

Construction Law

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LADS - penalties or a genuine pre-estimate of loss?

Where a contractor is in culpable delay, it has long been a requirement that where the contract specifies a sum in respect of Liquidated & Ascertained Damages, they must be a genuine pre-estimate of the employer's losses.

A contractor faced with a considerable deduction in respect of Liquidated & Ascertained Damages (LADS) may often seek to challenge whether the sum is reasonable. If the contractor can satisfy the court that the sum is overstated and amounts to a penalty, the court will not allow the deduction to be made. The penalty clause will be held to be void in its entirety. In such cases, the employer must then attempt to satisfy the court as to the extent of his loss and damage as a result of the breach, in accordance with general common law principles (which will include consideration of whether any loss has been mitigated and whether there is any proper counterclaim or set off, etc).

One important factor that will have a fundamental impact on the anticipated losses and their pre-estimate is any arrangement for the sequential phasing of the works. In particular, the LADS mechanism must genuinely reflect the losses that will flow as a result of the delay. This question was considered by the Technology & Construction Court in the case of *Liberty Mecian Ltd v Dean & Dyball Construction* [2008].

The facts

The facts of the case were that the contractor was engaged to undertake the construction of four new retail units. It was common ground that the first unit was to be completed during the first phase of the project, in order that a retailer could then move into that unit from another unit on the site, thereby freeing up its old site and associated car parking which were to be subject to later phases of the project.

The contract was in the form of the JCT Standard Form of Building Contract, 1998 edition 2003 revision. The contract was amended and referred to an appendix which sought to clarify the dates for each of the sequential phases, together with the LADS figure that applied in respect of each phase and sub-phase.

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From the Editor

Welcome to the September edition of Construction Law, Thomson Snell & Passmore's newsletter highlighting some key issues relating to those involved in the construction industry.

If you would like further advice on any of the issues covered please contact Chris Kirby-Turner.

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Section 1 of the project was subject to various delays, which led to an extension of time of four weeks being granted, with a further four weeks' delay found by the architect to be culpable delay.

The court's approach

The contractor maintained that, because completion of Section 1 had been delayed by eight weeks, it should be entitled to an extension of time of eight weeks in relation to each subsequent phase, regardless of the cause of delay.

In considering the matter, the court confirmed the well established case law in this area. In particular,

the court confirmed its general wariness of allowing a party to avoid the consequences of a liquidated damages provision that had freely been entered into. This is a question of balancing the commercial necessity of certainty against instances where there is a lamentably "unfair" application of the LADS provisions that would see the Employer recovering far more than their true losses. As an example, in *Bramall and Ogden Ltd v Sheffield City Council* [1983], the LADS provisions were held to operate as a penalty because whilst the contract (and the LADS mechanism) did not contemplate sectional completion, this was actually what was happening on the ground.

If it is not possible to properly pre-estimate losses then an employer must amend the contract to remove the LADS provisions in their entirety.

The court felt able to interpret the provisions with sufficient precision to give effect to what they deemed had been in the common intention of the parties at the time of the contract.

That case was criticised as being an overly strict construction of the contract, and led to changes being made to the JCT forms of contract. However, in the recent case of *Braes of Doune Windfarm (Scotland) Ltd v Alfred McAlpine Business Services Ltd* [2008] the court again found an instance where the LADS provision, owing to deficiencies in the drafting of the clause, had the effect of operating as a penalty clause and was therefore unenforceable.

In the *Liberty Mecian* case, having clarified the law in this area, the court considered the effect of the essential sequential nature of the works. The court was satisfied that it was clearly anticipated that a culpable delay to the first section would have an inevitable consequence of a delayed commencement (as a culpable delay) to each subsequent section. Therefore, the court was satisfied that LADS at the rate stated for each section should apply for that four week period.

Conclusion

Ultimately, the result of this case turned heavily on its facts, in light of the common intention of the parties and the precise wording of the contract. Whilst the documentation was not perfect, the court felt able to interpret the provisions with sufficient precision to give effect to what they deemed had been in the common intention of the parties at the time of the contract.

Another point that should be remembered when preparing the contract documents flows from the decision of *Temloc v Errill Properties* (1987). In that case, it was held that where '£0' or '£nil' is inserted as the figure for LADS, the effect is to prevent an employer from bringing any claim for provable loss arising from culpable delay - the rationale being that he is pre-estimating his loss to be of nil value. Inserting '£N/A' will be treated in the same way.

If it is not possible to properly pre-estimate losses then an employer must amend the contract to remove the LADS provisions in their entirety. Whether a contractor will find it commercially palatable is another issue. ■



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New 'polluter pays' regulations extend the scope of environmental liabilities for construction companies

Construction companies need to be aware of the Environmental Damage (Prevention and Remediation) Regulations 2009.

The changes inevitably bring into focus management systems and the policies and procedures in place for dealing with environmental incidents.

The Environmental Damage Regulations ('the regulations') came into force on 1 March 2009 and are based on the 'polluter pays' principle. They extend the scope of environmental liability by requiring businesses to meet the cost of preventing and repairing environmental damage. The regulations apply to environmental damage to land, water, species or habitats, and to sites of special scientific importance. For businesses carrying out 'designated activities' liability for environmental damage to land and water is strict, so arises automatically for any environmental damage stemming from such activities, irrespective of fault or an intention to have breached the regulations. The list of 'designated activities' includes:

- waste management operations (including collection, management and treatment)
- activities which require an environmental permit
- discharges into waters
- water abstraction or impoundment
- manufacturing or using dangerous substances
- transporting dangerous or polluting goods
- using and releasing genetically modified organisms.

Operators of any other activities can also be liable for environmental damage to species and habitats, but only if they intend to cause damage or are negligent. Businesses caught by the regulations are required to notify the authorities of any environmental damage that has occurred, and where there is an imminent threat of environmental damage. They must take all practicable steps to control damage which is occurring, or in the case of an imminent threat, to prevent any damage from happening in the first place. Once notified, the enforcing authority must decide whether there has actually been any environmental damage and decide on the necessary remedial measures. In the case of environmental damage to water or to species and habitats, businesses can now be required to make complimentary and compensatory remediation in addition to the primary remediation of cleaning up a contaminated site, potentially including the costs of cleaning up an alternative site if the damaged site cannot be fully restored, or providing alternative natural resources to compensate for the time it takes to remediate the

damaged site. The regulations also create a number of offences which are punishable by a fine of up to £5,000 and/or up to three months in prison, including:

- a failure to notify the authorities about environmental damage or the imminence of it
- failing to take immediate action to control or prevent environmental damage from occurring,
- failing to carry out remediation.

Directors and senior managers can be prosecuted personally where an offence is committed with their consent, connivance or neglect.

Practical steps

Construction companies need to consider what practical steps they can take to minimise their potential liabilities.

The most significant change in the law centres around the reporting and prevention obligations. This inevitably brings into focus management systems and the policies and procedures in place for dealing with environmental incidents.

- Undertake risk assessments to establish the extent of the risk your operations pose to the environment. Follow up on the results with emergency plans to deal with any environmental incidents.
- Internal monitoring and reporting systems are crucial to help identify the imminent threat of environmental damage or when actual damage has occurred so that emergency plans can be implemented and the authorities notified.
- Keep a record of the condition of the environment surrounding your operations.
- Check your insurance to see whether the remediation of environmental damage under the regulations is covered.

Responsibility for the adjudicator's fees

Jurisdiction challenges to adjudication

Earlier this year, the courts confirmed that a party who objects to the adjudicator's jurisdiction throughout the adjudication will still be jointly and severally responsible for the adjudicator's fees. It is common practice for a respondent in an adjudication to look for a "knock out blow" by contesting the adjudicator's jurisdiction either by seeking a court injunction to declare that the adjudicator has no jurisdiction or (more commonly) by voicing its objections and inviting the adjudicator to decline his appointment. Usually, in the latter case, the adjudicator will not decline his appointment and a party will participate in the adjudication reserving its position (to preserve the right to challenge enforcement of the adjudicator's decision, should the result not prove favourable).

The decision in *Linnett v Haliwells* earlier this year considered whether in those circumstances the responding party is jointly and severally liable for the adjudicator's fees. As is common, the responding party had objected to the adjudicator's appointment throughout and had not signed his terms of business or agreed to his hourly rate. The court ruled that the responding party should be jointly and severally liable for the adjudicator's fees, as their view was that the responding party had allowed the adjudicator to spend time dealing with the dispute, albeit it was keeping its options open. The logic and reasoning for the decision is quite

convincing. However, the case creates some considerable uncertainty as to what remedy follows. The referring party will, in these situations, have agreed to the adjudicator's terms of business and hourly rates, whereas the responding party will not. The court said, therefore, that the responding party is responsible for the adjudicator's "reasonable" expenses - these are not necessarily the same as the hourly rate the referring party has agreed to. This is fundamentally at odds with the notion of joint and several liability, as each party has a different liability. In practice, it seems that the case opens the doors to tactical shenanigans, as the adjudicator is unlikely to want to get into a dispute about the "reasonable" value of their work. The responding party could have some leverage to persuade the adjudicator they should chase the referring party for their fees first and/or settle for a lower fee to avoid the time and costs of litigating over their fees.

Now that the court have clarified that the responding party will be responsible (to some degree) for the adjudicator's fees in these situations, it could also make the option of a court injunction more palatable, given the responding party could be at risk of bearing all of the adjudicator's costs. If so, it could even make use of the second option appear weaker and less convincing in the future.

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Construction team - news and events

Thomson Snell & Passmore is delighted to have recently been appointed as panel solicitors to SusCon Enterprise, a venture established by the ProLogis Academy in conjunction with North West Kent College. The venture helps promote and increase knowledge of sustainable construction, and keeps its members updated with new developments and regulations by holding quarterly breakfast seminars with guest speakers from business providing a wide range of innovative ideas. Our Head of Construction, **Chris Whittington**, attended the inaugural event on 16 July, at which the topic for discussion was rainwater harvesting - the systems available and their implications for residential and commercial developments. If you would be interested in further details please contact Chris in the first instance. The Construction team will shortly be launching a series of workshops aimed at construction companies and professionals, dealing with a range of key and topical issues, including: effective security in challenging times, Letters of Intent, disputes arising from contract, administration, termination procedures and pitfalls, and adjudicator's decisions - enforcement and challenges. If you would like to register your interest please contact **Chris Kirby-Turner**.



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Although this newsletter highlights some key issues relating to construction law, it should not be considered comprehensive and is not a substitute for seeking professional advice on a specific issue.