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Legal developments in construction law

1. Collateral warranty fails Housing Grants Act "construction contract" test and sinks adjudication award

A collateral warranty was executed four years after practical completion, three years four months after a settlement agreement and eight months after the remedial works were completed by another contractor, when all latent defects discovered had been remedied. The party given the warranty brought an adjudication against the contractor and obtained an award in its favour but was the warranty a "*construction contract*" for "*the carrying out of construction operations*" under the Housing Grants Act, so as to entitle that party to bring the adjudication?

In ruling that it was not, the court reviewed the case law and said that, where a contractor agrees to carry out uncompleted works in the future, that will be a "*very strong pointer*" that the collateral warranty is a construction contract and that the parties will have a right to adjudicate. Where, however, the works have already been completed, and, as in the case, latent defects have been remedied by other contractors, a construction contract is unlikely to arise and there will be no right to adjudicate.

While contractors and beneficiaries should negotiate the contents of their collateral warranties with some caution, if they want them not to fall within the Act, the timing as to when they are executed is also important. On the facts of the case, the judge could not see how, applying commercial common sense, a collateral warranty executed four years after practical completion and months after disputed remedial works had been remedied by another contractor could be construed as an agreement for carrying out of construction operations. By the time the warranty was executed, it was no more than a warranty of a state of affairs, past or future, like a manufacturer's product warranty.

Toppan Holdings Ltd & Anor v Simply Construct (UK) LLP [2021] EWHC 2110

2. Court turns down penalty claim, as liquidated damages clause passes the Makdessi test

A construction contract provided, in typical fashion, for liquidated damages to be payable for failure to complete the works. There was no provision for sectional completion, or separate completion dates for the three blocks in the development, but the contract did entitle the developer to take over parts of the works before practical completion. There was, however, no contract mechanism to adjust the rate of liquidated damages, if it did so. The developer took possession of two blocks before practical completion but the rate of liquidated damages consequently remained unchanged. In those circumstances, were the liquidated damages a penalty, and therefore void and unenforceable?

The court was referred to the textbooks, Keating on Construction Contracts and Hudson's Building and Engineering Contracts, which predicted that a claim for liquidated damages in such circumstances would fail. The court said, however, that it is important not to elevate statements of general

principle into an inflexible rule of law, noting that the extracts do not state that liquidated damages provisions will never be enforceable where sectional completion or partial possession is used without any related reduction in the liquidated damages payable. They identify the potential danger of failing to draft effective provisions to respond in such circumstances.

In each case, it is necessary to construe the relevant contractual provisions, adopting the established contractual interpretation rules, to determine whether they give rise to a liquidated damages regime that is certain and enforceable. The judge also noted that, in the relevant case law, the courts did not reject, as automatically fatal, the concept of one rate of liquidated damages for late completion of the works where there is sectional completion or partial possession. The express provisions in the cases considered simply did not work because of drafting errors.

Applying the test in ***Cavendish v Makdessi***, the court ruled that the liquidated damages provision in the case was not unconscionable or extravagant so as to amount to a penalty. It was negotiated by the parties with advice from external lawyers, and the court should be cautious about interfering in the parties' freedom to agree commercial terms and allocation of risk in their business dealings. The developer had a legitimate interest in enforcing the contractor's primary obligation to complete the works on time. Late completion of any part of the works was likely to have an adverse impact on following trade contractors, causing delay and disruption to the whole project, late completion of two of the blocks would expose the developer to its own liability for liquidated damages to the local authority and late completion of the other block would expose it to the risk of losing purchasers.

Quantification of the damages that the developer would suffer from late completion would be difficult, particularly if only part was completed on time, and there was no evidence that the level of damages, with a grace period of four weeks and a maximum of 7% of the contract sum, was unreasonable, or disproportionate to, the likely losses in the event of late completion of the work in any one or more of the blocks. The liquidated damages provision was not extravagant, exorbitant or unconscionable and was therefore valid and enforceable.

Eco World - Ballymore Embassy Gardens Company Ltd v Dobler UK Ltd [2021] EWHC 2207

3. If liquidated damages are a penalty, can more be recovered as unliquidated damages?

In ***Eco World v Dobler*** the court decided that the liquidated damages clause was valid and enforceable but it also considered whether, if the liquidated damages were a penalty, the developer could have recovered a greater sum as unliquidated damages, or whether the unenforceable liquidated damages clause would have acted as a cap on the unliquidated damages.

After considering the textbooks and cases, the court noted that, in ***Makdessi***, the Supreme Court had said that, if a liquidated damages clause was found to be a penalty, it would be 'wholly unenforceable' and could not be partially enforced on a scaled down basis, i.e. only to the extent of any actual loss suffered by the breach. In this situation, the innocent party's remedy is damages under the general law.

Although the Supreme Court in ***Makdessi*** did not expressly consider whether a penalty clause could operate as a cap on general damages, in the court's view, if a penalty was held to operate as a cap, it would not be 'wholly unenforceable'. It did not follow, however, that a liquidated damages clause that was wholly unenforceable as a penalty would have no contractual effect; as it might, on a true construction, be found to operate as a limitation of liability. Each clause must be construed in accordance with the established principles of contractual interpretation.

The court considered that the agreed liquidated damages of £25,000 per week would fall away as unenforceable, but said that it would strive to give effect to the separate part of the provision containing an express limitation on liability, of 7% of the final contract sum. This limitation was the clear intention of the parties.

Eco World - Ballymore Embassy Gardens Company Ltd v Dobler UK Ltd [2021] EWHC 2207

4. Government works towards ending EWS1 forms on buildings below 18 metres

Following advice from fire safety experts that there is no systemic risk of fire in medium and lower-rise buildings, the government has agreed with major lenders to pave the way to ending the need for EWS1 form on buildings below 18 metres.

The expert advice states that fire risks should be managed, wherever possible, through measures such as alarm systems or sprinklers, and that the overwhelming majority of medium and low-rise buildings (those under 18m) with cladding should not require expensive remediation.

New guidance for the risk assessment of external wall systems is to be introduced. PAS9980 is to ensure that fire risk assessments are consistent, proportionate to risk and actions to manage risk are cost-effective, and the Consolidated Advice Note will be withdrawn. For buildings under 18m which do require remediation, the government will introduce a financing scheme.

The government has also confirmed that the Building Safety Fund will reopen in the autumn for any eligible buildings that missed the original June deadline. More details will be published in the coming months.

See: https://www.gov.uk/government/news/government-intervenes-to-support-leaseholders-as-report-finds-no-systemic-fire-risk-in-flats-under-18-metres

5. Consultation on building safety levy

The government is seeking views on the design and calculation of the proposed building safety levy, through which developers seeking permission to construct certain high rise buildings will contribute to the costs of remedying historical building safety defects. An impact assessment will be prepared to support the secondary legislation that will specify the details of the levy.

The consultation closes on Friday 15 October.

See: https://www.gov.uk/government/consultations/the-building-safety-levy/consultation-on-the-building-safety-levy

6. New fire safety planning gateway one in force

'Planning gateway one', that requires high-rise residential developments to consider fire safety at the earliest stages of planning, came into force on 1 August 2021. Developments involving high-rise residential buildings must now demonstrate that they have been designed with fire safety in mind before planning permission is granted (including through their site layout and with access provided for fire engines). This information is to be submitted in a fire statement, as part of the planning application.

Local planning authorities must seek specialist advice on relevant applications from the HSE, as the statutory consultee on fire safety, before a decision is made on the application. This role is, in future, likely to be undertaken by the new Building Safety Regulator which, led by the HSE, will oversee a new safety regime for high-rise residential homes.

Further details, guidance and new fire statement forms are to be found at: https://www.gov.uk/government/news/new-planning-requirements-on-fire-safety-come-into-force

7. Government Building Beautiful Places plan and revised National Planning Policy Framework

The government has launched its Building Beautiful Places plan, with the publication of the National Model Design Code, the creation of the Office for Place, within the Ministry of Housing, Communities and Local Government, and the updating of the National Planning Policy Framework.

The Code provides detailed guidance on the production of design codes, guides and policies to promote successful design, forms part of the government's planning practice guidance and expands on the characteristics of good design set out in the National design guide. The Office for Place will, this year, be supporting around 20 communities who are piloting the Code and providing training on the principles outlined in the Code. The government is considering whether to establish the Office for Place as an independent body.

See: https://www.gov.uk/government/news/vision-for-building-beautiful-places-set-out-at-landmark-design-event
and
https://www.gov.uk/government/publications/national-planning-policy-framework--2

8. NEC and CLC guidance on dealing with the effects of COVID-19 under NEC3/4 Contracts

The Construction Leadership Council, in collaboration with NEC, has issued guidance on dealing with the impact of Covid-19 on work under NEC4 contracts. The guidance focuses on the NEC4 Engineering and Construction Contract, but can also be applied to the NEC4 Subcontract, and to the NEC3 Engineering and Construction Contract and Subcontract, subject to some amendments outlined in the guidance.

See: https://www.constructionleadershipcouncil.co.uk/wp-content/uploads/2021/07/NEC-CLC-COVID-19-Contractual-Guidance-v0.1-1.pdf

9. CIC publish novation agreement – switch, and associated collateral warranty

The Construction Industry Council has published:

- Novation Agreement – Switch (second edition)
- Collateral Warranty Consultant – Employer: Switch (first edition)

The Novation Agreement – Switch is for use where a consultant's appointment is novated from a client to a design and build contractor or other organisation on a "switch" basis, where appointment by the contractor applies only from the date of the novation, rather than on an 'ab initio' basis, from the beginning.

The Collateral Warranty Consultant – Employer: Switch is for use with the Novation Agreement – Switch where a warranty is to be given by the consultant to the design and build contractor's employer in respect of the services performed after novation.

(Link not available)

If you have any questions or require specific advice on the matters covered in this Update, please contact your usual Mayer Brown contact.