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In this issue

Welcome to issue 60 of the Construction & Engineering Update.

With this issue we are delighted to bring you a supplement on Italian construction law, for which we are greatly indebted to our alliance colleagues, Umberto Baldi and Alberto Fantini of the Rome office of Tonucci & Partners.

Africa is our next destination in this issue, with Kwadwo Sarkodie reporting on how arbitration is faring there, and Raid Abu-Manneh and Jeremy Snead then take us to the Middle East to examine the relationship between arbitration and insolvency in Dubai. Jon Olson-Welsh updates us on procurement and there is an intriguing report from Sarah Byrt on the sensitive issue of the confidentiality of procurement tender documents.

In issue 58 we published a quick guide to bonds; in this issue Jonathan Hosie examines potential pitfalls with guarantees and bonds and their antidotes. We look at another headline-grabbing decision from recently appointed TCC judge, Mr Justice Edwards-Stuart, notably to outlaw a Tolent clause in advance of the Local Democracy, Economic Development and Construction Act 2009 coming into force. Gillian Sproul looks at how competition law compliance has become a key aspect of companies' risk management, we round up the news on contracts, edisclosure and other things, we have a little revision on frustration and add in some case notes as a finale.

And all this without mentioning the football once...

We hope you enjoy the contents.

Sub-Saharan Africa and international arbitration - how does that work?

SETTING THE SCENE

The past decade has seen a growing recognition of the substantial investment opportunities offered by Sub-Saharan Africa. This has been helped by increasing political stability, and the implementation of investor-friendly economic policies by many African governments. Measures to facilitate, promote and support the resolution of disputes by arbitration form a key element of these policies.

Africa is a diverse continent, and the legal position in each country is a product of the interactions between indigenous traditions, colonial history and more recent political developments. It is not possible here to address in detail the differences and distinctions between and within different Sub-Saharan African states, and some broad generalisations are unavoidable. What can be done, however, is to consider generally some of the key issues in arbitration in Sub-Saharan Africa and some recent developments.

Of course many international arbitrations about Sub-Saharan African projects and contracts end up having very little to do with Africa. It is common for contracts in Sub-Saharan Africa to provide for a foreign seat of arbitration (e.g. London or Paris) and to choose international arbitration rules (e.g. LCIA or ICC). Foreign parties also often seek, where possible, to enforce awards in jurisdictions outside Africa, if assets can be found there.

But, when contracting in Sub-Saharan Africa, there will still be times when a claimant has to conduct and perhaps enforce an arbitration in an African state (possibly under African arbitration rules), for instance where enforcement is sought against a party that does not hold assets outside Sub-Saharan Africa. The contract may also specify an African seat of arbitration or African arbitration rules. Whilst this is currently comparatively rare (particularly in relation to major projects), it is likely to occur more frequently in the future, particularly since this is something that many African governments (often contracting parties in relation to major African projects) are increasingly keen to promote.

WHAT CHALLENGES DOES SUB-SAHARAN AFRICA PRESENT?

The challenges and issues particular to arbitrating in Sub-Saharan Africa, and the concerns to which they give rise, may well account for the fact that so many "*African*" arbitrations end up taking place outside Africa. What are these challenges and issues and what recent developments have there been?

Domestic Courts

Several of the most commonly perceived challenges and obstacles in arbitrating or enforcing arbitral awards in Africa relate to the approach and efficacy of the domestic courts in African states. These courts will often have a key part to play in relation to arbitration, potentially ruling on matters such as the existence or validity of an arbitration agreement (and consequent anti-suit injunctions, etc.), challenges regarding the constitution or conduct of the arbitral tribunal or the enforcement of an arbitral award.

The lack of an established body of jurisprudence in relation to international arbitration in many Sub-Saharan African countries, coupled, in some cases, with limited judicial familiarity with issues concerning international arbitration, inevitably fuels uncertainty as to the attitude and approach that domestic courts are likely to take. Another issue faced by many national courts in Sub-Saharan Africa is a strain on resources which can lead to backlogs of cases and lengthy delays, even in addressing relatively straightforward matters.

Corruption, whether on the part of arbitrators, the judiciary or court staff, is also a serious concern. Although there is a tendency to generalise about the extent of corruption in African nations, it still remains the case that corruption can often constitute a significant obstacle to the just and effective disposal of disputes by arbitral tribunals and national courts. Any risk of corruption inevitably gives rise to major concerns on the part of a party faced with the prospect of arbitration.

Enforcement and public policy

A common exemption from the recognition and enforcement of arbitral awards is on the grounds of public policy (for example under Article V(2)(b) of the New York Convention[1]). This is an important factor in relation to arbitrations in Africa, since public policy can be a relatively fluid concept, and may be very widely construed.

This exemption, which may add a further element of uncertainty to the enforcement of awards, can be exacerbated by the wide-ranging cultural, linguistic, religious and political diversity between, and sometimes even within, African states. For example, a significantly different view of public policy could be taken in courts which apply aspects of Shari'a law (e.g. in Sudan, or certain states of Nigeria) from those which apply the common law.

TRENDS AND DEVELOPMENTS

There is a growing recognition among Sub-Saharan African states of the potentially detrimental effect of some of the issues outlined above, and an increasing acknowledgment that support for arbitration represents a key part of providing an investor-friendly climate. A number of states have therefore taken steps which have the potential significantly to facilitate and increase the use of arbitration.

New York Convention

One aspect of this is the growing trend in Africa of adoption of international standardised arrangements for the recognition and enforcement of arbitration agreements and arbitral awards.

A growing number of African countries (just over half) are signatories to the New York Convention, which provides that signatory states shall:

- recognise and uphold valid written arbitration agreements; and
- recognise and enforce arbitral awards (subject to certain exceptions – e.g. public policy).

Reliance on the Convention represents, in many instances, the preferred means by which arbitrating parties seek to enforce international arbitration awards in those states.

1 1958 Convention on the Recognition and Enforcement of Foreign Arbitration Awards

OHADA

The number of countries which are members of OHADA (the acronym, in French, for "*Organisation for the Harmonisation of Business Law in Africa*") is also growing. OHADA came into being in 1993, with the aim of modernising, standardising and harmonising commercial law in Africa. Almost all of the OHADA member states are former French colonies (although Equatorial Guinea (formerly Spanish) and Guinea-Bissau (formerly Portuguese) are also members). The OHADA rules and institutions draw strongly on civil law legal traditions and French business law.

OHADA has a "*Uniform Arbitration Act*", along similar lines to the UNCITRAL Model Law, which provides for the recognition and enforcement of arbitration agreements and arbitral awards. Arbitral awards with a connection to an OHADA member state are given final and binding status in all OHADA member states, on a par with a judgment of a national court. Support is provided by the OHADA Common Court for Justice and Arbitration (based in Abidjan, Cote d'Ivoire) which can rule on the application and interpretation of the Uniform Arbitration Act.

The enforcement regime under the Uniform Arbitration Act has a narrow definition of public policy. Enforcement of an arbitral award may only be refused on public policy grounds where the award manifestly breaches "*international public policy*", as opposed to the public policy of individual member states.

UNCITRAL Model Law

Progress with the adoption of arbitration legislation based on the UNCITRAL Model Law has so far been limited (six states in Sub-Saharan Africa have adopted laws modelled on the Model Law so far) but the OHADA Uniform Arbitration Act (the provisions of which mirror the Model Law) is applicable in each of the OHADA member states.

ICSID and bilateral investment treaties

The great majority of Sub-Saharan African states have acceded to the ICSID[2] Convention, and most bilateral investment treaties to which those states are party provide for the referral of investment disputes to ICSID for determination. In circumstances where a bilateral investment treaty is involved, this offers a further option for arbitration, although only in circumstances where the conduct of the state in question amounts to a breach of the applicable treaty, as opposed to a breach of the parties' contract.

Specialist commercial courts

Some of the most significant difficulties and potential uncertainties relating to international arbitration in Sub-Saharan Africa concern the support provided by domestic courts. Recent steps taken in some Sub-Saharan African countries to improve this support could address some of these issues. For example, Tanzania (1999), Uganda (1999) and Ghana (2005) have established specialist commercial courts which employ a number of measures directed at better serving the needs of business, including specialised training for judges and support staff (with the facility for assistance by lay experts), bespoke procedural rules and the extensive utilisation of information technology.

These specialist courts are therefore likely to be better equipped (in comparison with other domestic courts) to provide timely and consistent rulings in relation to issues arising out of international arbitrations, and therefore offer the opportunity significantly to improve the support infrastructure for arbitration within the relevant countries.

2 International Centre for Settlement of Investment Disputes

CONCLUSIONS

There still remain a number of Sub-Saharan African states (for example, Burundi, Eritrea and Sudan) which are not signatories to the New York Convention, do not have arbitration laws based on the UNCITRAL Model Law and are not members of bodies such as OHADA. In these states the obstacles in the way of arbitrations and enforcement of international arbitral awards could therefore be more pronounced. However, the number of states in this category is falling, as more and more states realise the value of promoting and supporting arbitration.

On the credit side, there are a number of countries (for example Nigeria, Kenya and Uganda) where institutions and legislation to support arbitration are comparatively well-developed, and active steps are being taken to develop these further.

Enforcing an arbitration agreement, arbitrating or enforcing an arbitral award within a Sub-Saharan African state will always bring challenges. The picture inevitably varies across the continent but as the obstacles are addressed so the use of arbitration in Africa is expected to continue to grow.

So long as there is an appreciation of the challenges and issues which may arise, and a knowledge of the increasing number of options available in many countries to address them, the risk of problems with dispute resolution by arbitration need not deter those wishing to avail themselves of the lucrative investment opportunities which Sub-Saharan Africa has to offer.

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ARBITRATION AND INSOLVENCY LAW IN DUBAI - IS THERE A LINK?

Try to imagine a legal system without an effective insolvency law, as in Dubai. How would creditors recover their entitlements? Does it lead to more arbitration activity? Does it explain why the Dubai International Arbitration Centre had over 300 new cases last year and why arbitration is increasingly used?

INSOLVENCY LAW - IS IT REALLY NECESSARY?

When a company reaches a state of insolvency, by definition it no longer has sufficient assets to meet its liabilities, but the handling of those assets takes on a paramount importance. There is value in the company that goes beyond its physical assets, provided by knowhow, goodwill, ongoing relationships, employee loyalty and other ephemeral aspects that cannot easily be transferred by contract. If, however, the physical assets are pulled apart and disposed of piecemeal, those additional elements may be lost, reducing the value of the company. If this happens, value and overall return to the creditors is lost and from this flows a fundamental principle of bankruptcy law: asset maximisation.

But asset maximisation is not in itself enough. The individual creditor may consider that there are amply sufficient assets for its debt to be realised and it is not until a later creditor tries to enforce its claim that the insolvency will prove fatal to the body of creditors' claims. The first creditor past the post will therefore secure a greater return than the creditor that is slower to take action. The competing processes add uncertainty and encourage protective action (including monitoring), that adds to the costs and takes value from the insolvency estate.

An American professor, Thomas Jackson, who has analysed the concept in some detail, has concluded that the neutral bankruptcy principle would be to ensure a ***collective*** and ***compulsory*** insolvency regime - *compulsory*, to prevent any creditor from jumping the queue and *collective* to ensure the greatest return for the greatest number of creditors. The concept of pari-passu (equal and proportionate) distribution of assets on insolvency in so many jurisdictions is a further neutral aspect of insolvency machinery, ensuring the creditor a proportional return wherever it finds itself in the process and removing another element of individual incentive. Logically, this would include a stay on individual litigation or arbitration, to prevent the race to the tribunal and the associated costs and asset attrition. Certainty and transparency would be a requisite so that repeat players could put their faith in the system and would not have incentives to seek to cheat or avoid the system to the overall detriment of their fellow creditors.

Jackson was attempting to rationalise US bankruptcy law, but consider now what the absence of an appropriate collective and compulsory bankruptcy process, with clear priority for creditors, might mean for a legal system. It is for this reason that reform is contemplated in the UAE.

THE NEED FOR REFORM IN THE UAE

According to Dahlia Khalifa, a senior World Bank adviser, it takes an average of five years to close a business in the UAE because of inadequate insolvency laws:

"In the UAE, because there is not a very strong insolvency regime, there are actually very few companies that go through the insolvency process.....What needs to be addressed is the creation of an insolvency regime so companies can go through a very clear process to resolve issues if there are any criminal obligations or results that come from filing for bankruptcy."

And it has been reported in Gulf News that the UAE will introduce a new law "*within months*" to deal with cases of corporate bankruptcies in the economic downturn. But where does that leave insolvencies in the meantime and what has this to do with arbitration?

If an efficient insolvency structure puts the creditors into an orderly system, enforcing a collective and compulsory proceeding for the greater good, and specifies how the financial remains of a failed company are to be dealt with, what happens in Dubai, when the structure fails to achieve that?

A free for all, perhaps, with creditors scrambling to lay hands on whatever assets are left. Which probably means more disputes, with scavenging creditors trying to establish their entitlement and no appropriate insolvency rules to regulate the bringing of proceedings. So much for the theory, but what if we test it against recent arbitration experience in Dubai? How far can judicial discretion be exercised in Dubai and to what extent does it fill the void left without an effective insolvency process?

The issues are clearly much in mind in Dubai. As recently as early March 2010 the Dubai International Arbitration Centre, in cooperation with the IBA, organised a roundtable discussion of international insolvency law and dispute mechanism models. The discussion involved representatives of local law firms including lawyers, legal executives, and company representatives wishing to familiarise themselves with insolvency law and dispute mechanism. Dr Hussam Talhuni, Director of DIAC, said that the purpose of the discussion was to apprise the business community and all stakeholders about the application of international insolvency laws in context to the domestic laws, and to bring the discrepancies in the dispute mechanism models to the notice of the legal practitioners. The participants were presented with some of the insolvency models implemented in the US, France, Canada, Switzerland, and UK.

A LINK WITH THE INCREASED NUMBER OF ARBITRATIONS?

The number of arbitrations started in the Dubai International Arbitration Centre in 2009 – of the order of 300, is a truly staggering number when measured against the relatively small size of Dubai. And that is to ignore the parties who could have gone to arbitration but did not because they decided that pursuing a failed company was going to take time and money and only produce an unsatisfied award.

So what might this tell us about arbitration and insolvency in Dubai? It is entirely consistent with the theory that the absence of an effective insolvency regime means a rise in disputes, as part of the scramble for what little cash may be left. And if that is right, the remarkable number of arbitrations may not be evidence of arbitration's popularity, but simply a reflection of the inadequacy of the existing insolvency regime.

Look also at the arrangements specially made to deal with Dubai World. In December 2009, Decree 57 was issued by the Ruler of Dubai to facilitate the restructuring of the Dubai World group of companies, with a special tribunal set up to deal with claims, and a modified legal regime. The Decree needed to address a jurisdictional issue but the special arrangements underline the absence of the necessary modern insolvency machinery.

The acid test for the theory (as to the likely explanation for the 300 arbitrations) will come after the promised new insolvency law has come into force and has become well used. If the number of requests for arbitration drop away in some sort of correlation then the theory can claim some proof.

Until then it is very much a matter for debate.

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Extras

QUEEN'S SPEECH – KEY PROPOSALS

The Queen's Speech on 25 May announced that a Decentralisation and Localism Bill will be introduced which would, among other things:

- return decision-making powers on housing and planning to local councils;
- abolish the Infrastructure Planning Commission and replace it with "*an efficient and democratically accountable system that provides a fast-track process for major infrastructure projects*";
- create Local Enterprise Partnerships (to replace Regional Development Agencies) – joint local authority-business bodies brought forward by local authorities to promote local economic development;
- form plans to deliver a genuine and lasting Olympic legacy;
- abolish Home Improvement Packs.

ARE YOU LOOKING AFTER YOUR LAPTOPS (AND OTHER THINGS)?

Disclosure is a feature of English and Welsh litigation that requires the parties to disclose to each other the documents that support and detract from the respective cases. In theory it's simple but in practice it can be a costly nightmare, made dramatically worse by the explosion of email and its exponential proliferation of copies. The disclosure court rules that started out in Victorian times and the process of listing were not designed to cope with email, Twitter and texting, not to mention BlackBerries and laptops. So what are the courts doing about it?

A current Practice Direction in the court rules says the parties should talk to each other about edisclosure issues and the launch is awaited, at some future date, of a new Practice Direction on edisclosure and a questionnaire for the parties. Among other data, the questionnaire seeks details to assist in establishing the extent of a reasonable search of electronic material and the method of searching, for example, the relevant date range, the creators and forms of electronic documents and problems with accessibility (where did that site laptop go?). As judges may not all wait for the new Practice Direction to come into force before ordering the parties to respond to the questionnaire, a preview of a form (though not necessarily the final form) of the questionnaire may be helpful. It can be found as a schedule to ***Goodale v The Ministry of Justice***. See: http://www.bailii.org/ew/cases/EWHC/QB/2009/B41.html

BRIBERY ACT WILL COME INTO FORCE BUT WHEN? TIME TO REVIEW PROCEDURES?

Although the Bribery Bill has received Royal Assent, because implementation of the Act's main provisions requires a statutory instrument it seems unlikely to come into force until later this year or even 2011. The Act is intended to make it significantly easier for enforcement agencies to bring successful prosecutions in respect of corruption offences committed at home and abroad.

It will be a defence if the organisation has "adequate procedures" in place to prevent bribery. The Act requires the government to publish guidance on procedures that commercial organisations should put in place but it is unlikely to be "one size fits all" guidance. Consideration should therefore now be given to the particular risks that

might arise in the course of a commercial organisation's business operations so that procedures can be introduced (if not already in place) to minimise the risk of bribery occurring. Once the Act does come into force there is unlikely to be any grace period for commercial organisations to get their house in order. It would consequently be wise to review existing procedures over the coming months, making any necessary improvements. For more details see; http://www.mayerbrown.com/publications/article.asp?id=8930&nid=6

CONTRACT ROUND-UP

RIBA Agreements 2010

The new suite of RIBA Agreements 2010 published in June supersede the RIBA Agreements 2007, which will be withdrawn from sale on 1 December 2010 along with SFA 99, the Standard Form of Appointment of an Architect, CE 99, the Conditions of Engagement for the Appointment of an Architect and SC 99, the Form of Appointment as Sub-Consultant.

The Conditions have been the subject of "*an extensive industry-wide review led by the RIBA*" and in the printed version there are five different packs, consisting of the Conditions of Appointment and a set of 'Core Components'. The five versions are the two Standard Agreements for an Architect and Consultant, the Concise Agreement and Domestic Project Agreement for an Architect and the Sub-consultant Agreement. See, for more details:
http://www.ribabookshops.com/topic/forms-of-appointment/04/

JCT 2011 terrorism cover and republication

The JCT has said that its Standard Building Contract, Design and Build Contract, Management Building Contract, Prime Cost Building Contract, Intermediate Building Contract and Measured Term Contract are to be "*republished*" in 2011, incorporating the JCT Terrorism Cover Update changes issued in the meantime. The Update deals with JCT's Works insurance provisions and the Contractor's liability for loss or damage to the Works or Site Materials resulting from terrorism, in cases where Insurance Option A applies. The Update containing the revised provisions and the associated guidance notes is available from www.jctltd.co.uk or www.jctcontracts.com.

NEC3 Supply Contracts

The NEC3 Supply Contract and Supply Short Contract, launched earlier this year, are said to be the first standardised terms for both complex and simple purchasing of domestic and international supply. See: http://www.neccontract.com/about/Supply.asp

FIDIC

And FIDIC has published a subcontract (as a Test Edition) to accompany the FIDIC Construction Contract (the 1999 Red Book). See: http://www1.fidic.org/news/content.asp?articlecode=80Co&lang=en

30 day government payment rule for subcontract payments

From 25 March all Government departments, agencies, non-departmental public bodies (and the bodies over which they have direct control) have been required to include a contract condition requiring their contractors to pay their sub-contractors in 30 days. The OGC published an action note providing guidance and an

appropriate model clause. The requirement covers new contracts for goods and services. See: http://www.ogc.gov.uk/documents/PPN_requirement_to_include_30_day_payment_clause_P1.pdf

What's the latest on amendments to the Housing Grants Act?

Because of the changes made to the Housing Grants Act by the Local Democracy Economic Development and Construction Act 2009, consequential amendments need to be made to the Scheme for Construction Contracts. The government published, for consultation, its proposals for the required Scheme amendments together with the proposals for further limited amendments put forward by the Construction Umbrella Body Adjudication Task Group to improve the effectiveness of the Scheme. The deadline for responses to the consultation was 18 June 2010. The consultation document can be found at http://www.bis.gov.uk/assets/biscore/business-sectors/docs/10-826-consultation-construction-contracts-regulations.pdf

Competition law compliance – now it's part of risk management;

Competition law compliance has become a key aspect of companies' risk management focus because:

- the maximum fine that can be imposed by the EU and UK competition regulators for infringement of the competition rules prohibiting anti-competitive agreements and abuse of market dominance is high, at 10% of global group turnover, and the level of fines imposed on infringing businesses is steadily increasing;
- actions to recover damages from infringing companies are on the rise;
- competition law is increasingly used as a mechanism to strike down key provisions in commercial agreements, resulting in significant loss to businesses;
- competition regulators tend to be publicly critical of large corporate groups that have infringed competition law and have not put an actively enforced compliance programme in place.

Individual directors and staff are also at risk. Employees engaged in cartel conduct may be prosecuted for the cartel offence; although the prosecution of British Airways executives for price fixing was recently abandoned, the regulators are keen to use their criminal powers in cartel cases and are looking for further opportunities to pursue.

In addition, directors of companies that commit *any* competition law infringement (not just the cartel rules) may be disqualified for up to 15 years from being directors of any company.

And individuals' assets may even be at risk – Safeway recently brought proceedings to recover an indemnity from Safeway directors whose actions resulted in the company's liability to pay a £16 million fine to the OFT.

Adopting a culture of conscious competition law compliance enables a company and its directors and staff significantly to mitigate these risks.

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And the risks for directors have just increased....

The OFT's new guidance on director disqualification orders in competition cases, published on 29 June 2010, creates increased risks for company directors. The OFT proposes to extend the circumstances in which it will use these sanctions. The aim is to increase incentives on company directors to take compliance seriously and deter anti-competitive activity.

Under the Company Directors Disqualification Act 1986, a director can be disqualified from acting as a director of any company for up to 15 years if his/her company is involved in a breach of competition law while he/she is a director and the court considers he/she is unfit to be concerned in the management of a company as a result. The breach of competition law may take any form and, unlike the cartel

offence, is not confined to cartel activity. It can therefore include any conduct constituting abuse of market dominance and hardcore (e.g. price fixing or market sharing) provisions in distribution and licensing arrangements.

Previous OFT guidance indicated that the OFT would focus principally on cases where a director was directly involved in a breach of competition law (e.g. cartel activity). The new guidance, the culmination of a consultation process held in the last quarter of 2009, makes clear that the OFT will take action not only in this situation, but also in circumstances where a director ought to have known about the competition law infringements.

The guidance sets out a five-step process for deciding whether to apply a disqualification order:

(i) consider whether there has been a breach of competition law;

(ii) consider the nature of the breach and whether a financial penalty has been imposed;

(iii) consider whether the company in question benefited from leniency;

(iv) consider the extent of the director's responsibility for the breach; and

(v) have regard to aggravating and mitigating factors.

The OFT may in certain circumstances also use this process to apply for a disqualification order against the directors or officers of a parent company where those directors are acting as shadow or de facto directors of the subsidiary.

The new guidance highlights an additional change in OFT policy. The OFT has decided that, in exceptional cases, it may not wait for a final infringement decision to be made (by it, by the UK sectoral regulators or by the European Commission) against the director's company, but could seek a disqualification order in advance. In these cases, the OFT would still have to satisfy the court that there had been an infringement of competition law, but without relying on the infringement decision.

The new guidance also makes clear that where the company has applied for leniency in respect of competition law breaches, the OFT will continue to offer immunity from disqualification orders for directors who cooperate with the OFT's investigation in respect of those same breaches. This emphasises the OFT's policy objective - to incentivise compliance and co-operation with the OFT from the outset.

The new guidance represents a real gear change in the OFT's approach to director disqualification. Although these are not new powers, the OFT has not to date used them, even following a number of recent serious infringement decisions. However, the new guidance makes it clear that the OFT will now actively seek disqualification orders, using them as an integral part of the enforcement toolkit available to regulators to incentivise compliance and punish infringements.

This may be a good opportunity for directors to revisit their companies' existing compliance programmes, to ensure that they remain effective in educating all employees in the real personal and commercial dangers of competition law infringements.

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Tolent clauses, interest and the case of the Chinese curtain walls

Do you remember the old song: "*I fought the law and the law won*"? To some extent, it could be what the defendant was feeling after reading the judgment in ***Yuanda (UK) Co Ltd v WW Gear Construction Ltd*** and losing key battles over the Construction Act and the Late Payment of Commercial Debts (Interest) Act 1998.

Yuanda, an English subsidiary of a Chinese company, entered into a trade contract with Gear to provide glazed curtain walling for a hotel. 30 or so trade contractors were involved in the project and they all negotiated on the basis of the same contract terms which were based on the JCT Trade Contract, but with a schedule of Gear's amendments.

Yuanda failed to spot some disagreeable amendments during the contract negotiations:

- replacement of the adjudication provisions with a clause 9A that incorporated the TeCSA Rules, amended:
  - "*...to require ...joining of the members of a professional team in a multi-party dispute situation*"; and
  - to make Yuanda fully responsible for both its own and Gear's legal and professional costs if it referred a dispute to adjudication;
- a reduction of the late payment rate of interest from 5% to 0.5% over Base Rate.

When it realised the unpalatable financial consequences of these amendments, Yuanda asked the court to make declarations, in particular, that:

- section 3(1) of the Unfair Contract Terms Act 1977 applied to the contract, because the contract was on Gear's written standard terms of business;
- clause 9A was contrary to section 108 of the Construction Act and the adjudication provisions should be replaced by the provisions of the Scheme for Construction Contracts; and
- the rate of interest was void by reason of the Late Payment of Commercial Debts (Interest) Act 1998.

SECTION 3(1) OF THE UNFAIR CONTRACT TERMS ACT

Yuanda claimed it had dealt with Gear on Gear's written standard terms of business, so that section 3(1) of UCTA applied to prevent Gear from excluding or restricting its liability for breach of contract, except to the extent reasonable. But what exactly are "*written standard terms of business*" under UCTA?

Mr Justice Edwards-Stuart considered the case law and noted that, to be standard, the terms have to be terms which the company in question uses for all, or nearly all, of its contracts of a particular type without alteration (apart from filling in the blanks). It is the essence of such terms that they are not varied from transaction to transaction.

Negotiations are not in themselves fatal to the terms being standard but, if there are significant differences between the terms offered and the terms of the contract actually made, then the contract will not have been made on one party's written standard terms of business.

The judge decided that the parties did not contract on Gear's written standard terms of business because:

- Gear did not have standard terms; although it had offered the same terms to all of the Trade Contractors, few if any had contracted on the same terms; and
- Yuanda had negotiated some material alterations to the terms.

SECTION 108 OF THE CONSTRUCTION ACT AND "TOLENT CLAUSES"

Clause 9A was an example of a '*Tolent clause*', so-called because in ***Bridgewater Construction Ltd v Tolent Construction Ltd*** Judge Mackay had decided that a clause requiring the party serving the notice of adjudication to bear both parties' costs and expenses and the adjudicator's costs, was *not* void. The claimants in ***Tolent*** had unsuccessfully argued that the clause inhibited the contracting parties from pursuing their lawful remedies through adjudication.

Mr Justice Edwards-Stuart in ***Yuanda*** considered that the non-reciprocal ***Tolent*** clause (9A) was contrary to s108 because its practical effect, that the contractor would be deprived of its remedy (up to the amount of the employer's costs), would discourage Yuanda from referring a dispute (particularly a low value dispute) to adjudication "*at any time*" (as it was entitled to do under the Construction Act). He disagreed with Judge Mackay's conclusion in ***Tolent***, at least on the basis of the ***Yuanda*** version of a ***Tolent*** clause.

This may mean it is curtains for ***Tolent*** clauses, in advance of the ban in the Local Democracy, Economic Development and Construction Act 2009 that is yet to come into force.

So what adjudication provisions did apply? Mr Justice Edwards-Stuart said that the effect of section 108(5) of the Construction Act was that the adjudication provisions of the Scheme applied "*lock, stock and barrel*" and replaced the adjudication provisions in the contract.

So far, so good, but, even though the judge did not need to decide the point, there was still the unusual multiparty aspect of clause 9A. Would that really work or was it uncertain or in conflict with s108? The judge said the requirement to join the professional team did not fall foul of section 108 and that proper effect could be given to this clause with some "*modest*" amendments to the TeCSA Rules. The thoughts of the Court of Appeal on the point could make interesting reading.

INTEREST – A SUBSTANTIAL RATE?

Last, but not least, the judge said that a 0.5% rate of interest over base rate was not a "*substantial remedy*" for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998 and that it must be replaced by the statutory rate (8% over base). Of interest to JCT contract users, however, are the judge's comments that he could see no reason why the rate in the standard printed form of JCT Trade Contract (5% over base) should not be regarded as a substantial remedy, even though 3% less than the statutory rate.

All of which probably left Gear feeling that statute had, overall, won the day.

Public procurement review

Members of our Public Procurement group look at recent developments.

CHALLENGING A PUBLIC PROCUREMENT AWARD – LATE IS BAD

Whatever you do, don't be late. No matter how big or serious your claim as a disappointed tenderer might be, missing the time limit for challenging an award procedure may be fatal, as the case of ***Sita UK Ltd v Greater Manchester Waste Disposal Authority*** very clearly shows.

Sita headed a syndicate that unsuccessfully tendered for what was said to be the UK's largest PFI waste disposal project. The awarding authority, the Greater Manchester Waste Disposal Authority, awarded the contract, worth £3.8 billion, to the other tenderer on 8 April 2009 but the Sita syndicate was not happy with the process. It raised a number of compliance objections in correspondence and eventually commenced proceedings against GMWDA on 27 August 2009.

There was, however, a problem. Regulation 32(4) of the Public Services Contract Regulations 1993, amongst other things, says that proceedings may not be brought under the regulation unless they are brought promptly:

"...and in any event within three months from the date when grounds for the bringing of the proceedings first arose unless the Court considers that there is good reason for extending the period within which proceedings may be brought."

GMWDA unsurprisingly asked the court to strike out Sita's claim, alternatively to give summary judgment, saying that the proceedings were started too late and that the Regulation 32(4) discretion to extend the time should not be exercised.

But when did that three month period start to run? The Court of Justice of the European Union has recently ruled that the time limit should run from the date on which the claimant knew, or ought to have known, of the infringement (see note that follows). So what was the appropriate date of knowledge? And as Sita said that it only knew about facts which demonstrated breach in July 2009, did the three month clock only start to tick when Sita had sufficient detail?

The judge concluded that:

"It cannot sensibly be the case that a claimant has to have great detail of how any breach came about before he has knowledge for present purposes...the grounds for bringing proceedings refers to the general basis of overall breach rather than the particular blow by blow errors which led up to the infringement."

Sita knew of the infringements in its correspondence between April and June 2009, and, although it did acquire further knowledge of earlier infringements during the correspondence, this did not materially change the picture. The three month clock therefore started to tick on, or shortly after, 8 April 2009 and expired shortly after 7 July 2009, some weeks before the proceedings were started at the end of August 2009. But were there any reasons for extending that time?

Sita was aware of a time limit as it obtained GMWDA's agreement to extending the three month period but it started its proceedings outside the agreed extension period

and the court found that there was no reason to extend it further. Any delays were attributable to Sita itself and unavailability of senior personnel was not sufficient reason to exercise the discretion.

An appeal is currently scheduled for late 2010 or early 2011 but, whatever the outcome, make sure that your claim is in time because being late could be very bad news.

CJEU RULES ON EU CONFLICT ON PROCUREMENT LIMITATION PERIOD

Earlier this year, the Court of Justice of the European Union delivered its judgement on the limitation period for bringing an action for damages for breach of the procurement laws. The period is three months from the date of the relevant breach but subject, in the UK, to the court's discretion if it considers there is "*good reason*" to extend the period. The CJEU in ***C-406/08 Uniplex v UK***, agreed with Advocate-General Kokott's opinion that, to comply with the principle of effectiveness, the UK courts would *invariably* be required to exercise that discretion so that the three month period would not start to run until the time when the applicant knew or ought to have known of the alleged breach. Which could be some time after the relevant breach.

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For your eyes only – is a tender safe from competitors?

For your eyes only; a tenderer might hope that's the case when it submits a bid, but it's not necessarily so. In ***Croft House Care Ltd and others v Durham County Council***, the TCC had to strike the right balance between a local authority's concerns to protect confidential information and the need for those attacking a procurement exercise to have access to that information to help assess the strength of their case.

Durham County Council had run a public procurement process for domestic care services. Following a challenge by one tenderer, the Council changed the basis of evaluation and re-ran the interviews. Three unsuccessful bidders then started litigation, claiming a breach of the procurement regulations. The parties in the case fell out over whether the disgruntled tenderers could see two types of documents:

- other tenderers' bid material; and
- the Council's own materials showing how it evaluated the bids, such as model interview question and answers.

The TCC gave short shrift to the Council's argument that disclosure of its own materials would make it impossible to re-run the procurement because the bidders would then have visibility of how to evaluate different criteria. Providing the tenderers with a better understanding of the council's requirements would hardly be detrimental to a fair and transparent process, which was one of the aims of the statutory framework.

Among the other arguments raised by the Council in seeking to limit disclosure was one relating to the procurement regulations themselves. Regulation 43 provides that an authority should not disclose information (in the context of a procurement) which a bidder has "reasonably designated" as confidential. (The rules are slightly different for the competitive dialogue procedure.) In fact, the relevant bidders had not marked their information as confidential in this case.

As an aside, construction companies would do well to mark their submissions as confidential where (as is very often the case) these contain business-sensitive material. That will help if the contracting authority is thinking about disclosing one submission to another bidder during the procurement exercise. Once litigation is under way, however, the Civil Procedure Rules, which govern litigation, require the parties to disclose documents which are necessary to dispose fairly of the proceedings – whether or not those documents are confidential. Having regard, however, to the fact that discovery of confidential documents would be a breach of confidence, in some cases the court will impose special safeguards to prevent leaks and misuse of confidential information.

In the ***Durham*** case, the Council asked for disclosure to be limited to the claimants' lawyers or business advisers, to avoid undermining the procurement process if it ended up having to re-run the whole exercise. In response, the claimants protested that their directors needed access to the documents to give their lawyers proper instructions. As small companies, they could not ring-fence off certain personnel or have separate business advisers (who would not know their businesses sufficiently), so the commonly used safeguard of a "confidentiality club" or "confidentiality ring" was just not feasible for them.

The court then had to carry out a balancing exercise between protecting confidentiality of information which had never been marked confidential, and enabling the litigation to run effectively. That exercise came down in favour of disclosure, but the TCC did order various safeguards. The unsuccessful bidders were only allowed access to the documents in their lawyers' presence and were not able to take copies or hang on to their notes. Some of the categories of documents sought were to be anonymised, for example to make it harder to identify a particular tenderer.

The case is a reminder of the different rules which apply when litigation has been commenced, rather than when a procurement is under way. It also shows that different rules may apply to small companies for whom "confidentiality clubs" limited to specific personnel are just not workable.

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What's been happening @ Mayer Brown?

LONDON CONSTRUCTION LAW AND STRATEGIES CONFERENCE

Jonathan Hosie from our London Construction & Engineering Group and Gillian Sproul from our London Competition and Antitrust Group were both involved in the Construction Law and Strategies Conference in London at the end of April.

Jonathan chaired the conference and Gillian spoke on OFT investigations and other competition law issues, including cover pricing, bid rigging and other types of infringement, OFT construction sector investigations, appeals against OFT decisions, 'Victims' – ability to sue for damages, other consequences and avoiding infringement.

"THE TENDER PROCESS FROM HELL" – TEAMBUILD

In early June, Gillian Sproul was again in action, presenting at our offices an interactive session "*The Tender Process from Hell*" to eight teams from Teambuild. Co-presenters Sarah Byrt from our Intellectual Property and IT Group and Chris Fellowes from our London Construction & Engineering Group (standing in for Jon Olson-Welsh) challenged the participating teams with a thought provoking presentation that included a range of questions on competition, copyright and confidentiality and EU procurement issues.

ICC INTERNATIONAL WORKSHOP IN AMMAN

In late June, Raid Abu-Manneh, our London Construction & Engineering Group Middle East specialist, was a speaker at the ICC International Workshop in Amman on Commercial Arbitration. The workshop involved a mock arbitration and analysis of the different stages of the arbitral proceedings under the ICC Rules of Arbitration.

EU INITIATIVE ON CONCESSIONS

Against the background of the European Commission's public on-line consultation on the need for and impact of an initiative on works & services concessions, with a view to improving the current binding EU public procurement law framework, Chris Fellowes was a speaker in June in a Brussels teleconference "*EU initiative on concessions: the key issues for lawyers?*". Chris presented the UK perspective on the definition of a concession.

WELCOME TO AMBER CHEW, NANCY HOUSALAS, WISAM SIRHAN AND CHRIS WRIGHT

Associates Amber, Nancy, Wisam and Chris recently joined the London Construction & Engineering Group and we are delighted to welcome them all to the team.

Security for payment: bonds and guarantees – five pitfalls and protection against them

In the current economic climate, security for payment is key. Although banks have started to lend money again, they remain cautious and those construction firms with weak balance sheets remain at risk of insolvency. This article discusses five pitfalls in the context of some relevant case-law and devices to protect against these.

Bonds and guarantees provide a form of security for a contractor's performance and also a measure of protection against insolvency. In the construction sector, there are a number of different types of bonds and guarantees available, the most common of which are parent company guarantees and performance bonds. The precise nature of a guarantor's obligations pursuant to a guarantee or a bond depends upon whether, on construction of the document, it operates as either a **"guarantee"** or an **"on-demand"** payment obligation. It may be useful briefly to revisit this distinction.

"GUARANTEES" VERSUS "ON DEMAND" PAYMENT OBLIGATIONS

A guarantee is a promise to answer for the debt, default or miscarriage of another. The obligation to make payment under the guarantee is dependent on the beneficiary establishing the principal's liability under the underlying contract. The guarantor's liability is co-extensive with that of the principal so the guarantor can rely on all rights, counterclaims and defences available to the principal. The contract of guarantee must be evidenced in writing and signed by the guarantor or his agent (section 4 of the Statute of Frauds 1677).

Under a bond, the bondsman promises to pay the beneficiary a sum of money up to the value of the bond if the debtor fails to perform the underlying contractual obligation. There are broadly two types of bond; the default and the on-demand form. In the former, the beneficiary has to prove that there has been a breach of the underlying contract and the amount of loss caused by such breach. In the latter, on-demand form, the beneficiary does not need to prove that this breach has occurred or that it incurred any loss in order to call the bond and receive the payment. As a matter of law, the only basis on which an on-demand bond can be resisted is if the call is made fraudulently.

PITFALLS AND PROTECTION

Pitfall 1: Variations to underlying contract

As a guarantor's obligations are co-extensive with the principal's obligations under the underlying contract, the guarantor will be discharged if there is a material variation or alteration in the underlying contract without the guarantor's consent. A material variation is one which cannot be seen to be unsubstantial or one that could be prejudicial to the guarantor. This is the rule in ***Holme v Brunskill*** (1878) 3 QBD 495.

The defendant in ***Holme v Brunskill*** entered into an arrangement to guarantee that the tenant of a farm would deliver up the farm and the associated flock of 700 sheep at the expiration of the lease in good condition and order. The lease was later varied without the knowledge of the guarantor and the tenant agreed to surrender a small field in exchange for a reduction in the rent. At the end of the term the sheep had reduced in number and had deteriorated in quality and value. The Court of Appeal held that the guarantor was discharged because it was possible that the surrender of

the field could have affected the tenant's ability to care for the sheep and therefore the guarantor may have been prejudiced by the variation. In brief, the tenant's final obligations (by virtue of the variations) were not something that the guarantor had agreed to cover.

To avoid the application of the rule in ***Holme v Brunskill***, guarantees usually contain clauses in which the guarantor gives advance consent for variations and amendments to the underlying contract. These are sometimes referred to as "*indulgence clauses*".

However, a decision of the Court of Appeal, ***Triodos Bank NV v Dobbs*** [2005] EWCA Civ 630, highlights that there are limits to the extent to which a guarantor's advance consent to variations to the underlying contract pursuant to an indulgence clause can make him responsible for those obligations as varied.

In ***Triodos*** the defendant director executed a personal guarantee in 1996 whereby he agreed to pay all monies due and owing to the claimant bank "*under or pursuant to*" two loan agreements made between the company and the bank. The guarantee was limited to £50,000 and the total amount under the loan agreements was £900,000. The guarantee included an indulgence clause. The bank entered into further loan agreements which were stated to 'replace' the earlier agreements up to a sum of £2.6million. The defendant knew about the terms of the facilities but had not countersigned the agreements. When the bank came to call for the repayment of the monies there was a shortfall and the bank sought to call on the guarantee.

The judge at first instance declared that the guarantee extended to the borrowing under the later loan agreements. However, the Court of Appeal disagreed and held that the later loan agreement was *not* an amendment or variation of the original loan agreements which was within the purview or general scope of those agreements. This was because the language of the indulgence clause was found not to extend to such matters.

The decision illustrates the importance of casting the terms of indulgence clauses sufficiently wide so as to try to ensure that changes to the underlying contract would fall within the purview of the original guarantee.

Protection:

The solution to the problem identified in ***Triodos***, is to obtain the guarantor's written agreement confirming that the existing guarantee remains in force and covers the amendment or variation of the underlying agreement or obtain a new guarantee. The mechanism for this will need to be in the original guarantee. In addition, parties may wish to tailor any indulgence clauses so as to provide for the types of variations that may be foreseen, particularly where significant scope change is possible. If there are step-in rights in the underlying contract, parties may also wish to include an obligation for the guarantor to enter into a new guarantee upon novation of the underlying contract because such novation will be a "new" contract, not a simple variation of the original one.

Pitfall 2: Is insolvency an act of default?

In ***Perar BV v General Surety & Guarantee Ltd*** (1994) 66 BLR 72, the building contract automatically terminated because the contractor went into administrative receivership. However, the employer treated that event as a "*default*" and made a claim under a performance bond. The Court of Appeal held that the non-performance of the contractor after the automatic termination was not a breach of the contract enabling the employer to call upon the bond; the form of contract (JCT with contractor's design 1981 edition) provided a code for what would happen in the event of insolvency and each party's liability to the other but this did not mean that an act of insolvency, by itself, was a "*default*".

Similar clauses appear under standard forms used in the civil engineering sector. Thus, clause 65 of the ICE Conditions of Contract Design and Construct 2nd edition September 2001 and clauses 90 to 93 of NEC core clauses (3rd edition) both provide (broadly) that where there has been a termination of the contractor's employment for insolvency, further payment is postponed. However and unlike under the JCT forms, the ascertainment process is not necessarily postponed until after completion of the works and making good of defects. Rather, under the ICE and NEC forms, the Employer's Agent or Project Manager (depending upon the form) has the power to certify a final payment earlier. However, the risk remains that the obligation for the contractor to account may be after the date of expiry of the performance bond if this has a fixed date duration.

Protection:

If a party wants to be able to call on a bond for an event of insolvency, the underlying contract should make it clear that this will be a "*default*" so as to trigger liability under the bond. As it is doubtful that the ABI form of bond would respond to contractor insolvency this would need to be amended. As to the duration of the bond, it would need to be made clear that this is co-extensive with the determination of any account following termination due to insolvency.

Pitfall 3: Guarantees by email

It is increasingly common for parties to correspond almost exclusively by email and therefore it is more common that documents said to evidence a promise to stand as guarantor have been generated electronically.

The case of ***Mehta v J Pereira Fernandes SA*** [2006] 1 WLR 1543 confirmed that although a promise to act as guarantor in an email was "*evidence in writing*" for the purposes of section 4 of the Statute of Frauds 1677, an email address in the header of a message did not constitute a signature by the guarantor for the purposes of section 4. However, the judge in Mehta said that "*if a party or a party's agent sending an e-mail types his or her or his or her principal's name to the extent required or permitted by existing case law in the body of an e-mail, then in my view that would be a sufficient signature for the purposes of s 4.*"

Protection:

Be aware of the potential to enter into a obligation as a result of an email and where on the receiving end of such a guarantee, take steps to ensure the document is validly "*signed*".

Pitfall 4: Adjudication decisions

In the absence of explicit words, a guarantor is not liable to pay any amount which may be awarded against the principal debtor by a third person, be it by a judge, jury or arbitrator (***Re Kitchin*** [1881] 17 ChD 668 and ***The Vasso*** [1979] 2 Lloyd's Rep 412). This is the case regardless of whether the underlying contract provides for such resolution of disputes. The rationale behind this is that the guarantor was not a party to those proceedings.

In ***Beck Interiors Limited v Dr Mario Luca Russo*** [2009] EWHC B32 Mr Justice Ramsey extended this principle to adjudication awards. Dr Russo had given a personal guarantee on behalf of a company in which he was a 90% shareholder. The company had entered into a contract with the claimant to build a spa at Westfield Shopping Centre. The company terminated the contract with the claimant and the claimant started and succeeded against the company in adjudication proceedings. It was, however, unable to recover the sums awarded because the enforcement proceedings against the company were stayed as the company was insolvent. As a result, the claimant sought to recover the sums awarded by the adjudicator from Dr Russo under the guarantee but the application for summary judgment failed for a number of reasons, in particular Mr Justice Ramsey's decision that Dr Russo had a real prospect of successfully defending the claim because Dr Russo was not bound by the adjudicator's decision.

Protection:

The way to overcome this difficulty is for the guarantee to contain an obligation on the part of the guarantor to be bound by the decision of an adjudicator, arbitrator or the court as between the parties to the contract or other means under which an underlying dispute arises. Since adjudication decisions are temporarily binding in nature, provision can also be made for this by saying that the guarantor will satisfy and discharge an adjudicator's award subject to the repayment by the beneficiary of any amounts determined in subsequent proceedings not to be owing to the beneficiary.

Pitfall 5: Amount recoverable under on-demand bonds

The Court of Appeal decision in ***Edward Owen v Barclays Bank International Ltd*** [1978] QB 159 says that on-demand bonds are enforceable notwithstanding objections about whether the principal debtor is in default; only proof of fraud on the part of the claimant can defeat a call on the bond. In ***Cargill International SA v Bangladesh Sugar and Food Industries Corporation*** [1998] 1 WLR 461, however, the Court of Appeal held that the principal debtor was entitled to recover any sum paid pursuant to an on-demand bond which represented overpayment once the full extent of the actual damage had been ascertained.

A recent decision of the Commercial Court has considered the perennial question as to whether the full amount under an on-demand bond can be recovered under the bond even though it exceeds the liability under the underlying contract or whether such a demand constitutes fraud. In ***Enka Insaat Ve Sanayi A.S. v Banca Popolare Dell'Alto Adige SPA and another*** [2009] All ER (D) 61, Mr Justice Teare considered the authorities and held that the amount which a person is entitled to demand under a bond depends upon the true construction of the bond in question. On the facts and the specific form of wording in the bonds ("*accordingly ENKA is entitled to receive*

payment") he concluded that there was no requirement for the beneficiary to have suffered damage in the amount claimed. He also said that if the beneficiary could only claim such sums as it estimated represented the loss and damage suffered, the bond would have included express terms to that effect. On this basis, the principal debtor would have to commence proceedings to recover the difference once the actual extent of the loss had been ascertained.

Protection:

Enka is a reminder of the unique nature of on-demand bonds and that depending on the construction of the performance bond, beneficiaries may be able to call on the bonds in their entirety notwithstanding that their actual loss is far less than the amount of the bond. Parties should always consider whether an on-demand bond is appropriate in the circumstances. Further, clear words are required if the intention is to limit a call on the bond to that which represents the loss and damage suffered.

SUMMARY OF KEY POINTS:

- A guarantor may be discharged by variations or other changes to an underlying contract notwithstanding an indulgence clause in the guarantee. Always consider the scope of the clause; it may be appropriate to draft this widely to try to capture future events. Consideration should also be given to obtaining the guarantor's agreement to enter into a new guarantee in circumstances where the original contract is replaced altogether (typically where a novation is contemplated).
- Ensure, again where appropriate, that insolvency is recorded expressly as an act of default in the words of the bond or guarantee and check the terms of the underlying contract to ensure these are consistent.
- Remember that a guarantee has to be in writing but can be entered into by email and needs to be "*signed*" by the guarantor.
- Note that guarantors are not bound by the decisions of adjudicators in respect of liability of the principal debtor unless there are express words to the contrary in the guarantee or bond.
- Be conscious of the risks associated with on-demand bonds. Fraud continues to be a very high hurdle to jump and depending on the wording, beneficiaries to an on-demand bond will be entitled to claim all monies under the bond regardless of whether this is commensurate with the loss or damage suffered. Where an on-demand bond is required, it may be appropriate to consider limiting it to the actual loss incurred at the point of demand in order to avoid costly and uncertain recovery proceedings later.

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Remember frustration – force majeure's English cousin?

Isn't it odd? The French law concept of force majeure is a familiar feature of UK standard form construction contracts yet its English law cousin, frustration, attracts comparatively little attention. In ***Gold Group Properties Limited v BDW Trading Limited***, however, Mr Justice Coulson had to deal with a housebuilder's claim that its development agreement had been frustrated.

Under the development agreement the house builder was to build houses and flats for sale on long leases with the freehold owner and the housebuilder sharing the sales revenue. A contract schedule set out minimum prices for the properties but, according to advice received by the housebuilder, a fall in the property market meant that those minimum prices would not be achieved. The housebuilder claimed it did not therefore have to start work and, amongst other things, that the contract was frustrated.

So what, exactly, is frustration? A 1981 House of Lords case set out this explanation:

"Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance."

And had the fall in the property market frustrated the development agreement? No, it had not because, according to Mr Justice Coulson:

- both parties had anticipated the possibility of a property market fall so that minimum prices would not be achieved;
- the agreement provided what should then happen by permitting the parties to renegotiate the schedule;
- there was therefore no reason for the law to bring the contract to an end; there was no injustice because if the parties could not agree new prices they could be fixed by an expert under the dispute resolution machinery;
- while a "gloomy forecast" two years before marketing the properties entitled the housebuilder to attempt to renegotiate the schedule of minimum prices, it was simply a warning of what might happen and was not an event giving rise to frustration.

Which underlines the unanticipated nature of frustration, that deals with risks for which the contract had not provided. The effect of frustration, when it does occur, is radical, because it kills the contract, automatically bringing its further performance to an end. Which may, of course, explain its rarity value.

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Case Notes

IF YOU WANT TO EXCLUDE NEGLIGENCE – SAY SO

A crane hire standard form contract said that the hirer would indemnify the crane owner against "…*all claims by any person whatsoever*…" for injury to persons or property. A crane driver supplied by the owner to a crane hirer with a crane, fell off the crane and injured himself. He sued the owner and they settled the claim. The owner claimed recovery of the settlement sum from the hirer, relying on two clauses, one of which was the indemnity clause, but did it cover negligence of the owner?

No, said the Court of Appeal. It was bound by its 1982 decision in ***E. Scott (Plant Hire) Ltd v British Waterways Board*** which had considered the indemnity clause in the same form of agreement. The indemnity did not refer to negligence and as it could cover heads of loss based on a ground other than negligence, it did not apply to the owner's negligence. If a contracting party wishes to limit their liability for negligence, they must do so in clear terms.

MacSalvors Plant Hire Ltd v Brush Transformers Limited [2009] EWCA Civ 1329

"BATTLE OF THE FORMS" AND OFFER AND ACCEPTANCE

In "*the battle of the forms*", where, for instance, a purchaser's offer containing its terms is followed by the seller's acknowledgement containing its own terms, and is then followed by delivery, a contract on the seller's terms (other things being equal) will be the result. There can, however, be circumstances in which the traditional offer and acceptance analysis is displaced by reference to the conduct of the parties over a long-term relationship. If it is clear that neither party ever intended the seller's terms to apply and always intended the purchaser's terms to apply, it is conceptually possible to arrive at the conclusion that the purchaser's terms are to apply but it will be a rare case where that happens. It will always be difficult to displace the traditional analysis, in a battle of the forms case, unless it can be said there was a clear course of dealing between the parties.

Tekdata Interconnections Ltd v Amphenol Ltd [2009] EWCA Civ 1209

MAKING YOUR (STATUTORY) DEMANDS

Armed with an adjudicator's decision and a TCC enforcement judgment, can a party issue a statutory demand for payment, even if the other party has a genuine and substantial cross claim against the sum awarded? No, said Judge Stephen Davies in ***Shaw v MFP***. Neither the Construction Act nor the Scheme was intended to displace the position under the Insolvency Rules, which give the court discretion to set aside a statutory demand if the debtor appears to have a counterclaim, set-off or cross demand which equals or exceeds the debt in the statutory demand. The paying party had a cross claim being pursued through arbitration in respect of the proper valuation of the final account and the judge set aside the demand, despite the failure of the paying party to participate in the adjudication.

Shaw & Anor v MFP Foundations & Piling Ltd (Rev 1) [2010] EWHC 9 (Ch).

CONCURRENT DUTY OF CARE IN TORT? THE HOUSEHOLDER LEFT OUT IN THE COLD

A householder who bought a new house discovered, over 12 years later, that the gas flues had not been properly constructed and his gas fires were disconnected for safety reasons. Any claim in contract against the builder was statute-barred but did the builder owe him a duty of care in tort, concurrent with his duty in contract, in respect of economic loss, which would enable him (with the help of s14A of the Limitation Act 1980) to overcome the limitation problem?

The judge (Judge Stephen Davies again) carefully analysed the difficult case law, notably ***Murphy v Brentwood*** and ***Henderson v Merrett***, and concluded that, in principle, a builder can owe a duty of care in tort to his client, concurrent with his duty in contract, in relation to economic loss. He decided, however, that the builder had successfully excluded the duty otherwise owed and the exclusion was not caught by the Unfair Contract Terms Act. The contractual rights provided through the NHBC agreement were wider than the original building contract warranty and any concurrent duty of care that they replaced.

Robinson v P E Jones (Contractors) Ltd [2010] EWHC 102 (TCC)

THERE ARE SOME THINGS ADJUDICATION CANNOT DO...

An adjudicator can only deal with one dispute under one contract. In ***Enterprise v McFadden*** the adjudicator could not therefore deal with a claim to a net balance arising out of mutual dealings on four separate subcontracts (one of which was not even a construction contract) under Rule 4.90 of the Insolvency Rules 1986. Tripartite adjudication is not possible so the adjudication could not cope with a cross claim which would have involved joining assignors. And adjudication would only provide a piecemeal (contract by contract) and temporarily binding solution but Rule 4.90 envisages a final and binding result of the taking of an account in one set of proceedings. All of which meant that the adjudicator in question had no jurisdiction.

In addition, a responding party has to have a reasonable period (however short) to consider a claim for a dispute to crystallise but the claimant first gave notice of its claim at the same time as referring it to adjudication. And quite apart from all that, the judge thought that the large Final Account claim was never suitable for adjudication because its sheer size meant that the adjudicator could not deal with it fairly in the time prescribed by the Housing Grants Act.

Enterprise Managed Services Ltd v McFadden Utilities Ltd [2009] EWHC 3222

THE ECONOMIC DOWNTURN – IS IT FORCE MAJEURE?

Since "*force majeure*" is not a term of art, whether an event triggers a "*force majeure*" clause depends on the proper construction of the clause wording. Under English law a change in economic/market circumstances, affecting the profitability of a contract or the ease with which the parties' obligations can be performed, is not a force majeure event.

In ***Tandrin Aviation v Aero Toy Store*** the force majeure clause wording "*any other cause beyond the Seller's reasonable control*" had to be read in the context of the entire clause. It was telling that there was nothing in any of the specific force majeure examples in the clause even remotely connected with economic downturn, market circumstances or the financing of the deal, and the natural and ordinary meaning of this wording was that it was addressing the position of the seller rather than the purchaser and was a force majeure circumstance that only the seller could rely on. The burden of proof was on the party relying on the clause to show that it could be construed to include any funding difficulties it was encountering (which it could not). And nothing in the doctrine of frustration helped that party as an increase in the mere expense or onerousness of a contract cannot constitute frustration.

Tandrin Aviation Holdings Ltd v Aero Toy Store Llc & Anor [2010] EWHC 40 (Comm)

SO HOW DOES FRAUD AFFECT ADJUDICATIONS?

In ***Speymill Contracts Ltd v Baskind***, where it was alleged that copies of withholding notices had been stolen and that lightning had irreparably damaged the computer on which electronic copies were stored, the Court of Appeal had to consider the effect of fraud on adjudication enforcement. They agreed with Mr. Justice Akenhead's analysis in ***SGSouth v Kings Head*** and his basic propositions to the effect, in summary, that:

Fraud or deceit can be raised as an adjudication defence provided it is a real defence;

If fraud is raised to resist enforcement or execution of an enforcement judgment, it must be supported by clear and unambiguous evidence and argument;

If fraudulent behaviour that was, or could have been, raised as a defence in the adjudication is in effect adjudicated upon, the decision is generally enforceable, but if such behaviour was not, or could not reasonably have been, raised in the adjudication but emerged afterwards it is possible that it can be raised.

Speymill Contracts Ltd v Baskind [2010] EWCA Civ 120

ECONOMIC DURESS AGAIN – A SIGN OF THE TIMES?

In ***Kolmar v Traxpo*** a party that had agreed to purchase methanol urgently required for a very important client was forced by the seller to agree to an increase in price and a reduced quantity. In finding that there had been economic duress which entitled the purchaser to recover the increased payment made, the court confirmed the ingredients of economic duress:

- illegitimate economic pressure which has constituted a "*but for*" cause inducing the claimant to enter into the relevant contract or to make a payment;
- a threat to break a contract will generally be regarded as illegitimate, particularly if the defendant must know that the action threatened would be a breach of contract;

- it is relevant to consider whether the claimant had a "*real choice*" or "*realistic alternative*"; if there was no reasonable alternative, that may be very strong evidence that the victim of the duress was influenced by the threat;
- the presence, or absence, of protest, may be relevant when considering whether the threat had coercive effect but even the total absence of protest does not mean that the payment was voluntary.

Kolmar Group AG v Traxpo Enterprises PVT Ltd [2010] EWHC 113 (Comm)

ADJUDICATION AT ANY TIME – BUT ONLY IF YOU'RE NOT UNREASONABLE OR OPPRESSIVE?

Engineers obtained adjudication awards for outstanding fees, judgment in enforcement proceedings and charging orders. Their clients then issued court proceedings for declarations as to the amounts due to the engineers (alleging these were considerably less than the sums paid on account) and for repayment of sums paid in excess of the engineers' entitlement. The court stayed the court proceedings on the grounds of unreasonable and oppressive behaviour, and some element of bad faith, by the clients in pursuing the claims without first honouring the adjudicator's decisions and the enforcement judgments. The clients then issued adjudication proceedings, which the engineers asked the court to stay.

The court stayed these proceedings until the judgment debts, costs and interest were paid and security for costs provided. The judge considered there was no difference between litigation and adjudication in the criteria for staying a claim brought unreasonably and oppressively, but applying the criteria to the facts might produce a different outcome, depending on whether the claim was made in litigation or adjudication. The current referrals were another attempt to circumvent the HGCRA machinery and policy and it was "*unreasonable and oppressive*" to subject the engineers to further (adjudication) proceedings when their clients had failed to honour the first awards and subsequent court judgments.

Mentmore Towers Ltd & Ors v Packman Lucas Ltd. [2010] EWHC 457 (TCC)

HADLEY V BAXENDALE DAMAGES TEST IS STILL THE NORM

The House of Lords' decision in ***The Achilleas*** placed a question mark over the English contract law rules on remoteness of damage and the classic statement of those rules in ***Hadley v Baxendale*** as to the extent of the losses recoverable for breach of contract. The generally accepted remoteness test was whether the loss claimed was of a kind or type within the reasonable contemplation of the parties at the time the contract was made as not unlikely to result, but at least two of the Law Lords in ***The Achilleas*** introduced an assumption of responsibility test that prompted much debate.

In ***Sylvia v Progress***, Mr Justice Hamblen reviewed the House of Lords judgment, subsequent case law and textbook commentary and said that only in relatively unusual cases (e.g. ***The Achilleas***), might a consideration of assumption of responsibility be required. It was important to make clear that there is no new

generally applicable legal test of remoteness in damages. Decisions are apparently being challenged for failing to recognise or apply the assumption of responsibility test and this results in confusion and uncertainty but in the vast majority of cases tribunals of fact can and should be able to apply the familiar and well established remoteness test which, in those cases, works perfectly well.

Sylvia Shipping Co Ltd v Progress Bulk Carriers Ltd [2010] EWHC 542 (Comm)

SUBJECT TO CONTRACT – DOES IT ALWAYS STOP A CONTRACT COMING INTO EXISTENCE?

In ***RTS v Molkerei*** the parties asked the courts, after work had been carried out and equipment supplied, to answer the all too familiar questions as to whether they had a contract and, if so, what were its terms. Just to complicate matters, the contract documents contained a clause that said the contract "*…shall not become effective until each party has executed a counterpart and exchanged it with the other…*" . But did that clause, which the parties had not complied with, prevent a contract coming into existence?

The Supreme Court said there was a contract. The striking feature of the case was that essentially all the terms were agreed, substantial works were then carried out and the agreement was subsequently varied in important respects, And the clear inference from all this and the lack of any suggestion that the variation was agreed subject to contract was that the parties had agreed to waive the subject to contract clause. Any other conclusion made no commercial sense.

RTS Flexible Systems Ltd v Molkerei Alois Muller Gmbh & Company KG (UK Production) [2010] UKSC 14

ADJUDICATOR'S DECISION UNENFORCEABLE BECAUSE KEY DEFENCE ISSUE EXCLUDED

Pilon, a refurbishment contractor the subject of a Company Voluntary Arrangement, brought an adjudication claim on an interim application in respect of one part of their works. Apart from disputes about valuation, the Employer's principal defence was that it was entitled to set off a substantial overpayment in respect of the other part of the works. The adjudicator did not consider this overpayment defence at all because the notice of adjudication made plain that the dispute was limited to the first part of the works and he considered he did not therefore have jurisdiction to consider Breyer's over-payment argument on the other part. Was he correct?

No, said Coulson J. The adjudicator was not entitled to determine his own jurisdiction, and by failing to take into account the over payment defence, the adjudicator had deliberately placed a "*highly material*" erroneous restriction on his own jurisdiction, which amounted to a jurisdictional error or breach of natural justice. The adjudicator's decision was not severable and was consequently unenforceable. Even if it had been enforceable the judge would have granted a stay of execution because of Pilon's parlous financial situation.

Pilon Ltd v Breyer Group Plc [2010] EWHC 837

A DEVELOPER'S PROFITS GO UP IN SMOKE - BUT ARE THEY RECOVERABLE?

A subcontract plumber negligently caused substantial fire damage to a house being developed, which was close to completion. The developer, a family owned company, was self-funded, with the profit from the sale of developed properties being used to fund the next project. It successfully claimed from the plumbing company the loss of profit that it said it would have earned on properties which, but for the fire and the need to reconstruct the property, it would have developed. The judge identified three applicable legal principles:

- whether the type or kind of loss claimed falls within either limb of ***Hadley v Baxendale***;
- on the balance of probabilities, what loss of that kind has actually been caused by the breach of contract?
- the loss may not be recoverable if caused by another event that may or may not be the claimant's fault and which was not reasonably foreseeable by the defendant at the date of the contract.

Aldgate Construction Company Ltd v Unibar Plumbing & Heating Ltd [2010] EWHC 1063

COURT TAKES ALL OR NOTHING APPROACH TO ENFORCING FLAWED ADJUDICATION AWARD

S104(5) of the Construction Act says that where an agreement relates to construction operations, and "*other matters*", the Act only applies to the agreement "*...so far as it relates to construction operations.*" So will the courts enforce an adjudication award in a dispute that relates both to construction operations and to "*other matters*" to which the Act does not apply?

In ***Cleveland Bridge v Whessoe-Volker Stevin*** Mr Justice Ramsey ruled that a subcontract involved both construction operations and operations which were not. Since the adjudicator's decision dealt with a dispute, part of which was within her jurisdiction and part of which was not, her decision, which was on the whole dispute (and not, as invited by the claimant, in the alternative, on the basis of the construction operations part of the dispute) was therefore invalid and unenforceable. The decision could not be severed to enable enforcement of the part within her jurisdiction; the decision was on a single dispute and paragraph 23(2) of the Scheme, requiring the parties to comply with an adjudicator's decision, did not require compliance with a part of a decision. Nor were the adjudicator's findings on issues leading up to the decision themselves individually binding and enforceable.

Cleveland Bridge (UK) Ltd v Whessoe-Volker Stevin Joint Venture [2010] EWHC 1076

SUBCONTRACTOR TORT DUTIES OF CARE IN RESPECT OF THE WORKS – THE JURY'S STILL OUT

The landmark case of ***Murphy v Brentwood D.C.*** decided that a builder with overall responsibility for constructing a building does not owe a duty of care to the building's owners or occupiers with whom it has no contract, in respect of damage to the building itself (as distinct from injury to people or other property). But does a subcontractor or supplier who only provides a building element owe a tort duty of care in respect of damage to the building, other than in respect of the element itself? In ***Linklaters Business Services v Sir Robert McAlpine*** it was alleged that pipework insulation had been inadequately installed and that the pipework insulation subcontractor owed the lessees of the premises a tort duty of care. The subcontractor asked the court to strike out the claim because it said it owed no such duty.

The judge noted that ***Murphy*** and other cases did not specifically address the extent of any tort duty of care owed by a subcontractor or supplier in respect of a building element. He did not strike out the claim because there were too many factual uncertainties against which to decide the legal issues and this is, or could be, "..*an area of developing jurisprudence*..", but he gave leave to appeal as the case raised "*interesting and important*" issues of law on which the Court of Appeal might wish to rule.

Linklaters Business Services v Sir Robert McAlpine Ltd [2010] EWHC 1145

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