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January 2023

Legal developments in construction law

1. Guarantees: what sort is it? (And how to tell them apart)

In a case about the termination of two shipbuilding contracts, one of the legal issues discussed was whether six insurance bonds operated as "*on demand bonds*". Although, because of other findings, it might have been unnecessary to decide the issue, the court did briefly consider it and, in particular, summarised the legal principles set out by the Court of Appeal, in ***Shanghai Shipyard Co Ltd v Reignwood International Investment (Group) Co Ltd***, in considering the different types of guarantees and bonds. The court's summary noted that:

- **Surety guarantees**

  A traditional guarantee, by way of suretyship, is an undertaking by the guarantor to answer for the debt or obligation of another party, if they default. Its essential feature is that the guarantor's liability depends upon there being a liability of that other party. Such guarantees sometimes describe the guarantor's obligations as those of a "*primary obligor*", to make clear that the other party's default gives rise to an independent and primary liability of the guarantor, who is liable by the very fact of the default. A surety guarantee may also require a demand.

- **Demand guarantees**

  Security may alternatively be provided by an undertaking to pay a sum on or following demand, irrespective of whether the other party is liable to make payment. Commonly called 'guarantees', but they are payable on, or by reference to, an event, namely the demand, and without the beneficiary having to establish the other party's liability. The demand may have to be in prescribed form, and/or may have to be accompanied by prescribed documents, but it is the demand that triggers the liability to pay. Payment against demand is the hallmark of a demand guarantee.

- A demand guarantee may only be called if it can be asserted in good faith that the secured obligation has arisen. The demand must say in what respect the other party is in breach of its obligations under the underlying relationship, so demand guarantees still have to make reference to the obligations for which they provide security.

- **Conditional bonds**

  Guarantees other than surety guarantees may require payment upon, or by reference to, an event other than a demand, or be conditional upon such an event, such as an arbitration award, in which case they may be described as a conditional bond. Analytically, demand guarantees form a subset of conditional bonds in this sense, the demand being merely one type of event upon which liability may be conditional.

- The starting point for categorising the instrument is not the nature of the institution providing the instrument, e.g. a bank or equivalent financing institution. What matters is the wording of the parties' bargain, interpreted in accordance with the well-established rules of construction.
- Reliance on previous cases on what are said to be similarly worded instruments is only of assistance in very limited circumstances, namely where the words used, taken as a whole, are materially identical and the contractual context is materially identical.

The court in ***Havila*** also considered that it made no difference that the bonds in question in the case did not use the words "*on demand*" or "*demand*", but instead used the (functionally similar) word "*claim*". The words "*demand*" or "*claim*" were not in themselves informative about whether a document is a surety guarantee or an on demand instrument. That is to be discerned by working out the substance of the obligation in the light of the instrument as a whole.

See: Havila Kystruten AS v Abarca Companhia De Seguros, SA [2022] EWHC 3196

2. Terminating a contract – when can you (and can't you)?

There is more than one way to terminate a contract (or, at least, to stop its further performance). An obvious way is to use an express termination clause, if, of course, the contract has one and its requirements are satisfied. But there are others, that can be uncertain and, consequently, commercially risky. In ***Havila Kystruten AS v Abarca Companhia De Seguros, SA*** the court dipped into the case law, and the other options, which can depend on whether contract obligations have been categorised as "conditions" or "warranties". The court noted from the cases that:

- all breaches of "conditions" entitle the innocent party to terminate the contract;
- the textbook Chitty on Contracts, 34th edn., states that "*the modern approach is that a term is innominate* (i.e. contract obligations not categorised as "conditions" or "warranties") *unless a contrary intention is made clear.*"
- the legal consequences of a breach of an *innominate term* (unless expressly provided for in the contract) depend on the nature of the event to which the breach gives rise;
- the test of "repudiatory breach" (i.e. a breach entitling the innocent party to accept it as bringing further performance of the contract to an end) is whether the occurrence of the event deprives the party with further obligations to perform of substantially the whole benefit which it was intended that they should obtain from the contract;
- applying this test involves evaluating all the relevant circumstances.

Havila Kystruten AS v Abarca Companhia De Seguros, SA [2022] EWHC 3196

3. Recovering remedial works costs; what is reasonable and does expert advice make a difference?

Assessing the costs of remedial works that a claimant should recover is fertile ground for argument but just how does a court decide what is reasonable, and does expert advice make a difference?

In ***LDC (Portfolio One) Ltd v George Downing Construction Ltd and European Sheeting Ltd (In Liquidation)*** the court noted that the costs incurred are the starting point for an analysis of what is reasonable and, if there is no reason to justify a departure from the actual costs incurred, then they will be regarded as reasonable costs to be recovered as damages.

In determining whether a remedial scheme was reasonable, the court will consider whether, and to what extent, the claimant relied on expert advice. In ***Axa Insurance UK Plc v Cunningham Lindsey*** the court summarised the relevant principles from case law:

- whether expert advice, even if professionally reasonable, can convert expenditure into reasonable expenditure involves a consideration of the facts. If that advice is merely tangential or coincidental to the work, the costs of the work carried out to that extent on the expert's advice, will generally not be recoverable;
- there must be some effective causal link between incurring the expenditure on the advice of the expert and the breach of contract;
- if two remedial schemes are proposed and one scheme is adopted on expert advice, the defendant is liable for the costs of that built scheme, unless the expert advice was negligent; although to put in issue the reasonableness of a decision based on expert advice does not require professional negligence on the part of the expert;

- although reliance on an expert will always be a highly significant factor in any assessment of loss and damage, it will not on its own be enough, in every case, to prove that the claimant has acted reasonably.

The court in ***LDC*** added, from the case law, that:

- when considering alternate remedial schemes, it is necessary to consider their cost, efficacy, and any guarantees or bonds offered by the relevant manufacturer or contractor;
- a claimant cannot recover for losses which it has failed to avoid because of its own unreasonable acts or omissions;
- the claimant is also subject to a duty to mitigate its loss, although the court will not be too critical of its choices if made as a matter of urgency or on incomplete information;
- it is not of itself an answer to a claimant's claimed remedial scheme to demonstrate that the defects could have been rectified through an alternative scheme for a lower cost. The defendant must demonstrate that the remedial scheme claimed for was unreasonable;
- where repair or reinstatement works result in the claimant having a better or newer building than it would have had but for the wrong for which damages are claimed, a deduction from the damages awarded will not usually be made for betterment if the claimant has no reasonable choice. This includes betterment resulting from compliance with legislation introduced since the original works were carried out which requires additional or enhanced standards to be met.

LDC (Portfolio One) Ltd v George Downing Construction Ltd and European Sheeting Ltd (In Liquidation) (*no link available*)

4. HSE advice for HRB owners and managers on preparing for the new regime

The HSE advises that existing occupied High-rise Residential Buildings must be registered with the Building Safety Regulator between April 2023 and October 2023.

The HSE says that it will be necessary to collect detailed, accurate information when preparing a safety case report and registering an HRB building and has set out examples of the information required and explained what needs to be done.

See: What we are doing to prepare - Building safety - HSE; and https://www.hse.gov.uk/building-safety/how-to-prepare.htm

5. Levelling Up Committee to take new year look at building safety

The Parliamentary Levelling Up, Housing and Communities Committee is to undertake follow-up work on building safety and has invited Lee Rowley, the Parliamentary Under Secretary of State (Local Government and Building Safety), to attend an evidence session early this year.

The Committee is likely to examine perceived gaps in the Building Safety Act 2022 and ongoing issues relating to building safety and remediation, including the liability of professional freeholders, the voluntary developer pledge and the fund for buildings 11-18m in height. It is also likely to explore questions around funding for non-cladding building safety works.

See: https://committees.parliament.uk/committee/17/levelling-up-housing-and-communities- committee/news/175127/building-safety-levellingup-committee-plan-followup-work-in-2023/

6. Building Act and Building Safety Act: Government finalises definition of "higher-risk building"

The government has issued its response to the consultation on the definition of "*higher-risk building*" (subject to the new building safety regime) and has published the draft regulations that require parliamentary approval.

The draft regulations specify, in more detail, the descriptions of buildings to be included in the definition of "*higher risk building*" in the Building Act 1984 and the Building Safety Act 2022 and are marked as coming into force on 6 April 2023. There are different definitions of "*building*" for the design and construction and occupation parts of the new regime.

The government is to publish full guidance on the regulations once they are approved by parliament and before the new regime comes into force.

See:

Draft regulations: https://www.legislation.gov.uk/ukdsi/2023/9780348242812/contents

Explanatory memorandum: https://www.legislation.gov.uk/ukdsi/2023/9780348242812/pdfs/ukdsiem_9780348242812_en.pdf

Government consultation response: https://www.gov.uk/government/consultations/consultation-on-the-higher-risk-buildings-descriptions- and-supplementary-provisions-regulations/outcome/government-response-to-the-higher-risk-buildings-descriptions-and-supplementary-provisions-regulations-consultation

7. Fluctuations provisions: JCT launches new information hub

The JCT has launched a new information hub and training video module on the use of fluctuations provisions.

See: Fluctuations and JCT Contracts – The Joint Contracts Tribunal (jctltd.co.uk)

8. Government proposes sprinklers in new care homes and second staircases in residential buildings over 30 metres

The government has launched a consultation on its proposals to amend Approved Document B to:

- recommend sprinklers in new care homes, regardless of building height;
- remove the national classification system for construction products (BS 476 series) - including Class 0 – and require all relevant construction products to be tested to the British Standard version of the European Standard;
- require new residential buildings above 30 metres in height to be designed and built with two staircases;
- call for evidence on revisions to paragraphs 10.6 and 10.7 of Approved Document B covering materials and products used in the construction of external walls.

The consultation closes on 17 March 2023.

See: https://www.gov.uk/government/news/government-pro poses-second-staircases-to-make-buildings-safer

9. BSR ebulletin: updates and guidance on the 'golden thread'

The January HSE Building Safety Regulator ebulletin has provided updates on:

- the first meeting, in December, of the Building Advisory Committee that will advise and inform the Building Safety Regulator (Read more);
- the recent work of the Interim Industry Competence Committee; and
- the first organisations to be awarded the Building A Safer Future Certificate of Commitment and Progress – Building Safety Stage One.

The ebulletin has also provided guidance on the 'golden thread', the information that allows those responsible to understand a building and the steps needed to keep both the building and people safe, now and in the future.

The guidance is for anyone responsible for a building's information throughout its life-cycle. This includes building companies, principal designers and principal contractors, and local authorities.

Read the guidance

Subscribe here to receive the Building Safety Regulator ebulletin.

10. Government fire safety and remediation update of information for leaseholders and other residents

The government has updated its information for leaseholders and other residents on fire safety and remediation of historic building safety defects. It includes a factsheet on the Fire Safety (England) Regulations 2022, which will implement the majority of the recommendations made by the Grenfell Tower Inquiry Phase 1 report that require a change in the law. The regulations came into force on 23 January 2023 following publication of guidance on 6 December 2022.

Also included is a link to updated information on the Building Safety Fund.

See: Information for leaseholders and other residents on fire safety and remediation of historic building safety defects - GOV.UK (www.gov.uk) and Fire Safety (England) Regulations 2022 - GOV.UK (www.gov.uk)

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

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