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Legal developments in construction law

1. Can a contract bar litigation or arbitration of a dispute until adjudication is over?

A party to a construction contract subject to the Housing Grants Act can go to adjudication at any time. But is a clause that says a dispute cannot be referred to court or arbitration until an adjudicator has made their decision, effective as a contractual bar? Or can it be sidestepped because the clause ousts the jurisdiction of the courts?

Clause W2.4(1) of NEC3 is such a clause and, in deciding that it is an effective contractual bar, making adjudication a mandatory step prior to referring any dispute to a tribunal (whether court or arbitration), a Scottish court said it was clear from the language of the clause, and its relationship with other clauses, that these provisions were intended to be definitive as to the means, and the sequence, for determining disputes. The claimant's approach, that these provisions could be ignored in favour of an unqualified right of direct recourse to the court without any stipulated timeframe, would effectively permit a parallel regime of dispute resolution wholly at odds with the clear words and detailed specification of the agreed means for dispute resolution and make the agreed terms of Clause W2.4 superfluous.

The claimant's approach also cut across the Housing Grants Act right to refer a dispute to adjudication, the quick and inexpensive means of interim dispute resolution introduced by the Act. It would deny the defendant the advantages and speed of that contractually-agreed first mode of dispute resolution.

The Scottish court also adopted analysis of the issue in the English case of ***Anglian Water Services Limited v Laing O'Rourke Utilities Limited***, where the court noted that a clause similar to W2.4(1) did not fetter the right to refer a dispute to adjudication at any time. It did, however, prevent a party starting court or arbitration proceedings at any time, without having first referred the dispute to adjudication.

The Fraserburgh Harbour Commissioners v McLaughlin & Harvey Ltd at:

https://www.bailii.org/scot/cases/ScotCS/2021/2021_CSOH_8.html

2. How to deal with a liquidated damages clause

In a dispute under an aircraft sale agreement, there was a claim for liquidated damages of US $42.95m, in respect of undelivered aircraft. The buyer claimed the liquidated damages were an unenforceable penalty and that, if they were not recoverable, the seller could not, instead, recover damages at common law.

Applying the Supreme Court ruling on liquidated damages in ***Cavendish Square Holding v Makdessi***, the court in this case noted that the judgment had said that, "*In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.*" and that, in judging whether the damages are "*extravagant,*

exorbitant or unconscionable…the extent to which the parties were negotiating at arm's-length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor."

The onus is on the party asserting that a liquidated damages clause is unenforceable, and the question is one of construction at the date of the contract. The parties in this case were both represented by sophisticated and experienced lawyers, and were substantial commercial operators in the aircraft industry with a long-standing commercial relationship, and with comparable bargaining power. The Defendant had every opportunity for advice, and to use its own experience, before agreeing, in a purchase agreement clause, that "such liquidated damages do not constitute a penalty and are a reasonable and agreed amount of the anticipated or actual harm or damages to be suffered by [the Claimant] as a result of or in connection with Buyer's default".

Ruling that the damages agreed as a pre-estimate of loss in this clause were not an irrecoverable penalty, the court said that the defendant had made no attempt to cast doubt on the realistic nature of the estimate.

Although the court did not have to decide the claimant's alternative claim for damages at common law, if liquidated damages were irrecoverable, it noted that the Supreme Court in ***Makdessi*** had said that if an innocent party was deprived of the benefit of a liquidated damages clause it then has a remedy in damages under the general law. The 'penalty' imposed for an excessive pre-estimate of loss is the need to calculate the actual loss, with the possible difficulty and expense entailed. It is not being deprived of any recovery at all. And by agreeing an exclusive remedies clause the parties had not irrevocably contracted out of the recovery of damages at common law.

De Havilland Aircraft of Canada Ltd v Spicejet Ltd [2021] EWHC 362

3. Agreement "Subject to contract" – not waiving? Not binding?

A site developer resisted enforcement of an adjudicator's award, claiming there had been a subsequent agreement, to deal with the award and with retention and warranty works. The agreement was made over the phone and confirmed by an email exchange but was stated to be "*without prejudice and subject to contract*", with a settlement deed and payment guarantee to be prepared by lawyers. Some, but not all, payments were made, and work carried out, under the agreement, but the deed and guarantee were never signed. Had the "*subject to contract*" label been waived so that the agreement was binding?

The court referred to ***RTS v Molkerei***, where the Supreme Court said that: "*Whether [in a without prejudice subject to contract case] the parties agreed to enter into a binding contract, waiving reliance on the 'subject to [written] contract' term or understanding will again depend upon all the circumstances of the case, although the cases show that the court will not lightly so hold.*" In this case the court said that the agreement was made on the basis of a common understanding between the parties that it would not be binding until reduced into writing and signed as a contract. The issue to be decided was whether the parties had agreed to enter into a binding contract (a new contract) without the need for all terms to be reduced to writing.

The court concluded they had not, for a number of reasons, in particular that the case was a paradigm example of why the court "*will not lightly hold*" that a condition that negotiations and agreements are "*subject to contract*" has been superseded. The parties set their own rules of engagement. They agreed that there would be no binding contract until the terms were reduced to writing and signed off. They clearly envisaged an agreement would be reached but that it would not be enforceable until the formalities had been observed. The presence of an agreement that was acted on, is not therefore, without more, enough to indicate that the parties intended to be bound.

It was obvious that the agreement would be acted upon before it became binding. Payments would be made and work would be done. Once "banked" those sums would need to be accounted for, whether or not there was a binding contract. Everything that happened during the course of the parties' dealings with one another happened at a time when the ground rules applied.

Aqua Leisure International Ltd v Benchmark Leisurel Ltd [2020] EWHC 3511

4. Adjudication: "fundamental" lack of jurisdiction cannot be waived

An adjudicator made an award of legal costs claimed by a contractor under the 1998 Late Payment of Commercial Debts (Interest) Act, but both parties accepted that the adjudicator had no power to do so. In ***Enviroflow Management Ltd v Redhill Works (Nottingham) Ltd***, decided after the adjudicator's decision, the court had ruled that an adjudicator had no power to make such an award unless there was an agreement in writing that complied with Section 108A of the Housing Grants Act. In this case there was none but, in the absence of any general or specific reservation of its position, had the defendant waived its right to raise any jurisdictional issue?

Although a judge dealing with enforcement of an adjudication award may not deal with an issue which the adjudicator has decided, there is an exception, which rarely arises, where the issue is a short self-contained point that can be dealt with without oral evidence and by short oral submissions, using a part 8 claim form, but this was not a case where this procedure must be followed. The question was one of jurisdiction in the most fundamental sense.

The adjudicator had no jurisdiction to make the award because the statute under which they purported to act had no application but the parties and the adjudicator had applied what had, no doubt, been a common approach until ***Enviroflow*** was decided. The court considered that it would be unreal not to take account of the fact that the common practice and understanding at the time of the adjudicator's decision was to proceed on the basis that there was jurisdiction and ruled that the defendant had not waived any right to raise this fundamental jurisdiction point. To conclude otherwise might well lead, undesirably, to parties to adjudication expressing general reservations in respect of developing law.

If that analysis was not correct, the point could be determined without the need for a Part 8 claim. The court considered, though without hearing argument, that a fundamental point of jurisdiction, such as the one in issue, could not be waived. The absence of jurisdiction in the case arose out of an express statutory provision rather than a mere procedural failure, the parties could not override the Housing Grants Act by agreement or conduct, and the statutory removal of the right to rely on the 1998 Act meant that the claimant could not reasonably be taken to have relied on the defendant's failure to raise the point as a waiver of the right ever to do so. Waiver is a type of estoppel, where the conduct of one party sends a clear and unambiguous signal to the other that they intend to act in a certain way and it would be unconscionable for them then to act contrary to that signal. Although the point was not argued, as a matter of law, the court considered that an estoppel (and so the waiver) could not operate and the question of waiver was not raised in ***Enviroflow***.

Aqua Leisure International Ltd v Benchmark Leisure Ltd [2020] EWHC 3511

5. Unsafe cladding – new government funding and developer levy and tax

The Housing Secretary has announced:

- new funding for the replacement of unsafe cladding for all leaseholders in residential buildings 18 metres (six storeys) and over in England;
- a new scheme for buildings between 11 and 18 metres for cladding removal, where needed, through a long-term, low interest, government-backed financing arrangement;
- plans for a 'Gateway 2' developer levy, to apply when developers seek permission to develop certain high-rise buildings in England;
- a new tax for the UK residential property development sector;
- the government will bring forward legislation this year to tighten the regulation of building safety and to review the construction products regime to prevent malpractice. arising again.

See: *https://www.gov.uk/government/news/government-to-bring-an-end-to-unsafe-cladding-with-multi-billion-pound-intervention*

6. VAT: HMRC thinks again on early termination fees and compensation payments

In September 2020, in Revenue & Customs Brief 12/2020, HMRC said that, following two EU Court of Justice rulings, most early termination and cancellation fees, even if described as compensation or damages, are liable for VAT. Brief 12/2020 also said that any taxable person that had failed to account for VAT to HMRC on such fees should correct the error.

HMRC has subsequently issued an update, advising that, after communication from businesses and their representatives, it has decided to apply the updated VAT treatment from a future date. Revised guidance, and a new brief, to explain what businesses need to do, including guidance on what to do if they have already changed how they treat such payments because of the brief, is to be issued.

Until then businesses can:

- continue to treat such payments as further consideration for the contracted supply; or
- go back to treating them as outside the scope of VAT, if that is how they treated them before the brief was issued.

See: *https://www.gov.uk/government/publications/revenue-and-customs-brief-12-2020-vat-early-termination-fees-and-compensation-payments*

7. 6 April start for postponed IR35 changes

The reforms to the off-payroll working rules (IR35), postponed from April 2020, take effect from 6 April 2021.

See: *https://www.gov.uk/guidance/april-2020-changes-to-off-payroll-working-for-intermediaries*

and this Mayer Brown update: *https://www.mayerbrown.com/en/perspectives-events/blogs/2020/09/*ir35-reforms-update-make-sure-you-are-ready-for-6-april-2021

8. MHLG clarifies nearly zero energy requirements for new buildings

The Ministry of Housing, Communities and Local Government has written to building control bodies to clarify the implementation of the requirements for new buildings to meet regulation 25B of the Building Regulations 2010, which sets out that all new buildings should be nearly zero energy buildings from 31 December 2020.

See: *https://www.gov.uk/government/publications/nearly-zero-energy-buildings-requirements-for-new-buildings*

If you have any questions or require specific advice on the matters covered in this Update, please contact your usual Mayer Brown contact.