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# Dispatch

*Dispatch* highlights some of the most important legal developments during the last month, relating to the building, engineering and energy sectors.

## The without prejudice rule

**Oceanbulk Shipping & Trading SA v TMT Asia Ltd & Others**
[2010] UKSC 44

This was an appeal to the Supreme Court concerning the scope of the exceptions to the principle that statements made in the course of "without prejudice" negotiations are not admissible in evidence. The appellants, TMT had entered into a series of freight forwarding agreements ("FFAs") with the respondent, Oceanbulk. Each FFA was a swap agreement used as a method of hedging against market fluctuations. In May 2008 the Baltic Exchange index of daily rates of time charter hire for capesize bulk carriers was about US$200,000. Extraordinarily, this fell to US$3,000 per day in December 2008.

As at the end of May 2008, TMT owed Oceanbulk over US$40m for that month. TMT sought time for payment, which led to the parties holding "without prejudice" settlement negotiations. The parties entered into a settlement agreement, which included agreement to crystallise 50 percent of each of the FFAs and co-operate to close out the 50 percent balance of the open FFAs against the market on the best terms achievable by 15 August 2008. The FFAs were not closed out and the market became more favourable to TMT, such that Oceanbulk ended up owing TMT significant amounts under the FFAs that remained open. Oceanbulk refused to pay and sought damages from TMT based upon a claim that TMT breached a term of the settlement agreement by not co-operating to close out the FFAs by 15 August 2008.

A dispute arose as to the true construction of the co-operation term of the settlement agreement. Oceanbulk said the term required TMT and Oceanbulk to close out the FFAs between themselves. TMT argued that because the parties knew the FFAs were "sleeved", i.e. at TMT's request Oceanbulk had entered into FFA trades with third parties and arranged these back-to-back with TMT, the co-operation term meant that TMT would (if Oceanbulk requested) assist Oceanbulk to close out Oceanbulk's opposite market positions and the FFAs between Oceanbulk and TMT. TMT sought to rely on evidence from without prejudice discussions to help prove that the parties knew that the FFAs were sleeved. Oceanbulk argued that this evidence was inadmissible.

The Judge at first instance held that the evidence was admissible notwithstanding the without prejudice rule. However, the majority of the CA allowed Oceanbulk's appeal, holding that the evidence was not admissible. The issue before the Supreme Court was whether TMT was entitled to rely upon anything written or said in the course of the without prejudice negotiations as an aid to interpretation of the settlement agreement.

The seven Supreme Court Justices unanimously allowed TMT's appeal and held that justice clearly demanded that the 'interpretation exception' should be recognised as an exception to the without prejudice rule. When construing a contract, the court will look at what a reasonable person, having all the background knowledge which was available to the parties, would have understood the language in the contract to mean.

It is a well recognised principle of contractual interpretation that evidence of what was said or done in the course of negotiating an agreement is not generally admissible for the purpose of drawing inferences about what the contract means. However, evidence of pre-contractual negotiations may be admissible to establish that a fact which may be relevant to the factual matrix or surrounding circumstances of the contract was known to the parties, or to support a claim for rectification or estoppel.

This Supreme Court judgment means that it is now accepted that an exception to the without prejudice rule is that facts identified during without prejudice negotiations which lead to a settlement agreement of the dispute between the parties are admissible in evidence in order to ascertain the true construction of the agreement as part of its factual matrix or surrounding circumstances. This exception means that the process of contract interpretation will in principle be the same whether the negotiations were without prejudice or not. It is important to note that in giving the substantive judgment, Lord Clarke stressed that he was not seeking to underplay the importance of the without prejudice rule or to extend the exception beyond evidence which is admissible in order to explain the factual matrix or surrounding circumstances to the court.

## Procurement - automatic suspension

**Indigo Services (UK) Ltd v The Colchester Institute Corporation**
Judgment 1 December 2010

This case was the first to consider an application under the Regulation 47H of the Public Contracts Regulations 2006, as amended by the Public Contracts (Amendment) Regulations 2009, which now automatically suspends the award of a contract when a claimant issues a claim form during the standstill period.

In May 2010, Colchester advertised a contract in the EU Official Journal for the provision of cleaning services at its two campuses, Colchester and Braintree. The contract was for a period of three years from 1 January 2011 with optional annual extensions until 31 December 2015. Colchester's current contract was with Indigo for the Colchester campus and expired on 31 December 2010.

Following the evaluation of five tenderers, Indigo placed third. Colchester announced the winner on 14 October 2010 and therefore the standstill period (the time during which Colchester was prohibited from signing the contract with the winner) expired on 25 October 2010, as required by Regulation 32A. On the last day of the standstill period, Indigo commenced proceedings, challenging Colchester's procurement decision. In accordance with Regulation 47G, Colchester was therefore unable to enter into the contract with the winning tenderer. Colchester then applied to the Court to lift the automatic suspension as there was some urgency since a 30 day mobilisation period was required prior to the commencement of a new cleaning contract. The Court held that although this application was made by the contracting authority, the position is the same as if the unsuccessful tenderer were seeking an interim injunction and therefore the usual *American Cynamid* guidelines applied.

After having discounted several complaints relating to the pre-qualification process and the unlawfulness of the Contract Notice, the Court noted that the main substance of Indigo's case was that Colchester did not apply the scoring methodology as described in the Invitation to Tender. Colchester did not disagree; however, it said that this had no causative effect and that Indigo would still have lost even if the scoring methodology had been strictly applied. Based on the evidence put forward, the Court held that it was not possible to conclude that there was plainly a lack of causative effect and that there was "*a serious issue to be tried as to whether Indigo has suffered, or is threatened by, loss of a more than fanciful chance of obtaining the contract*." However, the Court considered that (i) Colchester's case on causation would be more likely than not to be accepted at trial and (ii) even if it failed there was only a low likelihood that the Court would assess that loss of chance as much more than the minimum threshold level of non-fanciful. However, to deprive Colchester of a contract for cleaning services would force closure of the campus because of the impact of the health and safety regulations. Therefore, the prejudicial impact on Colchester and the wider public of continuing the standstill far outweighed any prejudice Indigo may be caused by lifting the standstill and relegating it to a claim in damages.

The Court held that "*the balance of irremediable prejudice points clearly in favour of lifting the standstill…*" Even if the prejudice caused had not been as clear, it was found that the limited prospects of an injunction being ordered at trial would have made it inappropriate to do anything else but terminate the standstill. Although Indigo had passed the threshold of having a serious issue regarding its cause of action, he held that that does not mean that a court would grant an injunction at trial. Therefore the Court, for the first time, lifted the automatic suspension thereby allowing Colchester to enter into a contract with the winning tenderer.

## Causes of action in tort

### Linklaters Business Services v Sir Robert McAlpine Ltd & Others

[2010] EWHC 2931

In 1996, Linklaters took a 25 year tenancy of the building at One Silk Street, London EC2, which had been refurbished the previous year. The developer engaged McAlpine to carry out the major redevelopment of the premises. McAlpine had in turn engaged How Engineering Group Ltd to carry out the mechanical and electrical works, which included insulated chilled water pipework for the air conditioning systems. How had in turn sub-sub-contracted this work to Southern Installation (Medway) Ltd. In June 2006, there was a leak from one of the sets of chilled water riser pipes in the premises which was traced to a leak at the fifth floor. This led to insulation being taken off and corrosion of pipes was discovered. Further investigations revealed extensive corrosion throughout the chilled water pipework, which in turn led Linklaters, on advice, to replace the corroded pipework throughout the building with new pipework. Following an earlier hearing, the Judge was asked to decide whether McAlpine and How were in breach of contract, and whether Southern was in breach of a duty of care in tort to How and/or Linklaters.

The Judge held that both McAlpine and How were in breach of contract, and those breaches led to the substantial and excessive corrosion of pipework at Linklaters' premises. The Judge also found that Southern did not breach its duty of care in tort to either How or Linklaters. How had contractually agreed to indemnify McAlpine in full for any breach of contract and the resulting damages. Therefore, the Judge decided that How was responsible for the costs of replacing the corroded pipework - some £2million plus and the parties' legal costs.

How also argued that there was a duty of care which extended to damage to the steel pipework caused by careless insulation work. Southern said that one cannot and should not differentiate between two components (insulation and pipework) which go to make up one installation (the insulated chilled water pipework). Thus, damage to the pipework was damage "to the thing itself" and in the case of physical damage negligence, damage to the carelessly manufactured designed or constructed "thing itself" does not found a cause of action. On the evidence, the Judge formed the view that the insulated chilled water pipework was essentially one "thing" for the purposes of tort. You could never have chilled water pipework without insulation because the chilled water would not remain chilled and it would corrode. Thus insulation was a key component but a component nonetheless and no cause of action arose as between Southern and Linklaters. That in itself was not unreasonable because it was open to Linklaters to protect themselves, as they in fact did, with the securing of contractual warranties from relevant parties such as the key contractors in any given development.

*Dispatch* is produced monthly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.
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