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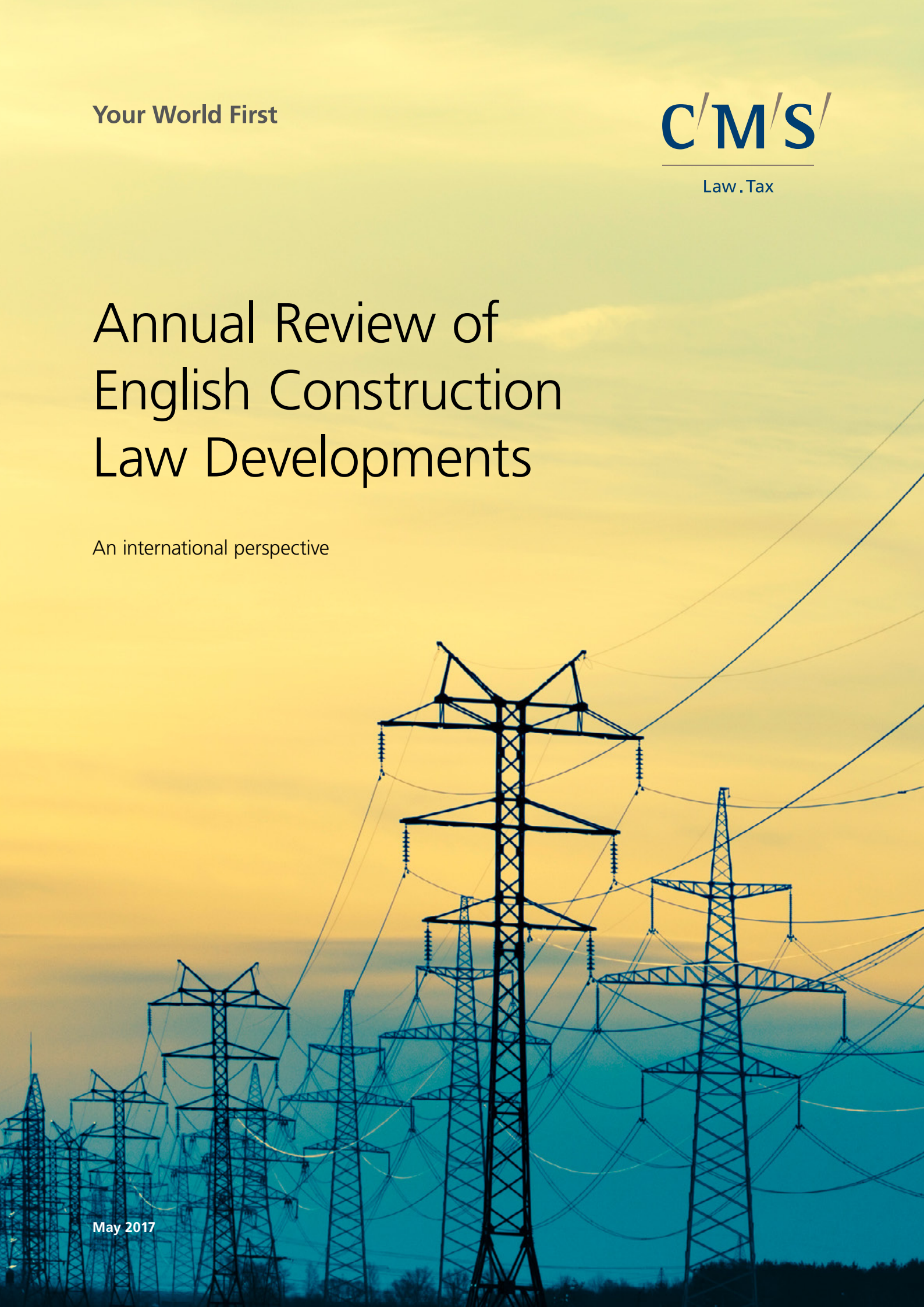
Annual Review of English Construction Law Developments

An international perspective



May 2017

Contents

I consider this Annual Review to be 'mandatory literature' for anyone interested in construction law.

General Counsel, Global Energy Company

Introduction

Welcome to the 2017 edition of our internationally focused Annual Review of English Construction Law Developments.

2016 has been a busy year for the development of English construction law, making this our largest *Annual Review* yet.

Earlier this year the UK Supreme Court noted that:

'The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation.'

This sentiment holds true for a number of the developments reported this year. The implication of duties of good faith into contracts continues to be resisted, and English law's traditionally robust approach to the enforcement of calls under on–demand securities has held firm in two cases at the Court of Appeal level.

Other cases reported this year have resolved long standing debates, such as the correct approach to the interpretation of exclusion clauses and the enforceability of so called 'no amendment' and 'no waiver' clauses.

In other areas, however – notably in relation to the interpretation of clauses excluding liability for indirect and consequential losses – one can discern a willingness to challenge long-standing principles where those principles are thought to be out of step with modern approaches to the law. In one sense this also represents continuity by ensuring consistency of approach in the interpretation of contracts, even where this means a break with past authority on a particular issue.

These developments, together with others on concurrent delay, rights of termination and the use of deleted clauses as an aid to the interpretation of contracts, are all covered in this year's *Annual Review.*

As always, we hope you find this publication of use and welcome any comments or feedback you may have. Should you wish to receive more frequent updates throughout the coming year, please feel free to sign up for our Law-Now services at **www.cms-lawnow.com** and select 'Construction' as your chosen area of law.

Whilst the Supreme Court may be emphasising continuity as a key tenant of English law, CMS Cameron McKenna as a firm is currently undergoing significant change. On 1 May, we merged with Nabarro and Olswang to create the sixth largest law firm in the world with over 4,500 lawyers across 65 offices in 36 countries. The new firm will continue under the CMS banner and we look forward to introducing you to our enhanced Construction practice over the coming year.

Key contacts from our International English Law Construction practice can be found at the end of this publication.

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The interpretation of exclusion and limitation clauses: clarity restored

In last year's Annual Review, we commented on a difference in approach apparent in recent first instance decisions of the English courts as to the interpretation of exclusion and limitation clauses. Decisions of the English Commercial Court in particular appeared to be adopting a restrictive approach to interpretation, whereas those of the Technology and Construction Court had sought to give such clauses their fair and natural meaning. The difference in approach has now been authoritatively resolved by an English Court of Appeal decision last year.

The opposing positions: a recap

The more restrictive approach adopted by the Commercial Court is exemplified by that court's decision in *Transocean Drilling v Providence Resources*. This case concerned a drilling contract agreed in the form of an amended LOGIC contract pursuant to which Transocean agreed to hire a drilling rig to Providence. Transocean claimed payment at the daily rates of hire specified in the contract. Providence claimed that the hire period was prolonged due to problems with the rig in breach of Transocean's obligations under the contract and that it should not be liable for the daily rates of hire during these periods of delay. Providence also counterclaimed for the costs of its personnel, equipment and third party services (known in the industry as 'spread costs') wasted as a result of the delay.

Transocean argued that spread costs were excluded losses under clause 20 of the contract. This clause excluded liability for 'Consequential Loss' as specifically defined by the clause. This included *'loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided by contractors or subcontractors of every tier or by third parties)'*. Transocean argued that spread costs were 'loss of use' because they were claims for loss of use (or the cost of use) of the property, equipment, materials and services provided by contractors, subcontractors and third parties.

The court interpreted the clause *contra proferentem* (in this case applying the principle that if the contractual interpretation is not clear, the provision is construed against the person seeking to rely on it), even though the clause applied to both parties. The correct approach was to require the party seeking to rely on an exclusion clause to establish that *'the words show a clear intention to deprive the other party of a remedy to which he would otherwise be entitled'*. This was said to flow from the principle established by the English House of Lords decision in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* where common law rights of set-off were held not to be impliedly excluded by interim payment provisions contained in a construction contract. The parties were not to be taken to have given up such common law rights without clear words to the contrary.

Adopting this restrictive approach, the Commercial Court interpreted clause 20 narrowly and limited the phase 'loss of use' to loss of expected profit or benefit to be derived from the use of property or equipment. It was held that spread costs did not fall into this definition as the costs were for equipment and services which were provided. The use of the equipment and services were not lost by Providence. They remained available at all times, even though they could not be used productively by Providence.

The court also cited in support of its conclusion the fact that a broader interpretation of clause 20 was likely to cover all losses which Providence could conceivably suffer as a result of breaches by Transocean. The court was reluctant to allow such an interpretation in the absence of clear language and relied on the so called 'declaration of intent' principle described as follows by Lord Wilberforce in Suisse *Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale*:

> *'One may safely say that the parties cannot, in a contract, have contemplated that the clause should have so wide an ambit as in effect to deprive one party's stipulations of all contractual force; to do so would be to reduce the contract to a mere declaration of intent.'*

The Commercial Court's decision in *Transocean* can be contrasted with the 2014 decision of the Technology and Construction Court in *Fujitsu Services Limited v IBM United Kingdom Limited* (referred to in previous editions of this *Annual Review*). That case concerned a clause excluding liability for *'loss of profits, revenue, business, goodwill, indirect or consequential loss or damage*'. The clause was upheld by the TCC as being sufficiently clear, despite the fact that it would have allowed either party to refuse performance of their primary obligations without financial consequences (although each party could still apply to the court for mandatory or injunctive relief in appropriate cases).

Similarly in 2015, the TCC upheld an exclusion clause in respect of *'liability for any claim in relation to asbestos'* as including liability resulting from the negligence of the party to whom exclusion clause was directed (*Persimmon Homes Ltd v Ove Arup & Partners Ltd*). The TCC judge in that case rejected the applicability of any restrictive rules for the interpretation of such clauses:

> *'[T]he Court's task is essentially the same when interpreting what is said to be an exclusion or limitation clause as it is when interpreting any other provision of a contract: it is to identify what a reasonable person having all the background knowledge which would reasonably have been available to the parties would have understood the parties to have meant. And in pursuing that task, the commercial and contractual context may make it improbable that one party would have agreed to assume responsibility for the relevant negligence of another, so that clear words are needed. What matters most, to my mind, is not that the words should initially seem clear (though that often makes life much easier – pace Charter Re) but that, at the end of the interpretative process their meaning should be clear and established. [Emphasis in original]'*

As noted in last year's *Annual Review* this broader approach had also received support from a decision of the Privy Council (composed of judges from the UK's highest court) on the Employer claims provision in the FIDIC form which requires claims to be made *'as soon as possible'* (*NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd*). The Privy Council found the FIDIC clause to be sufficiently clear to cover all Owner claims, not only those which the Owner wished to set-off from Payment Certificates in favour of the Contractor. In so deciding, the court overruled the arbitrator's finding that the clause lacked the clear words he thought to be required due to the *Gilbert Ash* principle referred to above.

Transocean on appeal

The *Transocean* decision was appealed to the English Court of Appeal last year, providing an opportunity for authoritative guidance to be given as to the correct approach. The court overruled the Commercial Court's decision, finding that the 'loss of use' exclusion quoted above extended to the spread costs claimed by Providence.

In reaching its conclusion, the Court of Appeal rejected the restrictive approach adopted by the Commercial Court. In the court's view, the Commercial Court had paid insufficient attention to the words used by the parties in the exclusion clause. The court noted that:

> *' … since the decision in Photo Production Ltd v Securicor Transport Ltd [1980] … the courts have recognised that artificial approaches to the construction of commercial contracts are to be avoided in favour of giving the words used by the parties their ordinary and natural meaning. More recently the principle that the court should give the language used by the parties the meaning which it would be given by a reasonable person in their position furnished with the knowledge of the background to the transaction common to them both has received support from a series of decisions of the highest authority … Most recently the Supreme Court in Arnold v Britton has re-emphasised that particular importance must be given to the language chosen by the parties to express their intentions …'*

The court considered that the Commercial Court was wrong to apply the *contra proferentem* principle. The principle was said to be restricted to circumstances in which the clause in question is one-sided and genuinely ambiguous (i.e. equally capable of bearing two distinct meanings). In such situations, the principle may allow the court to choose the meaning which is less favourable to the party in whose favour the clause operates. The principle has no part to play where the

meaning of the words is not ambiguous or in relation to a clause which favours both parties equally.

Similar comments applied to the *Gilbert Ash* principle. Whilst it was correct to presume that parties do not intend to give up common law rights unless they have made that intention clear, *'that is to say no more than their intention to do so must be apparent from the language they have used, fairly construed.'* The principle was not therefore to be used as a starting point, as the Commercial Court had done, but only when there was genuine ambiguity in the language used by the parties. The principle is also of limited application when interpreting the scope of an exclusion clause because by agreeing an exclusion clause in the first place it is clear that *'the parties did intend to give up some of their rights'*. The real question is not whether rights were to be given up, but to what extent.

Nor could the 'declaration of intent' principle be used to support a narrow interpretation of the exclusion clause. That principle was also reserved for cases of genuine ambiguity:

> *'I fully accept that where the language of an exclusion clause leaves room for doubt as to its meaning, the principle applied in these cases may provide a valuable tool for ascertaining its correct meaning and in some cases it may lead to the conclusion that a restricted meaning must be given to the clause in question in order to achieve the parties' common objective. But it does not in my view provide sufficient justification for overriding the parties' intention where that has been clearly expressed. The principle of freedom of contract, which is still fundamental to our commercial law, requires the court to respect and give effect to the parties' agreement. … If … the parties have effectively agreed to exclude any liability for damages for any breaches, it is difficult to see why the court should not give effect to their agreement.'*

Providence had argued for a stricter rule of law that a court could disregard a clause which effectively relieves a party from liability for any breach of contract on the basis that such a clause would render that party's obligations under the contract meaningless. The court doubted any such rule existed, but did not need to resolve the issue for the purpose of the appeal as the exclusion clause was not found to be as extensive as Providence had alleged.

Conclusion

The Court of Appeal's decision provides clear guidance resolving the conflicting approaches taken in recent years to the interpretation of exclusion and limitation clauses. Such clauses are to be given their ordinary and natural meaning and only in cases of ambiguity should restrictive rules such as *contra proferentem* come into play. This would appear to endorse the approach taken by the Technology and Construction Court in the *Fujitsu* and *Persimmon Homes* cases.

The case also demonstrates the greater emphasis placed on the language used by the parties following the Supreme Court's 2015 decision in *Arnold v Britton.* In a separate article in this *Annual Review* we consider the implications of both the *Transocean* and *Arnold v Britton* decisions for the interpretation of indirect and consequential loss exclusions commonly included in international construction contracts (see page 37 below).

References: *Suisse Atlantique Societe d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361; *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689; *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827; F*ujitsu Services Ltd v IBM United Kingdom Ltd* [2014] EWHC 752 (TCC); *Transocean Drilling UK Ltd v Providence Resources Plc* [2014] EWHC 4260 (Comm); *Persimmon Homes Ltd & Ors v Ove Arup & Partners Ltd* [2015] EWHC 3573 (TCC); *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)* [2015] UKPC 37; *Arnold v Britton* [2015] UKSC 36; *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372.

Good faith in the exercise of termination rights

Debate over implied obligations of good faith in English law has continued after a controversial decision in 2013 suggested that such obligations might more readily be implied than they had been in the past. Subsequent decisions have been heavily critical of this suggestion and 2016 proved no exception, with two further decisions clarifying in no uncertain terms that good faith obligations will not generally be implied into English law contracts. The first of these cases considers an area where good faith has often in the past been said to impose a restraint on the black letter: termination clauses.

Monde Petroleum SA v WesternZagros Limited

In early 2006, WesternZagros Ltd ('WZL') sought to negotiate and thereafter enter into an Exploration and Production Sharing Agreement ('EPSA') with the Kurdistan Regional Government ('KRG'). Following an impasse in negotiations, WZL were directed to Mr Yasser Al-Fekaiki, sole Director of Monde Petroleum SA ('Monde'), who had family connections within the KRG, to assist in lobbying the KRG to support WZL's cause.

In April 2006, WZL and Monde entered into a Consultancy Services Agreement ('CSA'). The CSA allowed for monthly payments together with success fees which could be triggered by achieving 'milestones' linked to the proposed EPSA and ratification of the EPSA. The CSA provided two milestones linked to ratification, the first being the passing into law of the EPSA by the KRG and the second being a Confirmation and Support Letter from the Government of the Republic of Iraq. If these steps were achieved, the CSA gave Monde the right to acquire a 3% working interest in the EPSA.

Article 10 of the CSA gave WZL the following rights of termination:

> *'10.1 Subject to the provisions of this Article 10, this Agreement shall be effective for a period of 4 months from the effective date hereof.*
>
> *10.2 Notwithstanding section 10.1, this Agreement shall continue if the EPSA is executed within four months from the date hereof or, if the EPSA is not executed, at the election of [WZL], provided that this Agreement … may be terminated by WZL upon thirty days' notice to [Monde] should the EPSA not become fully operational and enforceable within six months from the date hereof. …'*

In early May 2006, less than two weeks after the CSA was signed, an EPSA was signed between WZL and the KRG. However, at that stage the EPSA had yet to be ratified. A revised EPSA was signed between WZL and the KRG on 26 February 2007 and was formally passed into law by the KRG a few days later.

Despite these events, WZL's relationship with Mr Al-Fekaiki had deteriorated and on 16 March 2007 it sought to terminate the CSA under clause 10.2 as a result of the EPSA not having become *'fully operational and enforceable'* within 6 months of 23 April 2006.

Ultimately, the court found that WZL did have a right to terminate on 16 March 2007 as the term *'fully operational and enforceable'* – when

read in its contractual context – required both the passing into law of the EPSA by the KRG and the receipt of a Confirmation and Support Letter from the Government of the Republic of Iraq, the later of which had not yet occurred by 16 March 2007. The court also held that WZL's right to terminate under clause 10.2 was not lost simply because it was not exercised immediately on becoming available, and WZL had not lost its right to terminate through its conduct. Accordingly, whilst the 6 month period stipulated by clause 10.2 had expired on 23 October 2006, WZL was still entitled to terminate under that clause on 16 March 2007 due to the failure of the EPSA to become *'fully operational and enforceable'*.

Monde contended that these findings left the termination clause open to abuse by WZL. Once the 6 month period had passed, Monde's continued efforts to have the EPSA fully ratified could be taken advantage of by WZL. Once it became clear that the EPSA would be ratified, WZL could then proceed to terminate the agreement and deprive Monde of its 3% interest in the EPSA. WZL could, for example, wait until just before the Confirmation and Support Letter was to be issued by the Iraqi Government before issuing its notice of termination.

To account for these possibilities, Monde argued for an implied term of good faith to limit WZL's right to terminate under clause 10.2. Monde put its case in two ways.

Monde firstly argued that the relationship created by the CSA was intended to be one of long-term co-operation and, given the potential for Monde to acquire a 3% interest in the EPSA, amounted to a *'quasi-partnership'*. It relied on suggestions by one English judge, Mr Justice Leggatt, in the 2013 decision of *Yam Seng Pte Ltd v International Trade Corp Ltd* that *'some joint venture agreements, franchise agreements and long-term distributorship agreements [may] involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements'*. Monde argued that the CSA was such a contract.

The court rejected this argument, noting that there was *'no general doctrine of 'good faith' in English contract law'*. Aside from special relationships such as employment and insurance, a duty of good faith would only be implied in an English law contract where the contract would be unworkable without such a duty. The fact that the contract involved a long-term relationship was not of itself enough to imply such an obligation. In Monde's case, there was no particular difficulty which would make the CSA unworkable without a duty of good faith. Neither did the CSA contain any mutual obligations and commitments which had as their unstated assumption that the parties would act in good faith. Rather, the CSA simply required the provision of services by Monde in return for certain remuneration.

Monde's second argument relied on English law's approach to contractual discretions. This was a topic considered in detail in last year's *Annual Review*. Generally speaking, where a contract provides a contractual discretion to one party which affects the position of the other party (for example, where a performance bond is to be provided from a bank satisfactory to the employer), English law will imply an obligation that the discretion is to be exercised in good faith and not arbitrarily, capriciously or unreasonably. Monde argued that this rule should apply to the contractual termination provisions of the CSA, given that they provided WZL with the ability to bring the CSA to an end and deprive CSA of any further remuneration under the CSA. In this regard, Monde also relied on comments by Mr Justice Leggatt in the 2015 decision of *MSC Mediterranean Shipping Co SA v Cottonez Anstalt*. Talking of the rule as to contractual discretions, Leggatt J noted:

> *'The cases in this line of authority have all been concerned with the exercise of discretionary powers conferred by the express terms of the contract, whereas the choice whether or not to terminate the contract in response to a repudiatory breach is one which arises by operation of law. However, I cannot see why this should make any difference in principle. In each case one party to the contract has a decision to make on a matter which affects the interests of the other party to the contract whose interests are not the same. The same reason exists in each case to imply some constraint on the decision-maker's freedom to act purely in its own self-interest. The essential concern … is that the decision-maker's power should not be abused.'*

The court rejected this argument on the basis that a contractual right of termination did not involve the exercise of a discretion but rather a pure right. The court rejected the above passage from *MSC Mediterranean Shipping*, preferring instead the following passage from an earlier Court of Appeal decision (in *Lomas v JB Firth Rixon Inc*):

> *'The right to terminate is no more an exercise of discretion, which is not to be exercised in an arbitrary or capricious (or perhaps unreasonable) manner, than the right to accept repudiatory conduct as a repudiation of a contract. … no one would suggest that there could be any impediment to accepting repudiatory conduct as a termination of the contract based on the fact that the innocent party can elect between termination and leaving the contract on foot. The same applies to elective termination.'*

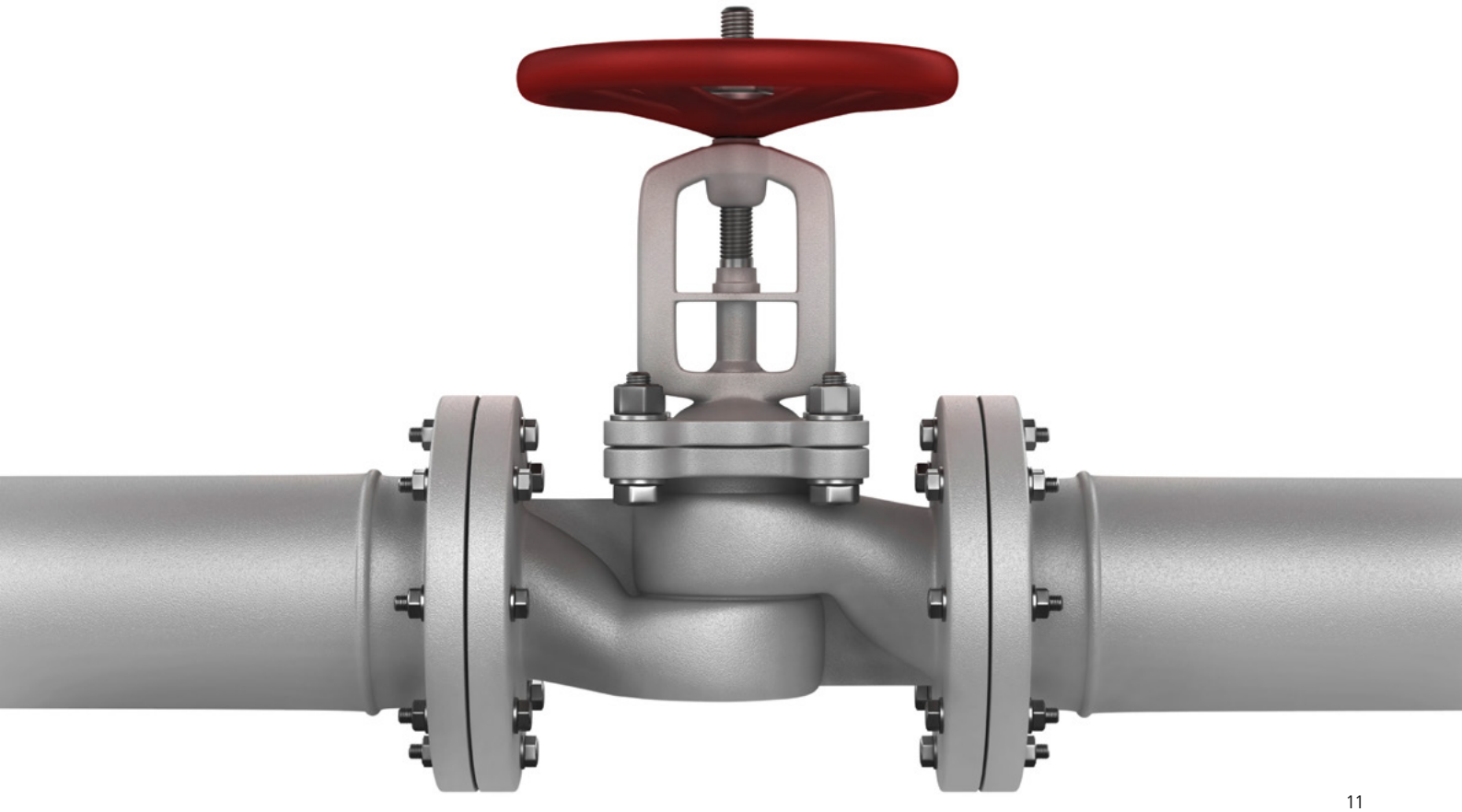
Conclusion

Shortly after the court's decision in the *WesternZagros* case, the English Court of Appeal considered an appeal from Leggatt J's decision in the *MSC Mediterranean Shipping* case. In the course of its judgment the Court of Appeal also noted is disagreement with the broader application of implied good faith obligations proposed by Mr Justice Leggatt:

> *'[Leggatt J] drew support for his conclusion from what he described as an increasing recognition in the common law world of the need for good faith in contractual dealings. The recognition of a general duty of good faith would be a significant step in the development of our law of contract with potentially far-reaching consequences and I do not think it is necessary or desirable to resort to it in order to decide the outcome of the present case. … this court had recently reiterated that English law does not recognise any general duty of good faith in matters of contract. It has … preferred to develop 'piecemeal solutions in response to demonstrated problems of unfairness', although it is well-recognised that broad concepts of fair dealing may be reflected in the court's response to questions of construction and the implication of terms. In my view the better course is for the law to develop along established lines rather than to encourage judges to look for what the judge in this case called some 'general organising principle' drawn from cases of disparate kinds. … There is in my view a real danger that if a general principle of good faith were established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement. The danger is not dissimilar to that posed by too liberal an approach to construction, against which the Supreme Court warned in Arnold v Britton …'*

These comments together with the decision in *WesternZagros* bring greater clarity as to the limited role that good faith plays in English contract law. Such clarity is especially welcome with regard to contractual termination rights given the serious consequences which can arise when termination rights are invalidly exercised. Such rights have previously been suggested to be subject to implied duties of good faith, but the above cases make clear that parties are be free to terminate a contract in accordance with any express rights given to them for whatever reasons they choose, whether in good faith or not.

References: *Lomas v JFB Firth Rixson Inc* [2012] EWCA Civ 419; *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2015] EWHC 283 (Comm); *Monde Petroleum SA v Westernzagros Limited* [2016] EWHC 1472 (Comm); *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2016] EWCA Civ 789.

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Concurrent delay: recent developments and continued uncertainty

An English Commercial Court decision last year, together with the publication of the 2nd edition of the SCL Delay and Disruption Protocol, have provoked further debate as to the correct approach to concurrent delay claims under English law. We summarise these developments below.

Concurrent delay: an overview

In its broadest sense, concurrent delay arises as an issue whenever claims for extension of time are met with an allegation that the contractor would have been unable to complete the works on time even if the event claimed for had not occurred due to its own delays or those for which it is contractually responsible.

The position with regard to concurrent delay in Scotland has largely been settled by the Inner House decision in *City Inn Ltd v Shepherd Construction Ltd* in 2010, which permits responsibility for concurrent delay to be apportioned between the parties. Apportionment has, however, been rejected by the English courts and the position in England is generally believed to be as stated in *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd*, that the contractor is entitled to an extension of time but not additional cost.

The primary area of debate under English law concerns the definition of concurrent delay for the purpose of the *Malmaison* principle. When are two delays sufficiently significant that they can both be said to have caused concurrent delay to completion? Is it sufficient merely that each would have caused delay to completion in the absence of the other? Or must they both be on the critical path or of roughly equal impact on the project? Broadly speaking, three schools of thought can be identified as to the causative connection required under English law:

1. The most commonly used test, sometimes referred to as the 'consensus view' or dominant cause approach, requires two delaying events to be of 'equal causative potency'. A critical path analysis will typically be used to eliminate delaying events which have not impacted the critical path, but even events which both impact the critical path may not, on analysis, be shown to be of 'equal causative potency'. The question is one of common sense in all the circumstances.

2. A broader test has recently been advocated by some commentators, described as a 'reverse 'but for' test'. This approach asks simply whether the delaying event for which an extension of time is claimed would have delayed completion in the absence of the delay event(s) that the contractor is responsible for. In such circumstances, the delaying event claimed for is an effective cause of delay and there is no need to ask whether it is of 'equal causative potency' with any contractor culpable delay events.

3. A narrower test to the consensus view is sometimes advanced which focuses on the point in time at which delaying events occur.

Where an existing event has caused delay to completion, subsequent delay events are treated has not being a cause of delay to completion at all unless and to the extent that they increase the delay already caused by the existing event. This is sometimes referred to as the 'first in time' approach.

Support may be found to varying degrees for each of the above approaches in the recent cases. However, a decision from the English Commercial Court last year appears to adopt the narrower, third approach.

Saga Cruises BDF Ltd v Fincantieri SPA

Saga Cruises (the 'Employer') contracted with Fincantieri (the 'Yard') for the refurbishment of a cruise ship originally constructed in 1981. The refurbishment included both engineering and outfitting works and was to be completed by 2 March 2012. Completion was ultimately achieved by the Yard on 16 March 2012 and the Employer sought to recover liquidated damages for delay (among other claims).

The Yard argued, among other things, that it had been prevented from completing the works by 2 March 2012 due to various delays on the part of the Employer. For example, following a Class inspection of the vessel, it was discovered that new insulation was required to be installed due to defective flooring carried out by others on behalf of the Employer. A Change Order was issued by the Employer to the Yard, but the new insulation could not be installed until the defective flooring had been repaired, which occurred between 2 and 10 March 2012. Completion could not therefore have been achieved by the Yard before 11 March 2012.

The court rejected the Yard's arguments in relation to the Employer's delays and found the Yard liable for the whole delay from 2 to 16 March 2012. The Employer's delays had been subsumed by the Yard's own delays which had persisted up until 16 March 2012. The Employer's delays had not therefore caused any additional delay to completion which was not already accounted for by the Yard's delays.

The court's reasoning appears to emphasise the starting and finishing dates for individual delay events. In particular, the court noted *'the importance in concurrency arguments of distinguishing between a delay which, had the contractor not been delayed would have caused delay, but because of an existing delay made no difference and those where further delay is actually caused by the event relied on'*.

The 'first in time' debate

In reaching its conclusion, the court relied on an earlier Commercial Court decision in *Adyard Abu Dhabi v SD Marine Services*. In both *Adyard* and in the present case the Commercial Court found support for a 'first in time approach' in the following passage from the Technology and Construction Court's decision in *Royal Brompton Hospital NHS Trust v Hammond (No. 7)* (per HHJ Seymour QC):

'However, it is, I think, necessary to be clear what means by events operating concurrently. It does not mean, in my judgment, a situation which, work already being delayed, let it be supposed, because the contractor has had difficulty in obtaining sufficient labour, an event occurs which is a relevant event and which, had the contractor not been delayed, would have caused him to be delayed, but which in fact, by reason of the existing delay, made no difference. In such a situation although there is a relevant event, 'the completion of the Works is [not] likely to be delayed thereby beyond the Completion Date.'

The relevant event simply has no effect upon the completion date. This situation obviously needs to be distinguished from a situation in which, as it were, the works are proceeding in a regular fashion and on

programme, when two things happen, either of which, had it happened on its own, would have caused delay, and one is a relevant event, while the other is not. In such circumstances there is a real concurrency of causes of the delay.'

This passage has, however, been doubted in other decisions, none of which were referred to by the Commercial Court in the *Saga Cruises* case. For example, the Scottish appeal court (known as the Inner House) reached a contrary view in *City Inn Ltd v Shepherd Construction Ltd*:

'I have difficulty in understanding the basis on which Judge Seymour drew the distinction which he did. In any event, his observations seem to involve the contemplation of a situation in which two events productive of delay, one a relevant event and the other not, occur simultaneously with chronologically coincident starting points, as the only one in which the effect of the relevant event can be assessed under clause 25, where a non-relevant event is also present. I consider that approach to its interpretation unnecessarily restrictive and one which would militate against the achievement of its obvious purpose of enabling the architect, or other tribunal, to make a judgment on the basis of fairness and a common-sense view of causation.'

Detractors therefore point out that causation at law is more a matter of common sense than strict logic and it cannot therefore be appropriate to exclude potential causes of delay merely because they happen to occur after other competing causes of delay.

A further criticism of the 'first in time' approach comes from the 'prevention principle' which recognises that a contractor should not be subject to liquidated damages for delay to completion for periods in which it had been prevented by its employer from completing the works. In *Saga Cruises*, for example, the Employer's defective flooring and resulting Change Order had prevented the Yard from completing the works from 2 March until 11 March 2012, yet the Yard was still ordered to pay liquidated damages for the full period of delay from 2 March until 16 March 2012.

The scope of the 'prevention principle' is, however, also the subject of debate. In *Jerram Falkus Construction Ltd v Fenice Investments Inc* the Technology and Construction Court held that the principle would not apply to cases of concurrent delay. The court noted that:

'for the prevention principle to apply, the contractor must be able to demonstrate that the employer's acts or omissions have prevented the contractor from achieving an earlier completion date and that, if that earlier completion date would not have been achieved anyway, because of concurrent delays caused by the contractor's own default, the prevention principle will not apply.'

This finding was contrary to position taken in the then current edition of Keating on Construction Contracts and has been subsequently criticised by a number of commentators including John Marrin QC.

SCL Delay and Disruption Protocol, 2nd Edition

Although not mentioned in the judgement, the court's decision in *Saga Cruises* provides substantial support for the recently released 2nd Edition of the SCL Delay and Disruption Protocol. With regard to concurrent delay the 2nd Edition posits the following example:

'[A] Contractor Risk Event will result in five weeks Delay to Completion, delaying the contract completion date from 21 January to 25 February. Independently and a few weeks later, a variation is instructed on behalf of the Employer which, in the absence of the preceding Contractor Risk Event, would result in Delay to Completion from 6 February to 20 February.'

Although noting that arguments exist in either direction, the 2nd Edition comes down in favour of a 'first in time' approach as follows:

> *'[T]he Employer Delay will not result in the works being completed later than would otherwise have been the case because the works were already going to be delayed by a greater period because of the Contractor Delay to Completion. Thus, the only effective cause of the Delay to Completion is the Contractor Risk Event.'*

The 2nd Edition has, however, been criticised for taking too simplistic an approach. There is no mention, for example, of the extent to which the second-in-time Employer delay affects the critical path or the overall potency of the events in question in the context of the works as a whole. In this respect, the 2nd Edition could be seen to be creating a false dichotomy between the 'first in time' approach and the 'reverse 'but for' test' noted in the introduction to this article. The more fact sensitive consensus view does not appear to have been adequately addressed.

As one commentator notes, the 'first in time' approach advocated by the 2nd Edition can give rise to practical issues:

> *'As it stands, the guidance may encourage an employer to hide behind the contractor's delays. The employer may have always needed to issue an instruction to change the works, but the canny employer may wait until the contractor is in its own period of delay.*
>
> *Focusing on the exact timing of events and the 'critical path' is likely to encourage parties to rely heavily on delay analysts, and on them identifying the critical path, which is by no means an exact science and different analysts may find a different critical path. This emphasis may distract the parties from applying the legal test of causation (and a healthy dose of common sense) to the facts.'*

Conclusion

This most recent Commercial Court decision is likely to provoke further debate as to the correct approach to concurrent delay claims under English law. The court's adoption of the previous Commercial Court decision in the *Adyard* case and its acceptance of a 'first in time' approach may reveal a fundamental difference in approach to concurrent delay claims between the Commercial Court and the Technology and Construction Court. Recent decisions of the TCC suggest that the 'consensus view' is more likely to be adopted there, or possibly the 'reverse 'but for' test'.

It is interesting to speculate how these issues might be resolved over time. One reasonably simple means of reconciling the cases may be to look for points of distinction among the contracts considered in each of them. The Commercial Court cases, for example, generally concern bespoke contracts whereas the TCC decisions largely concern the JCT contract form which stipulates that extensions of time are to be assessed on a *'fair and reasonable'* basis. It is possible that the broader approach adopted by the TCC could be distinguished on this ground, although the cases themselves do not make this distinction.

The recent publication of the 2nd Edition of the SCL Delay and Disruption Protocol and the debate which has surrounded it has helped to bring into focus the tension between the various approaches and the decided lack of agreement between construction law professionals as to the correct approach. Unfortunately for the industry, this area of the law appears to be one which is likely to remain unsettled for some time to come.

References: *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd* (1999) 70 Con LR 33; *Royal Brompton Hospital NHS Trust v Hammond (No. 7)* (2001) 76 Con LR 148; *City Inn Ltd v Shepherd Construction Ltd* [2010] CSIH 68; *Adyard Abu Dhabi v SD Marine Services* [2011] EWHC 848; *Jerram Falkus Construction Ltd v Fenice Investments Inc* [2011] EWHC 1935; *Saga Cruises BDF Ltd & Anor v Fincantieri SPA* [2016] EWHC 1875; Cough, *Concurrency and the SCL delay and disruption protocol: all together now* (2016).

Contractual warranties and representations: telling the difference

A decision of the English Commercial Court in 2016 provides an interesting example of the important role that claims for pre-contractual misrepresentations play in English law commercial contracts. The case also considers the extent to which contractual warranties, when broken, can automatically give rise to claims for misrepresentation.

Introduction

English law draws a distinction between warranties and representations. Warranties are contractual promises that a certain state of affairs exists or will exist. Representations are mere statements of fact and, whilst they can be included within a contract, are more likely to be made prior to a contract being concluded or during the course of its execution.

Contractual warranties are intended to provide a remedy in the event that the warranty is subsequently shown to be false. For example, a seller may warrant that goods are free from defects. Liability under the warranty is strict. If defects are found, the seller is liable regardless of whether he honestly believed in the truth of the warranty or had reasonable grounds for doing so.

Representations are usually not intended to provide a contractual remedy in the event that facts represented are shown to be false. However, they are commonly relied upon by parties when entering into a contract. In a construction context, a contractor may complain that the results of geotechnical information provided by an employer for tendering purpose have proved to be mistaken. An employer might complain that assurances made by a contractor as to the level of resources available to commit to a project have turned out to be unfounded.

The remedies available for false representations or 'misrepresentations' which have been relied upon by another party can include the rescission or cancellation of a contract entered into on the faith of the representation, or damages to compensate the innocent party for any loss suffered as a result of its reliance on the representation. As the remedies for breach of warranty and misrepresentation are different, it can be important for parties to ensure that rights in respect of both of them are preserved. For example, as a breach of warranty is a contractual claim, it will be subject to contractual provisions as to notification and limitation of liability, whereas a claim for misrepresentation may not be.

The Misrepresentation Act 1967

Under English law, the effect of pre-contractual misrepresentations is specifically governed by the Misrepresentation Act 1967 (the '1967 Act'). The 1967 Act will apply whenever English law is expressed to be the applicable law of the contract and therefore has the potential to apply to a wide range of international construction contracts.

The 1967 Act may prove relevant in a number of ways:

1. It provides a right of damages in relation to pre-contractual misrepresentations, regardless of whether they were made innocently, negligently or fraudulently, unless the party responsible for the misrepresentation proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the representations in question were true.

2. It modifies and some respects enhances a party's common law right to rescind or cancel a contract for pre-contractual misrepresentations made innocently or negligently.

3. It requires any attempt to exclude or restrict the rights and liabilities which arise in relation to pre-contractual misrepresentations to be reasonable (judged by reference to certain criteria).

Do contractual warranties automatically give rise to representations?

A Commercial Court decision decided last year provides a good illustration of the difference between warranties and representations and the importance of ensuring that rights as to both are preserved.

Two Japanese companies, Idemitsu and Sumitomo, reached agreement for the sale of shares in a Sumitomo subsidiary with interests in offshore oil and gas fields. Idemitsu paid Sumitomo approximately US$ 575 million for the subsidiary. The Sale and Purchase Agreement ('SPA') agreed between the parties included warranties in the following terms given by Sumitomo:

'6.1 Warranties

6.1.1 Each of the Sellers warrants to the Buyer in respect of itself and its Relevant Shares in the terms of the Warranties in paragraphs 1 and 2 of Schedule 4; and

6.1.2 Sumitomo warrants to the Buyer in the terms of the Warranties in the remaining paragraphs of Schedule 4, in each case on the date of this Agreement.'

After completion of the sale, Idemitsu learned that the subsidiary was subject to substantial liabilities arising from a dispute between the respective owners of the oil and gas fields in which it had an interest. Idemitsu believed that the existence of these disputes placed Sumitomo in breach of the warranties set out above. However, the SPA contained a requirement that any claim for breach of the warranties (save in relation to taxation issues) be notified by Sumitomo within 18 months of completion. Idemitsu had not notified a claim within this period and instead sought to claim on the basis of misrepresentation.

Idemitsu argued that clause 6.1 above implicitly represented the truth of the warranties to Sumitomo. These representations were said to have been made once the final execution draft of the SPA was agreed, by virtue of Sumitomo offering to sign and then subsequently signing that draft. Idemitsu was said to have relied on those representations by counter-signing the SPA. As a result, Idemitsu was said to have a claim for damages under the 1967 Act for US$106 million. Being a claim for misrepresentation under the Act, it was not subject to the 18 month time-bar contained in the SPA.

There have previously been conflicting decisions as to whether a contractual warranty implicitly carried with it a factual representation as to the matters warranted. Sometimes specific drafting is included in such clauses to make the position clear: for example, by stating that a party 'warrants and represents' certain matters. In the absence of such drafting, however, the question remains whether by agreeing to 'warrant' a certain state of affairs, a party is also to be taken to have made 'representations' of fact.

The Commercial Court found against Idemitsu, concluding that the warranties given by Sumitomo did not implicitly give rise to representations of fact. The court distinguished the two concepts as follows:

> *'When a seller, by the terms of the contract under which he sells, 'warrants' something about the subject matter sold, he is making a contractual promise. Nothing less. But also I think (and all things being equal) nothing more. That is so just as much for a warranty as to some then present or past matter of fact as it is for a warranty as to the future. By contracting on terms by which he warrants something, the seller is not purporting to impart information; he is not making a statement to his buyer. He is making a promise, to which he will be held as a matter of contract in the sense that any breach of the warranty will be actionable as a breach of contract, subject to any other relevant terms of the contract and to general principles of the law of contract, for example as to remedies.'*

It made no difference that the warranties in the SPA were communicated to Idemitsu in advance by virtue of the final execution draft. This draft was merely an offer by Sumitomo to enter into a contract containing the proposed warranties. If the warranties themselves did not amount to representations, an offer to agree those same warranties could not do so either.

Conclusion

The Commercial Court's decision provides a helpful illustration of the difference between warranties and representations and highlights that claims for misrepresentation can provide a valuable and important addition to the rights otherwise available to a party under the terms of their contract.

Idemitsu's claim against Sumitomo was also rejected by the court on the grounds that the SPA contained an exclusion clause stating that Idemitsu had not *'relied on, or been induced to enter into, this Agreement by any representations, warranties or undertakings of any kind other than the Warranties …'*. This clause would have ruled out Idemitsu's claim even if it had been successful in showing that representations had been implicitly made through the offering of warranties by Sumitomo.

The standard FIDIC forms of contract do not include any such exclusion. Accordingly, unless specific drafting is included, claims for pre-contractual misrepresentation will ordinarily be open to the parties under English law FIDIC contracts.

References: *Idemitsu Kosan Co Ltd v Sumitomo Corporation* [2016] EWHC 1909 (Comm).

On demand securities: the fraud exception in cases of legal uncertainty

In last year's Annual Review we commented on a hardening of approach by the English courts to challenges made to calls under on-demand securities. This trend has continued in 2016 with two cases on the fraud exception to the enforcement of calls reaching the English Court of Appeal. Both cases consider the application of the exception in circumstances where there is legal uncertainty as to a party's entitlement to make a demand under the terms of an on-demand security. These decisions concern construction or construction-like contracts and provide significant clarity for those considering the operation of English law on-demand securities under international construction contracts.

Introduction

As noted in previous editions of this *Annual Review*, calls under on-demand securities governed by English law, which otherwise comply with the requirements for making a call, may be challenged by one of two means: either by proving that the call was made fraudulently or by showing that the call was made in breach of a restriction contained in the underlying contract between the parties. The second of these grounds has been the subject of significant debate under English law over the past 10 years and, as reported last year, appears now to be returning to a more conservative position requiring any breach of a restriction in the underlying contract to be 'positively established'.

The fraud exception was considered by judges of the UK's highest court in 2014 and remains extremely difficult to satisfy. A case decided in 2016 is therefore notable for upholding a challenge based on the fraud exception, particularly given that the signatory to the relevant demand was an in-house counsel qualified to practice in England and Wales. The decision was overturned on appeal and provides an interesting example of the application of the fraud exception where there is legal uncertainty as to one party's entitlement to make a demand.

Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA & PDVSA Servicios SA

PDVSA Servicios SA ('PDVSA') is a subsidiary of Petroleos de Venezuela SA, a corporation wholly owned by the Government of Venezuela and responsible for the development of hydrocarbons in the country. In 2010, PDVSA entered into a seven year oil drilling contract with Petrosaudi Oil Services (Venezuela) Ltd ('POS') governed by Venezuelan law. Under the contract, POS was to provide oil rig drilling services to PDVSA and a drilling vessel.

POS was entitled to render invoices under the contract for services provided. Invoices were payable within 30 days and would be deemed to be accepted in full if PDVSA did not notify a dispute within 15 days of receipt (the 'Time Bar Provision'). If a dispute was notified, PDVSA was required to make payment in full within the 30 day period, subject to repayment by POS of any amounts subsequently agreed or proved not to have been due in an arbitration under the contract (the 'Pay-Now-Argue-Later Provision').

PDVSA also furnished a standby letter of credit ('SLC') to POS issued by Banco Espirito Santo SA and later transferred to Novo Banco SA (the 'Bank'). The SLC was for an amount of US $130 million and was

expressed to secure payment under the drilling contract. Among other things, the SLC required any demand made by POS to certify that PDVSA was *'obligated to [POS] to pay the amount demanded under the drilling contract'*.

Since January 2015, invoices issued by POS under the drilling contract had not been paid by PDVSA due to a dispute about the appropriate rate to be charged. POS had claimed the 'operating' or 'standby' rate whereas PDVSA contended that the much lower 'repair' rate was applicable. The dispute was referred to arbitration and various interim orders were made limiting the recourse POS could have to the SLC (certain demands were permitted for invoices prior to November 2015, with the proceeds to be held by POS's solicitors but with POS being entitled to access some of the funds on a monthly basis to defray operating expenses).

Aside from the principle issue between the parties as to the appropriate rate, issues also arose as to the enforceability of the Time Bar Provision and the Pay-Now-Argue-Later Provision. PDVSA relied upon a provision of Venezuelan law ('Article 141') applicable to the drilling contract which required certain conditions to be fulfilled before payment was permitted to be made by PDVSA (such as verification that the services supplied complied with the contract and the authorisation of payment by a competent person). PDVSA argued that Article 141 was incompatible with the Time Bar Provision and the Pay-Now-Argue-Later Provision.

In two partial awards, the arbitrators held that that the Time Bar Provision and the Pay-Now-Argue-Later Provision were inconsistent with Article 141 and therefore null and void. Article 141 laid down a mandatory requirement that a Venezuelan State entity should ascertain that invoices for services rendered were correct before paying them. Any provision of a State contract which required payment to be made without Article 141 being complied with was void. This did not, however, affect POS's ability to obtain an arbitral award for the amount of any payment properly due under the drilling contract.

By the time the second partial award was released, the arbitrators had already cancelled some of their previous orders limiting POS's recourse to the SLC. Upon the release of the second partial award, the remaining limitations were cancelled and the arbitrators refused to grant a fresh injunction preventing POS from seeking payment under the SLC. As the SLC had an English law and jurisdiction clause, it was more appropriate for the English courts to determine whether any such injunction should be granted.

Three days after the second partial award, POS demanded payment under the SLC for the full amount of US $ 130 million (the bond had been replenished by this point). As required by the SLC, the demand made by POS certified that PDVSA was *'obligated to [POS] to pay the amount demanded under the drilling contract'*.

Commercial Court: the fraud exception upheld

PDVSA was initially successful in obtaining an injunction from the English Commercial Court on the basis that POS's demand was made fraudulently. PDVSA argued that in light of the partial awards made by the arbitrators and the effect of Article 141, it was clear that no amount could presently be said to be payable by PDVSA. The Article 141 requirements had not yet been fulfilled in relation to the invoices relied upon by POS. Any contractual provision requiring earlier payment was therefore void and no payment could be said to be due until an arbitral award was obtained requiring payment. All of this was well known to POS and its certification that PDVSA was *'obligated'* to pay had, so PDVSA argued, been made fraudulently.

POS's demand had been signed by its general counsel, Mr Buckland, who was a solicitor qualified to practise in New Zealand and England and Wales. He gave evidence setting out the legal reasoning as to why he believed that PDVSA was obligated to pay POS's invoices, despite the effect of Article 141. He explained his view that a *'debt arises upon the performance of the services under the terms of the Contract'* and that Article 141 did not affect PDVSA's 'obligation' but simply required *'PDVSA to carry out certain steps before they discharge their pre-existing obligation to pay'*.

In cross-examination, Mr Buckland agreed that he could not have certified that PDVSA was 'obligated to pay now' if that is what the words 'obligated to pay' meant, but he claimed not to have considered the 'temporal' aspect of the issue at all when signing the demand. Instead, he had looked at what was due essentially in the abstract.

Applying the fraud exception, the Commercial Court judge first considered whether Mr Buckland's interpretation of the phrase 'obligated to pay' was correct. The judge found that the effect of Article 141 meant that there was no debt due *'in any real sense at all'* prior to the completion of the Article 141 requirements or an award by the arbitrators. The effect of the arbitrator's decision in his view meant that there was not in any real legal sense an obligation on PDVSA to pay any of the disputed invoices in those circumstances.

The judge then needed to consider whether Mr Buckland's view, although wrong about the law (as the judge thought), was nonetheless a view honestly held by Mr Buckland. Only if Mr Buckland had been dishonest in reaching this view would the fraud

exception apply. The judge concluded that Mr Buckland had been dishonest and placed particular emphasis on the fact that the 'temporal' argument that PDVSA needed to be 'obligated now' to pay the amount demand was said not to have even been considered by Mr Buckland despite his familiarity with the arbitration proceedings and his taking advice on the demand. The judge's conclusion was that Mr Buckland had essentially constructed a legal argument to suit POS's purposes:

> *'because he thought that an interpretation could be placed on the word 'obligated' which could somehow stand or be argued to stand with what the obvious effect of the FPA and SPA was, i.e. that no sum was presently due. But I do not believe that he actually and honestly believed it to be the real meaning of the certificate, (which is in fact what was due now), and I reject his evidence to the contrary.'*

The fraud exception was therefore engaged and the Bank was restrained from paying out under the SLC. POS was also ordered to write to the Bank withdrawing its demands under the SLC. POS appealed.

The Court of Appeal

The Commercial Court's conclusion was overturned on appeal. The appeal was upheld principally on the basis that the legal view taken by Mr Buckland was in fact the correct one. The Court noted that there was nothing contrived about recognising different types of debt obligation. A debt could be wholly contingent in that it only arises and comes into existence on the happening of a certain event. Or it can be due but not payable for a certain period or until an event occurs. Or it can be due and payable immediately but there may be some restriction on the discharge of the debt or the debtor may have a good excuse for not discharging it. The Court of Appeal concluded that the effect of Article 141 was to put this case into the latter category. In the court's opinion Article 141, *'provided PDVSA with a form of legal excuse for non-fulfilment of its existing obligation to pay'*.

This conclusion was supported by the fact that the ability of the arbitrators to make an award requiring payment presupposed that the invoices in question were due and payable. The same applied to the right of interest and suspension for non-payment provided for by the drilling contract. These provisions suggested that PDVSA had an obligation to pay the invoices even if that obligation could not immediately be enforced, short of arbitration, due to Article 141.

The Court of Appeal noted that the expression *'obligated to pay'* used by the SLC was capable of more than one meaning and could refer either to the accrual of a liability to pay (as POS contended) or an obligation to pay which is immediately to be discharged (as PDVSA contended). However, in the Court of Appeal's view, the broader view which POS contended for was more consistent with commercial good sense and ought to be preferred. Venezuela generally and PDVSA specifically had a poor history of prompt payment and a contractor such as POS needed an assured source of regular payment over the course of a long term drilling contract. The fact that Article 141 would prevent POS from being able to enforce regular payments explained why an SLC not subject to the Article 141 conditions was needed. The fact that the SLC referred specifically to the passing of 30 days since the receipt of invoices from PDVSA was also relevant, in comparison with the absence of any reference to an arbitration award.

The Court of Appeal's conclusions in this regard were sufficient to uphold the appeal, however it also noted some discomfort with the Commercial Court's finding of fraud against Mr Buckland:

> *'I wish, however, to express some disquiet at the finding of the judge that, on the view that he took of the legal position, Mr Buckland was fraudulent in signing the certificate. Whilst there is only one true construction of an instrument such as the certificate, different legal minds may obviously take different views on such a question. Had it been necessary to do so I would wish to have given anxious consideration to the question whether, despite the well-recognised advantages of a trial judge and the inhibition rightly felt by this court in overturning findings of fact, the judge was entitled to conclude that Mr Buckland was fraudulent (i.e. conscious of the falsity of what he was saying or with no honest belief in, or a reckless indifference to, its truth) in holding the view that I currently hold, when making what was, in essence, a representation of law.'*

These comments should provide some comfort to those calling on bonds based on particular legal views formed by themselves or on advice from legal advisors. The Commercial Court's decision had found that Mr Buckland did not believe in the legal position he advocated but considered that it was sufficiently plausible for the purpose of the bond call. Whilst the Court of Appeal has signalled that the court may have been too ready to draw this conclusion, the case provides an important warning for those calling on bonds that it is not sufficient merely for an interpretation of the bond to be legally plausible – they must also believe that interpretation to the be the correct one.

This can have significant implications for how a party prepares to make a demand under a bond. Serious consideration should be given as to whether legal advice should be obtained or not – as if the advice obtained suggests that the favoured interpretation is arguable but not likely to be correct, difficulties may arise in making an honest demand unless different advice is obtained elsewhere. A good example of the breadth given to those calling on bonds in a non-legal capacity is given by the next decision.

National Infrastructure Development Co Ltd ('NIDCO') v Banco Santander SA

NIDCO, a government owned corporation, entered into a contract with a Brazilian contractor, OAS Construtora, for the construction of a large highways project in Trinidad and Tobago. A number of SLCs were procured by OAS to secure its performance under the contract and the repayment of an advanced payment.

OAS entered insolvency proceedings in Brazil and its contract with NIDCO was terminated. NIDCO made demands under the SLCs, including those provided by Santander, to secure the repayment of retention money. The demands were in the form stipulated by the SLCs which required NIDCO to state that the amount demanded *'is due and owing to us by the Contractor'*.

Santander did not pay out on the demands because a Brazilian court had issued an injunction to the apparent effect that the SLCs should not be honoured – and Santander would be exposed to penalties if it breached that injunction. However, the SLCs were subject to English law and the jurisdiction of the English courts. NIDCO therefore brought proceedings against Santander in England and applied for summary judgment.

Santander relied on the fraud exception and claimed that NIDCO did not have an honest belief that the amounts demanded were 'due and owing' to it by OAS. Santander argued that:

— The SLCs required more than a mere statement that a breach of contract had occurred and/or that loss had been suffered as a result. The amounts demanded were required to be 'due and owing'.

— NIDCO's claim against OAS was one for damages which pursuant to the law of Trinidad and Tobago would not become 'due and owing' until liquidated by an arbitration award under the construction contract.

— Correspondence prior to the demands showed that NIDCO's claim against OAS was based on estimated amounts for future sums.

— Santander contended that previous payment certificates showed that a maximum of US $31 million in retention money could be claimed by NIDCO, whereas the total it had claimed under all of the SLCs provided as retention security (by Santander and other banks) was US $35 million.

Santander argued that the above facts were sufficient to put the honesty of NIDCO's demands in issue and to require a full trial with cross-examination of those responsible for the demands within NIDCO.

Santander separately argued that English law should be developed to recognise a different approach to on-demand securities used to secure performance obligations, such as in construction contracts, from those used to secure primary payment obligations, as in contracts for the sale of goods. It suggested that there should be an exception for unconscionable conduct in such cases alongside the existing fraud exception (as is the case in other common law jurisdictions such as Singapore and Australia).

Commercial Court: no evidence of fraud

The court disagreed that any of the matters advanced by Santander provided a justification for further investigating the honesty of NIDCO's demands. The fact that under the law of Trinidad and Tobago the amounts demanded might be shown not to have been *'due and owing'* at the date of the demand was not directly relevant to whether NIDCO honestly believed in the validity of its demands: *'what really matters is not the law of England, nor the law of Trinidad, but the belief of [NIDCO].'*

For similar reasons, the court was not persuaded that the maximum retention sum of US $31 million alleged by Santander provided any basis to challenge the honesty of NIDCO's demands. The court noted the broader context of *'what was happening in this case and … under the construction contract, and the future of the construction contract'*. NIDCO's belief was not to be treated as a *'function of the legal analysis urged by [Santander], save perhaps in the plainest case, of which this is not one.'*

Whilst noting support for an unconscionability exception in the Singaporean cases and in academic writings, the court rejected the existence of any such exception in English law. The court emphasised that *'standby letters of credit must work in accordance with their terms, and that includes working on time'*.

Court of Appeal: legal interpretation correct in any event

Santander's appeal against the Commercial Court's decision was heard on an expedited basis and was decided two and a half months later. Whereas the Commercial Court had focused on whether Santander's legal analysis was sufficient to impugn NIDCO's honesty in making its demands under the SLCs, the Court of Appeal directly challenged the correctness of Santander's legal analysis.

The court disagreed as a matter of law with the contention that the requirement for a valid call to include a statement that the amounts claimed were 'due and owing' did not allow NIDCO's unliquidated claims for damages arising from termination to be included in such a call. The underlying contract incorporated the standard FIDIC clause 4.2(d) which stated that performance securities were required not merely for failures to pay amounts due but also for *'circumstances which entitle the Employer to termination … irrespective of whether notice of termination has been given.'* This was important background against which the SLCs were to be interpreted and showed that unliquidated claims for damages arising on termination were permissible.

NIDCO was also entitled to call for the full amount of the retention security even though this sum exceeded the amount of the cash retention which would have been held by NIDCO at the date of termination had the retention security not been provided in lieu of a cash retention. The court viewed the provision of a retention security in lieu of cash retention as being *'for the benefit of the contractor'* and any restriction on the Employer's ability to call on the full amount of the retention security needed to be expressly stated in the SLC.

NIDCO's calls were therefore valid in law and there could be no basis for impugning their honesty.

Conclusions

A number of conclusions can drawn from these cases as to the ability of parties to make calls under on-demand securities in circumstances where legal uncertainty may exist as to their entitlement to do so:

— The *Petrosaudi* decision represents one of the only times in which the fraud exception has been successfully argued after a call has been made on an on-demand security. Although the decision was reversed on appeal, the case provides a lesson as to use of legal advice when making such calls. Lawyers will tend to identify various interpretations of bonds or contracts which may be 'arguable' or 'plausible' but which they consider to be unlikely to succeed. Making a call on the faith of an 'arguable' or 'plausible' interpretation which is not thought likely to succeed will be fraudulent. As the Commercial Court judge noted in *Petrosaudi*: *'The fact that [Mr Buckland] may have thought that an argument or even a strong argument could be put forward to justify the [demand] by means of the different interpretation of 'obligated' is irrelevant. He himself had to believe in that different interpretation so as to render the certificate true …'*.

— A party may therefore be better off without obtaining legal advice as to the merits of a proposed call where a commercial view is already held that a call is justified. As shown by the *NIDCO* case, the court will be slow to conclude that a commercially held view is fraudulent merely because it is at odds with the legal position. In the court's language, a party's state of mind (in the absence of legal advice) is not to be taken as a function of a particular legal analysis save in the clearest of cases.

— Care should be taken, however, not to avoid taking legal advice in respect of pre-existing doubts as to a party's ability to make a call. A deliberate decision not to investigate such doubts can also amount to fraud, sometimes referred to as recklessness or 'wilful blindness' under English law. A better course, is for a written policy to be put in place in advance detailing the procedure for making calls under on-demand securities, including whether or not legal advice will be taken and in what respects, and covering other matters such as board authorisation, signatories and the like.

— The *NIDCO* decision provides an important precedent for Employers wishing to call on on-demand securities after the termination of a construction contract. Difficulties can sometimes arise in such circumstances where the contract requires the Employer's entitlement to additional costs and/or compensation to be calculated after completion of the works by a replacement contractor or the Employer itself. On-demand securities will often be due to expire before completion in such circumstances, meaning that the Employer may look to make a demand based on estimated losses. Depending on the drafting of the contract in question, an Employer may sometimes have no claim at all until the works are completed.

— For FIDIC based contracts, and subject to the precise terms of the securities in question, the Court of Appeal's decision in *NIDCO* suggests that the standard clause 4.2 can be used to argue for a broad interpretation of on-demand securities provided thereunder, permitting unliquidated claims for damages arising on termination. This decision may also encourage parties in other circumstances to rely to the terms of their construction contract to influence the interpretation of on-demand securities which have been supplied under them.

— It appears also that retention securities given in lieu of cash retentions will, in the absence of any contrary wording, allow demands to be made for their full amount regardless of the stage at which a project has reached (although to avoid a later challenge the Employer must of course have genuine claims up to the amount demanded). Contractors wishing to limit such securities to amounts which would otherwise have been held as retention at any given time should include specific wording to this effect.

— Finally, English law remains opposed to any unconscionability exception for on-demand securities, unlike other common law jurisdictions such as Singapore and Australia and the many civil law jurisdictions which permit challenges to be made to calls which although not fraudulent may nonetheless be characterised as 'abusive'.

References: *National Infrastructure Development Co Ltd. v Banco Santander S.A* [2016] EWHC 2990 (Comm); *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2016] EWHC 2456 (Comm); *National Infrastructure Development Co Ltd. v Banco Santander S.A* [2017] EWCA Civ 27; *Petrosaudi Oil Services (Venezuela) Ltd v Novo Banco SA* [2017] EWCA Civ 9.

On-demand securities: compliance with formalities and the doctrine of strict performance

Calls under on-demand securities may also be challenged where the call does not comply with the requirements specified for making calls under the security in question. There is an ongoing debate under English law as to the extent to which strict compliance is necessary with such requirements or whether the more commercial approach taken to contractual notices generally should apply. A number of cases have considered this issue over the past year and would appear to provide support for arguments that strict compliance may not be necessary in certain circumstances.

Introduction: the doctrine of strict performance

It is a long standing rule of English law that a presentation made under a letter of credit must comply strictly with any requirements stipulated by the letter of credit. As noted by the English House of Lords as early as 1927 (in *Trust Co of New York v Dawson Partners Ltd*):

> *'There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transaction thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down, it acts at its own risk.'*

Accordingly, in *JH Rayner & Co Ltd v Hambros Bank Ltd*, a letter of credit was payable against an invoice and bills of lading for 'Coromandel groundnuts'. However, the plaintiffs presented bills of lading for 'machine-shelled groundnut kernels' accompanied by an invoice for 'Coromandel groundnuts'. Although evidence was initially accepted by the court that 'machine-shelled groundnut kernels' were universally understood in the trade to be identical with 'Coromandel groundnuts', the case was rejected on appeal. The bank was not required to investigate whether the two terms were synonymous and was entitled to decline payment *'on the ground that the documents tendered … did not comply precisely with the terms of the letter of credit which they had issued.'*

This approach is also said to encourage the provision of documentary credits by banks. It is said to enable *'banks to issue letters of credit for a modest charge in the knowledge that they will not have to take decisions of substance as to whether the documents presented are sufficient.'* (*IE Contractors Ltd v Lloyds Bank Plc*)

It is unclear to what extent the doctrine also applies to performance bonds i.e. documentary credits which secure the performance of obligations rather than payment. In *IE Contractors* the English Court of Appeal commented that:

> *'there is less need for a doctrine of strict compliance in the case of performance bonds, since I imagine that they are used less frequently than letters of credit, and attract attention at a higher level in banks. They are not so much part of the day-to-day mechanism of ordinary trade. And….the kind of documents which they require is usually different from the kind required under a letter of credit.'*

The court therefore concluded that: *'the degree of compliance required by a performance bond may be strict, or not so strict. It is a question of construction of the bond.'*

IE Contractors was decided in 1990 and more recently the existence of a distinction between performance bonds and Letters of Credit has been challenged. In *Sea-Cargo Skips AS v State Bank of India*, a case decided in 2013, a judge of the English Commercial Court noted that:

> *'The distinction suggested [in IE Contractors] between letters of credit and performance bonds has not met with universal approval … For my part I would respectfully doubt that there is less need for a doctrine of strict compliance in the field of performance bonds than in letters of credit. In the field of performance bonds, as in the field of letters of credit, the banks who provide the bonds deal with documents. Banks must honour their obligation to pay if documents which conform with the requirements of the bond are tendered. Thus the banks must determine, on the basis of the presentation alone, whether it appears on its face to be a complying presentation; see articles 6 and 19(a) of the ICC's Uniform Rules for Demand Guarantees 2010 Revision which are good evidence of banking practice.'*

More recently still, judges of the UK's highest court have noted that: *'The principles governing letters of credit are as much applicable to letters of indemnity of the present nature, as well as other forms of on demand guarantee.'* (*Mauri Garments Trading and Marketing Ltd v The Mauritius Commercial Bank Ltd)*

The *Sea-Cargo Skips* case provides a good example of a reasonably strict approach being taken to a performance bond. The bond in that case was a refund guarantee, given to secure the refund of payments made under a shipbuilding contract in the event of termination. The guarantee required any demand to include a statement that: *'that the vessel or the construction thereof is delayed with more than 270 days as set out in the contract article IV 1 (E) which entitles the buyer to cancel the contract and to receive repayment of the advance payments'*. A demand was made under the guarantee which confirmed that the construction of the vessel had been delayed by more than 270 days and that the buyer had accordingly exercised its right to cancel the contract, however no mention was made of article IV 1 (E). This was held to invalidate the demand, as it was not for the bank to enquire as to whether the 270 days of delay alleged was *'as set out in the contract article IV 1 (E)'*.

A further objection made by the builder was that the demand did not expressly state that the buyer was entitled to receive repayment of the advance payments. The demand stated that the buyer had demanded repayment of those payments from the builder and that the buyer was entitled to demand repayment under the guarantee, but did not state in terms that it was entitled to repayment under the shipbuilding contract. The buyer argued that by stating it had demanded repayment from the builder it was implicit that it had lawfully demanded repayment i.e. that it was entitlement to repayment. This argument was rejected. The bank was not a party to the shipbuilding contract and an express statement of entitlement was therefore required. Such strictness was also said to help prevent abuse of the guarantee by requiring the buyer to verify its entitlement under the shipbuilding contract in express terms.

The strictness of the approach taken in the *Sea-Cargo Skips* case can be contrasted with a number of decisions over the past year by the English and Scottish courts. As we summarise below, these decisions may suggest a more lenient approach to the interpretation of performance bonds.

South Lanarkshire Council v Coface SA

Coface granted a performance bond in favour of South Lanarkshire Council as security for the land restoration obligations of the operator of an open cast mine, the Scottish Coal Company Limited ('Scottish Coal'), following the cessation of mining operations.

Coface's maximum aggregate liability under the bond was fixed at £4,499,411 and various sub-limits were to apply on an index linked basis depending on the period which had passed since commencement of work by Scottish Coal. Coface's obligation to make payment under the bond was expressed as follows:

> *'In the event of a breach of the Restoration Obligations as referred to in Clause 2.1 above, [Coface] shall, if called upon by the Council, pay to the Council the cost to the Council of the works required to be carried out in implement of the Restoration Obligations (which works are hereinafter referred to as the Restoration Works).'*

Clause 3 of the bond set out the requirements for a demand under the bond as follows:

> *'3.1 Prior to the obligation upon the Cautioner to pay any sums due hereunder becoming enforceable by the Council, notice in writing of any breach of the Agreement by the Company and the cost of Restoration Works to be carried out must be provided to the Cautioner at its above-mentioned address for service.*

3.2 The Cautioner shall not be obliged to investigate the authenticity or validity of a claim; a written demand for payment from an authorized official of the Council being sufficient evidence of any sum due hereunder.'

Interim liquidators were appointed to Scottish Coal on 29 April 2013. They later informed the Council that Scottish Coal's funds were insufficient to pay for any restoration works.

The Council wrote to Coface on 1 May 2013 stating that it was likely that the bond would be called. On 29 May 2013 the Council sent a notice expressed to be a *'Notice in terms of Clause 3 of the … Bond'* which stated that Scottish Power was in breach of its Restoration Obligations and that *'the cost of the Restoration Works as defined in the … Bond is … £9,199,892.00 Sterling'*. The notice did not specify the particular sum that Coface was being asked to pay and nor did the Council indicate the cost which it would incur in carrying out the restoration works itself.

Coface challenged the Council's notice and, after failing before the Commercial Court of the Scottish Court of Session, appealed to the Scottish Court of Appeal, known as the Inner House. Coface argued that the notice was invalid because whilst it stated a breach of the Restoration Obligations and stated the cost of the Restoration Works, it did not actually make a demand for payment of a specified sum. As the bond contained provisions for different levels of liability at different times and required index linking, the sum demanded was not known.

The Inner House adopted the more liberal approach to performance bonds from the *IE Contractors* case, noting that the performance required could be strict or not so strict, depending on the interpretation of the bond. In this regard, the court emphasised the need for a common sense approach and to avoid an unduly technical interpretation. Whilst accepting that the cost of the restoration works was not the same as the amount due under the bond, the court considered that Coface could easily examine the terms of the schedule to the bond, carry out the index-linking exercise and determine its liability. The Council's notice was therefore sufficient.

Coface also argued that the notice did not state in plain terms what the breach of contract was other than stating that there had been a breach of the Restoration Obligations. Coface argued that specification of the precise breach that had occurred was required. The court rejected this argument noting that the bond merely required *'notice in writing of any breach'*. Interestingly the court also noted that such a breach might occur *'at an anticipatory stage'* where it became apparent before the termination of mining operations that Scottish Coal was insolvent and would be unable to carry out the Restoration Works.

A final point of difference between the Council's notice and the terms of the bond was that the bond referred to the cost *'to the Council'* of carrying out the Restoration Works, whereas the Council's notice referred only to the original cost agreed with Scottish Coal for carrying out the Restoration Works as recorded in the bond. This may have provided a further objection to the Council's notice, although the point is not discussed in the judgment.

Overall the Inner House's judgment appears to reflect a more lenient approach than one might expect to be applied to a presentation under a letter of credit or that adopted in the *Sea-Cargo Skips* case. In this regard, the finding in *Sea-Cargo Skips* that an express statement of

entitlement was required makes an interesting contrast to the Inner House's finding that no express demand for payment was needed under the Coface bond.

Fife Council v Royal & Sun Alliance Insurance plc

The insolvency of Scottish Coal has prompted other similar cases in Scotland involving bonds provided to secure the company's remediation obligations. On such case decided earlier this year involved a bond provided by Royal & Sun Alliance ('RSA') in favour of Fife Council.

The Council made a demand under the bond by a letter dated 2 December 2015 in which it notified RSA of a default and called on it to make payment of £3.1m for the costs of remediation work.

Clause 3.1 of the bond stated as follows:

> *'3.1 Prior to the obligation upon [RSA] to pay any sums due hereunder becoming enforceable by [the Council], notice in writing of any Default and a full breakdown of any proper and reasonable cost … must be provided to [RSA] … together with reasonable evidence of the intention and ability of [the Council] to proceed forthwith with any such operation.'*

RSA rejected the Council's demand and, among other objections, argued that the Council had not provided reasonable evidence of its intention and ability to proceed forthwith with the work as required by clause 3.1. The Council's demand had enclosed evidence of Scottish Coal's default of its remediation obligations together with a cost breakdown for the proposed remediation work. However, with regard to its *'intention and ability'* to proceed with such works, it had merely stated that the Council would *'comply with its obligations under the Bond'* with no additional supporting evidence provided.

The Council's claim to enforce the demand came before the Scottish Commercial Court. The court referred back to its own decision in the *South Lanarkshire* case referred to above and to the *IE Contractors* case for the proposition that compliance with the requirements of a performance bond may be strict or not so strict depending on the interpretation of the bond.

In this respect, the court held that the performance required by the RSA bond was not so strict. This was highlighted by the fact that the strict compliance rule is usually justified by the fact that a bank is required to pay on the presentation of documents alone, whereas the requirement in the present bond for *'reasonable evidence'* of the Council's intention and ability to complete the remedial works required a factual assessment which was inconsistent with a strict compliance approach.

The Council had argued that the RSA was fully aware of its intention to undertake work and pointed to prior correspondence and evidence that it had carried out work on other sites. It argued that the statement in the demand that it would *'comply with its obligations under the Bond'* was to be read in this context. The court agreed with this approach and sent this part of the case to a hearing on the evidence in order to ascertain whether this background evidence was sufficient to comply with the reasonable evidence requirement of the bond.

The court's findings in this regard would appear to provide further encouragement for a lenient approach toward the interpretation of performance bonds. Even assuming strong background evidence, the bare statement in the demand that the Council would *'comply with its obligations under the Bond'* would not itself appear to be evidence of ability to carry out the works, nor of its ability or intention to carry out those works *'forthwith'*. Similarly, the requirement for *'reasonable'* evidence of intention might be thought to require something more than a bare statement of intention. The latitude given to the Council in this regard is perhaps better explained by the unique nature of the bond itself, which was not limited to the presentation of specified documents alone, but required a value judgment to be made by the bondsman as to the reasonableness of the evidence put forward by the Council.

MUR Joint Ventures BV v Compagnie Monegasque de Banque

As the above two decisions emanate from the Scottish courts, they may be argued not to represent the English law position as to performance bonds. Such an argument is however complicated by a third decision last year adopting a similar approach, this time by the English Commercial Court, in *MUR Joint Ventures BV ('MUR') v Compagnie Monegasque de Banque*.

MUR entered into a joint operations agreement with Seatrade for the chartering and operation of a bulk carrier. Seatrade's obligations under the agreement were secured by an on-demand guarantee issued by a Montenegrin bank. MUR alleged that Seatrade had failed to make payments due under the agreement and made a demand under the guarantee.

The guarantee was expressed to guarantee a maximum amount of $500,000, *'provided that the Bank's obligation under this Guarantee to make a Guaranteed Payment shall arise forthwith upon written demand sent to the bank by way of registered mail to the above*

mentioned bank's address'. The guarantee also required certain authorisation and authentication requirements to be complied with.

Seatrade objected to the demand on the grounds that the authorisation and authentication requirements had not been complied with and that the demand had not been sent by registered mail. The bank refused to pay and MUR commenced proceedings against the Bank.

The Commercial Court upheld MUR's demand, finding that the authorisation and authentication requirements had been complied with and that the failure to send by registered mail did not invalidate the demand. There was no question that the demand had been received by the Bank. The requirement for registered mail was *'directory, not mandatory … because the guiding principle is one of effective presentation of a demand'*.

In reaching its conclusion, the court considered the correct approach to the interpretation of on-demand guarantees and noted that *'[t]he principle of strict compliance does not necessarily apply to demand guarantees'*. The court relied in this regard on *IE Contractors* and the proposition that the degree of compliance required by a performance bond may be strict or not so strict depending on the construction of the bond.

Although the court also referred to the *Sea-Cargo Skips* case, the court's decision on the facts may suggest a more lenient approach akin to the two Scottish cases referred to above. The court's finding in particular that the prescribed means of making a demand need not be strictly complied with, so long as the demand has been effectively presented to the bank, may be surprising to some. The fact that such a demand must be complied with immediately by the bank and involves the payment of large amounts of money might otherwise have been thought to require strict compliance with any stipulated means of communication.

The court's finding on this issue might be thought to draw some support from the *ICC Uniform Rules for Demand Guarantees* although the Rules were not referred to in the judgment. Article 14(d) of the Rules states that:

> *'Where the guarantee indicates that a presentation is to be made in paper form through a particular mode of delivery but does not expressly exclude the use of another mode, the use of another mode of delivery by the presenter shall be effective if the presentation is received at the place and by the time indicated in paragraph (a) of this article.'*

Whether or not the bond in this case expressly excluded the use of another mode of delivery would appear to be debatable given the conditional language of the bond that the bank would guarantee Seatrade's obligations *'provided that'* a demand was issued in accordance with the prescribed mode of delivery. Such language may well have supported a finding that no other mode of delivery was permissible were a stricter approach to the interpretation of the bond to have been adopted.

Conclusion

The Scottish and English cases decided over the past year appear to show a greater degree of leniency as regards the interpretation of perfrmance bond requirements. These cases will give encouragement to Employers to argue that close enough is good enough with regard to demands made under such securities.

It is unclear how these recent cases are to be reconciled with the approach taken in earlier cases such as *Sea-Cargo Skips* or whether the position taken by the English Court of Appeal in *IE Contractors* remains good law, given the much greater popularity of performance bonds and on-demand guarantees than was the case when *IE Contractors* was decided.

One potential means of reconciling these divergent positions is to distinguish between matters which concern the underlying relationship between the two contracting parties, such as the entitlement to repayment in *Sea-Cargo Skips*, and matters which pertain only to the bond, such as the alleged requirement to make an express demand in *South Lanarkshire* and the requirement to send by registered mail in *MUR Joint Ventures*. It may be said that matters which concern the underlying relationship between the two contracting parties require strict compliance, as the bank has no ability to investigate and in order to prevent abuse of the bond, whereas a broader approach may be open for matters which purely concern the bank and the beneficiary under the terms of the bond.

References: *Trust Co of New York v Dawson Partners Ltd* [1927] 27 Lloyd's Rep 49; *JH Rayner & Co Ltd v Hambros Bank Ltd* [1943] KB 37; *IE Contractors Ltd v Lloyds Bank Plc* [1990] 2 Lloyd's L R 496; *Sea-Cargo Skips AS v State Bank of India* [2013] 2 Lloyd's Rep 477; *Mauri Garments Trading and Marketing Ltd v The Mauritius Commercial Bank Ltd* [2015] UKPC 14; *South Lanarkshire Council v Coface SA* [2016] CSIH 15; *Fife Council v Royal & Sun Alliance Insurance plc* [2017] CSOH 28.

Indirect and consequential loss exclusions: English law on the brink of change?

Exclusions or limitations of liability for 'indirect' or 'consequential' loss are commonplace in international construction and engineering contracts. Such exclusions appear in many of the commonly used standard forms, including the FIDIC suite[1], the LOGIC General Conditions of Contract for Construction[2], and the NEC[3]. English law has given a specific meaning to such exclusions, limiting their application to losses falling within the second limb of *Hadley v Baxendale*[4].

The narrowness of this approach has been subject to growing criticism of late. Other common law jurisdictions have departed from it and a recent Commercial Court decision appears to be the first considered refusal to apply it in England. We consider below the extent to which these developments provide a basis for challenging the existing English law position, particularly in light of what appears to be an increasing judicial willingness to interpret contracts with a greater degree of literalism and to give exclusion clauses their fair and natural reading.

Introduction

The narrow interpretation of exclusion clauses for 'consequential' or 'indirect' loss can sometimes be overlooked by international parties contracting on English law terms. Those not familiar with English law's treatment of such clauses can be tempted to think that all losses which follow as a consequence from a breach of contract are intended to be excluded. They would be encouraged to do so by the dictionary definition of the word 'consequential' being something *'of the nature of a consequence or sequel; following, especially as an effect or result …'*.[5]

English law, however, treats such clauses as reflecting a fundamental distinction between two types of recoverable loss set out in the well known case of *Hadley v Baxendale*. They are:

1. Losses that may fairly and reasonably be considered to arise '*naturally*', i.e. according to the usual course of things from the breach of contract. These are referred to as 'direct' losses.

2. Additional losses which, although not being the direct or natural consequence of the breach, were within the contemplation of both parties at the time they made the contract as the likely consequence of such a breach. These are referred to as 'consequential' or 'indirect' losses.

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* This is an abridged version of an article which is due for publication later this year in Volume 34, Part 3 of the International *Construction Law Review*.

1. Clause 17.8 of the Gold Book and clause 17.6 for the remainder of the suite exclude 'any indirect or consequential loss or damage' among other things.
2. Clause 25(i) of the Logic Conditions of Contract, Construction, Edition 2, excludes 'consequential or indirect loss under English Law.'
3. Optional clause X18.1 of the NEC Engineering and Construction Contract limits liability for 'the Employer's indirect or consequential loss'.
4. (1854) 9 Exch. 341.
5. Oxford English Dictionary, 2nd Edition (1989).

English law therefore confines such exclusions to losses which have arisen from unusual sets of circumstances which both parties were aware of at the time the contract was entered into. If the parties were not so aware, losses are unrecoverable in any event due to the rule in *Hadley v Baxendale*. The opportunity for such exclusions to 'bite' is therefore rare. It is thought that there is no single reported case in which such an exclusion has been effective to exclude losses which would have otherwise been recoverable.

The traditional rule

One of the earliest English cases to consider an exclusion for indirect and consequential loss was *Saint Line v Richardsons*. This case involved the sale and installation of a set of engines, which turned out to be defective. The court was asked to consider whether the ship owner's claim for loss of profit, expense of wages and fees paid to experts were excluded by the contract which stated '*nor shall their liability ever or in any case… extend to any indirect or consequential damages or claims whatsoever.*' In his judgment, Atkinson J remarked that the word '*consequential*' was not very illuminating as all damage is in a sense consequential. He drew from the Court of Appeal's earlier judgment in *Millar's Machinery Company v David Way & Son* which noted that the word '*consequential*' had come to mean '*not direct*.' In finding that none of the damages were caught by the exclusion clause, Atkinson J stated:

> '*In my judgment the words 'indirect or consequential' do not exclude liability for damages which are the natural result of the breaches complained of… If one takes loss of profit, it is quite clear that such a claim may very well arise directly and naturally from the breach based on delay.*'

In *Croudace Construction Ltd v Cawoods Concrete Products Ltd*, the plaintiff sold the defendant masonry blocks. The blocks were delivered late and the plaintiff argued that it suffered loss in relation to workmen and materials being kept on site without work, inflation costs and also claims made against it by subcontractors. The Court of Appeal held that the exclusion clause, which stated: '*we are not under any circumstances to be liable for any consequential loss or damage caused by reason of late supply,*' did not exclude the losses claimed. The word '*consequential*' did not cover any loss that directly and naturally resulted in the ordinary course of business from late delivery.

The traditional rule has been applied in a great many other cases since. Under English law, the interpretation of contracts is usually carried out on a case by case basis, as the court is required to consider the context and background against which a contract was concluded. Previous decisions on similar wording are usually of limited assistance in this regard, save to illuminate the different approaches which may have been adopted and/or argued for previously. However, in certain circumstances a particular interpretation of certain words or phrases in a given context may develop into a principle of general application as a judicial consensus grows as to how such words or phrases are to be interpreted.

It is now clear that such a position applies to indirect and consequential loss exclusions. In *British Sugar Plc v NEI Power Projects Ltd*, decided twenty years ago in 1997, the defendants argued that a different distinction should be followed between '*normal*' and '*consequential*' losses. They argued that normal loss is that which every plaintiff in the like situation will suffer, whereas consequential loss is that which is special to each particular plaintiff. The Court of Appeal rejected that approach, in part due to the weight of previous authority. As Waller LJ explained:

> '*[O]nce a phrase has been authoritatively construed by a court in a very similar context to that which exists in the case in point, it seems to me that a reasonable businessman must more naturally be taken to be having the intention that the phrase should bear the same meaning as construed in the case in point. It would … take very clear words to allow a court to construe the phrase differently.*'

Eleven years later in 2008 an even stronger reiteration of this principle as regards indirect and consequential loss exclusions was given by Teare J in *Ferryways NV v Associated British Ports*:

> *'Clause 9(c) provides that liability for such losses as are 'of an indirect or consequential nature' is excluded. In the light of the well-recognised meaning which has been accorded to such words in a variety of exemption clauses by the courts from 1934 to 1999 it would require very clear words indeed to indicate that the parties' intentions when using such words was to exclude losses which fall outside that well-recognised meaning.'*

Recent criticism

Despite the weight of authority on this subject, the current position is not without its detractors. A strong alternative school of thought exists which would give to the phrase '*consequential loss*' the same meaning as it has in the law of tort. In tort, a distinction is made between normal and consequential loss. As noted above, the normal measure of loss is the loss that every

claimant in a similar situation would suffer. Consequential loss is the loss that is unique to the circumstances of that particular claimant.

A helpful illustration of this distinction applied to a contract case involving an exclusion clause can be found in *Scottish Power UK Plc v BP Exploration Operating Company Ltd*. Scottish Power entered into a long term agreement for the sale and purchase of natural gas from the owners of an oil and gas field known as the 'Andrew Field' some 230km north east of Aberdeen in the North Sea. The owners were found by the court to have breached the agreement by failing to produce gas from the Andrew Field during a period of shutdown. Scottish Power claimed to recover the additional costs it had incurred in sourcing replacement gas from third parties at a higher price than provided for by the agreement.

Among other defences, the owners relied on an exclusion clause in the agreement which provided that: *'…neither Party shall be liable to the other Party for any loss of use, profits, contracts, production or revenue or for business interruption howsoever caused and even where the same is caused by the negligence or breach of duty of the other Party.'* The owners argued that Scottish Power's claim was one for 'loss of use' or 'loss of production' as it concerned Scottish Power's inability to use gas produced from the Andrew Field or a lack of production of gas by the owners from the Andrew Field.

In rejecting this argument, Leggatt J in the Commercial Court noted that the normal measure of loss in such circumstances would be the difference between the contract price and the market price for the gas which the owners were obliged to supply. Consequential loss might arise if, for example, Scottish Power was delayed in procuring replacement gas such that it would suffer a shortage of gas for use in its own business. With this distinction in mind, the exclusion clause noted above was held to be limited to consequential losses and not to affect the normal measure of loss. The clause did not therefore apply to Scottish Power's claim, which was purely for the greater cost of procuring replacement gas and not for any consequential disruption to its business.

In applying this distinction, Leggatt J noted the line of cases referred to above:

> *'… which has interpreted the term 'consequential loss' where it appears in contractual exclusions of liability more narrowly, as referring only to losses which fall within the second limb of the test of remoteness of damage formulated in Hadley v Baxendale … that is, losses that could be expected to follow from the breach of contract under special circumstances known to both parties. I respectfully agree with the late Harvey McGregor that, as he maintained over many editions of his treatise, this unnatural interpretation of the term 'consequential loss' is to be deprecated: see McGregor on Damages (19th Edn, 2014) at paras 3-013 – 3-016.'*

Aside from the *Scottish Power* case, other doubts have been raised as to the traditional rule by English judges who have nonetheless felt bound to apply the rule as it stands. In *BHP Petroleum Ltd v British Steel plc*, Rix J (later to become a Lord Justice of Appeal) commented on the conceptual difficulties attending the traditional definition of 'consequential loss'. If a claim fell within the first limb of *Hadley v Baxendale*, the loss would be recoverable and the exclusion clause ineffective. If a claim fell within the second limb, the loss would only be recoverable if there was knowledge of special circumstances. Without such knowledge the claim would fail as being too remote, in which case the exclusion would be redundant. The potential scope of such an exclusion clause on the traditional interpretation was therefore very narrow indeed.

When the meaning of consequential loss was briefly considered by the House of Lords in the 2002 decision of *Caledonian North Sea Ltd v British Telecommunications plc*, Lord Hoffman stated that he '*would wish to reserve the question of whether … the construction adopted by the Court of Appeal [in Saint Line, Croudace and other similar cases] was correct.*' It was not necessary to decide the issue in that case, as the consequential loss clause was not applicable on the facts.

More recently in 2016, the Court of Appeal has cast doubt on the traditional rule in *Transocean Drilling v Providence Resources.* Transocean provided a drilling rig to Providence. A dispute subsequently arose as to the financial consequences of delays to the drilling of an appraisal well. The Court of Appeal was asked to determine whether certain delay related costs were caught by a 'loss of use' exclusion contained within the parties' contract, based loosely on the LOGIC form. The loss of use exclusion was part of a broader exclusion for 'Consequential Loss' as specifically defined by the parties. In finding that the delay related costs were not caught by the exclusion for consequential loss (as defined), Moore-Brick LJ noted that:

> *'The expression 'consequential loss' has caused a certain amount of difficulty for English lawyers, mainly as a result of attempts to define its meaning in the interests of commercial certainty: see the line of cases that includes Saint Line … Croudace Construction … It is questionable whether some of those cases would be decided in the same way today, when courts are more willing to recognise that words take their meaning from their particular context and that the same word or phrase may mean*

different things in different documents. The existence of that line of authority may account for the unusual terms of clause 20(i), but those cases do not fall for discussion in this case …'

Star Polaris

Shortly after the Court of Appeal's decision last year in *Transocean*, the Commercial Court delivered judgment in *Star Polaris LLC v HHIC-PHIL INC*. This case appears to be the first in which an English court has taken a reasoned decision to depart from the traditional rule and allow a broader meaning to be given to a consequential loss exclusion.

The case concerned a ship called STAR POLARIS (the 'Vessel') which had been built by the defendant (the 'Yard') under a shipbuilding contract with the claimant (the 'Contract'). After delivery the Vessel suffered a serious engine failure and was towed to a dockyard for repairs.

The claimant commenced an arbitration against the Yard, alleging the engine failure was caused by the Yard's breaches of the Contract and claiming: the costs of repairs to the Vessel; towage fees; agency fees; survey fees; off-hire and off-hire bunkers; and diminution in value of the Vessel.

The Yard denied liability for the failure and relied, among other things, on an exclusion of liability in the Contract for '*consequential or special losses, damages or expenses*'. The exclusion was contained in a clause setting out detailed provisions as to the repair of defects discovered in the Vessel and any physical damage caused thereby. The clause was expressed to replace all other obligations and liabilities of the Yard under the Contract or at common law. In this context, the Yard contended that the word 'consequential' was used in a cause-and-effect sense as excluding any losses caused as a knock-on effect of the engine failure.

The arbitral tribunal found that the claims over and above the costs of the repair were caught by the exclusion. In reaching their decision, the arbitral tribunal interpreted the word 'consequential' in the exclusion clause in the cause-and-affect sense contended for by the Yard, meaning 'following as a result or consequence'. The Yard had only undertaken to repair defects and physical damage caused thereby in accordance with its express repair obligations and all other financial consequences were the claimant's risk.

The claimant was granted permission to appeal on a point of law to the English Commercial Court as to the arbitral tribunal's interpretation of the consequential loss exclusion.[6] The claimant argued that '*consequential or special losses*' should be interpreted in accordance with the traditional rule meaning losses falling within the second limb of *Hadley v Baxendale*. Relying on the judgment of Teare J in *Ferryways NV v Associated British Ports*, quoted above, the claimant argued that very clear words would be required to interpret the clause in a way other than in accordance with the traditional rule.

The Commercial Court dismissed the appeal. It found that the exclusion clause had to be considered in light of the contractual liability regime as a whole, which included the detailed repair obligations and the fact that these were expressed to replace all other obligations and liabilities of the Yard under the Contract or at common law. In this context, the word 'consequential' meant that the parties had agreed to exclude liability for any damage which followed from the defective engines and any physical damage caused thereby i.e. losses over and above the cost of repair and replacement, even though such losses might fall within the first limb of *Hadley v Baxendale*.

The case makes an interesting comparison with the *Saint Line* decision (above) given that both cases concern losses flowing from the defective manufacture of ship engines and both concerned consequential loss exclusions. The key point of distinction between the two cases appears to be that the contract in *Star Polaris* made sufficiently clear that the Yard's express obligations of repair were to be the claimant's only remedy for defective work. In this context, the wider definition given to term 'consequential' is readily understandable. Nevertheless, the case is significant for being the first time in which such contextual factors have led to a departure from the traditional rule. Coming as it does so soon after the Court of Appeal's comments in *Transocean*, the case may encourage other attempts to use contextual arguments to overcome the traditional rule and to persuade judges in other cases that consequential loss exclusions *'may mean different things in different documents'*.

A change of emphasis in contractual interpretation

The *Transocean* and *Star Polaris* decisions themselves come shortly after the English Supreme Court's 2015 decision in *Arnold v Britton,* which is thought by many

6. Unless excluded by agreement of the parties, such appeals are available under the English Arbitration Act 1996, but are subject to permission from the court and the meeting of certain criteria.

to have heralded a greater degree of literalism in the approach taken to contractual interpretation under English law.

The longstanding principle under English law is that a court's task in interpreting a contract is to identify the intention of the parties by reference to *'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean'* (quoted from *Chartbrook Ltd v Persimmon Homes Ltd*). This does not necessarily equate to what the parties understood or intended.

Recent decisions of the Supreme Court in *Chartbrook* and *Rainy Sky S.A. v Kookmin Bank* seemed to suggest a broader approach to contractual interpretation which emphasised business common sense over the literal meaning of a given clause. This trend is regarded by many to have stopped with the Supreme Court's decision in *Arnold v Britton*.

Arnold concerned chalets in a leisure park, which were subject to 99 year leases from 1974. The court was asked to interpret a service charge contribution provision in which the lessees had promised to pay a service charge of £90 increasing every year by 10%. The tenants argued that the rate was designed to act as a cap rather than a flat rate. The compound rate every year would lead to extraordinary high charges in the later years of the lease (over £1,000,000 each year by the time the leases came to an end). The landlord argued that the charge was reasonable. Even though inflation is now much lower than the rate of compound interest in the leases, at the time they were entered into it was above 10%.

The case was appealed to the Supreme Court who dismissed the tenants' appeal and held that the tenants had contracted to pay £90 a year, compounded annually at 10%. Despite the '*unattractive consequences*', the escalation in price was not sufficient to enable the court to depart from the natural and unambiguous meaning of the words used. Lord Neuberger stated:

> '*[T]he mere fact that a court may be pretty confident that the subsequent effect or consequences of a particular interpretation was not intended by the parties does not justify rejecting that interpretation.*'

In his judgment, Lord Neuberger laid out a number of guidelines of general application including that *'the reliance placed in some cases on commercial common sense and the surrounding circumstances (eg in Chartbrook …) should not be invoked to undervalue the importance of the language of the provision which is to be construed'.*

Many commentators saw in *Arnold* a shift away from the Supreme Court's previous emphasis on commercial common sense as seen in the *Rainy Sky* and *Chartbrook* decisions. One commentator writing in the Edinburgh Law Review (Mr Craig Connal QC) perceived:

> *'a clear shift back toward primary focus on the words used. At the high point of judicial thinking, influenced by cases such as Chartbrook and Rainy Sky, an observer might have thought that the words could largely be ignored and that the goal was to reach a broad view of what the parties' intentions 'must have been'. Neither the words nor potential corrections to the words were of much significance. That approach is difficult to square with Arnold.'*

Earlier this year, the Supreme Court had the opportunity itself to address the suggestion that *Arnold* represents a change from the position adopted in *Rainy Sky.* In *Wood v Capita Insurance Services Limited*, the court rejected a submission that the court in *Arnold* had *'rowed back'* from the guidance given in *Rainy Sky.* In the court's view, *'Rainy Sky and Arnold were saying the same thing'*:

> *' [O]nce one has read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language in the contract, so long as the court balances the indications given by each.'*

This of course begs the question as to how the court is to hold the balance between these two, sometimes competing, considerations.

It is interesting to speculate how these developments might affect the traditional rule as to the interpretation of indirect and consequential loss exclusions. Despite the clarification provided by the court in *Wood*, the true effect of *Arnold* appears to be one of emphasis rather than principle. Judges appear to be more willing to hold the balance between the written word and business common sense closer to the literal meaning of an agreement than they might have done prior to *Arnold*.

It is thought that a more literal interpretation of indirect and consequential loss exclusions would tend to favour a broader, dictionary based interpretation like that adopted in *Star Polaris*, rather than the narrower second limb of *Hadley v Baxendale* interpretation. A particular difficulty in this regard for the traditional rule is that the second limb of *Hadley v Baxendale* requires knowledge of special circumstances, yet the words 'indirect' and 'consequential' are terms of causation which say nothing about the knowledge of either party.

Part of the rational for the traditional rule can also be seen in the historic approach of the English courts to exclusion clauses. In a separate article in this year's *Annual Review* (see page 5), we note how the Court of Appeal's *Transocean* decision last year has (by reference to *Arnold*) rejected a restrictive approach to exclusion clauses in favour of an approach which allows them to have their fair and natural meaning.

The early cases which establish the traditional rule in relation to indirect and consequential loss might be said to be affected by this shift in approach. For example, in *Croudace* Parker J (the judge at first instance) noted that he was approaching the interpretation of the consequential loss exclusion in that case *'on the basis that the clause, being an exclusion clause, will only exclude what can be brought clearly within the words used.'*

Conclusion

The scene appears to be set for a challenge to the traditional rule under English law. The greater emphasis on literalism after *Arnold*, together with the uninhibited approach to exclusion clauses affirmed in *Transocean*, would appear to add weight to the already strong criticism made of the traditional rule by academic writers and judges of late. *Star Polaris*, although explicable on its facts and the terms of the contract under consideration, provides an important precedent for the natural meaning of the word 'consequential' winning out over the weight of authority. Those looking to challenge the traditional rule can now ask with some force: 'why should this not happen more often?'

Forceful arguments against change can, however, also be made. With businessmen having been expected to be aware of the rule now for some considerable time, the disruption caused by any fundamental shift in the law could be extensive. Parties who had been assured by their legal advisers that an exclusion for consequential loss proposed by their contractual counter-party was narrow and unlikely to affect any claim for normal and ordinary losses, could find themselves without a remedy in a variety of situations.

Such considerations may lead to a more gradual change in the law. The more warnings given by judges and commentators as to the potential for change, the weaker the precedent and usage arguments will become. There may then come a time when well advised businessmen must be taken to know that the traditional rule has uncertain foundations and that courts or tribunals asked to consider the matter in the future may reach a different conclusion from those in the past.

References: *Hadley v Baxendale* (1854) 9 Exch. 341; *Millar's Machinery Co v David Way & Son* (1935) 40 Com Cas 204; *Saint Line v Richardsons* [1940] 2 KB 99; *Croudace Construction Ltd v Cawoods Concrete Products Ltd* [1978] 2 Lloyd's Rep 55; *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 42; *BHP Petroleum Ltd v British Steel plc* [1999] 2 Lloyd's Rep 583; *Caledonian North Sea Ltd v British Telecommunications plc* [2002] BLR 139; F*erryways NV v Associated British Ports* [2008] EWHC 225 (Comm); *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38; *McGregor on Damages* (19th Edn, 2014); *Rainy Sky S.A. & Ord v Kookmin Bank* [2011] UKSC 50; *Scottish Power UK Plc v BP Exploration Operating Company Ltd* [2015] EWHC 2658 (Comm); *Arnold v Britton* [2015] UKSC 36; *Transocean Drilling v Providence Resources* [2016] EWCA Civ 372; *C Connal QC, Has the rainy sky dried up? Arnold v Britton and commercial interpretation* (2016) 20(1) Edin. L.R. 71; *Star Polaris LLC v HHIC-PHIL INC* [2016] EWHC 2941 (Comm); *Wood v Capita Insurance Services Limited* [2017] UKSC 24.

The effect of express termination clauses on common-law rights to terminate

Two cases over the past year have considered the extent to which 'material breach' clauses affect rights to terminate at common law for repudiation. Such common law rights are easily overlooked, but will often be relevant in termination scenarios and can provide a valuable addition to those specified under the contract. We consider this topic in detail below.

Introduction

Most international construction contracts will contain express rights of termination in favour of both the Employer and the Contractor. These rights will usually be backed by detailed provisions setting out each party's rights, obligations and liabilities following termination. Rarely, however, will the parties specify how these contractual provisions are to affect common law rights of termination arising under English law.

It is sometimes thought that the agreement of express termination provisions will displace common law rights of termination. This is rarely the case and: English law requires clear words before such rights will be excluded. The mere fact that the parties have agreed their own termination provisions will not be sufficient.

The inclusion of express rights of termination may, however, have the effect of modifying common law rights. They may, for example, become subject to the same notification regime applicable to terminations under the express provisions. Common law rights of termination usually depend on the seriousness of a given breach of contract, and in this regard express termination provisions can provide a reference point for what the parties consider to be sufficiently serious to justify termination.

The availability of common law rights of termination can also have important consequences. They may allow a terminating party to access remedies not otherwise available under express termination provisions. For example, some termination mechanisms will defer an Employer's right to claim the additional costs arising from termination until completion of the works. This may give rise to problems if the Employer has in mind an immediate call on performance securities after giving termination. A common law right of termination could assist the Employer in such circumstances by providing an immediate right to damages. Common law rights of termination might also be relied upon to support an otherwise invalid termination under express provisions.

Two cases in the past year have considered the extent to which clauses permitting termination for material breach impinge on common law rights of termination under English law. We consider these cases below together with the position arising under the standard FIDIC termination provisions.

Lockland Builders

The leading English construction law authority in this area is *Lockland Builders v Rickwood*. In that case, a construction contract provided for

a right of termination in the event that the Contractor failed within 21 days to remedy any delay or defective work which had been certified by a qualified architect or surveyor and notified to him by the Employer. The Employer was dissatisfied with the quality of the construction work and sought to terminate at common law for repudiation, outside the terms of the express clause.

The English Court of Appeal held that the express right to terminate provided the only means by which the Employer could terminate for delay or defective work. Without following the procedure prescribed by the contract, the Employer could not otherwise seek to show that the seriousness of the Contractor's delay or defective work was such as to justify the termination of the contract (i.e. for repudiation). The exception for this would be clear acts of renunciation such as abandoning site or deliberately refusing to carry out the works in accordance with the required design.

Subsequent cases have suggested that similar express rights of termination, rather than excluding the common law right to terminate for repudiation, may only mould it to the circumstances of the particular contract. For example, in *BskyB Ltd v HP Enterprise Services UK Ltd*, it was noted that:

> *'in deciding whether by its conduct a party evinces an intention not to be bound by the terms of the contract [i.e. a common law repudiation has taken place], the way in which parties agreed to treat breaches within the terms of their contract must be a factor to take into account. In particular, if a breach of a term had to reach a degree of seriousness before a contractual termination clause could be applied, it is unlikely that a breach which was less serious would, by itself, amount to a repudiatory breach. Equally, the fact that for a particular breach the contract provided that there should be a period of notice to remedy the breach would indicate that the breach without the notice would not, in itself, amount to a repudiatory breach.'*

Material breach clauses

This line of authority raises a question as to how clauses which permit a party to terminate for 'material breach' are to be interpreted. These clauses typically require a cure period to be allowed before termination. However, as material breaches may range from the less serious to the most serious of breaches, an issue arises as to whether such clauses modify the common law right of termination to require cure periods to be given for even the most serious of repudiatory breaches.

This question was considered in the recent case of *C&S Associates UK ltd v Enterprise Insurance Company*. Enterprise, an insurance company, entered into a contract with C&S, an insurance claims handler, for C&S to handle third party motor claims on behalf of Enterprise. The parties fell into dispute over the provision of the services and Enterprise requested that a large number of claim files be delivered to it for inspection. C&S refused this request, noting that it would prevent it from continuing to work on the files, but offered to allow Enterprise to inspect the files at its offices. Enterprise considered that this refusal amounted to a repudiation of the contract and sought to terminate at common law.

Although the court found that C&S's refusal was not in breach of contract, Enterprise also argued that its termination was nonetheless justified by the overall poor quality of C&S's service up until that stage. This was also said to have amounted to a repudiation of the contract providing an alternative justification for Enterprise's termination. The quality issues were contested, and in addition C&S argued that Enterprise's right to termination for repudiation in such circumstances had been modified by a right to terminate for 'material breach' contained in the contract. This clause in question conferred a contractual right of termination where:

> *'the other Party commits a material breach of any provision of this Agreement and (if such default is capable of remedy) it is not remedied within 30 days (or such longer notice as the Aggrieved Party may specify) after written notice shall have been given by the Aggrieved Party to the other Party requiring such remedy giving full particulars of the breach and the reasonable steps necessary to remedy it'*

C&S argued that this clause showed an intention that breaches which were capable of being remedied, such as the quality issues complained of by Enterprise, were not to be repudiatory unless the innocent party had first given a notice requiring those breaches to be remedied.

The court accepted that parties may by their contractual terms modify the types of circumstances which will give rise to a common law right to termination. The court noted that this can occur where the parties specify a cure period for certain breaches of contract before rights of termination can be exercised (such as in *Lockland Builders*) or where compensation is expressly provided for certain kinds of breach of contract (such as liquidated damages for delay). By specifying that notice must be provided or compensation paid, the parties may show an intention that the breach itself is not sufficient to permit termination at common law.

Material breach clauses were unlikely to have this effect, however. They will usually cover breaches which could have a whole range of severity, from the barely material

to fundamental failures. The court concluded that such clauses *'will generally provide for a right to termination which is in addition to a party's common law rights'*. This was to be contrasted with clauses which stipulate cure periods for specific types of breaches, as was the case in *Lockland Builders*, which are more likely to curtail a party's common law rights. Enterprise was not therefore required to serve a notice to remedy before seeking to terminate at common law for repudiation, subject of course to it proving the factual basis of its claim.

A similar result was reached last year in *Vinergy International (PVT) Ltd v Richmond Mercantile Limited FZC*. Vinergy was held by an arbitral tribunal to have repudiated a long term bitumen supply contract by breaching an exclusivity clause. Vinergy's counter-party, Richmond, had therefore validly terminated the contract at common law. Vinergy appealed to the English Commercial Court on a point of law, arguing that Richmond had failed to comply with a clause in the contract requiring a cure period to be given prior to termination. The clause permitted termination in the event of a:

> *'failure of the other party to observe any of the terms herein and to remedy the same where it is capable of being remedied within the period specified in the notice given by the aggrieved party to the party in default, calling for remedy, being a period not less than twenty (20) days'*

No appeal was possible from the tribunal's finding of fact that a repudiation had occurred and it was not therefore possible for Vinergy to pursue the point raised in the *Enterprise* decision as to whether this clause required a cure period to be allowed before conduct could be said to be repudiatory. However, Vinergy contended that the clause was to be interpreted as applying to repudiatory breaches so that the giving of a notice and cure period was a contractual requirement applicable to common law termination.

As a matter of interpretation, Vinergy's argument failed. There was no reference to repudiation or common law rights in the clause, but rather the clause allowed an independent right of termination applicable to breaches of varying degrees of seriousness. The contract had also contained other express rights of termination which were not subject to the notice and cure period procedure (upon insolvency for example). The clause did not therefore place any restriction on Richmond's ability to terminate immediately for repudiation.

Liquidated damages clauses

As noted above, another category of clause which has the potential to affect common law rights of termination are clauses which specify compensation for certain breaches of contract, such as liquidated damages clauses. A good example of how such clauses can shape common law rights of termination is the English Court of Appeal's decision in *Stocznia Gdynia SA v Gearbulk Holdings Ltd*. That case concerned a shipbuilding contract which prescribed liquidated damages for delay coupled with a longstop provision which permitted the purchaser to terminate in the event that delays reached a certain point.

The Court of Appeal considered that these provisions impacted the purchaser's common law right to terminate for repudiation in the following way:

> *'The primary purpose of Article 10 in the present case is to provide an agreed measure of compensation for breaches of contract by way of delay in delivery and deficiencies in capacity and performance which, although important, do not go to the root of the contract. For these the parties have agreed the payment of liquidated damages which are to be deducted from the final instalment of the price and to that extent their agreement displaces the general law, at least as regards the measure of damages recoverable for a breach of that kind. However, they have also agreed that there comes a point at which the delay or deficiency is so serious that it should entitle Gearbulk to terminate the contract. In my view they must be taken to have agreed that at that point the breach is to be treated as going to the root of the contract. In those circumstances the right to terminate the contract cannot sensibly be understood as anything other than embodying the parties' agreement that Gearbulk has the right to treat the contract as repudiated, with … the usual consequences.'*

Although the purchaser had only terminated using its express contractual rights in this case, the Court of Appeal found that its termination was also effective to terminate at common law, with the result that it was entitled to damages in excess of the remedies provided by the express contract terms.

FIDIC termination provisions

The above cases have relevance to the standard FIDIC termination provisions. Clause 15.1[8] permits the engineer to give a notice identifying a failure by the Contractor to carry out *'any obligation under the Contract'* and to remedy it within a specified reasonable time. Clause 15.2(a) then provides a right to terminate upon the giving of 14 days notice if the Engineer's notice to remedy is not complied with. Clause 15.2(b)[9] also provides for a right to terminate on 14 days notice if the Contractor *'abandons the Works or otherwise*

plainly demonstrates the intention not to continue performance of his obligations under the Contract'.

In light of the *Enterprise* and *Vinergy* cases, the ability to give a notice to remedy and to terminate under clause 15.2(a) is unlikely to affect the Employer's common law rights to terminate for repudiation.

A more difficult question is whether the inclusion of clause 15.2(b), which effectively mirrors the test for renunciation at common law (which is one form of repudiation), affects the Employer's ability to rely on common law rights. Clause 15.2 is unlikely to be interpreted as displacing the Employer's common law rights to terminate in their entirety, but an argument might be made that a termination for renunciation must be made in accordance with the provisions of clause 15.2.

The logic of this argument follows the *Lockland Builders* case and the fact that the parties have specified a certain type of breach which would otherwise amount to a common law renunciation as being one of the triggers for an express right of termination with a 14 day notice period. Following *Lockland Builders* it might be said that clause 15.2(b) therefore represents the only way in which the Employer can terminate for renunciation.

Alternatively, a similar argument to that considered in the *Vinergy* case could be made to the effect that the 14 day notice provision in clause 15.2 should apply to any common law right of renunciation to the extent that it survives independently of clause 15.2. Whereas in *Vinergy* there was no reference to common law rights of repudiation, clause 15.2(b) appears to have these directly in mind and is expressly made subject to the 14 day notice period, whereas termination for insolvency or bribery under clauses 15.2(e) and (f) is allowed immediately upon notice being given.

The contrary position may receive support from the English Technology and Construction Court's decision in *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar*, where it appears to have been assumed under the FIDIC Yellow Book that a common law renunciation could lead to an immediate termination as opposed to the giving of 14 days notice under clause 15.2 (see paragraph 375). The question is not addressed in any detail however.

Although clause 15.2 states that the Employer's election to terminate *'shall not prejudice any other rights of the Employer, under the Contract or otherwise'*, the emphasis is on the Employer's election rather than the existence of clause 15.2 itself. This reference would not therefore appear to go so far as to prevent clause 15.2 affecting common law rights of termination in the manner outlined above.

Conclusion

Common law rights of termination often play an important role in supplementing express rights of termination. With this in mind, parties should consider careful how their express termination and liquidated damages regimes may affect the application of common law rights. An express reservation providing that common law rights remain unaffected by any express rights of termination clauses may in certain circumstances be worthwhile.

References: *Lockland Builders v Rickwood* (1995) 46 Con LR 92; *Stocznia Gdynia SA v Gearbulk Holdings Ltd* [2009] EWCA Civ 75; *BskyB Ltd v HP Enterprise Services UK Ltd* [2010] EWHC 86 (TCC); *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar* [2014] EWHC 1028 (TCC); *C&S Associates UK ltd v Enterprise Insurance Company* [2015] EWHC 3757; *Vinergy International (PVT) Ltd v Richmond Mercantile Limited FZC* [2016] EWHC 525 (Comm).

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7. In all of the FIDIC books.
8. Also in all of the FIDIC books.

No amendment and anti-variation clauses

In last year's Annual Review we provided an overview of the various ways in which parties can attempt to control management risk on construction projects using 'entire agreement', 'no amendment' and 'no waiver' clauses. The effectiveness of 'no amendment' clauses had previously been unclear under English law. A Court of Appeal decision in 2016 has now authoritatively determined that they are unable to prevent the agreement of amendments or variations contrary to their terms, but may still be taken into account by the court when deciding whether a binding agreement has been reached to amend a contract or agree a variation.

'No amendment' and 'no waiver' clauses: a recap

Large international construction contracts are typically administered for Employers and Contractors alike by project managers or engineers within defined project teams. In a FIDIC context, these positions are occupied by the Engineer and the Contractor's Representative (and any of their delegates or assistants). Throughout the course of a project, these personnel will discuss a broad range of issues, including technical matters, financial details and the legal merits of particular positions adopted by either party. As they are appointed by the parties and given responsibility for the management of such issues, these personnel will usually have authority to conclude agreements on behalf of the parties or to make statements which have legal effect under the relevant construction contract. Given that project level discussions often take place informally, risks arise that agreements or statements may be made without proper consideration or without prior approval of senior management. So called 'no amendment', 'anti-variation' and 'no waiver' clauses are often included within construction contracts to protect against these risks.

'No amendment' clauses will typically seek to preclude the making of amendments to a contract unless certain formalities are followed. A popular form is to require that any amendment be 'in writing and signed by the parties'. 'No waiver' clauses are similar and will usually seek to preclude any informal waiver of rights by stating that any waiver must be in writing and signed by the party concerned. In a construction context, 'anti-variation' clauses are often included which provide that a contractor will not be entitled to payment for varied or additional work unless agreed or instructed in writing by the Employer or the Employer's Engineer or Architect.

The effectiveness of these clauses has long been questioned on the basis that freedom of contract requires that parties be able to make new contracts through whatever means they choose and they cannot therefore put beyond their power their ability to do so in the future. On the other hand, proponents of such clauses argue that by giving effect to them the courts are upholding an exercise of the parties' freedom of contract. This debate has now been authoritatively resolved by the English Court of Appeal in *Globe Motors v TRW Lucas Varity Electric Steering ('TRW')*.

The Globe Motors decision

TRW was a producer of electric power-assisted steering systems. It entered into an exclusive supply agreement with Globe Motors, a

component manufacturer, which included a clause stating that: *'This Agreement … can only be amended by a written document which (i) specifically refers to the provision of this Agreement to be amended and (ii) is signed by both Parties.'* The court was asked to consider whether, despite this clause, the parties had made a binding oral agreement to novate or vary the contract to include a third party subsidiary of Globe Motors.

The court considered the following two previous Court of Appeal decisions in making its decision:

1. *United Bank Ltd v Asif*, where a clause precluding variations to a Deed of Guarantee without a signed written agreement was held to overrule a subsequent oral agreement; and

2. *World Online Telecom v I-Way Ltd*, in which an oral agreement was found to be a valid amendment despite the presence of such a clause, on the basis that commercial parties have *'made their own law by contracting, and can in principle unmake or remake it'*.

The court unanimously followed *World Online Telecom* to decide that, in the absence of statutory or common law restrictions, parties to a contract are free to amend or alter an agreement as they see fit. They cannot *'effectively tie their hands so as to remove from themselves the power to vary the contract informally'*.

A key argument raised in support of the enforceability of 'no amendment' clauses which prelude the making of oral amendments or variations, is that they served an important purpose in making sure that the enforcement of a party's rights cannot be frustrated by false or frivolous allegations that oral variations had been made to a contract. Such allegations could be raised to delay the enforcement of otherwise clear entitlements held by one party, for example by requiring lengthy arbitration or court proceedings to determine the truth of the alleged oral agreement. By establishing that amendments or variations can only be made in writing, such clauses would promote certainty and minimise the risk that the enforcement of clear entitlements could be derailed by such means. This is particularly important in large organisations or projects where those dealing with day to day matters may otherwise have the authority to reach contractually binding agreements orally.

Support for this argument was sought to be drawn by analogy from legislative requirements under English law for certain types of agreement (such as guarantees and dispositions of real property) to be made in writing. If the English Parliament has the power to prescribe such limitations, then why could the parties themselves, by consent, not be able to adopt such a regime?

The court was unpersuaded that these arguments could overcome the fundamental ability of the parties to make, unmake or remake agreements as and when they see fit. It did, however, consider whether the presence of such clauses should 'raise the bar' in terms of what would be required to prove an oral amendment or variation contrary to what the parties had previously agreed. Previous decisions had queried whether 'strong evidence' of an oral amendment should be required in circumstance where a 'no amendment' clause applied. This, however, was also rejected: all that was required was for the party alleging an oral amendment to prove to the usual standard, on the balance of probabilities, that a binding oral agreement had indeed been concluded.

The court also made reference to 'anti-variation' type clauses noted above, commonly found in building contracts, barring payment for extra work unless ordered or agreed in writing. The court agreed with a previous decision of the High Court of Australia in this regard (*Liebe v Molloy*), finding that such clauses could not preclude a claim for extras based on an oral agreement or an agreement by conduct. Accordingly: *'an oral agreement or the conduct of the parties to a contract containing such a clause may give rise to a separate and independent contract which, in substance, has the effect of varying the written contract.'*

Worth the paper they are written on?

Although depriving these clauses of much of their effect, the court's decision indicates that they may still be of relevance when considering whether any subsequent agreements are effective in binding the parties:

> *'In many cases parties intending to rely on informal communications and/or a course of conduct to modify their obligations under a formally agreed contract will encounter difficulties in showing that both parties intended that what was said or done should alter their legal relations; and there may also be problems about authority. Those difficulties may be significantly greater if they have agreed to a provision requiring formal variation.'*

Intention to create legal relations and authority are two essential ingredients to a binding agreement under English law. This passage therefore suggests that the presence of a 'no amendment' or 'anti-variation' clause may make it more difficult for a party to argue that an oral agreement was intended to be legally binding or that the person who was alleged to have made the agreement had authority to do so.

Whether this applies in any given case will be highly contextual. For example, the presence of a 'no amendment' clause in banking agreements is likely to

reinforce the impression that informal oral agreements with representatives of the bank cannot objectively be said to be intended to bind the bank, or that those representatives lack the authority to bind the bank by such agreements.

In construction contracts, however, a 'no amendment' or 'anti-variation' clause will need to compete against the fact that project teams are placed in positions of authority and agreements made by them are often acted upon. In such circumstances, the mere presence of such clauses may change little. A greater impact may be achieved, however, if a party is able to show that the clause in question was specifically negotiated. Such negotiations may provide important context for how subsequent agreements made between project teams are to be judged.

The courts comments noted above would also appear to support two of the ways in which we had suggested in last year's *Annual Review* that these types of clauses could be strengthened:

— A 'no amendment' clause might state that any amendments agreed shall be 'subject to contract' and enforceable only once certain formalities have been completed. 'Subject to contract' is a phrase commonly used when negotiating English law contracts to signify that the parties do not intend to be bound by any agreement until a formal contract is drawn up and signed. Evidence that an informal oral agreement was actually reached by the parties, whilst potentially sufficient to override a simple 'no amendment' clause, may not be sufficient to override a 'subject to contract' clause. That is because such a clause contemplates that informal agreements will be reached – albeit 'subject to contract' – and therefore reduces the scope for arguments that evidence of an informal agreement should be taken to be inconsistent with or have overridden the clause. This would appear to be recognised in the passage quoted above when the court refers to the impact that such clauses can have on ascertaining whether the parties had the required intention to be bound to an informal oral agreement.

— Better still, 'no amendment' or 'anti-variation' clauses might seek to state those persons or categories of persons who have authority to agree amendments or variations under the contract. Such a clause might, for example, specify the need for the agreement of two directors. Agreements or waivers made by persons outside of those mentioned in the clause should not bind the party concerned unless by other words or conduct the party has indicated that those persons do have authority to amend or waive rights under the contract on their behalf. The potential for such clauses to give rise to issues over authority is also recognised in the passage quoted above.

The FIDIC suite of contracts does not contain any express 'no amendment' or 'anti-variation' provisions. It does however contain provisions seeking to limit the authority of those who can act on behalf of the Employer. For example, clause 3.3 of the Red Book states that the *'Contractor shall only take instructions from the Engineer, or from an assistant to whom the appropriate authority has been delegated under this Clause'*. Depending on the circumstances, this clause may have a similar effect to the strengthened 'no amendment' clause recommended in the second bullet point above i.e. it is likely to make it difficult for a Contractor to rely on informal oral agreements reached with persons other than the Engineer or his delegates.

Conclusion

The Court of Appeal's decision in the *Globe Motors* case has subsequently been upheld by the Court of Appeal in *MWB Business Exchanges Centres Ltd v Rock Advertising Ltd*. The law in this area has therefore been significantly clarified over the course of 2016. Simple 'no variation', 'anti-variation' or 'no waver' clauses are unlikely to be of a great deal of assistance to those parties wishing to control management risk on construction projects. However, steps can be taken to improve these clauses in the ways set out above should parties wish to do so.

References: *Liebe v Molloy* (1906) 4 CLR 347; *United Bank Ltd v Asif* (unreported, 11 February 2000); *World Online Telecom Ltd v I-Way Ltd* [2002] EWCA Civ 413; *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396; *MWB Business Exchanges Centres Ltd v Rock Advertising Ltd* [2016] EWCA Civ 553.

The use of deleted clauses in interpreting contracts: a FIDIC example

The use of deleted clauses in the interpretation of contracts is an uncertain area of English law. The issue frequently arises in a construction context where parties agree amendments to standard forms such as FIDIC or the NEC. Arguments may be made that deletions or modifications to the standard form can be used to shed light on the intended meaning of the construction contract ultimately entered into by the parties. A decision of the English Technology and Construction Court last year provides an example of a generous approach being taken to such arguments in the context of an amended FIDIC Yellow Book contract.

Introduction: a summary of the English position

It is a longstanding rule of English law that pre-contractual negotiations are inadmissible for the purpose of interpreting a contract. This rule is based in part on English law's objective theory of contract interpretation and in part on the need for efficiency and predictability in resolving contractual disputes. In this regard, the English law position differs considerably to the approach taken in civil law countries, where pre-contractual negotiations are commonly admissible and more subjective theories of contractual interpretation apply.

The English rule was first laid down in *Inglis v Buttery*, an 1878 decision of the House of Lords. Lord Blackburn noted that:

> *'The very purpose of a formal contract is to put an end to the disputes which would inevitably arise if the matter were left upon verbal negotiations or upon mixed communings partly consisting of letters and partly of conversations. The written contract is that which is to be appealed to by both parties, however different it may be from their previous demands or stipulations, whether contained in letters or in verbal conversation.'*

One issue which arose in *Inglis v Buttery* was whether words which had been struck through in a final draft of the contract, and which were still visible in the executed version, could be relied upon to interpret the contract. The House of Lords ruled that these were akin to pre-contractual negotiations and therefore inadmissible. Lord Hatherly stated:

> *'When I turn to the deleted words and find that in spite of a line being drawn through them I can read the words … it appears to me that, those words being deleted, and a marginal note affixed shewing that they were deleted before the contract was finally concluded, it is not in the power of any Court to look at words, which have been so dealt with and absolutely taken out of the contract, for any purpose whatever connected with the construction of that contract of which they form no part whatsoever. … It is to my mind perfectly immaterial whether the instrument was torn up and rewritten, written out again with those words no longer contained in it, or whether the course was taken of running through those words as they stood in writing.'*

Despite this being the general rule under English law, subsequent cases have mooted whether an exception applies where standard forms are used and modified by the parties. Whilst pre-contractual negotiations are inadmissible, English law allows evidence of background facts known to both parties to be taken into account in interpreting a

contract. The question as to the interpretation of the terms of a contract is *'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean'* (*Chartbrook Ltd v Persimmon Homes Ltd*).

This rule has been used to argue that a standard form selected by the parties is itself admissible background, which may shed light on any deletions or departures from the standard form agreed by the parties. A good example is *Mottram Consultants Ltd v Sunley (Bernard) & Sons Ltd*, which involved a contract for the construction of a supermarket in Zaire. The contract, based on a printed standard form, provided for interim payments to be assessed, against which deductions could only be made for retention money and sums previously paid. The Employer argued that a disputed counterclaim for previous overpayments could also be deducted from interim payments. In rejecting this contention, the House of Lords relied on the fact that an additional ground for deductions had been struck through in the printed standard form. This additional ground permitted deductions for any amount due to the Employer under the contract or for its breach and would therefore have applied to the Employer's counterclaim. Lord Cross of Chelsea explained the use of such deletions as follows:

> *'When the parties use a printed form and delete parts of it one can, in my opinion pay regard to what has been deleted as part of the surrounding circumstances in the light of which one must construe what they have chosen to leave in.'*

In modern times, no doubt due to computerisation and word processing software, parties less frequently use pre-printed standard forms and strike through clauses which are not needed. More often standard form construction contracts, such as FIDIC or the NEC, will be reproduced with amendments incorporated in a single document. Whether or not a comparison with the original standard form is admissible to interpret the amended version is a difficult question which brings the concept of background evidence to the borderline of contractual negotiations.

The issue was considered by the English Court of Appeal in *Team Services Plc v Kier Management and Design Ltd*. That case concerned the construction of a shopping centre and a sub-contract for the design and construction of a multi-storey car park. The sub-contract required payment within 7 days of payment falling due to the main contractor under the head contract. Payment was also to be subject to a *'cash discount of 2.5%'* in favour of the main contractor. The main contractor paid late and a question arose as to whether it was still entitled to apply the cash discount in such circumstances.

The majority of the Court of Appeal relied on the fact that the sub-contract appeared to be based on a standard form known as the Green Book which had originally included the words, *'if payment is made within fourteen days'*, after the reference to a cash discount. The deletion of these words was held to be a *'strong indication'* that the discount was to remain applicable regardless of late payment.

The fact that the sub-contract was a 'one off' contract without the deletion being apparent on its face was not thought to be important:

> *'One-off contracts are often composed of ready-made clauses taken from one or more sources, together with ad hoc clauses drafted afresh for the purpose of the particular contract. I can see no difference in principle between looking at a deletion in a printed form of contract, and looking at a deletion in a printed form of clause included in a one-off contract.'*

Nor was it of any consequence that the words in question had not actually been deleted, but only omitted from the drafting of the sub-contract:

> *'I can see no sense in such a distinction. What difference can it make whether the parties incorporated clause l1(b) [from the Green Book] in their contract by means of scissors and paste and then deleted [the words], or whether they omitted the words when retyping the clause without physical incorporation? Of course, it would be necessary to show that the omission was deliberate. But if the court is satisfied as to that, then the omission is as much a surrounding circumstance as a deletion.'*

This case therefore supports the use of comparisons with standard forms for the purpose of interpreting a contract, even where the standard form has only been used as a basis or starting point for the contract. This position is not, however, without dissent among the English cases. Earlier decisions, including one of the House of Lords, have refused to consider deletions made to standard form documents, even when shown as struck through on a printed form. One judge in a relatively recent decision considered these contrary authorities to be of *'such persuasive weight that I do not feel entitled to disregard them'* and refused therefore to take account of a clause struck through in a printed standard form charterparty (*The C Joyce*).

In the *Team Services* case itself, a strong dissenting opinion was given by Lord Justice Hoffmann, who was subsequently to become a judge of the Supreme Court and one of the most distinguished UK judges of recent times. In his view, the deleted text from the Green Book was inadmissible:

'It is true the sub-contract used in this case shows signs (as one might well expect) of being derived, at least in part, from standard precedents. The Green Form may well be the direct or indirect source of some of the clauses. … But this is not a case in which the parties have simply taken a standard commercial form and struck out certain words. There are other verbal differences between cl 16 and its equivalent in the Green Form. Even if cl 16(4) is ultimately derived in part from the Green Form, it may well have passed through intermediate stages of alteration in the hands of other draftsmen. This makes it, in my judgment, impossible to say when the words were deleted so as to cast any light on the intentions of the actual parties to this agreement. The provenance of the agreement seems to me entirely speculative. There is, in my judgment, no material upon which one could find that these parties had the original Green Form before them and deliberately decided to strike out the missing words. I, therefore, derive no assistance from a comparison with the Green Form.'

A case decided by the English Technology and Construction Court last year has considered a similar situation arising under an amended FIDIC Yellow Book contract.

J Murphy & Sons Ltd v Beckton Energy Ltd

Beckton Energy Ltd ('Beckton') engaged J Murphy & Sons Ltd ('Murphy') to design and construct a Combined Heat and Intelligent Power Plant under an amended FIDIC Yellow Book contract.

The works were delayed and Beckton gave Murphy notice that it was going to make a call on the performance bond because Murphy had failed to pay Delay Damages pursuant to clause 8.7 of the contract. Murphy argued that it was not obliged to pay Delay Damages because there had been no agreement or determination of the amount to be paid to the Employer as required by clauses 2.5 and 3.5 of the contract (dealing with Employer's claims). Murphy therefore applied to the court for a declaration to this effect and also an injunction preventing Beckton from making a demand on the bond until there had been an agreement or determination by the Engineer.

Clause 2.5 of the contract was largely un-amended from the FIDIC Yellow Book version. As noted in last year's *Annual Review*, the Privy Council's *NH International* decision had decided that clause 2.5 required Employer claims to be notified *'as soon as practicable'* and to be determined by the Engineer. The concluding sentence to clause 2.5 states specifically that the Employer shall *'only be entitled to … claim against the Contractor in accordance with this Sub-Clause'*.

Clause 8.7 of the contract had been entirely redrafted and bore little resemblance to the original FIDIC clause. The standard FIDIC term provides no mechanics for the payment of Delay Damages but states simply that payment is *'subject to Sub-Clause 2.5'*. Pursuant to clause 2.5, an Employer claim must first be determined by the Engineer before being deducted from a Payment Certificate and, as noted above, an Employer is only entitled to claim in accordance with the terms of clause 2.5.

Clause 8.7 of the present contract made no reference to Sub-Clause 2.5 but instead stated that:

'Delay damages due pursuant to this Sub-Clause 8.7 shall be deducted from the next applicable Notified Sum following the end of the month in which such delay occurred or where no such Notified Sum is applicable or is disputed, shall be payable within 30 days of the end of the week in which such delay occurred.'

Despite the broad wording of clause 2.5, the Technology and Construction Court concluded that the amended clause 8.7 was intended to provide an independent right to recover Delay Damages outside of the clause 2.5 procedure. In reaching this conclusion the court derived some support from the fact that the reference to clause 2.5 which appears in the original FIDIC version of clause 8.7 had not been reproduced in the amended clause:

'Objectively assessed on the facts here, this selected deviation from the standard form is consistent with the parties' intention being not to make Beckton's right to claim delay damages subject in any way to Clauses 2.5 and 3.5. I accept that this is only context and certainly by no means determinative of the issue in Beckton's favour. … Here of course, the position is that the parties chose to agree a clause wholly different from the standard wording and one which excluded any reference to Sub-Clause 2.5. It is relevant background at least.'

Although not determinative of the issue, the court's willingness to allow this evidence to support Beckton's case under clause 8.7 would appear to be a step further than the position adopted in the *Team Services* case. In that case, the court was able to see where words from the original form had been kept and where they had been deleted, but in the present case the clause had been entirely redrafted and bore no resemblance to the original. In such circumstances, Lord Hoffmann's criticism quoted above might be thought to have even greater force; for example, the absence of any reference to clause 2.5 may have been entirely inadvertent.

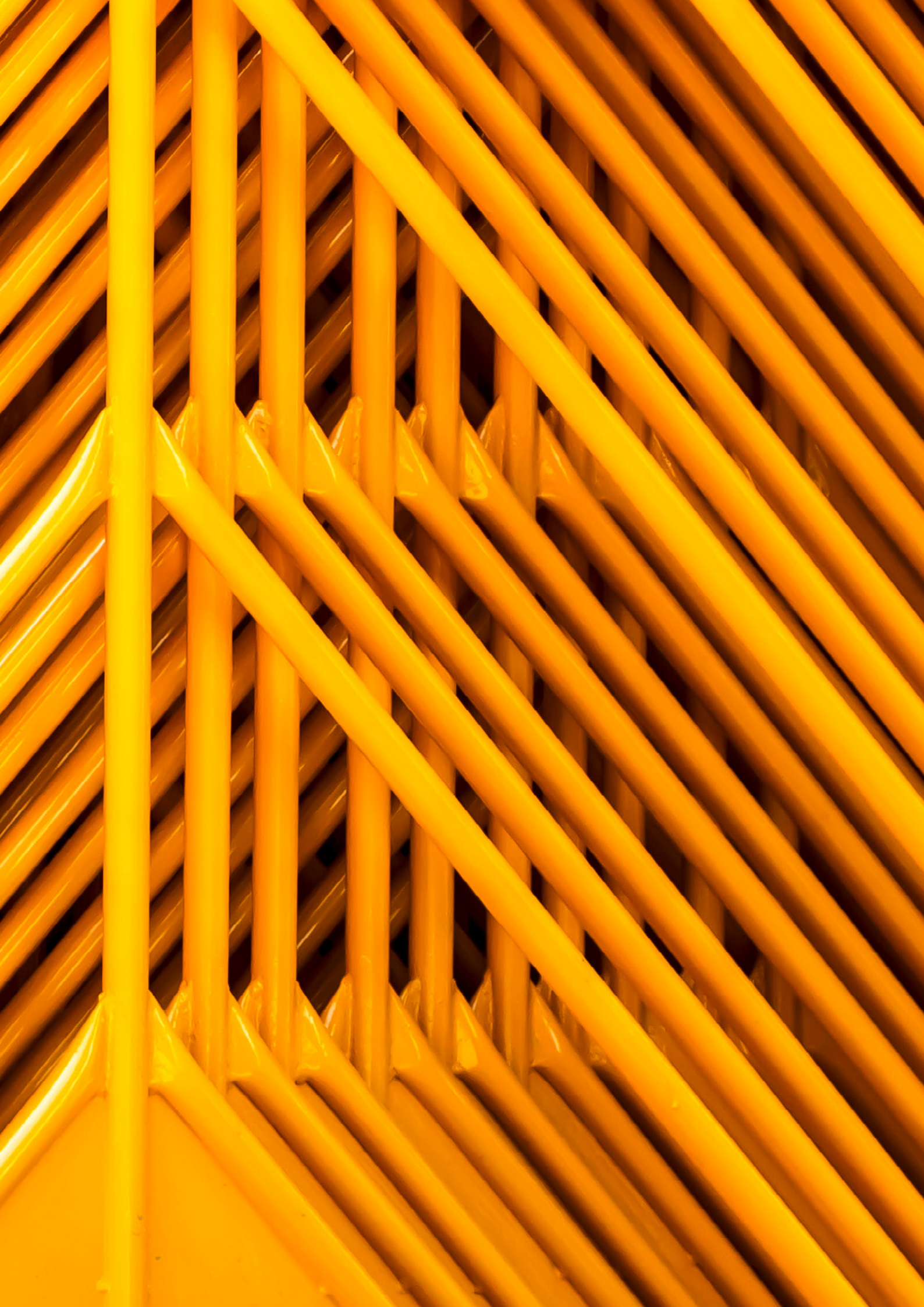
The court also concluded that the requirement for an Engineer's decision under clause 2.5 would not have prevented a call on the performance bond in any event. To hold to the contrary would *'confuse liability on the part of Murphy to pay delay damages under Clause 8.7 with the agreed mechanism for resolution of the parties' dispute in Sub-Clauses 2.5'*.

There was nothing in the contract which suggested otherwise that Murphy's liability was to be subject to an Engineer's decision. In this regard the court also noted that the parties had rejected the standard Yellow Book wording at clause 4.2 which permits an Employer to call on the performance bond for amounts due only where an Engineer's determination has been made in accordance with the clause 2.5 procedure (or the parties otherwise agree or the matter is determined under clause 20). This deletion was also said to be relevant background evidence.

Conclusion

This case provides an interesting example of the extent to which the interpretation of a contract based on a standard form can be influenced by wording from the standard form left out of the final contract. The court in the present case appeared particularly willing to take such omissions and deletions into account. While the legal basis for such an approach remains uncertain in English law, parties contracting on the basis of amended versions of standard forms such as the FIDIC Yellow Book should be conscious of the fact that deletions may have a double meaning. The words deleted will no longer have contractual force, but they may also by their absence alter the meaning of the words which remain.

References: *Inglis v John Buttery & Co* (1878) 3 App Cas 552; *Mottram Consultants Ltd v Sunley (Bernard) & Sons Ltd* [1975] 2 Lloyd's Rep 197; *The C Joyce* [1986] 2 Lloyd's Rep 285; *Team Services Plc v Kier Management and Design Ltd* (1993) 63 BLR 76; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38; *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)* [2015] UKPC 37; *J Murphy & Sons Ltd v Beckton Energy Ltd* [2016] EWHC 607 (TCC).



Dispute resolution update

2016 has seen developments with regard to the law on emergency arbitrators as well as updated rules published by the ICC and SIAC. We consider these developments below and look more closely at the enforceability of expedited procedures, freshly introduced in the new ICC rules and extended in the new SIAC rules.

Emergency Arbitrator provisions

In our 2015 *Annual Review* we commented on the recent introduction of Emergency Arbitrator provisions into the rules of the London Court of International Arbitration ('LCIA'). These largely mirrored rules adopted by the International Chamber of Commerce ('ICC') and other popular arbitral bodies around the world. The impact of such rules on a party's ability to seek relief from local courts was, however, unclear. A decision of the English Commercial Court last year, in *Gerald Metals SA v Timis*, has now clarified the position under English law.

In late 2014, Gerald Metals SA ('GM') entered into a contract (essentially a form of financing arrangement) with Timis Mining Corp (SL) Ltd ('Timis Mining'). Timis Mining was owned by Mr Timis, whose business interests were in turn owned by the Timis Trust (the 'Trust'). Before entering into the contract, GM obtained a guarantee from the trustee, Safeguard Management Corp. The guarantee was governed by English law and provided for disputes to be referred to arbitration in London under the rules of the London Court of International Arbitration ('LCIA').

There were defaults under the contract, which led to negotiations and further agreements between the parties. GM subsequently claimed that certain conditions that had been agreed had not been met, and arbitration proceedings were commenced under the guarantee. In seeking to prevent assets being dissipated prior to obtaining a final ruling from the arbitral tribunal, GM applied to the LCIA for the appointment of an emergency arbitrator so that it could then seek an order preventing the Trust from dissipating its assets.

The Trust responded by giving undertakings not to dispose of any assets other than for full market value and at arm's length, and to give seven days' notice before disposing of certain assets. Following the provision of these undertakings, the LCIA rejected GM's application for the appointment of an emergency arbitrator due to a perceived lack of urgency.

GM then issued proceedings in the English Commercial Court, seeking urgent relief under section 44 of the English Arbitration Act 1996 (the 'Act'), including that a freezing order be made against the Trust. Notwithstanding the LCIA's decision, GM argued that the Court should grant such an order because although the LCIA Court had decided the matter was not sufficiently urgent to warrant the appointment of an emergency arbitrator under the LCIA Rules, the circumstances still fulfilled the criteria of 'urgency' under section 44 of the Act.

Section 44 permits an English court to make interim orders for the preservation of evidence or assets in support of arbitration proceedings where the *'case is one of urgency'* and the appointed arbitral tribunal *'has no power or is unable for the time being to act effectively'*. This requires the court to determine whether the arbitral tribunal has the power and practical ability to grant effective relief within the relevant timescale.

In rejecting GM's application under section 44, the court confirmed that the agreement of Emergency Arbitrator provisions significantly curtails the ability of an English court to provide urgent relief under section 44. It accepted that the need for relief may be so urgent that the Emergency Arbitrator provisions are insufficient. One example given by the court and mooted in our 2015 *Annual Review* is where an application needs to be made *ex parte* or without notice to the other party. However, where the Emergency Arbitrator provisions are in theory able to cater for a given situation, the urgency requirements of section 44 will not be fulfilled.

The court also considered the relevance of rule 9.12 of the LCIA rules which states that the Emergency Arbitrator provisions are not to *'prejudice any party's right to apply to a state court or other legal authority for any interim or conservatory measures before the formation of the arbitration tribunal and it shall not be treated as an alternative to or substitute for the exercise of such right.'* As the urgency requirements are governed by section 44 of the Act by reference to whether the arbitral tribunal is able to act effectively in a given situation, this rule made little difference to the outcome:

> *'That rule makes it clear that [the Emergency Arbitrator provisions are] not intended to prevent a party from exercising a right to apply to the court, for example under section 44 of the Arbitration Act; but it does not prevent the powers of the court on such an application from being limited as a result of the existence of [the Emergency Arbitrator provisions]– as they are pursuant to the terms of section 44 itself.'*

New SIAC rules

The Singapore International Arbitration Centre has issued a new set of rules which come into force on 1 August 2016. The new rules apply to all arbitrations commenced after that date unless the parties specifically opt out.

Some of the key changes in the new rules are as follows:

— The expedited procedure has been extended to claims up to S$6 million (approximately US$4.3 million). The procedure is also expressed to apply *'even in cases where the arbitration agreement contains contrary terms'*.

— A more efficient process for dealing with disputes arising out of multiple contracts has been introduced. A single Notice of Arbitration may now be used which will double as an application for consolidation.

— A new procedure for the joinder of additional parties has been introduced which allows the president of SIAC, prior to the appointment of the arbitral tribunal, to allow one or more additional parties to be joined to the arbitration (provided they are parties to the arbitration agreement and/or where all parties consent).

— A new procedure has been introduced permitting the early dismissal of claims or defences on the basis that they are *'manifestly'* without legal merit or outside the jurisdiction of the tribunal. This procedural appears to be intended to be similar to the 'summary judgment' procedure often available in court proceedings. The tribunal's ruling on any application under this rule is to be made within 60 days. The procedure may therefore enable significant cost savings to be made where parties are faced with weak or baseless claims or defences which might otherwise require a full merits hearing. Conversely, however, the unrestrained use of such a procedure may only distract from the overall resolution of the dispute submitted to the tribunal.

New ICC rules and expedited procedure

The ICC has also issued a new set of rules which will apply to arbitrations commenced after 1 March 2017. The new rules include a new expedited procedure which applies to all cases below US$2 million and to any cases above this amount if the parties agree.

Under the expedited procedure, the ICC Court has the power to appoint a sole arbitrator even if the arbitration agreement provides otherwise. There will be no Terms of Reference in the expedited procedure and the tribunal will have the discretion whether to decide the case without a hearing, document production requests and examination of witnesses. Also of particular note is the fact that awards must be made in six months from the date of the case management conference. Extensions will only be granted in limited and justified circumstances. The ICC has announced that expedited procedures will have a 'significantly reduced' pay scale, although the ICC Court and its Secretariat will continue to carry out quality control through the scrutiny of awards.

The introduction of an expedited procedure follows the trend set by other institutions which have made similar

changes to their rules including the American Arbitration Association, the Arbitration Institute of the Stockholm Chamber of Commerce, the Hong Kong International Arbitration Centre and SIAC, amongst others.

The ICC has also introduced other amendments to its Rules to streamline non-expedited proceedings including a reduction in the time limit to establish Terms of Reference from two months to one. In a bid to increase transparency, the Rules now allow the ICC Court to provide reasons for is decisions made on challenges, jurisdictional decisions and consolidations without having to seek the consent of all of the parties.

The enforceability of expedited procedures

Like the new SIAC rules, the revised ICC rules also state that the expedited procedure provisions are to *'take precedence over any contrary terms of the arbitration agreement'*. This potentially gives rise to jurisdictional issues where the expedited procedure is carried out contrary to the express terms of the arbitration. Such a situation is most likely to occur with regard to the number of arbitrators. Arbitration clauses in international construction contracts will frequently specify for a three person tribunal, whereas both the SIAC and ICC rules, along with others, specify a sole arbitrator for their expedited procedure. Objections may therefore be made that in such circumstances an award made by a sole arbitrator pursuant to the expedited procedure is unenforceable. In this regard, one of the grounds for refusal of enforcement under the New York Convention is that *'the composition of the arbitral tribunal … was not in accordance with the agreement of the parties'*.

In what appears to be the first case to address this issue, the High Court of Singapore has rejected a challenge to the enforceability of an award given by a sole arbitrator pursuant to the SIAC expedited procedure in *AQZ v ARA*. The arbitration clause in that case provided for arbitration in accordance with the SIAC rules *'by three arbitrators'* and had been agreed prior to the expedited procedure having been incorporated into the SIAC rules. Nevertheless, the SIAC president decided that the expedited procedure was to apply and an award was rendered by a sole arbitrator.

The court held that despite the reference to three arbitrators and the fact that the arbitration agreement had pre-dated the expedited procedure, it was within SIAC's power to appoint a sole arbitrator. The court appears to have taken the view that the parties express choice of the SIAC rules made it *'consistent with party autonomy for the Expedited Procedure provision to override their agreement for arbitration before three arbitrators'*. In doing so the court emphasised that *'the rules together with the rest of the contract must be interpreted purposively'*.

It remains to be seen whether this decision will be followed in other jurisdictions. As noted earlier in this *Annual Review*, the English courts appear to presently favour a greater degree of literalism in contractual interpretation. There would appear to be risk, therefore, that an English court may give precedence to the an express agreement to three arbitrators in an arbitration clause over and above the expedited procedure provided in any institutional rules incorporated by reference. As the matter is one of interpretation and the intention of the parties, contextual factors may also be relevant. For example, for very large contracts where most disputes referred to arbitration could be expected to be in excess of the monetary limits applicable to any expedited procedure, the use of a sole arbitrator under the expedited procedure may be seen as a minor intrusion into the parties' express selection of a three person tribunal. In lower value contracts, however, the tension is likely to be greater because many of the disputes contemplated by the arbitration clause will fall bellow the monetary limit applicable to the expedited procedure. In such cases, strong arguments may be made that the parties' intention is more accurately recorded in the specific terms of their arbitration agreement rather than in the institutional rules incorporated by reference.

References: *AQZ v ARA* [2015] SGHC 49.

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