FENWICK ELLIOTT

The construction & energy law specialists

Issue 214 - April 2018

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

Dispatch

Judging oral evidence

Dacy Building Services Ltd v IDM Properties LLP

[2018] EWHC 178 (TCC)

This case started off as an application by Dacy to enforce the decision of an adjudicator. IDM's position was that there was no contract with Dacy which meant that no adjudicator could have jurisdiction to deal with any dispute that may arise. This was one of the very rare adjudication enforcement cases where a full trial was ordered. Dacy's case was that a contract was agreed orally at a meeting on 3 December 2015 attended by three people. The Judge heard oral evidence from all those who attended the meeting. One interesting feature about the judgment was the comments made by Mr Justice Fraser about how a court approaches witness evidence:

"Watching a witness answer questions, and considering not only what they actually say, but how they say it, and also considering that evidence against contemporaneous documents, can give a tribunal a very good idea of what actually transpired on any particular occasion. Oral statements are not however the whole story."

The Judge noted that often a witness will try to recall events from many years back, which led him to recall Leggatt J's comments in Gestmin *SGPS SA v Credit Suisse UK Ltd* [2013] EWHC 3560:

"the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

Of course, everything depends on the particular circumstances of the witness, the lapse of time, the case and the nature of the issues. In construction disputes, especially in this digital era, there can be a significant amount of contemporaneous correspondence. Therefore, in the case here, where the central issue was what was agreed orally at a particular meeting, the Judge said that there were what he termed "common sense conclusions" that could be drawn from not only the documents, but also the circumstances. This did not mean that the oral evidence was of no assistance. However, it was not necessarily "the paramount source of authenticity". Here a combination of factors helped sway the Judge. The evidence from the key individual for Dacy, at the adjudication and at the trial, was very similar to the contents of a text message. Dacy's evidence was also supported by a third party.

Another issue was that there were a number of IDM entities, for example the Defendant IDM Properties LLP, IDM Investment Holdings Ltd and IDM Construction London Ltd. Dacy was given a business card from the Defendant at the 3 December meeting. Mr Justice Fraser commented that he found that the number of companies with very similar names, all with IDM in their title, with the consequence that it was possible to "almost seamlessly and interchangeably" attribute acts or relations to whichever IDM company suited at any particular time, to be an "unsatisfactory feature". Further, the contemporaneous documents showed that IDM Properties had at this time started corresponding about engaging subcontractors directly. Taken together, this all led the Judge to conclude that Dacy was told at the December meeting that it would be contracting with IDM Properties, who would pay Dacy, and that a binding contract was made.

Complying with Instructions

Oil States Industries (UK) Ltd v Lagan Building Contractors Ltd

[2018] CSOH 22

On 15 October 2014 OSI and Lagan entered into a contract for the design and construct a new production facility. During the course of the contract OSI's agent issued certain instructions and on 13 July 2016 OSI gave notice to Lagan that it was in default in failing to comply with four of these instructions. OSI said that Lagan did not remedy the default and accordingly, by letter of 2 August 2016, OSI gave notice of termination. This was a preliminary hearing. Amongst other issues, Lagan said that contract instructions numbers 67 and 68 were not valid contract instructions. For example Instruction 67 said this:

"Roof Cladding: The Roof has not been constructed in accordance with the contract. We instruct you to carry out any Works necessary to remedy this. Please provide a copy of your proposals together with a Programme for undertaking these works."

Lagan said that this instruction was not sufficiently clear and unambiguous to enable them to understand (i) the nature of the issue raised, and (ii) the particular action demanded to remedy the issue. To be valid, an instruction has to be sufficiently clear and detailed to allow the contractor to act upon it forthwith. Lagan accepted that there was a right under the contract to give notice of persistent or material breach, failure to remedy which gave rise to a right to terminate the contract. Its purpose was to enable the recipient to understand what contractual right was being relied upon, and what he was alleged to have done wrong, with sufficient clarity that he could assess the validity of the notice and take such steps as were open to him to remedy the alleged breach. The level of detail necessary for these purposes will differ from case to case, and may be affected by the express terms of the relevant clause. It will not generally be necessary for the notice giver to identify the steps necessary to remedy the breach, if they can be understood sufficiently clearly from the details given of the breach itself; but where the notice does so, the steps identified as necessary to remedy the breach will usually help the recipient to understand the nature of the breach being alleged.

A notice must be interpreted as a whole. It must be sufficiently clear and unambiguous to enable a reasonable recipient (i.e., one having all the background knowledge reasonably available at the time of the notice) to understand the contractual basis for the notice and the nature of the breach that is alleged to have occurred, so as to be able to assess the validity of the notice and take such steps as are open to him to remedy the alleged breach.

With the second of the instructions, no. 68, the Judge was not persuaded that OSI was bound to fail to establish that it was a valid instruction. At this stage he could not be satisfied that the reasonable recipient, having all the background knowledge reasonably available to it at the time of the instruction, would not have understood the respects in which it was said that the slab did not comply with the contract and that the non-compliance had to be remedied. There was pre-instruction correspondence which may provide an arguable basis for maintaining that the instruction was sufficiently clear on these matters. It was not possible to reach a conclusive view without a hearing. The Judge did doubt that it was incumbent upon OSI here to specify in the instruction a particular means of remedying the non-compliance. Where there is a design and build contract, to do so would have encroached upon the contractor's design responsibility under the contract.

Instruction no. 67, was different in that it stood alone, uninformed by any relevant background context, and so did not enable Lagan to understand the respects in which there was said to have been non-compliance with OSI's obligations and that non-compliance had to be remedied. Accordingly, the issue was whether there was a background context about the instruction which would have allowed a reasonable recipient to understand those matters. Apart from the instruction itself, no correspondence about the instruction had been produced. There did not appear to be any relevant background context by virtue of which the reasonable recipient of the instruction would have understood what the suggested non-compliance was and that it needed to be remedied.

Claims for overhead and profit

Fluor Ltd v Shanghai Zhenhua Heavy Industry Co, Ltd

[2018] EWHC 490 (TCC)

This judgment is part of an ongoing dispute about the quality of steel monopiles at an offshore wind farm. See, for example Dispatch 212. Here, Mr Justice Edwards-Stuart, amongst other quantum issues, had to consider Fluor's claims for overhead and profit. Fluor claimed a percentage for overheads at the rate of 4%. Fluor said that (i) whenever a company incurs a direct cost, it does not do so in a vacuum, at no cost to itself: it generally incurs head office costs or overheads – in doing so; (ii) that overhead cost is just as much a cost of the relevant event as the direct costs; and (iii) it is a cost which should be directly recoverable.

SZH's position, relying on *Emden's Construction Law*, was that whilst overheads can be claimed as a matter of principle, Fluor could not do so here. A contractor must show that, had it not been for the breach of contract, its labour force would otherwise have been profitably employed on other work, thereby making a contribution to the contractor's fixed overheads (such as head office costs). Further, the loss of the opportunity to recover that contribution to its overheads can be a legitimate head of claim. A contractor must also show that he would have been able to undertake other work, or that his staff would have been otherwise profitably employed. In other words, the costs would not have been incurred in any event. With hired-plant, a contractor can recover the increased hire costs, which are recoverable. With contractor-owned plant, a contractor may be able to recover losses suffered because they could not use it elsewhere or hire it out. If not, then the claim may be limited to "any depreciation in value of the plant which has resulted from the intensified or prolonged use". This meant that if the effect of the employer's breach of contract was to delay completion, so that the contractor remains on site for, say, an additional three months, the contractor may have a claim for a contribution to its fixed costs for the extended period if it can show that it would have been able to redeploy its labour force on other profitable work during the period of delay. This was because the contractor would have been deprived of the opportunity to earn not only profit, but also a contribution to its fixed costs during that period. SZH said this was not how Fluor had put their claim.

The Judge made it clear that he did not disagree with the authors of *Emden*. However, he did consider that there was at least one other situation in which a contractor could legitimately claim a contribution towards its overheads. This is where its head office overheads have been "thickened" during the period of the contract. He gave the following example: assume a contractor employed six accountants, whose activities concerned the administration of the business generally and were not project related:

"As a result of the substantial extra administration required to deal with problems caused by a sub-contractor's breach of contract, such as those with Shipment No 1..., the company's most experienced accountant, Mr Cruncher, is required to spend half his time dealing with those problems. However, fortunately his five colleagues are not overworked and are able to deal with the balance of Mr Cruncher's work in their ordinary working time. But when further problems arise – such as those with Shipment No 2 – the contractor decides that Mr Cruncher will be required to spend all his time dealing with those problems. Now his colleagues are no longer able to cope with the balance of his work and so a new accountant, Mr Bean-Counter, is taken on. Being inexperienced, Mr Bean-Counter is assigned relatively menial tasks, none of which has anything to do with the breaches of contract. In those circumstances, in spite of the fact that Mr Bean-Counter was not involved with the problems caused by the breaches, it seems to me that the cost of employing him would have been a direct consequence of those breaches and would therefore be recoverable as damages... It represents a 'thickening' of the head office costs."

Fluor did not advance a case on this basis. The figure of 4% was a calculation. For 2009 the project cost was £374.735m (57% of Fluor's overall activity for the year). Fluor's total overheads for the year were about £22m, 57% or £12.645m was allocated to this contract. To this figure £1.3m was added for certain infrastructure project-specific overheads, producing a total of £14m of overheads allocated to the project. This was about 4% of the project cost of £374.735m. The Judge was reluctant to accept this. The figure of 4% was simply a ratio of one set of costs against another: it said nothing about the extent to which the former was increased as a result of breaches of contract by SZH. Whilst the Judge suspected that Fluor may well have incurred increased overhead costs as a result of the breaches of contract by SZH, he was not prepared "to pluck a figure out of the air". The claim failed.

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.

Dispatch is a newsletter and does not provide legal advice.

Edited by **Jeremy Glover, Partner**
jglover@fenwickelliott.com
Tel: + 44 (0)20 7421 1986

Fenwick Elliott LLP
Aldwych House
71 - 91 Aldwych
London WC2B 4HN

www.fenwickelliott.com