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Payment provisions in JCT Form of Contract considered by House of Lords

***Reinwood Ltd v L Brown & Sons Ltd* [2008] UKHL 12**

On 20 February 2008 the House of Lords gave its decision in *Reinwood Ltd v L Brown & Sons* in which **Alexander Hickey** was junior counsel for appellant. This was the second occasion in recent months that the House of Lords has had to consider s111 withholding notices under the Housing Grants, Construction and Regeneration Act 1996. This time it was in the context of the deduction of liquidated damages (LDs) under the JCT Standard Form of Building Contract 1998 edition.

The facts

The project was delayed. On 14 December 2005 pursuant to clause 24.1 the Architect issued a certificate of non-completion stating that the contractor failed to complete by the fixed completion date ('CNC') which was a condition precedent to the employer's right to LDs. An interim payment certificate was issued on 11 January 2006, the final date for payment of which was 25 January 2006. The employer knew by 16 January 2006 that the Architect intended imminently to grant an extension of time fixing a later completion date ('EOT'). On 17 January 2006 the employer served an early withholding notice stating its intention to deduct LDs based on the CNC dated 14 December 2005 for the period from the CNC up to the date of its notice. On 20 January 2006, 5 days early, the employer paid the certified amount less the amount set out in its withholding notice. On 23 January 2006 the Architect issued the EOT to 10 January 2006. This cancelled the certificate of non-completion on which the withholding notice was based. On 24 January 2006, the contractor required the employer to pay the outstanding balance of the payment certificate by the final date for payment (less one week's LDs). The employer did not pay the shortfall by 25 January 2006 and the following day the contractor issued a notice of specified default which ultimately led to the contractor determining its employment in June 2006 for repeat of a specified default.

The Court of Appeal's decision [2007] EWCA Civ 601

The Court of Appeal (in a decision covered in Issue 2 of the Newsletter) had held that as soon as the withholding notice was given, the employer's right to LDs crystallised so that it could deduct or withhold LDs on the final date for payment. But in light of the EOT the employer would then be required to repay the liquidated damages within 'a reasonable time'. The contractor appealed.

The House of Lords' decision

The issue for the House was whether an employer who served a withholding notice intending to deduct LDs from an interim payment was entitled to withhold LDs after an extension of time had been granted in advance of the final date for payment. In other words are employer's rights altered by events that occur between the giving of the withholding notice and the final date for payment? The contractor argued that by the final date for payment the employer was no longer entitled to withhold LDs from payment of the amount properly due to the contractor.

The House dismissed the appeal but did not reach exactly the same conclusions as the Court of Appeal. An employer may withhold LDs against payment due to the contractor under an interim certificate despite the grant of an EOT where he has paid against the withholding notice early. The House of Lords considered that the policy of the 1996 Act provided a regime with notices so that parties are entitled to know where they stand. In the present case, the employer was entitled to give the withholding notice when it did and it had paid in reliance on that notice before the extension had been granted. The employer would then be obliged to repay the liquidated damages under clause 24.2.2 in accordance with the default provisions of the Scheme. Lord Neuberger said that this would be due after 7 days and the final date for payment would be 17 days.

The fact that the employer had paid early in reliance on its withholding notice seems to have been the deciding factor in the case. The House expressly left open for debate whether the result might have been different if the extension of time had been issued before the employer had paid in advance of the final date for payment. Lord Neuberger, giving the lead opinion with which the other Lords agreed, said there was "undoubtedly a case" for saying that the Employer would not have succeeded upon those facts: there was a difference between paying out on the strength of a notice which was accurate at the time of paying and paying out in reliance on a notice which is no longer accurate. The House acknowledged there were arguments either way and because it was not "tolerably clear" it would be "wrong to express a view on this outstanding question". Lord Hope, giving additional reasons, thought that a contractor was not in a position to complain about non-payment of the amount properly due unless he had referred to adjudication, before the final date for payment, a dispute concerning the claimed entitlement in the withholding notice.

Implications

The decision leaves a number of unanswered questions and uncertainties, not just in the case of LDs but more generally in respect of the payment and withholding regime under the Act. Contractors will no doubt be surprised to learn that an extension of time which lands before the final date for payment will not always (and maybe not ever) give them relief from an interim deduction of liquidated damages. It is unclear what will happen if the employer does not deduct until the final date for payment or if the withholding would result in a nil payment. It is also unclear whether a contractor's reference to adjudication before the final date for payment contesting the claimed entitlement in the withholding notice might alter the position. More generally the House's decision seems to make the 'final date for payment' irrelevant once payment has been made early, which could well have profound implications.

Contractors will need to be alive to employers who decide to give a withholding notice and pay against that notice a lesser amount early – those who pay early buy themselves considerably more time to pay any shortfall. There is still uncertainty about the timescale for repaying LDs under clause 24.2.2 – or its equivalent provision in the latest versions of the JCT contract. A standard amendment ought to be made setting out the due date and the final date for payment or else parties will have to make their own amendments. Contractors will have to take note when negotiating contracts that a failure to repay liquidated damages on time (whatever that time is) does not constitute a specified default, so that they cannot determine for a breach of the repayment obligation. It is advisable to add this breach to the list of specified defaults.

TCC applies Commercial Court guidelines for notification under 'claims made' insurance policies

***Kajima UK Engineering Ltd v The Underwriter Insurance Co Ltd* [2008] EWHC 83 (TCC)**

In a decision of Mr Justice Akenhead, the principles governing notification of potential claims under 'claims made' policies of insurance outlined by the Commercial Court in *HLB Kidsons v Lloyds Underwriters* [2007] EWHC 1951 (Comm) were applied to a construction case. **Rachel Ansell** was junior counsel for the Defendant Insurer.

Kajima was the main contractor employed to design and build a block of flats involving the novel application of installation of a stacked pre-constructed pod and flat pack construction. The Insurer provided professional indemnity insurance on a 'claims made' policy, under which it was open to Kajima during the period of insurance to notify the Insurer of circumstances which might reasonably be expected to produce a claim. During the course of the works, Kajima notified the Insurer that the pods were settling and moving excessively, causing adjoining roofing, balconies and walkways to distort under differential settlement, and that investigations were being carried out ("the notification"). Several years later, after the period of insurance had ended, the ongoing investigations revealed that the flats were at risk of collapse due to wind loadings, and the tenants were evacuated. The Insurer argued that the defects discovered during the ongoing investigations were not of the same type as, and not directly associated with, the matters in the notification.

Akenhead J, handing down judgment on 25 January 2008, identified that the parties sought guidance on the extent to which the defects and damage to the flats were covered by the notification, although he was not asked to decide with precision whether particular defects/damage fell within the notification. Akenhead J applied the decision of the Commercial Court (Gloster J) in *HLB Kidsons v Lloyds Underwriters*, holding that the notification was effective only in relation to the specific circumstances noted. Although the investigations which eventually revealed the defects in the flats were instigated by reason of the notified circumstances, this "historical continuum" was insufficient where the defects subsequently discovered after the period of insurance were unrelated to the notified circumstances.

There must be some causal relationship between the defects and the notified circumstances: by way of example, Akenhead J stated that the notification would cover either (i) the defects which caused the notified circumstances; (ii) the symptoms of the notified circumstances; or (iii) the consequences of the notified circumstances.

Consideration of causation in claim for loss adjuster's professional negligence

AXA Insurance UK plc v Cunningham Lindsey UK **[2007] EWHC 3023 (TCC)**
The court considered whether a "top down" or "bottom up" approach to assessing quantum was appropriate in a professional negligence claim against a loss adjuster. In a decision handed down on 18 December 2007, Akenhead J had regard to the caveat that only in exceptional cases would a wrongdoer be held liable for all the consequences of his wrongful conduct. **Jeremy Nicholson QC** acted for the Claimant.

AXA brought a claim for professional negligence against loss adjusters, Cunningham Lindsey ("CL"), in relation to the reinstatement of an old farmhouse, which had suffered subsidence for which AXA had accepted liability under a householder's policy. CL was retained by AXA to provide services in connection with that reinstatement. Whilst the original sum insured was just over £200,000, and the expectation when CL was involved was of a reinstatement cost of much less than £100,000, the eventual cost to AXA was said to be over £1.5 million. AXA claimed that the bulk of this cost was attributable to CL's negligence, which was so extensive and all pervading that AXA was left in a position which was so difficult that the only way out, having embarked upon the re-instatement option, was to do whatever was necessary to make the house inhabitable.

The major area of dispute between the parties was quantum and causation. AXA adopted what a "top-down" approach to the quantum issues (i.e. taking the total costs and losses allegedly incurred and then deducting any elements not sufficiently causatively linked to the pleaded negligence). CL adopted a "bottom up" approach, i.e. pricing those defects for which it accepted liability.

This was a case largely decided on its facts, and Akenhead J upheld 7 of the 21 breaches alleged, awarding damages of £282,902. However, a number of interesting points of causation arose. Applying the judgment of Lord Hoffman in Banque *Bruxelles Lambert v Eagle Star Insurance Co Ltd* [1997] AC 191 (who warned that rules making the wrongdoer liable for all the consequences of his wrongful conduct were exceptional), Akenhead J held that the top-down approach was inappropriate because many of the alleged breaches had not been proved, and the established breaches as a whole were not as pervasive as alleged by AXA. Akenhead J held that CL's "bottom up" approach was not wholly appropriate either, and that the correct measure of damage was: (a) to ascertain what it actually cost AXA to put right the established defects; (b) to assess whether those costs were reasonable or not unreasonable; and if not, (c) determine what would be a reasonable cost, which might involve considering the market rate.

Arbitration clause upheld despite dispute over incorporation and fairness of contractual terms

Heifer International Inc v Helge Christiansen & ors **[2007] EWHC 3015 (TCC)**
This was a successful application by the Defendants for a stay of proceedings on the basis that the parties had agreed an arbitration clause providing for arbitration in Denmark. **Simon Henderson** was instructed by the third, fourth and fifth defendants (D3, D4 and D5).

The first defendant, a Danish architect (D1), through his firm (D2) was engaged by an offshore company (C) owned by a Russian to design the refurbishment of a property in England. D3, D4 and D5 were Danish contractors engaged by C to carry out the refurbishment works. C issued a claim in the TCC for an account of moneys paid to the Defendants on the basis that the works were not completed, and claimed damages for defects in the design and construction of the works.

The Defendants applied for a stay of the proceedings on the basis *inter alia* that (a) D1 did not enter into any contract personally; and (b) D2-D5 carried out work pursuant to contracts which contained an arbitration clause referring any disputes to Danish arbitration. C opposed the application, arguing that the arbitration clause was not incorporated into the contracts; and, in the alternative, these terms were unfair and not binding pursuant to regulation 8 of the Unfair Terms in Consumer Contracts Regulations 1999.

HHJ Toulmin QC found that (a) there was no contract between C and D1 because the agreement was with D2, albeit a framework agreement with D2 was not replaced by a final agreement as envisaged. In respect of (b) he applied the approach outlined by Longmore LJ in *Fiona Trust Corp v Privalov* [2007] EWCA Civ 20, i.e. that any jurisdiction or arbitration clause in an international commercial contract should be liberally construed, and found that the contracts with D2-D5 contained an arbitration clause within section 5 of the Arbitration Act 1996. Perhaps the most interesting element of the judgment is that the arbitration clause was held to be fair and binding largely because C had chosen to engage a Danish architect, his Danish firm, and Danish workmen; and C's Danish lawyers had prepared the contracts. C has sought permission to appeal against D1, D2 and D4.

Court of Appeal decision on latest Multiplex judgment

***Multiplex Constructions (UK) Ltd v Cleveland Bridge UK Ltd & anr* [2007] EWCA Civ 1372**
The long-running dispute concerning the steelwork sub-contract for Wembley stadium continues. **Alice Sims** is instructed as one of the junior counsel team for Multiplex.

On 21 December 2007 the Court of Appeal allowed in part Multiplex's appeal against the decision of Jackson J in a preliminary issue hearing of one of a number of disputes arising out of the steelwork sub-contract. The preliminary issue was whether (as Multiplex argued) Cleveland Bridge (CB) was responsible for carrying out temporary works to support the roof of the stadium under the fixed price Supplement Agreement (entered into between the parties after disputes arose under the steelwork sub-contract), or whether (as CB argued) these works were to be carried out on a cost plus basis.

At first instance Jackson J held *inter alia* that the design, drafting and fabrication of the temporary works relating to the roof did not form part of the fixed sum scope of works, but was to be carried out on a cost plus basis; CB having failed to carry out these works, Multiplex was not therefore entitled to claim as damages for repudiation the cost of engaging another sub-contractor to carry out these works.

The Court of Appeal (May LJ giving the leading judgment) overturned in part Jackson J's decision, finding that the fabrication and supply of the temporary roof steelwork (but not the design and fabrication drawings) was omitted altogether from the scope of the fixed price Supplemental Agreement. Although this decision concerned the construction of a short clause of a one-off agreement, it is of some interest in that May LJ rejected CB's argument that commercial commonsense dictated that "whoever erects the roof must also be responsible for the design and fabrication of the temporary work".

The trial of the remaining issues in this case comes up for hearing on 10 March 2008 before Jackson J.

Article on "black hole cases" published

David Friedman QC, "*Black Hole Cases*", Const LJ (2008) Vol 24 No. 1 pg 10
The most recent edition of the Construction Law Journal has published **David Friedman QC**'s article on the concept of "black hole cases", whereby the wrongdoer escapes a claim for damages. This term was first used in the House of Lords case, *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd*. The article identifies the basic principles, and reflects on the issues raised in leading cases, including *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd*, *Alfred McAlpine Construction Ltd v Panatown Ltd (No.1)* and *Offer-Hoar v Larkstore Ltd*.

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