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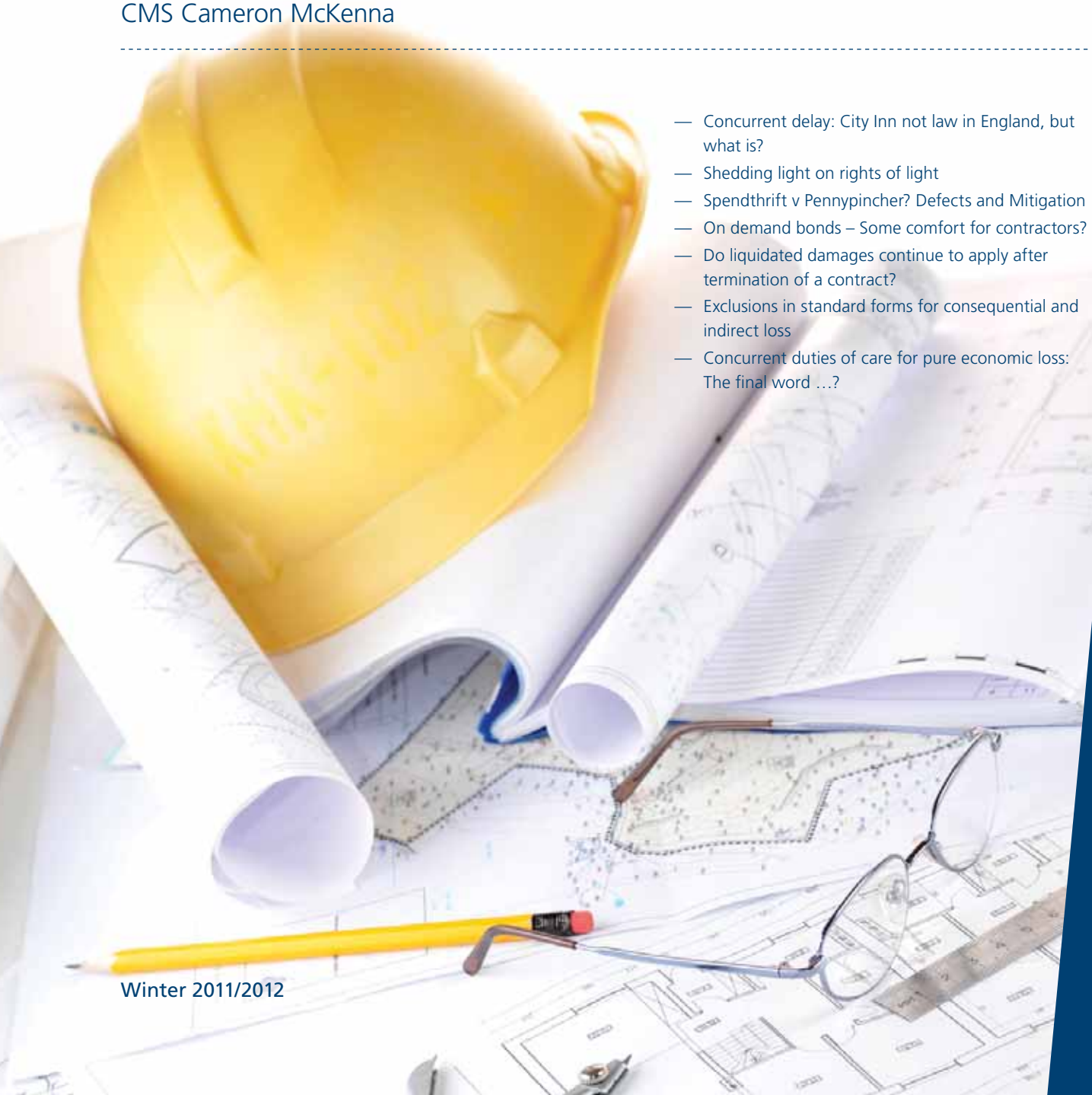
LEGAL UPDATE

REAL ESTATE AND CONSTRUCTION

CMS Cameron McKenna



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Winter 2011/2012

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Legal Update is prepared by the Real Estate and Construction Group of CMS Cameron McKenna. It should not be treated as a comprehensive review of all developments in this area of law or of the topics it covers. Also, while we aim for it to be as up-to-date as possible, some recent developments may miss our printing deadline.

This newsletter is intended for clients and professional contacts of CMS Cameron McKenna. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The newsletter is intended to simplify and summarise the issues which it covers.

Welcome

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Among the editorial team's more palatable resolutions for 2012 was an ambitious programme of bulletins. First out of the starting blocks is this winter catch-up issue covering a wide range of subjects. Many will be familiar to you and a number, such as the evolving law of guarantees and bonds, are likely to see further developments during the year. One topic which we have decided not to tackle this time is the amended Construction Act. So much has already been said and written on this issue that we thought that, before putting pen to paper, we would await the decisions which are expected over the coming months as the courts begin to interpret and apply the amended Act. You can also keep up to date through our much-expanded online adjudication update service, the Adjudication Zone.

Hot on the heels of this bulletin with be our annual look at developments in English construction law likely to be of interest to an international readership. The plan is for further bulletins at regular intervals during the year. As always, please let us know what you think - about what you'd like to see covered and where we have got it right or can do better. It's always good to have feedback. And it will help us to keep that resolution.

In the meantime, happy reading.

Concurrent delay: City Inn not law in England, but what is?

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The decision of a Scottish court in July 2010 dismissing appeals in the City Inn litigation continues to provoke debate in England over delay analysis under EOT clauses. A subsequent decision of the Commercial Court in 2011 in *Adyard v SD Marine* has now raised doubts over both the majority and minority views in City Inn.

Adyard was a small to medium-size shipyard situated in Abu Dhabi. It contracted with SD Marine Services to construct two sea vessels in time for sea trials to be held on specified dates (the 'Sea Trial Dates'). Two separate contracts each allowed SD Marine a right of termination if the vessels were not ready for sea trials on their respective Sea Trial Dates. The works were delayed and SD Marine gave notice of termination shortly after the Sea Trial Date for each vessel.

The contracts stated that, *'to the extent that any delays are caused by the Buyer's default or any Permissible Delay, [the Sea Trial Dates] shall be extended to the same extent'*. Adyard accepted primary responsibility for the delays which had occurred, but alleged that two relatively small variations had been made to the works which justified an extension of time ('EOT'). As SD Marine had given notice of termination within a week of the original Sea Trial Dates, Adyard only needed to establish a small extension of time in order to invalidate the notices of termination.

Adyard's own very long delays meant that it was unable to show any actual delay caused by the alleged variations. The project was already in irretrievable critical delay before the variations arose and Adyard had admitted that no additional delay had been caused. Instead, Adyard relied upon Lord Carloway's minority opinion in *City Inn* to argue that the alleged variations justified an EOT regardless of existing delays and regardless of whether the variations had any actual impact on the progress of the works. Adyard's argument, like Lord Carloway's opinion, was based substantially on the prevention principle and can be summarised as follows:

— the parties had agreed that Adyard was to have a certain amount of time to be ready for sea trials and that in the event of variations, Adyard would receive any additional time which those variations (viewed on their own) would require

— variations had occurred which in the ordinary course would have required additional time; Adyard was not to be deprived of that additional time merely because the variations could be accommodated within its existing period of culpable delay

— to deny Adyard's claim would be to deprive Adyard of the time which the parties had agreed that Adyard would have to complete the works.

This is one way of expressing the prevention principle and is often advanced on the authority of *Wells v Army and Navy Co-operative*. In that case (decided in 1903), the Court of Appeal held that where a contract limits the time in which a builder is to perform work, '*that means, not only that he is to do it within that time, but it means also that he is to have that time within which to do it … that limitation of time is clearly intended, not only as an obligation, but as a benefit to the builder*'. Based on this reasoning, the court

in Wells rejected a suggestion that the contractor was to be deprived of an extension of time due to concurrent causes for which it was responsible. The decision in *Wells* formed the basis of Lord Carloway's opinion in *City Inn*.

Adyard's argument was rejected, along with Lord Carloway's opinion. Mr Justice Hamblen sitting in the Commercial Court found that under English law it is essential to prove that an employer risk event or a Relevant Event (to adopt JCT-language) had caused actual delay to the progress of the works. Given that Adyard's own delays were already operative at the time of the alleged variations, no actual delay had occurred due to the variations. The court noted that this requirement for actual delay was in accordance with the majority opinion in *City Inn* and other English authorities, but ruled out any ability to apportion delay under English law. The court made no reference to the decision in *Wells*.

Mr Justice Hamblen's decision marks out three distinct approaches to the assessment of EOT claims for concurrent or parallel delay:

1. A Relevant Event is to be considered on its own and an assessment made of the delay it would have caused to the then current completion date in the absence of any culpable delays. The assessment is hypothetical i.e. what delay 'would' the event have caused, not 'did' cause. This reflects the approach submitted by Adyard and adopted by Lord Carloway in *City Inn* (based in turn on the decision in *Wells*). According to Hamblen J, this approach does not represent English law.
2. The Relevant Event must be considered alongside all of the other circumstances affecting the works at the time and an assessment made of the delay actually caused by the Relevant Event. This is the approach adopted by Hamblen J in the Commercial Court, largely in reliance on the English authorities of *Malmaison* and *Royal Brompton*.
3. Actual delay caused by a Relevant Event, as per (2) above, may be apportioned if there are other concurrent delays which can also be said to have caused the same delay and for which there is no entitlement to an EOT (and none of the competing causes can be said to be dominant). This is the approach adopted by the majority in *City Inn*, but which according to Hamblen J, does not represent English law.

'For the prevention principle to apply, the contractor must be able to demonstrate that the employer's acts or omissions have prevented the contractor from achieving an earlier completion date and that, if that earlier completion date would not have been achieved anyway, because of concurrent delays caused by the contractor's own default, the prevention principle will not apply.'

The Commercial Court's decision in Adyard may be contrasted with the TCC's decision late in 2010 in *De Beers UK Ltd v Atos Origin It Services UK*. That case concerned a large software development project commissioned by De Beers aimed at upgrading its diamond handling systems and supporting the relocation of various processing activities from London to Botswana. The project was put out to tender and a contract was awarded to Atos. The project fell behind schedule, due in part to additional works ordered by De Beers and in part due to matters for which Atos was responsible (such as unrealistic tender assumptions).

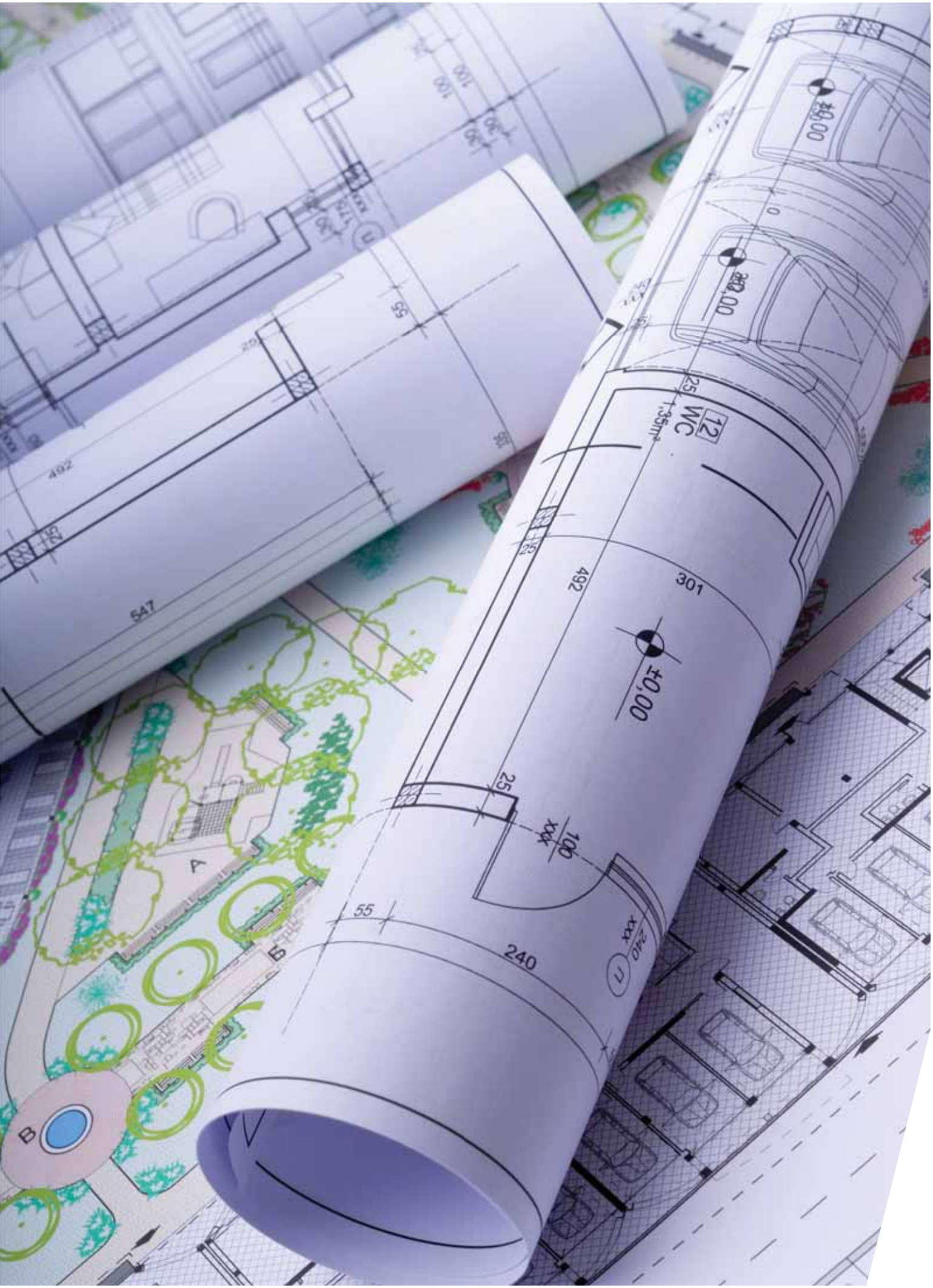
Mr Justice Edwards-Stuart found that both the Atos delay and the De Beers delay were critical and operated concurrently. That is to say, either delay was sufficient on its own to delay completion. In those circumstances, he appeared to apply the general rule from *Wells* referred to above (adopted by Lord Carloway in *City Inn*) to grant a full extension of time in respect of the Atos delay.

The facts in *De Beers* and *Adyard* bear some resemblance. Both cases concerned extension of time claims in respect of varied work in circumstances of pre-existing contractor delay. The opposing conclusions reached in each case reflect two different approaches to assessment, with Adyard emphasising causation and *De Beers* emphasising the prevention principle as expressed in *Wells*. Both decisions appear to rule out the apportionment approach adopted by the majority in *City Inn*.

One commentator writing recently in the International Construction Law Journal has described the finding in *De Beers* as 'premised on logic of universal application'. Judging from the most recent TCC decision on the topic, Mr Justice Coulson would appear to disagree. In *Jerram Falkus Construction v Fenice Investments*, decided in July 2011, he held that the prevention principle did not apply to cases of concurrent delay. In contrast to both *De Beers* and *Wells*, Coulson J concluded that, *'for the prevention principle to apply, the contractor must be able to demonstrate that the employer's acts or omissions have prevented the contractor from achieving an earlier completion date and that, if that earlier completion date would not have been achieved anyway, because of concurrent delays caused by the contractor's own default, the prevention principle will not apply.'*

This latest finding appears to support a general trend among the English cases toward a more robust causative approach to issues of prevention and concurrent delay. For the moment, however, uncertainty is likely to persist until the opportunity arises for the debate to be addressed authoritatively by the English Court of Appeal.

References: *Wells v Army and Navy Co-operative Society* (1903) Hudson's BC (4th Edition, volume 2) 346; *Henry Boot Construction (UK) Limited v Malmaison Hotel* (1999) 70 Con LR 32; *Royal Brompton Hospital NHS Trust v Hammond (No. 7)* (2000) 76 Con LR 148; *City Inn Ltd v Shepherd Construction Ltd* [2010] CSIH 68; *De Beers UK Ltd v Atos Origin It Services UK Ltd* [2010] EWHC 3276 (TCC); *Adyard Abu Dhabi v SD Marine Services* [2011] EWHC 848 (Comm); Stephenson A, 'Early Completion and its Effect on the Contractor's Right to an Extension of Time' [2011] ICLR 327; *Jerram Falkus Construction Ltd v Fenice Investments Inc* [2011] EWHC 1935 (TCC).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Shedding light on rights of light

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A successful right of light claim can have catastrophic consequences to a development not only in terms of cost and delay but potentially requiring a developer to revise or even abandon a development. It is therefore imperative that well in advance of commencing any development, a comprehensive strategy is agreed upon in conjunction with appropriate specialist advisors to deal with rights of light.

So what is a right of light? It is a right to enjoy natural light coming from the sky to a building and through windows in that building so those owning or using the building can enjoy an acceptable level of light in the building. It does not apply to open spaces. It only relates to light coming through apertures intended to admit light. It is only a right to light and not to sunlight, a view or air and it is not a right always to receive the same amount of light but rather an acceptable level.

In practice, the most common means by which rights of light come into being is by 'prescription' i.e. by twenty years continuous enjoyment, or by expressly being granted a right of light.

Those with such a right are entitled to take action to protect that right if a development would interfere with it by bringing the level of light below what is legally acceptable. What is acceptable and how the reduction is measured are based on numerous factors and complex calculations carried out by a rights of light surveyor.

The first step for any developer needs to be to obtain a survey of all surrounding and adjoining buildings to the proposed development to establish where the risks may lie. Rights of light are considered both by individuals and corporations as important – particularly in towns and cities where light can be a very precious commodity indeed. Very few would consider artificial light to be an acceptable substitute which is evidenced by the fact that well (naturally) lit buildings have higher values both in the commercial and residential arenas.

In addition to the picture on the ground, lawyers need to be engaged to search through and assess the deeds and Land Registry records for both the details of the various property interests in the surrounding and adjoining buildings should compromise agreements need to be struck, but also for evidence of any rights to light agreements or deeds which may either assist or detract from such negotiations or to be used at Court.

The question is then whether the developer/its agents should take a pro-active stance and contact the owners of the various interests highlighted to commence negotiations, whether to rely on insurance, and/or to go down the Light Obstruction Notice route. Some of these options will be to the exclusion of others. For instance, not all developments will be insurable. Insurance would generally not be available if the affected neighbours have already been approached or are aware of their rights. A positive decision either way therefore needs to be made at the outset.

The Light Obstruction Notice process is an alternative to writing direct to owners where it is not clear that sufficient time has elapsed to give the owners a prescriptive right of light. It is also a useful means of flushing out who may have or is willing to protect a right of light. In very broad terms, the developer is able to register a Light Obstruction Notice as a local land charge and if it remains unchallenged for 12 months the 20 years prescriptive clock is turned back to zero.

Where the advice is instead to open negotiations with a view to reaching agreements to compromise the rights of light with the relevant owners, any compensation payments are a matter of individual negotiation. It is important that these agreements are legally enforceable and binding both on the owner and its successor in title. It also should be widely drawn

to include both the proposed development and, potentially, any alternative development within the same envelope.

Developers need to realise that even these initial steps can take many months to complete and should be in place before work begins on site. To do otherwise is a risky strategy bearing in mind the consequences to which we now turn.

If it is not possible to rely on insurance, to extinguish rights by Light Obstruction Notices and/or to reach settlements with all those affected and the owner is insistent on protecting its right, then the matter could reach the doors of the Court. The broad principle is that an aggrieved owner is entitled to an injunction i.e. a Court order preventing the developer carrying out that part of the development which infringes the owner's right of light unless the Court is satisfied that the owner would be adequately compensated in damages. There is a high threshold which the developer will have to overcome to persuade a Court that damages will be an adequate alternative remedy. In order to decide this, the Court at this stage will look at the conduct of the parties throughout any preceding negotiations and will be critical of any developer who has ignored the rights of neighbouring owners and has not made an effort to accommodate them. Other factors relevant will include the extent of the interference, the effect on the development of an injunction and also the nature of both the development and the affected premises.

Not so long ago the general consensus was that injunctions were inappropriate in rights of light cases. This in turn gave some comfort to developers that most likely the worst case scenario would be having to pay damages if a claim was mounted. That consensus was fuelled by the case of *Midtown -v- City of London Real Estate Property* where the Court was persuaded that it would be oppressive to grant an injunction as the development was generally beneficial and worthwhile. However this line of thinking was shaken by the case of *Regan -v- Paul Properties DPF No 1 Limited* where despite being only able to show a diminution in value of his property as a result of the development of 2% to 2.5%, (a loss itself capable of being compensated in damages) this injury was considered substantial and an injunction would not be oppressive despite the cost to the developer of amending its proposed development being in the region of £35,000 and a resulting development value loss of £150,000. The Court was critical of the developer having taken a calculated risk proceeding with the development in spite of protests even though the developer had made attempts to settle with Mr Regan.

This willingness to grant an injunction has most recently been seen in the case of *HKRUK -v- Heaney* which resulted in an injunction requiring the removal of two floors of a development already completed. This was despite the developer seeking to resolve matters with Mr Heaney, and Mr Heaney failing to seek an injunction, before the development was completed.

Emboldened by the *Heaney* case, adjoining owners with rights of light are less likely to settle at least in the early stage of negotiations and developers should commence their rights of light strategy at an even earlier stage - to allow sufficient time to conclude all negotiations, the use (where appropriate) of Light Obstruction Notices and to obtain (if necessary) a determination from the Courts. Insurers will undoubtedly be looking to increase premiums and may be more reluctant to insure certain schemes.

The above may make more attractive the power under Section 237 of the Town and Country Planning Act 1990 which enables developers of land acquired for this purpose by local authorities to develop free from any rights of light claims (but with compensation being payable). In the light of recent case law, more interest in this power has been shown recently, but even this option is not a risk free option and is open to challenge ultimately by way of judicial review.

It is a brave developer who does not include right of light issues near the top of his agenda for his proposed development.

References: *Midtown Ltd v City of London Real Property Co Ltd* [2005] EWHC 33 (Ch); *Regan -v- Paul Properties DPF No 1 Limited* [2006] EWCA Civ 1391; *HKRUK II (CHC) Ltd v Heaney* [2010] EWHC 2245 (Ch).

Spendthrift v Pennypincher? Defects and Mitigation

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Is an owner required to permit a contractor to fix its defective work, or can the owner arrange to have the remedial work performed by another contractor and send the first contractor the bill? A recent Court of Appeal case looks at the difficult issue of mitigation of loss in the context of defective works.

Just about every construction contract provides for how defects are to be managed. A typical scheme under a contract involves the contractor being required to correct defects as and when notified of them, up until the end of a defects liability period (or a period of a similar name). After that the contractor is not *obliged* to correct any further defects that become apparent, nor is it entitled to correct any further defects. The owner can usually sue the contractor for damages, for the cost of repairing the defects. However, damages are subject to a number of constraints, including that the owner must act reasonably to mitigate its loss. Damages are not recoverable to the extent that the owner has unreasonably failed to mitigate its loss.

A relatively common argument that contractors (and subcontractors) make in defects cases, where the defects have been rectified by the owner (who sues the contractor for the cost of repair), is that the owner failed to mitigate its loss by not giving the contractor the chance to fix (at no cost to the owner) its defective works. If an owner spends £100,000 on engaging a second contractor to repair a defect for which the first contractor was responsible, and the first contractor was willing to correct the defect at no cost to the owner, and at a cost of £20,000 to the first contractor, should the owner be able to recover the £100K that it spent in having the defect repaired? Or should it have gone back to the first contractor and given it the chance to repair the defect, meaning – if the first contractor accepted the invitation and undertook the repairs satisfactorily – that the owner would not have been out of pocket, and the first contractor would have borne an expense of only £20K instead of £100K? Can the owner who carries out the work through a second contractor recover £0, £20K, £100K, or some other amount?

The law does not offer any fixed rules or even clear guidance on mitigation, and when an owner will be taken not to have mitigated its loss. Everything is fact and context dependent, however the following points may be noted:

- When a failure to mitigate is raised as a defence against an owner claiming damages for defective works, the question will be whether the owner acted reasonably by arranging for another contractor to perform the works, instead of asking the original contractor to come back and fix its defective work.
- The reasonableness of the owner's conduct depends upon a number of matters, including the difference in cost between the owner arranging for the defects to be repaired by a new contractor as opposed to the cost to the original contractor in undertaking the repairs.
- The fact that the contractor could have undertaken the repair work (or claims it could have) more cheaply than the owner does not necessarily indicate a failure by the owner to mitigate its loss. What needs to be shown is that there was something unreasonable about the owner's conduct which meant it spent significantly more money than it needed to on the repairs.
- There is usually no legal requirement on an owner to invite the contractor to repair its defective works. But a failure to do so can (and often does) lead to a mitigation of loss issue, exposing the owner to the risk that it will not be able to recover from the original contractor all of the amount it spent on correcting the defect. If it is found that the owner failed to mitigate its loss, it will often only be entitled to recover the hypothetical cost to the original contractor of performing the necessary repairs or re-supply.
- A significant factor that goes to the reasonableness of the owner's conduct is whether the owner has

(justifiably) lost confidence in the original contractor, and its ability to effect satisfactory repair work. If there are reasonable doubts as to the contractor's competence, the owner may be justified in arranging for another contractor to effect the repairs, and its damages will not be reduced on the basis of any failure to mitigate its loss. As HHJ Coulson QC (as he then was) held in *Iggleden v Fairview New Homes (Shooters Hill) Ltd*:

> 'it would take a relatively extreme set of facts to persuade me that it was appropriate to deny a homeowner financial compensation for admitted defects, and leave him with no option but to employ the self-same contractor to carry out the necessary rectification works'.

Iggleden concerned defective works performed in constructing a new home, but the same principle applies to commercial properties and facilities.

This brings us to the Court of Appeal's decision last year in *Woodlands Oak Ltd v Conwell*. The facts were straightforward. Owners engaged a contractor to perform certain work under a simple contract that did not include a defects liability provision. The work was performed defectively, leading to snags. The owners undertook the snagging works at their own cost, and sought to recover the cost from the contractor as damages. The claim for damages was rejected on the basis that the owners had failed to mitigate their loss because they did not invite the contractor to correct the defects. The contractor established to the trial judge's satisfaction that it was willing to undertake the repair work, and that it would have come at no cost to either the owner or the contractor, because the contractor would have arranged for its subcontractor (who was presumably responsible for the snagging items) to repair them at no cost.

The result of this case may seem a little extreme, as the contractor was able to escape liability for its defective works simply by virtue of the fact that the owner carried out the repair work itself, and if the contractor had arranged for the work to be done it would have been at zero cost to it. Furthermore, it is not readily apparent as to how the owners could be said to have acted unreasonably, in failing to mitigate their loss. They may rightly have lost confidence in their contractor, which is why they did not offer it the chance of fixing the snagging items. Nor was it suggested or held that the repair of the defects by the owners was itself unreasonable to do, or that the amount they spent on repairing the defects was unreasonably large.

If anything, *Woodlands Oak v Conwell* highlights the perils that owners face in trying to recover damages for defective works without having offered their contractor a chance to repair its defective works. The risk is that if (unbeknownst to the owner) the contractor can repair the work at minimal or no cost, the owner will be unable to recover any damages should it arrange for another contractor to undertake the repairs. To play it safe, the approach that owners should take is to give their contractors a second chance, unless it is clear that the contractor will not rectify the defects satisfactorily.

References: *Iggleden v Fairview New Homes (Shooters Hill) Ltd* [2007] EWHC 1573 (TCC); *Woodlands Oak Ltd v Conwell* [2011] EWCA Civ 254.

'The risk is that if (unbeknownst to the owner) the contractor can repair the work at minimal or no cost, the owner will be unable to recover any damages should it arrange for another contractor to undertake the repairs.'

On demand bonds – Some comfort for contractors?

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In international construction contracts, Employers usually require Contractors to provide on demand bonds as security for the proper performance by the Contractor of his obligations under the contract. Normally issued by a bank, such bonds can be called by the Employer on demand without the Employer having to prove that the Contractor is in default or the amount of loss the Employer has suffered. In the absence of fraud, there is often little that the Contractor can do to prevent an unjustified call upon the bond. The recent TCC case of *Simon Carves v Ensus*, in which the Contractor successfully applied for an injunction to prevent the Employer from calling upon a bond, may however have given contractors a grain of comfort.

The Facts

In *Ensus*, the contract required the Contractor to provide an on demand performance bond for 12% of the Contract Price. Clause 3.8 of the Contract stated that 'upon issue of the Acceptance Certificate the Performance Bond shall become null and void (save in respect of any pending or previously notified claims)'. The Acceptance Certificate was issued. The Contractor considered that the bond had therefore become null and void and asked the Employer to return it. However, prior to the Acceptance Certificate, the Employer had notified the Contractor of a number of alleged defects pursuant to the provisions of the defects liability clause, which the Employer alleged had not yet been made good. The Employer argued that under clause 3.8, the bond should therefore 'be left open to cover the costs of making good the defects should this be required'. After discussions, the Contractor agreed to extend the validity of the Bond for an agreed amount until a specified date whilst at the same time reserving his right to argue that the bond had become null and void when the Acceptance Certificate was issued.

The issues regarding the alleged defects were not resolved, and shortly before the extended bond was due to expire, the Contractor applied to the Court for an emergency injunction preventing the Employer from calling upon the bond on the basis that the bond should be treated as null and void, as he had originally argued. The Employer resisted the application by relying upon the long line of cases where the Courts have held that they would not interfere with a call on an on demand bond unless there was clear evidence that the party calling upon it was acting fraudulently; and there was no suggestion of fraud in this case.

The Decision

The Court granted the emergency injunction. In doing so the Court held, relying upon the judgment of the Court of Appeal in a 2003 case, that in addition to cases of fraud, the beneficiary of a bond could also be prevented from calling upon the bond if the underlying contract clearly and expressly prevented him from making a demand under the bond. The Court held that, for the purposes of the grant of an emergency injunction, it had to be satisfied on the

arguments and evidence put before it that the party seeking the injunction had 'a strong case'. Here, the Contractor's case was a strong one. In particular, there was a specific provision in the contract that required any claim to be supported by a written statement of grounds and a summary of the material facts upon which it was based. The Employer's notifications under the defects liability clause could not therefore be regarded as 'claims', which would have prevented the bond from becoming null and void under clause 3.8. The Court held that the other criteria for the grant of an emergency injunction were also satisfied and the Contractor's application therefore succeeded.

Comment

International construction contracts often include clauses regarding the provision of on demand performance bonds. Such clauses cover not only the amount and period of validity of the bonds but also the circumstances in which the Employer can make a call upon them. The FIDIC contracts contain just such provisions. This case will therefore give some comfort to Contractors concerned about the possibility of the Employer making an unjustified call on a bond. If a Contractor can show that he has a 'strong case' that, under the terms of the underlying contract, the Employer is not entitled to make a call on the bond, the Contractor may be able to argue that the court should grant an emergency injunction preventing the Employer from making the call.

However, this case was decided upon the basis of special facts and in another TCC case, from 2007, the Court noted that an injunction might be granted where it is 'positively established' (rather than where there is a 'strong case') that under the terms of the underlying contract the beneficiary was not entitled to call on the bond. It remains to be seen which approach is preferred by the Courts in future cases.

One thing this case underlines for Employers, however, is the importance of complying with the correct procedural requirements of the construction contract for the making of claims against the Contractor. If these are not followed the Contractor may, depending upon the wording of the clause in the underlying contract relating to the calling of bonds, have not only a strong case but also a positively established one that the Employer is not entitled to make a claim under the bond.

References: *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657.

'If a Contractor can show that he has a 'strong case' that, under the terms of the underlying contract, the Employer is not entitled to make a call on the bond, the Contractor may be able to argue that the court should grant an emergency injunction preventing the Employer from making the call.'

Do liquidated damages continue to apply after termination of a contract?

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Most people would think the obvious answer to this question is 'no'. Why would a party be liable for further delays to a construction project once its contract has been terminated and it can no longer influence the project completion? However, following one case in 2010 the answer seemed for a while to be 'yes' before a subsequent case restored the status quo.

The traditional position

Most construction contracts will contain clauses imposing liquidated damages for delay. Under English law, such clauses will also be taken to impose a limit on the contractor's liability for delay or, as is sometimes said, they provide the employer's sole remedy for delay.

It has traditionally been thought that the exercise of a contractual right to terminate would, in ordinary circumstances, bring to an end the accrual of liquidated damages from the date of termination. That was the position adopted by the House of Lords in *British Glanzstoff Manufacturing Co v General Accident Fire and Life Assurance Corp [1913]*. The House approved the decision of the Scottish Court of Session, which held that a clause allowing an employer to terminate and take over the works was 'obviously incompatible' with the continued operation of a liquidated damages clause. It was said that liquidated damages clauses '*apply and…apply only to a case where the works are finished by the original contractor*'. Termination therefore brought to an end the accrual of liquidated damages and the employer was left to prove its actual losses for any delay occurring post-termination.

A (temporary) change in approach

In March 2010, the traditional position was placed in doubt by the Technology & Construction Court in the case of *Hall v Van Der Heiden [2010]*.

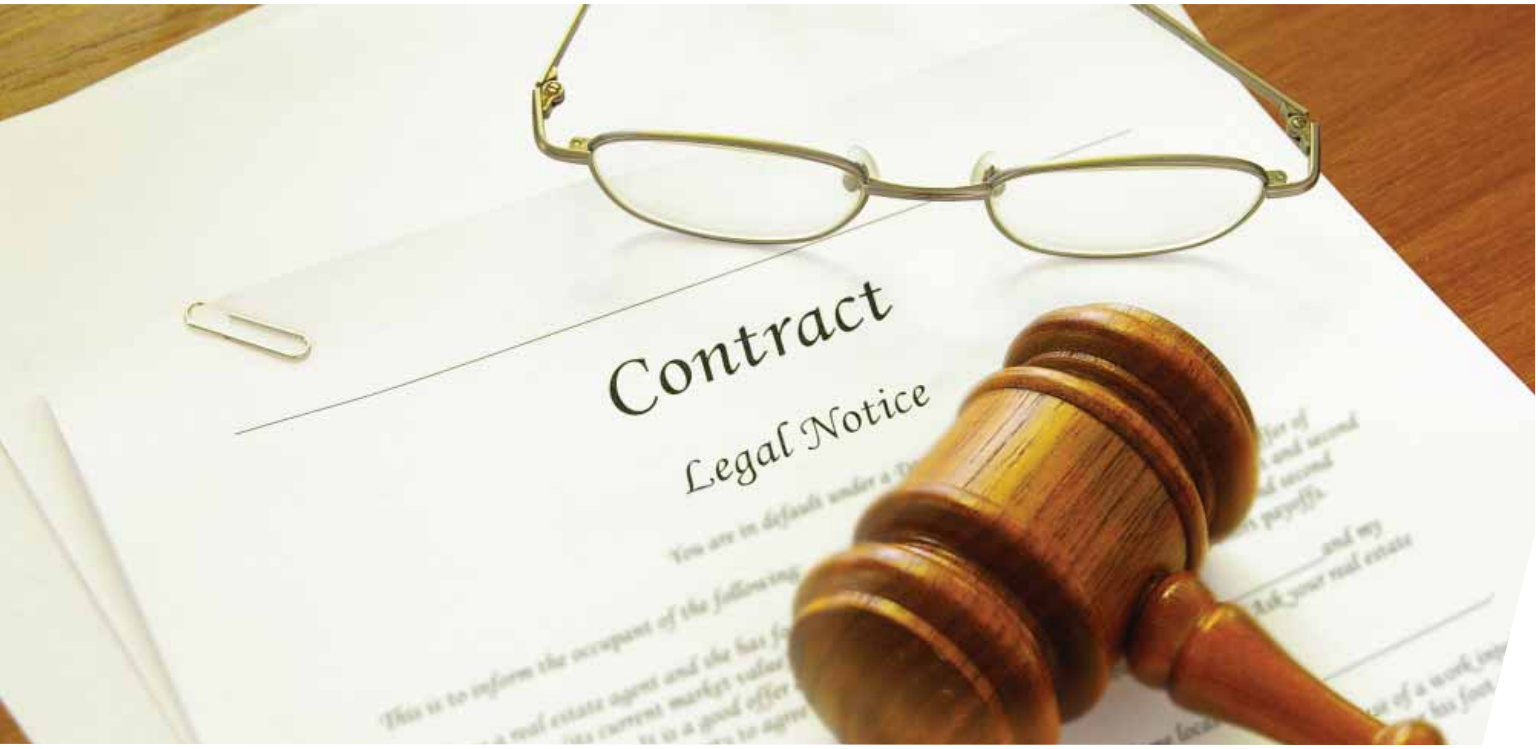
In this case, Mr Van Der Heiden was employed to carry out refurbishments to a property owned by Ms Hall. The contract said that liquidated damages would accrue between the planned completion date (as extended) and the actual completion date. Completion was delayed and the contract was terminated. Ms Hall then sought to levy liquidated damages. Mr Van Der Heiden's defence that his liability to pay liquidated damages ceased on termination was rejected.

Interestingly the Judge did not refer to the case of *British Glanzstoff* (which should have bound the TCC, as it is a lower court). Instead he decided, he said, as a matter of principle, that ceasing to apply liquidated damages after termination would reward a contractor for its own delay. The Judge said that interpreting the contract in the way that Mr Van Der Heiden contended '*would not be a commonsense interpretation of this (or any) construction contract*.' Surprisingly, in reaching this view, the Judge made no reference to the fact that Mr Van Der Heiden would still in that situation be exposed to the risk of delay damages, albeit unliquidated.

The inconsistency between the two cases gave rise to a question about the limit imposed by liquidated damages clauses. Such clauses often impose an aggregate cap on the amount of damages or delay days recoverable, and even without such an aggregate cap, daily or weekly sums for liquidated damages represent in law the employer's exclusive remedy for delay. Should, then, such limits survive termination, as they are thought to do in situations where the liquidated damages clause has been rendered inoperable?

The traditional position restored

Four months after *Hall*, in July 2010 the TCC had to address this issue directly in the case of *Shaw v MFP Foundations and Pilings Ltd [2010]*.



In this case, Mr and Mrs Shaw employed MFP to carry out works at their home. The contract provided for £Nil per week liquidated damages. MFP were late in carrying out the works and failed to replace some defective stone windows. The Shaws then terminated the contract. An arbitration followed in which the arbitrator decided, amongst other things, that MFP's failure or refusal to replace the defective stone windows amounted to a repudiatory breach of contract which was accepted by the Shaws.

The TCC was asked to consider whether the arbitrator had failed to deal with all of the issues put to him, including whether the liquidated damages provision survived the repudiation of the contract by MFP and whether, in consequence, the Shaws were entitled to recover the costs of the delay in carrying out the works.

The Judge held that the arbitration had in fact decided that issue, so that no right to further damages arose. He went on to say (again without citing any authority) that the liquidated damages provision ceased to apply once the contract had been terminated. He said:

'…after the date of termination the parties are no longer required to perform their primary obligations under the contract and so the contractor's obligation to complete by the completion date no longer remains and the provision for liquidated damages therefore becomes irrelevant. In its place arises an obligation to pay damages for the employer's losses resulting from the breach of contract, including damages for any loss resulting from any further delay…'

The traditional view, set out in *British Glanzstoff* and endorsed in *Shaw* is clearly to be preferred as a matter of logic. Additionally, the suggestion in *Hall* that it prejudices the innocent party is not entirely correct; the latter has a choice in principle as to whether to retain the contractor and continue to rely on the contractual damages regime or, alternatively, to determine the contractor's employment and seek unliquidated damages. In the latter case, the innocent party's recovery may well not be capped at the previously applicable amount of liquidated damages as the fact that the liquidated damages mechanism has ceased to operate is not his fault. He will however have to demonstrate actual loss in the usual way. These will be important factors when balancing the advantages and disadvantages of termination.

References: *British Glanzstoff Manufacturing Co v General Accident Fire and Life Assurance Corp* (1912) SC 591; [1913] AC 143; *Hall v Van Der Heiden* [2010] EWHC 586; *Shaw v MFP Foundations and Pilings Ltd* [2010] EWHC 1839

'… the innocent party's recovery may well not be capped at the previously applicable amount of liquidated damages as the fact that the liquidated damages mechanism has ceased to operate is not his fault.'

Exclusions in standard forms for consequential and indirect loss

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It is common for contractors and consultants to seek to limit their liability for consequential and indirect losses. There is no standard approach within the industry to this area of potential loss and standard forms of building contract adopt differing stances as to what losses should or should not be limited (if any).

Recoverable Losses

The venerable case of *Hadley v Baxendale*, decided in 1854, establishes the types of losses that are recoverable for breach of contract. The decision breaks recoverable losses down into two categories, commonly referred to as the first and second limbs of *Hadley v Baxendale*, as follows:

— Direct losses – these are those losses that fall within the first limb of recoverable losses being those losses that may fairly and reasonably be considered either as arising naturally, in the usual course of things, that is, according to the usual course of things, from the breach of contract itself.

— Indirect losses - these are those losses as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

It has been widely accepted in English Courts (at least in the context of exclusion and limitation clauses) that consequential and indirect losses are in effect the same thing and that they constitute losses that fall within the second limb of *Hadley v Baxendale*.

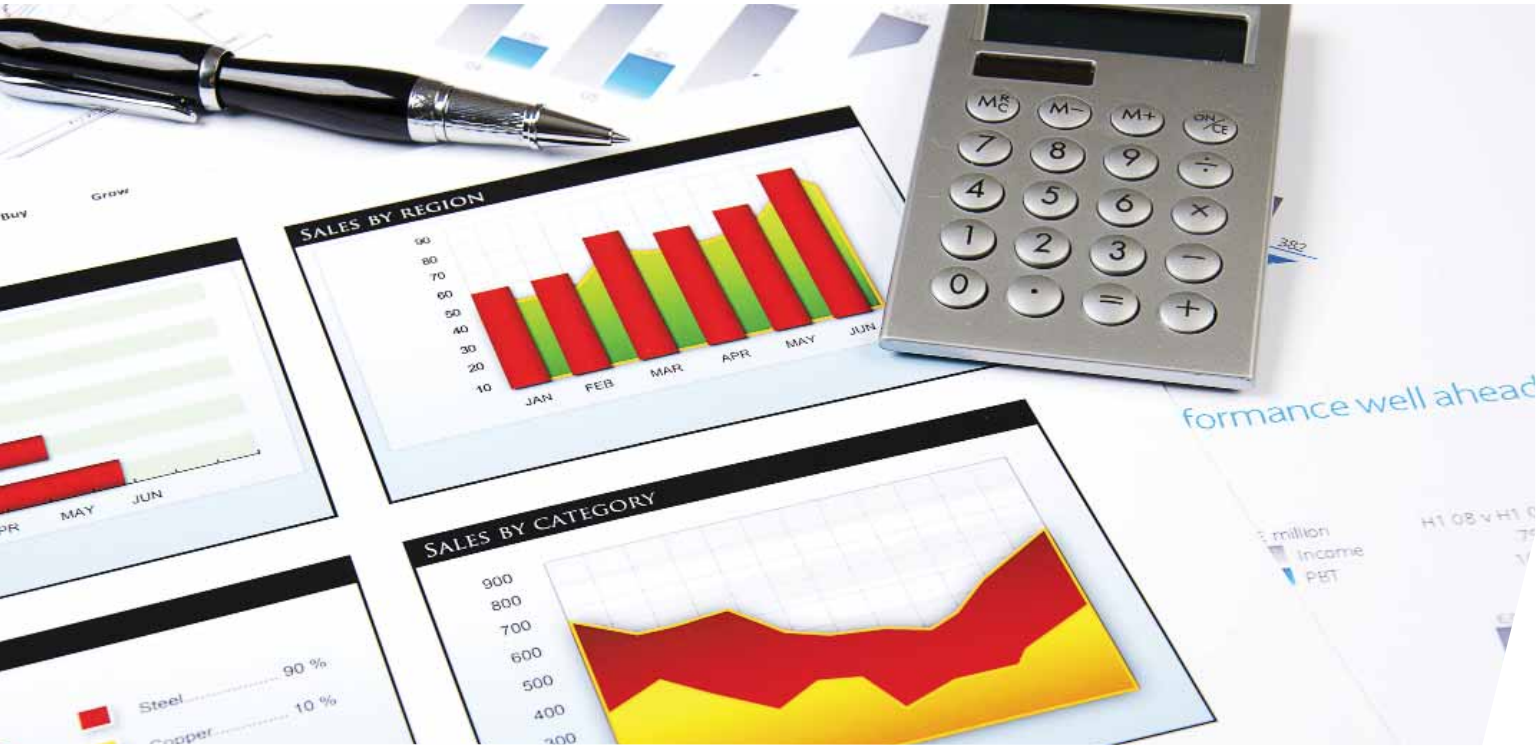
Consequential and Indirect Losses

Limitation clauses for consequential loss can still cause confusion and uncertainty. There may for example be a question as to what heads of loss fall foul of such clause and what heads of loss do not. Depending on the facts, what in one contract may be deemed to be an indirect loss could well be a direct loss in another. For example, in the case of *Hadley v Baxendale* referred to above, loss of profits was held to be irrecoverable under both limbs. In other cases, however, loss of profit has been held to be an indirect loss and in yet other instances a direct loss (as acknowledged in *McCain Foods v Eco-Tec*). The ambiguity surrounding these terms means that careful drafting is required to ensure that the parties are agreed as to what heads of losses are excluded. Furthermore, cases such as *Peglar Limited v Wang* and *BHP Petroleum Ltd v British Steel* demonstrate that words such as 'other' and 'including' have the potential to limit recoverable losses further than may have been originally anticipated by the parties.

Approach adopted in Standard Form Construction Contracts

The standard forms of construction contract take different approaches when it comes to consequential and indirect loss. Below is a table setting out the position adopted in a selection of contracts and the expected effect of the wording.

References: *Hadley v Baxendale* (1854) 9 Exch 341; *BHP Petroleum Ltd v British Steel plc* [1999] 2 All ER (Comm) 544; *Pegler Ltd v Wang (UK) Ltd (No.1)* [2000] BLR 218; *McCain Foods GB Ltd v Eco-Tec (Europe) Ltd* [2011] EWHC 66 (TCC).



Contract	Consequential and Indirect Loss Wording	Effect
JCT	Where clause 2.13.3 applies (D&B): ' … the Contractor's liability for loss of use, loss of profit or other consequential loss arising in respect of the liability of the Contractor referred to in clause 2.171 [design liability] shall be limited to the amount, if any, stated in the Contract Particulars … '	Recovery of loss of profit/loss of use is probably limited pursuant to this clause, whether direct or indirect (see *BHP Petroleum v British Steel*)
NEC3	Where Secondary Option Clause X18.1 is selected 'The Contractor's liability to the Employer for the Employer's indirect or consequential loss is limited to the amount stated in the Contract Data'	Direct losses are fully recoverable. Loss of profit therefore fully recoverable (unless special circumstances mean the lost profit claimed should be characterised as an indirect loss, when such loss will be limited as stated).
FIDIC	'Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract'	Direct and indirect loss of profit excluded along with consequential losses.
MF/1 (rev 4)	'Neither the Contractor not the Purchaser shall be liable to the other … for any loss of profit, loss of use, loss of production, loss of contracts or for any financial or economic loss or for any indirect or consequential damage whatsoever that may be suffered by the other'	Direct and indirect loss of profit excluded along with consequential losses. Query however what effect the reference to 'economic' loss has and whether this operates as a broader exclusion than an exclusion of indirect and consequential loss.
GC/Works	No limitation	Direct and indirect losses potentially recoverable

'The ambiguity surrounding these terms means that careful drafting is required to ensure that the parties are agreed as to what heads of losses are excluded.'

Concurrent duties of care for pure economic loss: The final word …?

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In recent years conflicting case law has emerged on the issue of the circumstances in which a builder will owe a duty of care in negligence in respect of pure economic loss. In a recent decision the Court of Appeal set itself the task of laying down definitive guidelines. It remains to be seen whether it has done so.

The background

To succeed in a claim in negligence a claimant must show that the defendant owed it a duty of care not to cause it the type of loss that it suffered. In the case of defective works where damage has not been caused to other property (i.e. where the only loss that arises is the cost relating to the remedying the defects), which is classed as 'pure economic loss', the circumstances in which a duty of care will arise are narrow. There must be a sufficiently proximate relationship between the parties, marked by an assumption of responsibility by the defendant, and it must have been foreseeable that if the defendant failed to act carefully loss of that type would be suffered. In the absence of such a duty of care a claimant will have no claim in negligence. If there is a contract between the parties, it may, however, still have a claim for breach of contract.

In general, claims under contract are easier to advance than claims in tort. In the case of latent damage, however, there may be a need to bring a claim for pure economic loss in tort rather than for breach of contract. This is because different limitation regimes mean that in certain circumstances a claimant who is time barred from bringing a claim for breach of contract may still be able to bring a claim in negligence.

In recent years there have been a number of cases in which the courts have considered the circumstances in which a tortious duty of care will arise which is concurrent with the duty of care under a contract. On occasion, the courts appeared to favour the proposition that a concurrent duty of care in tort can arise by virtue of the building contract between the parties (for example, in *How Engineering Services Ltd v Southern Insulation (Medway) Ltd*). However, no single line of authority emerged and it was widely felt by commentators that a definitive statement as to the law was required on the part of a higher court (see, for example, *Keating on Construction Contracts*, para 7-018). It was this task that the Court of Appeal set itself in *Robinson v P.E. Jones (Contractors) Ltd*.

Robinson v P.E. Jones (Contractors) Ltd

In 1991 Mr Robinson contracted with P.E Jones, a firm of builders, to buy a property which was at that time under construction. Having gone undetected for more than 12 years, in 2004 testing by British Gas revealed that the chimney flues and gas fires were defective. There was no damage to the property itself, but the works needed to be replaced. The loss incurred in relation to these replacement works was therefore pure economic loss. Seeking to gain the benefit of a longer limitation period, Mr Robinson argued that the builder owed him a duty of care in tort as well as in contract.

Although the court recognised that a concurrent duty of care can arise in both contract and tort, it held (by a majority) that a builder does not, by reason of the building contract alone, owe a tortious duty of care not to cause pure economic loss. The court drew a distinction between agreements with professional persons, such as architects or engineers, and building contracts, stating that there is likely to be an assumption of responsibility, and therefore a duty of care, in the case of the former but that the same cannot be said of building contracts generally. On the facts, no such assumption of responsibility occurred here. In the leading judgment, Jackson LJ accepted, with some reluctance, that there might be circumstances (albeit narrow in scope) where an assumption of responsibility could arise in the case of a building contract although he gave no examples. Another judge, Stanley-Burnton LJ goes further:-

'In my judgment, it must now be regarded as settled law that the builder/vendor of a building does not by reason of his contract to construct or complete the building assume any liability in the tort of negligence in relation to defects in the building giving rise to purely economic loss. The same applies to a builder who is not the vendor, and to the seller or manufacturer of a chattel.'

In other words, where the contractual obligations undertaken by the builder are limited to construction activities alone, no concurrent duty in tort arises.

This reasoning was contrary to the decision at first instance, which identified a line of authority suggesting that a contractual relationship can, of itself, amount to an assumption of responsibility sufficient to give rise to a tortious duty of care, particularly where there is a contractual requirement to exercise reasonable skill and care. At first instance the judge queried the need for a distinction between professionals and non-professionals. Having cited with approval the decision in *Barclays Bank v Fairclough Building*, in which the Court of Appeal held that *'a skilled contractor undertaking maintenance work to a building assumes responsibility which invites reliance no less than the financial or other professional adviser does in undertaking his work*.' The judge went on to point out that it '*can be difficult to distinguish between a builder's design and his workmanship details*' and that to seek to do so '*could…produce absurd results*'.

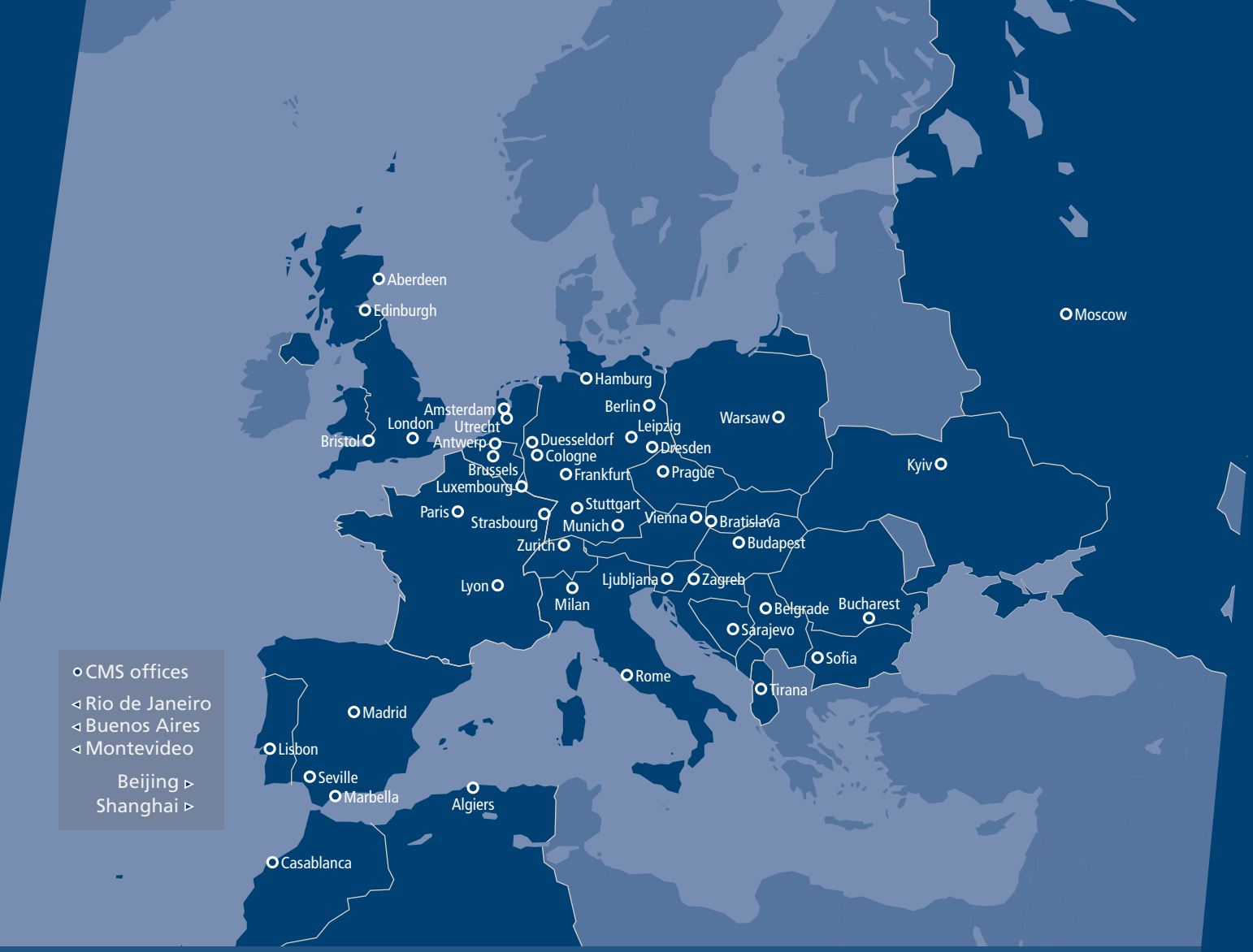
Conclusion

Absurd or not, being a Court of Appeal case, the decision in *Robinson* is binding on all inferior courts, including the TCC. However, it seems likely that what purports to be the final word on the matter may not be. The majority view leaves the door open for courts to find that in appropriate circumstances there has been an assumption of responsibility so as to give rise to a duty of care.

Notably, it is likely to be possible to distinguish *Robinson* on the basis that here the builder had no design responsibility. In the case of design and build contracts there will be an argument to be made that an assumption of responsibility arises by virtue of the fact that the builder has contracted to provide design services (even if it is a third party that actually carries out those services). In other cases, a duty of care is likely to be the exception rather than the rule.

References: *Barclays Bank plc v Fairclough Building Ltd* [1995] 1 All ER 289; *How Engineering Services Ltd v Southern Insulation (Medway) Ltd* [2010] EWHC 1878 (TCC); *Keating on Construction Contracts* (8th ed. 2006); *Robinson v P.E. Jones (Contractors) Ltd* [2011] EWCA Civ 9.

'In my judgment, it must now be regarded as settled law that the builder/vendor of a building does not by reason of his contract to construct or complete the building assume any liability in the tort of negligence in relation to defects in the building giving rise to purely economic loss. The same applies to a builder who is not the vendor, and to the seller or manufacturer of a chattel.'



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