



Welcome to the latest edition of Construction Law. Our lead article reports on the progress of the proposed changes promoted by Government to the Construction Act and the likely affects this will have on construction contracts.

This edition covers a wide variety of issues including the importance of knowing the risks of corporate manslaughter and the adjudication tactics which have been deployed over the years to try and secure an advantage. We also discuss the lessons to be learnt from *Chartbrook v Persimmon* and the legal issues in hotel procurement.

If you would like any advice on any of the issues covered in this newsletter or another aspect of construction law please contact:

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## Construction Act 2009 Update

In the Summer 2009 edition of Construction Law, we outlined the proposed changes to the Construction Act. The legislation including the proposed changes (The Local Democracy, Economic Development and Construction Act) received Royal Assent on 12 November 2009.

A number of interesting amendments were proposed at the third reading in the House of Commons including an amendment to give contractors the right to demand security for payment and removal of the insolvency exception to the prohibition of pay when paid clauses. Those amendments and others were rejected but two amendments promoted by the Government were made to the Bill with all party consent.

The first amendment concerns the power to exclude certain types of construction contract from the scope of the Act (you may recall this has already been done in respect of most development agreements). The amendment has two effects: first, as regards Scotland and Wales it vests the power in the Scottish Ministers and Welsh Ministers respectively; secondly, it enables the disapplication of the Act in whole or in part only (previously it was all or nothing).

The second change concerns provisions in contracts dealing with the costs of an adjudication. Readers may recall that the Bill provided that agreements as to costs are invalid unless made after the adjudication starts. The aim of this was to outlaw clauses that made one party bear the costs of the adjudication regardless of the outcome, thus acting as a deterrent to using adjudication. The Bill also had the unintended consequence of preventing

the parties from agreeing in their contract that the adjudicator could decide what proportion of his fees and expenses each party should pay. The amendment made at Third Reading is aimed at removing this unintended consequence.

The Bill, with these two Government amendments, was passed at Third Reading. The amendments were later approved by the House of Lords.

The Minister said at the Third Reading there will be a consultation on the Scheme for Construction Contracts, probably starting early in the New Year. Whether that will delay the coming into force of the Act remains to be seen.

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“The courts are not easily convinced that an adjudicator has exceeded his power or has infringed the basic rules of natural justice..’

## Adjudication tactics - the rush to judgment

The adjudication process lends itself to tactical thinking and participants in the process have deployed a number of tactical devices over the years to try to secure an advantage.

‘Ambush’ was added to the lexicon of adjudication soon after the statutory process was introduced. Claimants realised that there was considerable advantage in taking time to prepare a claim and serving it at the most inconvenient moment leaving the other side to scramble around to put together a response in a matter of days. There were tales of notices of adjudication being served on Christmas Eve. Whilst this extreme version of the ambush certainly does happen, there seems to be no evidence that it is commonplace. (See Report 9 from the Adjudication Reporting Centre at Glasgow Caledonian University)

Another common tactic has been to limit the ambit of an adjudication by carefully drafting the notice of adjudication to refer only a narrowly formulated dispute. It is clear from the many cases on the subject that the adjudicator’s remit is limited to the dispute identified in the notice. If there are other issues that the responding party wants decided, he must start his own adjudication. Clearly, the tactical response from the responding party must either be to derail the first adjudication if possible or to start his own adjudication as soon as he can. A key question will be: does the responding party have to pay out whatever the claiming party wins in the first adjudication and then try to claim it back if he is successful in the second adjudication or can he avoid doing so by setting off his claim or his adjudication award against the amount awarded against him in the first adjudication? Two recent decisions have addressed these questions. Before we come to them, let’s look at the approach of the courts in previous cases.

One of the strengths of the adjudication process has been the robust approach which the courts have taken to the enforcement of adjudicator’s awards. The courts are not easily convinced that an adjudicator has exceeded his power or has infringed the basic rules of natural justice (just about the only two bases upon which enforcement might be defeated). They are also cautious about attempts to stay enforcement judgments on the basis that the successful party would be unable to pay the money back if the adjudicator’s decision ultimately turns out to have been wrong.

The courts have dealt with a number of cases where a party on the receiving end of an adverse adjudicator’s decision has sought to avoid paying up on the grounds that it has good claims against the other party which should be set-off against the adjudicator’s award. By way of example:

In *Interserve v Cleveland Bridge* there was a series of adjudications. Interserve were the winners in adjudication number two. They were awarded £1,368,270 including interest. Cleveland did not pay up so Interserve sued for payment. Some ten weeks later, on the day of the hearing of Interserve’s enforcement claim, the decision in adjudication number 3 was issued. Cleveland won this one. The amount payable to Cleveland under adjudication number 3 was £1,450,352.90. Cleveland said that this should be set off against the sum awarded in adjudication number 2 or at the very least, they should not be ordered to pay up on adjudication number 2 until their application to enforce the decision in adjudication number 3 had been decided. There was also the prospect of adjudication number

4 in which Interserve would claim a further substantial sum. The court said it would enforce adjudication number 2 and Cleveland would have to wait its turn to try to enforce the decision in adjudication number 3 later.

In *Hillview v Botes*, Hillview sought to enforce a substantial adjudication award. In the meantime, Botes had started proceedings for payment of its final account. It thought its claim was bound to succeed and sought summary judgment. It asked the court to delay enforcing the adjudicator’s decision until the summary judgment application was heard about a month later. ‘No’ said the court. The adjudicator’s award was to be paid and it could be repaid later if Botes’ final account claim succeeded.

There are, however, some limited circumstances where it is permissible to set-off against sums awarded by an adjudicator. In *Balfour Beatty v Serco*, the judge held that it was permissible to deduct liquidated damages from sums awarded by a adjudicator when it follows logically from an adjudicator’s decision that the employer is entitled to recover a specific sum by way of liquidated damages, provided that the employer





has given proper notice (insofar as required). Typically this will arise when the adjudicator deals with an extension of time claim but does not deal with liquidated damages consequent on his decision. The court said that where the entitlement to liquidated and ascertained damages has not been determined either expressly or implied by the adjudicator's decision, then the question whether the employer is entitled to set off liquidated damages against sums awarded by the adjudicator will depend upon the terms of the contract and the circumstances of the case.

This all sets the scene nicely for our two recent decisions. First up was *Hart v Smith* on 3 September 2009. The Smiths engaged Hart to convert three barns into four dwellings. Disputes arose and there were two adjudications. In the first, Hart claimed payment under two interim certificates. Hart was successful and was awarded £79,900.43.

The Smiths then started adjudication number 2 claiming that they were entitled to certificates of non-completion and to payment of liquidated damages (this was all under a JCT Standard Building Contract, 2005). They also claimed

repayment of £7,381.20 which the contract administrator certified they had overpaid. They served a withholding notice for this sum and the liquidated damages.

The adjudicator decided that the Smiths were entitled to the non-completion certificates but said he could not issue them himself. He also decided that until they were issued, there could be no entitlement to liquidated damages. Hence, he did not award liquidated damages.

Following the decision, the contract administrator issued the non-completion certificates and the Smiths claimed the liquidated damages. The issue for the court was whether the Smiths could deduct the liquidated damages from the sums they owed under the decision in adjudication number 1. The court held that they could not. The adjudicator had made no finding as to liquidated damages and it could not be said that the liquidated damages claimed followed as a matter of logic from his decision that the Smiths were entitled to certificates of non-completion.

The second case was *JPA Design and Build v Sentosa*, decided on 28 September 2009. This was another case

of multiple adjudications. JPA had an award for payment of £300,000 which was the advance payment due under the contract. Sentosa had an award of £180,000 for liquidated damages. Sentosa could not deduct the liquidated damages from payments to JPA because they had not served a withholding notice. Could they set it off against the £300,000 adjudication award in favour of JPA?

This was not a case like *Balfour Beatty v Serco* or *Hart v Smith* where it was argued that the entitlement to liquidated damages was a logical consequence of an adjudicator's decision. This was a case like *Interserve v Cleveland Bridge* where there were two adjudication decisions awarding payments in opposite directions. This case differed from *Interserve* in that not only did Sentosa have an adjudicator's award but they also managed start enforcement proceedings and get them to a hearing at the same time as JPA's enforcement was heard. That, it seems, was a crucial difference and the set-off was allowed.

There are lessons to be learned from these cases. The best way to deal with an adjudication that is framed in a way that prevents you bringing in claims you want to make, is to start your own adjudication as soon as possible to give yourself the best chance of having any enforcement proceedings heard at the same time. Secondly, you need a little tactical thinking of your own. If it had been possible in the *Hart* case, it would have been better for the Smiths if the contract administrator had issued the non-completion certificates and if the liquidated damages had been demanded before starting the adjudication. Entitlements that may at first seem to follow as a matter of logic from an adjudicator's decision often do not follow on closer examination. The *Balfour Beatty v Serco* line of authorities will be of limited application.

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'There is potential for misunderstanding and uncertainty whenever the drafting is not spot on'

# Overage clauses - lessons to be learnt from *Chartbrook v Persimmon*

Overage clauses are often used as a good way to protect both Buyer and Seller of development land from the uncertainties of the planning process, or fluctuations in market prices.

The idea is simple. The developer pays a guaranteed minimum price when he acquires the site, and agrees to make a further payment at a later date depending on the outcome of his planning application, or actual sales values.

The legal mechanics and drafting are often very complex and the subject of detailed one off negotiations. There is potential for misunderstanding and uncertainty whenever the drafting is not spot on, and these cases are ripe for litigation given the very large sums which are often at stake.

A recent example is *Chartbrook v Persimmon* which was finally decided by the House of Lords on 1 July 2009.

Chartbrook brought their claim under a contract by which they had sold development land to Persimmon on which Persimmon were to build new apartments. Chartbrook believed they were entitled to an additional payment of £4,484,862. Persimmon thought that Chartbrook were entitled to an additional payment of £897,051. Chartbrook won the trial, and won in the Court of Appeal, but they lost in the House of Lords on a unanimous decision. There is a lesson here that the outcome of litigation is an uncertain business even when judges in the High Court, Court of Appeal, and the House of Lords are considering competing interpretations of contracts drafted by lawyers. However, the unanimous decision of the House of Lords should give us signposts for the future.

The House of Lords were prepared to base their decision on the underlying

purpose of the contract, rather than a strict grammatical interpretation of the words used. In considering the contract in this way they came close to blurring the rule that where there is a written contract the courts can only decide what it means against the background facts, and not by evidence from the parties themselves of what they had actually intended at the time of the contract.

At the heart of the case was a formula for calculating Additional Residential Payments to be made by Persimmon depending on the outcome of ultimate sales values, which read:

23.4% of the price achieved for each residential unit in excess of the minimum guaranteed residential unit value less the costs and incentives.

Chartbrook said that this meant:

ARP = 23.4% of (£ Price achieved minus £ Minimum Guaranteed minus £ Costs and (incentive)).

Persimmon said it meant:

ARP = [23.4% of (£ Price achieved minus £ Costs and (incentives))] minus £ Minimum Guaranteed.

It is a shame the lawyers did not use Year 10 algebra rather than uncertain wording.

The natural reading of the words used favoured Chartbrook. However, on the facts and the valuations it was obvious that the idea was that 23.4% was the element of the land value in the sale price of the finished apartments and the mechanism in the contract was intended



to give Chartbrook an increment to the price which Persimmon had already paid for the land in the event that sale prices were higher than anticipated at the date of the contract.

The minimum guaranteed payment was meant to reflect the land value element. The additional residential payment similarly was meant to reflect the increase in the land value element, and was not intended to be a proportion of the value of the completed development. Chartbrook only contributed the land. Why would Persimmon agree to pay Chartbrook more than the value of that contribution?

The trial judge and two out of three judges in the Court of Appeal were not prepared to look further than the natural reading of the words used, and considered that they were not able to take into account the facts and the valuation evidence which made sense of those words.

Persimmon went to the House of Lords thinking they would need to persuade the Court to overturn the rule which excludes evidence of what was said or done during the course of negotiating the agreement for the purpose of drawing inferences about what a contract means.

In the event, the House of Lords was able to reach a decision in favour of



Persimmon without disturbing this long established rule. Two points of principle emerge from the House of Lords decision, both of which support the general trend in reported decisions on the interpretation of contracts that the Court should be ready to recognise and enforce the parties contractual commitments even where those commitments are not expressed as clearly as they would be in a perfect world.

First the House of Lords decided the case on the basis that:

Something has gone wrong with the language - not, in this case, with the meaning of words, but with the syntactical arrangement of those words. If, however, the context drives one to the conclusion that this must have happened, it is no answer that the interpretation does not reflect what the words would conventionally have been understood to mean.

In other words, the contract would be interpreted in line with Persimmon's view of the commercial reality of the deal, rather than the natural meaning of the words taken in isolation from their commercial context.

Second, the House of Lords said that if the proper interpretation of the meaning of the contract had been different, the House of Lords would have been prepared to step in to rectify

the agreement on the basis that the document had been signed by the parties in the mistaken belief that it represented what they had previously agreed as it appeared from their pre-contract correspondence and the oral evidence given at trial.

There are subtle distinctions here. Pre-contract evidence is not admissible to prove the intention of the parties for the purpose of interpreting the contract, but it is admissible for the purpose of establishing 'prior consensus' to see whether or not the contract should be rectified.

The practice of the House of Lords in this case (which should be reflected in more junior courts in cases to come) is that it is very important for the courts to give sensible commercial effect to commercial contracts, even where the drafting is not all it should be.

It is disappointing that Persimmon had to go all the way to the House of Lords to get the right result, but it is encouraging to think that Courts of Law are also Courts of Justice, and to see pragmatic decisions which produce a fair result interpreting the parties true commercial intentions, even where specific words used are less than crystal clear.

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## Newsbrief

### Services for Construction Contractors - Fixed price legal work

Is the prospect of open-ended, hourly rate based fees deterring you from taking the top quality legal advice you need?

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- Fixed-price contract reviews - our team will review and provide advice on contracts, warranties and other documents at fixed prices, alerting you to the key risks in the documents you are asked to sign without the uncertainty of hourly rate based fees
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If you would like further information on our fixed fee products, please contact Mark Clinton on 01293 742811 or [mark.clinton@thomaseggar.com](mailto:mark.clinton@thomaseggar.com) or John Kittow on 01293 742791 or [john.kittow@thomaseggar.com](mailto:john.kittow@thomaseggar.com)

'The production of the design and approval process must dovetail with the technical services agreement and the operating agreement.'

# Legal issues in hotel procurement

Procuring a hotel, whether as the owner or as the architect or project manager on behalf of the owner is different from procuring any other building. How you may ask? Well many of the principles are the same, but there are agreements between the owner and third parties which must be considered from the outset when constructing a hotel.

A hotel is a unique asset insofar as it is usually owned by one party and operated by another, often as a branded hotel. The hotel owner usually (but not always) retains responsibility for the building and maintenance of the hotel, whilst the operator sets out detailed requirements regarding the specification. There are documents such as technical services agreements and management agreements which are important from the construction point of view. The design and construction must meet all the operator's requirements. If this is factored in from the outset, this should not delay the project or increase the cost.

We advise that the lawyers who negotiate your technical services agreement and management agreement are the same lawyers who draft your construction documents. They will be different people, but if at the same firm, they will communicate with each other and close communication and exchange of information is the key.

The form of procurement, in other words design and build or not, Novation or not, NEC, JCT, PPP2000, FIDIC or bespoke terms, pre construction services agreements or not, all depend on the particular project timetable, site risks and the management agreement. The management agreement contains provisions regarding:

- the specification;
- the responsibility for maintenance;
- the timetable for opening including periods for a test run and a soft opening (the periods between

completion of a hotel and opening to the public set aside for installing the IT systems, ordering the supplies and outstanding equipment, training the staff and testing the systems.); and

- the approval of design and specifications by the operator.

If your construction contract and timetable are not back to back with this agreement, the outcome will most certainly mean a cost to the client in sorting out the mess.

Hotel procurement in today's market often involves a mixed use scheme or a scheme of serviced apartments and a phased completion planned in order to begin generating income from the hotel prior to completing the remainder of the scheme. This will give rise to access, health and safety and business interruption issues. All factors which must be considered and dealt with in the contracts with the designers and the contractor and most importantly in the management agreement.

You will also need to ensure that your consultant's appointments address hotel specific issues such as, a high degree of co-operation and integration with other consultant's designs from the outset. For example the architect, structural engineer, M&E engineer, interior designer, lighting designer and kitchen designer will all need to be involved in the design of the restaurant, bar and kitchen areas. The earlier all consultants are on board the better. The design must comply with the operator's technical requirements which depending on the brand can be



extensive. The production of the design and approval process must dovetail with the technical services agreement and the operating agreement.

The same principles apply for the contractor. The owner and operator want high degrees of control over the design and specification. The contractor must work to designs produced by the interior designer, lighting designer, kitchen designer etc which are specified in detail. The contractual matrix needs to be carefully considered when putting the contracts together so that it works. This is problematic if one uses the standard design and build contract, lets face it, this is not a case of handing the final design decisions over to the contractor and this difference must be reflected in amendments to the terms.

The issue of practical completion is an important one, particularly if the contractor is not also carrying out the installation of the furnishings and equipment. The management agreement must be back to back with issues such as practical completion under the building contract, sectional completion, if any, defects liability periods and insurance of the works.



'The penalties on conviction include unlimited fines and 'remedial' and 'name and shame' orders.'

## Corporate manslaughter know the risks

One third of all work related deaths so far this year have been in the construction industry. The HSE tells us that over the last 5 years there was an average of 3.4 deaths per 100,000 construction workers. The good news is that the numbers are falling, but whether that is because of safety improvements or is simply a sign of the economic times remains to be seen.

April 2008 saw the introduction of The Corporate Manslaughter and Corporate Homicide Act 2007 which created a new criminal offence of corporate manslaughter that only companies can be charged with. The penalties on conviction include unlimited fines and 'remedial' and 'name and shame' orders.

The Act has been brought in as a result of public demand following a perceived failure to hold companies to account for major public disasters. Whilst this was the driving force behind the Act, the application of the Act is not limited to large scale catastrophes and given its record, the construction industry in particular vulnerable.

The first prosecution under the Act has been brought against Cotswold Geotechnical Holdings. A pit collapsed whilst a member of staff was taking soil samples. The company has been charged and faces an unlimited fine if convicted. A director has been charged with the criminal offence of gross negligence manslaughter and faces life imprisonment, if convicted.

The following elements must be present before a company can be convicted:

The company must owe a 'relevant duty of care' to a victim who is connected to the company in some way. This stems from the law of negligence and examples include the duty to ensure a safe system of work for all employees and the duty owed airlines to their passengers.

The company must breach that duty by the way its functions are managed and/

or organised. In essence this is senior management failure and can be either individual or collective. The relevant duty will extend to sub-contractors who are employed by the company.

The senior management failure must cause the death. It does not need to be the only cause.

The breach of duty must be gross. The test is whether the conduct that constitutes the failure falls far below what would reasonably have been expected.

In addition, the jury must consider:

- whether the company failed to comply with any health and safety legislation;
- the seriousness of that failure; and
- the degree of the risk of death.

Further, the jury may also consider:

- attitudes, policies, systems, practices and matters likely to have produced a management failure or a tolerance of it; and
- health and safety guidance.

It is relatively easy to see how all of this will apply in the case of small companies. It will be interesting to see how the law is applied to larger, more complex organisations. For example, will a parent company be liable for its subsidiaries' failings? What approach will be taken where there are many layers of management? The first case will not answer these questions as it involves a small family company but the courts will, no doubt, be called upon to grapple with them in subsequent cases.

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Then you have the banks. We know what the banks are looking for when it comes to financing. A mistake often made is to negotiate a management agreement, appoint a design team and then go to the bank for finance. Bank's are looking for specific terms in all of your contracts, they want to be involved in negotiating the management agreement and they want the appointments of the professionals and contractor to include certain terms, not least of which are prescribed third party rights or collateral warranties in favour of the bank. The best advice we can give is to have a proper appointment drafted by your lawyer who specialises in the hotel sector prior to tendering for consultants and contractors. This will give you far better value for money and access to funding with far less hassle and legal cost.

The message is the same for all projects, legal and procurement costs are higher if you appoint your project manager and lawyer once the horse has bolted.

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Whatever the size of the company, it will be able to avoid liability if it can show that it took reasonable precautions to guard against the risk in question. The key to self-protection is the taking of reasonable precautions backed up with a paper trail.

You could consider insurance as second measure to protect yourself. Cover may be available for the legal costs of defending a prosecution but as a matter

of public policy you cannot insure against a criminal fine.

As 33% of work place deaths are in the construction industry, it seems inevitable that this sector will see an increasing number of prosecutions.

Be aware. Review and tighten your health and safety procedures. Take reasonable precautions.

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