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Annual Review of English Construction Law Developments

An international perspective

July 2019

Contents

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

General Counsel, Global Energy Company

Introduction

Welcome to the 2019 edition of our internationally focused Annual Review of English Construction Law Developments.

The volume of reported judgments dealing with significant issues of concern to people dealing with construction contacts governed by English law continues unabated.

As with previous years, some of our favourite topics have been before the courts again.

Implied terms concerning good faith have been a recurring theme over the past few years, and, despite the best efforts of parts of the judiciary to quash any application of them, seem to be reviving themselves in connection with "relational" contracts. Anyone involved in joint ventures or long-term "partnering" style contracts should read our article on that topic.

We also have further developments in relation to concurrent delay, and the extent to which reasonable or best endeavours obligations require the sacrificing of commercial interest. The effect of termination for convenience clauses as limiters on liability has also been considered again, although authoritative guidance is still needed.

It is rare that fundamental changes in English contract law occur, but the Supreme Court's decision in the *Rock Advertising* case last year has had that effect. That case has given full enforceability to "anti-variation", "no-waiver" and "no-oral-modification" clauses which require amendments, variations and waivers to a contract to be made in writing. Prior to the Supreme Court's decision, the English Court of Appeal had upheld the ability of the parties to impliedly dispense with such provisions through sufficiently clear oral agreements. The Supreme Court has now determined that it is possible for parties to English law contracts to effectively "tie their hands" as to how agreements are to be made in the future. Such clauses are widely used on international construction contracts and are likely to have significant ramifications for the management of those contracts and the bringing of claims where they have not been complied with.

Another more unusual area that has been covered is the interpretation of force majeure clauses. The English cases on such clauses, particularly in a construction context, are sparse and the additional guidance provided as to their interpretation is welcome. Significant areas of uncertainty remain, however.

We also have an article on the interesting topic of the consequences of adopting a strategy to force a contractor into insolvency. Definitely a case of "be careful what you wish for"…

And finally a short article outlining some of the pros and cons of using expert determination to deal with disputes.

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, please feel free to sign up for our Law-Now service at **www.law-now.com** and select 'Construction' as your chosen area of law.

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Causation and the interpretation of force majeure clauses

Force majeure clauses are commonly found in international construction contracts. They typically excuse a party from performance and/or allow a right of termination upon the happening of events which render performance of the contract impossible, whether temporarily or permanently. A force majeure clause may apply only to certain events or generally to matters beyond the control of the parties.

Such clauses typically require a force majeure event to have "prevented" performance of the contract. The FIDIC 1st Editions (all versions) permits the giving of a Force Majeure Notice where a party is "*prevented from performing any … obligations under the Contract*". Performance of such obligations is then excused "for so long as such [Force Majeure Event] prevents [the party] from performing them". The FIDIC 2nd Edition is in the same terms, save that Force Majeure Events are now referred to as Exceptional Events.

Such language gives rise to a number of questions as to when work can be said to be sufficiently "prevented" for the purpose of a force majeure claim. Two cases in 2018 have touched on the difficulties arising in this regard in relation to three issues:

— What does it mean to say that the performance of an obligation has been prevented? Does it require a party to otherwise be in breach of contract?

— What if two events combine to prevent performance, one being a force majeure event and the other not?

— What if performance has already been prevented by an unrelated cause at the time the force majeure event occurs in circumstances where the force majeure event would have been sufficient on its own to have prevented performance?

We consider these issues further below.

Prevention of performance

The issue of what qualifies as "prevention" under a force majeure clause was considered briefly by the English Commercial Court last year in Seadrill Ghana Operations Ltd v Tullow Ghana Ltd. Tullow Ghana Ltd ("Tullow") had interests in a number of oil fields off the coast of Ghana. Some were already in production and others were planned for development subject to approval from the Government of Ghana.

On 3 November 2011, Tullow entered into a contract with Seadrill Ghana Operations Ltd ("Seadrill") for the hire of an ultra deep-water semi-submersible drilling rig. The contract was subsequently amended to have a term of 5 years and the daily rate of hire for the rig was US$600,000.

Some of the oil fields which Tullow had interests in, known collectively as "TEN", were subject to a territorial dispute between Ghana and Cote d'Ivoire. This dispute was submitted to arbitration pursuant to the United Nations Convention on the Law of the Sea in September 2014. As part of this arbitration Cote d'Ivoire obtained a provisional measures order in April 2015 which prevented any new drilling within TEN. The Ghanaian Government required Tullow to comply with the order in May 2015 and Tullow relied on this to terminate the drilling contract under the terms of a force majeure clause. The clause in question excused "*any failure to fulfil any term or condition of the Contract if and to the extent that fulfilment has been delayed or temporarily prevented by an occurrence, as hereunder defined as FORCE MAJEURE*".

An issue arose in the litigation as to whether the moratorium on drilling which flowed from the provisional measures order could be said to have "prevented" the fulfilment of any term or condition of the drilling contract. The contract allowed Tullow to suspend work to suit its convenience and provided for a daily suspension rate of 70% of the operating rate in such circumstances. A 95% standby rate also applied in the event that Seadrill was unable to conduct operations due to a failure by Tullow to issue instructions or if Tullow gave a specific instruction for Seadrill to standby. In these circumstances, Seadrill submitted that the moratorium had not "prevented" the fulfilment of any term or condition by Tullow. Seadrill relied on the fact that Tullow had a discretion as to how and when to use the rig. The fact that Tullow might be forced to suspend operations under the drilling contract, or put the rig on standby, would not place it in breach of contract and could not therefore be said to amount to a failure to fulfil a term or condition of the contract.

The Commercial Court noted that Tullow did not properly address this argument and, as it dismissed Tullow's case on causation grounds in any event (see below), it did not fully address the issue. Nonetheless, the court noted that the following argument would have been open to Tullow:

> *"If one assumes that Tullow intended to issue a drilling programme but was prevented from doing so because of a drilling moratorium imposed by the Government Tullow can say that it had failed to fulfil a term of the contract, namely, clause 18.1 which required it to provide Seadrill with a drilling programme, notwithstanding that failure to issue a drilling programme would not, in all cases, render it in breach of contract. I shall assume, without deciding, that this argument is correct."*

Similar difficulties of interpretation can arise in a construction context. As noted above, the FIDIC forms require a party to have been "*prevented from performing any … obligations under the Contract*". A number of issues arise as to how this test is to be applied to events which delay a contractor in carrying out the works. What is the obligation performance of which is said to have been prevented by such delay? If this is said to be the contractor's obligation to complete by the Time for Completion, need the contractor show that it could not, even with expensive accelerative measures, have overcome the delay caused by the force majeure event? If not, then in what sense can the contractor be said to have been "prevented" from completing by the Time for Completion?

Some light is shed on these issues by older English cases dealing with force majeure clauses in sale of goods contracts. One of the earliest is *Comptoir Commercial Anversois v Power, Son & Co*. That case concerned a contract for the sale of wheat to be shipped from merchants in New York to buyers in Rotterdam and Antwerp. It was not the custom of American grain shippers at the time to finance their own shipments to Europe, but rather to negotiate bills of exchange from an American exchange buyer. Owing to the outbreak of the First World War, the sellers were unable to obtain war risks insurance in respect of the shipment and as a result were unable to negotiate a bill of exchange. This in turn meant that they were unable to ship wheat to the buyers.

The contract contained a force majeure clause stating: "*In case of prohibition of export, force majeure, blockade, or hostilities preventing shipment, this contract or any unfulfilled part thereof shall be at an end.*" The sellers argued that due to hostilities, and the impact on their ability to negotiate exchange, shipment of the wheat had been prevented. Although accepted by an arbitration tribunal, the argument was rejected by the English High Court, who considered that "*physical or legal prevention*" of the shipment itself was required. This was upheld by the English Court of Appeal, with Scrutton LJ noting that: "*Economic unprofitableness is not "prevention," though a very high price for the article sold may be evidence of such a physical scarcity due to hostilities as amounts to prevention by hostilities.*"

The strict requirements of a clause which requires prevention as opposed to mere "delay" was considered further by the House of Lords (the United Kingdom's highest court) in *Fairclough Dodd & Jones v Vantol (JH)*. That case concerned a contract for the sale of Egyptian cotton seed oil, which allowed for a shipment period of two months between December 1950 and January 1951. The contract contained a force majeure clause which distinguished between prevention and delay. In the event of certain events "*preventing shipment*" the contract was to be cancelled. In the event of the shipment being "*delayed*" by other events including a prohibition of export, the time of the shipment was to be extended by two months.

The sellers had initially made arrangements to ship the goods on 20 December 1950. However, on 12 December 1950 the Egyptian Government imposed a ban on export of cottonseed oil which lasted until 3 January 1951. Cottonseed oil was available for shipment between 4 January and 31 January 1951, but the sellers claimed to be entitled to the two month extension period as a result of delays falling within the force majeure clause.

The buyers argued that the shipment would not be "delayed" within the meaning of the force majeure clause unless the delay continued to operate up until the end of the contract period because only then would the sellers be in breach of their obligations under the contract. The House of Lords disagreed with that interpretation, finding it too close to the concept of prevention. Lord Morton of Henryton:

> *"There is … a marked contrast between the use of the words "in the event of war, hostilities or blockade preventing shipment" in clause 11.A and the words "Should the shipment be delayed by … prohibition of export" in clause 11.B. The former clause, as I read it, applies to a case where shipment remains impossible up to the end of the contract period, while the latter clause applies to a case in which shipment is delayed for a period, whether or not the cause of delay persists throughout the contract period. The submission of counsel for the buyers would give the same effect to two strongly contrasted phrases."*

An analogy can be drawn with the completion of works under a construction contract by the contractual date for completion. The performance of that obligation might be thought to be "prevented" only if a force

majeure event renders completion by the date for completion physically or legally impossible when all available accelerative measures are taken into account. On the other hand, performance could be said to be "delayed" if the Contractor's intended programme of works had been disrupted or suspended for a short period.

Some contracts used for international construction and engineering projects will include force majeure provisions which refer to both prevention and delay. The LOGIC form is one such example. However, the FIDIC form refers only to prevention. In such cases, careful attention is needed when considering a force majeure claim to ascertain precisely what obligation is being relied upon to satisfy the test for prevention.

Contractors commonly rely on the obligation to complete by the contractual date for completion as being the obligation which has been prevented. In this regard, the force majeure event is often advanced as being simply another ground for an extension of time, with a delay analysis showing the delay caused to completion by the event in question. However, such an approach overlooks the requirement for the force majeure event to "prevent" completion by the contractual date for completion in the sense of rendering completion impossible even with all possible accelerative measures.

In the FIDIC forms, there are two other obligations relevant to delay, the performance of which might be argued to be prevented by an Exceptional Event (or Force Majeure Event under the 1st Edition). The first is the obligation in Clause 8.1 to proceed with "*due expedition and without delay*". This obligation is usually taken to refer to the degree of effort being made by the Contractor to achieve completion, rather than the mere fact of delay itself: see the Court of Appeal and first instance decisions in *Obrascon Huarte Lain SA v AG for Gibraltar*. As such it may be difficult to argue that an Exceptional Event which has delayed the work has prevented the Contractor from proceeding with due expedition and without delay. Particularly where, in accordance with Clause 18.3 (2nd Editions), the Contractor is using reasonable endeavours to minimise delay caused by an Exceptional Event, the Contractor itself can be said to be proceeding without delay, albeit that the works are being delayed by the Exceptional Event.

The other obligation of potential relevance is the Contractor's obligation in Clause 8.3 to "*proceed in accordance with the Programme*". It might be argued that where an Exceptional Event leads to progress falling behind the Programme (which no amount of acceleration could have avoided), the event has prevented the performance of the obligation in Clause 8.3. The position is by no means clear, however:

- Clause 8.3 specifically contemplates that a Programme may cease to reflect actual progress and in that case requires the Contractor to "*submit a revised programme which accurately reflects the actual progress of the Works*".
- The obligation to proceed in accordance with the Programme is followed by the qualification "*subject to the Contractor's other obligations under the Contract*". Read together with the obligation to update the Programme, mere delay to activities in the Programme seems more naturally to trigger the obligation to update rather than placing the Contractor in breach of contract. It is also notable in this regard that the Programme is to state earliest and latest finish dates for each activity, meaning that in most cases the Contractor's obligation to update the Programme is likely to be triggered prior to a finish date being missed.
- The obligation to proceed in accordance with the Programme may therefore be more apt to refer to the way in which the Contractor resources and seeks to carry out the work, rather than mere delay imposed upon the Project by an external event.
- Clause 8.7 also deals specifically with a situation in which progress has fallen behind the Programme. The Engineer is entitled to instruct the Contractor to submit an accelerated programme in order to expedite progress and "*complete the Works … within the relevant Time for Completion*". No such entitlement exists where progress falls behind the Programme but the Time for Completion is not in jeopardy. In such circumstances, the Engineer's remedy appears to be to instruct an updated Programme under Clause 8.3.

The difficulties posed in the above analysis flow from the need to identify a breach of contract caused by an Exceptional Event which could not, even with all possible accelerative measures, be avoided by the Contractor. The recent *Seadrill* case mentioned above presents a potential way around this difficulty by challenging the need for a breach of contract in order to show that performance of an obligation has been prevented. The court in that case did not reach a concluded view, but suggested that an argument open to the claimant was to say that it was prevented from submitting a drilling programme, even though a failure to do so would not always result in a breach of contract. Similar arguments might be said to apply to the obligation in Clause 8.3 to proceed in accordance with the Programme. Even though a delay to progress due to an Exceptional Event might not result in a breach of contract in light of the Contractor's obligation to update the Programme, it might be said that the Contractor had still been prevented from performing its Clause 8.3 obligation in relation to the original Programme.

Whether such an argument would succeed remains to be seen. At first blush, it seems difficult to reconcile with the sale of goods cases noted above as to the meaning of force majeure clauses which require the prevention of performance. On the other hand, the question does not appear to have been considered by an English court in the context of a construction contract.

Concurrent causes

The *Seadrill* case referred to above also considered a separate question of causation arising on the force majeure clause in that case. Tullow argued that it had been prevented from drilling by the moratorium imposed by the Ghanaian Government (as a result of the provisional measures orders). This moratorium related to the TEN oil fields and prevented the "spudding" of new oil wells, meaning the drilling of new holes in the sea bed. However, the "completion" of wells which had already been "spudded", meaning the continuation of drilling until first oil had been achieved, was not affected by the moratorium.

At the time the moratorium was imposed (in May 2015), Tullow had intended to use the Seadrill rig to complete the drilling of ten existing oil wells in the TEN field and then to complete one further well (known as EN10) which was to be spudded by another rig. For the remainder of the hire period (from roughly October 2016 until May 2018), Tullow had intended to put the Seadrill rig to use in a separate field known as Greater Jubilee. The practical effect of the moratorium was to prevent Tullow from using the Seadrill rig to complete EN10, and to move it to the Greater Jubilee field roughly one month sooner than would otherwise have been the case.

Drilling in the Greater Jubilee field was, however, subject to approval by the Ghanaian Government. Whilst the Seadrill rig was completing the 10 remaining wells in the TEN Field, a major problem was discovered with Tullow's Floating Production, Storage and Offloading ("FPSO") vessel which significantly limited the amount of oil which Tullow could process. In the wake of the FPSO problem approval for drilling in the Greater Jubilee field was withheld.

With drilling of the ten remaining oil wells in the TEN field coming to an end, Tullow gave a force majeure notice in September 2016 noting that drilling would come to end in early October 2016. The notice relied both on the moratorium and the Government's withholding of approval in relation to the Greater Jubilee field "*either individually and/or cumulatively*". Tullow subsequently accepted that the withholding of approval did not amount to a moratorium on drilling and, as such, did not fall within the force majeure clause in the hire contract. Tullow's force majeure case was therefore solely reliant on the moratorium flowing from the provisional measures order.

The English Commercial Court held that both the moratorium and the withholding of approval were effective causes of the cessation of drilling in October 2016. The withholding of approval was "*a much greater impediment*" to Tullow's plans, but both were held to operate to prevent the continuation of drilling in October 2016. The moratorium had prevented drilling of the EN10 well, and the lack of approval prevented any drilling in the Greater Jubilee field.

In such circumstances, the court held that Tullow could not bring itself within the force majeure clause. Fulfilment of the hire contract could not be said to have been prevented by the moratorium, because Tullow's

inability to drill in the Greater Jubilee field had not been caused by a force majeure event, even though other drilling activities had been prevented by such an event. This approach was thought to be consistent with an older English Court of Appeal decision in *Intertradex v Lesieur*:

> *"where it was held that where two causes operated to prevent a seller from shipping goods a force majeure notice had to be given in respect of each of them. Where notice had only been given of one the seller could not rely upon the force majeure clause. That decision is regarded as one which establishes the proposition that a force majeure event must be sole cause of the failure to perform an obligation; see Frustration and Force Majeure by Sir Guenter Treitel, 3rd.ed at paragraph 12-032. Ultimately, however, (and as Sir Guenter Treitel also accepts; see paragraph 12-032) the question is one of construction of the contract before the court."*

Whether or not this decision or the *Intertradex* case establishes a sole cause principle in relation to force majeure clauses deserves further scrutiny. In *Intertradex*, a supplier was unable to supply goods due to a breakdown of machinery, but there had also been interruptions in the supply of raw materials to the suppliers factory by rail. A force majeure notice was given only in relation to the breakdown of machinery, but no finding had been made in arbitration proceedings as to whether the breakdown of machinery was of itself sufficient to prevent supply in accordance with the contract. The Court of Appeal considered this essential to the case under the force majeure clause:

> *"Suppose … that the loss of production was caused simultaneously by the two causes: partly because of the breakdown of machinery – reducing production by a half – and partly because of the difficulty in getting the raw materials down – reducing production by another half. Those two together might have operated to prevent delivery, but not the breakdown of machinery by itself. … there would be two causes operating. Taken together they might constitute a case of force majeure. But … the proper notice or notices would have to be given in regard to both those causes. …*
>
> *So it comes to this: If the breakdown of machinery would by itself have been sufficient to prevent delivery, the sellers would be protected by the force majeure clause, even though there may have also operated another cause, namely, the difficulty in getting raw materials. But, if the breakdown of machinery would not by itself have prevented delivery, and if the goods could have been delivered in time, but were prevented by the difficulty of getting raw materials, then the sellers could not rely on the force majeure clause: because they gave no notice in regard to the difficulty in getting raw materials."*

This passage suggests that a force majeure event need not be the sole cause of non-performance, but must be a complete cause in itself. A similar description applies to the facts in the *Seadrill* case. The moratorium was not a complete cause of the cessation of drilling, as drilling could have continued had approval not been withheld in relation to the Greater Jubilee field. Had the moratorium applied to both the TEN and Greater Jubilee fields, it would have been a complete cause of the cessation, but not the sole cause.

Whether a force majeure event, in addition to being a complete cause, must also be the sole cause of non-performance was more directly considered by a second decision of the English Commercial Court last year, which we consider further below.

Sole cause and the "but for" test

There exists a well established line of English cases considering the sole cause issue in the context of what are known as "frustration clauses". Frustration clauses result in the automatic cancellation of a contract where performance has been prevented by a force majeure event. They are intended to be a contractual expansion of the common law doctrine of frustration and may be distinguished from clauses which merely seek to excuse non-performance upon the occurrence of a force majeure event, but which otherwise allow the contract to subsist.

The position in relation to frustration clauses was determined by the House of Lords (the UK's highest court, now called the Supreme Court) in *Bremer Handelsgesellshaft v Vanden Avenne*. Lord Wilberforce explained the point as follows:

> *"The clause applies 'in case of prohibition of export …..preventing fulfilment' so that a question may arise of causation. Was it the prohibition that prevented fulfilment or something else? This question may be phrased more specifically by asking whether the seller must prove that he had the goods ready to ship within the contract period, and a ship to carry them. The answer to it, in my clear opinion, is in the negative. The occurrence of a frustrating event – in this case the prohibition of export – immediately and automatically cancels the contract, or the portion of it affected by the prohibition."*

Part of the justification for the rule is to mirror the position which applies under the doctrine of frustration at common law. As frustration clauses result in the automatic cancellation of the contract, their effect is very similar to the doctrine of frustration. Whether the same rule applies to force majeure clauses which merely

excuse non-performance has not previously been considered by the English courts, but came before the English Commercial Court last year in *Classic Maritime Inc v Limbungan Makmur SDN BHD*.

Classic, a ship owner, entered into a long term contract of affreightment with Limbungan for the carriage of iron ore pellets from Brazil to Malaysia. Limbungan intended make shipments under the contract using iron ore pellets obtained from the Germano iron ore mine in Brazil, owned by Samarco. On 5 November 2015 a tailings dam forming part of the mine burst, leading to loss of life and an environmental disaster. Production was halted and Limbungan was unable to fulfil its obligation to make shipments under the contract.

Classic sued Limbungan for damages. As the freight rates in the contract were agreed prior to the collapse in demand for steel in 2009, they were more than seven times the market rate at the time the dam burst, giving a sizeable claim for damages.

Limbungan defended the claim on the basis of a force majeure clause in the contract providing: "*… the Charterers … shall [not] be Responsible for loss of or damage to, or failure to supply, load, discharge or deliver the cargo resulting from: … accidents at the mine or Production facility… always provided that such events directly affect the performance of either party under this Charter Party…*"

There was no argument about whether events constituted an "accident at the mine", as referred to in the clause. However, Classic argued that due to the collapse in demand for steel, Limbungan would not have been in a position to meet the required shipments under the contract even if the dam hadn't burst. On the facts, the Court agreed with Classic and found that Limbungan would not have made the shipments regardless of the production stoppage. This raised an issue as to whether the force majeure clause applied in such circumstances.

Limbungan relied on the *Bremer* line of cases noted above dealing with frustration clauses. The Court accepted the strength of this line of authority and acknowledged that the wording of the clause before it was in essence the same as considered in those cases. Nevertheless, the court considered that a different approach was warranted for clauses which merely exempted a party from liability for non-performance:

> *"There appears to me to be an important difference between a contractual frustration clause and an exceptions clause. A contractual frustration clause, like the doctrine of frustration, is concerned with the effect of an event upon a contract for the future. It operates to bring the contract, or what remains of it, to an end so that thereafter the parties have no obligations to perform. An exceptions clause is concerned with whether or not a party is exempted from liability for a breach of contract at a time when the contract remained in existence and was the source of contractual obligations. It is understandable that a contractual frustration clause should be construed as not requiring satisfaction of the "but for" test because that is not required in a case of frustration."*

The application of the "but for" test meant that the force majeure clause did not apply and Classic had made out its claim for breach of contract. Somewhat paradoxically, however, the force majeure clause was found to defeat the quantum of Classic's claim.

Classic's damages claim was calculated by reference to the position it would have been in had Limbungan made the required shipments under the contract (i.e. absent the breach of contract). Although that is an entirely conventional approach to damages, the Court found it to be "unrealistic" because it ignored why Lumbungan was in breach of contract. Lumbungan was in breach not simply because it didn't make the shipments, but because the force majeure clause did not excuse non-performance due to Lumbungan not being ready and willing to make the shipments even in the absence of the production stoppage. The correct comparison, according to the Court, was with the position that would have occurred had Lumbungan been ready and willing to make the shipments. In that case, the shipments would have been prevented by the production stoppage and the force majeure clause would have applied. Classic had not therefore suffered any loss as a result of Lumbungan's breach and was not entitled to substantial damages.

Conclusions

The above cases show significant points of uncertainty as to the operation of force majeure clauses in a construction context under English law. Clauses such as those in the FIDIC forms which refer only to the "prevention" of performance raise difficult questions as to whether mere delay caused by a force majeure event falls within the clause, or whether impossibility as regards the Time for Completion is required to be shown.

It is reasonably clear that a force majeure event must be a complete cause of any prevention or delay, in the sense that it would have caused such a result without the assistance of any other causes. Whether the event need to be the sole cause of such consequences, and to satisfy the "but for" test is less clear. The *Classic Maritime* decision has been appealed and there are a number of issues which arise from it:

- The Court's reasoning as to why the "but for" test applied to force majeure clauses relies on a distinction between a categorisation of those clauses as exception clauses and frustration clauses, where a contract is automatically cancelled upon the occurrence of a defined event. An appeal court may disagree with such a distinction and find that the rule which applies to frustration clauses should also apply to force majeure clauses.
- The distinctions relied upon by the court as to the characterisation of force majeure clauses pre-date recent developments as to the interpretation of limitation and exemption provisions at common law. The modern approach is to interpret such clauses according to their natural meaning rather than by reference to any preliminary categorisation.
- The Court's decision poses difficulties for the interpretation of hybrid force majeure clauses which contain rights of exception, suspension and/or termination. Many force majeure clauses will fulfil both purposes of exempting or suspending performance and providing for the termination of the contract (typically if the force majeure event persists for a certain period of time). The FIDIC form of contract is one such example and is widely used on international construction projects. The LOGIC form is another and is widely used in the international oil and gas market. As a single interpretation is needed for such clauses regardless of whether the exemption/suspension or termination provisions are relied on, a conflict arises as to which of the competing categorisations relied on by the court ought to apply.
- The Court's findings as to the assessment of damages are also significant. They would appear to make the conclusion reached as to the "but for" test largely theoretical. The court's findings mean that, for practical purposes, the defence of a claim on force majeure grounds would not need to surmount the "but for" test (save perhaps where the claim is one for a remedy other than damages). This may, in turn, affect the Court's primary reasoning as to why the "but for" test ought to apply to a force majeure clause in the first place.
- The Court's reasoning in relation to damages may also be subject to question. The suggestion that damages should be assessed by reference to the reasons why a party is in breach, rather than solely by reference to the breach itself and its consequences, appears to be novel. A similar logic could well be said to apply to a variety of other scenarios, such as termination, where the hypothetical application of the force majeure clause (i.e. had a party otherwise been ready and willing to perform) might be said to negate a claim for damages.

References: *Comptoir Commercial Anversois v Power, Son & Co.* [1920] 1 KB 868; *Fairclough Dodd & Jones v Vantol (JH)* [1957] 1 WLR 136; *Intertradex v Lesieur* [1978] 2 Lloyd's Reports 509; *Bremer Handelsgesellshaft v Vanden Avenne* [1978] 2 Lloyd's Reports 109; *Seadrill Ghana Operations Ltd v Tullow Ghana Ltd* [2018] EWHC 1640 (Comm); *Classic Maritime Inc v Limbungan Makmur SDN BHD* [2018] EWHC 2389 (Comm).

Concurrent delay exclusions and the prevention principle

An English Court of Appeal decision last year has provided important guidance as to the operation of the "prevention principle" under English law and the ability of employers to exclude liability for concurrent delay. The decision also provides commentary on the English law approach to concurrent delay claims, but ultimately leaves this question unresolved.

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 has been preferred in some of the recent cases and 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 as 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.

Closely connected to a consideration of these approaches is the prevention principle. This principle applies where parties to a construction contract have failed to provide an entitlement to extensions of time for acts of prevention by the employer. In such circumstances, employer acts of prevention can cause the contractual date for completion and any liquidated damages connected with it to be replaced with an obligation to complete within a reasonable period and an entitlement to unliquidated damages for delay.

The precise scope of the prevention principle is not free from doubt. Some commentators also believe that the operation of the prevention principle may influence which of the above approaches to concurrent delay is favoured. Those with a broader view of the prevention principle may be expected to favour a broader view as to concurrent delay claims (i.e. so as not to offend a broader operation of the prevention principle).

The persisting uncertainty as to the correct approach to concurrent delay has in part led to the rise of concurrent delay exclusion clauses. These clauses expressly allocate responsibility for concurrent delays to the contractor, ruling out claims against the employer in concurrent delay scenarios. A decision of the English Court of Appeal last year is the first to authoritatively uphold the validity of such a clause.

North Midland Building Ltd v Cyden Homes Ltd

North Midland entered into a design and build contract with Cyden for the construction of a large domestic residence. The contract contained a concurrent delay exclusion from the contractor's entitlement to an extension of time as follows: "*any delay caused by a Relevant Event which is concurrent with another delay for which the Contractor is responsible shall not be taken into account*". Delays caused by one of a list of "Relevant Events" would otherwise entitle the contractor to an extension of time.

The works were delayed and North Midland applied for extensions of time based on a variety of different Relevant Events. Cyden's accepted that the Relevant Events relied upon could in theory entitle North Midland to an extension of time, but rejected the majority of the extension applied for on the basis of the concurrent delay exclusion. Save for a small amount of delay attributable to weather, North Midland's own delays were said to have consumed the delays arising from Relevant Events.

North Midland brought proceedings for a declaration that the concurrent delay exclusion had resulted in time being set at large under the contract. North Midland argued that, by agreeing Relevant Events (including employer acts of prevention) were "not to be taken into account" where concurrent delays exist for which North Midland were responsible, the parties had not provided an adequate extension of time mechanism, thereby engaging the prevention principle.

The Technology and Construction Court rejected North Midland's case, finding that the concurrent delay exclusion was effective to exclude North Midland's entitlement to extensions of time whilst concurrent delays for which it was responsible were operative. The prevention principle applied only where the parties had failed to provide for extensions of time in respect of acts of prevention and not where such extensions had been expressly excluded by the parties.

North Midland renewed its argument on appeal. It argued that the prevention principle was a matter of legal policy, similar to the doctrine of penalties, operating regardless of the express terms of the contract. The Court of Appeal disagreed, finding the prevention principle operated by way of implied terms which could be displaced by the express terms of a contract. As noted by Lord Justice Coulson:

> *"A building contract is a detailed allocation of risk and reward. If the parties do not stipulate that a particular act of prevention triggers an entitlement to an extension of time, then there will be no implied term to assist the employer and the application of the prevention principle would mean that, on the happening of that event, time was set at large. But it is a completely different thing if the parties negotiate and agree an express provision which states that, on the happening of a particular type of prevention (on this hypothesis, one that causes a concurrent delay), the risk and responsibility rests with the contractor."*

The court also rejected a supplementary argument by North Midland that a term should be implied preventing the levying of liquidated damages in cases of prevention. Such a term would be inconsistent with the concurrent delay exclusion which was an integral part of the extension of time and liquidated damages mechanism under the contract.

Concurrent delay claims

In reaching its decision the Court of Appeal also made reference to the ongoing debate in English law as to the correct approach to concurrent delay claims. For this purpose, the court adopted as a definition of concurrent delay "a period of project overrun which is caused by two or more effective causes of delay which are of approximately equal causative potency". Although, at first blush, this would appear to support the "consensus view" noted above, it is apparent from the court's judgment that delays falling within that definition may nonetheless not entitle a contractor to an extension of time. The court noted that:

> *"a contractor's entitlement to an extension of time in circumstances of concurrent delay is not entirely free from doubt. There is no Court of Appeal authority on the issue. In Walter Lilly and Co Limited v Giles Mackay … Akenhead J said that a contractor was entitled to an extension of time for concurrent delay. In reaching that conclusion he referred to a number of first-instance decisions, including Henry Boot Construction (UK) Limited v Malmaison Hotel (Manchester) Limited … (where the point was conceded) and the Scottish case of City Inn Limited v Shepherd Construction Limited … (where a different approach was adopted). Keating on Construction Contracts, 10th Ed., paragraph 8-014 takes the opposite view. It states:*

'However, where there are concurrent causes of delay (one the contractor's responsibility and the other the employer's) the prevention principle would not be triggered because the delay would have occurred anyway absent the employer delay event.' Two more first instance decisions are cited in support of that proposition: Adyard and Jerram Falkus Construction … In Adyard, Hamblen J said, at paragraph 279, that 'there is only concurrency if both events in fact cause delay to the progress of the works and the delaying effect of the two events is felt at the same time'.

For reasons which will become apparent below, it is unnecessary to resolve this potential difference of opinion on this appeal."

This passage is difficult to follow because the reference to Keating is in relation to the prevention principle rather than concurrent delay. In a separate passage (paragraph 8-026), Keating in fact supports the Walter Lilly decision and rather ambitiously states that the consensus view is "now generally accepted". Despite this confusion it is reasonably clear that the Court of Appeal considers that an unresolved question exists as to whether English law favours the "consensus view" or the "first-in-time" approach.

As regards a connection between the prevention principle and concurrent delay:

"the prevention principle has no obvious connection with the separate issues that may arise from concurrent delay. There is no mention of concurrent delay in any of the authorities on which the prevention principle is based … Akenhead J's analysis in Walter Lilly was unconnected to the prevention principle …"

This passage is also difficult to follow, as the analysis in Walter Lilly was expressly based on the prevention principle. Justice Akenhead in that case explained that "part of the logic of [his approach to concurrent delay] is that many of the relevant events would otherwise amount to acts of prevention and that it would be wrong in principle to construe cl.25 on the basis that the contractor should be denied a full extension of time in those circumstances."

Conclusions and implications

This is an important Court of Appeal decision clarifying the legal basis of the prevention principle and confirming that concurrent delay exclusions will be upheld. The court's findings will provide comfort to employers looking to rely on such exclusions that they are effective and will not risk setting time at large or jeopardising rights to liquidated damages. The use of these clauses had increased after the TCC's original decision and this trend is likely to continue in light of the Court of Appeal's findings.

As regard concurrent delay claims, the Court of Appeal's decision is helpful in the sense of confirming that English law remains uncertain and in suggesting that the real contest is between the "consensus view" and the "first-in-time" approach. In this respect, the decision supports the criticism made of the SCL Delay and Disruption Protocol, 2nd Edition in the 2017 edition of this Annual Review. In considering concurrent delay, the SCL Protocol, considers only the "reverse 'but for' test" and the "first-in-time" approach and ignores the "consensus view". In other respects, however, the court's comments as to concurrent delay may cause added confusion, particularly in relation to the relevance of the prevention principle to questions of concurrent delay.

References: *Henry Boot Construction (UK) Ltd v Malmaison Hotel (Manchester) Ltd* (1999) 70 Con LR 33; *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; *Walter Lilly and Co Limited v Giles Mackay* [2012] EWHC 1773 (TCC); *North Midland Building Ltd v Cyden Homes Ltd* [2017] EWHC 2414 (TCC); *North Midland Building Ltd v Cyden Homes Ltd* [2018] EWCA Civ 1744.


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Construction joint ventures and implied duties of good faith

Implied duties of good faith remain a lively topic in English law. Suggestions made some years ago that an implied duty of good faith might be implied into any ordinary commercial contract have not been taken up in subsequent cases. However, there has been increasing acceptance in recent cases that such a duty will be implied into "relational contracts". This developing area of law has particular relevance to joint ventures.

Introduction

In the 2013 edition of this Annual Review we commented on an English High Court decision which suggested that English law might now imply a duty of good faith into "*any ordinary commercial contract*". That was a decision of Mr Justice Leggatt (as he then was) in *Yam Seng PTE Ltd v International Trade Corporation Ltd*.

The Yam Seng decision sparked controversy among English lawyers. A Court of Appeal decision soon after it (*Mid Essex Hospital Services v Compass Group*) appeared to imply criticism of the decision. The court noted that:

> *"…there is no general doctrine of "good faith" in English contract law, although a duty of good faith is implied by law as an incident of certain categories of contract … If the parties wish to impose such a duty they must do so expressly."*

As noted in the 2017 edition of this Annual Review, Justice Leggatt developed his views as to implied duties of good faith in *MSC Mediterranean Shipping v Cottonex*, deciding that the exercise of common law rights of termination were subject to an implied obligation of good faith. That conclusion was also rebuffed by the Court of Appeal:

> *"[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."*

Despite the reluctance to embrace Justice Leggatt's views as to the implication of duties of good faith generally in commercial contracts, there has been a growing acceptance of his views in relation to a narrow category of contracts known as "relational contracts". These were described in *Yam Seng* as follows:

> *"English law has traditionally drawn a sharp distinction between certain relationships – such as partnership, trusteeship and other fiduciary relationships – on the one hand, in which the parties owe onerous obligations of disclosure to each other, and other contractual relationships in which no duty of disclosure is supposed to operate. Arguably at least, that dichotomy is too simplistic. While it seems unlikely that any duty to disclose information in performance of the contract would be implied where the contract involves a simple exchange, many contracts do not fit this model and involve a longer term relationship between the parties which they make a substantial commitment. Such 'relational' contracts, as they are sometimes called, may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and 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. Examples of*

such relational contracts might include some joint venture agreements, franchise agreements and long term distributorship agreements."

Yam Seng itself involved a long-term distributorship agreement and the implication of good faith duties in that case can be explained as a feature of such relational contracts. The case was applied in *Bristol Groundschool v Intelligent Data Capture* to imply a general obligation of good faith into a relational contract, in that case a joint venture agreement. It was also applied in *D&G Cars Ltd v Essex Police Authority* to imply the same term into a long-term car disposal contract for a policy authority, that being described as a "*relational contract par excellence*". There have also been cases in 2019 continuing this theme. Mr Justice Fraser in *Bates v Post Office Ltd* noted that:

"there is a specie of contracts, which are most usefully termed 'relational contracts', in which there is implied an obligation of good faith (which is also termed "fair dealing" in some of the cases). This means that the parties must refrain from conduct which in the relevant context would be regarded as commercially unacceptable by reasonable and honest people."

The only consideration at appellate level of the relational contract caselaw is *Globe Motors v TRW Lucas Varity Electric Steering*, where the Court of Appeal commented that the Yam Seng analysis of relationship contracts "*might have given considerable force*" to an argument for an implied term in that case. However, another appeal court judge (Lord Justice Jackson, now retired) has voiced criticism of the concept. Writing extra-judicially he noted:

"I accept that there are contracts [a relational] character and I have no objection to people giving them a label if they want to. Those contracts will generally contain express or implied obligations to co-operate and no doubt a host of similar obligations. But I question whether there is any need to super-add an obligation of good faith. The general law implies a duty to co-operate. It is difficult to see what additional conduct an obligation of good faith will import, beyond those obligations arising under the express or implied terms."

In a case last year, Justice Leggatt (who has since been elevated to the Court of Appeal) has developed the concept of relational contracts further in connection with a joint venture agreement.

Sheikh Tahnoon v Kent

Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan ("Sheikh Tahnoon") is a member of the Royal Family of Abu Dhabi. In 2008 he agreed to invest in a hotel business owned and promoted by Mr John Kent which had the aim of establishing a brand of luxury hotels in Greece under the name Aquis. The business was first mentioned to Sheikh Tahnoon by Mr Kent during a boat trip in the Greek islands. Sheikh Tahnoon expressed interest in becoming involved with the business. More detailed commercial discussions ensued resulting in Sheikh Tahnoon agreeing to purchase 50% of the shares in the Aquis holding company. A price of €4 million was fixed for the purchase, roughly representing half the amount that Mr Kent had already invested in the business.

Sheikh Tahnoon and Mr Kent became close friends and the Sheikh invested further sums in the Aquis business on a number of occasions. Further investment was required, in part, due to cashflow difficulties encountered by the business. In mid-2010, Sheikh Tahnoon also agreed to fund the purchase of an online travel business called "YouTravel". Mr Kent owned a minority shareholding in the business and the remaining shares had been offered for sale by an investment bank. The intention was for the two businesses to be run together.

The financial performance of the businesses continued to deteriorate during the course of 2010 and 2011, driven in part by the Greek government debt crisis and the international bail-out which followed it as well as the eruption of an Icelandic volcano which heavily disrupted air travel. A final cash injection of €6.5 million was agreed by Sheikh Tahnoon in December 2011 which was intended to see the Aquis businesses through to profitability. The Sheikh's shareholding in both businesses was increased to 70% on account of this investment.

The YouTravel business also suffered problems at around this time. Mr Kent negotiated a proposal with a German tour operator ("FTI") whereby in exchange for extending credit of €6-8 million to the YouTravel business, FTI would have the option to buy two hotels owned by Aquis and an option to purchase 40% of the shares in YouTravel for £1. Sheikh Tahnoon's consent was required to pursue this proposal, but he was surprised to learn that the YouTravel business was in difficulty. He did not give his consent and begun to consider how best to recover his investments in the two businesses.

Over the course of the following month, Mr Kent was pressured into signing a Framework Agreement and Promissory Note. The effect of these documents was to give Sheikh Tahnoon sole ownership of the two hotels owned by Aquis and for Mr Kent to pay Sheikh Tahnoon €5.4 million over a period of time. This arrangement was intended to allow the Sheikh to recover the amount of his investment.

Mr Kent had sought to include amendments in the Framework Agreement to clarify that he was free to negotiate and agree the FTI proposal. Mr Kent made strenuous attempts to convince Sheikh Tahnoon and his representatives to agree this amendment, as he considered it would allow him to "*try and secure the survival of [You Travel] and Aquis (without, of course, [the two hotels]) through the FTI deal*". Sheikh Tahnoon refused these amendments without explanation. Unbeknownst to Mr Kent, the Sheikh's representatives were separately negotiating with FTI to sell the Sheikh's 70% interest in YouTravel for €6 million.

The Framework Agreement was drafted by the Sheikh's representatives to allow them to conclude an agreement with FTI without revealing that intention to Mr Kent. The Agreement provided that the Sheikh would "*transfer any remaining shares in [YouTravel] to [Mr Kent] once the YouTravel Solution is concluded with FTI.*" The "YouTravel Solution" was defined as an arrangement whereby FTI would "*acquire equity in [YouTravel] and provide financial relief*". Mr Kent thought this was a reference to the proposal he had negotiated with FTI to grant an option over 40% of the YouTravel shares for £1 in return for extending credit to the business – which would leave him with a 60% interest in YouTravel. He did not know that the Sheikh was planning to dispose of all of his shares to FTI with the result that no remaining shares would be transferable to him.

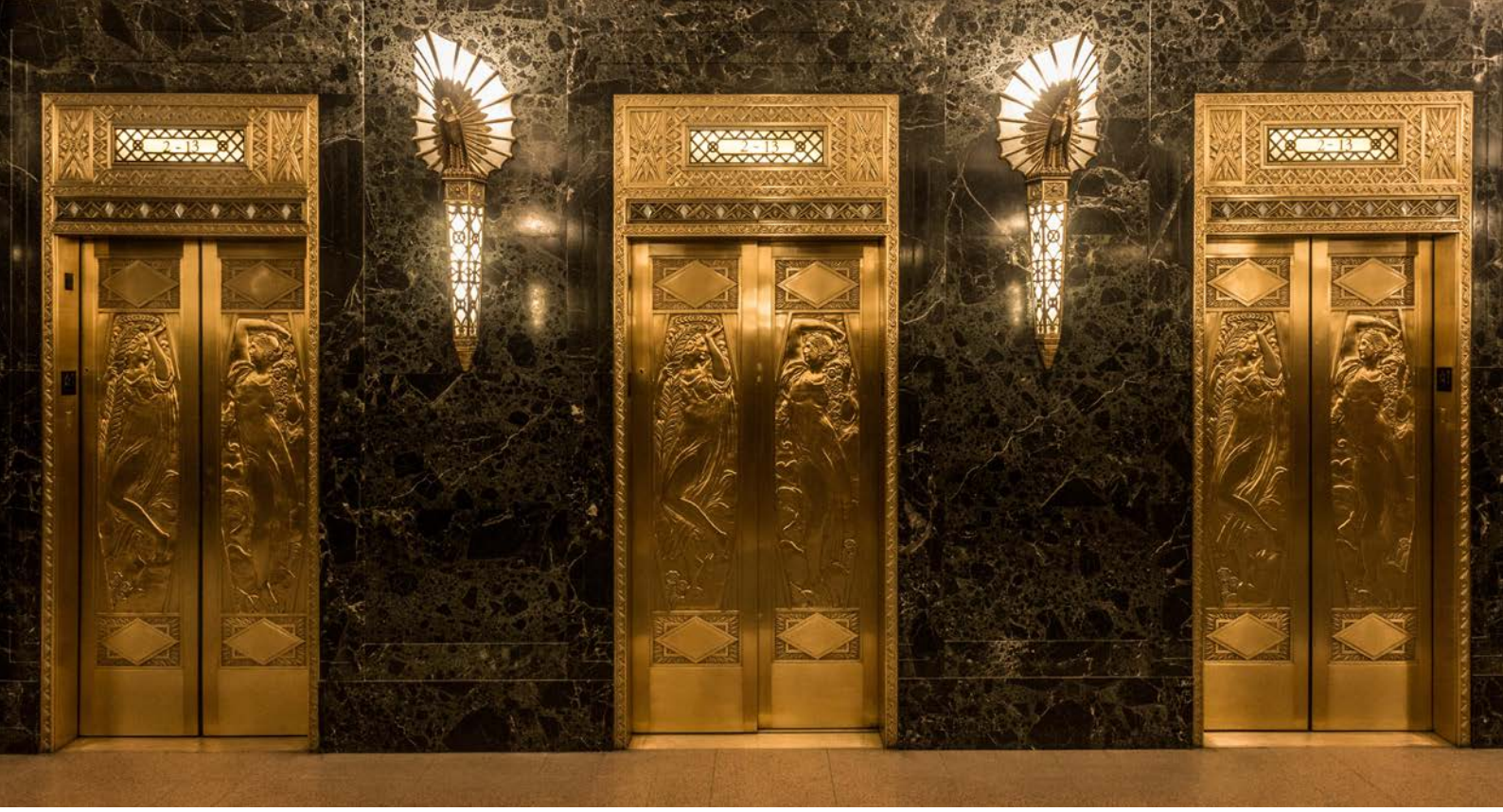
In the event, the Sheikh's sale to FTI did not proceed as it was subject to a financial audit by Deloitte which turned out to be unsatisfactory. The Sheikh also benefited little, if at all, from the two hotels transferred to him. He was required to inject additional funds to pay outstanding debts and a subsequent sale of the hotels resulted in a net purchase price (after liabilities had been ascertained) of slightly more than the additional funds provided. The Sheikh then looked to the Promissory Note and claimed payment of the €5.4 million owed under it by Mr Kent. Among other things (including clams of physical duress), Mr Kent resisted payment by claiming that the Promissory Note and Framework Agreement had been induced by breaches of an implied obligation of good faith between himself and Sheikh Tahnoon.

An implied obligation of good faith

The English Commercial Court upheld Mr Kent's claim for a breach of implied obligations of good faith. Reflecting some of the developments covered in the introduction above, Lord Justice Leggatt summarised the reception of his decision in Yam Seng as follows: "*Although the observations that I made in the Yam Seng case about the scope for implying duties of good faith in English contract law have provoked divergent reactions, there appears to be growing recognition that such a duty may readily be implied in a relational contract.*"

The Judge then proceeded to define the agreement between Sheikh Tahnoon and Mr Kent as a relational contract in the following terms:

> *"I have held that Sheikh Tahnoon did not agree to provide funding on an open-ended basis and did not owe any fiduciary duties to Mr Kent. But I think it clear that the nature of their relationship was one in which they naturally and legitimately expected of each other greater candour and cooperation and greater regard for each other's interests than ordinary commercial parties dealing with each other at arm's length. When Sheikh Tahnoon agreed to become an equal owner of the Aquis business with Mr Kent, the two men entered into a joint venture agreement which was intended to be a long-term collaboration, in which their interests were inter-linked and which they saw, commercially albeit not in law, as a partnership. Their collaboration was formed and conducted on the basis of a personal friendship and involved much greater mutual trust than is inherent in an ordinary contractual bargain between shareholders in a company. Although day to day management of the businesses was left to Mr Kent, strategic decisions which would involve further capital investment, such as whether to purchase a hotel or the decision to acquire the majority stake in YouTravel, were (of necessity) taken jointly and could only be reached by consensus between them. The pursuit of the venture therefore required a high degree of co-operation between the two participants. They did not attempt to formalise the basis of their cooperation in any written contract but were content to deal with each other entirely informally on the basis of their mutual trust and confidence that they would each pursue their common project in good faith. In the circumstances the contract made between these parties seems to me to be a classic instance of a relational contract."*



The implication of a duty of good faith into such a contract was considered "*essential to give effect to the parties' reasonable expectations and satisfies the business necessity test which Lord Neuberger in Marks & Spencer Plc v BNP Paribas … reiterated as the relevant standard for the implication of a term into a contract.*"

One difficulty with this finding in the context of this case is the absence of any real analysis by the Court of what the relational contract between the parties actually was. It was not written down. The suggestion seems to be that a "*joint venture agreement*" was entered into when Sheikh Tahnoon initially agreed to invest in the Aquis business. However, the Court's description of that agreement at the outset of the judgment is minimal:

> *"In a conversation which probably took place on 5 October 2008 he and Mr Kent made what Sheikh Tahnoon accepts was a binding contract for him to acquire a 50% stake in Aquis Cyprus. The price that Sheikh Tahnoon would pay for his shares was not fixed at this stage, but the agreement appears to have been that Sheikh Tahnoon would pay half the amount that Mr Kent had already himself invested in the business."*

The suggestion that this amounted to a "joint venture agreement" seems difficult to justify. Sheikh Tahnoon would presumably have been free to sell his shareholding a short period after investing if circumstances had changed. There is no finding in the judgment that he was bound into his investment for a long or indeed any period of time. Whilst the parties developed a close business relationship, there is nothing in the judgment to suggest that this closeness carried over into a legal relationship. Individual investments were always made on specific terms, for example, by way of loans or in return for increased shareholding.

It is difficult to identify from the judgment a single term of the supposed relational contract aside from the implied duty of good faith itself. That makes it very difficult to understand how such an implied term can satisfy the business necessity test referred to above. This test requires consideration of whether the express terms of the contract would be unworkable, in a business sense, if the implied term were not upheld. If there are no express terms of relevance, there can be no talk of an implied term necessary to make them workable. An implied term cannot be the only term of a contract.
It is interesting to consider whether the obligation of good faith found by the Court might have been better characterised as one which arose from an implied contract, rather than an implied term. The real justification for the Court's finding of a relational contract appears to be the close and collaborative business relationship which developed between the two parties. It might be argued that it was implicit in such a relationship that a contract existed requiring the parties to act in good faith, even if that were the only term of such a contract. Considerable hurdles would still face such an argument, as an implied contract will not be found under English law unless such a contract is the only plausible explanation for a set of facts. Close and collaborative business relationships may, of course, exist independently from a contract. Such an argument would, however, avoid the oddity of implying a term in a contract whose terms the Court had not identified.

Implications for joint ventures generally

Although the Court's conclusions on the facts of the case are difficult to understand, there can be no doubt as to the strong support given for the implication of terms into relational contracts generally. Of particular note, in addition to the test for implied terms confirmed in the *Marks & Spencer* decision (including the business necessity test), Lord Justice Leggatt also justified the implied term on the following broader basis:

> *"I would also reach the same conclusion by applying the test adumbrated by Lord Wilberforce in Liverpool City Council v Irwin … for the implication of a term in law, on the basis that the nature of the contract as a relational contract implicitly requires (in the absence of a contrary indication) treating it as involving an obligation of good faith."*

This is a significant development which has not previously been suggested in the cases on relational contracts. Such terms are only implied by law in specific classes of contract, such as employer and employee or landlord and tenant. The test of business necessity does not apply and they are instead implied by the English courts based on broader considerations such as fairness and policy considerations. Once such a term has been determined by an English court, it applies to all contracts of that class, unless excluded by the parties. As most classes of contract are well known to English law, the identification of a new term to be implied by law is very rare.

The suggestion that an implied duty of good faith is to be implied by law into relational contracts is significant therefore. It means that questions of business necessity fall away and that the only requirement for the implication of a duty of good faith is whether a contract can be classified as a relational contract. Many joint ventures will meet this description and would therefore be subject to implied obligations of good faith, unless excluded by express terms.

In this connection, it is also worth noting the following approval given by the Court to a leading textbook on Joint Ventures:

> *"Hewitt on Joint Ventures … a book edited by practitioners who specialise and have extensive experience in this area of commercial activity, contains a lengthy and helpful discussion of duties of good faith between joint venture parties. I note with interest the authors' conclusion that '"good faith" and "fair dealing" are concepts that at root seem entirely appropriate to very many joint venture relationships' and that: 'If findings of fiduciary duties in the fullest sense between joint venture parties will continue to be rare, principles relating to "good faith" seem to fit a relationship between parties to a joint venture where mutual trust and commitment are crucial to the success of the venture …'"*

Conclusion

This latest decision from Lord Justice Leggatt can be seen as potentially extending the law as to implied obligations of good faith in two ways. Firstly, any contract which can be characterised as "relational" will be subject to the implied term. This would seem likely to apply to most sizeable construction joint ventures. Secondly, the looseness with which the Court appears to have identified a relational contract in the present case may signal a broader approach in circumstances where no formal contract exists between the parties governing the whole of their relationship. This may have relevance in a construction context where joint venture agreements are entered into between two or more parties on a project-by-project basis. In such cases, the closeness of the business relationship is likely to transcend individual projects and arguments may arise as to whether the parties owe implied obligations of good faith more generally. For example, the extent to which one party can negotiate with different joint venture partners for new projects without the knowledge of its existing joint venturers.

This is an emerging area of English law and there is a notable absence of any authoritative Court of Appeal guidance on the treatment of relational contracts. Until such guidance emerges, as it undoubtedly will at some point, parties would be well advised to consider the effect of any implied duties of good faith in the context of any close, collaborative or long-term business relationships.

References: *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB); *Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200; *Bristol Groundschool Ltd v Intelligent Data Capture Ltd* [2014] EWHC 2145 (Ch); *D&G Cars Ltd v Essex Police Authority* [2015] EWHC 226 (QB); *Globe Motors v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396; *Sir R Jackson, Does Good Faith Have Any Role in Construction Contracts* (2018) SCL Paper No. 207; *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent* [2018] EWHC 333; *Bates v Post Office Ltd (No 3)* [2019] EWHC 606 (QB).

Claims for pre-contractual misrepresentation in international construction projects: the enforceability of entire agreement and contractor enquiries clauses

An English Court of Appeal decision last year has made clear that clauses which deem a party to have made their own enquiries or to have not relied on pre-contractual representations by the other party will be subject to the reasonableness test set out in section 3 of the Misrepresentation Act 1967. This finding is directly applicable to international construction contracts subject to English law and is likely to apply to a number of clauses commonly included in such contracts.

Section 3 of the Misrepresentation Act 1967

It is sometimes assumed that English law imposes no limits on the ability of parties to exclude or limit their liability in international contracts. Certain limitations apply to domestic English law contracts by virtue of the Unfair Contract Terms Act 1977, but these do not apply to international contracts where English law applies only by virtue of a choice of law clause. An important exception to this, however, is section 3 of the Misrepresentation Act 1967 which imposes limits on any term which purports to exclude or restrict a party's liability for misrepresentation.

The Misrepresentation Act applies to English law international contracts in the same way as other English statutes which modify English common law, such as the Sale of Goods Act 1979 and the Supply of Goods and Services Act 1982. It provides a right to damages for a party who has been induced to enter into a contract by a misrepresentation, whether made negligently or otherwise. It also alters the common law position as to the circumstances in which a party may rescind a contract due to pre-contractual misrepresentations.

Section 3 of the Misrepresentation Act provides:

> *"If a contract contains a term which would exclude or restrict:*
>
> *(a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or*
>
> *(b) any remedy available to another party to the contract by reason of such a misrepresentation,*
>
> *that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11(1) of the Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does."*

The "*requirement of reasonableness*" referred to is elaborated by the Unfair Contract Terms Act as follows:

> *"In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 … is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made."*

The potential for misrepresentation claims in construction contracts typically arises from pre-contractual information provided by an employer as part of a tender process, such as site data, geotechnical reports and the like. Contractors are likely to rely on this information in preparing their tender and entering into the construction contract. Any inaccuracies or mistakes in the information may entitle the contractor to bring a claim for damages under the Misrepresentation Act.

A number of clauses are commonly deployed to combat this risk:

— Contractors will often be deemed to have made enquiries and to have satisfied themselves as to a range of matters including the characteristics of the site (including sub-surface conditions), the nature of the work and any equipment or materials necessary for it, hydrological and climatic conditions, local laws and practices, access to the site and the provision of accommodation and utilities. Such a provision appears at Clause 4.10 of each of the FIDIC Second Edition contracts and at Clause 7 of the 3rd Edition LOGIC Conditions for Construction. The deeming nature of these provisions mean that they may affect any claim a contractor has under the Misrepresentation Act. The contractor might, for example, have relied on geo-technical information supplied to it by the employer, but is nonetheless deemed to have made its own enquiries as to sub-surface conditions.

— Sometimes a more direct approach is taken whereby the contractor accepts responsibility for verifying any information provided by the employer and/or accepts responsibility for inaccuracies or errors contained within it. This again has the potential to affect any claim the contractor might otherwise have had under the Misrepresentation Act in relation to such matters.

— Although notably absent from the FIDIC forms of contract, entire agreement clauses are very often included to prevent either party attempting to rely on pre-contractual exchanges as forming part of the contract (see for example, clause 34.8 of the LOGIC contract above). They are commonly expanded to state that neither party has relied on any statements or representations from the other party in entering into the contract. Such language has been held by the English courts to successfully defeat a claim under the Misrepresentation Act (subject to section 3).

Given the impact of the above clauses on potential claims under the Misrepresentation Act, an issue arises as to whether they are caught by the section 3 criteria of a clause which "excludes or restricts" liability for misrepresentation. That issue has been significantly clarified by an English Court of Appeal decision last year.

First Tower Trustees Ltd v CDS (Superstores International) Ltd

First Tower Trustees Ltd ("FTT") agreed to lease commercial property owned by it to CDS (Superstores International) Ltd ("CDS"). As is normal in the commercial letting market, CDS's solicitors had raised a number of enquiries with FTT, including whether the property was affected by any actual, alleged or potential environmental problems (including actual or suspected contamination). FTT's solicitors answered that FTT had "*not been notified of any such breaches or environmental problems relating to the Property but [CDS] must satisfy itself*". The form used to raise and answer the enquiries included a statement that FTT would notify CDS if, before exchanging contracts, it became aware of anything which may cause any of their replies to be incorrect.

FTT subsequently learned that there was asbestos contamination within the Property, but failed to pass that information onto CDS prior to the lease being executed. The contamination was such that the Property was dangerous to enter without asbestos remediation work being carried out. Upon learning of the issue, CDS terminated the lease and claimed damages under the Misrepresentation Act.

FTT relied on a clause in the lease which provided: "*The tenant acknowledges that this lease has not been entered into in reliance wholly or partly on any statement or representation made by or on behalf of the landlord.*" At first instance, the English High Court struck down the clause as being an attempt to exclude liability for misrepresentation which did not satisfy the reasonableness requirement. CDS was awarded £1.4 million in damages and FTT appealed.

The English Court of Appeal dismissed the appeal and affirmed the invalidity of the clause. In considering the nature of the clause and whether it could properly be characterised as an exclusion or limitation of liability, the Court distinguished terms which merely seek to define the extent of the parties' relationship. Accordingly, in one case (*Thornbridge v Barclays Bank plc*) a clause which stated that a buyer was not relying on any communication "*as investment advice or as a recommendation to enter into*" certain transactions did not fall within section 3 as it merely purported to ensure that the buyer did not rely on communications for purposes outside the proper scope of the parties' business relationship.

Where the representations addressed by the clause fall squarely within the scope of the parties' relationship, the Court favoured a straight-forward approach to determining whether section 3 applies:

> *"… it seems to me that [the question] can only be answered by enquiring what the position would have been if [the no-reliance clause] had not been there. Absent [the clause], I consider that the position is clear. The landlords would have been liable for misrepresentation. The only reason why they may not be is the existence of [the no-reliance clause]. On the face of it, therefore, [the clause] is a contract term which would exclude liability for misrepresentation."*

The fact that the clause was cast in terms of CDS's reliance on any representations rather than directly addressing liability for misrepresentation was in the Court's view a matter merely of form:

> *"Section 3 of the 1967 Act must be interpreted so as to give effect to its evident policy. That policy, in my judgment, is to prevent contracting parties from escaping from liability for misrepresentation unless it is reasonable for them to do so. How they seek to avoid that liability is subsidiary."*

The Court's broad approach makes those clauses commonly found in construction contracts noted above susceptible to the effect of section 3. Each of those clauses may, depending on the circumstances, result in liability for misrepresentation being avoided by the employer.

The Court's decision also points the way to an alternative approach for the employers in a construction context. Nothing in section 3 prevents a party from qualifying representations at the time they are given. In this regard, the Court cited with approval the following contrasting examples from *Raiffeisen Zentralbank Osterreich AG v The Royal Bank of Scotland plc*:

> *"[A] seller of a car who says to a buyer 'I have serviced the car since it was new, it has had only one owner and the clock reading is accurate'. Such statements would be representations and would remain so even if the seller had added the words 'but those statements are not statements on which you can rely'.*
>
> *By contrast, if the seller of the car said 'The clock reading is 20,000 miles, but I have no knowledge whether the reading is true or false' the position would be different because the qualifying words could not fairly be regarded as an attempt to exclude liability for a false representation arising from the first half of the sentence."*

The better approach for employers, therefore, is to ensure that any tender packs or other pre-contractual information is made subject to a clear disclaimer stating that the employer makes no representation as to the accuracy or correctness of the information provided.

Reasonableness

In addressing the reasonableness test, the Court of Appeal emphasised the absence of any exclusion from the clause in respect of the formal enquiries and answers exchanged between solicitors. Previous cases had held such clauses to be reasonable where they sought to prevent reliance on anything outside a formal exchange of enquiries and answers prior to the transaction. The absence of any carve out for answers to enquiries made the clause unreasonable even though the parties were of equal bargaining power and were represented in the contract negotiations by competent solicitors. As the Court of Appeal noted:

> *"if [the no-reliance clause] governs the landlords' liability the important function of replies to enquiries before contract becomes worthless. Although there might be a case where, on exceptional facts, a clause which precludes reliance on replies to enquiries before contract might be held to satisfy the test of reasonableness even where those replies have in fact been relied on, I find it very hard to imagine what those facts might be."*

Parallels can be drawn between these comments and major construction projects. During the tender process, it is not uncommon for contractors to make specific enquiries or tender clarifications of the employer. Although less formalised than the process for making enquiries in conveyancing or leasing transactions, similar considerations of unreasonableness could be said to arise in respect of any clause in a construction contract which prevents a contractor from relying on answers given by the employer to such enquiries. The reasonableness of any given clause will depend on the circumstances of each case, but it is certainly conceivable that the types of clauses noted above which commonly appear in international construction contracts could be held to be unreasonable for the same reasons given by the Court of Appeal in this case.

Conclusion

This decision has significant ramifications for international construction projects. It is now clear that clauses in construction contracts which have the effect of circumventing reliance placed by contractors on documents and information supplied to them prior to the contract will need to meet the reasonable test stipulated by section 3 of the Misrepresentation Act. That test will be less likely to be met where the contractor has been encouraged to rely on such information by the employer's actions or through a formal exchange of enquiries and answers. The common approach, therefore, of attempting to address the risk of misrepresentation claims through deeming provisions or no-reliance clauses is now open to challenge. Employers can, however, put themselves in a stronger position by including carefully drafted qualifications in any information supplied to contractors prior to contracting.

References: *Raiffeisen Zentralbank Osterreich AG v The Royal Bank of Scotland plc* [2010] EWHC 1392 (Comm); *Thornbridge v Barclays Bank plc* [2015] EWHC 3430 (QB); *First Tower Trustees Ltd v CDS (Superstores International) Ltd* [2018] EWCA Civ 1396.

Reasonable endeavours obligations in construction contracts and the balancing of commercial interest

Introduction

Endeavours clauses raise a number of issues in practice:

— What is the standard of "endeavour" required? Does "best endeavours" refer to every means available, or only those which are reasonable?

— What if there is more than one endeavour available which meets the standard? Should they all be pursued, or only one?

— Do such clauses require endeavours to be pursued even though they conflict with one's own commercial interests?

The answer to the first issue is largely clear: the endeavours required are to be reasonable, even in the case of "best endeavours" clauses. One is not required to "move heaven and earth". What will be reasonable in any given case depends on all the circumstances, including the nature of the contract and businesses involved and the financial position of the company upon which the obligation rests.

Given this position, one might well ask whether there is any difference between "reasonable endeavours" and "best endeavours". This question was considered in *Rhodia International Holdings Ltd v Huntsman International*, where the difference was held to lie in the number of endeavours required to be pursued. "Reasonable endeavours" required only one of a number of reasonable endeavours to be pursued, whereas "best endeavours" required all reasonable endeavours to be pursued. In this context, the court noted that: "it may well be that an obligation to use all reasonable endeavours equates with using best endeavours".

A "best endeavours" obligation may also be said to more readily require a party to subordinate its own financial interests to the agreed object. For example, in *Jet2.com v Blackpool Airport*, a contract between budget airline Jet2.com and Blackpool Airport ("BAL") contained an agreement that both parties would "*… co-operate together and use their best endeavours to promote Jet2.com's low cost services*". This clause was held by the Court of Appeal to require BAL to allow Jet2 to operate outside of normal hours even if this required BAL to incur a loss as a result.

By contrast, a "reasonable endeavours" obligation will rarely require a party to sacrifice its own commercial interests. For example, in *Phillips Petroleum Company United Kingdom v Enron Europe*, a contract for the supply of North Sea gas contained a requirement for the parties to use reasonable endeavours to agree the date on which deliveries of gas were to begin (a long-stop date was also specified in the absence of agreement). Because of a fall in the price of gas Phillips refused to agree a date earlier than the specified long-stop date. Enron argued that each party was under a duty to use reasonable endeavours having regard only to criteria of technical and operational practicability and without regard to selfish or commercial motives. The Court of Appeal disagreed, with Kennedy LJ finding it "*impossible to say that [the contract terms] impose on the buyer a contractual obligation to disregard the financial effect on him, and indeed everything else other than technical or operational practicality …*".

Similar reasoning was applied to an "all reasonable endeavours" clause in *CPC Group v Qatari Diar REIC* to conclude that, "*the obligation to use 'all reasonable endeavours' does not always require the obligor to sacrifice his commercial interests.*"

In practice, however, the extent to which any of these obligations will require significant expense to be incurred or commercial interests to be subordinated will be heavily dependent on the contractual context in which they appear. Thus, an important part of the reasoning in the Jet2 decision was that the ability to operate out of hours was held to be essential to the airline's business and was therefore fundamental to the agreement. In those circumstances:

> *"one would not expect the parties to have contemplated that BAL should be able to restrict Jet2's aircraft movements to normal opening hours simply because it incurred a loss each time it was required to accept a movement outside those hours, or because keeping the airport open outside normal hours proved to be more expensive than it had expected."*

Reasonable endeavours to complete construction works

Whether a reasonable endeavours obligation requires a party to sacrifice its commercial interests has been considered in a number of recent construction related cases.

The first is *Ampurius NU Homes Holdings Ltd v Telford Homes (Creekside) Ltd* decided in 2012. Telford was the developer of a mixed-used development known as "Creekside Village West" in Greenwich, London. It agreed to provide a long lease of the commercial parts of the development to Ampurius. Telford and Ampurius entered into an Agreement for Lease on 7 October 2008 where, in return for Ampurius' agreement to take up the lease, Telford agreed to "*use its reasonable endeavours to procure completion of the Landlord's Works by the Target Date or as soon as reasonably possible thereafter.*"

Telford had already commenced work on the development at the time the Agreement for Lease was signed. Work continued until March 2009 when, with the onset of the credit-crunch, demand for residential units began to dry up and Telford was unable to meet the level of pre-sales required by its development financing. As a result, Telford was unable to access additional funds and decided to suspend part of the commercial works which Ampurius was to lease. Ampurius subsequently sought to terminate for repudiation and one issue between the parties was whether the "reasonable endeavours" clause justified Telford's suspension. Telford argued that the expression "reasonable endeavours" encompassed financial resources, so that a failure to complete due to funding problems would not amount to a breach provided reasonable endeavours had been made to procure finance.

The court accepted that Telford had made reasonable endeavours to procure finance, but rejected Telford's submission that funding came within the scope of the clause. According to Mr Justice Roth, the reasonable endeavours obligation was:

> *"…designed to cover matters that directly relate to the physical conduct of the works, thereby providing an excuse for delay in such circumstances as inclement weather or a shortage of materials for which the Defendant was not responsible. The clause does not, in my view, extend to matters antecedent or extraneous to the carrying out of the work, such as having the financial resources to do the work at all."*

The court appears to have reached its decision by confining the clause strictly to the construction works and thereby limiting the scope of matters to be taken into account in considering "reasonable endeavours". As the construction works themselves had not been affected, Telford was unable to find any support for its position in the reasonable endeavours clause.

A further case last year appears to have reached similar conclusions. *Gaia Ventures Ltd v Abbeygate Helical (Leisure Plaza) Ltd* concerned the redevelopment of an existing leisure space, including an ice rink, a bowling alley and a restaurant. The developer purchased the ice rink owner's interest in the site for £1.5 million, subject to an overage provision which entitled the ice rink owner to a further £1.4 million if two conditions were fulfilled. The first condition was the obtaining of planning permission and the second, referred to as the "Assembly Condition", was the acquisition of all other property interests at the site. The developer was required to use "reasonable endeavours" both in obtaining an acceptable planning permission and in meeting the Assembly Condition as soon as reasonably practicable upon the happening of certain events.

The overage provision was subject to a longstop date of 10 years. If the two conditions noted above had not been fulfilled by that date, the ice rink owner would never be entitled to the overage payment. In the event, planning permission was obtained prior to the longstop date, but the Assembly Condition was only satisfied shortly afterwards. The ice rink owner claimed that the developer had not used reasonable endeavours to satisfy the Assembly Condition as soon as reasonably practicable and that, had it done so, the condition would have been fulfilled prior to the long-stop date. The developer contended that it needed to secure funding for the development before satisfying the Assembly Condition as that would in turn trigger obligations for it to begin construction of parts of the development.

Although finding that the developer's funding constraints were largely self-imposed, the court nonetheless found that the developer's own financial position was of little relevance:

> *"What is undertaken is a positive obligation: a promise to use 'reasonable endeavours' or to take 'reasonable steps' is not to be read as equivalent to a promise to act 'if and to the extent that it is in conformity with my proposed arrangements'. This was an obligation to take reasonable steps. The question is whether the relevant step was feasible, and then whether in all the circumstances it was reasonable to take it (or unreasonable not to take it), balancing the risk of adverse consequences against the obligation to perform the promise. When assessing adverse consequences, the court is*

concerned to see whether the consequences of taking a particular step are on an objective view unreasonable and impractical. As Alghussein Establishment v Eton College … makes clear, something which merely affects the margin of a developer's profit would not in the ordinary course be taken into account in considering whether it is reasonably practicable for a developer to commence or continue development at any time."

The *Alghussein* case, although much older, also concerned a development scenario and an obligation to use "*as soon as reasonably practicable following all necessary licences … use its best endeavours to commence and proceed diligently with the development in accordance with such licences*". The developer contended that the very high rates of interest which prevailed in the 1980s entitled it to hold off proceeding with the development. The English Court of Appeal held that this was not something which could properly be taken into account:

"There is no doubt that, at all material times, the commencement and completion of the development has been practicable in the sense that there has been no engineering or construction difficulty, and all necessary consents and permissions have been available.

There is no doubt also in my view -- and this is really common ground -- that in a general sense the appellants are not required to do anything unreasonable so as to complete the [development] earlier. For instance, they are not required to use arc lights and pay vast amounts of overtime in order to work the site round the clock, seven days a week, to finish the completion of the development sooner. Equally, they are not required to hire expensive equipment to start excavation a few days earlier when the site is deeply frostbound.

Other such instances can be thought of where a measure of delay could be avoided at very high cost to the developers. Those are matters which affect the profit of the developers. From their point of view that is why to incur such costs would objectionable. Indeed, practically anything that happens may affect the profit of a developer. But as it seems to me these matters are outside the contemplation of this agreement because, as methods of working, they are on an objective view unreasonable and impracticable and not merely because they would affect the profit of the developer.

The agreement does not guarantee to the developer any specified level of profit or even, in my view, a reasonable profit. The fact, therefore, that there are matters such as those I have mentioned, as to which it may be said that it would be unreasonable to expect the developer to bear such costs which would in fact so adversely affect his profit, does not mean that any matter which would affect his profit is a matter to be taken into account in considering whether it is reasonably practicable for him to commence or continue the development at any time. It does not mean that all financial matters have to be considered as matters of fact and degree."

The Gaia Ventures decision has been appealed and the Court of Appeal's judgment has very recently been handed down. Given the finding that the developer's funding constraints were self-imposed, the court did not feel the need to deal in detail with the judge's comment that matters which affect a developer's profit margin are "*not in the ordinary course be taken into account*". However, it considered that was "*to state the matter too broadly*". The Court of Appeal also noted in this regard that the comments in *Alghussein* were heavily dependent on the wording of the clause in that case and concerned a "best endeavours" obligation rather than a "reasonable endeavours" obligation.

The Court of Appeal's comments may, by analogy, also cast doubt on the conclusions reached in the *Ampurius* case. For the time being, therefore, a measure of uncertainty exists as to the extent to which an obligation to use "reasonable endeavours" to complete construction works allows any financial constraints on the developer or contractor to be taken into account. The position is clearer for a "best endeavours" obligation following the *Alghussein* case.

Reasonable endeavours to overcome a force majeure event

In a construction context, endeavours obligations often also appear in connection with force majeure clauses. A party entitled to the protection of such a clause may be required to use reasonable endeavours to overcome in the impact of the force majeure event. The effect of such a clause was considered in the Seadrill case considered earlier in this year's publication (see page 5 above). That case concerned a drilling rig hire agreement based on the LOGIC form with an amended force majeure clause as follows:

"Neither COMPANY nor CONTRACTOR shall be responsible for any failure to fulfil any term or condition of the Contract if and to the extent that fulfilment has been delayed or temporarily prevented by an occurrence, as hereunder defined as FORCE MAJEURE, which has been notified in accordance with this Clause 27 and which is beyond the control and without the fault or negligence of the party affected and which, by the exercise of reasonable diligence, the said party is unable to prevent or provide against. Both parties shall use

their reasonable endeavours to mitigate, avoid, circumvent, or overcome the circumstances of FORCE MAJEURE.

…

In the event of force majeure occurrence, the party that is or may be delayed in performing the Contract shall notify the other party without delay giving the full particulars thereof and shall use all reasonable endeavours to remedy the situation without delay. [Emphasis added]"

Although Tullow's force majeure claim failed for want of causation (as explained earlier in this publication), the court went on to consider whether Tullow would nonetheless have been in breach of its reasonable endeavours obligation. Seadrill claimed that this obligation required Tullow to provide it with drilling instructions at a number of wells which were not subject to the moratorium. Tullow contended that there was no business case for working on any of the wells identified by Seadrill and that it was not in its commercial interest to do so.

The court noted that, as a matter of language, there was no reason to exclude the absence of a business case or Tullow's commercial interests from those matters which could be taken into account when considering a reasonable endeavours obligation. However, the weight to be given to such considerations would depend on the contractual context in which the obligation was found. The specific context of a force majeure clause suggested, in the court's view, that Tullow's own commercial interests were not determinative:

"Tullow's obligation is to provide Seadrill with drilling instructions. The contract area included TEN and Jubilee. Let it be assumed that Tullow was 'delayed or temporarily prevented' from providing Seadrill with drilling instructions in TEN by reason of the moratorium. In consequence Tullow's contractual duty was to exercise its reasonable endeavours to avoid or circumvent that prohibition by providing Seadrill with drilling instructions in Jubilee to the extent that was reasonable. If providing such instructions would be more expensive to Tullow than drilling in TEN or would be accompanied by a greater risk of a non-profitable outcome than drilling in TEN, such that it was not convenient to Tullow or in its interests to provide such instructions, Tullow would not be able to say (with regard to Jubilee) that fulfilment of a term or condition of the contract had been 'delayed or temporarily prevented' by the moratorium. It would merely be more expensive or less attractive to Tullow. That suggests that in the present context greater expense or a greater risk of an unprofitable outcome is not a matter which enables Tullow to say that it has exercised it reasonable endeavours. Were it sufficient for Tullow to show that drilling in Jubilee was not in its commercial interest Tullow would be able to avoid its obligation to provide drilling instructions on the grounds of expense or expected lack of profit. That would be surprising in the present context. Tullow could not rely upon such matters to excuse non-performance before a force majeure and, in my judgment, it cannot do so after a force majeure.

… Thus, in the context of a force majeure clause such as the present, the mere fact that a step to avoid or circumvent the moratorium would or may be unprofitable would not necessarily lead to it being regarded as unreasonable. By contrast, to take an example used by counsel for Tullow in his closing argument, were it known that a well was dry there would be no purpose in completing it and it would be outside the contemplation of the parties that it should be completed in those circumstances. Reasonable endeavours would not require completion."

This passage is a notable example of a "reasonable endeavours" obligation requiring the subordination of the commercial interests of the obligor. The court's reasoning appears to flow from established caselaw to the effect that the mere difficulty or additional expense is not sufficient to show that performance had been prevented by a force majeure event. On that basis, if additional expense or the lack of a business case would be insufficient to bring an event within the force majeure clause to begin with, one might also expect that such matters would not be sufficient to overcome the requirements of an obligation to use reasonable endeavours to mitigate or circumvent the force majeure event.

While the logic of this reasoning is clear, it appears to involve an element of circularity or redundancy. If there are endeavours which can reasonably be taken to mitigate or circumvent a force majeure event, then it would appear doubtful that the force majeure clause would apply at all, as performance will not have been delayed or prevented. On the other hand, if circumstances are such that performance is delayed or prevented, then there will, by definition, be no endeavours which can reasonably be taken to mitigate or circumvent the force majeure event.

One answer to this difficulty may be that the reasonable endeavours obligation merely states what is already implicit: that relief under the force majeure clause lasts only so long as the force majeure event continues to delay or prevents performance notwithstanding the making of reasonable endeavours to mitigate or overcome it.

The FIDIC Exceptional Events clause makes for an interesting comparison. Clause 18.2 of the 2nd Edition (in all books) requires a party to be "*prevented from performing any obligations under the Contract due to an Exceptional Event.*" Clause 18.3 then requires each party to "*at all times use all reasonable endeavours to minimise any delay in the performance of the Contract as a result of an Exceptional Event*". The circularity noted above is reduced on this drafting as the object of the "all reasonable endeavours" obligation is distinct from the Exceptional Event itself. The FIDIC clause distinguishes between prevention of an obligation (which is required for the clause to apply) and delay caused by an Exceptional Event. This language allows for situations where the obligation prevented is not itself a time obligation, but nonetheless causes delay to the works. In such circumstances, an obligation to use all reasonable endeavours to minimise delay has a clear field of operation.

It seems likely that the FIDIC obligation would also require the subordination of commercial interests. The same contextual analysis relied upon in the Seadrill case should apply and use of the "all reasonable endeavours" language makes the subordination of commercial interest easier to reconcile with previous English cases. In the context of minimising delay, however, there are likely to be limits on the extent to which expense must be incurred. It may be argued, for example, that a contractor should not be required to incur greater expense than the amount of liquidated damages applicable to the savings in time likely to be achieved. That might be said to be commercially wasteful and the equivalent in the Seadrill case of requiring Tullow to instruct the drilling of dry wells. On the other hand, the reasoning in Seadrill may well require the carrying out of some of the accelerative measures considered outside the scope of the "best endeavours" obligation considered in the Alghussein case in a different context.

Conclusion

Although reasonably clear in other contexts, the interpretation of endeavours obligations in construction contracts gives rise to a number of unresolved issues. The extent to which an obligation to use reasonable endeavours to complete construction works allows a contractor to take into account funding difficulties remains uncertain in light of the Court of Appeal's decision in the Gaia case. The use of endeavours obligations in force majeure clauses is likely to impose a greater burden than in other contexts, but the extent to which accelerative measures will be required is unclear and may also depend on unresolved issues as to the extent to which such clauses already require accelerative measures to be taken into account when assessing the causative effect of a force majeure event (as noted in the article at page 5 above).

References: *Alghussein Establishment v Eton College* The Times 16 February 1987; *Phillips Petroleum Company United Kingdom v Enron Europe* [1997] CLC 329; *Rhodia International Holdings Ltd v Huntsman International LLC* [2007] EWHC 292 (Comm); *CPC Group Ltd -v- Qatari Diar Real Estate* [2010] EWHC 1535 (Ch); *Jet2.com Ltd v Blackpool Airport Ltd* [2012] EWCA Civ 417; *Ampurius NU Homes Holdings Ltd v Telford Homes (Creekside) Ltd* [2012] EWHC 1820; *Gaia Ventures Ltd v Abbeygate Helical (Leisure Plaza) Ltd* [2018] EWHC 118; *Gaia Ventures Ltd v Abbeygate Helical (Leisure Plaza) Ltd* [2019] EWCA Civ 823.

Termination for convenience clauses and contractual discretions as limiters of liability

Two decisions of the English Technology and Construction Court last year provide increasing clarity as to the extent to which termination for convenience clauses and other contractual discretions provide inherent limitations on loss of profit claims. The limitation said to arise from these clauses is based on the fact that in the absence of any breach or repudiation, the employer could have legitimately deprived the contractor of any entitlement to further profits by terminating for convenience or exercising its discretion.

Termination clauses as limiters of liability

A party terminating a contract for repudiation or otherwise for default by the other party will usually be entitled to compensation for loss of the contractual bargain. For a contractor, this will often take the form of a loss of profits claim for the remaining term of the contract. However, complications can arise where the defaulting party nonetheless had a contractual right to terminate for convenience. Is the innocent party still able to claim for loss of profits for the remaining duration of the contract on the assumption that the right to termination for convenience would not have been exercised? Similar issues arise where one party is given a discretion to approve the continuation of work or certain parts of it.

The cases on this issue are not entirely consistent. In a previous edition of this publication, we reported on an English Commercial Court decision in 2014 (*Comau v Lotus Lightweight*) which had taken a strict approach, finding that a termination for convenience clause eliminated a right to claim for loss of profit. The court there noted that to find otherwise would ignore the limited nature of the innocent party's "expectation interest" in the contract: "*[it] was never entitled to profits on the whole of the goods and services to be supplied pursuant to the Agreement but was only ever entitled to such profit as it might have gained prior to any 'termination for convenience'.*"

A somewhat different line was taken by the TCC in *Willmott Dixon v London Borough of Hammersmith and Fulham,* also decided in 2014. There a factual enquiry was deemed necessary to determine, in all of the circumstances, if and when the defaulting party would have exercised its right to terminate for convenience.

The different outcomes reached in these two decisions reflect an underlying difference in approach to the assessment of damages. In one instance, the court permits the contract breaker to rely on the *theoretical minimum* level of performance the contract allows and in the other the court requires a factual investigation into the likely level of performance which would have been achieved.

The correct approach in these circumstances is usually governed by the characterisation of the obligations which were to be performed by the contract breaker. The leading case in this respect is the English Court of Appeal's decision in *Abrahams v Herbert Reiach Ltd* where the contract was one to publish a book and pay royalties to the author on the number of books published. The contract did not specify the number of copies that were to be published or the price of the book. The publisher repudiated the contract and the author sued for loss of royalties. The court found that the agreement was an enforceable contract which required the publication of at least one book. That left a question as to whether the author was entitled to royalties only on one book or something greater. Lord Justice Atkin held as follows:

> *"If a merchant makes a contract to deliver goods to a shipowner to be carried by him for reward, and the merchant fails to provide the goods, the Court must first find what is the contract which has been broken; and if it was to carry the goods to one of two alternative ports at different distances from the port of loading at rates of freight differing according to the distance, the only contract on which the shipowner can sue is a contract for carriage to the nearer port. The plaintiff cannot prove a contract for performance of the more onerous obligation. This*

explains why in cases of this kind the Court regards only the lesser of two alternative obligations. But in the present case there are no alternatives, and to adjust the rights of the parties the only method is to form a reasonable estimate of the amount the respondents would be in pocket if the appellant had kept his promise. Everything likely to affect the amount of the profit must be considered; the nature and popularity of the subject matter, the reputation of the authors, the cost of producing a book on that subject, the price at which it would command a sale, the business capacity of the publishers and the chances of earning a profit by the sale of the book. On the other hand the publishers are not bound to run risks contrary to their judgment; they would naturally and properly allow for fluctuation in the public taste for literature of this kind. An analogous calculation has to be made when a man having engaged to take another into his service for a time and to pay him a share in the profit of his business, refuses to employ him at all. In assessing the damages for the breach of this contract the question is not how the employer could carry on his business so as to make the least possible profit and so involve himself in the least possible obligation towards the plaintiff. Apart from his contract, he need not carry on business at all. The proper method of assessment is quite different; it is to make a reasonable computation of the amount the respondents would have received had the contract been fulfilled."

This passage has been applied in subsequent cases and is said to require the court to first ascertain whether the repudiated obligations are ones which allow for true alternatives in performance or whether they are a single obligation with a discretion as to the level of performance. For example, in *Durham Tees Valley Airport Ltd v BMIBABY Ltd*, an agreement between an airport and an airline gave the airline a discretion as to how many flights, and to where, it would operate. The airline was found to have repudiated the contract and a question arose as to whether damages should be calculated on the basis of the minimum performance possible under the contract. As the contract did not provide for alternative methods of performance, but rather a discretion:

"The court, in my view, has to conduct a factual inquiry as to how the contract would have been performed had it not been repudiated. Its performance is the only counter-factual assumption in the exercise. On the basis of that premise, the court has to look at the relevant economic and other surrounding circumstances to decide on the level of performance which the defendant would have adopted. The judge conducting the assessment must assume that the defendant would not have acted outside the terms of the contract and would have performed it in his own interests having regard to the relevant factors prevailing at the time. But the court is not required to make assumptions that the defaulting party would have acted uncommercially merely in order to spite the claimant. To that extent, the parties are to be assumed to have acted in good faith although with their own commercial interests very much in mind."

The categorisation of a construction contract with a termination for convenience clause poses some difficulties. It is difficult to say that the clause gives rise to a real alternative mode of performance and nor does it turn the performance required of the employer into one with a discretion as to the level of performance. A termination for convenience clause simply provides a means by which the employer may be relieved of performance altogether. This difficulty of categorisation would appear to account for the different conclusions reached in the *Comau and Wilmott Dixon* decisions.

Redbourn Group Ltd v Fairgate Developments Ltd

In this most recent case, a development manager, RGL, was appointed by Fairgate in respect of the development of Fairgate's own building and two adjoining pieces of land. RGL's remuneration under its appointment was broken down into stages with fixed fees associated with those stages of work. The key stages were to: (i) assemble the site from three titles (one of which included obtaining a long lease from England's national rail utility, Network Rail); (ii) obtain planning permission; and (iii) management of the project to completion. Fairgate's fee for project management was to be a fixed percentage of the build cost together with a bonus for completion on time and within budget. It was also entitled to a fixed fee upon the securing of planning permission, however the submission of a planning application was subject to approval by Fairgate.

Fairgate purported to terminate the contract for material breach by RGL. Among other things, Fairgate complained that RGL had failed to obtain planning permission for the project and had failed to negotiate the necessary lease with Network Rail who had since leased the relevant land to an alternative investor. Fairgate's allegations in this regard were rejected by the court in a previous hearing and Fairgate was found to have repudiated the contract. It is notable in this regard that Network Rail had decided at an early stage that the Fairgate development was not aligned with its own strategy for the land in question, meaning the lease would never have been agreed. Without the lease, RGL could not be criticised for failing to submit a planning application.

RGL claimed damages for Fairgate's repudiation, consisting of the fixed fee for securing planning permission and its project management fee together with the bonus for completing on time and on budget. This was said to reflect the sums RGL would have earnt had the contract been carried out. RGL's claim was rejected by the TCC on two grounds:

— The contractual discretion given to Fairgate to approve any application for planning permission meant that RGL never had a guaranteed right to earn the remaining fees under the contract. RGL's appointment could have stalled at the planning permission phase through no fault of its own or Fairgate's.

— Alternatively, on the facts RGL would never have been able to achieve a key deliverable (namely the lease of the Network Rail land) and the project originally envisaged in RGL's appointment had therefore become an unrealistic project to pursue. Fairgate would therefore have been justified in deciding not to proceed with the project.

This case therefore provides somewhat of a hybrid of the two approaches noted above. On closer analysis, however, the case appears to lend greater support to the stricter approach taken in the *Comau case*. The court described the "*critical question [as] the nature of Fairgate's obligation, if any, to approve a planning application for the development contemplated in the contract between Fairgate and RGL.*" It then considered whether Fairgate's discretion was required to be exercised in good faith or whether the discretion was entirely unqualified. It felt it unnecessary to determine that question, as even if an obligation of good faith applied, the circumstances of the project would have justified a decision not to proceed. By implication, if an obligation of good faith did not apply, Fairgate's position would have been even stronger.

A similar analysis could be said to apply to a termination for convenience clause. It is now also very difficult under English law to argue that the exercise of contractual termination rights are subject to implied duties of good faith (see the *Monde Petroleum SA* case reported in last year's *Annual Review*). In the absence of such a duty, the court's reasoning in this case suggests that a termination for convenience clause would provide a strict cap on claims for loss of profit without the need for a factual investigation.

The court also indicated that an "*instructive comparison*" could be made with wrongful dismissal cases in an employment context:

> *"In a case of wrongful dismissal, the damages are usually limited to the benefits that the employee would have gained during the period during which his employment would have continued if he had been dismissed by lawful notice: Addis v Gramophone Co Ltd … In other words, the assumed performance in such a case is a lawful termination instead of an unlawful one."*

A termination for convenience clause in a construction contract would appear to present an even closer comparison with an employment contract.

Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd

Further support for a stricter approach comes from another case involving termination issues last year: *Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd*. ICI engaged MMT to manufacture and install steelwork and pipework for a new paint manufacturing facility. Part way through the contract in October 2014, ICI ceased making payment to MMT and issued an instruction to cease all welding work. ICI alleged that MMT's welding was of very poor quality. Welding recommenced in January 2015 but the following month ICI purported to terminate the contract for repudiatory breach by MMT on account of quality issues. MMT strenuously disputed ICI's allegations and challenged the validity of ICI's termination. MMT claimed that ICI had repudiated the contract and served its own notice of termination.

At a trial on liability issues, the court found that background cost pressures had led to ICI devising a strategy to force MMT into insolvency. ICI's allegations of very poor welding were largely made up and designed to provide an excuse for ICI to stop payment and terminate the contract. MMT therefore succeeded in showing that ICI had repudiated the contract.

MMT claimed for a number of heads of damage as a result of ICI's repudiation. One was for work which MMT claimed that ICI would have instructed it to carry out, in addition to the original contract scope, had it not repudiated the contract. MMT relied on the Durham Tees case noted above to claim that a factual investigation was necessary "*as to how the contract would have been performed had it not been repudiated. Its performance is the only counter-factual assumption in the exercise*".

MMT's claim in this respect was rejected by the court for the reason that ICI had no contractual obligation to instruct additional work from MMT, regardless of how ICI might have acted had it not repudiated the contract:

> *"I consider that MMT are misconceived in attempting to rely upon [the Durham Tees case] … the question of what works MMT was obliged to perform contractually (and entitled to perform, absence the repudiatory breach) is not in issue; ICI accept that MMT would be entitled to profit lost on that work. Here, the work in question is non-contractual and the counter-factual scenario relates, not to what would have occurred had the repudiatory breach not occurred, but rather an imaginary world where … ICI had always behaved as MMT wished ICI had behaved, but in respect of which ICI had no contractual obligations, namely by instructing it to perform a great deal more work. Durham Tees Valley Airport Ltd v BMIBABY Ltd concerns a contractual obligation upon the airline to operate aircraft from the airport; ICI had no contractual obligation to instruct MMT to perform the works that form the underlying subject matter of this element of the counterclaim. … The lack of any contractual obligation in this respect is fatal to MMT's arguments."*

The court's emphasis on ascertaining the scope of any legal obligation to perform a contract in the absence of a repudiation is similar to the approach taken in the *Fairgate* case.

Conclusion

The relevance of these cases will be greatest in disputed termination scenarios. In circumstances where an employer terminates a construction contact for alleged breaches by the contractor, it may or may not have been willing to terminate for convenience absent its entitlement to terminate for breach. Termination for convenience would not (absent highly unlikely clauses providing for this) enable it to recover the additional costs of completing with another contractor or other damages arising from termination. The termination for convenience clause may also require it to pay certain costs to the contractor. In such circumstances, if the contractor successfully challenges the employer's termination for breach, it may be able to show that the contract would have continued on foot had the employer not wrongfully attempted to terminate for breach. It might then seek to claim loss of profit for the remainder of the contract on the basis of the *Durham Tees* case, as applied in *Wilmott Dixon*.

The recent *Fairgate* and *ICI* cases would appear to move the law away from such an approach and further in the direction of the stricter approach to termination for convenience clauses applied in *Comau*. Pending a Court of Appeal decision on the topic, parties should carefully consider the limiting effect that termination for convenience clauses or contractual discretions such as that considered in the *Fairgate* case may have on the recoverability of losses arising on termination.

References: *Abrahams v Herbert Reiach Ltd* [1922] 1 KB 477; *Durham Tees Valley Airport Ltd v BMIBABY Ltd* [2010] EWCA Civ 485; *Comau UK Limited v Lotus Lightweight Structures Limited* [2014] EWHC 2122 (Comm); *Willmott Dixon Partnership Ltd v London Borough of Hammersmith and Fulham* [2014] EWHC 3191 (TCC); *Monde Petroleum SA v Westernzagros Limited* [2016] EWHC 1472; *Redbourn Group Ltd v Fairgate Developments Ltd* [2018] EWHC 658 (TCC); *Imperial Chemical Industries Ltd v Merit Merrell Technology Ltd* [2018] EWHC 1577 (TCC).

Withholding payment: the legal implication of pushing contractors into insolvency

A decision of the English Technology and Construction Court last year has considered the scope of damages recoverable by a contractor pushed into insolvency by an employer's wrongful withholding of payment. The decision highlights the additional damages which can be recoverable in such circumstances and has ramifications for any party seeking to withhold large payments under a construction contract against a party who is likely to suffer serious cash-flow pressure as a result.

Imperial Chemical Industries Limited v Merit Merrell Technology Limited

As mentioned in the previous article, this case concerned a contract for the manufacture and installation of steelwork and pipework for a new paint manufacturing facility being developed by ICI. The contractor, MMT, succeeded in showing that ICI had intentionally repudiated the contract by evicting it from the site and that allegations made against it of poor welding were largely made up. This was found to be part of an overall commercial strategy by ICI to reduce costs:

> *"part of the strategy adopted by …ICI … was one aimed at driving MMT from site. … The hope was clearly that MMT would simply leave; the fact that MMT's expectation of a sizeable payment of £2.75 million to MMT (and its non-payment) was potentially going to push MMT close to insolvency was seen as a commercial benefit. MMT thought it had been agreed a payment of £2.75 million would be paid to it after certain steps were taken; Mr Boerboom and the members of Steer Co knew MMT thought this, knew this sum had been offered, and knew it would not be paid. … there were no proper grounds for making allegations of repudiatory breach against MMT in [relation to welding], [they were] a device simply designed to remove MMT from the project, and possibly also to cause irreparable financial damage to MMT."*

ICI's conduct had a profound impact upon MMT's business as a whole. Although MMT commenced adjudication proceedings in relation to the amounts owed to it by ICI, the time taken in obtaining a decision and enforcing that decision through court proceedings led to MMT's bank losing confidence in it and withdrawing its lending facilities. MMT sought professional advice from lawyers and insolvency practitioners and proposed a Creditors Voluntary Arrangement ("CVA", a form of insolvency process) to its creditors, a move that inevitably damaged its commercial reputation.

MMT was owed substantial sums from clients on other projects and, as a direct result of its financial problems, was forced to settle these sums for a reduced value. One of these clients, Murphy, received notice of the CVA plans and dramatically reduced its final account offer to MMT by £1.3m on the basis that any adjudication award obtained by MMT would be stayed on financial grounds. Eventually, MMT entered voluntary liquidation.

ICI brought proceedings against MMT to recover the sums paid pursuant to the adjudicator's decision mentioned above. MMT counterclaimed (through its liquidator) for repudiation and sought to recover a wide range of losses flowing from the deterioration of its financial position. The court awarded a number of heads of loss to MMT in respect of its counterclaim, including loss of profit on the remaining work under the contract. With regard to the deterioration in its financial position, MMT recovered:

- £1.3 million in respect of the reduced final account settlement accepted from Murphy.
- Wasted management time of £266,472.
- £239,369 incurred for professional advice in relation to the proposed CVA.
- Additional banking costs of £168,599 (including bank advisor fees).
- A VAT loan for £58,994 which was necessary for cash flow reasons.

In relation to the reduced settlement sum, the court accepted that the financial difficulties faced by MMT would have made it very difficult for it to enforce any adjudication decision against third parties because of the principles governing stays of execution upon adjudication enforcement. Murphy's conduct in using this fact to negotiate a lower settlement (described by the judge as "*purely opportunistic*") was not too remote. MMT was justified in accepting the reduced offer (given its financial position) and could recover the difference from ICI.

Comment

This decision provides a rare illustration of the dangers of adopting an insolvency-based strategy for the resolution of construction disputes. The court was hugely critical of ICI's ultimately successful attempts to push MMT into insolvency by withholding payment and seeking to terminate the contract when it knew it had no grounds to do so. ICI's knowledge that its conduct was likely to push MMT into insolvency was specifically noted by the court in connection with its assessment of the quantum of MMT's counterclaim.

The court's ruling in relation to the Murphy settlement is particularly notable. The documentation before the court showed that Murphy did not dispute its liability to MMT but was simply attempting to take advantage of the grave financial difficulties caused to MMT by ICI's repudiation. As the large award under this heading shows, claims of this nature represent a very significant exposure for companies considering aggressive disputes strategies with a view to putting their opponents under cashflow pressure.

The court's decision in relation to the Murphy settlement also has potential ramifications for genuine payment disputes. The court specifically noted that such a loss was within the contemplation of the parties at the time of contracting, which was long before ICI had formulated a strategy to push MMT into insolvency. Such a finding may readily apply to other construction contracts and lead to similar findings where payment is withheld on more genuine grounds.

Overall, the effect of this decision is to show the large and potentially unexpected liabilities which may fall to a company withholding payment on incorrect grounds. Employers and main contractors withholding large sums from their downstream counterparties would be well advised to consider their potential exposure in this regard. Whilst the cashflow pressure which such conduct can exert may be productive of a commercial settlement, it may also give rise to a considerable counterclaim if the right to withholding is not made out.

References: *Imperial Chemical Industries Limited v Merit Merrell Technology Limited* [2018] EWHC 1577 (TCC).


CONSTRUCTION
AREA

The operation of anti-variation and no-waiver clauses in international construction projects

A decision of the Supreme Court (the UK's highest court) last year has reversed two Court of Appeal decisions in 2016 which had significantly diluted the effect of "anti-variation" and "no-waiver" provisions. The Supreme Court has ruled that such clauses are effective to bind the parties as to the mode by which subsequent variations or waivers must be made. This decision has particular relevance for construction projects where variations and other agreements or waivers are often discussed informally among the project teams for each party.

Introduction

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.

"Anti-variation" clauses will typically seek to preclude the making of variations or 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 informal waivers 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 drafted to preclude 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 was thought to have been resolved by two Court of Appeal decisions in 2016: *Globe Motors v TRW Lucas Varity Electric Steering* and *MWB Business Exchanges Centres Ltd v Rock Advertising Ltd*. These decisions emphasised the freedom of parties to amend or alter an agreement as they see fit: they could not "*effectively tie their hands so as to remove from themselves the power to vary the contract informally*".

This position has now been reversed by the Supreme Court, on appeal from the *Rock Advertising* decision.

Rock Advertising Limited v MWB Business Exchange Centres Limited

Rock Advertising entered into a licence with MWB to occupy office space for a fixed term of 12 months. The licence contained an anti-variation clause in the following terms: "*All variations to this Licence must be agreed, set out in writing and signed on behalf of both parties before they take effect.*"

Six months later, the director of Rock Advertising had a telephone conversation with MWB's credit controller about payment arrears. The court at first instance found that, during this conversation, a variation to the payment schedule was agreed. However, MWB treated the variation as merely a proposal and ultimately

rejected the varied schedule. It then proceeded to lock Rock Advertising out of the premises for failure to pay the arrears and terminated the licence.

As noted above, the Court of Appeal held that the clause noted above, referred to as a "No Oral Modification clause", did not prevent a varied payment schedule being agreed informally in a telephone conversation. In the Court of Appeal's view, it was necessarily implied into such an oral agreement that the parties also intended to vary the No Oral Modification clause to allow the oral variation. The Supreme Court disagreed, with Lord Sumption noting that there were legitimate reasons why commercial parties might wish to contract against the common law's usual antipathy toward contractual formalities:

> *"In my opinion the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation. … The advantages of the common law's flexibility about formal validity are that it enables agreements to be made quickly, informally and without the intervention of lawyers or legally drafted documents. Nevertheless, No Oral Modification clauses like clause 7.6 are very commonly included in written agreements. This suggests that the common law's flexibility has been found a mixed blessing by businessmen and is not always welcome. There are at least three reasons for including such clauses. The first is that it prevents attempts to undermine written agreements by informal means, a possibility which is open to abuse, for example in raising defences to summary judgment. Secondly, in circumstances where oral discussions can easily give rise to misunderstandings and crossed purposes, it avoids disputes not just about whether a variation was intended but also about its exact terms. Thirdly, a measure of formality in recording variations makes it easier for corporations to police internal rules restricting the authority to agree them. These are all legitimate commercial reasons for agreeing a clause like clause 7.6."*

In relation to the Court of Appeal's finding that subsequent oral agreements must be taken to have impliedly agreed to dispense with the anti-variation clause:

> *"This does not seem to me to follow. What the parties to such a clause have agreed is not that oral variations are forbidden, but that they will be invalid. The mere fact of agreeing to an oral variation is not therefore a contravention of the clause. It is simply the situation to which the clause applies. It is not difficult to record a variation in writing, except perhaps in cases where the variation is so complex that no sensible businessman would do anything else. The natural inference from the parties' failure to observe the formal requirements of a No Oral Modification clause is not that they intended to dispense with it but that they overlooked it. If, on the other hand, they had it in mind, then they were courting invalidity with their eyes open."*

The Court also considered the potential for injustice to arise where oral agreements in contravention of an anti-variation clause have been acted upon by the parties who then find themselves unable to enforce the agreement. The Court left open whether the doctrine of estoppel might assist a party in such circumstances, although at the same time identifying a number of difficulties lying in the path of such an argument:

> *"It will be recalled that both the Vienna Convention and the UNIDROIT model code qualify the principle that effect is given to No Oral Modification clauses, by stating that a party may be precluded by his conduct from relying on such a provision to the extent that the other party has relied (or reasonably relied) on that conduct. In some legal systems this result would follow from the concepts of contractual good faith or abuse of rights. In England, the safeguard against injustice lies in the various doctrines of estoppel. This is not the place to explore the circumstances in which a person can be estopped from relying on a contractual provision laying down conditions for the formal validity of a variation. The courts below rightly held that the minimal steps taken by Rock Advertising were not enough to support any estoppel defences. I would merely point out that the scope of estoppel cannot be so broad as to destroy the whole advantage of certainty for which the parties stipulated when they agreed upon terms including the No Oral Modification clause. At the very least, (i) there would have to be some words or conduct unequivocally representing that the variation was valid notwithstanding its informality; and (ii) something more would be required for this purpose than the informal promise itself …"*

Subsequent developments

The Supreme Court's decision has already been applied by other English cases in 2018. In *UK Learning Academy Ltd v The Secretary of State for Education* an attempt was made to overcome an anti-variation clause through estoppel. The clause provided: "*This Contract constitutes the entire Contract between the parties and shall not be varied except by instrument in writing signed by the parties*". The evidence relied upon as showing an agreement did not meet these requirements.

Referring to the passage quoted above from *Rock Advertising*, the English Commercial Court rejected the existence of an estoppel. None of the offers and representations relied on had been specifically directed at the anti-variation clause or the need for formality:

> *"I have carefully considered all the evidence to which I was referred. There is nothing, in my view, which amounts to an unequivocal statement or other representation by LSC that it would not rely on the 2008 Yorkshire Contract formalities in this case (that is, that it would not rely on the No Oral Modification clauses). All that UKLA can point to are, on its case, repeated promises, not satisfying those formalities … The fact that any such promises were repeated does not establish the 'something more' than those promises themselves that Lord Sumption made clear would be required for an estoppel."*

In *Agilisys Limited v CGI IT UK Limited*, the Supreme Court's decision was applied to change control provisions contained in a subcontract for the provision of software services. CGI entered into a main contract with Edinburgh Council for the replacement and consolidation of three legacy computer systems in relation to finance and human resources. Part of these works were subcontracted to Agilisys. The subcontract required Agilisys to achieve a list of milestones by dates specified in an "Implementation Plan". Liquidated damages were to be paid for delays in achieving these dates. Clause 31 provided a mechanism for the Implementation Plan to be amended in the event of delays caused by CGI. This clause required a Relief Notice to be given by Agilisys and responded to by CGI and, if accepted by CGI, for a formal "Change Control Procedure" to be followed to amend the Implementation Plan.

Agilisys had given a number of Relief Notices under the subcontract and, although CGI had accepted the entitlement to relief, the Change Control Procedure had not been followed to amend the Implementation Plan. An issue arose as to whether the extended milestone dates could nonetheless be assessed by the court based on Agilisys' entitlement to relief under clause 31. Applying *Rock Advertising*, the Outer House of the Scottish Court of Session found that the operation of the Change Control Procedure was an enforceable requirement for extending the milestone dates:

> *"it is clear that the principle enunciated [in Rock Advertising] is applicable not only to NOM clauses but to all clauses which lay down a specified procedure for making changes to a contract. Thus where in the present case specific formalities for making changes to the Subcontract namely: Change Control have to be followed a valid variation cannot be made in the absence of such formalities being complied with."*

This meant that CGI could unilaterally stand in the way of Agilisys' entitlement to extend the milestone dates by refusing to operate the Change Control Procedure. The appropriate remedy in such circumstances was for breach of contract (i.e. failing to operate the Change Control Procedure), not to extend the milestone dates contrary to the terms of the subcontract.

Comment

In the 2017 edition of this *Annual Review* we commented that the Court of Appeal's decisions in the *Globe Motors* and *Rock Advertising* cases meant that anti-variation and no-waiver clauses were unlikely to be of a great deal of assistance to parties wishing to control management risk on construction projects. The Supreme Court's decision means that the reverse is now true. These clauses will be robustly enforced and the risk now is that parties will be caught out by such clauses, having agreed and acted on changes to a contract but being unable to enforce them.

The risk is neatly encapsulated by the key difference in opinion between the Court of Appeal and the Supreme Court. The Court of Appeal considered that the correct interpretation of a state of affairs where parties have reached an informal agreement outside the terms of an anti-variation clause was that the parties intended the informal agreement to be valid notwithstanding the clause i.e. that the clause was to be amended or waived to that extent. The Supreme Court, on the other hand, preferred to view such a scenario as one where the parties had simply overlooked the clause, rather than intending to dispense with it. It might be said that, having overlooked the clause, the parties must have intended that their informal agreement would be valid. Be that as it may, the Supreme Court's decision requires an anti-variation clause to be interpreted as specifically having in mind circumstances where the clause has been overlooked. In other words, such clauses have in mind the potential that the parties may forget to observe the required formalities and the intention in such circumstances is that any agreement will be unenforceable. As noted by the Supreme Court there are credible commercial reasons why such a position may be thought to be beneficial, but the consequences are potentially very serious and parties should now think very carefully about whether to include and/or agree to such clauses. If they are to be retained, project teams should be regularly warned about their effect and the crucial importance of adhering to the required formalities whenever agreements are reached.

The starkness of this new position is softened somewhat by previous caselaw (covered in the 2016 edition of this *Annual Review*) which has held that a clause requiring amendments to be in "writing" and "signed" by the parties may be satisfied by an exchange of emails. These cases have interpreted the requirement for a signature broadly to include a signature block at the bottom of an email. Whether this line of authority will survive the stricter approach to such clauses introduced by the Supreme Court's decision remains to be seen, but for the time being it remains good law.

In a construction context, the *Agilisys* case shows that the Supreme Court's decision is likely to be of direct application to change control provisions and any formalities required for the ordering of additional or varied works. It might be thought that contractors have the greatest to lose in this regard, however risks exist for employers also. For example, additional works may be instructed on the basis of a quotation submitted by the contractor which turns out to be inadequate. The contractor might seek to claim that the quoted price is not binding on the basis that certain formalities were not fulfilled (i.e. the signing of a formal variation order). In such circumstances, the additional work carried out by the contractor would have been provided extra-contractually and could potentially be made the subject of a restitutionary claim for a reasonable price.

The Supreme Court's decision has already been argued to apply to no-waiver clauses, although no decided case is yet to consider the issue. There are clear parallels between an anti-variation clause and a no-waiver clause, but also some important differences. Waivers sometimes operate by way of contract, but more often through the doctrine of estoppel. It is unclear under English law whether parties can contract out of this doctrine, such that an estoppel or waiver which would otherwise be effective will be defeated by a clause requiring certain formalities to be observed (i.e. such as a waiver in writing and signed). Given the emphasis placed by the Supreme Court on the ability of the parties to regulate their affairs as they wish, it is certainly plausible that the same position will be found to apply to no-waiver clauses as now applies to anti-variation provisions.

References: *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; *Rock Advertising Limited v MWB Business Exchange Centres Limited* [2018] UKSC 24; *UK Learning Academy Ltd v The Secretary of State for Education* [2018] EWHC 2915 (Comm); *Agilisys Limited v CGI IT UK Limited* [2018] ScotCS 112.

Expert determination in construction disputes

A Scottish decision in 2018 provides an interesting example of a successful jurisdictional challenge to an expert determination procedure in a construction context. Whilst expert determination can be particularly vulnerable to such challenges, careful drafting can do much to avoid them and the unique advantages of the process have been claimed by some to be driving an increase in its popularity on international construction projects.

Introduction

"Expert determination" can refer to a broad range of decisions – binding or non-binding – made by a third party. Expert determination has been used for a long time under construction contracts as a way of settling disputes by the engineer or contract administrator. With a vast array of dispute resolution options available to contracting parties, expert determination certainly has a role to play. However, its advantages and distinguishing features when considered alongside similar procedures such as adjudication can easily be overlooked.

A recent decision of the English Commercial Court (*O'Brien v TTT Moneycorp Ltd*) provides a helpful summary of the distinctive character of expert determination under English law:

> *"i. Parties elect to use expert adjudication dispute resolution as it is quick and inexpensive…*
>
> *ii. Where, as here, expert adjudication is specified to be final and binding, the Court will not usually allow parties to circumvent the agreed process. …*
>
> *iii. The Court will generally decline, save in exceptional circumstances, to intervene in anticipation of the determination of an expert of a matter remitted to him, as this is likely to prove wasteful of time and costs, the saving of which is presumed to be one of the reasons why the parties agreed to expert determination …*
>
> *iv. The Court will also take into account the fact that expert adjudication would be more likely to produce a speedy and more economic solution to the dispute …*
>
> *v. It is well-established that there is no necessary requirement for natural justice or procedural fairness in expert determination, which is typically part of the reason why the mechanism is adopted in the first place … The Court will therefore not assume that the parties intended to mimic court proceedings, when they elected for an expert determination instead."*

Expert determination is therefore the least fussy of options available to parties to a construction contract to resolve disputes (save perhaps for direct negotiation). The absence of a need for natural justice or procedural fairness means that the process can proceed more swiftly and with less involvement from the parties than in adjudication. This also reduces costs. Of course, it also means that the parties have less control over the process and less ability to influence the outcome. However, such control can prove to be illusory in disputes over narrow technical points where the expert or adjudicator is pre-eminent in the field or at least very well regarded. He or she is likely to reach their own conclusion without the need or desire for input from either of the parties. Such disputes have traditionally been the *raison d'etre* of expert determination.

Another advantage of expert determination is the ability of the parties to tailor the process to suit their requirements. For example, and as a reflection of the reduced level of control over the process, parties often agree that the expert's decision will not be enforceable in the event of "manifest error" i.e. an error that is easily recognizable from the decision itself. Similar objections to the enforceability of arbitral awards were common prior to the emergence of modern arbitration legislation based on the UNCITRAL Model Law on International Commercial Arbitration. In England, the courts held a power to refuse enforcement of an arbitral award due to "*an error of law apparent on the face of the award*" until this power was abolished by the Arbitration Act 1979.

Another means by which parties to an expert determination can retain a measure of control over the outcome is through claims against the expert for negligence. Such claims are not available against adjudicators or arbitrators, who are immune from suit, but are sometimes preserved against expert

determiners. This reflects the difference in role, with the expert not being expected to fairly manage an adversarial process, but rather forming their own view as to a specific question within their area of expertise. That said, experts appointed from large international consultancies may have policies which require immunity from suit as a condition to accepting an appointment as an expert determiner. Most of the standard rules for expert determination published by industry bodies such as the ICC, the IChemE, and the Academy of Experts also contain provisions conferring immunity.

A key disadvantage to expert determination is the potential for jurisdictional issues to arise where ambiguity is found as to the question to be determined by the expert. As expert determinations are most suited to technical disputes of a narrow nature, clarity as to the question to be answered by the expert is essential. Unlike in adjudication or arbitration, the expert will not usually determine a whole dispute between the parties but only specific issues falling within their technical expertise.

The most frequently cited passage concerning the jurisdiction of an expert determiner under English law is from *Nikko Hotels (UK) Ltd v MEPC plc*, where the court explained that if an expert "*has answered the right question in the wrong way, his decision will be binding. If he has answered the wrong question, his decision will be a nullity.*" This simple hurdle occasionally leads to the demise of an expert determination process as illustrated by a Scottish decision last year discussed below.

TMW Pramerica Property Investment GmbH v Glasgow City Council

Glasgow City Council (the "Council") agreed to purchase a newly constructed office building from TMW Pramerica Property Investment GmbH ("TMW") in 2011. The building was known to have a number of defects and the sale contract made provision for the making good of those defects by TMW and for part of the purchase price (referred to as the "Retention") to be held in trust pending making good.

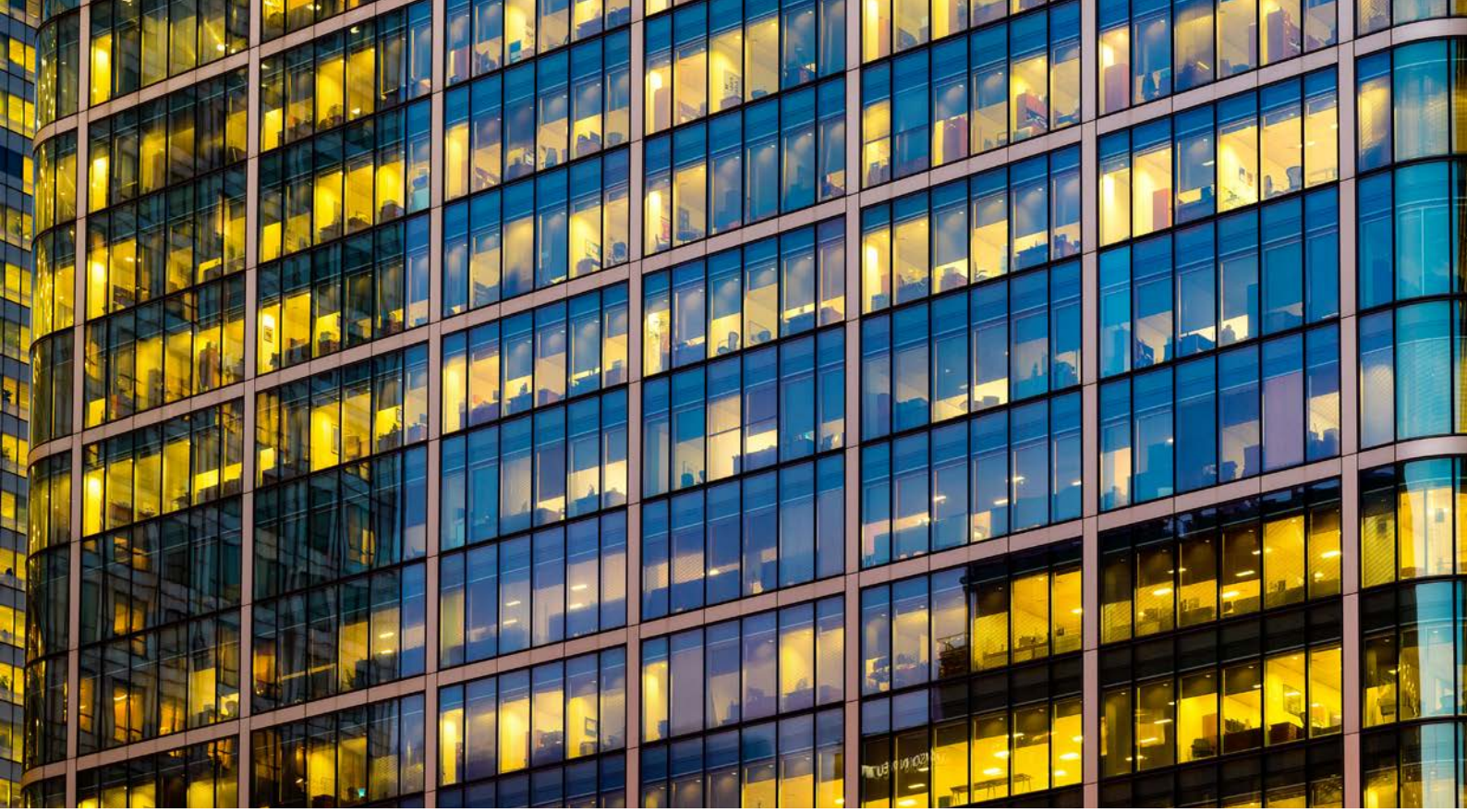
The making good works were detailed in a table of 23 items and were categorized as either priority or non-priority works. Each of these categories was given a longstop date, being the time at which the Retention would be released back to the Council if the work on the items in that category had not commenced. If work had started by the longstop date a "Deferred Long Stop Date" for completing the works was to be agreed by the parties or in the absence of agreement determined by an expert. This was recorded in paragraph 5.2.1 of the sale contract and as follows:

> *"Where at the Long Stop Date the Seller has made a substantive start to carry out, and are continuing in a meaningful way to carry out, any Remedial Works (either by way of works commencing on site, a building contract having been let, the relevant statutory consent applications having been lodged) their entitlement to carry out those particular works shall continue until the Deferred Long Stop Date and their entitlement to claim the Retention in respect of such works shall continue appropriately. If those works are not completed by the Deferred Long Stop Date the Seller's entitlement to complete those Remedial Works shall cease along with any right of access to the Property."*

The right to refer the fixing of the Deferred Long Stop Date to an expert was provided for in the definition of that term as follows: "*for Remedial Works to which paragraph [5.2] applies, such further period of time after the Long Stop Date as the parties agree (or the Independent Expert determines) as being reasonable to permit the remainder of those works which have been started to be completed*".

In the event, TMW did not meet the longstop date, but had commenced work by that stage. The parties were unable to agree on the fixing of the Deferred Long Stop Date and the question was referred to an expert. The expert fixed a Deferred Long Stop Date for each of the 23 items. TMW objected to this, claiming that the contract required the fixing of only two dates, one for priority works and one for non-priority works. The expert also fixed some of the 23 dates in the past, which TMW again objected to claiming that the contract required a reasonable period to be determined from the date of the expert's decision.

The Scottish Court of Session found the contractual provisions to be ambiguous, commenting that they "*could undoubtedly have been drafted with greater care and clarity*". After a thorough analysis of the relevant provisions, the Court sided with TMW in determining both that the expert was required to fix only two Deferred Long Stop Dates and also that these could not be fixed in the past. Accordingly, "*he failed to answer the question that was referred to him for determination*" and his determination was a nullity.



Comment

The *TMW Pramerica* decision highlights the importance of expert determination procedures providing sufficient clarity as to the question to be asked of the expert. As expert determinations are intended to be more focused procedures, and rarely include jurisdiction to determine the whole of a dispute between the parties, this is a key vulnerability of the process. Nevertheless, the process does offer a number of advantages over adjudication or arbitration.

Expert determination is included as one feature of the IChemE standard forms and according to those involved with the drafting of the form:

> *"Expert determination has an important role in the dispute resolution process. It has been successfully used by the process industries for more than four decades and continues to remain an integral part of IChemE's standard terms. … The IChemE's experience and the recent update by the ICC of its own expert rules would indicate a growth in use of this form of dispute resolution and an increasing acceptance of the process internationally. This is particularly so where the parties to a dispute recognise and respect the knowledge and experience being brought to bear by the expert in resolving the parties' differences."*

The use of expert determination on international contracts inevitably raises questions of enforcement. An expert determination will in the majority of cases not qualify as an arbitral award and will not, therefore, be capable of enforcement under the New York Convention. Similar issues apply to DAAB decisions under the FIDIC form and have led to difficulties in relation to the use of subsequent arbitration proceedings for enforcement purposes. These difficulties have now largely been addressed through clause 21.7 of the FIDIC 2nd Edition forms and it is suggested that a similar provision should also be included in relation to the enforcement of any expert determination.

References: *Nikko Hotels (UK) Ltd v MEPC Plc* [1991] 2 EGLR 103; *P Buckingham and J Challenger, Expert determination under IChemE contracts* (June, 2015) Construction Law Review 14; *TMW Pramerica Property Investment GmbH v Glasgow City Council* [2017] CSOH 152; *O'Brien v TTT Moneycorp Ltd* [2019] EWHC 1491 (Comm).

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