Talking Point:
Construction and Engineering

Hogan Lovells

Important 2016 English law cases for the construction industry (Part Two)

The second of our two-part guide to 2016's significant English construction law cases looks at contract interpretation, final account applications in the absence of pay less notices, extension of time clauses and negligence claims where a defective product causes damage.

7. A company buys products it finds to be defective may be unable to claim in negligence where its employees adopt workarounds before the products cause damage

Howmet's factory was damaged by fire. Howmet claimed in negligence against Economy Devices, which had manufactured a malfunctioning fire warning device. Although at first instance the thermolevel was found to be defective, Howmet's claim failed because causation was not established – before the fire, the knowledge of some employees meant Howmet knew the devices were not working properly.

Howmet's appeal in *Howmet Ltd v Economy Devices Ltd* [2016] EWCA Civ 847 was dismissed. The Court of Appeal held that the knowledge of Howmet's employees maintaining the thermolevel was attributable to the company. They had appreciated the thermolevel was malfunctioning and adopted an alternative system to prevent fires. Although manufacturers of products often owe a duty of care to end-users, this duty is not owed where defects are discovered by end users before damage is caused. The judgment left open the possibility that courts in future could apportion liability, depending on the reasonableness of the alternative system adopted.

8. You can challenge final accounts, even where no payment or pay less notice is served

In 2015, the Court of Appeal in *Harding v Paice* [2015] EWCA Civ 1231 (see our March/April 2016 Talking Point) held that an adjudication decision valuing the sum in an interim payment application could be challenged in a subsequent adjudication, but left the position regarding final account applications unclear. The TCC in *Killker Projects Ltd v Purton* [2016] EWHC 2616 (TCC) attempted to resolve this.

Kilker engaged Purton to carry out specialist joinery works. The revised Housing Grants, Construction and Regeneration Act 1996 and Scheme for Construction Contracts applied.

Purton launched an adjudication claiming full payment of its final account application as Kilker had not served a payment or pay less notice. The adjudicator decided the final account was payable. Following an unsuccessful attempt to resist enforcement, Kilker paid the amount due.

Kilker began a second adjudication on the true value of the final account. The adjudicator ordered Purton to repay the overpayment to Kilker. Purton refused. Kilker issued enforcement proceedings. Purton argued that the first adjudication decided the valuation in the second adjudication, meaning the second adjudicator lacked jurisdiction as he was determining the same dispute as in the first adjudication. Purton also argued that Kilker had agreed Purton's valuation by failing to issue a payment or pay less notice. Kilker submitted that the payments provisions in the Act and Scheme regulate payment and cash flow. Neither decide the substantive payment entitlement nor conclusively determine the amount to be paid.

The court held that, unless the contract provides otherwise, where a sum determined in an adjudication relates to a final account, either party can have its ultimate value determined in subsequent adjudication, litigation or other proceedings. The failure to issue a payment or pay less notice does not prevent a challenge.

9. You may be able to vary contracts orally even though they prohibit oral variations

For the first time in several years, the Court of Appeal in 2016 tackled clauses prohibiting parties from amending written contracts orally.

In *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396, TRW agreed an exclusive supply contract with Globe under which TRW had to buy all Globe's first generation motors and Globe could not sell them to anyone else. TRW could propose changes to the motors, which Globe also obliged to make. Globe argued TRW breached the contract by purchasing over three million second generation motors elsewhere, even though Globe could and would have manufactured second generation motors by changing its first generation motors. TRW argued that the motors purchased elsewhere fell outside the class of products in the contract and that Globe could not have produced them. The judge held that Globe could have made the changes. The second generation motors were therefore covered by the contract, meaning TRW was in breach.

The Court of Appeal allowed TRW's appeal as the first instance judge had wrongly interpreted the contract. The Court also made obiter comments on TRW's other argument that the second generation engines would have amounted to an oral variation and so been prohibited by an anti-oral variation clause, which required amendments to be in writing and signed by both parties. These comments were affirmed in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2016] EWCA Civ 553. After considering the conflicting authorities on anti-oral variation clauses, the Court of Appeal held that freedom of contract prevails. Nothing stops parties from making a later contract to vary an earlier one. However, anti-oral variation clauses are still useful. They encourage courts to look for evidence that purported oral variations are established on the balance of probabilities and incentivise the parties to record agreed variations carefully. They also make it difficult for a party relying on an oral variation to establish that what was said was intended to alter legal relations.

10. Think about a word's plain meaning in the context of the whole contract

The courts in 2016 keenly applied 2015's seminal Supreme Court decision in *Arnold v Britton* [2015] UKSC 36 on interpreting express terms. Where clauses are clear and unambiguous in their context, the courts adopt their natural and plain meaning, no matter how uncommercial it seems. Rules such as contra proferentem don't apply and the courts won't entertain lengthy arguments about clauses' supposed ambiguity.

Dooba Developments Ltd v McLagan Investments Ltd [2016] EWHC 2944 (Ch) illustrates this well.

Dooba agreed to sell land to McLagan for a supermarket development. Completion was conditional on securing various planning and highways permissions. If "any" of these conditions had not been met, either party had a recission right. Without prejudice to this right, the next paragraph of the agreement allowed either party to rescind if "all" the conditions had not been met by a long stop date (this right being important where a party did not rescind at the time an individual condition was not met (in hope it might be eventually) but where its subsequent behaviour meant it had waived the first rescission right). The planning condition was fulfilled before the long stop date but the highways condition was not. McLagan sought to rescind.

The court held that McLagan could rescind. A commercial interpretation of the second rescission right was that McLagan had the right to rescind unless all of the conditions were met.

Dooba's appeal was successful. The court preferred a more literal approach based on grammatical correctness – a rescission right expressly contingent on "all" conditions not being met is unambiguous and on a natural and plain reading may only be exercised if none of the conditions has been met. The context of the second rescission right was important as it appeared after the first rescission right referring to "any" of the conditions. This meant McLagan could rescind only if it could show that all the conditions had not been met.

11. A consequential loss exclusion may be broader than you think

Most English lawyers assume the phrase "consequential or special losses" means those under the second limb of the rule in *Hadley v Baxendale* [1854] EWHC Exch 270, namely indirect losses flowing from the circumstances of a particular transaction. However, the court in *Star Polaris LLC v HHIC-Phil Inc* [2016] EWHC 2941 (Comm) found otherwise, again because of the clause's context.

Star Polaris engaged HHIC to build a ship. After delivery, the ship's engine failed. The ship was towed to port for repair. Star Polaris began an arbitration against HHIC, contending that the engine failure was caused by HHIC's contractual breaches and claiming compensation for the repair and other financial losses, such as towage fees. HHIC relied on article 1X of the contract, which provided for HHIC's liability for defects in detail. HHIC guaranteed materials, workmanship and the remedying of physical defects, but expressly had no other liability after delivery and excluded any "consequential or special losses, damages or expenses unless otherwise stated".

The tribunal found that the parties used "consequential" to mean losses treated as a result of the engine failure. As the only positive obligations assumed were the repair or replacement of physical defects, consequential losses had a wider meaning than those falling under the second limb of *Hadley v Baxendale*. The contract distinguished the cost of repair or replacement caused by guaranteed defects from the broader financial consequences of repair or replacement.

The court agreed. Article IX operated as a complete code under which all liability for losses above those specifically accepted by HHIC was excluded. While "indirect or consequential" has acquired a well-recognised meaning and very clear words are needed to show an intention to exclude losses falling outside that meaning, its scope depends on its true construction in context.

12. A JCT subcontract extension of time usually runs from the completion date, even if granted while the party claiming it is in culpable delay

2016 of course saw many existing principles confirmed (for example that a causal delay to the scheduled completion date is required for a concurrent delay claim to succeed and that contract documents are construed by reading them together (the rules on interpreting express and implied terms assisting only with irreconcilable inconsistencies), but new TCC and Court of Appeal rulings in *Carillion Construction Ltd v Woods Bagot Europe Ltd* [2016] EWHC 905 (TCC) and *Carillion Construction Ltd v Emoor Engineering Services Ltd* [2017] EWCA Civ 65 concerned a JCT subcontract extension of time clause whose meaning everyone already seemed to know.

Rolls Development employed Carillion to build the Rolls Building, the TCC's home. Carillion engaged subcontractor Emoor under a JCT SBCM 2 1981, which provides for an extension of time for the subcontract works beyond the completion date "or any revised such period" in the event of certain delays. The project finished late.

Carillion claimed liquidated damages from Emoor. Emoor denied Carillion's claim, arguing it was entitled to an extension of time which should be given by adding the time to the end of the period set. Carillion argued the extension should not run contiguously from the end of the existing period for completion, as the extension was granted while Emcor was in culpable delay. The Court of Appeal upheld the TCC's finding that the period for the extension should be added to and therefore run from the end of the current completion date. Carillion could not award an extension that fixed discrete periods during which Emcor could undertake its works (such periods not necessarily being contiguous to the existing completion date). This was the clause's natural and ordinary meaning. However, similar wording appears in many construction contracts and the judge said that in some circumstances Carillion's argument would succeed.

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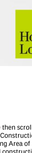

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