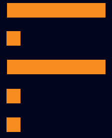

Fishburns LLP

CONSTRUCTION UPDATE

JANUARY 2013

"The substantial team at Fishburns LLP provides a 'high level of service', and is 'very responsive and client focused', 'with expertise in the … construction and engineering sectors." (Legal 500, 2013 edition)

Welcome to the latest edition of the Construction Update which includes a selection of topical articles of interest to construction professionals and their insurers. All of our articles are also available on our website which, *inter alia*, provides details of our unique construction support offering through integrated claims handling, loss adjusting and legal services.

Page 1 **Peter Campion reviews the highly significant Court of Appeal decision in *Ace European Group & Others v Standard Life Assurance Limited* concerning the operation of 'first party' or mitigation of loss cover and its implications for insurers of D&C risks.**

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Page 9 **Mark Prince considers the interesting case of *Hawksford Trustees Jersey Ltd v Stella Global UK Ltd*, in which the Court of Appeal held that retrospective After-The-Event insurance premiums were not recoverable, thereby serving to underline the court's commitment to upholding the principle of access to justice.**

We welcome all feedback on our publications and whether you are a consultant, a contractor, a sub-contractor, an insurer or broker, we hope that you will find something of interest in this edition.
Peter Campion, Chairman

Ace European Group & Others v Standard Life Assurance Limited [2012]

Peter Campion
Chairman

The Court of Appeal decision in *Ace European Group & Others v Standard Life Assurance Limited* on 19 December 2012 was no doubt an unwelcome Christmas present for insurers of financial institution ("FI") risks. The appeal concerned the operation of "first party" or mitigation of loss cover which is also commonly seen in design and construct ("D&C") policies so it will also be of interest to insurers of D&C risks.

The Facts

In essence, ACE's appeal related to whether SLAL were entitled to full indemnity for costs incurred in heading off actual and potential claims arising as a result of the manner in which it sold and operated a pension fund ("the Fund"), or whether ACE were entitled to apportion the mitigation spend between claim avoidance and brand protection and to refuse indemnity for the latter.

The *"civil liability"* policies in question had a limit of indemnity of £100M excess £10M and covered any *"legally enforceable obligation … to pay compensatory damages"*. The mitigation section provided indemnity for *"any payment reasonably and necessarily incurred by the Assured in taking action to avoid a third party claim or to reduce a third party claim (or to avoid or reduce a third party claim which may arise from a fact, circumstance or event) of a type which would have been covered under this policy"*.

SLAL's marketing of the Fund had suggested it was a low risk cash-type investment rather than an asset backed security; however by 2008 50% of its investment was asset-backed. In January 2009, as the market prices of asset-backed securities fell and valuation became increasingly subjective, SLAL adopted a new method of valuation which led to a one-off fall in value of some 4.8%. In the face of substantial media criticism, SLAL recognised it had to act as the total fall in value amounted to some £190m since the Fund had been launched in July 1996. It considered two options:

Option 1 was to set up a scheme to compensate claimants and invite all customers to claim. As some 64% of investors had received misleading literature, SLAL tentatively costed this option at 64% of the total fall of £190M, i.e. £124m plus £15m administrative costs, albeit on the assumption that everyone who could claim would claim. However, Option 1 did not address brand damage, which SLAL estimated at £300m.

Instead, SLAL resolved to pursue Option 2 which was to make a cash injection of £82 million to restore the fall in value attributable to the Fund's re-valuation and to pay some £20 million to those purchasers who had sold off their units post re-valuation. SLAL felt that this cash injection would be seen as *"the right thing"* to do, would protect the brand and would reduce claims to *"single digit millions"*; in fact actual claims totalled just £5m as at January 2012. It was accepted at trial, therefore, that this £102 million injection was intended both to head off claims and to avoid/reduce further damage through loss of current and future custom.

First Instance Judgment

ACE unsuccessfully argued that the dominant purpose of the cash injection was to avoid/reduce brand damage and it had not been *"necessary"* to avoid/reduce claims. Instead, Eder J found that it removed the cause for complaint and the risk of action from many customers. He accepted that it was not *"necessary"* to make the injection in the sense that it was certainly possible for SLAL to have adopted Option 1, but he accepted that in view of the *"realities"*, it was necessary to avoid/reduce claims albeit it also avoided/reduced brand damage. He also found that once the *"reasonable and necessary"* test was satisfied, ACE had no entitlement to apportion the spend to reflect other motives. After taking into account its policy excess of £10m, SLAL was awarded £96m.

The Appeal

ACE appealed against the refusal to apportion. ACE argued that as the brand damage SLAL faced was in the order of £300m by contrast to £124m of maximum claim liability, no more than 25% of the cash injection was properly referable to avoiding claims within the £100m policy limit. ACE also appealed on the basis that there should be no indemnity to the extent that the cash injection represented a *"windfall"* to those who had not been mis-sold the product.

In the principal judgment, Tomlinson LJ found that *"the Cash Injection was one indivisible sum which had to be paid in full in order to restore the value of the Fund"* and that the *"whole payment was incurred for the relevant purpose and I can see no basis upon which it can be said, consistently with the plain words of the insuring clause, that because the payment also achieved and was intended to achieve another incidental objective so it is in some part irrecoverable as Mitigation Costs."* He was happy to give judgment for SLAL on the basis of that construction alone, but he went on to consider other arguments raised.

Tomlinson LJ considered whether mitigation cover was analogous to *"sue and labour"* clauses: these are traditionally found in marine policies and provide cover for the costs of rescue or salvage of insured ships and goods; these permit apportionment of such costs when spent partly on insured perils and partly on uninsured perils and also where there has been underinsurance. However Tomlinson LJ rejected any analogy on the basis that apportionment in *"sue and labour"* clauses derived from the peculiarities of marine property insurance which proceeded on the assumption that the insured was *"his own insurer"* for uninsured losses. That was said not to be the default position in liability insurance where, unlike with a marine property policy, the Insured's maximum liability cannot generally be known or, therefore, be said to have been under-estimated at policy inception.

In addition, Tomlinson LJ recognised the great uncertainty in quantifying the value of, for instance, brand protection or brand damage; he doubted whether the figures presented and calculated by SLAL, whether as to costs spent to avoid brand damage or to avoid claims in excess of the policy limit of indemnity, could truly be accurate.

Finally, Tomlinson rejected the *"windfall"* argument on the basis that any windfall to investors arising from the implementation of Option 2 was irrelevant to recoverability as the cash injection was *"indivisible and could not have been made in a reduced amount to achieve its purpose"*.

Conclusions

Tomlinson LJ concluded that apportionment was unavailable as it was *"inconsistent with the clear language of the policy and because it is not a principle which has any application in liability insurance"*. That said, apportionment is commonly provided for in professional indemnity policies in relation to actual defence costs, for instance in circumstances where settlement has been effected at a level above the limit of indemnity.

Notwithstanding the Court of Appeal's antipathy towards apportionment in liability insurance, would it still be possible for a professional indemnity policy expressly to provide for pro-rata apportionment in the event that mitigation costs are incurred for a dual purpose? Certainly, it would require very clear wording and a clearly workable method of distinguishing between insured and uninsured spend. Whilst D&C insureds are less likely than FI insureds to face the complexity of mass claims from multiple claimants including the general public, it still remains a challenge to define exactly which spend is aimed at protecting commercial interests/relationships as well as the constant difficulty of distinguishing between those costs of correcting design as opposed to, for instance, defects in workmanship or materials. Ultimately, insurers' response may be to limit cover to costs incurred "solely and exclusively" for the purpose of heading off any potentially insured loss.

Insurers' other main protection is to maintain full control over the

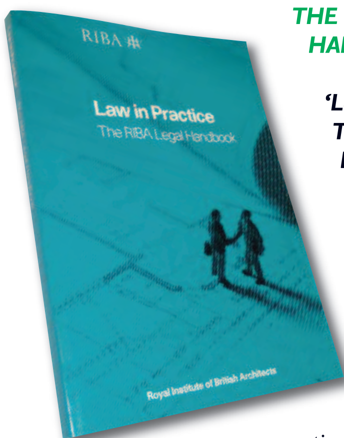
nature and extent of any mitigation spend. Insurers' consent is also always likely to be required "in advance" with no option for it to be obtained after the event. Accordingly, any provision that such consent cannot be unreasonably withheld may well disappear to remove any possible suggestion whatsover that mitigation spend can be presented as a fait accompli. Indeed, the requirement for insurers' advance consent as to purpose and amount may well in future commonly become subject to condition precedent, i.e. in the event that it is not obtained cover can be declined regardless of whether prejudice has resulted from the failure.

D&C as well as FI insurers will no doubt be carefully considering their own policy wordings in the light of this Appeal judgment. However, mitigation or first party cover remains an incredibly useful tool for D&C insurers and insureds if correctly drafted and operated: it provides insurers and insureds with the opportunity to work together to head off potential claims at a very early stage and avoid the disproportionate legal and other knock-on costs that may otherwise flow. It is to this end that Fishburns LLP has developed unrivalled experience with its mixed D&C teams of loss adjusters and lawyers operating under one roof.

We are delighted that Fishburns LLP's strong reputation in the professional negligence and insurance fields continues to be recognised in the latest editions of Legal 500 and Chambers UK rankings where 12 of our partners are recommended, with 3 of those listed in the 'elite' leading lawyer list (Legal 500). Fishburns LLP's international construction group is also collectively recommended by Chambers & Partners for its expertise in handling construction related disputes. Indeed, 3 of our specialist construction partners, Peter Campion, Antony Marsh and Peter Sewell are praised for their handling of high value technical construction related claims, often with an international element. Chambers & Partners also noted that clients admire the firm's *"common sense approach"* to resolving a case and for providing *"services that are economical without losing quality"*.

"Peter Campion is extremely experienced in professional negligence litigation, and is regularly instructed by international clients. He is particularly respected for his expertise in construction-related claims". (Chambers & Partners, 2013 edition)

A REVIEW OF *'LAW IN PRACTICE: THE RIBA LEGAL HANDBOOK'*



Mark Prince
Trainee Solicitor

'Law in Practice: The RIBA Legal Handbook' written by **John Wevill**, is the RIBA's jargon-free, professional guide to the law as it relates to a construction project.

The book focuses on the legal implications of the architect's relationship with the client, other professionals, and with the contractor, and takes a strongly practical approach. It describes as simply as possible the law an architect should know and provides tools to enable architects to work through construction law queries successfully, highlighting the potential pitfalls or dangers that may result from certain courses of action or contractual terms.

For those with limited legal experience, or simply in need of a refresher, the book begins with a general overview of the law of contract, tort, liability, construction and professional appointments. All of this is kept relevant to the reader because of its focus on architectural professionals. From here the book progresses to provide a valuable source of practical legal guidance on, amongst other things, contract negotiation, architects' responsibilities and dispute resolution.

"Law in Practice will become an invaluable comfort and trusted authority for the architectural profession."

(Angela Brady – President, RIBA)

Although publication has been alongside the RIBA, the book has much broader application than just the RIBA standard terms. In addition to the RIBA standard terms the book also addresses the important points which arise when the FIDIC, ACE and NEC2 standard forms of appointment are used.

As a trainee solicitor in the non-contentious department at Fishburns LLP, the chapters which I have found most useful are those relating to the wording of bespoke terms of appointment, collateral warranties and novation. This is because industry standard terms are used less frequently in large scale commercial appointments. Instead bespoke terms of appointment are drafted which seek to shift contractual risk and responsibility away from the client and onto the architect. The book explains the purpose behind an extensive range of clause types, the impact that different wordings will have and suggests changes which the architect should look to make.

In the foreword Angela Brady, President of the RIBA, ranks the book in the same class as the Architect's Job Book and the Architects Handbook of Practice Management. Overall the book provides a valuable guide for anyone involved with the appointment of architects, whether they are a building contractor, client, architect, contract negotiator or lawyer.

It is available from www.ribabookshops.com.

WHEN ARE LIQUIDATED DAMAGES A PENALTY?

John Wevil
Senior Associate

Liquidated and ascertained damages ("LADs") are damages for breach of contract, the level of which has been agreed in advance by the parties. The most common use of LADs is in relation to delay damages within building contracts. The established principle of law is that the level of LADs must be a genuine pre-estimate of the losses that the employer client is likely to suffer as a result of the breach of contract. The time for assessing whether the level of LADs represented a genuine pre-estimate of the client's likely losses is the time when the contract was entered into. If the level of LADs was based on a genuine pre-estimate of likely losses at that date, but that estimate subsequently proves to be inaccurate – if, for example, the employer's actual losses would have been much lower than the LADs payable by the contractor – then the courts will typically enforce the LADs provisions and the employer will receive a windfall.

The Australian appeal case of ***Spiers Earthworks Pty Limited v Landtec Projects Corporation Pty Limited (No 2) [2012] WASCA 53*** provides guidance as to what factors the courts (in both Australia and this country) may take into account when assessing whether the

level of LADs was a genuine pre-estimate, at the time the contract was made, of the employer's likely losses. If the LADs provision is not a genuine pre-estimate then it may be considered a penalty and may not be enforced.

Background

The employer, Landtec, was the developer of an area of land in Western Australia. The local authority had granted conditional approval to the employer to subdivide the land into a number of lots and sell them off. Importantly one of the conditions, condition 25, required the employer to complete construction and sealing of a road known as Curtis Lane, which was intended to extend to the development land, before the land could be subdivided and sold.

By a contract in writing dated 21 February 2005 the contractor, Spiers, agreed to carry out works on the employer's land, including earth works, drainage, road works and construction of a bridle path, but not including the Curtis Lane improvement works required by the local authority.

The date for practical completion of Spiers' works was 10 May 2005. Their contract with Landtec provided for LADs to be paid in the event of delay in completion of the works. The rate of LADs was *"$13,846 per week or part thereof"*. In the event, Spiers did not achieve practical completion of their works until 26 July 2005, and the employer claimed LADs for the whole of the period from 10 May to 26 July 2005. Spiers claimed that the liquidated damages clause imposed a penalty. The original trial judge granted the contractor a limited extension of time, but rejected its argument that the LADs provision was a penalty. Spiers appealed.

The Court of Appeal decision

The Court of Appeal of Western Australia agreed with Spiers, by a majority, that on the evidence of the employer's intentions at the time the contract with Spiers was made, the LADs clause did not represent a genuine pre-estimate of Landtec's likely losses from a failure by Spiers to complete its works on time.

The LADs clause in Spiers' contract had been intended, according to Landtec, to provide compensation for the losses Landtec could expect to suffer resulting from delays in the receipt of proceeds from the sale of the various lots in the event that Spiers did not complete their work on time. The level of LADs was based on the expected total sale price of the 32 lots divided by 52 to give a weekly figure. Spiers however had claimed that the LADs clause was a penalty because any delay on its part in achieving practical completion of its contract work could not possibly have any relevant adverse financial consequences for the employer because of condition 25. Condition 25 made it impossible for Landtec to sell off any of the lots prior to completion of the Curtis Lane improvement works; that was the case whether or not Spiers had completed their separate package of works.

At the date of entry into the contract with Spiers, Landtec had taken no steps towards securing the construction and sealing of the outstanding section of Curtis Lane. The Court of Appeal took this to be good evidence that, at the time of entering into its contract with Spiers, Landtec had no intention of attempting to achieve compliance with condition 25 before the scheduled date for practical completion of Spiers' works. So Landtec was aware at the time of making its contract with Spiers that the satisfaction of condition 25, upon which receipt of the sale proceeds depended, would not take place before practical completion of Spiers' works.

In the circumstances, the LADs clause could not be characterised by the Court as a genuine pre-estimate of damages to which the employer would be entitled at law. Delay in performance of the contract works by Spiers was in fact incapable of causing any relevant financial loss to Landtec until condition 25 was satisfied.

Summary

The Landtec case shows clearly that an LADs clause which is not based on a genuine pre-estimate of the employer's losses may be unenforceable as a penalty. Employers should be especially careful when making the initial assessment to set the level of LADs. They should only include losses which are in fact likely to result directly from contractor delays and should give credit for losses which may be wholly or partly dependant on their own future actions. The calculations on which the level of LADs is based must also be transparent; the employer must be able to justify the level of LADs if necessary before a court, adjudicator or arbitrator.

LEGALESE: TOO OFTEN CLIENTS WILL IGNORE NOTIFICATIONS OR RESPOND IN A CONFRONTATIONAL OR EVASIVE MANNER…

Mark Klimt
Partner

'I am in blood stepp'd in so far that should I wade no more, returning were as tedious as go o'er.' Architects who find that they have unwittingly provided substantial additional services without first securing client approval, and facing the prospect of being unable to recover their additional fees will know exactly how Macbeth felt. Arguments over whether something is part of the contracted basic services or additional, and whether it has been properly authorised are legion. Too often a conscientious architect will continue to provide the services for the good of the project without waiting for a recalcitrant client to provide confirmation.

Add to that considerations over whether an architect should be entitled to recover prolongation costs if its percentage fee has already risen with the construction cost and, even before any discussions about why these events have occurred, the stage is set for battles far bloodier than anything Dunsinane might offer.

As usual, the starting point is a clear appointment contract, with the basis of the fee proposal and what it embraces carefully defined, so that a client is properly informed. The RIBA SFA sets out the services to be provided at each work stage and has a section for other services. It is as important to make clear what the basic service does not include, as to explain what will be provided.

Clients will not necessarily accept the RIBA standard, nor will it be conducive to a successful relationship if the client is given the impression that its architect will effectively 'work to rule', and not go beyond the listed services. Some flexibility therefore needs to be built in, to allow for, say, reasonably incidental services to be part of the basic service.

Clients will also want to know that the risk of unforeseen events will

not fall on their shoulders, so provision could be made for an increase in a particular service of up to a pre-arranged percentage, also falling within the basic service. Time spent in realistic discussions at the outset may save a lot of trouble later.

Once the basic services have been established, a sensible process for notifying and approving additional services and expenditure needs to be applied. By their nature, additional services will not be capable of precise quantification in advance. It would be unfortunate for an architect to be under a strict contractual duty to give a quote for additional costs; otherwise, when that is inevitably exceeded, the client will argue its consent has been undermined.

But, if the architect has agreed to give timely notice of additional services, notification must be given. The client must also be contractually obliged to respond to this notification quickly. Far too often - even with the threat of adjudication in the background - clients will either ignore such notifications or respond in a confrontational or evasive manner, effectively relying on the architect's good nature and professionalism to do what is necessary, without the written confirmation in place.

Finally, as the landscape grows ever more unpleasant, architects must learn to be ruthless in enforcing the terms of their hard-fought contracts. If a client has insisted on stringent safeguards before additional services can be authorised and extra fees incurred, then there is nothing wrong in turning these requirements back upon the client and insisting on compliance on pain of downing tools, rather than taking sole responsibility for maintaining the programme.

Nor does there have to be a stand-off with a client who is genuinely of the view that the additional service is not justified; the parties could agree to pay the disputed fee into an interest-bearing joint account and commit to a streamlined impartial process of determining where the entitlement lies. But with profit margins being squeezed ever more tightly, what architects can no longer countenance is continuing to work frenziedly to rescue projects that have taken unexpected turns, and then find that they are also financing the project. Who needs that type of toil and trouble?

This article has previously appeared in Architects' Journal. Mark Klimt is an expert Specialist Practice Consultant to RIBA members, operating the RIBA Advice Helpline to Architects in London. He is the RIBA's legal advisor on RIBA 2010 Appointment Agreements and also a regular lecturer for the RIBA and a contributor of articles to both in-house and external publications.

PRE-ACTION PROTOCOL COMPLIANCE: *Higginson Securities (Developments) Limited and Another v Hodson [2012] EWHC 1052 (TCC)* – THE END OF THE PROTOCOL MEETING?

Matthew Olorenshaw
Senior Associate

This recent case provides a useful example of the Technology and Construction Court's approach to the application of the Pre-action Protocol for Construction and Engineering Disputes (the "Protocol"), specifically the circumstances when it may be appropriate to dispense with the Protocol meeting.

The facts

The Claimant developer contracted with the Defendant architect to design a development on the Isle of Wight comprising a spiritualist church and a block of nine flats. Following completion, the Claimant brought a claim against the Defendant for negligent design and overpayment of fees. The value of the claim was said to be just under £70,000.

Pursuant to the Protocol, the Claimant sent a letter of claim to the Defendant in March 2011. After requesting various pieces of further information, the Defendant provided its letter of response in December 2011, robustly denying all of the allegations and inviting the Claimant to withdraw its claim. Neither party proposed that a Protocol meeting should take place.

The Claimant issued proceedings in February 2012. The Defendant's solicitors requested a stay of the proceedings on the basis that a Protocol meeting had not yet taken place. The Claimant's solicitors responded by noting the Defendant's categorical denial of the claim and stating that they could see no benefit in a Protocol meeting taking place.

Heated correspondence ensued regarding the need for a Protocol meeting. The Claimant's solicitors indicated that they were prepared to grant an extension to the Defendant to serve its Defence in order to allow a without prejudice meeting to take place.

At the end of March 2012, the Defendant's solicitors prepared an application seeking a stay of the proceedings. After further heated correspondence in April 2012, the Claimant offered to stay the proceedings provided that the Defendant agreed to attend a Protocol meeting within the next six weeks.

The Defendant's solicitors responded that their client would only accept this proposal if the Claimant agreed to pay the Defendant's costs arising from the Claimant's alleged failure to comply fully with the Protocol; including the costs which the Defendant's solicitors had incurred in preparing their application. No agreement was reached.

The principles underlying the Protocol

The Defendant's application for a stay was heard at the end of April 2012 by Mr Justice Akenhead. The Judge outlined the key principles underlying the Protocol.

a) The Protocol must always be considered in the context of the overriding objective;

b) It must not be used as a weapon or tactic; and

c) Both parties must seek to co-operate during its implementation. For low value claims it is particularly important that the parties proceed reasonably expeditiously, do not drag the process out and keep the costs of the exercise to a reasonable minimum.

In relation to the need for a Protocol meeting to be held, the Judge commented as follows:

> *"…the wording of the Protocol does not state that a meeting is absolutely mandatory; it does however say that "normally" a meeting should take place. Essentially, the "default option" is that a meeting should take place unless there is a reasonably good reason for such a meeting not to take place. The wording does not impose specifically on a particular party an obligation to arrange the meeting and so it must be incumbent on both parties to seek to set up a meeting. Usually, if one party expresses the view that it wants a meeting, that will be a good reason for a meeting to take place."*

The Judgment

The Judge noted that it was unsurprising that the Claimant did not wish to proceed with a Protocol meeting given the vehement manner in which the Defendant had rejected the claim.

Ultimately, the Claimant adopted a pragmatic view in agreeing to the meeting and a temporary stay of the proceedings, but the Defendant did not. It insisted on cost concessions which in effect would have secured for the Defendant all of the costs of the action to date. A pragmatic response would have been for the Defendant to:

- seek to reserve its position in relation to the costs of and occasioned by any purported non-compliance with the Protocol;
- secure a Protocol meeting; and, pending that
- secure an extension of time for service of the Defendant's Defence.

The Judge concluded that:

> *"It follows from the above that this application is dismissed; it should not and needed not have been brought let alone pursued… As indicated in court, the fighting of this case is largely pointless since, unless indemnity costs are ordered, each party's costs will exceed the value of the claim even assuming that it succeeds completely and the proportion of any standard costs assessment which the "winning" party will have to bear itself will account for a sizeable part of the claim."*

Conclusions

This case confirms that although usually held, the Protocol meeting is not mandatory; in particular in circumstances where both parties feel

that there is little to be gained in holding a meeting and/or in lower value claims where there is a risk that the respective costs of the parties could become disproportionate to the sums in dispute. That said, if one party feels strongly that a meeting should be held, then this is likely to be reason enough for it to take place. The decision is unlikely to spell the end of the Protocol meeting.

SET-OFF AGAINST ADJUDICATOR'S DECISIONS: PAY WHEN CERTIFIED CLAUSES – *R&C Electrical Engineers Limited v Shaylor Construction Limited [2012] EWHC 1254 (TCC)*

Jonathan Brown
Senior Associate

Everybody knows that adjudication is a way of resolving a dispute quickly. However, it does not always mean that the winning party will receive their money quickly, as illustrated by the recent case of ***R&C Electrical Engineers Limited v Shaylor Construction Limited***.

The Adjudication

In this case R&C, the mechanical and electrical sub-contractor, commenced an adjudication against Shaylor (the main contractor) seeking damages for delays and a determination of its final account. Shaylor cross-claimed for damages due to R&C's failure to complete the works by the contractual due date.

The adjudicator found that time was *"at large"* but that R&C had failed to complete the works in a reasonable period of time. The adjudicator also found that Shaylor had not established any entitlement to delay damages because its cross claim was based on the provisions in the contract relating to the time for completion, whereas time was in fact at large.

The adjudicator ruled that the final payment due to R&C was £196,963, albeit:

> *"Any sum to which R&C are entitled to be paid by Shaylor shall not be paid forthwith (but only following issue of the Final Certificate under the Main Contract and then in accordance with clause 21.8(b))."*

The reference to clause 21.8(b) of the contract between R&C and Shaylor is significant. That clause says that the Final Certificate under the contract – under which R&C was entitled to its payment of £196,963 – shall not be issued until after the Final Certificate has been issued by the Employer to Shaylor under the Building Contract.

Part 8 Proceedings

R&C, however, considered that it should be paid the outstanding sum immediately, and commenced proceedings under Part 8 of the CPR. R&C's contention was simple; namely, that the contractual mechanisms under the building contract had broken down with the result that the Final Certificate under that contract could not be issued, which in turn prevented R&C's final payment from being released. R&C said that it should not be deprived of the outstanding monies any longer, and that the Court should disregard the contractual mechanisms that had broken down and order the monies to be paid.

Judgment

The Court was, however, unimpressed with R&C's arguments, for a number of reasons. First, no evidence was adduced by R&C as to precisely how or why the Final Certificate mechanisms in the building contract were no longer functioning properly. The Court said that this was a matter solely between Shaylor and the employer under the building contract, and no evidence had been provided on this issue in the Part 8 proceedings.

Second, the adjudicator expressly said that R&C's outstanding monies were not payable straightaway, but should be paid in accordance with clause 21.8(b). In addition to clause 21.8(b) saying that the final payment shall only be due to R&C once the Final Certificate under the building contract has been issued, the clause also expressly reserves Shaylor's right to withhold monies from R&C's final payment to account for any outstanding liabilities that R&C might have to Shaylor.

Although the adjudicator refused to allow Shaylor's cross claim for delay, that was solely on the basis that it was founded on the contractual provisions relating to the completion date, whereas the completion date no longer applied because time was at large. The adjudicator had not determined whether Shaylor had a valid claim for delay in circumstances in which time was at large. Therefore Shaylor was entitled under clause 21.8(b) to serve a notice withholding funds from R&C's final payment on the basis of its alleged losses sustained by reason of R&C's delayed completion.

By way of a final point, R&C also argued that no deduction could be made by Shaylor on the basis of the applicable adjudication rules, which said: *"No party shall be entitled to raise any right of set-off, counterclaim or abatement in connection with any enforcement proceedings"*. However, the Court ruled that Shaylor was not attempting to exercise a right of set-off or counterclaim to the enforcement of an adjudication decision, but rather to exercise a contractual right to deduct monies from a final account sum, a right which had been expressly preserved by the adjudicator himself.

Comment

Accordingly, the Court refused R&C's application. The case is a salutary lesson as to why winning an adjudication, and the immediate payment of monies, do not necessarily go hand-in-hand.

LETTERS OF INTENT – *Merit Process Engineering Ltd v Balfour Beatty Engineering Services (HY) Ltd [2012] EWHC 1376 (TCC)*

Mark Prince
Trainee Solicitor

This case provides another cautionary tale of the dangers which may arise when construction begins under the terms of a letter of intent.

Background

Merit Process Engineering Ltd ("Merit") was appointed as sub-contractor by Balfour Beatty Engineering Services (HY) Ltd ("Balfour") to carry out three packages of works. This article focuses on the main installation package.

In March 2004 Merit commenced work under the terms of a letter of intent. The letter of intent entitled Merit to recover its construction costs up to a maximum of £500,000 if a contract could not be agreed. This limit was subsequently increased (up to £1,600,000); that final limit was agreed in September 2004.

In March 2005 Balfour sent Merit a sub-contract agreement. Merit

replied that the stated contract price differed from what they had agreed. Over the next month a series of emails between Merit and Balfour debated what contract price had been agreed. The difference between the two parties amounted to £37,500 and whether or not the contract price was net or gross of the main contractor's discount. The last in this series of emails was sent in early May 2005 and the disagreement remained unresolved. Merit continued construction but did not sign or return the sub-contract agreement.

Merit subsequently brought a claim against Balfour and Balfour sought to rely on an arbitration clause which had been included in the sub-contract agreement proposed in March 2005.

Decision

In his judgment Mr Justice Edwards-Stuart held that the disagreement over the contract price meant that the sub-contract agreement had not been entered into. The construction work therefore continued to be governed by the letter of intent, as amended in relation to Merit's costs limit. The arbitration clause had not been incorporated into the agreement between the parties and Balfour could not rely on it.

Conclusion

Letters of intent continue to cause problems within the construction industry and for the reasons set out above, it is important for the parties to look at the real reason why a letter of intent is being proposed. Only a formal contract will contain sufficient detail to accurately reflect the deal intended, and properly allocate risk. If a contract can be concluded in time for works to commence, it should be, as only this will provide best protection of both parties' legal and commercial interests.

Parties should always ask themselves whether the perceived *"need"* for construction to start under the terms of a letter of intent outweighs the inherent risks involved in proceeding with work on this basis. Great care must be taken to ensure that the terms of any letter of intent properly reflect the intentions of the parties, whether the intention is to create a binding contract, or not. In carrying out the works, the contractor must bear in mind that additional work which it carries out over and above the scope of the letter will potentially be carried out at its own risk.

COST CONSEQUENCES – *Walter Lilly & Co Ltd v Mackay and Another [2012] EWHC 1972*

Caroline Watkins
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Mr Justice Akenhead's 100-plus page judgment in ***Walter Lilly v Mackay*** helpfully clarified the treatment of concurrent delay and disruption claims which are advanced without fully showing cause and effect. The judgment highlighted the court's departure from the apportionment approach taken in *City Inn Ltd v Shepherd Construction Ltd* by endorsing the approach in *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd* that the contractor should get an appropriate extension of time for the employer's delay even where there was a concurrent delay caused by the contractor.

In our Summer 2012 Construction Update, Robert Goodlad considered the interlocutory judgment in *Walter Lilly v Mackay* regarding legal professional privilege in relation to communications with construction claims consultants. The subsequent costs hearing, which caught the attention of the wider press, involved an analysis of the parties' actions during litigation.

Contractual and discretionary interest

The contractual interest flowed from the withholding of the sums due under the contract. The Court accepted Walter Lilly's simplified calculation of the interest due, assuming a "mid-point" between the start of the deductions and the date when the full deduction was being maintained, and applying a rate of base rate plus 5%. A small amount of discretionary interest was applied to the sum claimed for static security. On wrongful deductions totalling £854,596, £216,046.33 interest was due.

Interest on prolongation and thickening costs

Mr Mackay had argued that the award of contractual and discretionary interest on the prolongation and thickening costs ought to be reduced, as Walter Lilly had only produced a detailed analysis of loss and expense in February 2011 and in fact was still providing information on the loss and expenses up until early 2012. The calculations made by the cost consultant had reduced the claimed figure of due loss and expense to £407,727 and Mackay attempted to claim that the figure was in fact below £100,000. The Court held that the contractual interest figure (and the calculation of loss) was accurate, as it was justifiable on the basis that enough information was available for the cost consultant's calculations ("ascertainments") to have been made at various points, which would have enabled them to be certified and thus become due.

Mr Justice Akenhead commented that the discretionary interest *"should not punish a losing defendant, [but] should reflect the fact that the winning claimant has been kept out of its entitlement until judgment and the losing defendant has had the use of the money."* He also considered that the imprecise sums for prolongation and thickening were immaterial, especially as Mr Mackay had attempted to reduce the cost consultant's ascertainments in any case. A similar argument was put forward with regard to interest on the head office overhead and profit, with similar results.

Costs

Given its success in the judgment, Mr Justice Akenhead ruled that Walter Lilly would be entitled to have its costs paid by Mr Mackay.

Indemnity costs

Mr Justice Akenhead followed the principle in *Reid Minty v Taylor [2002] 1 WLR 2800* that indemnity costs are to be awarded having regard to what in the circumstances is fair and reasonable, and that they are not intended to be a penalty; indemnity costs are not limited to cases where the court wishes to express disapproval of the way in which litigation has been conducted. The courts do have a wide discretion to award indemnity costs where there has been a high degree of unreasonable conduct. If one party had made an effort to find a reasonable solution to the proceedings and the other party had resisted the approach, that party leaves itself open to the risk of indemnity costs being awarded (*Reid Minty* again). The Court also applied guidance from Paragraph 1341 of the White Book and CPR Part 44.3 with regards to the likely circumstances in which indemnity costs were appropriate, and the scope of the court's discretion to award.

The evidence showed that, following initial without prejudice discussions between the parties, Walter Lilly had made a Part 36 Offer in October 2011 and a subsequent open offer to settle the mechanical and electrical defects. Neither of these offers were acknowledged by Mr Mackay. Two without prejudice offers were made by Mr Mackay in December 2011 and January 2012, with offers of settlement in relation to various claimed defects. Walter Lilly responded by inviting acceptance of its own earlier offers. Walter Lilly withdrew its Part 36 offer a week before the trial as Mr Mackay had not responded.

Mr Justice Akenhead reiterated comment from the earlier judgment that Mr Mackay had pursued a *"vendetta"* against Walter Lilly, citing Mackay's unjustifiable attempt to antagonise Walter Lilly; his accusation that Walter Lilly had rigged sub-contract tenders; the launching of an anti-Walter Lilly website and interfering with acquisitions by Walter Lilly's parent company. Further, he mentioned that he was *"positively unimpressed"* with Mr Mackay's conduct at trial describing him as having been *"careless with the truth"*. He said it was *"clear that Mr Mackay was simply not prepared to engage in terms of settlement or compromise on any basis"*. On this basis he awarded Walter Lilly its costs on a standard basis until November 2011 and thereafter on an indemnity basis.

COURT OF APPEAL REJECTS 'RETROSPECTIVE' ATE INSURANCE – *Hawksford Trustees Jersey Ltd v Stella Global UK Ltd [2012] EWCA Civ 55*

Mark Prince
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In ***Hawksford Trustees Jersey Ltd v Stella Global UK Ltd*** the Court of Appeal confirmed that a successful claimant could not recover the full cost of an After- the-Event ('ATE') insurance policy designed to provide retrospective cover in respect of first instance costs. Although the long term implications of this decision are limited (from April 2013 the Legal Aid, Sentencing and Punishment of Offenders Act will prevent recovery of premiums), this is, nevertheless, an interesting decision and provides a helpful reminder of the need to consider the terms of ATE cover very carefully when advising clients on the protection it offers and the options available.

Background

Hawksford Trustees Jersey Ltd ("Hawksford") entered a contract to sell shares to Stella Global UK Ltd ("Stella Global"). Hawksford subsequently applied to have the contract rectified for reason of common mistake. Stella Global contested this but the High Court granted the rectification order.

Stella Global appealed. One working day before the appeal hearing Hawksford obtained ATE insurance (having been unable to obtain this prior to the original trial). The premium was £394,638 but this was only payable if Hawksford won. If Hawksford lost nothing needed to be paid to the insurer but the policy would pay towards both parties' appeal costs and Stella Global's first instance costs.

In the event the appeal was refused. Stella Global accepted that it would need to pay costs but challenged the ATE premium. If the ATE premium was included within the costs order Stella Global would have to pay six times the amount it would have had to.

The costs decision

The case turned on the interpretation of Section 29 of the Access to Justice Act 1999 and specifically whether, when it talks about a party insuring *"against the risk of incurring a liability in those proceedings"*, the last two words, *"those proceedings"* mean just the appeal or the entire case.

By a majority of 2:1 the Court of Appeal took the view that the first instance trial and the subsequent appeal were separate proceedings

for costs purposes within the meaning of Section 29. Hawksford could not recover the cost of insuring against risks arising out of the trial at first instance.

This was because Section 29 was intended to increase access to justice and operate fairly. Denying recovery would not prevent access to justice since Hawksford had brought the case to trial without the benefit of insurance and accepted the risk of a costs order being made against it. Further, it would be unfair to impose liability at the appeal stage when Stella Global had incurred costs with no way to know that ATE insurance would subsequently be purchased.

Conclusion

This decision should play an important role in limiting the financial implications and potential costs awards which follow an appeal. If premiums such as these were recoverable appeals could become prohibitively expensive for many applicants.

A number of important issues flow from this case which deserve consideration:

- ATE premiums can still be recovered when the ATE insurance is purchased between first instance trial and appeal so long as the risk insured arises out of the appeal;

- In situations where an ATE premium is recoverable in principle, the full amount of the premium will not necessarily be recovered. In his dissenting judgment, Patten LJ drew attention to the role played by costs judges. They have a wide discretion in setting the amount of any costs order. It is therefore important to arrange any ATE policy early in the process and to ensure that the cost is reasonable when considered against the levels of costs incurred;

- The situation in the above case must be distinguished from when a claimant obtains ATE insurance before trial, loses at trial but then wins at appeal. Here the premium would be recoverable in principle because the ATE insurance was obtained before the insured risk (having to pay costs) occurred;

- The reasoning behind the judgments should also be considered. The belief that Parliament intended the section to operate fairly was the only real difference that separated the majority from the dissenting judgment. Patten LJ dissenting accepted allowing recovery could be unfair but did not consider it relevant. In contract the pursuit of a *"fair"* outcome appears to underpin much of the majority reasoning. This leaves the question as to the extent to which the court will imply the intention of fairness when interpreting any ambiguity or uncertainty in legislation;

- Consideration should also be given to whether the changes to litigation funding being introduced in April 2013 and discontent with the cost of litigation may have played a role in this decision. The majority judgments of Rix LJ and Etherton LJ definitely fall much closer to the current political mood than the dissenting judgement of Patten LJ.

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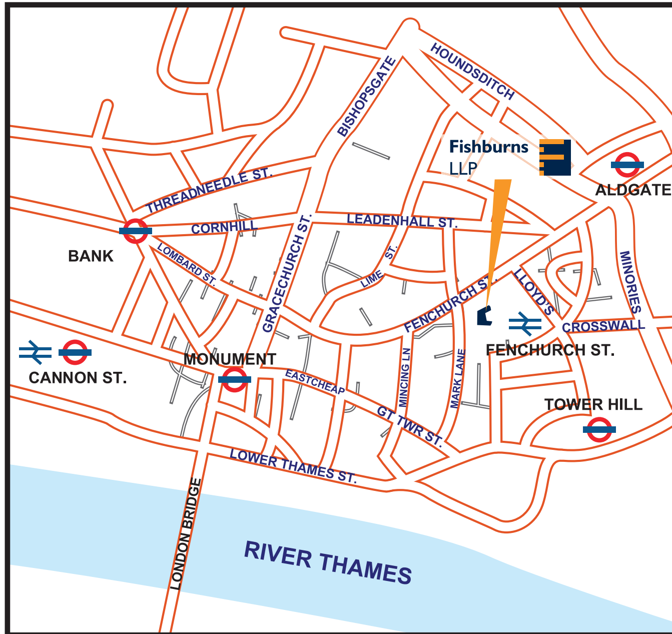

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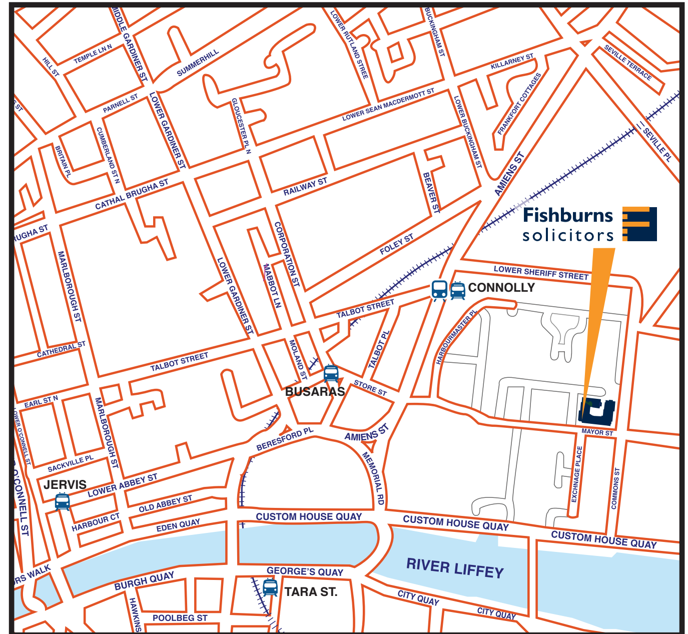

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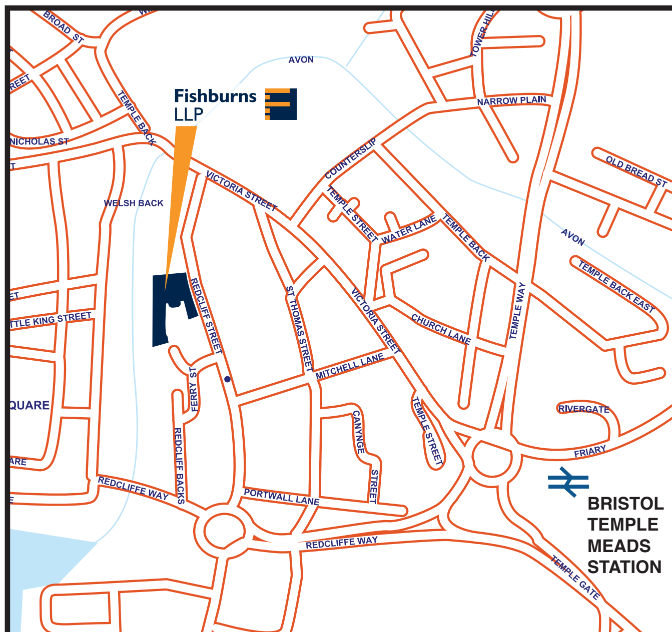

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