rise to concerns that employers would be able to use termination to avoid making interim payments. However, these concerns were quickly allayed in July 2007 as Judge Coulson in the TCC was given an opportunity to consider the Melville decision in slightly different circumstances.

The case was *Pierce Design International Limited v Mark Johnston and Another*. Johnston had engaged Pierce under a JCT 1998 With Contractor’s Design contract, but following slow progress from Pierce, Johnston stopped making interim payments, failed to issue any withholding notices and eventually terminated the contract.

Pierce raised a similar s.111 versus JCT clause argument to the one that had been considered in the Melville case. The Judge concluded that the operation of clause 27.6.5.1 was not limited to insolvency cases and he was therefore bound by the House of Lords’ decision on that point.

However, Pierce also relied on the proviso contained within clause 27.6.5.1 which states that the operation of the clause should not prevent the contractor receiving any payment that it is due and which the employer has “unreasonably not paid” more than 28 days before the termination. The Judge held that since Johnston had not served a withholding notice, the sums due to Pierce had been “unreasonably not paid” and Johnston was not able to rely on the clause to escape payment.
In summary, whilst the answer to the opening question can be yes in certain cases of insolvency, the important point for payers arising out of the Pierce case is that Melville does not seem to have the wider application it was initially feared it would have. It merely provides an employer with a possible safety net where circumstances conspire to make it impossible for him to comply with the statutory framework for issuing a withholding notice. Consequently, payers cannot rely on termination to avoid making interim payments without issuing a withholding notice. Accordingly it is still necessary to issue a timely withholding notice should you wish to withhold monies from any applications for payment under a building contract.

Round-up of notable 2007 cases

**Costs of Reinstatement/Repair**

John F Hunt Demolition Ltd v ASME Engineering Ltd. Where the contractual provisions exclude liability for a certain type of loss (in this case reinstatement value after destruction by fire where the employer is responsible for maintaining insurance to cover that liability) the court should not allow a separate duty in negligence to be tacked on to the back of the contract. This case also dealt with settlement sums being sought in subsequent proceedings from third parties (see separate article entitled “Are you considering settlement?” for other aspects of this case).

McGlinn v Waltham Contractors Ltd. When a claimant seeks to recover remedial or reinstatement costs it is not enough just to take expert advice on what is the appropriate course of action, the claimant must act reasonably at the same time, e.g. in this case although the expert had advised that demolition and reinstatement (the more expensive course of action) was appropriate the judge found that the claimant was only entitled to the less expensive cost of repairs.

**Pre-action Protocol**

Charles Church Developments Ltd v (1) Stent Foundations (2) Peter Dann Ltd. The Claimant issued proceedings just before the expiry of the limitation period without complying with the court pre-action protocol and without making an application for directions to the Court on what should be done to remedy the breach of the protocol. Despite the action being only part-way through the judge awarded 50% of the Defendants costs to them whatever happened later in the action. In addition the Claimant had to bear 50% of its own costs. The Judge made it clear that parties do not have to wait to the end of an action to make an application for costs based on non-compliance with the protocol.

Cundall Johnson & Partners v Whipps Cross University Hospital NHS Trust. In complying with the pre-action protocol what is required from each side is a clear and concise summary of their respective cases – neither the letter of claim nor the defendant’s response needed to resemble pleadings either in their length or their detail.

**Liquidated Damages (LAD’s)**

Reinwood Ltd v L. Brown & Sons Limited - If a valid notice to deduct LADs is issued following a certificate of non-completion and then subsequently, but before the final date for payment an extension of time is granted so that the certificate of non-completion falls away, the notice to deduct LADs nonetheless remains valid and the employer may deduct the LADs. If it is later found that in light of the extension of time the amount of LADs deducted is too much then the employer (under the provisions of the contract in question) had an obligation to refund the excess deduction within a “reasonable time”. No definition of a reasonable time was given and as such this concept may be open to abuse. Also if the deducting payer becomes insolvent before the money is repaid the payee inevitably loses out.

**Wasted Management/Staff costs**

In Aerospace Publishing and another v Thames Water Utilities Ltd. it was held that in order to claim wasted staff costs as damages for breach of contract the following principles apply: (1) the fact and the extent of the diversion of staff time have to be properly established – all relevant evidence needs to be put forward. It is important to maintain records to show how staff have spent their time (2) the claimant must establish that the diversion caused “significant disruption” to the business; (3) ordinarily it is reasonable for the court to infer that if there had been no disruption the staff involved would have generated revenue for the claimant in an amount at least equal to the cost of employing them during that time.

Bridge UK.Com Ltd v Abbey Pynford Plc. Evidence to support a claim for lost management time can be in the form of a witness statement from memory – it does not have to be from formal time records. However, the court may apply a discount to reflect the uncertainty of this method of calculation (in this case it was 20%).
**Tender Procedure**

*J&A Developments Ltd v Edina Manufacturing Ltd.* concerned failure by the employer to adhere to the Code of Procedure for Single Stage Selective Tendering 1996. The principles of the Code were expressly incorporated into the tender and the court held that this created a contractual obligation to comply with those principles. Unusually the judge found that had the principles been followed the claimant was virtually certain to have been awarded the contract and awarded damages for both the cost of preparing the tender and for loss of profit (subject to a discount of 20% for regular staff being freed for other activities).

**Right to Light**

*Regan v Paul Properties Ltd.* The claimant notified the developer defendant before their building (opposite his property) reached full height that the 5th floor penthouse would infringe his right to light. The defendants continued to build and had partially constructed the penthouse by the time the claimant issued proceedings for an injunction to stop that part of the development. The Court found that the relative financial loss of the parties (the developers stood to lose a substantial amount) was not the only factor in deciding whether an injunction should be awarded. Given that the claimant had raised his objections early in the development the defendants had their eyes open and took a calculated risk when they continued to build – they must now suffer the consequences of that risk and the injunction was granted.

**Insurance – smoke and mirrors?**

Everyone involved in development/construction projects recognises the importance of adequate insurance being in place to cover the multitude of risks that can arise. Although there is a general awareness of the type of cover available, there is less awareness of the wide variations in, for example, professional indemnity and contractor’s all risk policies. This may mean that those taking comfort from the existence of such policies have an unpleasant surprise when they come to make a claim.

Added to that is the fact that as a way of mitigating the high cost of premiums, those insuring often agree to take on a substantial excess/deductible or agree to the exclusion of claims of higher risk. A developer or funder is therefore well advised to look behind the standard insurance certificate now routinely produced as evidence of insurance cover. Such certificates commonly do not state the total cover in place (instead they are geared to the level of cover the consultant or contractor has agreed to maintain – which may be different); whether such cover is inclusive or exclusive of costs of defending the claim; and do not usually specify what exclusions there are from the policy.

Other practical points to consider are:

- Is there a “non vitiation” clause which means that on a joint policy if one party breaches the policy, the insurer will still maintain cover for the other parties. If not the insurer may avoid the whole policy?

- Standard contractor’s all risk policies do not cover delays in completion of the project. Whilst a developer may take comfort from the provision for liquidated damages in the building contract, such damages may be mitigated by extensions of time granted under the building contract leaving him with no recourse for lost rent or costs of delays in sales. It may therefore be worth considering specific delay insurance cover;

- Professional indemnity policies cover negligence but some exclude breach of contract claims. Some also exclude cover for adjudication claims and awards. Negligence on the part of the insured must be proven (sometimes a long, laborious and expensive process) before the insurers meet any claim. The fact that a consultant or a contractor has made an error does not of itself mean that he is negligent and a non-negligent error or default may be very costly to the Employer. If “no fault” cover is required the developer/funder should consider latent defects insurance which may have the added bonus of dispensing with the need for collateral warranties;

- Some policies provide that insurers will not pay out until the insured’s excess is paid, this is a major consideration if the insured cannot pay or has become insolvent;

- Public liability policies often have a limitation for recovery of statutory contamination clean up costs, potentially a major expense;

- On any development there may be a number of policies covering the same risk because each of the participants has its own insurance. Savings may be made and gaps in cover avoided by the employer taking out a project policy at the outset.

In short, insurance is an important area which deserves more attention and planning than it is often given, if it is truly to cover for the risks which may arise from modern construction and engineering projects. Accordingly it pays for insurance to be thought about and addressed early in the procurement planning.
Are you considering settlement?

Construction disputes are often not limited to two parties. Even where two parties are considering settlement, the paying party will often be banking on recovering part if not all of the settlement monies from another part of the supply chain.

For example, if an employer makes a claim for defective work against the main contractor, the main contractor retains responsibility for all the contract works, but in reality the work may have been carried out by a sub-contractor or caused by defective materials supplied further down the supply chain. In the interests of dealing with the employer’s claim quickly, reducing time and costs involved in resolving the dispute and getting on with new profit making work, the contractor may come to a commercial settlement with the employer to pay him a sum of money. The contractor may be happy to do this as he assumes he will be able to recover the sum he has paid from those actually responsible for the defect – a sub-contractor. However, following the case of Hunt v Asme decided by HHJ Peter Coulson, the contractor should not necessarily be so confident.

In that case the employer (Kier (Whitehall Place)) and the contractor (Kier Build) had brought a joint claim against the demolition sub-contractor (Hunt) for damage caused by fire to facades. Hunt considered that the fire was the fault of one of its sub-sub contractors, ASME. Hunt came to a commercial agreement with the employer and contractor, paying out a sum of £108,987.12 to the employer and £43,512.88 to the contractor, all the time thinking that it would be able to recover such sums from ASME.

ASME claimed that although Hunt was liable to the contractor, Hunt were never actually liable to the employer due to the joint insurance in place and therefore should not have agreed to pay anything to the employer. ASME considered that the maximum sum Hunt could claim against them was £43,512.88. The Judge disagreed with this analysis although he did find that the settlement was unreasonable for other reasons and decided that the maximum Hunt could claim against ASME was £43,512.88. In reaching his decision, the Judge carried out a helpful review of the relevant authorities regarding settlements and the position can be summarized as follows:

The general principle from the earlier case of Biggin v Permanite is that if a settlement is reasonable and not too remote it can be taken as the measure of damages, even if it is at the ‘upper end’ of what is reasonable, for a subsequent claim against a third party. There is no need to show that the claim settled would have succeeded or been likely to succeed. However it must have sufficient substance to be reasonable to settle;

A settlement may still be deemed reasonable where there is no actual legal liability;

The question of whether a settlement is reasonable will depend on the facts of each individual case;

If a settlement sum is found to be unreasonable, it will be disregarded when calculating the measure of damages that the paying party may be able to recover from a third party and the paying party will only be able to recover the losses it can actually establish.

What should you do when considering settlement?

There are warnings here both for parties seeking to recover settlement sums and those seeking to resist them:

If you are seeking to recover a settlement sum from a third party, you cannot automatically assume that you will be able to do so. In an ideal world you would not settle a dispute without involving the party from whom you hope to recover the settlement sum. However where this is not possible you need to ensure that it is both reasonable to settle and that the settlement sum you agree is reasonable, bearing in mind the merits of the case, likely litigation fees involved and commercial reality. A legal opinion on these points is likely to assist in illustrating that the settlement was reasonable.

If you are seeking to resist a claim based on a settlement between other parties and consider that you have a strong defence, beware: you may find this more difficult than you first imagine. For public policy reasons the courts are keen to support the settlement of claims by negotiation. As mentioned above, in some circumstances a settlement will be considered reasonable and recoverable from a third party even where a court might hold that there is no liability.
We continue to be busy in the Construction Team with innovative projects ranging from hotels (including one prefabricated overseas and then assembled in England), student accommodation, private health care, and a cinema complex as well as a range of mixed use developments including private and social housing. Contractual and advisory work predominates but we wait to see if the predicted upturn in disputes comes about (on the premise that this usually follows an economic slowdown!).

As in previous years we are delighted to be included as a recommended construction team in the Chambers and Legal 500 directories of law firms which report that we are “a good solid construction firm” with a reputation for providing “quick, highly responsive advice”. Joe Bellhouse was said to be “commercial” and “sensible, bright and flexible” and Suzanne Reeves as “bright”, “down to earth and very user friendly” and “having an ability to explain things to the ignorant in a way they can understand”! Many thanks to those clients who said good things about us.

If you would like more information about any of the articles in this bulletin or generally, please contact Joe Bellhouse 020 7395 3073 | jbellhouse@wedlakebell.com or Suzanne Reeves 020 7395 3168 | sreeves@wedlakebell.com