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Newsletter

Construction

19 June 2023

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Privy Council rules on admissibility of without prejudice letter in construction dispute

Joseph Chung

In A&A Mechanical Contractors and Company Ltd v Petroleum Company of Trinidad & Tobago [2022] UKPC 39, the issue before the UK Privy Council was whether the Court of Appeal had erred in allowing the appeal of Petroleum Company of Trinidad & Tobago (PCTT) including (i) finding that a letter was without prejudice or inadmissible, (ii) in its approach to other evidence, and / or (iii) in failing to make an award with respect to interest.

Background

High Court decision

A&A, a construction company, provided steelworks to PCTT. Disputes arose in relation to the value of variations carried out by A&A at PCTT's request. The parties' representatives met in May 2008 (May 2008 Meeting) in an attempt to settle the matter and during that meeting an agreement was reached in relation to the variations and their values. PCTT sent a letter to A&A (June 2008 Letter) which included a record of what had been agreed at the May 2008 Meeting. The letter was not marked "without prejudice".

At the trial before the High Court, PCTT objected to the June 2008 Letter being admitted in evidence on the basis that it was part of without prejudice negotiations between the parties. The High Court held that the June 2008 Letter was not written on a without prejudice basis and therefore could be admitted as evidence. Based on that letter, the High Court awarded A&A TT$7,291,961.81 and a further TT$2,680,300.93 in relation to variations numbered 27A, 27B1, 27B2, 28 and 29 which were not addressed in the June 2008 Letter. Accordingly, the total award in favour of A&A was TT$9,972,262.74.

Court of Appeal decision

On PCTT's appeal, the Court of Appeal held that the June 2008 Letter was a "without prejudice" communication and was therefore inadmissible. Consequently, the Court of Appeal set aside the award of TT$7,291,961.81 and remitted the question of the variations addressed in the June 2008 Letter for retrial. The Court of Appeal unanimously set aside the further award of TT$2,680,300.93 in respect of variations 27A, 27B1, 27B2, 28 and 29 on the basis that the judge had been wrong to conclude that there was no evidence given by PCTT concerning those variations. A&A's claims in relation to those variations were also remitted for retrial.

Appeal to Privy Council

A&A now appealed to the Privy Council. On this appeal, A&A accepted that the total amount of the valuations agreed in the June 2008 Letter was TT$5,180,175.31 rather than TT$7,291,961.81 and that by its pleadings it had excluded variation numbered 10c so as to further reduce its claim based on the June 2008 Letter by TT$290,000.00 to TT$4,890,175.31.

The issues on appeal were:

(a) whether the Court of Appeal was correct to find that the June 2008 Letter was without prejudice and inadmissible (first issue);
(b) Whether the Court of Appeal was correct to interfere with the judge's approach with respect to variations 27A, 27B1, 27B2, 28 and 29 (second issue); and
(c) Whether the judge erred in failing to make an award with respect to interest (third issue)

First Issue: Was the June 2008 Letter without prejudice and inadmissible?

The Privy Council held that the June 2008 Letter was admissible because the agreements reached at the May 2008 Meeting, as recorded in the June 2008 Letter, were part of the process under clause 7 of the relevant contract between the parties for arriving at a value for the work, which process was intended to be open. Clause 7 of the contract made provision for adjustment of the contract price, stating that: *"[PCTT] may at any time during the progress of the Work make alterations in or additions to or omissions from the Work or any alterations in the kind or quality of the materials to be used therein and if [PCTT] shall give notice thereof in writing to the [A&A] and the [A&A] shall alter, add to or omit as the case may require and the value of such extras, alterations, additions or omissions shall in all cases be agreed between [PCTT] and the [A&A] the amount thereof shall be added to or deducted from the Contract price as appropriate. No variation shall be made to the Work stipulated without prior written approval of [PCTT's] authorized representative. Failure to observe this condition may at the sole discretion of [PCTT] result in non-payment for the unauthorized Work.*"

The Privy Council said that, even if contrary to its conclusion that the June 2008 Letter was part of without prejudice negotiations, then in accordance with the contractual obligation to individually agree each variation, the letter recorded concluded agreements that certain individual items were variations and as to the value of those individual items. Accordingly, the letter fell within the well-established exception that without prejudice correspondence can be admitted to determine whether an agreement has been concluded. In any event, the Privy Council said, there had been a waiver of the without prejudice qualification, since PCTT in its defence had pleaded that the parties had engaged in efforts to amicably resolve the dispute via a series of meetings and correspondence and that PCTT would rely on such correspondence for its full terms and true meaning and effect. Accordingly, by this pleading, PCTT had expressly taken the voluntary decision to put all this correspondence before the court and expressly intended to rely on it for its full terms, true meaning, and effect. This, the Privy Council said, amounted to an unequivocal waiver of any without prejudice qualification attached to all the correspondence, including the June 2008 Letter.

Second Issue: Was the Court of Appeal correct to interfere with the judge's approach with respect to variations 27A, 27B1, 27b2, 28 and 29?

The Privy Council held that the award made in relation to these variations was on the erroneous basis that there was no PCTT evidence and that these variations should be remitted to the High Court for rehearing. In such circumstances where a rehearing is ordered it would not be appropriate, the Privy Council said, for it to analyse all the evidence in relation to these variations, as questions as to the strength or the effect of the evidence must now be decided at a rehearing.

Third issue: did the judge err in failing to make an award with respect to interest?

The Privy Council held that the High Court judge had erred in failing to consider his discretion under s.25 of the Supreme Court of Judicature Act to award interest on the amounts awarded to A&A. Consequently, the question as to whether interest should be awarded on the amount of TT$4,890,175.31 should be remitted to the High Court. Further, the Privy Council held that if the High Court makes any award in favour of A&A in relation to variations numbered 27A, 27B1, 27b2, 28 and 29 then in respect of that award the High Court should also consider its discretion to award interest.

Comments

Parties are always free to agree final accounts of their construction projects between themselves. It is trite law that without prejudice correspondence can be admitted to determine whether an agreement has been concluded. It is also common for the employer's consultants to discuss final accounts with the contractor. Such discussions are usually not "without prejudice" and are admissible evidence in arbitration or legal proceedings, since the employer's consultants are carrying out their duties under the construction contract, not trying to reach a settlement agreement with the contractor. Prudent

consultants would make it clear to the contractor about the purpose of the discussions and that their discussions are not binding on the employer or the consultants.

Court confirms very limited grounds upon which adjudicator decisions will not be enforced

KK Cheung

In J&B Hopkins Ltd v A&V Building Solution Ltd [2023] EWHC 301 (TCC), England's Technology and Construction Court granted J&BH's claim to enforce an adjudication decision by way of summary judgment. The judgment usefully sets out the legal principles applicable to an application to enforce an adjudicator's decision and makes it clear that there are only very limited grounds upon which such decisions will not be enforced by the court.

Background

The adjudication arose out of a Sub-Contract under which A&V, as Subcontractor, undertook to carry out plumbing installation works at a university campus. A&V alleged that J&BH had breached the Sub-Contract in a number of respects and claimed sums totalling £455,526.53 plus VAT. The adjudicator held that A&V had failed to prove any entitlement to the sum claimed and that the true value of the Sub-Contract works was £289,182.31, and taking into account previous payments and retention of 2.5%, a balance of £82,956.88 was to be paid by A&V to J&BH (less any release of retention as appropriate), by a specified date plus the adjudicator's fee of £13,962.00.

Application for enforcement of adjudication decision

J&BH sought to enforce the adjudicator's decision. A&V resisted enforcement on the basis that after the time for completion of the Sub-Contract had expired, instead of J&BH giving A&V necessary instructions and access to an important management system (the IAuditor system), A&V were left without instructions and instead, J&BH brought in other labour to complete the Sub-Contract.

Principles in deciding an adjudication enforcement application

The judgment usefully sets out the legal principles applicable to an application to enforce an adjudication decision as follows:

- There are only very limited grounds upon which an adjudicator's decision will not be enforced by means of summary judgment. An adjudicator's decision will be enforced by summary judgment, regardless of errors of law or errors of fact contained within it, or the merits of the underlying dispute resolved by the adjudicator.

- The starting point is that if the adjudicator has decided the issues referred to him or her, whether he or she is right or wrong in fact or in law, as long as they have acted broadly in accordance with the rules of natural justice, that decision will be enforced by summary judgment. Defendants must pay now and argue later.

- There are, on contested enforcement applications therefore, only two bases upon which a decision will not lead to summary judgment, namely if the decision (i) was one made without jurisdiction; and (ii) was made in the presence of material breaches of natural justice. Neither of these features were contended for in the present case.

- The principles of enforcement are subject to two narrow exceptions: (i) an admitted error; (ii) a self-contained legal point concerning timing, categorisation or description of payment notices or payless notices, in respect of which the potential paying party has issued Part 8 proceedings seeking a final determination of that or those substantive points. Part 8 proceedings in the UK are typically used for simpler claims which involve minimal disputes and no overly complex facts. Neither of the two exceptions applied in the present case.

- Adjudication is all about interim cash flow and it is routine to enforce decisions that require substantial allocations of cash to one party or another in the knowledge that it may prove to be merely an interim measure. The fact that the basis of an adjudicator's decision is to be challenged in other proceedings is of itself seldom, if ever, a ground for non-enforcement.

- An adjudicator does not need to provide an answer to each and every issue which may be raised in the parties' submissions.

- An inadvertent failure to consider an issue within a dispute will not ordinarily render a decision unenforceable.

- Inadvertent failure by an adjudicator to consider a particular document has been held, at its highest, to be a procedural error, not amounting to a breach of natural justice.

Court's decision

The court acknowledged that the adjudicator's decision must have come as a considerable shock to A&V, in that it was the party seeking payment, but ended up with a decision that it was liable to J&BH and which would be financially ruinous for it. Although the court pointed to a number of ways in which the adjudicator's decision could have been improved upon, for example, by raising certain points with the parties, the court rejected A&V's assertions that the decision was so riddled with errors to show that the adjudicator did not do his duty and that there had been bias and a breach of natural justice. Insofar as the result of the adjudicator's conclusions was to show that a sum was due or would become due to J&BH, that seemed to the court to be a legitimate conclusion. Accordingly, the court granted summary judgment in J&BH's favour.

Comments

Although enforcement of an adjudicator's decision in court is still not heard of in Hong Kong, it is likely that the Hong Kong Court will follow the approach as explained in this UK case. Errors of law or fact of the adjudicator are not good grounds for resisting enforcement of his/her decision.

When will the court stay enforcement of an adjudicator's decision?

Stanley Lo

In WRB (N.I.) Ltd v Henry Construction Projects Ltd [2023] EWHC 278 (TCC), the Claimant sought summary judgment to enforce an adjudicator's decision in its favour, while the Defendant sought a stay of execution of enforcement. The judgment usefully sets out the legal principles applicable to such stay applications. In this case, the court refused to grant a stay.

Background

The action concerned a dispute arising out of a construction project in relation to which Henry Construction Projects Ltd (HCPL) was the main contractor. HCPL engaged WRB (N.I.) Ltd (WRB) to design, supply, install, test and commission the mechanical, electrical and public health systems for the project for a total of £2.18 million plus VAT. The unusual feature in this case was that WRB was a dormant company prior to the Sub-Contract and remained such. WRB in a previous adjudication disputed that it was a party to the Sub-Contract, arguing that the true sub-contractor under the Sub-Contract was WRB Energy Ltd, while HCPL contended that it had contracted with WRB. The previous adjudicator ruled that WRB was the true sub-contractor.

Adjudication

WRB served a notice of adjudication in respect of the value of an interim payment application and the adjudicator decided that the true balance owed to WRB was £120,655.35 plus interest of £96.79 to 13 May 2022. The adjudicator directed HCPL to pay £120,752.14 including the interest payable to 13 May 2022 and thereafter interest until payment at the daily rate of 99p. HCPL made no payments pursuant to the adjudicator's decision. WRB subsequently applied to court for summary judgment to enforce the adjudicator's decision. HCPL applied to stay enforcement pending adjudication of its asserted cross claims. It also argued that WRB's parlous financial standing meant that it was highly probable that any monies paid now would not be repaid in the event that HCPL should succeed in its own claim.

Legal Principles

The court referred to the legal principles applicable to applications to stay enforcement of adjudicator decisions, as follows:

- UK's Civil Procedure Rules provide that the court may stay the execution of a judgment or order if there are "*special circumstances which render it inexpedient to enforce the judgment or order*."

- The relevant legal authorities provide that:

- Adjudication is designed to be a quick and inexpensive method of arriving at a temporary result in a construction dispute.

- Consequently, adjudicators' decisions are intended to be enforced summarily and the claimant (being the successful party in the adjudication) should not generally be kept out of its money.

- In an application to stay the execution of summary judgment arising out of an adjudicator's decision, the court must exercise its discretion with the above considerations firmly in mind.

- The probable inability of the claimant to repay the judgment sum (awarded by the adjudicator and enforced by way of summary judgment) at the end of the substantive trial, or arbitration hearing, may constitute special circumstances rendering it appropriate to grant a stay.

- If the claimant is in insolvent liquidation, or there is no dispute on the evidence that the claimant is insolvent, then a stay of execution will usually be granted.

- Even if the evidence of the claimant's present financial position suggests that it is probable that it would be unable to repay the judgment sum when it fell due, that would not usually justify the grant of a stay if:

  (i) the claimant's financial position is the same or similar to its financial position at the time that the relevant contract was made; or

  (ii) the claimant's financial position is due, either wholly, or in significant part, to the defendant's failure to pay those sums which were awarded by the adjudicator.

Court's Decision

The court concluded that this was a case where it was probable that, should the court refuse a stay and HCPL later established its own cross-claim, WRB would be unable to repay the judgment sum. While such risk could be addressed, or at least mitigated, by the guarantee offered by WRB Energy Ltd, HCPL had not established that it would be inexpedient to enforce the adjudicator's decision because:

(i) On its own case, HCPL chose to place the Sub-Contract with a newly formed dormant company. The risk it now complained of was the inevitable consequence of having placed this Sub-Contract with a dormant company. It was the result for which it contracted. It would be unfair and contrary to the spirit of the adjudication regime to allow HCPL to now escape its liability to meet an adjudication award on the basis of WRB's essentially unchanged financial position.

(ii) It was HCPL that resisted the argument that the true sub-contractor was WRB Energy Ltd. It had essentially made its own bed.

(iii) This judgment became regrettably delayed behind a judgment in another very substantial TCC case. By the time it is handed down, HCPL will have had ample opportunity to establish its alleged entitlement upon its cross-claims.

Accordingly, the court did not require WRB Energy Ltd to provide a guarantee and it dismissed the application for a stay.

Comments

This case, like J&B Hopkins Ltd v A&V Building Solution Ltd reported in this Newsletter, illustrates that it is difficult to resist enforcement of an adjudicator's decision and respects the principle of using adjudication as a quick and inexpensive method of temporarily resolving disputes in construction contracts.

Can an adjudicator seek security for fees?

Justin Yuen

Nicholas James Care Homes Ltd v Liberty Homes (Kent) Ltd [2023] EWHC 360 (TCC) concerned an application for summary enforcement of an adjudicator's decision. Liberty resisted enforcement, asserting that the adjudicator's requests for payment of his fees in advance were an implied threat to exercise a lien on his decision, which amounted to bias and impartially. The court rejected these assertions and granted the application to enforce the adjudicator's decision.

The adjudicator had made a decision in favour of Nicholas James Care Homes (NJCH), who then applied to enforce that decision against Liberty Homes (Kent) Ltd (Liberty). The adjudicator's terms of appointment provided that he was "*entitled to a sum as and whenever determined by him as Security for payment of fees and expenses and may request this sum in advance of any invoices* …".

The adjudicator's clerk sent a number of email requests to Liberty for payment in advance of the adjudicator's fees, which Liberty argued amounted to making demands in breach of paragraph 19 of the Schedule to the Scheme for Construction Contracts (Part I - Adjudication) (Scheme), which requires an adjudicator to reach his decision within a specified time. Although the adjudicator did not exercise a lien, Liberty argued that the (implicit) threat to do so was unlawful and /or contrary to paragraph 12(a) of the Scheme (which provides that an adjudicator must act impartially when carrying out is duties) and that there was manifest bias, meaning that his decision should not be enforced.

It was not in dispute that the effect of the Scheme and legal authorities is that an attempt to exercise a lien over the delivery of a decision within the statutory /agreed time periods is unlawful and that such attempt may well render the decision once delivered unenforceable.

However, in this case, the court concluded that, whilst emails from the adjudicator's clerk were certainly tenacious and persistent, they did not at any stage cross the line into being properly construable by the reasonable observer as improper threats to impose a lien and none of them could be described as "extraordinary". The reality, the court said, was that neither the adjudicator nor his clerk had used the word "lien", let alone threaten to exercise it. The court pointed out that there was no submission before it supported by any authority that it was impermissible for an adjudicator to ask for and indeed obtain security for fees from both parties during the course of the adjudication reference, irrespective of whether those are agreed as part of an adjudicator's terms and conditions. As matter of principle, the court said, that of itself without more, in particular any attempt to exercise a lien, cannot be objectionable.

Comments

This case is a good reminder to adjudicators that they should be careful about securing their fees, in order not to render their decisions unenforceable, assuming that the Hong Kong Court will follow the same approach as in the UK when the security of payment legislation is implemented in Hong Kong.

Contractual terms regarding variations

KK Cheung

In Cobalt Data Centre 2 LLP and Cobalt Data Centre 3 LLP v The Commissioners for His Majesty's Revenue and Customs (HMRC) [2022] EWCA Civ 1422, England's Court of Appeal had to consider how to interpret a contractual term regarding variations. It held that the clause in question in a JCT contract, was not wide enough to allow a change because such change amounted to a completely new project. Consequently, the Claimants were not entitled to allowances in relation to the construction of two data centres.

Background

At the relevant time, Parliament encouraged investment in the construction of industrial buildings in disadvantaged areas (enterprise zones) by permitting generous allowances against tax on construction expenses, known as enterprise zone allowances (EZAs). The issue before the Court of Appeal was whether the two taxpayers (LLPs) were entitled to EZAs on the whole or part of sums paid by them in order to obtain rights under contracts relating to the construction of certain buildings. The buildings that were eventually constructed were two data centres (DC2 and DC3).

Upper Tribunal Ruling and appeal

The Upper Tribunal had held that that the LLPs were entitled to EZAs on some, but not all of their expenditure. HMRC now appealed to the Court of Appeal, on the basis that the LLPs were not entitled to the EZAs. The LLPs cross-appealed on the basis that they were entitled to EZAs on the whole of their expenditure.

Legal Framework

EZAs were a sub-set of industrial building allowances (IBAs). The relevant legislation (Capital Allowances Act) provided that capital expenditure incurred in the construction of certain types of buildings qualified for IBAs. Under s.298 of that Act, EZAs were only allowable if the expenditure was incurred within a 10 year time frame, namely 10 years after the site was first included in the zone.

The Contracts

On 17 February 2006, the Contractor and Developer executed a contract (referred to as the Golden Contract) which incorporated the JCT Standard Form of Building Contract with Contractor's Design 1998 Edition (JCT Contract), with modifications. This was one day before the enterprise zone at the site expired and formed part of the arrangements that both the Developer and Contractor hoped would ensure that EZAs could still be claimed on future construction on the site. One significant amendment to the JCT Contract embodied in the Golden Contract was that, while the JCT Contract envisaged that the Contractor would be obliged to perform and the Employer be obliged to pay for, a single building project, the Golden Contract contained a number of different works options, each linked with a specific part of the overall site. The LLPs were two limited liability partnerships, who in 2011, acquired an assignment of rights under the Golden Contract.

Clause 12 of the JCT Contract, as modified by the Golden Contract, permitted the Employer to make "Changes" in the "Employer's Requirements". The LLPs' case was that the Developer had exercised its rights under Clause 12. On 1 April 2011, the Developer's agent issued "Change Order 2", which required the Contractor to add to the Employer's Requirements for Works Option 1 so as to provide the shell and core for a data centred (DC2). The LLPs argued that this legitimately altered the scope of Works Option 1, so that instead of involving the construction of a semiconductor manufacturing facility, it would involve the construction of a data centre. The Developer then served a Notice to Proceed, also on 1 April 2011, and the Contractor ultimately built DC2.

On 4 April 2011, the Developer's agent issued Change Order 3, which the LLPs again argued invoked Clause 12, altering the scope of Works Option 1 yet again, so that it involved construction of a further data centre. The Developer then served a Notice to Proceed and the Contractor ultimately built DC3.

Issues before the court

One of the issues before the court was whether the changes made to the contract by the two Change Orders issued by the Developer's agent were such that they amounted in law to a new contract, which was made outside the 10 year period, meaning that any expenditure was not incurred under a contract made within the 10 year period. HMRC argued that the effect of the Change Orders was so radical as not to amount to a variation of the Golden Contract, but rather took effect as the rescission of that contract and its substitution by a new contract as at the date of the Change Orders. Accordingly, the expenditure was not incurred under the original contract, but under a new and different contract made outside the 10 year period. Also, they argued, the data centres constructed as a result of the Change Orders, were not any of the original Works Options. The LLPs argued that by virtue of Clause 12, the Employer in effect had unlimited power to change its requirements.

Court's decision

The court said that the underlying question was whether the contract under which the expenditure incurred by the Developer on the construction of a building was the same contract as that made within the 10 year period and whether that was characterised as a rescission of the old contract and its replacement by the new one, or was simply a new contract, did not matter. The court pointed out that not only was each Work Option defined by reference to a particular type of building, but it was also site-specific. It said that it would be extraordinary if a contract to build an industrial unit could be unilaterally changed by the employer to require the contractor to design and build a nuclear power station; still more extraordinary, if instead of requiring the industrial unit to be built in one location, the employer could require the nuclear power station to be built in another location. There must, the court said, be some limits to the power to instruct changes under Clause 12 and the extent of a contractual power of variation must be a question of interpretation of the contract in question.

The court agreed with the editors of Hudson's Building and Engineering Contracts (14th Edition), paragraph 5-030, that "*Whether additional or omitted work which has been ordered is of the character contemplated by the contract, and so within the conditions of the contract relating to the power to order variations, or whether on the other hand it is outside the contract, will depend in each case on the nature of the work and the terms of the contract*". Even a widely drawn variation clause has its limits.

The court agreed with the Upper Tribunal that the Employer's Requirements were requirements about how the particular Works Options were to be achieved. The Golden Contract recited that that the Employer wished to obtain the design, construction and commissioning of one of the Works Options, each of which was described in detail. Each Works Option was both building and site specific. In addition, the Golden Contract required the Contractor to provide the design for each of the Works Options, and it was entered into on the basis that the Contractor's proposals met the Employer's Requirements for each of the Works Options. It could not have been the meaning of Clause 12, the court said, that the Employer was entitled to require a complete design which had the effect of substituting a different project. The Court of Appeal unanimously concluded that the expenditure on the construction of DC2 and DC3 was not under the Golden Contract and accordingly, there was no entitlement to the EZAs.

Comments

The definition of variation is usually very wide in construction contracts. A challenge by the contractor that a change order is too wide is seldom heard of. However, as Hudson's says, even a widely drawn variation clause has its limits. In this case, the changes of the type of the building and its site were considered to be substituting a different project, rather than a variation authorised by the contract.

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