



Welcome to the latest edition of Construction Law. Our lead article provides an update on adjudication and explores the effects associated with having an adjudication agreement in your contract.

John Kittow reports on Overage disputes and the various reactions overage deals receive from the courts and developers alike.

We also have articles on the Construction Act's second consultation paper, the effects of extending the Act to cover oral and partly oral construction contracts and what you should consider before mediating.

We have included details of our Fixed Fee Construction Adjudication service and we'd be happy to discuss this further with you.

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Adjudication update

We all know that if you draft an arbitration agreement in your contract this agreement may prevent you from litigating in Court. Either party is able to ask the Court to stay any proceedings because in fact the parties agreed to settle their disputes by way of arbitration and the Court has no discretion as to whether to stay or not. It must grant the stay.

However, the interesting issue regarding whether an adjudication agreement has the same effect is whether either party can ask the Court to force the parties to adjudicate before going to Court. In *DGT Steel and Cladding v Cubbitt Building and Interiors Limited [2007]* the Court found that your adjudication agreement may very well be phrased in such a way that it precludes you from going to Court rather than adjudicating. One might ask why you would prefer to go to Court rather than adjudicate, or at least to have the choice, and the answer is that you would prefer a Technology and Construction Court Judge to deal with the dispute rather than a Quantity Surveyor or Adjudicator without the same level of legal expertise. You may also wish to recover your legal fees expended.

Furthermore, the TCC is now so efficient, that it is no longer a case of waiting for years before your matter is decided. However, if you want to leave this choice open you need to ensure that the adjudication agreement drafted into your contract is not drafted in such a way that the Court finds that the parties have agreed to settle all disputes by way of adjudication first. In the judgment of *DGT Steel*, the Court was very willing to grant a stay because it thought that it was a good idea to have the matter heard by a building expert first and it was keen to respect the agreement of the parties as to their chosen dispute resolution mechanism.

Of course the principle can work both ways and you can now draft your

adjudication provisions so that you force the parties to adjudicate before they litigate with the confidence that the Court will grant a stay regarding the Court proceedings allowing you to adjudicate first.

The other interesting decisions regarding adjudication in the past few months have involved the question of whether or not the construction contract is in writing. In the case of *ART Consultancy Limited v Nevada Trading Limited [2007]*, an interesting question arose. Some of the issues referred to the adjudication were evidenced by a contract in writing but other issues were not. The question which would be of interest to those who adjudicate is whether or not the fact that the adjudicator could not have jurisdiction regarding part of the claim, namely, that part where there was no contract in writing, would result in the adjudicator having no jurisdiction over all of the claim, or whether the adjudicator could decide parts of the claim over which he had jurisdiction and refuse to decide parts of the claim in respect of which he had no jurisdiction.

continued overleaf

In this issue

Overage disputes - recent decisions	2
Construction Act Third time lucky?	4
Contracts in writing... why bother?	6
Mediation... things to look out for	7
Newsbrief	7

continued from front cover

In other words, could you bundle up or divide the claim when it comes to questions of jurisdiction. The Court found that you could. The Court found that the adjudicator was right to decide those issues which were evidenced by a contract in writing, and was right not to decide those issues which were not evidenced by a contract in writing, and that he was entitled to carve up the Referral in such a way.

The other case which considered the question of whether or not a contract was in writing is *Mott MacDonald Limited versus London and Regional Properties Limited [2007]*. This case is a good example of the fact that your construction contract still needs to be evidenced in writing. In this case a letter of intent had been the subject of substantial amendments that were partly evidenced in writing, and partly to be inferred from conduct. The Court held that the agreement was not in writing, nor was it evidenced in writing.

It would therefore appear that the issue of a contract being in writing is still very much alive and can still be very confusing. In *MOTT*, some of the contract was not evidenced in writing and the Court found that a sufficient amount of the contract was not evidenced in writing and therefore the whole contract was not evidenced in writing while in *ART*, the Court found that although some of the claim was not evidenced by a contract in writing, the part that was could be decided, and the part that wasn't could be discarded.

Given the subtleties and technicalities that can be involved in this simple question of whether your contract is in writing or not, we would expect to see some more cases on this issue in the future.

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Overage disputes – recent decisions

The number of cases which are reported on Overage disputes is evident enough of the inherent problems with the type of deal which includes differed additional payments.

A conditional contract or call option to purchase will usually be preferable where a developer has a clear idea of his plans for a scheme and is therefore able to assess what risk he is prepared to take and what price he is prepared to pay.

However overage deals have their place. For instance where the uncertainties of future development are such that a developer cannot commit to do more than offer to buy at a lower price, and agree to share potential additional profit with the seller as and when this might be realised in the future.

Typically public sector bodies and charities will look for the comfort of an overage provision when selling off land, whether as a possibility of development or enhanced value in the future.

The problems which get to court come in various categories.

- 1 Is there an agreement at all?
- 2 Drafting problems and rectification
- 3 Implementation
- 4 Enforcement

All are differed by money. There can be very substantial sums at stake.

1 Is there an agreement at all?

Anyone would be foolish to invest in a development without a written agreement, but that is what happened in *Yeomans Row Management v Cobbe (2006)*. Yeomans Row owned property. They had an agreement with Cobbe which was not put in writing, that Cobbe would apply for planning consent for residential development, and once granted Yeomans Row would sell the property to Cobbe for £12 million, plus 50% of the gross proceeds of sale of the property after development in

excess of £24 million. Cobbe spent about £200,000 in obtaining planning consent (although Yeomans Row did not accept this figure), and Yeomans Row then tried to back out of the deal, and wanted to renegotiate.

The Court of Appeal decided that in relying on the spoken agreement, making a substantial investment in the successful planning process, Yeomans Row had established an equitable interest in the property and was entitled to 50% of the increase in value resulting from the grant of the planning permission.

The courts will generally be sympathetic where there is an agreement, which one party has relied on and incurred substantial costs which creates value in an asset owned by the other party.

2 Drafting problems and rectification

Not putting an agreement in writing is a problem, but so is an agreement which contains errors. In *George Wimpey UK v VI Components* there was a dispute on the formula for calculation of overage. The formula in the final agreement did not include an adjustment in Wimpey's favour which had been agreed in previous drafts. Wimpey failed to notice what they believe to be an error. VI maintained that the formula in the final agreement was correct.

The outcome of this type of case depends on the evidence. The general policy is that when an agreement is signed the parties are assumed to know what they are doing, and that document represents their true intentions. The court will only find there is an error which should be



rectified where the prejudiced party can prove that it believed the disputed term was included, and the benefited party was aware of the problem and did not raise it at the time, thereby taking unfair advantage of the mistake.

Wimpey lost this case. The Court of Appeal found that Wimpey had not provided convincing evidence that VI had shut its eyes to the obvious or wilfully or recklessly failed to do what an honest and reasonable person would have done.

3 Implementation

Where an agreement only takes effect in particular circumstances, ie notices have to be served by a particular date, then it is very important to comply to the letter of the agreement.

In *Rennie v Westbury Homes* an extension to an overage agreement had to be triggered by service of a notice within the last year of the overage period (for which time was of the essence) and by payment of £20,000. Solicitors served the notice in time, but in error were a day late in paying the £20,000. The question for the court was whether the overage extension had been triggered or not. The solicitors were lucky. The court decided that while delay in serving the notice would have been fatal, the marginal delay in payment did not have such drastic consequences. The result could easily have been very different.

4 Enforcement

As a land owner, negotiating advantageous overage terms in the first place is one thing. Making them stick some years down the line is another, particularly as the property has been sold on before the development gain is realised.

The best and most common security is by agreement that a restriction is registered at the Land Registry prohibiting a disposal without consent, which will only be given with a similar agreement from the new owner.

Other methods of securing overage rights such as easements and restrictive covenants in particular can run into difficulties. The lands tribunal will generally modify or discharge a covenant where planning permission has been granted for a development, and this can knock on to the enforcement of conditions of use of an easement such as a right of way, if these are also linked back to the restrictive covenant. Although the lands tribunal will award a compensatory payment in these circumstances, this will not be calculated by reference to the development gain.

On the other hand developers must be cautious where a development site has the burden of easements such as the right to light of third party adjoining owners. The courts will only award damages rather than an injunction

restraining development where the injury to the third party right is small, and suitable for compensation by a small money payment, and the circumstances and conduct of the parties does not justify more than financial compensation.

In *Regan v Paul Properties* an injunction was granted to remove a part built penthouse which obstructed light to a neighbouring property, and the court placed considered weight on the fact that the neighbour had consistently complained about the development before construction, and the developer appeared to have taken a calculated risk in proceeding.

Conclusion

The twists and turns of the negotiation and implementation of overage provisions are wide-ranging. The number of cases which reach trial indicates the uncertainties and difficulties in predicting the outcome. Given the sums often involved, this is an area which will continue to be a subject of great importance to developers and their advisers.

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Construction Act Third time lucky?

The first review of the Construction Act 1996 was announced in the March 2004 Budget by the then Chancellor, Gordon Brown and, following this announcement the first Consultation paper proposals appeared in March 2005. Further proposals were issued in January 2006 and a second consultation paper was then issued during June 2007. Interested parties had until September 17 to respond.

The three main areas which this most recent paper deals with are:

1 Adjudication where it suggests:

- Improved access to the right to refer disputes to adjudication
- Applying the Construction Act to all contracts
- Ensuring a fair allocation of costs.

2 Payment where it suggests:

- The prevention of unnecessary duplication of payment notices
- The clarification of the issue of Section 110 (2) Payment Notices
- The clarification of the contents of Payment Withholding Notices
- The ensuring of an interim entitlement to payment.

3 An improvement of the right to suspend performance by allowing the suspending party to claim the resulting cost and delays.

I could write at length on any of the above but the proposals for a payment framework are important because it is a complex area which is frequently misunderstood by both contractors and employers.

Background

The current law is set out in the following sections of the Act:

- Section 109 introduces the right to instalment, stage or periodic payments; and

- Section 109 (2) provides that the parties are free to agree the amounts of payments and the intervals and circumstances in which they become due.
- Section 110 (1) requires the contractor to have an adequate mechanism for determining what will become due and when.
- Section 110 (2) provides that the payer gives the payee early communication of what will be paid.
- Section 111 provides that the payer may not withhold money unless he has effectively communicated this to the payee.
- Section 112 provides the payee may suspend performance when the amount due is not paid by the final date for payment.
- Section 113 prohibits so called 'pay when paid' clauses.

The payment framework introduced by the Construction Act created a means of crystallising the amount to be paid on or before the final date for payment for each instalment, stage or periodic payment. It did this by introducing a sum due and a due date together with a requirement to issue notices during the payment period to communicate the basis on which the amount paid or proposed to be paid had been calculated.

The due date starts the payment period.

The payment period is the time between the due date and the final date for payment.

The sum due is a notional amount determined by the contract which begins the process of crystallising the amount payable on the final date for payment.

The final amount for payment is the sum due minus deduction.

Duplication of payment notices

The paper explains that it wishes to prevent the unnecessary duplication of payment notices. At present Section 110 (2) requires the payer to issue a payment notice setting out the payments made or proposed to be made not later than five days after the date on which the payment becomes due. Under most contracts with certificates there is an unnecessary duplication of information contained within the certificate.

The paper proposes that the payment notice should be issued by a person identified in the contract or a person who has been identified in a notice to the payee.

Service of a Section 110(2) Notice

The paper also proposes that the requirement that a Section 110 (2) payment notice should be clarified.

At present this Section provides that a payment notice is to be served in certain circumstances, such as where a payment is due or where the payment would have been due to combination of circumstances.

It is proposed that the Section be amended so that a payment notice will be required where a payment would have been due if:





- The party performing work under the contract had carried out his obligation of the contract.
- No set off was permitted by reference to any sum claimed under the contract or one or more other contracts.
- No abatement was permitted in respect of the work.

As the paper rightly points out the current drafting of Section 110 (2) may lead the payer to mistakenly conclude that he need not issue a payment notice because of certain deductions from the sum that would have otherwise have been due. Payment notices are an important tool in ensuring early communication of payments made or proposed to be made and are therefore important even when no payment is proposed because the work has not been carried out.

Clarification of payment and withholding notices

Under the Act a payer has to serve Section 110 (2) payment and Section 111 withholding notices on the payee. As I said earlier there is much confusion in the industry about how they relate to each other, what they should contain and how they create a sum due. This can lead to the needless issue of two separate notices when a single payment notice would suffice.

To ensure clarity the payer would have to set out in the payment notice the amount (if any) that he has paid or

proposes to pay. Where it differs from the amounts that would have to be paid had the payee carried out his obligations under the contract the paper proposes that the payer would have to set out the grounds for paying less than the amount calculated. Each ground would have to be set out along with the amount attributable. It is also proposed that all withholding notices should be in the same format as a Section 110(2) notice so that the withholding notice becomes a revision of the payment notice.

The aim is to ensure a clear connection between the information and the Section 110 (2) notice and that required to withhold payment in accordance with Section 111. It is hoped that this would remove unnecessary duplication in the system.

Clarity of the sum due

The paper believes that the sum due is the cornerstone on which the rest of the payment structure is built. The sum due can easily be defined in contracts controlled by an architect or an engineer who must issue a certificate. In contracts without certificates the current payment framework could fail to create a clear understanding between the parties as to what is the sum due.

Additionally the paper proposes that where the payer has issued a payment notice this amount becomes the sum due which can then be subject to withholding. Non payment of the remainder would provide the payee with the right to suspend performance:

- Where the payment notice was not issued the sum due should be determined by a new fallback provision which would be the amount claimed by the payee issued before the final date for payment;
- Where that claim determines the sum due but is issued after the due date, the payment period would then run from the date of the claim to allow the payer time to issue a withholding notice.

Use of pay when certified clauses

This is perhaps one of the most controversial issues in the construction arena today. The present law is contained in Sections 110 (1) and 113 of the Act.

The paper proposes to prohibit pay when certified clauses. This is in fact the same proposal as set out in the January 2006 proposal but unfortunately the paper does not grasp the thornier issue of pay when paid clauses. There is a clear danger that the main contractor would have to pay the subcontractor before he is paid himself but it is in keeping with the purposes of the Act for funds to be distributed through the construction supply chain promptly. The paper aims to ensure that, provided a subcontractor has completed the work he has been engaged to do, once he issues his invoice the payer must pay regardless of whether a certificate has been issued under the main contract.

There is no doubt that the proposals to prohibit the use of pay when certified clauses are a welcome development but clearly much further work will have to be done to ensure that pay when paid clauses are finally prohibited.

Quite when the very laudable proposals contained in the Second Consultation Paper will come into effect, if at all, is hard to predict but progress has certainly been made and it can only be hoped that time will be made to deal with it in this year's legislative programme.

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Contracts in writing... why bother?

We have already mentioned the Government's consultation exercise regarding possible changes to the Construction Act. One of the more controversial proposals is to extend the application of the Act to cover oral and partly oral construction contracts.

Section 107 of the Act says that all provisions relating to adjudication, withholding notices and so on, apply only when the contract is in writing.

The definition of a 'contract in writing' is a broad one. It basically means an agreement recorded in writing. It does not have to be a single document, but can be a series of emails or letters. Also, if a deal has been struck orally and later recorded in writing, it is a contract in writing for the purposes of the Act.

According to the Government's consultation, the proposal to extend the application of the Act to oral or partly oral construction contracts is not intended to encourage more oral contracts and 'nor is it likely to do so'. The Government is keen to see an end to challenges to adjudicators' decisions on grounds of jurisdiction, based on an argument as to whether the construction contract was in fact in writing.

The case against introducing the proposal is a strong one. There are those who say it will remove an incentive for getting the contract terms down on paper. Section 107 provides a strong incentive for the industry to commit its contracts to writing. Amending Section 107 removes this incentive. On the other hand, there are those in the industry (and they are

many) who still fail to commit their contracts to writing. Should we amend the Act for their benefit?

According to the Technology and Construction Court, in 2005 and 2006, 15% of claims for enforcement of adjudications related to whether the contract was in writing. Supporters of the Government's proposal will argue that these 15% of claims would 'disappear' if the Act was extended to apply to oral contracts, thereby saving the parties the time and money of fighting it out in court. However, would they disappear, or would those very same adjudications be challenged by some other means. As readers will know, there are many ways to challenge an adjudicator's decision on grounds of jurisdiction.

We also need to question whether adjudicators really have the time or the experience to deal with disputes about 'what was said' between the parties. The whole point of having the requirement that contracts are in writing, was so the adjudicator would have all the information before him in order to arrive at his decision within the 28 days he is allowed (without the need to consider oral evidence).

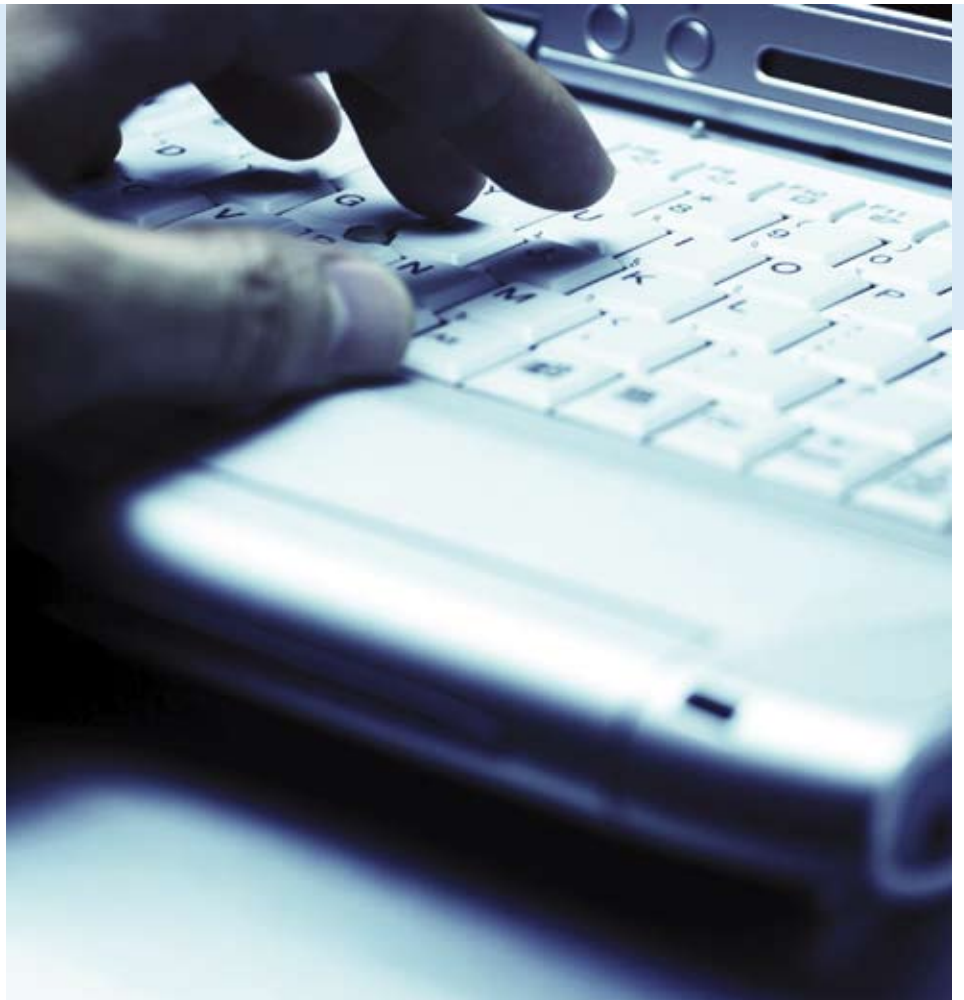
In the face of a dispute between the parties as to oral evidence, one party may

insist on an oral hearing. If the adjudicator agrees (which he is likely to do) this will inevitably add time and cost to the process, the complete opposite to why the process was set up in the first place.

The other argument against amending the Act is 'if it ain't broke why fix it'? There has been plenty of case law in recent years as to what is meant by a contract in writing. Most people know (even if they choose not to do it) that its best to get things down in writing so both parties know where they stand. If the Act is amended, it may lead to a spate of litigation cases at a time where the industry's understanding of the Act is fairly well settled.

The deadline for responses to the consultation is September 2007. It will be interesting to see the reaction of the industry. We will be sure to follow this up in our next edition of Construction Law. However, for the reasons mentioned above, the response on extending the application of the Act to oral or partly oral contracts is likely to be met with a fair amount of opposition.

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Mediation... things to look out for

Mediation is a popular way of resolving disputes. At its best, it is a quick, inexpensive and effective way of resolving disputes. However, if the process is not managed properly it can be anything but. Before you set off down the road to mediation it is important to consider the following.

Is mediation appropriate?

Mediation can be a far cheaper alternative to litigation or arbitration. However, it is important to remember that in general, mediators do not have specialist technical or legal knowledge (see more on this below). If the nature of the dispute involves technical or complex issues, or the parties require a legal remedy, it may be more appropriate to go down the litigation or arbitration route.

The role of a mediator is to facilitate an agreement between the parties, and generally he will not give an opinion as to who he thinks is right or wrong. A good mediator will identify the issues between the parties, their relative strengths and weaknesses, and encourage compromise wherever possible. Mediation can be most appropriate where the parties have an existing commercial relationship which, despite their dispute, they wish to maintain in the future. In a mediation, the parties can agree a variety of commercial measures to settle the dispute (e.g. one party issuing a public apology to the other), which a judge or arbitrator could never grant, as they are only interested in the legal rights of the parties.

Timing your mediation

With any mediation it is important not to mediate too early or too late. If mediation is held too early, the parties may not have enough information and advice to form a definitive view on the merits of their case, which may make them less likely to want to settle the dispute. This is particularly relevant where expert evidence is crucial in a case, and therefore the mediation may stand more

chance of success if there is a prior exchange of expert evidence.

On the other hand, if mediation is held too late, both parties may have already incurred considerable costs to get to that stage. If so, agreeing in the mediation how to deal with the apportionment of those costs can often become a more divisive issue than the original dispute, making it less likely that the parties will settle.

Choosing your mediator

There are a number of factors to take into account when choosing your mediator. It is very important that the mediator earns the trust and confidence of the parties. Therefore the parties should consider the personality and characteristics of a mediator in deciding whether they will be able to achieve this. Every mediator will have their own individual style. The best way of establishing whether a particular mediator is right for you is to speak to people who have been involved in mediations with the particular mediator under consideration.

If the dispute is particularly technical in nature the parties may consider appointing a mediator with experience in that field. For example, if the dispute involves complex design issues, a mediator with a background in architecture may be appropriate. The advantage of this is that the mediator will be able to ask the parties more relevant questions which may flush out the strength and weaknesses of both side's case and lead to settlement.

continued overleaf

Newsbrief

Fixed Fee Construction Adjudication

Is adjudication cost effective for claims up to £150,000?

Should Lawyers share risk on fees?

Thomas Eggar LLP say YES and YES and to prove it offer a new scheme for Fixed Fee Adjudication

Thomas Eggar LLP's Fixed Fee Adjudication Service is designed for disputes with a value of up to £150,000 where:

- There is a signed contract order
- The issues have been defined in writing
- The adjudication is completed within the standard period of 28 days from the date of referral

Thomas Eggar LLP is very willing to look at other Fixed Fee or Conditional Fee arrangements for cases which may not qualify for the standard scheme.

What do you get?

Advice from specialist construction lawyers who will:

- 1 Review the case, and
- 2 Represent you in the adjudication

What do you pay?

Preliminary review £850

Fixed price representation in adjudication

As referring party £9,150

As responding party £7,150

As referring party in claim for professional fees £2,150

These prices are subject to VAT and terms and conditions

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continued from page 7

Preparation is key

There is far more chance mediation will be successful if both parties are well prepared. Both parties should prepare a written case summary setting out the key issues in dispute and the position they are taking in respect of those issues. It may be useful for the mediator to receive the case summaries in advance of the mediation so he can prepare his approach to the conduct of the mediation.

As well as preparing their own case summary, both parties should consider the other side's case summary before the mediation as well as any other documents or evidence that will be relied on. It may be useful to come up with a list of questions you would like to ask the other side.

The parties should always keep their own case under review. It is always important to ask in respect of every issue in dispute, whether the issue is in fact worth fighting over or is it something that can be conceded so you can concentrate on the issues that do matter.

During the mediation

In order to achieve settlement, it is critical that the people with the authority to settle the dispute are present at the mediation. There is little point in proceeding with the mediation if the people with the power to agree a settlement are missing.

However, it is just as important that you do not have too many people on both sides attending. If you do, there is a danger of appearing 'mob-handed', and inevitably, the more voices and differing opinions in the room the less likely a settlement will be reached.

Finally, and perhaps most difficult of all, it is vital to remember the feelings of the other party. A settlement will only be reached with the consent of both parties, and that is only going to happen if the parties compromise. If either party is unable to compromise, or consider the dispute from the other side's point of view, a settlement of the dispute by mediation will be very difficult, if not impossible.

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