



Welcome to the latest edition of Constructionlaw. We publish this newsletter twice a year to update and inform readers with a mix of recent and forthcoming changes to the construction scene. This edition includes items on Risk Management, Health and Safety and Dispute Resolution.

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## Risk management - will we ever learn?

In an era when people are readier than ever to litigate it is essential that businesses turn their attention to risk management. It was with this in mind that we decided to focus on risk management in our 5th Annual Construction and Engineering Seminar this month. Risk management issues also permeate this edition of *Constructionlaw*.

In particular, a number of the issues addressed in this edition highlight the perils of failing to get project paperwork in order. The facts behind the examples given are far from unusual. In *Maggs v Marsh* we see another in a long line of cases where the building contract was not properly documented. After a trip to the Court of Appeal and many thousands of pounds in legal fees later, the parties to this relatively modest claim found themselves back at square one with a clear warning from the court that they should settle their differences.

Cases where work starts before contract documents are finalised are very common. They have been a regular feature in the courts for many years. We have all become used to the letter of intent which is intended to fill the gap. Unfortunately, letters of intent in many cases simply change the problem rather than solving it. In this edition we look at two such cases - *EDRC Group v Brunel University* and *Cunningham & Good v Collett & Farmer*, both of which were decided earlier this year.

In *Associated British Ports v Hydro Soil Services and others* (decided this summer) the employer called for a Parent Company Guarantee. It was not provided by the time the contract was entered into, so the

contract obliged the subsidiary to procure it. Could that obligation be enforced? Read on inside to find out.

As if that was not enough litigation involving problems with paperwork, we also consider, for good measure, recent decisions arising from assignments and from a poorly worded collateral warranty.

Even the best laid plans go wrong sometimes, but in the cases mentioned above the problems might easily have been avoided. They provide plenty of food for thought as to how we all might improve our risk management procedures.

Mark Clinton  
Construction & Engineering Unit

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# Drink and drugs in the workplace

*Construction News* reports (5 October 2006) that Laing O'Rourke have dismissed ten per cent of workers who took random drugs tests this year because they failed them. Meanwhile, a recent survey revealed that alcohol consumption was a problem in 90 per cent of businesses. Whilst many regarded this as a minor problem affecting only a handful of employees, 17 per cent of businesses described it as a 'major problem'.

Concerns in order of priority were:

- Loss of productivity and poor performance
- Lateness and absenteeism
- Safety concerns
- Effect on team morale and employee relations
- Bad behaviour or poor discipline
- Adverse effects on company image and customer relations

There are no precise figures on the number of alcohol or drug related accidents in the workplace but alcohol is known to affect judgement and physical co-ordination. Drinking even small amounts before or while carrying out 'safety sensitive' work will increase the risk of an accident. In some industries drink and particularly drug use is wide spread. Workers in the construction industry are six times more likely to be killed at work than other workers.

Even if drugs or alcohol are not consumed during working hours

employees can still be under their influence. For example, if someone drinks two pints of ordinary strength lager at lunchtime, they will still have alcohol in their bloodstream three hours later. Likewise a heavy drinking session over the weekend may still leave a person over the drink drive limit come Monday morning. However, blood alcohol concentrations lower than the drink drive limit still affect co-ordination, reaction times, judgement and mood. A problem with drug taking is that the effects vary substantially between individuals. Heavy or long-term drug users develop a tolerance and will generally use greater quantities of drugs. The indications of drug use may also be less apparent in these people. Even occasional users pose a problem to employers as the effects of drugs can last days.

## Duties of the employer

The legal position is that employers have a duty under the Health and Safety at Work Act to ensure, as far as reasonably practicable, the health and safety and welfare of its employees and further more to ensure that non-employees (the general public) are not exposed to risks to their own health and safety.

In blunt terms if you knowingly allow an employee under the influence of alcohol or drugs to continue working placing employees and others at risk **YOU COULD BE PROSECUTED**. There is further legislation in the Transport industry whereby operators of certain transport systems (including railways) would be guilty of an offence unless they could show that all due diligence had been used to prevent such an offence being committed.

Employers must also remember that possession of controlled drugs by an employee is a criminal offence punishable with imprisonment. Further



more if employees are "sharing" their drugs whilst at work, e.g. passing round a cannabis joint, the law will classify these people as drug dealers and the employer will also be criminally liable if they knowingly permit work premises to be used for this activity.

## What can employers do?

Employers need to act before drink or drugs cause an accident in the workplace. Supervisors and other managers need to be clear about company rules and what to do if employees' drinking or drug taking is affecting their work - most importantly they need to know the implications of ignoring such issues especially where safety could be compromised. Many companies have a policy which sets out their position on drinking and drug misuse. Written policies have several advantages not least less room for misunderstanding.

Some employers have decided to adopt drug screening as part of their drug policy. If you think you want to do the same, think very carefully about what you want screening to do, and what you will do with the information it generates. Screening by itself will never be the complete answer to problems caused by drug misuse. However a US study showed that companies that tested workers and job applicants for drugs, experienced a 51 per cent reduction in injury rates within two years of implementing a drug testing programme.

*Sarah Dineley, Associate 01243 813243*

# Third party claims - more from the courts

The two cases considered below deal with claims brought by parties with an interest in a development but who were not party to the original contracts with the contractor and professional team. In both cases the insolvency of a party involved in the original construction process limited the claimants' options.

## Is it ever too late to assign?

Property owners frequently have to commission reports or surveys for technical or planning purposes. Where possible, the benefit of any such reports should be assigned to the new owner when the property changes hands. Written notice of the assignment should be given to the author of the report, who would then know that the new owner has the benefit of the report.

In many cases reports are made available to a buyer but there is no assignment to the buyer on completion of the sale. In order to save time and costs the new property owner may seek to rely on an existing report without entering into any contractual relationship with the author, who is unlikely to be unaware of this. This was the position in *Offer-Hoar v Larkstore* (also known as *Technotrade Ltd v Larkstore Ltd*) which was decided by the Court of Appeal on 27 July 2006.

## The facts

- Starglade Limited sold a site to Larkstore Ltd with the benefit of planning permission which included a report by Technotrade Limited obtained to satisfy planning requirements.
- Larkstore, without Technotrade's knowledge or consent, used the report to carry out a residential development on the site. During the construction of the development there was a landslip which damaged adjoining properties. The contractor involved was insolvent so Larkstore's only hope was to pursue a claim against Technotrade based on the report. In order to do so, Starglade

assigned the benefit of the report to Larkstore. This was some five years after the land transaction between them.

- The main issue before the court was whether, following this assignment, Larkstore could recover substantial losses from Technotrade, as Starglade had not suffered any (significant) loss prior to the date of assignment. Technotrade sought to rely on a well established rule that an assignee cannot recover losses that could not have been recovered by the original contracting party.
- The court took the view that Technotrade were relying on a mistaken interpretation of that well established rule. What had been assigned was a 'cause of action' not a 'loss' so Larkstore's losses would not be limited to the losses accrued at the date of the assignment. The courts are keen to see that contract breakers are not prejudiced by assignments and that they are not able to rely on assignments to avoid liability altogether. To achieve that objective the court's approach is to look at what the original contracting party would have been able to claim for if neither the land transfer nor the assignment had taken place.

## Implications for authors of reports

Whilst restrictions on the right to assign are becoming common in letters of reliance given to third parties in relation to reports; the reports themselves rarely contain any such restriction. This recent Court of Appeal decision shows that a subsequent interested party (which could be a future owner or funding institution) does not have to enter into a separate arrangement with the author of a report to have the

benefit of a report. In the absence of any restrictions in the report, it can be assigned any number of times exposing the author to a greater likelihood of a potential claim.

## For interested parties

The case means that the theoretical black hole, into which it was once considered claims could disappear if assignments were not simultaneous with the land transfer, may have been filled. If it is not possible to effect an assignment simultaneously with the land transfer, purchasers and investors should provide in their property or funding agreements for the seller or borrower to execute any documentation necessary to give effect to any assignments in the future.

## Collateral warranty defeated

Collateral warranties are provided to buyers, financiers and tenants to provide a direct contractual remedy where there would not otherwise be one. However, in the case of *Safeway Stores Limited v Interserve Project Services Limited* (Technology and Construction Court 1 December 2005) the remedy was rendered worthless by the inclusion of very commonly used wording. Safeway engaged a developer, who in turn engaged the contractor (Interserve), to build one of Safeway's stores. Defects in the car park came to light which Safeway put right at its own cost (approximately £400,000). The developer settled the final account with the contractor at over £1Million but the developer became insolvent before this was paid.

The collateral warranty contained the following wording:

*'The Contractor shall owe no duty or have any liability under this deed which are greater or of longer duration than that which it owes to the Developer under the Building Contract.'*

The court held that the contractor was allowed to deduct from any sum it was liable to pay, money it was owed under the building contract. The fact that Interserve had not been paid meant Safeway could not recover from the contractor. The case highlights the need for beneficiaries of collateral warranties to take care in drafting these documents to ensure they are entitled to enforce their rights effectively.

*Patricia Nathan-Amisshah*

# Letters of intent – two cautionary tales

Getting the contract documents in order at the outset of a project can be a bit of a chore when so much else is happening to get the action going on site. If the paperwork is holding things up, the usual response is to issue a letter of intent. Problem solved. Or is it?

The invention of the letter of intent has led many of us into bad habits – some of us have been lulled into believing that there is no need to get the contracts in place on time. What happens when there is a dispute about valuation or defects but the contract never materialised? Two relevant cases have come before the courts in the last few months – one concerned valuation and defects issues. In the other, an architect was sued for advising a client to issue a letter of intent. Are you feeling worried now? Read on for some words of warning – and just a little comfort.

*ERDC Group Limited v Brunel University* was decided a few months ago. Brunel wanted to crack on with the project but full planning permission had not been granted. Planning permission was expected shortly so Brunel issued a letter of intent so that ERDC could get on with some design work. The letter was limited in time. As time rolled on and planning remained unresolved, further letters were issued. There were five letters of intent in total and the last of them expired on 1 September 2002. The work carried on and most of it was complete by the end of November 2002. When they received the contract documents in December that year, ERDC declined to sign them. They said they would only continue on the basis that their work was valued on a *quantum meruit* basis (a fair valuation) rather than by reference to the JCT rules in the unsigned contract documents which had been the basis of their previous payment applications and which had been referred to in the letters of intent. In fact, ERDC did work on but had not fully completed the work by the time they left site by agreement the following March.

The judge observed that sometimes letters of intent give rise to contracts and sometimes they do not. It all depends

on the drafting. In this case he had no doubt that the letters of intent gave rise to contracts. In fact, many modern letters of intent will create binding contractual obligations.

It was common ground that there was no contract after 1 September and that ERDC's right to payment was under the relatively modern legal right of restitution rather than under a contract. That gives a right to a fair value. The issue was how the entitlement to restitution was to be valued. Often the valuation is a cost based one. ERDC argued for that. Brunel said that a fair value should be arrived at by using the same rates and principles as applied under the now expired letters of intent. On the facts of the case the judge favoured Brunel's argument.

That was not the end of it. Brunel said some of the work was defective. They counterclaimed for the defects. This raised a tricky point in the law of restitution. In the absence of a contract, what basis is there for such a counterclaim? The judge was clear that Brunel could not simply deduct the cost of putting the work right. They needed a contract for that. They could however have the defects taken into account in deciding a fair value. Such an approach is likely to leave the employer worse off than he would have been with a contract. That is what happened here.

Barely three months later, the second letter of intent came under the judicial microscope in *Cunningham and Good v Collett & Farmer*. Mr Cunningham and Ms Good owned what was, by all accounts, a fine Georgian country house and they decided to refurbish it. Collett & Farmer were their architects. On 31 January an agreement was reached to issue a letter of intent to the chosen contractor so that work could proceed whilst a contract was agreed.

Things got off to a bad start and the project was soon in delay. The parties could not agree the contract, the claimants would not pay for work because of the delays and within three months there was a parting of the ways with the contractor. Matters went from bad to worse. The architects fell out with the owners over payment and suspended work. A firm of building surveyors were engaged to provide similar services to those for which the architects had been engaged. New contractors were lined up. They withdrew. More contractors were lined up. They went into administration. They came out of administration and started work. Incredibly, there was then a further twist when Mr Cunningham lost his job, he could not fund the work and the contractor abandoned ship. The works remained incomplete when the case came to court.

The architects sued for their fees and the owners counterclaimed for negligence. For our purposes, the important allegation was that of negligence in the advice given about the letter of intent. This judge too noted that there are letters of intent that do not give rise to contractual obligations and those that do – he also said that those most commonly in use do create such obligations. He had some useful points to make about when contractually binding letters of intent may be appropriate and when they are not.

He said: "*Letters of intent are too often used... as a way of avoiding, or at least putting off, potentially difficult questions as to the make-up of the contract and the contract documents. There is no doubt that, sometimes, they are issued in the hope that, once work is underway, potentially difficult contract issues will somehow resolve themselves. They are plainly not appropriate in such circumstances.*"



The judge went on to identify the following circumstances in which a letter of intent may be appropriate:

- the workscope and price are agreed or there is a clear mechanism for agreeing them
- the contract terms are (or are very likely to be) agreed
- the start and finish dates and contract programme are broadly agreed
- there are good reasons to start work before finalisation of the contract.

The nature and status of letters of intent are generally poorly understood. Their use usually introduces an additional risk and should be given careful consideration. The drafting must be undertaken very carefully and with a proper understanding of the relevant legal principles. If it is proposed to use one, we should begin by asking: what is the intended status of a

letter of intent? Do we intend it create contractual rights and obligations? Is it for the whole of the work or just a limited part - and if the latter, what happens when the limit is exceeded? How will you extract yourself from it if you need to?

Remember that if it has contractual force, such a letter probably brings with it the whole panoply of the Construction Act - payment terms, adjudication etc. It may also damage your negotiating position when it comes to trying to get the contract documents agreed later - see what happened in the ERDC case.

And the little bit of comfort? ...the architect was held not to have been negligent on the facts of the Cunningham case.

*Mark Clinton*

## Thomas Eggar Construction Unit - New additions

We welcome two new members of the team:



Zac Spyrou joined us in September immediately upon qualification as a solicitor. He completed his professional training with a City Practice.



Also joining following a stint in London is Kim Teichmann who is qualified in South Africa. She holds an MSc in Construction Law and Arbitration and has several years' specialist experience. Zac and Kim will work in both the transactional and disputes sides of our business.

## Newsbrief

### Construction Industry Scheme

The new Construction Industry Scheme comes into effect in April 2007. HMRC issued their second update in September and their Business Support Teams are now running seminars on the topic. For more details visit [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

### Construction (Design and Management) Regulations 2007

The draft of the new CDM Regulations was approved by the Health and Safety Commission on 17 October 2006, clearing the way for them to be presented to the Minister. Following his approval the publication of the Approved Code of Practice is expected in January 2007 with the new Regulations coming into force on 6 April 2007. The new Regulations will revise and bring together the CDM Regulations 2004 and the Construction (Health Safety and Welfare) Regulations 1996.

### 5th Annual Construction and Engineering Seminar

This lively event was held on 1 November 2006 and examined the various aspects of Risk Management in Construction and Engineering. Mike Walker, Chairman of The Institute of Risk Management and Head of Risk Management at Currie & Brown delivered a thought provoking keynote speech and was followed by Thomas Eggar speakers on Health & Safety, Contract Strategies and Dispute Resolution. For those unable to attend a brief summary is available. Please contact the team for a copy. Keep an eye out for future events by visiting [www.thomaseggar.com](http://www.thomaseggar.com).

## Promises, promises

Failing to get written agreements in place gives rise to difficult issues and often leads to litigation. In two recent cases the parties had made agreements but litigation proceeded - in one case over what had been agreed orally and in the other over the enforceability of what had been agreed.

Interpreting written contracts can be a tricky business. Proving what was agreed orally is more difficult still. It is therefore surprising how often projects proceed without a written agreement - a fact that has been remarked upon several times in the courts down the years. The tale that unfolded before the Court of Appeal in *Maggs v Marsh* this summer involved the refurbishment of a house. The problem of proceeding without a written contract is endemic in projects on domestic property. It is also a significant problem on commercial projects. The issues arising from the relatively modest claim in *Maggs* serve as a cautionary tale for all types of projects.

The facts of this particular story are all too familiar. Mr Marsh had some preliminary drawings prepared for his proposed project. He called in Mr Maggs to price the work needed. Mr Maggs gave a budget estimate which was subsequently reduced following discussions. The works involved were very briefly described in the estimate. Mr Marsh accepted the estimate orally and work got underway. Extras were ordered and carried out but no prices were agreed. Invoices were issued and were paid. About three months after work started Mr Maggs issued a list of the work he considered to be extra. After the work was completed Mr Maggs issued his final bill together with another list of omissions and extras. The price had almost doubled and the bill was challenged. Arguments followed as to what was and was not an extra. Litigation started on April Fools' Day 2004.

The pre-trial processes did not bring the parties any closer; quite the opposite. After the experts had had a good look at it all, Mr Maggs's claim almost doubled

again. Almost 17 months after the litigation started, the parties and their lawyers arrived at court for a three day trial. The judge had the rather ominous task of deciding which items were extras and what they were worth. Given the very sparse written evidence as to what was in the original workscope, the judge would have to rely heavily on the oral evidence of the parties.

Mr Marsh argued that the judge should look at what the parties said and did during the job to shed light on what had been agreed. In particular, he said, the judge should take into account the first list of extras that Mr Maggs produced and look sceptically upon items added to the list later. Mr Marsh said the judge could not do that. It is well established that when interpreting a contract a court is not concerned with what either party actually intended. The exercise for the court is to decide what a reasonable person would conclude the parties agreed based upon what they said and wrote up to the point the contract came into existence. Mr Maggs said that there is a well established rule that the court may not consider the conduct of the parties after the contract was made. That, he said, could only be (at best) evidence of what one party thought he had agreed, not what was actually agreed. The judge agreed and Mr Maggs was largely successful.

Mr Marsh decided to try his luck in the Court of Appeal. The basis of the appeal was that the judge had been wrong to refuse to consider the conduct of the parties during the project as evidence of what had been agreed. The Court of Appeal held that in the case of a written contract it is correct to say that evidence



of the parties' conduct after the contract has been made cannot be taken into account in interpreting that written contract. However, different rules apply to oral agreements. For oral contracts, the exercise is not simply one of working out what the words written down should be taken to mean. In oral contracts the courts have to decide what the words are. In such cases it may well assist the court to look at what the parties did and said after the contract was made to assist in working out what was agreed.

The judge should have considered Mr Marsh's evidence based on the original list of extras. The Court of Appeal sent the case back to the original court to be dealt with again. Almost two and a half years after the final bill was issued and, no doubt bearing some heavy legal bills, the parties were no nearer a resolution.

*Associated British Ports v Hydro Soil Services* was a case packed with technical engineering issues sufficient to tax any brain - bending stiffness, soil pressure, shear forces and much, much more. We, however, are concerned with a more prosaic corner of the judgment that concerned a parent company guarantee. For some reason (and this is not unusual) the parent company guarantee was not available when the contract was entered into. The contract therefore obliged the defendant to procure one (again this is not uncommon). Subsequently a guarantee was provided but it expired earlier than the contract required. The claimant sought to enforce the obligation to procure the guarantee. The judge refused to enforce the obligation. He said that the parent company was not a party to the contract and could not be

forced to give the guarantee. If the claim was for damages because the defendant could not meet a claim that would have been covered by the guarantee, such a claim was futile. If it could not meet that claim, how could it meet the damages claim?

The moral of these tales is that whenever one embarks on a project, the first rule of risk management is that you should ask yourself what could go wrong and how you can protect yourself against that risk. Defining in writing who is going to do what and making sure that any agreement can be enforced when necessary are basic essentials. What's more, these days written contracts also have the additional benefit that they are subject to the Construction Act.

*Mark Clinton*

# Alternative Dispute Resolution: Can the courts order mediation?

The courts are very keen on ADR, and mediation in particular, but mediation is a consensual process, ie voluntary. Courts cannot specifically order it to happen, but they do have sticks and carrots to encourage the voluntary process.

In the course of case management of a case a typical order for directions will now include a provision along the following lines: 'The parties should consider if the case is suitable for resolution by ADR, and any party which considers the case unsuitable shall file a witness statement without prejudice save as to costs giving reasons why'.

This will be a very important document in any later argument on costs. These days anyone rejecting an offer to mediate is running a big risk on costs even if they win the case.

An example of this is the 2005 case of *Burchell v Bullard*. This was a small building dispute which ended up in the Court of Appeal, and is an example of where the parties' and their advisors appear to have got things badly wrong. It shows where cases can end up if they are not managed properly.

Mr Burchell the builder built two houses for Mr Bullard the developer. Mr Bullard complained about defects and refused to pay the final stage payment. Mr Burchell's solicitors proposed mediation before proceedings were started. Mr Bullard was advised by his surveyor to turn down mediation on the basis that the issues were too complex. Mr Burchell sued for just £18,000. Mr Bullard counterclaimed for £100,000. Mr Burchell brought in his roofing sub-contractor as a defendant to the counterclaim so there was now a three party dispute.

The outcome at trial was that Mr Burchell, the builder, won his claim in full but Mr Bullard the developer won £14,000 on his counterclaim, and so Mr

Bullard had to pay Mr Burchell about £4,000. Mr Burchell got just £79.50 from his roofing sub-contractor on the counterclaim.

The trial judge awarded Mr Burchell his costs on the claim but ordered him to pay the costs of both Mr Bullard and the subcontractor on the counterclaim. Mr Burchell considered this to be very unfair, and he took the case to the Court of Appeal.

The total costs spent by all parties both at the trial and later in the Court of Appeal came to £185,000, in order to procure a judgment of £5,000.

No doubt there are a lot of lessons that can be learned on case management: did the parties get suitably robust advice from their experts? Did they use the pre-action protocol properly to try and identify issues and fix meetings. Did Mr Burchell repeat the offer to mediate once refused. Should he have got the roofing sub-contractor involved in the case at all? Did either side get proper estimates of the costs which would be involved in taking a case to trial and then to the Court of Appeal?

The Court of Appeal was more interested in providing further guidance with regard to ADR.

They made the following points:

- A small building dispute is perfect for mediation.
- Mediation would have been very cost effective.
- Mediation would have had a good chance of succeeding - and it was not open to Mr Bullard to rely on his own



obstinacy to say that there was no prospect of success, particularly where he had substantially over-valued his own case.

- Mr Bullard would normally be penalised in costs, but would escape on this occasion because his decisions to reject mediation in this particular case were made before the Court of Appeal had given its key rulings on mediation in an earlier case.

Mr Bullard was very lucky, and Mr Burchell very unlucky; but as for the next time - we have all been warned.

*John Kittow*



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The register can be accessed via the Financial Services Authority website at [www.fsa.gov.uk/register](http://www.fsa.gov.uk/register). We can also provide certain further limited investment services to clients because we are members of the Law Society if those services are incidental to the professional services we have been engaged to provide. A comprehensive range of investment services and advice is provided by Thesis Asset Management plc, our associated financial services company, which is regulated by the Financial Services Authority.

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