

Top Five Construction Law Cases of 2015



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Introduction

As a follow up to our recent [webinar](#), this article considers our chosen top 5 construction cases of 2015, highlighting the key facts and legal points of each case. These provide some important lessons that can be learned, considered and applied in future contract formation and disputes. Our chosen cases come from a range of jurisdictions and appeal levels, including the Supreme Court, Privy Council and English Appeal Court.

Cavendish Square Holdings BV v Talal El Makdessi and ParkingEye Limited v Beavis [2015] UKSC 67

These were two appeal cases on penalty clauses heard simultaneously before the Supreme Court. Although the background facts of both cases are markedly different, the Supreme Court decided to consider them jointly and to fully review the rule on penalty clauses for the first time in a century.

The El Makdessi case concerned restrictive covenant clauses included in the contract of sale of El Makdessi's company to Cavendish Square Holdings. El Makdessi breached the restrictive covenants and the dispute centred on the contractual consequences which applied to the breaches.

The second case was instigated by Mr Beavis, who was challenging an £85 fine, levied by the operator of a car park, because he had stayed longer than the 2 hour free period. Was this a penalty? [We reported on the first stage appeal of this case last year.](#)

Lord Dunedin provided the classic authority for penalty clauses in *Dunlop Pneumatic Tyre Company Limited v New Garage and Motor Company Limited* (1914). He stated that a penalty is a sum designed to threaten the offending party to prevent breach. That can be distinguished from proper liquidated damages which are a genuine pre-estimate of the damage, to compensate the innocent party for its likely loss. An extravagant and unconscionable sum is a likely pointer to a sum being a penalty. In more recent court developments, a clause may further survive if there is some other commercial justification.

In reviewing the law of penalties in the El Makdessi and Beavis cases, the Supreme Court distinguished between on the one hand a primary contractual obligation, which the courts don't interfere with or consider the fairness of, and on the other hand a secondary obligation which is the remedy for the breach of a primary obligation, which the penalty clause rule does regulate. This means that conditional primary obligations: for example a provision that a specified sum will be paid unless an optional obligation is performed, would not engage the penalty clause rules at all. In contrast, an obligation which has to be performed, a primary obligation, the breach of which will trigger the payment of a sum, a secondary obligation, will engage the penalty clause rules. This is not new law as such, but is useful clarification.

The Supreme Court also provided guidance as to when the penalty clause rule is broken. The new test of whether a clause will be considered a penalty is: "whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all



proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation". This moves the court's approach away from genuine pre-estimates, and provides for other factors to be considered as justification, such as wider economic or social policy considerations.

The clauses in the El Makdessi case were properly conditional primary obligations, and did not engage the penalty clause rule at all, so the court did not consider the reasonableness of the bargain. The clause in the Parking Eye case did engage the penalty clause rules, but the court decided £85 was not out of all proportion to the legitimate social and economic interest which the car park operator had in preventing long stays in the car park.

MT Hojgaard A/S v EON Climate and Renewables UK Robin Rigg East Limited [2015] EWCA Civ 407

This is a hugely significant case heard by the Court of Appeal regarding design liability, and reliance on design standards. MT Hojgaard was the appointed contractor for the design, fabrication and installation of the turbine foundations for the Robin Rigg offshore wind farm project in the Solway Firth. The contract required Hojgaard to exercise reasonable skill and care in the design of the foundations, but Hojgaard also warranted that the design, fabrication and construction of the foundations would be fit for purpose for 20 years. The contract specified that Hojgaard was to use an internationally recognised design standard for the design of offshore wind turbine foundations, known as DNV-OS-J101.

The foundations were duly designed and installed, but shortly after the project was completed, it was established within the industry that the design standard DNV-OS-J101 contained a fundamental formula calculation error which would result in underperformance of foundations, causing movement requiring remedial works and significantly reducing design life. The Robin Rigg foundations did indeed start to show signs of movement. This necessitated remedial works costing 27million Euros. But who was responsible for this?

The judge at first instance decided that if the employer specifies a design standard, and the standard of care of the party using that design standard is reasonable skill and care, with no warranties as to design life, then the employer will carry the responsibility and liability for errors in the underlying design standard. That is unless the error is so obvious that, with reasonable skill and care, the designer should have noticed it – an objective test. But if there is a warranty as to fitness for purpose and a 20 year service life, which are absolute obligations, that effectively trumps the specification of the design standard by the Employer, and so the contractor, in agreeing to the fitness for purpose warranty, takes on all risks, including the risk of defective design guidance, however trustworthy and even where specified for use by the employer.

The Appeal Court decided that the contract did not in fact contain an absolute warranty for a 20 year service life, but was rather subject to a 20 year design life, which is what had been designed using the defective guidance. The court distinguished between service life and design life. Accordingly, as there was no absolute warranty from the contractor, the employer carried the risk for the defective design guidance that they had specified.

This appeal decision does not reduce the logic of the first instance decision, which is that if a contract contains an absolute warranty, then a contractor could be liable for failing to achieve a specific result, even if it had otherwise complied with the specified design guidance. However, for such a circumstance to arise, the absolute warranty would have to be worded with sufficient clarity and be consistent with the rest of the contractual provisions surrounding the design.

SSE Generation Ltd v Hochtief Solutions AG [2015] CSOH 92

This case considers a discrete point on joint insurance. SSE contracted with Hochtief to design and build a new hydro-electric scheme at Glendoe in Scotland, which included the creation of a major head race tunnel in rock. The contract required the contractor to take out a joint names insurance policy to cover all contractor risk events. The contract also included an indemnity provision and a cap on total liability.

Shortly after the project was completed and opened, the tunnel suffered a collapse, resulting in the complete shut-down of the scheme. Hochtief denied that they were responsible or bore the risk of the collapse, and SSE had to employ a third party to undertake remedial works, claiming over £100m in damages. Hochtief further argued that the joint insurance policy took the place of any liability between the parties, so that SSE should have made a claim under the policy rather than pursue Hochtief.

The judge agreed with SSE's position stating that "there is no irrebuttable presumption that the parties have no liability to one another simply because a joint names insurance policy is in place". There was also no express term in the contract addressing the issue, and the inclusion of some other contractual terms, such as the indemnity provision and the cap on total liability, which would only be relevant if the parties could make claims against each other, suggested the parties did not intend for liability to be displaced by the joint insurance policy. Words in the insurance policy could not be used to consider or interpret the contractual provisions.

The lesson from this case is that it is important that parties consider the purpose and impact of any required joint names insurance up front, and set out in their contract whether the policy takes the place of any contractual liability or whether these co-exist.



Scottish Power UK Plc v BP Exploration Operating Co Ltd [2015] EWHC 26588 (Comm)

A number of important aspects arise from this case, in particular regarding the limitation and exclusion clauses and their interpretation.

SP contracted with BP to purchase natural gas produced from the Andrew oil and gas field in the North Sea. The contractual arrangement was a “take or pay” arrangement, where SP agreed to pay for a specified quantity of gas each year even if it took delivery of less gas than the specified amount. From 2011 to 2014 the Andrew field was closed down to tie the field into another oil and gas field being developed, and during that period no gas was delivered to SP under the contract. It was admitted by BP that the failure to deliver gas during this period was a breach of contract, but there was a dispute as to the measure of the damages arising from that breach.

BP argued that the consequences of non-delivery were exclusively provided for in the contract between the parties by a compensation mechanism which required BP to provide gas at a reduced price to SP once deliveries resumed. This was on the basis of Article 16 of the contract which said that the delivery of gas at the reduced price “shall be in full satisfaction and discharge of all rights, remedies and claims howsoever arising whether in contract or in tort or otherwise in law... in respect of under deliveries”.

SP argued that it had an entitlement to damages at common law, which would be measured as the additional cost to SP of buying replacement gas from elsewhere during the period of non-delivery. SP contended that Article 16 did not apply in a wider breach of contract situation, which was relevant because BP had not simply under delivered but had failed to comply with the standard of a reasonable and prudent operator when they decided to close down the Andrew field for the tie in.

The court considered that the phrase “in respect of under deliveries” in Article 16 meant that it was the sole remedy available to SP when the breach of contract caused a loss to SP because of the under delivery of gas, thus they rejected SP’s arguments. It would be an improbable intention of the parties to create an automatic compensation arrangement for under delivery and still leave open the option for SP to pursue claims by another remedy.

The case is a useful reminder of the range of interpretations often available to the courts when considering contractual limitation clauses, and therefore the importance of considering how best to provide such clauses.

NH International (Caribbean) Limited v National Insurance Property Development Company Limited [2015] UKPC 37

This is a Privy Council decision on appeal from the Caribbean.

NH International was engaged by National Insurance Property Development Company to construct a new hospital in Tobago, under a FIDIC Red Book contract. The contractor had requested, under clause 2.4 of the contract, financial information from the employer to demonstrate that the employer would be able to pay the contract price. The contract states that the employer had 28 days to provide such information. After the provision of limited information, which the contractor thought was inadequate, the contractor suspended works and then terminated the contract. The employer in return attempted to set-off sums through a counterclaim at the termination of the contract.

Clause 2.5 governed set-off and required that if the Employer “considers itself to be entitled to any payment under any Clause of these Conditions or otherwise in connection with the Contract”, it should, subject to certain specified exceptions “give notice and particulars to the Contractor... as soon as practicable after the Employer became aware of the event or circumstances giving rise to the claim”

The court supported the notice provision of clause 2.4 and firstly held that insufficient information had been provided by the employer in response to the contractor’s request within the contractual time period. Accordingly, the contractor was entitled to suspend and terminate the contract.

With regard to the counterclaim made at termination, the court considered that clause 2.5 prohibited the employer from making any counter claims or set-offs as the employer had not provided the required notifications as soon as practically possible during the contract period, and was not validly able to raise these counterclaims upon termination. They did note that there may be other mechanisms available to the employer, if say the employer considered that the work undertaken was so poorly carried out as to not justify payment, but that was separate to a set-off or counterclaim, which in this case had not been sufficiently notified.

This case is interesting because it echoes a judicial trend in the UK jurisdictions that notice provisions will be interpreted strictly and supported by the courts, even if doing so kills off an otherwise perfectly good claim. The overall message is that you must always be aware of the notice provisions in your contracts, and adhere to them, in order to avoid a good claim being lost. This applies, for example, whether you are a contractor notifying a compensation event under NEC3 or an employer notifying a counter claim under FIDIC.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with your usual Shepherd and Wedderburn contact.