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

The first of our two-part guide to 2016's key English construction cases is appropriately the final one sent by John Gerszt, our Global Co-Head of Construction and Engineering, a man who for almost 35 years has carefully, clearly and patiently navigated clients and Hogan Lovells lawyers around the evolving and often complex contours of construction law. In the new year, John will be joining a long-standing client of the firm. On behalf of his past and present clients and colleagues, we wish him the best for the future and salute his hard work, wisdom and incisiveness, always coupled with immense warmth and generosity, which we will all miss.

This month we examine the importance of well drafted interim payment clauses and applications, liquidated damages clauses in FIDIC contracts, the adjudication of settlement agreements and the use of experts.

1. Keep interim payment applications clear in substance, form and intent

Whilst we continue to stress how important it is for employers to focus on adopting measures for the timely issue of pay less notices to comply with the revised Housing Grants, Construction and Regeneration Act 1996 and to avoid having to pay a contractor's disputed invoice by default, this year has seen the courts reminding contractors that they need to be equally careful in checking interim payment provisions.

In ***Jawaby Property Investment Ltd v The Interiors Group Ltd*** [2016] EWHC 557 (TCC), Jawaby engaged Interiors as contractor to refurbish a London property. As is common in construction contracts, the contractor was required to send a monthly valuation, supporting documents and an indication of the sum applied for to Jawaby's agent. The agent would then check the site with the contractor and issue a certificate enabling the contractor to invoice Jawaby. Problems arose when the contractor ambiguously termed one of its valuations an "initial assessment". Subsequently, Jawaby undertook a pro-rata

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reconciliation of the progress on site and emailed the contractor a payment certificate containing a negative figure with no supporting documents. Jawaby then failed to meet the contractual deadline for a pay less notice. The contractor contested Jawaby's claim that the contractor had not sent a valid interim application. In Jawaby's application for declaratory relief, the Technology and Construction Court held that the contractor's valuation was not a valid interim application. Although the contractor's email was a valid method of communication and conformed to the parties' previous course of dealing, the disputed valuation was materially different to previous valuations. As it was described as an initial assessment, it could not be objectively construed as a firm statement of what the contractor considered was due.

2. Provide for interim payments at periodic intervals, rather than on specific dates

The courts have also been robust regarding interim payment dates which parties claim were wrongly drafted. For example, one decision this year found that the Scheme for Construction Contracts will not be implied to fill gaps or even correct clear errors where it is possible to construe the incorrect dates by looking at previous dates and the parties' earlier payment practices.

Unless there is some contractual mechanism, the courts also won't imply additional interim payment dates where practical completion moves to a date well beyond specific contractual interim payment dates, as illustrated in ***Grove Developments Ltd v Balfour Beatty Regional Construction Ltd*** [2016] EWCA Civ 990.

Grove appointed Balfour Beatty to carry out a hotel project under an amended JCT Design and Build 2011 form. The parties agreed a schedule of 23 specific valuation and payment dates from September 2013 to July 2015. Following delays, Balfour Beatty, beginning in August 2015, claimed four additional interim payments beyond the 23 payments agreed contractually with Grove, as its works ran beyond the original contractual practical completion date. Grove successfully sought a declaration that Balfour Beatty had no contractual right to make or be paid any additional interim payment claims. Balfour Beatty argued it made commercial common sense for Grove to keep up interim payments for as long as the works continued. However, a majority of the Court of Appeal upheld the first instance decision. After valuation 23 there had been no agreement between the parties (through conduct, correspondence or otherwise) stating when valuations should be made, notices be served or payments be made. Extrapolation from the schedule suggested one possible timetable; application of contractual clauses suggested an alternative timetable - commercial common sense could only rescue a contracting party if it was clear what the parties had intended, or would have intended, in the circumstances which subsequently arose. It could not be said that the parties had clearly intended payments to continue, with the dates of valuations, notices and payments left as a matter of detail. Those elements were essential. The case was one of one party making a bad bargain, which the court could not rescue it from.

The Scheme's payment provisions would only be imported to the extent that the parties had not already concluded binding contractual arrangements that could remain operative. While most construction contracts provide for interim payments at predetermined intervals, the wording of the Act is such that parties can agree stage payments at

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highly irregular intervals and for highly variable amounts. It followed that the mere fact that a contract does not provide for interim payments covering all the work carried out under the contract would be no reason to import the Scheme. The contract therefore contained an adequate mechanism for quantifying interim payments, as required by the Act.

3. Beware of amending standard forms and unwittingly narrowing your contractual rights

As well as the usual annual collection of JCT cases, the growth of case law on FIDIC contracts continued in 2016. One case, ***J Murphy & Sons Ltd v Beckton Energy Ltd*** [2016] EWHC 607 (TCC), highlighted the perils of failing to see how small amendments to one clause affect the operation of several others. Beckton engaged Murphy under an amended version of the FIDIC Yellow Book to design and build a combined heat and power plant in East London. Clause 2.5 provided that if Beckton considered itself entitled to payment under the contract, Beckton or the engineer should give notice and the engineer then proceed to agree to determine the amount. Clause 3.5 provided that if agreement was not achieved, the engineer should make a fair determination and that without prejudice to either party's right to refer any matter to adjudication or litigation, each party should give effect to any such agreement or determination.

Beckton gave notice of its intention to call the on demand performance bond obtained by Murphy in Beckton's favour in respect of a claim for liquidated damages under clause 8.7. Murphy sought a declaration that, until there had been an agreement or determination by the engineer, it was not obliged to pay, and that in such circumstances Beckton would be acting fraudulently as it could not have an honest belief that it could make a call. The judge dismissed Murphy's claims for declaratory relief and held that Beckton was entitled to payment of the liquidated damages without agreement or determination by the engineer under clauses 2.5 and 3.5 as clause 8.7 set out a self-contained regime for the trigger and payment of liquidated damages. The parties had deleted the words "subject to [Clause] 2.5" in clause 8.7 of the standard FIDIC Yellow Book. Clause 2.5 also refers to deductions in the contract price and payment certificates and contains no timetable for agreement or determination, whereas the mechanism in clause 8.7 provides that liquidated damages due under clause 8.7 are deducted from the next applicable notified sum and provides for a precise timetable.

The judge also held that even if she were wrong in this finding, a call on the bond would not have been fraudulent in the absence of agreement or determination by the engineer. The parties had expressly rejected the standard FIDIC Yellow Book form of wording which restricts an employer's right to call a bond to when the engineer has made a determination. In addition, the obligation to pay arose under clause 8.7 and what then followed under clause 3.5 was a determination of what the obligation was for enforcement purposes. Murphy had confused its liability to pay liquidated damages (which accrues under clause 8.7 and not on the engineer's determination) with the agreed mechanism for resolution of the parties' dispute in clauses 2.5 and 3.5 which leads to enforcement.

4. Settlements which deal with entitlements in underlying contracts can be adjudicated

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J Murphy & Sons Ltd v Maher and Sons Ltd [2016] EWHC 1148 (TCC) saw Murphy back at the TCC, this time putting an NEC3 contract through its paces.

Murphy engaged Maher under a subsubcontract based on the NEC3 subcontract to remove spoil on a tunnel project in Manchester. It provided that any dispute "arising under or in connection with" the subsubcontract could be adjudicated. The TCC was incorrectly identified as the adjudicator nominating body. Maher alleged that a settlement agreement was reached with Murphy through telephone and email discussions and that Murphy would pay Maher. Murphy failed to pay. Maher informed Murphy it would apply to the RICS to appoint an adjudicator (rather than the TCC). A RICS adjudicator was appointed. Murphy alleged that Maher had no contractual basis to apply to the RICS and that the Scheme applied. Murphy also argued that the settlement agreement did not contain an adjudication clause and so the dispute should be litigated. Maher argued that the dispute concerned payment under the subsubcontract and started new adjudication proceedings pursuant to the Scheme. The Scheme permits only disputes arising "under" a contract to be adjudicated. Murphy sought a declaration that the second adjudicator had no jurisdiction because the dispute related to the standalone settlement agreement. Maher contended that the settlement agreement was a variation of the original subsubcontract.

The court held that a dispute as to whether the entitlements which one party had against the other had been settled in a binding way arose under the original contract and that the adjudicator therefore had jurisdiction. The court should assume the parties were likely to have intended any dispute arising out of their relationship to be decided by the same tribunal. In this case, what was supposedly settled was the entitlement to be paid under the original subsubcontract. It would not make commercial sense if the parties had intended that an adjudicator would have jurisdiction to decide entitlements between Murphy and Maher except where a dispute arose as to whether that entitlement had been settled. The NEC3 subsubcontract adjudication provisions also complied with the Act and were wide enough to cover disputes under the settlement agreement.

5. Clearly reserve your rights at the outset if you wish to challenge an expert determination

In ***ZVI Construction Co LLC v The University of Notre Dame (USA) in England*** [2016] EWHC 1924 (TCC), ZVI carried out works to a building being purchased by the University and each was a party to the development agreement with the company selling the building. The University alleged the works were defective and the parties turned to the expert determination dispute resolution clause in the development agreement. The expert determined ZVI was liable for the defects. ZVI then claimed that its minimal obligations under the development agreement meant the stipulated dispute resolution method did not apply and thus the determination lacked jurisdiction. ZVI unsuccessfully applied for an injunction to stop the University enforcing the determination. The deputy judge reviewed the circumstances in which submission to an expert's jurisdiction could be inferred. ZVI had served submissions without expressing any reservation as to the expert's jurisdiction and agreed issues of procedure. The parties also jointly formulated questions for the expert. At no point prior to the expert's determination on liability did ZVI challenge the procedure. The deputy judge found that ZVI had, by its conduct, implicitly submitted to

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the expert's jurisdiction. A reservation of rights does not need to take a particular form but it must be sufficiently clear to all parties that a reservation is being made.

6. If a replacement expert is instructed, the first expert's reports and opinions are potentially disclosable

In ***Allen Tod Architecture Ltd (in liquidation) v Capita Property and Infrastructure Ltd*** [2016] EWHC 2171 (TCC), Barnsley Metropolitan Borough Council engaged ATA as architect to provide construction management services on its town hall renovation. ATA retained Capita to provide structural engineering advice. Issues concerning the walls and foundations delayed the project. The Council initiated arbitration proceedings against ATA, claiming professional negligence on ATA's part. In December 2013 ATA issued court proceedings against Capita and in September 2014 ATA instructed Expert A. Between then and mid-2015 ATA attempted to obtain a written report from him. In July 2015 Expert A produced a summary of his views by email, which he described as his preliminary report. A case management conference was held in September 2015 and a detailed order for directions given, including permission to call expert evidence. The names of the experts were not specified in the order. Expert A produced a draft report in February 2016 but ATA was concerned, notwithstanding that he supported ATA's case, that he would be unable to produce the final report and assist the court. Consequently, ATA instructed a new expert, Roberts.

At the pre-trial review, Capita sought disclosure of all reports, documents and correspondence in which the substance of Expert A's expert opinion was set out (whether in draft or final form). ATA resisted disclosure, arguing that the documents were privileged, that sufficient material had already been disclosed to provide a proper basis for the court to permit ATA to call Roberts as its expert witness and that it had not been guilty of expert shopping. The court held that privilege did not apply to Expert A's preliminary report and other documents in which he expressed his opinion. It further held that ATA should disclose those documents as a condition of the court permitting ATA to rely on Roberts – this is the "price" a party has to pay for relying on a new expert's evidence. Whilst this was a case either of no expert shopping or of expert shopping to a faint degree, the court could still order disclosure.

Parties need to be aware of the court's wide power to exercise its discretion to impose conditions in relation to expert evidence irrespective of expert shopping, although such conditions will depend on the court having regard to all the circumstances of the particular case. For example, disclosure of documents such as attendance notes of discussions between a solicitor and an expert will usually only be required where there is strong evidence of expert shopping.

As we end this first part of our 2016 review, may we wish you and your colleagues, families and friends all the very best for 2017.

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STOP PRESS! John Cook, our Colorado Springs Office Managing Partner and a member of our global construction and engineering team, was earlier this month named a Lawyer of the Year by Law Week Colorado.

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