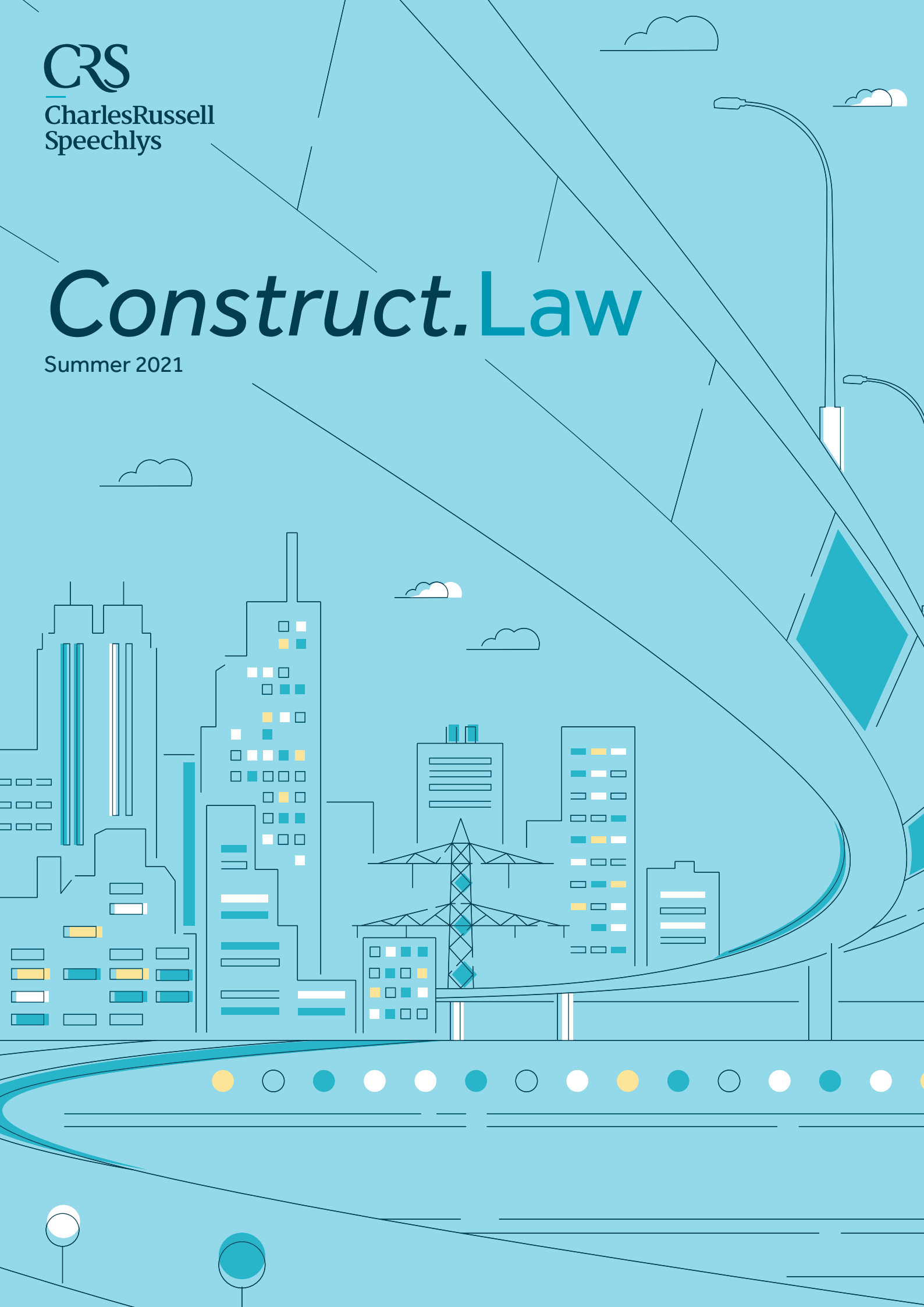
CharlesRussell Speechlys

Construct.Law

Summer 2021



Contents

Introduction

Andrew Keeley
Partner (Editor)
Construction

T: +44 (0)14 8325 2581
Andrew.Keeley@crsblaw.com

Welcome to the latest edition of our construction, engineering and projects publication, Construct.Law.

The construction industry is still navigating the concurrent challenges of the COVID-19 pandemic and Brexit. However, the difficulties of the last 12 months may also create opportunities. With this in mind, we feature a number of articles on modern methods of construction, which may finally become more mainstream in the coming years.

The Housing Grants, Construction and Regeneration Act 1996 (as amended) continues to generate new case law. We look at two recent cases, concerning interim payment applications and jurisdictional issues.

The words "Subject to Contract" are often used during negotiations. We review an interesting case in the Technology and Construction Court about the effect of these words. The fiendish complexity of contractual relationships can also cause issues during construction projects. We have a couple of articles considering assignment, novation and how a "black hole" might arise. This should provide a warning to any involved in preparing construction contracts to 'get the parties right'!

Our Essential Law series also continues, with not one but three articles covering liquidated damages – what are LADS and can they be challenged? There is news of a new regulator for construction products. Finally, there are interesting and varied articles on competition law, expert evidence and residential property developers tax.

We hope you enjoy reading this edition of Construct.Law. You may also be interested in our regular podcasts, which are available on Podbean, Apple Podcasts, Spotify and on our website. Recent episodes include practical tips for handover of a successful project and a mock conference with counsel covering insurance claims and delay issues. Please do get in touch if you would like to discuss any of the issues covered by Construct.Law or if there are any topics which you would like us to cover in future editions.

Procuring modular housing: is MMC becoming mainstream?

Modern methods of construction (MMC) offer a more efficient, more sustainable and rapid means of project delivery.

Paul Henty
Partner
Construction

The signature characteristic of modern methods of construction is the manufacturing offsite of building components for assembly on-site. The considerable potential of modular housing solutions has been highlighted consistently. Frequently, modular construction is cited as a means of the Government achieving its ambitious target of delivering 300,000 housing units a year.

Currently, the take-up of modular housing in the UK has been disappointing. Modular homes account for only 15,000 of the 200,000 units built each year. That contrasts sharply with the adoption rates in jurisdictions such as Germany, Sweden and Japan, where modular housing is an important and well-established part of housing policy.

It is likely that public procurement in the UK has been contributing to the blockage of modular housing as the construction method of choice in public procurement contests. The procurement rules should foster competition which in turn should promote innovative and efficient solutions. As set out below, procurement has tended to make modular solutions too difficult to deliver or pitted them unfairly against tried and tested modes of construction.

There is good news though. Notwithstanding the difficulties of the previous 12 months, there are clear signs from procurement practice that this is changing and that modular is at last moving into the mainstream. There are also examples of innovative thinking and solutions designed to force MMC into the front of mind of public bodies.

This article charts some of the difficulties for public which may have been posed by modular. It also sets out the growing evidence of a turning tide, as key public actors take significant steps towards the adoption of modular housing solutions.

Inherent difficulties in procurement: classification

It is possible that public bodies until now have struggled to determine whether a contract for the development of modular housing would constitute either a supply or a works contract for the purposes of the public procurement rules.

If the subject matter relates to the purchase of components, the project may need to be put out to tender as a supply contract. On the other hand, if the supplier is expected to install the modular components as units, the procurement may need to be carried out as one for works. Often the contract will contain elements of both, requiring the authority to decide whether they are buying supplies or works. This is not an insurmountable difficulty and can be overcome by an analysis of the relative value of the different pockets. In reality, the classification of the contract as either one for supplies or works is unlikely to spark a legal challenge. However, this may have added to the headaches of those seeking to devise procurement strategies for this type of construction.

Inherent difficulties in procurement: Specifications

Legally, when drafting specifications for their preferred solution, the contracting authority should not draft too narrowly or widely in order to rule out or unduly favour any potential workable solutions which may meet its particular needs. Not knowing how to draft specifications for a new type of solution – or to draft them wide enough so as not to inadvertently discriminate against that new type of solution – may have been a barrier against the adoption of modular in public procurement.

Drafting of specifications is a difficult exercise and it is possible that authorities simply found it too difficult to do this for a new type of solution, particularly against the backdrop of a possible allegation of being unduly discriminatory to more traditional solutions. The Construction Innovation Hub identified "defining the need" as one of the biggest obstacles to the growth of modular solutions, noting that there had been confusing imprecision and inconsistency in the way specifications and standards had been drafted. There is, as set out in Section 6 below, evidence that this is changing. Central Purchasing Bodies setting up frameworks and dynamic purchasing systems which other public bodies can opt into effectively provides them with a ready-made solution.

Inherent difficulties in procurement: Evaluating cost

Modular solutions sometimes also suffer as a result of making cost the primary focus of the procurement. The up-front costs of modular solutions are significantly higher as developers must foot the bill for sizeable manufacturing costs. The overall costs may work out on average around 12% more expensive overall, according to one source.

However, there are countervailing efficiencies which modular brings. One relates to time: a modular home can be built in as little as three days whereas a traditional build may take up to 32 weeks to deliver. Modular construction also reduces labour costs, as component manufacturing is largely a mechanised process, requiring fewer operatives to oversee it than on-site construction.

Depending on how the cost evaluation is carried out, modular solutions may find themselves at a disadvantage at the evaluation stage. For example, if the cost evaluation mechanism in the tender focuses purely on cost, modular solutions may lose the opportunity to be credited with the savings that can be made over the entire life-cycle. On a pure project cost basis, modular is likely to compare less favourably than traditional solutions. That fact may disincentivise providers capable of delivering either traditional or modular units from specifying the latter.

The playing field is likely to be more level where the procuring authority structures the cost evaluation to take into account the whole life cycle costs rather than focusing disproportionately on the upfront and short term costs. In a Report entitled "Modern Methods of Construction" published by the House of Commons' Housing, Communities and Local Government Committee in 2019, the Committee outlined how it had heard evidence that the MMC homes were usually more efficient than those traditionally built. For this reason, The Royal Institute of British Architects said that if the whole-life value of residential units were taken into account at the procurement stage, it would increase the demand for MMC homes. The Report recommended that local authorities liaise with social landlords who had adopted MMC homes to learn more about their potential and also that authorities should "factor in whole-life running costs of social homes when tendering for building contracts".

Similarly, in 2018, Mott MacDonald told a Committee of the House of Lords that "procurement needs to move from a traditional, transactional, risk-averse approach to recognise that value (not price) is all important". A similar point was made by Mace, who said "[a] scorecard that tracks elements such as spend with [small and medium-sized enterprises], payment practices, productivity and use of [modern methods of construction]" can be used to drive the right behaviour and practices that will promote productivity improvements.

Whole life costing is permitted under the Public Contracts Regulations 2015 as a means of carrying out the financial appraisal of tenders. Procurers can be educated as to the longer term cost savings which modular can offer. After all, competitive tender exercises should not identify the cheapest option but that which is the most economically advantageous. Through engagement, public bodies might be persuaded to include award criteria which reward some of the benefits that modular housing has to offer, such as shorter lead in time and more sustainable solutions.

The all too clear dangers of prioritising the lowest cost solution were highlighted by the tragedy of Grenfell Tower. The ensuing public inquiry have highlighted the risks of pursuing the cheapest option at the expense of other quality, safety or performance factors. When choosing a contracting partner to deliver refurbishment to Grenfell in 2014, the Kensington and Chelsea Tenants Management Organisation tried to cut £800,000 from projected project costs. They accepted a proposal from the preferred bidder to save £293,368 from switching from the originally specified zinc cladding to plastic-filled aluminium panels which had "significantly worse" fire performance.

Public bodies can also be encouraged to give a greater weighting in their evaluation criteria to some of the known benefits which modular can deliver. These can include, for example, including a significant proportion of the overall criteria being linked to sustainability criteria and delivery time. The weighting for cost could be reduced in favour of these other non-price considerations which are arguably of equal or greater importance anyway.

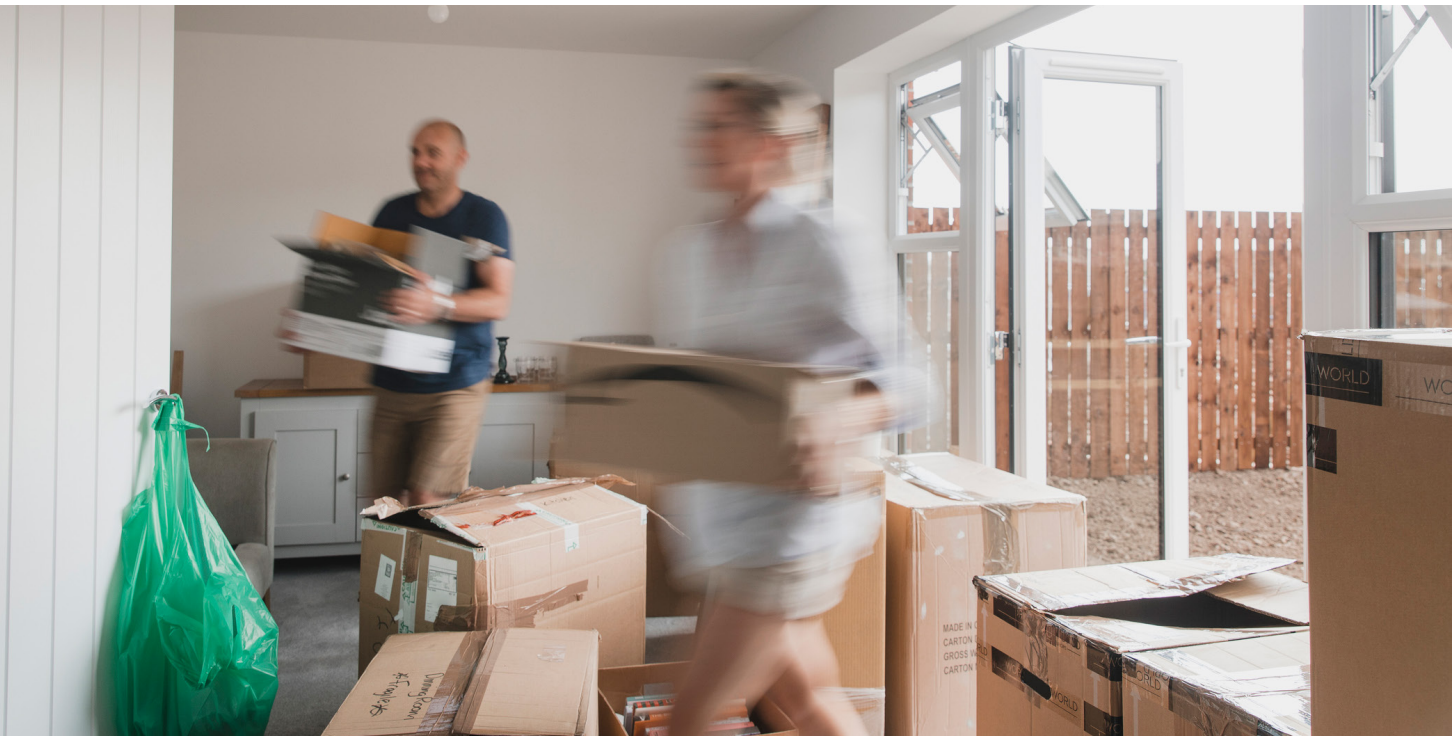
Procuring MMC: is modular becoming mainstream?

Recent procurement and policy activity has clearly highlighted a potential change. Firstly, an impetus for further adoption of offsite construction was provided by the Government's Construction Playbook, published in December 2020. The Playbook supports best practice in construction, underpinned by three key principles: build back better, greener and faster. The Playbook encourages public bodies to set targets for the adoption of modular construction and requires them to consider the social value that modular can bring, including the drive to net zero. Public bodies are expected to comply with the directions of the Playbook on a "comply or explain" basis.

In April 2021, Homes England opened a further competitive bid round under the Affordable Homes Program, which will lead to a fresh intake of strategic partnerships. At the time of writing, this initiative remains open for applications. Homes England is seeking strategic partners to deliver affordable housing at scale; organisations interested in applying now have until noon, 18 May 2021 to submit their proposal online.

Strategic partners need to demonstrate how they are supporting Homes England's strategic objectives within their development programme. This includes the adoption of modern methods of construction (MMC), a dedication to high-quality sustainable design and a commitment to working closely with SMEs.

Strategic partnerships are one of two routes to access grant funding from Homes England through the Government's Affordable Homes Programme (2021-2026). Rather than access funding on a scheme-by-scheme basis (via Continuous Market Engagement), strategic partners enter into a multi-year grant agreement with Homes England to deliver affordable housing. While strategic partnerships have historically only been available to not-for-profit providers, this time Homes England is welcoming proposals from for-profit affordable housing providers and developers, and local authorities. The benefit of a Homes England grant will assist developers in meeting some of the cost obstacles mentioned elsewhere associated with upfront investment required in the manufacturing process.



This is far from being the only initiative in support of MMC. On 7 April 2021, two local authorities in Sussex announced they were jointly procuring a four-year modular housing framework worth £110m. Lewes District Council (LDC) took the lead on behalf of Eastbourne Borough Council (EBC) in relation to a collaboration on housing development programmes, primarily in relation to affordable homes. The estimated value of LDC's portion of the framework is £41.25m, for EBC it is £35.25m and for other contracted authorities it is £33.5m. Only one lot is available.

A number of Dynamic Purchasing Systems ("DPSs") have also recently been established with the aim of providing contracting authorities with a direct route to market. These DPSs have been procured by "Central Purchasing Bodies" ("CPBs"), which are public bodies carrying out purchases on behalf of one or more contracting authorities. One of the exciting aspects of a DPS as opposed to a framework is that a DPS allows qualifying contractors to join at any point during its lifetime. Given modular's status as a fast moving market, it is perhaps a smarter procurement choice and one more compatible with the goal of delivering innovation. Relative to qualification to a framework, a DPS is a simpler system for an SME to join.

One of the DPC was launched, in November 2020 by EN:Procure, a CPB which has expressly specified MMC as a requirement for admission into the system. EN:Procure has said this was developed in response to members' MMC aspirations and to help them achieve Homes England targets for funding. It also says the new DPS is fully flexible and able to respond to changes in systems and market maturity. There are three Lots, two of which have been awarded: Lot 1 (Panelised System Homes), Lot 2 (Volumetric System Homes) and Lot 3 (Turnkey Modular Homes). The lotting structure allows suppliers from Lots 1 and 2 to be integrated into a more traditional form of contract with a principal contractor, whilst Lot 3 provides for supplier and contractors to partner and offer a turnkey service to members.

In March 2021, Constructing Modern Methods (CMM) and the South West Procurement Alliance (SWPA) announced the creation of a database that could allow local authorities to analyse the marketplace and define their requirements before procuring against a dynamic purchasing system (DPS). One of the key aims of the program is to deliver offsite, low-carbon housing. The initiative has been developed in partnership with YTKO, the Bristol Housing Festival, Bristol City Council and nine modular housing providers – and backed by Innovate UK.

What can be done to encourage further take-up of modular?

There are clearly encouraging signs for modular housing, suggesting a rising level of popularity among procuring entities. However, some providers of modular solution may remain frustrated that certain local authorities are reluctant to take advantage of the benefits it brings and that opportunities remain few and far between. While the frameworks and dynamic purchasing systems that have been set up are helpful, there is no guarantee that authorities will wish to buy into them.

To the extent there is still resistance to specify modular, suppliers may need to engage with local authorities, housing authorities and other public bodies in order to sell the clear benefits. An excellent way to do this is through participation in market engagement exercises. Regulation 40 of the Public Contracts Regulations 2015 allows public bodies to engage in consultation with suppliers and other stakeholders in order to assist it in defining its specifications for the tender exercise. Market engagement exercises are frequently advertised to invite interest from consultees.

Ideally, suppliers will want to convince the procurer to specify modular solutions or at least to draft specifications widely enough so as not to exclude modular solutions. The Construction Playbook and other examples cited above will strengthen their case. Modular procurement having been undertaken by a number of authorities already, some useful precedents are available (for example, a number of offsite procurement specifications have been published online). Suppliers may also wish to emphasise some of the social and environmental benefits of modular, which ought to be of interest to any public body. They could alert individual authorities to the growing number of frameworks and DPSs which may be available to them and which would also reduce procurement time and cost.

Another way to "break the ice" with public bodies may be to engage in small-scale pilot schemes with them, possibly constructing a small number of modular units. If the pilot goes well, they may get a taste of the benefits of modular, possibly whetting their appetite for its deployment larger projects. The pilot may need to be seen as a loss leader by the supplier. Seeing the "long game", the pilot may be a means of demonstrating relevant experience for the purpose of satisfying shortlisting requirements in competitive procurement exercises as well as winning the trust of public bodies, both with regard to working with the supplier and in specifying modular construction.

Assignment, inovation and construction contracts - What is your objective?

Consider a not too hypothetical situation where the parties to a construction project (employer, contractor and sub-contractor) enter into a Deed of Assignment intending that the employer, having lost confidence in the contractor, would directly engage the sub-contractor to complete the sub-contract works.

Eveline Strecker
Knowledge Development Lawyer
Construction

Anna Sowerby
Trainee Solicitor
Construction

But what if no assignment has taken place? What are the terms of the contract under which the sub-contractor carries out the works for the employer?

Potential risks with assignment

In construction projects, main contractors often assign the benefit of their key sub-contracts to the employer in the event of contractor default and consequent termination of the main contract. The employer can then enforce the rights in the sub-contract against the sub-contractor, including rectification of the works and the performance of particular obligations.

However, there are potential risks associated with assignment in these situations as the Technology and Construction Court's decision in Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd demonstrated. We discussed this decision in Assigning a sub-contract on termination: which rights is the contractor giving up? In this case, the nature of the assignment meant that the main contractor could not pursue claims made by the employer against its sub-contractor under the sub-contract. This limited the main contractor's ability to 'pass on' any liability it had under the main contract to the sub-contractor.

But what if the Deed of Assignment does not take effect as an assignment?

Assignment v novation

Both assignment and novation are forms of transferring an interest under a contract from one party to another. However, they are very different and in their effect. An assignment transfers the benefit of a contract from one party to another, but only the benefit, not the burden. In contrast, a novation will transfer both the benefit and the burden of a contract from one party to another. A novation creates a new contractual relationship - a 'new' contract is entered into.

Another key difference with novation is that the consent of all parties concerned must be obtained, which is why novation is almost always effected through a tripartite agreement. In the case of an assignment, it is not always necessary to obtain consent, subject to what the specific terms of the contract provide.

When deciding whether to assign or novate, parties should consider (i) whether there is in fact a burden to novate, (ii) whether the novatee will be willing to take on the burden, (iii) whether all parties will consent to the novation and indeed enter into the agreement. If there is no burden under the contract to transfer, then an assignment is likely to be the most appropriate way to transfer the interests.

Is the Deed for an assignment or a novation?

Although a document may be labelled a Deed of Assignment, if it has references to the transfer of 'responsibilities and obligations' and is a tripartite agreement these are characteristic of a novation as opposed to an assignment.

A key issue in such circumstances is to ascertain whether making use of the words 'assigning' and 'assignment' actually affects the characteristics of the document.

There has been some consideration of this characterisation issue by the courts. In the case of *Burdana v Leeds Teaching Hospitals NHS Trust* [2017] EWCA Civ 1980, by majority the Court of Appeal decided that on the facts of the case, although the Deed of Assignment in question referred to an 'assignment' of the benefit and burden, on proper analysis there was indeed a novation.

Furthermore, in the case of *Langston Group Corporation v Cardiff City FC* [2008] EWHC 535, Briggs J made it evident that even though the variation agreement in question did not use the word 'novation' and did not describe itself as such, the circumstances and effect of the agreement was indeed a novation and a new contract had been created.

It may be the case that even if a document does not describe itself as a novation, yet has the key characteristics of one, then as a matter of interpretation the courts would accept that the document takes effect as a novation.

Key characteristics of a novation

If entering into a document that purports to be a Deed of Assignment, tread carefully as it may well take effect as a novation, particularly if the following characteristics are present:

- It is a tripartite agreement;
- All the parties give their consent;
- The novator has been released from its obligations;
- There has been an acceptance of the terms of the novation on the part of the novatee and the substituted party; and
- There is a vesting of remedies.

What is your objective?

Although a document may well be labelled as an assignment, it may have the characteristics of and take effect as novation. Parties need to be cautious and consider what they want to achieve when assessing whether to assign rights or to novate them along with obligations.

Grand designs – Who should take the design risk in an MMC project?

Modern Methods of Construction (MMC) have been touted by many as a way to tackle costs and inefficiencies within the construction industry.

Carolyn Davies
Associate
Construction

The impacts of Brexit on worker availability, skills shortages in the construction industry, and the ever pressing need for affordable, high quality homes has meant that MMC may play an increasingly crucial role in the United Kingdom in future.

One of the issues to be considered on any MMC project is who is to take the responsibility for the design of the MMC elements? In traditionally built projects, there is generally a design phase and a construction phase. The developer's professional team may retain responsibility for the bulk of the design of the works. Alternatively, the contractor may take responsibility for the design of the works under a design and build contract.

However, MMC introduces an additional element in this process, being the 'manufacture' step after design, and before construction on site. This manufacturing step may be undertaken by a specialist MMC contractor and may involve completing the design of elements of the MMC work.

The question of design risk on projects involving MMC is therefore not necessarily clear cut. There are a number of options that may be suitable depending on the type of project, the extent of the MMC required and the MMC capabilities of the parties involved.

Professional team retaining design responsibility

MMC may include completed rooms with internal and external finishes installed such as bathroom pods, hotel pods, or component parts of houses.

Developers can develop a comprehensive detailed design at an early stage for these modular elements in part due to the increased digitisation of construction design through tools such as BIM.

The advantages of the professional team taking on the design risk is that the developer's design can be established and crystallised at an early stage, which can then be repeated over numerous different projects such as housing developments (although this will also depend on the copyright licences provided to the developer). There should therefore be limited unexpected costs arising on a project through design changes, one of the core benefits of MMC. As anyone watching Kevin McCloud over the years will know, the more changes to design that are made during development, the longer projects take and the more they cost.

In this scenario, a contractor would take responsibility for procuring the MMC elements in line with the professional team's design, and then installing these MMC elements correctly on-site.

However, this approach relies on the professional team's design being robust and the developer being comfortable with the main contractor not having single point design responsibility. If an element of the end works is defective due to design and installation issues, a developer would need to pursue both its professional team and the contractor, which will usually lead to longer and more expensive proceedings with arguments as to which party should take responsibility for the defects.

A developer could mitigate these issues by carrying out regular rigorous inspections of the works and maintaining thorough records, so that it can identify the responsible parties should defects arise.

Contractor taking single point design responsibility

Another option is for the contractor to have single point design responsibility on projects involving MMC elements.

A contractor may be comfortable accepting the design risk of MMC work to be designed by others. This will usually be subject to the contractor having recourse in respect of that MMC design through either novation of the relevant designer's appointment, or a collateral warranty provided by that designer. In addition, insofar as the MMC work is to be manufactured by a specialist MMC sub-contractor who is also taking design responsibility for some elements of the MMC work, that design risk could be accepted by a main contractor in a similar manner to the design risk of other elements of the works carried out by specialist sub-contractors.

Some main contractors and housebuilders have (or are increasing) their internal capabilities to manufacture elements of an MMC project. If the main contractor has the internal capability to design and manufacture elements of an MMC project, it would be able to accept single point

responsibility for these elements and there would be no third party specialists from whom the main contractor had to secure contractual rights of recourse.

Insofar as the contractor is accepting the design risk for MMC work, its professional indemnity insurance would have to be carefully reviewed to ensure it adequately covers any design risk in MMC work.

Construction management

Some developers will procure their projects using construction management. In that situation there would be no main contractor. The developer would appoint the professional team and the trade contractors to design and construct the works, this would include the specialist MMC contractor.

The MMC contractor is only likely to accept single point design responsibility for the MMC work in such a situation if they have a contractual right of recourse against the members of the professional team who designed any parts of the MMC work. This cannot usually be provided by a novation of the relevant designer's appointment, as their responsibilities would usually extend beyond the MMC work such that they would have to remain employed by the developer.

Such a contractual right of recourse could be provided by a collateral warranty from the relevant designers. However, if the relevant designers are not willing to provide such a collateral warranty, the MMC contractor is unlikely to accept single point design responsibility for the MMC work. The design responsibility for the MMC work would therefore be split between any party who had contributed to its design.

Conclusion

Parties are always considering design risks when considering procurement options and negotiating construction contracts. The introduction of MMC into a development is an added consideration in this process.

The key point is to ensure there is a clear agreement as to who is accepting the design risk for the MMC work and that this is properly documented in the various contracts for the construction of the project.

Interim Payment Applications – Substance over form

It is important that parties to construction contracts comply with the contract's payment provisions in order to be entitled to payment.

Eveline Strecker
Knowledge Development Lawyer
Construction

Isabella Eacott
Trainee Solicitor
Construction

In the recent case of *RGB Plastering Limited v Tawe Drylining and Plastering Limited* [2020] EWHC 3028, the Technology and Construction Court found that a sub-contractor's interim payment application was invalid as it failed to strictly comply with the sub-contract's payment provisions.

Clear and unambiguous

Applications for interim payment must be clear and unambiguous in their intention. In *Henia Investments Inc v Beck Interiors Ltd* [2015] EWHC 2433, the court stated:

"...the document relied upon as an Interim Application must be in substance, form and intent an Interim Application... stating the sum due by the Contractor as due at the relevant date and it must be free from ambiguity."

Interim payment process in the sub-contract

The subcontract between the parties set out a detailed mechanism for interim payments, which included the following requirements:

(a) Applications must be submitted on or before a certain date in the payment cycle;
(b) Applications were to be valued up to a certain date in the payment cycle; and
(c) Applications must be submitted electronically to a particular email address.

The subcontract contained a payment schedule. For the April 2019 cycle, the sub-contractor (Tawe) was required to issue its application on or before 28 April and the valuation date was 3 May. The corresponding dates for the May 2019 cycle were 29 May and 2 June. The payment schedule also stated that any applications received after the 28th of the month would not be considered but would be administered with the following month's payments.

The dispute

Tawe issued an interim payment application on 7 May, valuing works up to 30 April. The interim payment application was issued to a number of email addresses of employees at RGB, but not the one stipulated in the subcontract.

RGB argued that Tawe failed to comply in three crucial respects:

- The interim payment application was issued too late for the 28 April payment cycle and too early for the May payment date;
- It valued works up to the 30 April, contrary to both the 3 May and 2 June valuation dates in the payment schedule; and
- It was not emailed to the email address stipulated in the subcontract.

The decision

The judge held that the contractual mechanism had not been complied with and the interim payment application was invalid. It was not just late (which would simply delay payment by a month), but it did not value the works to the correct date and had been sent to the wrong email address. It was not clear to RGB what to do with the application for payment and when.

The judge rejected Tawe's argument that the application was early for the May/June deadline of 29 May because the valuation date for the May/June cycle was 2 June and the application only valued works up to 30 April. An application with a 30 April date would make sense for a due date at the start of May and any reasonable recipient would think it was a late application for the April payment cycle. The application was "not clear or unambiguous in substance form or intent".

The provision in the payment schedule stating that applications received after the 28th would be administered the following month did not help. It merely meant that an application for the same sums could be made the following month, not that it became an application for payment for the next month.

The fact that the application was made on RGB's template and accompanied by supporting documentation setting out a breakdown of the works also made no difference. It is how the application is filled out that is important rather than the template used and supporting documents do not help answer questions of compliance.

Estoppel argument

Tawe sought to rely on an estoppel argument, arguing that RGB knew or ought reasonably to have known what to do and when. There had been instances where RGB made payments on interim payment applications which were made late or sent to the wrong address.

However, this was first raised in a witness statement that was filed only two days before the hearing, nearly four weeks late, and the judge did not give permission for this evidence to be relied upon. He concluded that it would be unfair to give permission for the witness statement to be relied upon without giving RGB a chance to file evidence in response, which would ultimately lead to further delay and expense.

Comments on the estoppel argument

However, the judge did make some points about this potential estoppel argument.

RGB submitted that the estoppel argument would fail for several reasons, including:

- RGB had made its own valuations in past applications, and it was not inequitable for RGB to insist on the strict requirements in relation to this application when Tawe would still be able to recover the true value of the works it had carried out.
- Clause 38 of the subcontract provided that nothing contained in any approval or consent should prejudice, modify, affect or otherwise relieve Tawe of any of its obligations under the subcontract and that no purported waiver or amendment to the subcontract provisions should be construed as an amendment to those terms and conditions.

The judge agreed that these were difficulties which the estoppel claim would face (though he stopped short of agreeing that it was bound to fail).

We cannot know if the estoppel argument would have made a difference, but it would have been interesting to see what the court would have made of it based on the facts in this case.

Going forward

This case confirms the well-established position that interim applications for payment must be clear and unambiguous and, importantly, comply with any contractual requirements however precise.

As the judge said in this case, the interim payments regime under the Construction Act 1996 is intended to provide a speedy interim payment procedure to promote cash flow during the contract period, and a balancing procedure at the end. It is important that each party has the right to have a balancing payment made at the end so that the true value is paid.

Better Buildings: construction products to be subject to higher scrutiny

On 19 January 2021 the government announced its intention to establish a new regulator for construction products in order to ensure that safer materials are used to build homes.

Carolyn Davies
Associate
Construction

The government advised that the regulator's powers will include removing a product from the market that presents a significant safety risk and prosecuting any companies who "flout the rules on product safety". The government has also advised that:

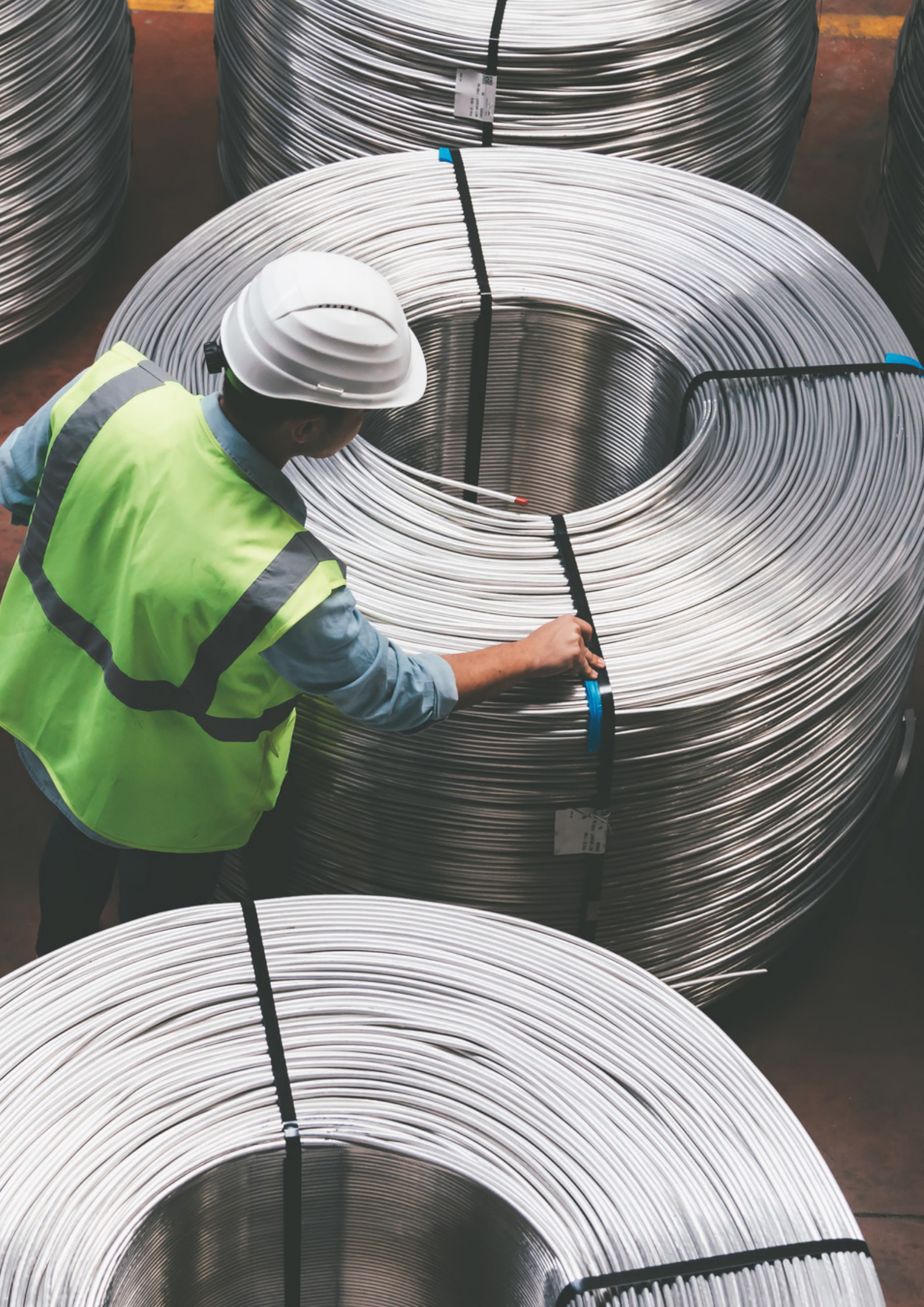
"The regulator will have strong enforcement powers including the ability to conduct its own product-testing when investigating concerns. Businesses must ensure that their products are safe before being sold in addition to testing products against safety standards."

The government has not provided firm details on the new regulator, including when it will come into being, although it has advised that the regulator will operate within the framework of an expanded Office for Product Safety and Standards, and in tandem with the Building Safety Regulator and Trading Standards to encourage and enforce compliance.

The construction products testing regime is also in the process of being investigated by a government appointed expert panel with construction industry, regulatory and technical experience. The panel is expected to produce a report later on this year with its recommendations.

While the government continues responding to issues arising from the on-going Grenfell Inquiry, further detail is needed as to how these new functions, regulators and committees are intended to operate together within the construction industry.

We look forward to hearing more about how the regulator's role will work in practice so the construction industry can better understand how the new framework will impact on obligations and risks.

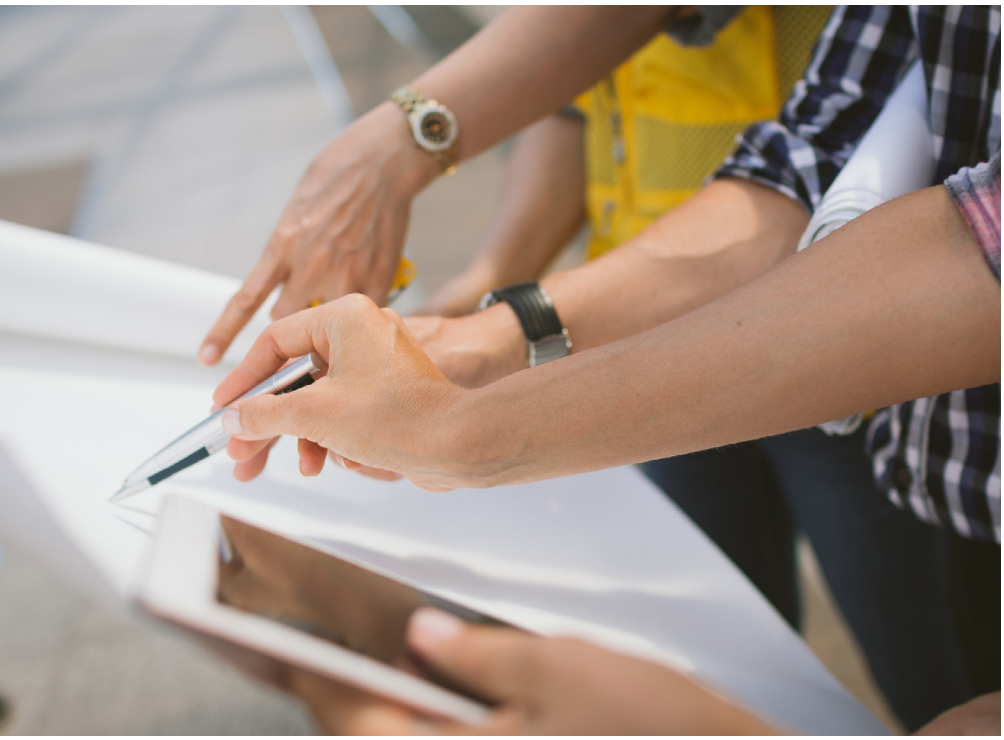


Disputes under more than one contract: jurisdictional issues to remember if considering adjudication

It is a well-established legal principle that without jurisdiction an adjudicator's decision will not be enforceable.

Michael O'Connor
Partner
Construction

Georgina Bernard
Trainee Solicitor
Construction



Under section 108(2)(a) of the Housing Grants Construction and Regeneration Act 1996 (as amended) (**Construction Act**) a party can refer 'a dispute' under a construction contract at any time. If a party refers more than one dispute under a single contract or commences an adjudication where the dispute concerns more than one contract, the adjudicator will not have jurisdiction to decide that "dispute". These issues were recently considered in *Delta Fabrication & Glazing Ltd v Watkin, Jones & Son Ltd* [2021] EWHC 1034 (TCC).

Background

The claimant (Delta) and defendant (Watkin) entered into two distinct sub-contracts, both of which were for different works at the same development in Walthamstow. However, the parties agreed that the payment process under both contracts would be carried out simultaneously and through a single application process. At the end of the project a single final overall sum for all the works was agreed. A dispute over payment of this final sum arose which Delta referred to adjudication.

Watkin challenged the adjudicator's jurisdiction from the outset on the basis that Delta had referred disputes under the two separate contracts to the adjudicator in the same adjudication. The adjudicator issued a non-binding decision that he had jurisdiction and continued with the adjudication, eventually deciding the sum of £2,244,210.28 was due to Delta.

Delta sought to enforce the adjudicator's decision raising three arguments in favour of enforcement:

- The parties had agreed, by their conduct and the way in which the contracts were administered, to vary the two contracts so that they amalgamated to form one singular contract. On this basis, Delta argued that it did not refer disputes arising under more than one contract to the adjudicator, thereby ensuring that he had jurisdiction and his award was valid. Delta relied on a payment notice dated February 2020, which referenced a single sum for payment. Delta argued that this constituted the offer to amalgamate the contracts.

- For the purposes of the Construction Act (both in terms of the payment process and adjudication), it was possible to treat two separate contracts as a single contract where the parties had elected to merge or consolidate the payment process of the two contracts, even though in all other respects they were to be treated as two separate contracts under law.
- Watkin was estopped from denying that the separate contracts should be treated as one for the purposes of the Construction Act. It argued that a payment notice dated February 2020 where Watkin referenced a single sum for payment under both contracts was a representation that the contracts were to be treated as one. Delta argued that it had then relied on that representation and suffered detriment as a result.

The Court's decision

With regard to the first argument, the court held that the documents put forward by Delta did not unequivocally demonstrate that the parties had mutually intended for the contracts to be amalgamated. The court held that although the February 2020 payment notice was for one figure for both contracts, it did not have the effect of amalgamating the contracts as the supporting documentation dealt with the calculations for each contract separately.

When considering the parties' conduct, Judge Watson highlighted examples of Delta referring to both contracts after the alleged amalgamation and emphasised the fact that subsequent correspondence did not make reference to an amalgamation of the contracts.

The primary evidence Delta relied on was the final account documentation, included in which was a letter from Watkin to Delta. Delta argued that Watkin's reference to a "statement of Final Account for the above contract" was indicative of the agreement to amalgamate the contracts, an argument which the adjudicator had agreed. The court departed from the adjudicator's decision and held that the wording "the above contract" should not be read as a reference to the two contracts being amalgamated into one, but rather as a reference to the main contract, under which Delta and Watkin had entered into the two sub-contracts.

As to Delta's second argument, Judge Watson was not persuaded that the parties' conduct gave rise to a single contract for the purposes of the Construction Act, but not for any other purposes. Judge Watson held that the Act does not suggest that the words "contract" or "agreement" should be read as or given anything other than their natural meaning. Delta failed to persuade the court that it was possible for the sub-contracts to have been amalgamated to form one contract within the definition of the Act, but not at common law.

The court dismissed Delta's final argument on the basis that it had failed to produce any evidence in support of its argument and therefore did not prove the essential elements of estoppel were satisfied. The February 2020 payment notice had already been considered and did not amount to a representation that Watkin was treating the sub-contracts as one, it merely evidenced Watkin's wish to administer the payment provisions of both contracts together. No evidence of Delta's reliance on Watkin's alleged representation was presented, and Delta's conduct by referring to more than one contract following the alleged amalgamation was inconsistent with Delta's argument of reliance. Finally the court was not persuaded that Delta had suffered a detriment by incurring additional costs in dealing with the payment applications as though they were one contract.

Concluding thoughts

In dismissing Delta's application for summary judgment, the court concluded that the adjudicator had lacked jurisdiction because Delta had referred disputes under two separate contracts to the adjudicator in one referral. This case demonstrates that unless there is clear evidence to the contrary, entering into and executing two sub-contracts, or purchase orders, will be treated as two distinct contracts for the purposes of the Construction Act regardless of how they are administered.

‘Black holes’ on construction projects – The gravity of the situation

The TCC’s recent decision in *Dr Jones Yeovil Limited v The Stepping Stone Group Limited* is a useful reminder of the issues posed by legal “black holes”.

Sam Johnson
Associate
Construction

What is a “black hole” in contract law?

It is a fundamental principle of English law that damages for a breach of contract are to put the innocent party in the position that it would have been in had the other party complied with its obligations under the contract. Damages should compensate for loss incurred. So, if there is no loss, then the claimant should only receive nominal damages even if the defendant is in breach of their contractual obligations.

In construction projects, the no loss argument can lead to a contractual “black hole”, even if the defendant’s actions have caused the claimant to suffer serious losses.

One way a black holes may arise is where the developer is a separate legal entity to the owner of the land. In this case it may be argued that the developer (the entity with a contractual claim against the contractor/consultant responsible for the defect) has not suffered a loss, as it doesn’t own the works in question and isn’t under any obligations to repair. This risk can be mitigated by the developer entering into a development agreement which provides obligations to the owner of the land so that the loss incurred by the owner can then be passed to the developer. However, the developer may seek to restrict its liability period under such an agreement to only a limited period following practical completion. Another way to avoid such a black hole is to require all the relevant contractors and consultants to enter into collateral warranties with the owner of the land so that it can claim against the relevant contractor and/or consultant directly.

Transferred loss

In order to avoid such situations where a ‘black hole’ may arise, the courts have developed a number of principles, including the principle of “transferred loss”. Transferred loss is a complicated area of evolving case law, but essentially it can be divided into a “narrow” and “broad” ground. The narrow ground enables an employer to claim on behalf of a third party purchaser where the purchases are foreseeable at the time of entering into the building contract. The broad ground applies where, at the time of entering into the contract, the parties have a common intention and/or a known objective to confer a benefit to an independent third party.

Dr Jones Yeovil Limited (*DRJ*) v The Stepping Stone Group Limited (*Stepping Stone*) - Background

DRJ was employed by Stepping Stone to carry out works on a number of assisted living units. The property on which the assisted living units were constructed was owned by NCL, a subsidiary of Stepping Stone and a separate legal entity. After practical completion NCL sold the properties on long leases and retained the freehold of the common parts.

A dispute regarding defective work arose after practical completion. The building contract specified the use of ground source heat pumps. DRJ had not complied with this specification and instead installed less efficient heat pumps. Stepping Stone claimed against DRJ for the increased energy costs incurred by the leaseholders of the units as a direct result of the less efficient heat pumps.

The court’s decision

DRJ contended that Stepping Stone had in fact suffered no loss, as it was neither the occupier nor owner of the assisted living units. Stepping Stone initially suggested that it had entered into a development agreement with NCL, which contained an obligation to indemnify for defective work. This argument was dismissed as there was no documentary evidence that this development agreement actually existed. Stepping Stone therefore attempted to rely on the broad ground of the transferred loss principle, arguing that at the time the building contracts were entered into, Stepping Stone and DRJ had intended to transfer the benefits under those contracts to both NCL and the purchasers of the assisted living units.

However, the court rejected Stepping Stone’s argument. The court noted that the broad ground of the transferred loss principle was good law, underpinned by the need to provide a remedy for a breach of contract in the interests of giving effect to the object of that contract. However, the court reasoned that, as the building contract contained a clause expressly dis-applying the effect of the *Contracts (Rights of Third Parties) Act 1999* (pursuant to which contractual rights may be conferred on identifiable third parties), there was a positive disclaimer of the known third

party benefit. Therefore, the broad ground of the transferred loss principle could not apply.

Going forward

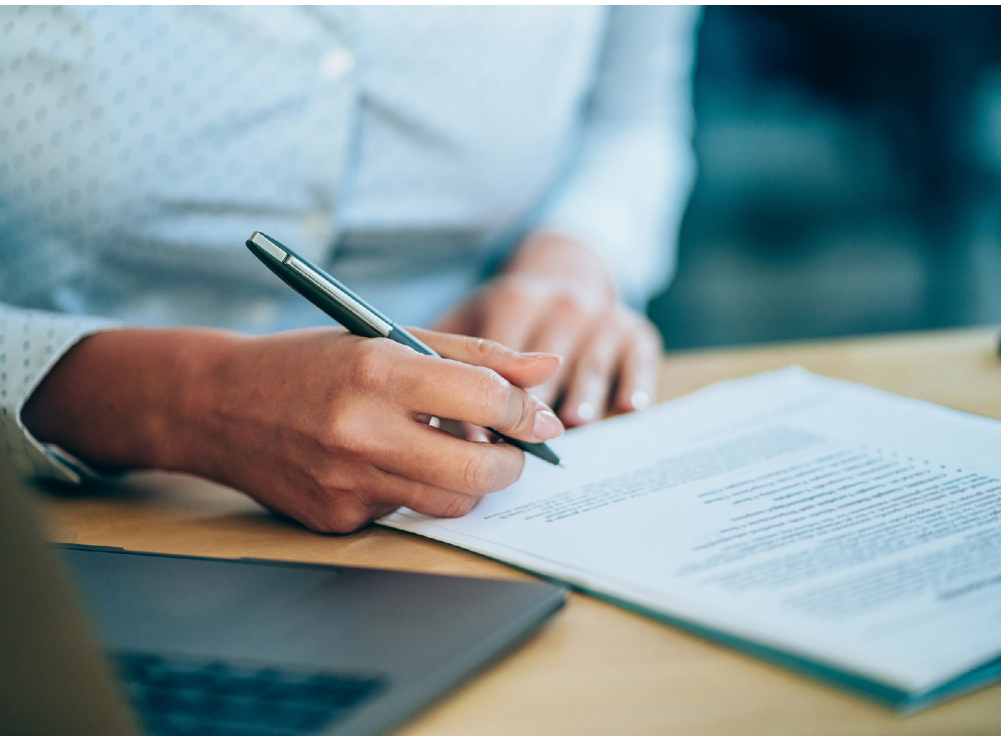
As 'boilerplate' clauses dis-applying the effect of the Contracts (Rights of Third Parties) Act 1999 are ubiquitous in UK construction contracts (and for good reason), the broad ground of the transferred loss principle is unlikely to assist parties in the future who find themselves in Stepping Stone's position.

The court's decision in this case demonstrates the importance of collateral warranties and third party rights agreements in construction projects where the loss may fall on a party with no contract with the defendant. Had NCL or the residents had the benefit of collateral warranties or third party rights from DRJ, they would have been able to recover their losses directly, rather than passing them on to Stepping Stone to pursue. As such, while the preparation, negotiation and execution of collateral warranties and third party rights agreements might seem a laborious exercise during a project, their worth should not be overlooked.

"Subject to Contract" does not amount to an agreement

My colleagues Anna Sowerby and Eveline Strecker recently commented on the case of *Joanne Properties Limited v Moneything Capital Limited* where the Court of Appeal overturned a decision of the lower court which had found that a binding agreement had been arrived at despite communications being labelled "subject to contract" during settlement negotiations: 'Subject to contract' – The effect of these words in settlement negotiations.

Karen Morean
Associate
Construction



A recent case in the Technology and Construction Court has reinforced the message that labelling communications "subject to contract" will generally prevent an agreement coming into force.

Section 108(3) of the *Housing Grants, Construction and Regeneration Act 1996* states that:

"...the decision of the adjudicator is binding until the dispute is finally determined by legal proceedings, by arbitration (if the contract provides for arbitration or the parties otherwise agree to arbitration) or by agreement" [emphasis added].

In *Aqua Leisure International Limited v Benchmark Leisure Limited* the court had to decide whether the conduct of the parties amounted to an agreement so that the adjudicator's decision was no longer binding and therefore incapable of enforcement.

Background facts

Aqua Leisure was successful in an adjudication in July 2017 in relation to an interim application for payment. Following that decision, the parties met to discuss and agree the final settlement of the account, including release of any retention which was subsequently due to Aqua Leisure.

On 31 August 2017, agreement was reached via a telephone conversation between the principals of the parties. This was recorded in an email exchange between the principals which was expressly stated to be without prejudice and subject to contract.

The agreed terms were for staged payments to be made by Benchmark, for Aqua Leisure to complete the "warranty works" and for a payment of £110,000 to be guaranteed by Benchmark's parent company. Some of these stage payments were subsequently made by Benchmark, albeit not strictly within the deadlines stipulated in the parties' agreement.

In the interim, Aqua Leisure circulated a settlement deed and asked Benchmark to execute it. The terms of the settlement deed did not reflect the entirety of the parties' agreement of August 2017 and instead sought to increase the payment

that the parent company was guaranteeing. Benchmark never signed the settlement deed and on 11 May 2018 confirmed that there would be no parent company guarantee.

The sums awarded under the adjudication were not paid in full and the payments due under the staged payment regime agreed by the parties in August 2017 were also not paid in full.

Aqua Leisure therefore applied to the court to enforce the adjudicator's decision in April 2019.

The Late Payment of Commercial Debts (Interest) Act

This case also confirmed the previous position that an adjudicator cannot award legal costs pursuant to the *Late Payment of Commercial Debts (Interest) Act 1998*. The court severed the aspects of the adjudicator's decision awarding costs, finding that the adjudicator had no jurisdiction to make such an award.

Practical tips

Due care must always be taken by parties seeking to compromise matters arising out of an adjudicator's decision. If communications are labelled as "subject to contract" and no formal agreement has been executed, it is likely that a court will find that the parties have not reached a binding agreement. Until such time as a binding settlement agreement has been reached, the parties would be well advised to treat the adjudicator's decision as binding.

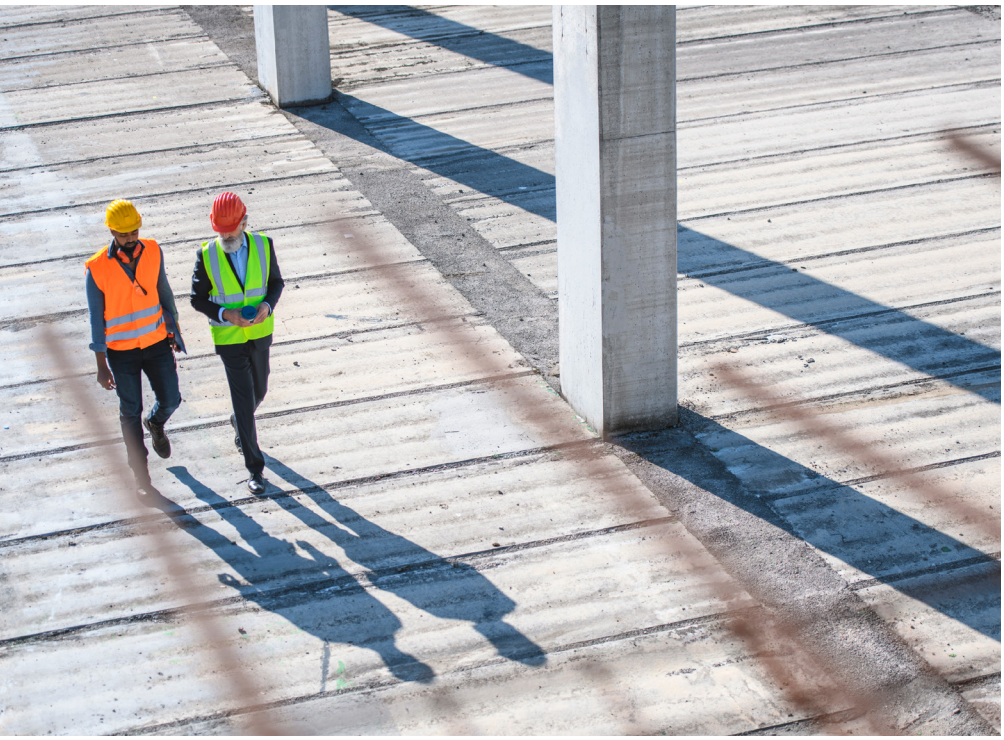
Care should also be taken to carefully record the terms of any oral agreement between the parties and to then ensure that any subsequent settlement agreement accurately reflects that agreement.

Essential law: liquidated damages, part one

Our series on the basics of construction law moves on to liquidated damages. In the first of four articles, James Worthington and Carolyn Davies look at ways to challenge such clauses

James Worthington
Partner
Construction

Carolyn Davies
Associate
Construction



Liquidated and ascertained damages (LADs) are a common mechanism used in construction contracts to fix a predetermined amount that will be payable by one party to the other in the event of a specified breach.

They are commonly payable by the contractor where the works have not been completed by a specified date or where the performance of the works does not achieve specified criteria. LADs usually operate as an exhaustive remedy thereby excluding any claims for general damages, although this is subject to the wording of the particular contract.

They benefit employers by giving certainty as to the amount payable in the event of a specified breach without having to spend time and effort in proving such losses. They benefit contractors by effectively capping their potential liability for the relevant breach and giving them certainty as to their potential exposure so they can accurately price the risk.

When can LAD clauses be challenged?

The courts' starting point is that they are generally averse to interfering in the agreed terms of a contract to say that any of its terms are unenforceable, particularly for a contract negotiated between commercial parties. However, there are some ways a party may successfully challenge the application of LADs.

- **If the LADs provision is void for uncertainty.** While bad drafting of a contract can make an LADs clause difficult to interpret and apply, the courts will generally seek to interpret ambiguous or uncertain clauses within contracts in such a way as to make the clause valid. However, there are examples of such a challenge being successful, such as the Hong Kong case of Arnhold & Co vs The Attorney-General of Hong Kong, where the LADs clause was held to be void for uncertainty as it provided for a minimum and maximum daily LADs figure but failed to provide how the figure should be fixed within that range.

- **If the employer has not complied with a condition precedent** to its right to claim LADs. This will depend on the particular drafting of the contract. It is common in the JCT forms to require certain conditions to be met before LADs can be claimed, such as the employer issuing a certificate of non-completion, and notifying the contractor prior to the due date for final payment that LADs are required to be paid by the contractor.
- **There may be an express or implied waiver by the employer** of its right to claim LADs. In addition, the employer may be estopped from relying on its right to claim LADs if it has represented that it does not intend to do so and the contractor has acted to its detriment in relying on such a representation.
- **Time has become "at large"** because the contract's extension of time provisions do not provide for an adjustment to the completion date where there has been an act of prevention by the employer. The prevention principle then operates to prevent a party from benefiting from its own breach and enforcing the LADs clause for the completion date required by the contract. Instead, the contractor is only under an obligation to complete the works within a reasonable time and the LADs clause will potentially fall away.
- **If the LADs clause constitutes a penalty.** A penalty is the exertion of undue pressure on a party to perform a contractual obligation, which the courts will not enforce on grounds of public policy. The test set out in the Supreme Court decision in Cavendish vs Makdessi is whether or not the clause imposes a detriment on the contract-breaker "out of all proportion to any legitimate interest of the innocent party" in the enforcement of the primary obligation. This is an evolution from the previous test as to whether the rate of LADs was a genuine pre-estimate of loss, as the Supreme Court recognised that an LADs clause may be properly justified by other considerations than the desire to recover compensation for a breach. However, if the rate of LADs can be shown to be a genuine pre-estimate of loss, this should still be sufficient to show that it is not a penalty.

The penalty argument is generally difficult to succeed with if it follows an arm's-length commercial negotiation of the type common in construction contracts.

However, situations where it may be successful include where:

- The employer takes part of the works into partial possession but the contract does not provide for the LADs to be reduced in proportion to the value of the works taken into possession.
- The contract provides for sectional completion but does not provide a mechanism to calculate the LADs payable for each section that reflects the likely loss that would be suffered in the event that completion of that section was delayed.

Our next instalment in this series will review issues that can arise when LADs clauses are found to be unenforceable.

This article was first published in 'Building' magazine on 23 November 2020 and is reproduced with their kind permission.

Essential law: liquidated damages, part two

Continuing our series on the basics of construction law, Andrew Keeley looks at the consequences of a liquidated damages clause being unenforceable

Andrew Keeley
Partner
Construction

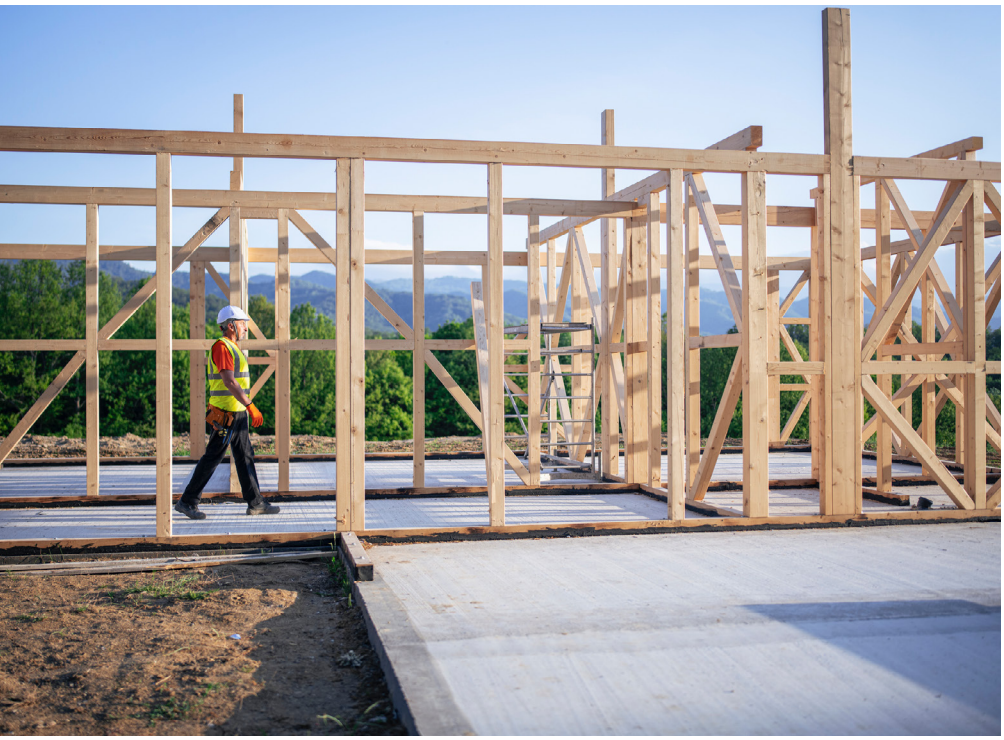
Parties often agree to predetermine the level of damages that an employer is entitled to claim in the event of late completion. This benefits the employer, by avoiding the need to prove the actual losses it has suffered as a result of the delay. It can also benefit the contractor, whose liability for late completion is limited to the agreed rate of damages (known as liquidated and ascertained damages or LADs).

LADs clause struck down

If a court decides that a LADs clause is unenforceable for some reason, the clause will be struck down and the employer will not be entitled to automatically recover the agreed level of damages.

However, the employer will usually still be entitled to claim general damages in such circumstances. The aim of general damages is to put the employer, so far as money can, in the same position as if the contract not been breached and the works had been completed on time. However, there are hurdles to bringing a claim for general damages that do not apply to a claim for LADs:

- The employer must prove both the amount of the losses it has actually suffered and that the losses would not have occurred but for the breach of the contract. In contrast, when claiming LADs the employer is entitled to the predetermined amount regardless of whether its actual losses are higher or lower.
- The employer must establish that the losses were not too "remote", meaning that the losses arose naturally from the breach or were within the reasonable contemplation of the parties when entering into the contract.
- The employer has a duty to mitigate its losses and therefore cannot recover losses that could have been avoided had the employer taken reasonable steps to minimise its losses.
- The damages may be reduced if the employer is partly responsible for the losses.



Do unenforceable LADs clauses limit the general damages recoverable?

To make matters worse for the employer, an unenforceable LADs clause may also limit the amount of general damages that can be recovered, depending on the reason why the clause is deemed unenforceable:

- If the LADs provision is void for uncertainty, the level of general damages that can be recovered is not capped at the level of the unenforceable LADs clause.
- If the rate of LADs is found to constitute an unenforceable penalty, it is possible that the employer's claim will be capped at the level of the LADs clause. This was the position in the Court of Appeal decision in Jobson vs Johnson, where it was held that the penalty clause was not struck out, but the court would not enforce it "beyond the sum which represents the actual loss of the party seeking payment". However, there is contradictory case law from the case of Steria Ltd vs Sigma Wireless Communications Ltd, where the judge found that the LADs clause was not penal but made non-binding comments that, if it had been unenforceable as a penalty, it could not in any way act as a cap.
- The employer's claim may also be capped at the level of unenforceable LADs if time has become "at large", such that the contractor is no longer bound by the original completion date (for example, because the employer has delayed the works and there are no extension of time provisions in the contract).

Exclusive remedies clauses

The presence of an exclusive remedies clause may also affect the employer's potential recovery if the agreed rate of LADs are found to be unenforceable. Such clauses usually stipulate that the parties' remedies for breach of contract are restricted to those expressly set out in the contract and exclude all common law remedies.

The courts have held that clearly worded exclusive remedies clauses will be enforceable. For example, in *Strachan & Henshaw vs Stein and GEC*, the Court of Appeal ruled that an exclusive remedies clause was enforceable even though it meant that the rights of the wronged party under the contract were worthless.

If such a clause was present in the contract, it could remove the common law right to damages in the event that the LADs clause is unenforceable, leaving the employer without any remedy at all for late completion.

One way to protect the employer's ability to recover damages in such circumstances is to stipulate that the LADs are an exclusive remedy unless the LADs clause is found to be unenforceable, in which case general damages are recoverable.

This article was first published in 'Building' magazine on 22 February 2021 and is reproduced with their kind permission.

Essential law: liquidated damages, part three

Continuing our series on the basics of construction law, Chris Busaileh considers some of the issues with including liquidated damages clauses in subcontracts

Chris Busaileh
Senior Associate
Construction

Construction contracts commonly use liquidated and ascertained damages (LADs) clauses to set a predetermined rate of damages to be paid on the occurrence of certain breaches, most commonly delay. The commercial rationale is clear: LADs promote certainty and avoid the need for the innocent party to establish its actual losses as a result of the delay (which can often be costly and protracted).

There are a number of specific issues that need to be considered for a main contractor looking to include LADs clauses in subcontracts.

Setting the rate of LADs – out of pocket or a windfall?

At first view, it would seem that the safest way for a main contractor to protect itself against delay losses under the main contract would be to simply flow down the rate of main contract LADs to each of the subcontracts. It is not that straightforward, though.

Even if the subcontractors agreed to the same LADs rate as in the main contract (a big assumption), the main contractor may still not recover all its losses. The reason comes back to the concept of LADs being an exclusive remedy for delay, something touched on in a previous article in this series, on enforceability of LADs clauses. Where LADs clauses are included in construction contracts, they are typically drafted as being an exclusive remedy for delay. This essentially means that the party seeking to rely on the clause cannot recover any more than the stipulated rate. If a main contractor incurs greater delay-related losses than the rate of LADs, it will be out of pocket.

For a main contractor, LADs under the main contract are not its only possible losses from delay. A subcontractor in delay may cause delay or disruption to other subcontractors, which may then seek to recover the resulting loss and expense from the main contractor. In addition, the main contractor is likely to incur its own costs from delay, such as extended preliminaries. If the main contractor is limited to recovery of the main contract LADs from the delaying subcontractor, it cannot recover any such additional losses.

On the other hand, a main contractor could benefit financially from delay if it flows down the main contract LADs to all its subcontracts. Firstly, a delay under a subcontract may cause no overall delay to the main contract works, and so the main contractor could recover LADs from a subcontractor when it has no liability to the employer.

Secondly, if there were a number of subcontractors in delay, but those individual delays caused the same or overlapping periods of delay to the main works, then the main contractor would only have to pay the employer once for that period of delay, but might be able to recover that same rate of LADs from each of the delaying subcontractors. While the possibility of a financial windfall may appear to be a good position to be in, it leaves the main contractor open to having the subcontract LADs clause challenged as an unenforceable penalty, something covered in the first LADs article in this series.

General damages and caps on liability

In practice, it may be difficult for main contractors to estimate accurately the delay losses that could be caused by a subcontractor. There are any number of possible scenarios resulting from a subcontractor being in delay. The consequences could range from no overall effect on the main contract programme to the main contractor facing delay claims from the employer and other subcontractors, as well as incurring its own costs as a result of such delay.

Main contractors therefore sometimes prefer to rely on claims for general damages for delay in subcontracts. Indeed, many of the standard form subcontracts, including JCT, do not include LADs clauses. Although general damages mean that the main contractor has to prove its losses, this can be made easier by including an express clause in the subcontract where the subcontractor acknowledges that it is aware of the main contract rate of LADs.

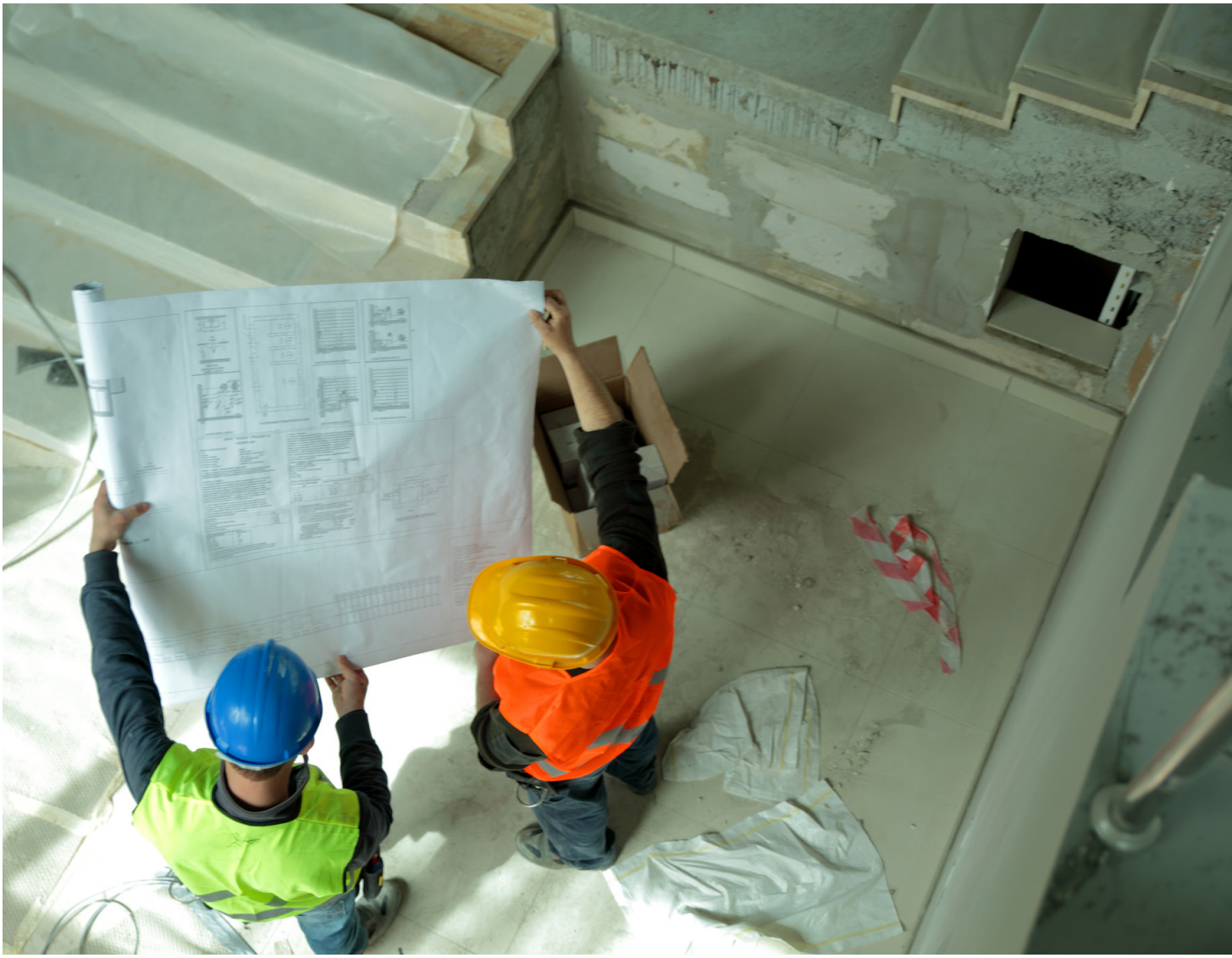
That said, the commercial reality is that the potential level of delay losses a main contractor could suffer may be far greater than a subcontractor is willing to accept, particularly where the subcontract works form only a small part of the overall project. For this reason, the parties often

agree to limit the amount of delay losses a main contractor can recover from a subcontractor – whether by way of LADs or as general damages.

This may be set at a percentage of the subcontract sum so that it is proportionate to the value of the subcontract works. Of course the value of the subcontract works is not necessarily a good indicator of the likely delay losses a subcontractor could cause, and so any cap would have to be considered on a case-by-case basis.

The next and final article on LADs essential law will review whether liquidated damages clauses survive termination of a construction contract.

This article was first published in 'Building' magazine on 27 May 2021 and is reproduced with their kind permission.



New tax on property developers - consultation paper published

On 29 April the government published a consultation paper on the design of the new residential property developers tax (referred to as the "RPDT"), which is proposed to take effect from 1 April 2022.

Helen Coward
Partner
Construction

The consultation seeks views on the design, implementation and administration of the new tax and will no doubt be read with interest by those in the industry. There are significant outstanding questions which represent a real opportunity to help shape the policy and prevent any unexpected casualties.

Unusually, the tax is very targeted and appears to be intended to be limited in time. It is being introduced in large part to pay for the remediation of unsafe cladding following the Grenfell tragedy. The government however has taken pains to point out (both in the previous announcement and again in the consultation) that the tax is industry wide and is not targeted at developers who were involved in buildings requiring remediation.

According to the consultation paper, the intention is to ensure that only the largest residential property developers are caught and in a way that will raise sufficient revenue to achieve the aggregate revenue target of £2 billion within a decade.

The consultation paper does not address the question of the rate, but recognises that many stakeholders will be concerned about the combined effect of the RPDT and the corporation tax rate increase from 1 April 2023.

Who will be caught?

It appears that the measure will only capture standalone companies or corporate groups but will take into account profit shares from development activities conducted through joint ventures.

There will be a threshold so that profits are only caught in excess of an annual allowance – suggested to be £25 million. This is welcome given the broad range of activities that fall within the proposed scope of the new tax, but means that the burden of the tax will fall on a fairly small number of taxpayers.

What activities will be caught?

The proposed scope of activities is broad: the tax will catch the conversion of existing buildings and new construction whether for sale or for letting. The tax will also apply where a development site is sold in whole or in part.

The proposed inclusion of build to rent activities is of particular concern. This is stated to be required to prevent housebuilders adopting alternative business models to avoid the tax, but seems likely to throw up a lot of complex questions as to how the profits should be computed for the purposes of the tax in that scenario.

What is "residential property"?

There are a number of definitions of this phrase in UK tax legislation. It appears that a new definition will be used for this measure that draws on principles from existing legislation but doesn't adopt any of them wholesale. This will create further complexity in the UK taxation of residential property.

The definition will be expansive, including undeveloped land or land undergoing a change in use for which planning permission to construct has been obtained. As is the case with other taxes, most specialist communal dwellings (such as residential nursing homes and prisons) will be excluded. There is a question mark over the inclusion of purpose built student accommodation.

Profits from the development of affordable housing will be within the scope of the tax. Most developers will be unaffected by this given affordable housing is rarely delivered at a profit, but for those it will impact this seems particularly out of kilter with the government's general aim to deliver more affordable housing in the coming years.

The fundamental design of the tax

The government is seeking views as to whether it is more appropriate to apply the tax on the basis of a company approach (i.e. companies / groups whose activities include residential property development, as long as it is not insignificant) or an activity based approach (i.e. taxing residential property development activity of any extent).

In the first approach, the entire profit of the company would be taxed but in the second approach only the residential property development activity would be taxed. The second approach seems fairer but is likely to give rise to a great deal of complexity in identifying the profits which fall within the scope of the tax.

Another thorny question raised by the paper is the treatment of losses. The government's view is that losses incurred before the introduction of the RPDT should not be capable of being carried forward against profits subject to the RPDT. The question left open is whether losses realised after the introduction of the tax should be capable of carry forward.

The new rules regarding corporate losses are already fiendishly complex, but if the government avoids adding to that complexity then property developers are likely to lose out on the ability to carry forward losses, which could be punitive.

Impacts

The government appears to be keenly aware that there is the potential for the RPDT to have unanticipated impacts and in particular to affect housing supply.

The paper specifically recognises that if developers factor the cost of the tax into the price they are willing to pay for land this may result in a reduced number of plots viable for development and therefore in due course fewer houses being completed.

Ultimately, it may be difficult to predict how behaviour may change in response to the tax, but it seems unlikely that the government will be able to deliver all of its stated aims: to avoid complexity, to avoid negatively impacting housing supply and to raise significant revenue.

Experts in two minds – but within one firm

A recent appeal case looked at whether a company can provide expert services in claims for and against the same party

Steven Carey
Partner
Construction

Multidisciplinary consultancies providing expert and litigation support services from offices around the world are increasingly common and there have, over the past few years, been a number of high-profile acquisitions that indicate consolidation is afoot. In what circumstances can they potentially provide expert services in claims for and against the same party?

The Court of Appeal addressed this in the recent case of *Secretariat vs A Company*, where they had to decide whether experts who worked for different companies in the same group could act for and against the same company in disputes arising out of the same project.

A developer of a large petrochemical plant (referred to in the judgment as "A Company" to protect the confidential nature of the underlying arbitrations) was facing an arbitration claim brought by its subcontractor for additional costs due to delay and disruption. Part of this claim was for costs arising out of the alleged late release of the IFC drawings. A Company appointed a delay expert who worked for Singapore-based Secretariat Consulting Pte Ltd (SCL) in that arbitration.

A few months later, the EPCM contractor appointed by A Company in relation to the petrochemical plant commenced a separate arbitration against A Company claiming unpaid fees under the EPCM contract. A Company counterclaimed for the failure to manage or supervise the subcontractor involved in the first arbitration, as well as for the alleged delay in issuing the IFC drawings to that subcontractor. The EPCM contractor appointed a quantum expert for this arbitration who was employed by Secretariat International UK Ltd (SIUL). Both SCL and SIUL were within the same group of companies, albeit located in different jurisdictions.

When A Company discovered that SIUL was acting against it in the second arbitration, it sought an injunction preventing SIUL from doing any further work in that second arbitration.

This injunction was granted by the Technology and Construction Court on the basis that SCL owed A Company a fiduciary duty extending to the Secretariat

group of companies. Secretariat appealed against that decision.

The Court of Appeal unanimously agreed that the injunction should remain. However, all three judges declined to find that the expert owed a fiduciary duty to its client. Instead, they decided the case by reference to the terms of the retainer between A Company and SCL – in particular, that SCL was under a contractual duty to avoid any future conflict of interest and this bound all entities in the Secretariat Group.

The leading judgment by Lord Justice Coulson gave a number of reasons why he considered a conflict of interest arose. The first related to the scope of what each expert was being asked to undertake. SCL was advising A Company in relation to its commercial position in the first arbitration as well as giving expert evidence. If SIUL were appointed, it would be giving advice opposing A Company. In addition, SCL and SIUL would be engaged to give advice about the design and construction of the petrochemical plant and both arbitrations concerned the causes of delay in the design and construction of the plant.

Key to the existence of a fiduciary duty is that an expert must put the client's interests first. The court noted that there was no tension between this and an expert's overriding duty to the court or tribunal. Lord Justice Coulson said

"there is no point in the client spending a good deal of money pursuing or defending a claim if his underlying position is hopeless but none of his advisers are prepared to tell him so".

The expert being prepared to stand up to a court or tribunal to justify their position is therefore ultimately to the benefit of the client. An expert having this dual loyalty does not prevent a fiduciary duty from existing.

However, the court was hesitant to conclude that there was such a fiduciary duty because there were potentially unseen ramifications and a fiduciary obligation is freighted with "legal baggage". Ultimately, the court arrived at its decision without having to resort to expanding the circumstances where a fiduciary duty would be implied. Lord Justice Coulson concluded that "a fiduciary duty of loyalty would not add or enhance" the obligations already present in the contract between the parties.

The key here was the terms of the retainer, which clearly provided that, as well as confirming that there was no existing conflict, SCL would not in the future be involved in or create any conflict of interest. On the facts, the court found this covered other Secretariat entities that made up a "global firm".

The court concluded that an expert witness group operating on a global scale with separate subsidiaries in a variety of jurisdictions can, if it wishes, make clear in its retainers that the conflicts were based solely on a specific entity and that other entities within the group remained free to act for parties opposed to the client in the same or related disputes.

However, this is unlikely to be at all attractive to those employing such experts and I would expect those instructing them to pay particular attention to the terms of the conflict provisions in the retainer going forward.

This article was first published in 'Building' magazine on 26 March 2021 and is reproduced with their kind permission.

Client alert: construction under competition law spotlight

A number of announcements from the Competition and Markets Authority ("CMA") illustrate that the UK competition regulator has once again brought scrutiny on businesses in the construction and engineering sector as being culpable of anti-competitive conduct, notably around price fixing, collusive tendering and cover pricing.

Paul Henty
Partner
Construction

Readers may recall that in the 2000s, the CMA's predecessor, the Office of Fair Trading, led a series of long-running investigations into a wide range of businesses in the construction and engineering industry, who were ultimately charged and penalised for infringing the Competition Act 1998 ("**CA 98**").

This began with a series of dawn raids against roofing contractors in the West Midlands who were discovered to have been involved in collusive tendering, notably cover pricing. That case revealed evidence of similar practices in other parts of the UK, culminating in penalties to 103 companies worth a total of £129.5 million after an investigation into bid-rigging in England. Only a handful of the fines issued were reduced on appeal to the Competition Appeal Tribunal.

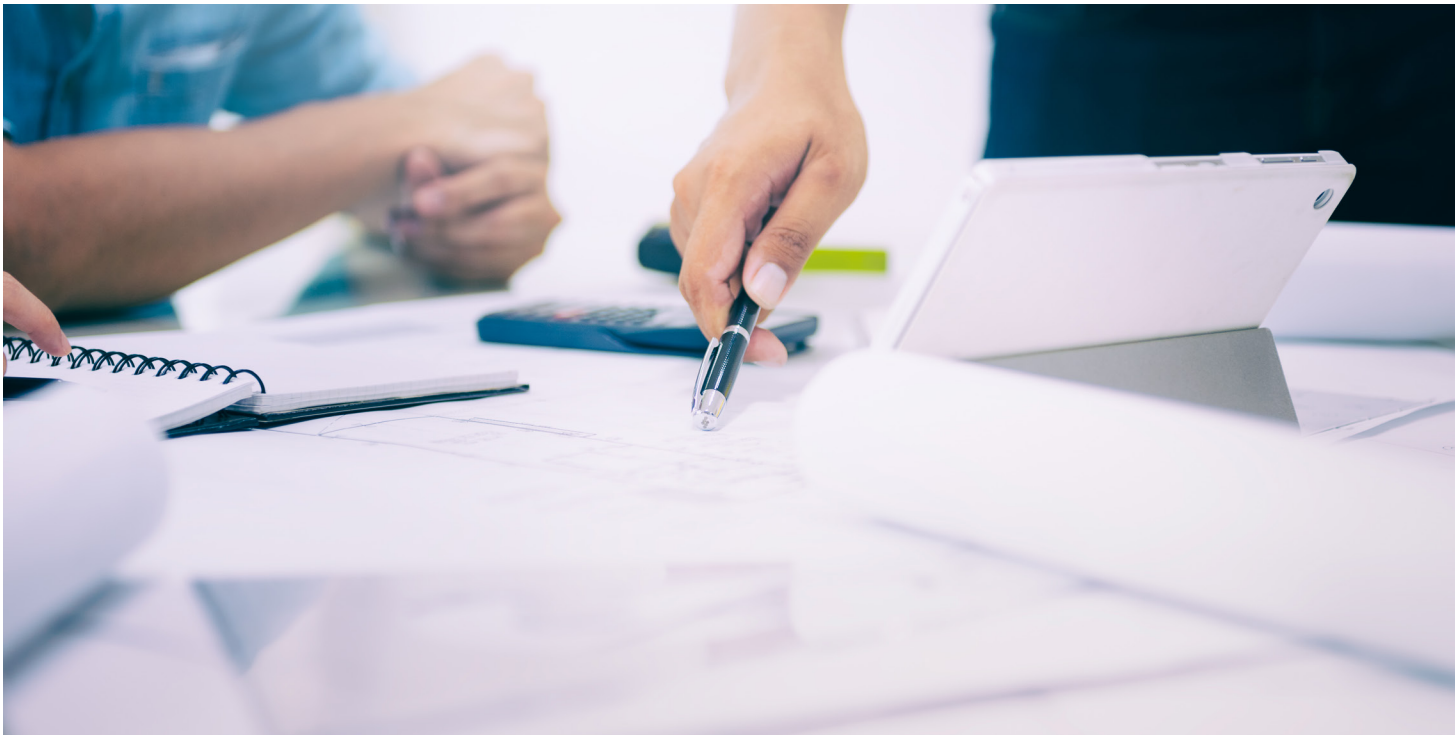
In this brief alert we outline the three investigations which have either recently concluded or are ongoing together with a summary of what this means for businesses.

What is competition law and collusive tendering?

Chapter I of the CA 98 prohibits agreements and concerted practices between businesses the effect of which is to prevent, limit or distort competition. Chapter I precludes the possibility of arrangements such as price fixing, bid rigging / collusive tendering or customer or market allocation.

Collusive tendering or bid rigging is the practice of distorting the competitive tender process. This can occur in the following ways:

- Businesses **fix tender prices** between themselves or facilitate price coordination by revealing sensitive bid information to each other;
- **Bid suppression** takes place when one or several competitors, who would otherwise be expected to tender for a contract, refrain from tendering or withdraw a previously submitted tender, so that a competitor's tender will be accepted instead.
- **Cover pricing** (also known as



'complementary', 'protective' or 'shadow' bidding) occurs when competitors submit token tenders that are too high to be accepted. Such tenders are not intended to be accepted, but are merely designed to give the appearance of genuine tendering. This enables another competitor's tender to be accepted when the contracting authority requires a minimum number of bidders. Sometimes this has occurred where one bidder has been too busy to return a genuine price and so requests a cover price from a rival tenderer. Unfortunately, the intention behind seeking or providing a cover price is irrelevant and this practice will always contravene Chapter I of the CA 98.

- **'bid rotation'** entails suppliers agreeing to take turns to win contracts, similarly **market** or **customer allocation** involve parties allocating customers or opportunities between themselves.

The CMA has wide ranging powers to investigate suspected breaches of the CA 98, including on-site inspections, the ability to require key witnesses to attend interviews and to remove documents and require individuals to provide explanations for those documents.

The CMA may not only issue fines based on its findings of up to 10% of group turnover but also issue director disqualifications and even bring criminal prosecutions under the Enterprise Act 2002 ("**EA 02**"). It must be remembered that bid rigging is not only a serious violation of Chapter I of the CA 98 but also a criminal offence under Section 188 of the EA 02, carrying a penalty of unlimited fines for individuals and custodial sentences of up to five years.

If this were not bad enough, businesses found guilty of anti-competitive conduct can be excluded from competitions for public contracts under Regulation 57 of the Public Contracts Regulations 2015. This may prevent a business bidding for such contracts in its own right and also damage its prospects of becoming a subcontractor or consortium partner.

We now summarise the three most recent decisions of the CMA involving players in the sector.

Investigation 1: Roofing materials

Following an investigation into suspected cartel conduct in 2017, the CMA discovered anti-competitive agreements in place between Associated Lead Mills Ltd (ALM) and H.J. Enthoven Ltd (trading as BLM British Lead) (BLM), who had broken the law by entering into anticompetitive arrangements. ALM and BLM are two of the biggest suppliers of rolled lead, a key component in the production of roofing materials.

The four anticompetitive arrangements took place between October 2015 and April 2017 and included colluding on prices, sharing the rolled lead market by arranging not to target certain customers and avoiding supplies to a new business which risked disrupting the firms' existing customer relationships. Each of the arrangements also included exchanges of commercially sensitive information.

The CMA imposed fines totalling over £9 million on the parties which included settlement discounts linked to admission of guilt and cooperation with the inquiry. In March 2021, the CMA also announced an additional sanction: it has exercised its powers of director disqualification against three executives of the parties involved in this decision.

Investigation 2: Construction services

Little has been publicly announced regarding this inquiry, which began in March 2019 and remains ongoing. Publicly, the CMA has said only that it is investigating suspected anti-competitive arrangements in the supply of construction services in Great Britain which may infringe Chapter I of the Competition Act 1998. The CMA's press release discloses only that the investigation is ongoing with a further announcement expected in October 2021.

Investigation 3: Groundworks

In 2017, the CMA opened an investigation into a number of suppliers of groundworks products to the UK construction industry.

Subsequently, the CMA issued a statement of objections setting out its provisional findings that three suppliers to the construction industry had breached competition law by coordinating their commercial behaviour (in particular pricing practices) with the aim of reducing competition on price and strategic uncertainty, through the sharing of competitively sensitive, confidential pricing and strategic information in relation to the supply of certain groundworks products in the United Kingdom.

The CMA in December 2020 issued a decision finding that Vp plc, M.G.F (Trench Construction Systems) Ltd and Mabey Hire Ltd had infringed competition law by colluding illegally. Fines totalling more than £15 million were imposed on Vp and M.G.F. The non-confidential version of the decision was released in March 2021.

So what? Why is this important for construction businesses?

There are a number of essential take-aways here for businesses active in construction and engineering:

- the construction sector remains in the CMA's sights. After a period in which it seemed other industries were the focus, it is now clear that construction is a key target. Whereas previously competition compliance had been at the forefront of many firms' practices, a significant number have now sloppily lapsed back into unlawful conduct;
- Brexit and the pandemic have created acute challenges for construction and engineering businesses. These pressures make it more appealing to cut corners in competitive tender processes and lead to a false instinct that there must be a defence based on the prevailing difficulties. The CMA has sent a clear message that tough market conditions are no excuse for breaking the law;
- the exchange of competitively sensitive information between competitors is not permitted. Neither are agreements between rivals not to compete for customers or business or to decide between themselves who will win any given contract or customer; and
- the CMA has sophisticated means of capturing evidence and despite the businesses meeting in various different locations, it was able to obtain the necessary evidence. Individuals involved in cartel behaviour frequently use private email addresses to conceal illicit conduct but this strategy is not always effective.

The penalties for anti-competitive conduct are severe. Businesses may face fines of up to 10% of group, worldwide turnover as well as lawsuits from parties who have been affected by cartel activity. Fines can be reduced or even wiped clean for firms who self-report through the CMA's leniency policy. That can lead to the reporting firm bringing to the CMA's attention other cartel activity of which it may not already be aware, thus putting other businesses at risk.

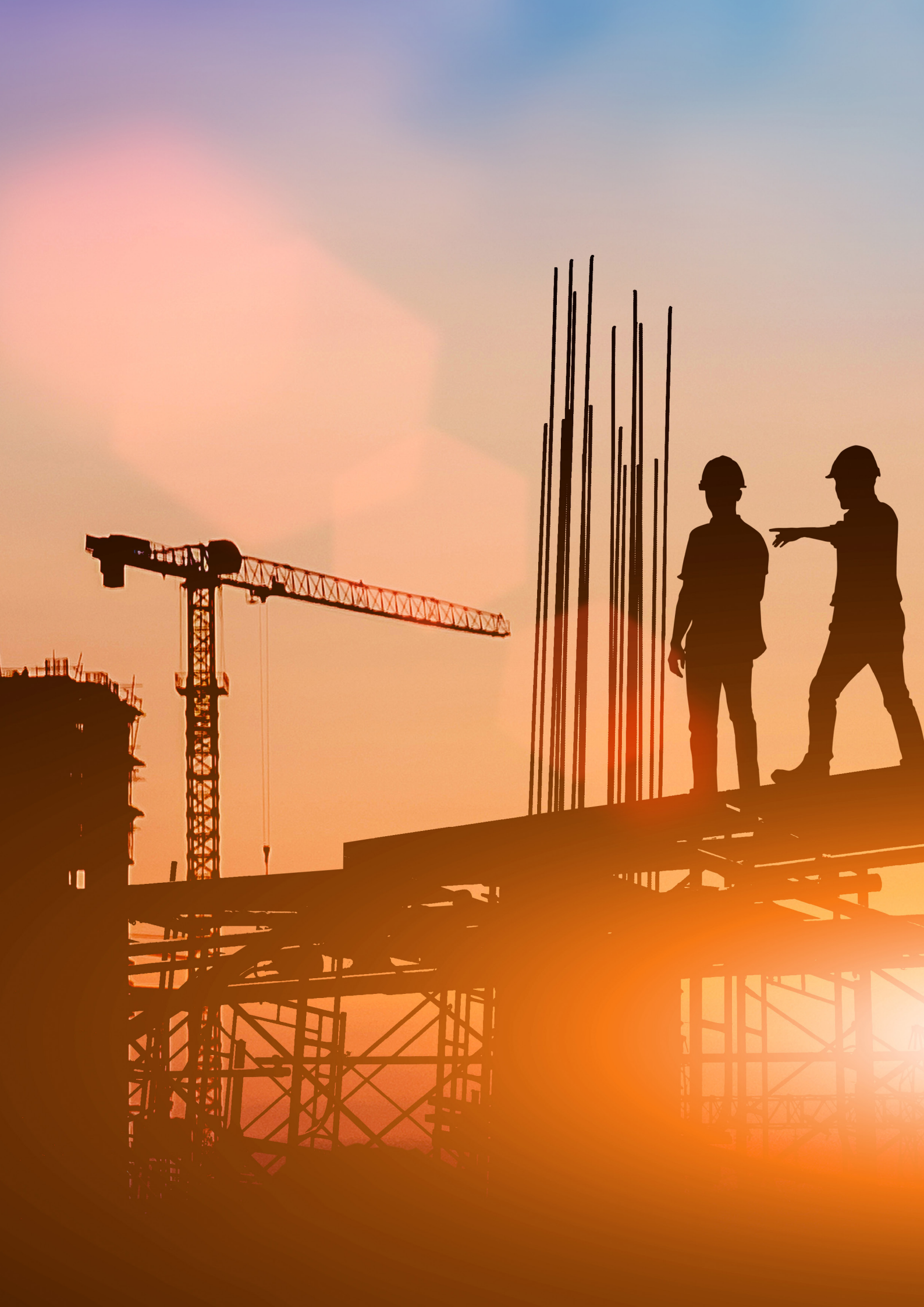
Increasingly, the CMA is using its powers to press for disqualification of directors who have been involved in illicit conduct. They may also be subject to mandatory debarment for up to 15 years from directorships and management positions in companies, a process that will also involve them being publicly and personally "named and shamed".

The key step for businesses to take is to put in place a competition compliance program, that will involve training staff to avoid and to be on the look-out for unlawful practices. The aim is to both prevent the occurrence of behaviour that could land the company in trouble as well as to be able to spot it early where it arises and to take timely action to remedy or mitigate the risk (such as considering an application for leniency to the CMA).

Rights to compensation for victims of cartel behaviour

Finally, remember that competition law gives your business important compensation rights, particularly if you have been buying over the odds as a customer of a cartel. Losses may have arisen because your business procured goods and services at inflated and artificial anti-competitive prices. Legally, the overpayment will only be compensated if the victims initiate a claim. The CMA has no jurisdiction to distribute the proceeds of fines to injured parties.

Businesses should therefore consider whether they have been bearing the cost of unlawful prices. Given the tight margins in construction and the challenging trading environment, simply "taking it on the chin" may be considered contrary to the interests of shareholders. Businesses should move quickly to secure their right to be refunded for unfair, exploitative pricing.



Contributors

Paul Henty
Partner
Construction

T: +44 (0)20 7427 6506
Paul.Henty@crsblaw.com

Anna Sowerby
Trainee Solicitor
Construction

T: +44 (0)207 203 5226
Anna.Sowerby@crsblaw.com

Eveline Strecker
Knowledge Development Lawyer,
Knowledge

T: +44 (0)20 7438 2272
Eveline.Strecker@crsblaw.com

Carolyn Davies
Associate
Construction

T: +44 (0)20 7438 2149
Carolyn.Davies@crsblaw.com

Isabella Eacott
Trainee Solicitor
Construction

T: +44 (0)1483 252 512
Isabella.Eacott@crsblaw.com

Georgina Bernard
Trainee Solicitor
Construction

T: +44 (0)1483 252 787
Georgina.Bernard@crsblaw.com

Michael O'Connor
Partner
Construction

T: +44 (0)20 7427 6441
Michael.O'Connor@crsblaw.com

Sam Johnson
Associate
Construction

T: +44 (0)20 7203 5391
Sam.Johnson@crsblaw.com

Karen Morean
Associate
Construction

T: +44 (0)1483 252 611
Karen.Morean@crsblaw.com

James Worthington
Partner
Construction

T: +44 (0)20 7427 1070
James.Worthington@crsblaw.com

Andrew Keeley
Partner
Construction

T: +44 (0)20 7438 2149
Andrew.Keeley@crsblaw.com

Isabella Eacott
Trainee Solicitor
Construction

T: +44 (0)1483 252 581
Isabella.Eacott@crsblaw.com

Chris Busaileh
Senior Associate
Construction

T: +44 (0)20 7427 4546
Christopher.Busaileh@crsblaw.com

Helen Coward
Partner
Construction

T: +44 (0)20 7427 6766
Helen.Coward@crsblaw.com

Steven Carey
Partner
Construction

T: +44 (0)20 7427 1062
Steven.Carey@crsblaw.com

About the construction, engineering & projects group

We are a large team of over 40 specialist lawyers, based in 11 locations across the UK, Europe, the Middle East and Asia, enabling clients to access the full range of the firm's skills and expertise, both in the UK and internationally. The team includes dual qualified barristers and solicitors, engineers, and accredited mediators and adjudicators.

Our Construction, Engineering & Projects group provides the full range of dispute and transactional services for large scale construction and engineering projects, in the UK and internationally.

We act for a wide range of clients, but with a particular emphasis on:

- major contractors
- major engineering consultancies
- real estate developers
- housebuilders
- property investment companies

Our core transactional legal experience include advising on all forms of construction and engineering contracts and associated documentation, insurance arrangements, and all related financial security (such as bonds, guarantees and warranties).

Our dispute resolution experience is extensive, including advising on:

- court proceedings
- adjudication
- arbitration (domestic and international)
- expert determination
- mediation and dispute avoidance

We focus our dispute resolution strategy on maximising the net recovery for our clients when bringing claims, and minimising or extinguishing their exposure when defending them.

Our full-service approach ensures that an appropriate strategy can be adopted to achieve our client's priorities throughout the lifetime of a project. Our aim is to provide a personable and highly responsive specialist service.

Who to contact

If you are interested in more information on anything you have read in this newsletter, please contact the relevant author, your usual Charles Russell Speechlys contact, or alternatively:

Andrew Keeley
Partner, Editor

+44 (0)14 8325 2581
Andrew.Keeley@crsblaw.com

Our Construction, Projects and Engineering lawyers operate in the following offices:

London
5 Fleet Place
London
EC4M 7RD UK

T: +44 (0)20 7203 5000

Cheltenham
Compass House
Lypiatt Road
Cheltenham
GL50 2QJ UK

T: +44 (0)1242 221122

Guildford
One London Square
Cross Lanes
Guildford
GU1 1UN UK

T: +44 (0)1483 252525

Doha
Level 21, Burj Doha
West Bay
Qatar

T: +974 (0)4034 2036

Dubai
Office 1108, 11th Floor
Index Tower
DIFC, UAE

T: +971 4246 1900

Manama
Floor 24, East Tower,
Bahrain World Trade Centre
Isa Al Kabeer Avenue
Kingdom of Bahrain

T: +973 (0)17 133200

London | Cheltenham | Guildford | Doha | Dubai | Geneva | Hong Kong | Luxembourg | Manama | Paris | Zurich

0541_06_21