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Welcome to the Spring edition of In Site. This edition covers the following topics:

- a brief overview of the "Jackson cost reforms" to civil litigation which came into force on 1 April 2013;
- a note of the new NEC3 forms published on 22 April;
- changes to the Late Payment of Commercial Debts (Interest) Act 1998 which came into effect on 16 March 2013;
- foreseeability of loss and the decision in *John Grimes Partnership Ltd v Gubbins*;
- "good faith" obligations: the decisions in *Yam Seng PTE Ltd v International Trade Corporation Ltd* and the appeal in the *Mid Essex Hospital Services NHS Trust* case;
- *Westfields Construction Ltd v Clive Lewis*: the residential occupier exemption in s 106 of the Housing Grants, Construction and Regeneration Act 1996; and
- enforceability of tiered ADR clauses.

For more information on any of these articles, or on any other issue relating to construction and engineering law, please contact any of the authors or your usual K&L Gates' contact.

The Jackson reforms

The majority of Lord Justice Jackson's civil litigation costs reforms came into effect on 1 April 2013. They are, in his own words, intended to be "*a coherent package of interlocking reforms, designed to control costs and promote access to justice*". Changes have been made to many facets of the civil litigation structure, and although the changes are expected to be felt most strongly in personal injury litigation, this note looks briefly at some of the key changes likely to impact on construction and engineering disputes in the Technology and Construction Court (TCC).

Case management and costs management

One of the key reforms has been to amend the overriding objective of the Civil Procedure Rules (CPR 1.1) to enable the court to deal with all cases both justly "*and at proportionate cost*". Costs management – from start to finish of a case - is at the heart of the reforms. To support this, the court's case management powers have been extended and the relief from sanction provisions (CPR 3.9) tightened. As Jackson LJ cautioned in the pre-1 April 2013 case of *Fred Perry (Holdings) Ltd v Brands Plaza Trading Ltd*, litigants who substantially disregard court orders and CPR requirements should expect to receive considerably less indulgence than in the past.

The new cost management rules in CPR 3.12-3.18 apply to all multi-track cases started on or after 1 April 2013 (unless fixed costs apply, the court orders otherwise, or the court or claim is exempt) and include the requirement to submit a detailed cost budget at least 7 days before the first case management conference.

The changes are similar to those adopted by the TCC in October 2011 under its cost pilot scheme and apply to TCC claims where the amount in dispute is less than £2 million. In contrast, TCC

claims for more than £2 million (as valued at the date of the first case management conference) fall within one of the stated exemptions (CPR 3.12(1)) and hence the new costs rules do not apply to these higher value claims, unless the court orders otherwise. Ramsey J has recently suggested that, in practice, parties to these higher-value claims may be invited to provide costs estimates in any event.

Perhaps counter-intuitively, this split means that higher-value claims are less likely to have the benefit of the CPR cost controls. The rationale behind this split comes from Lord Justice Jackson's identification of a general view that costs management would not be appropriate for high value cases which generally pass through the Commercial Court. Hence, to avoid the risk of "forum shopping", the decision was reached during the review process to extend the same exemption to the TCC (and Admiralty and Mercantile courts). These exemptions are only intended to be an interim measure with the intention that the case for any exception be re-visited in due course.

"Part 36" offers

To address a perception that the enhanced rate of interest available to claimants who make and beat a settlement offer made under Part 36 of the CPR is an insufficient incentive to make settlement offers, the Jackson reforms include a bonus payment of up to 10% of the claim amount (capped at £75,000) for a claimant in that position (Offers to Settle in Civil Proceedings Order 2013) with the aim of giving a claimant's offer the same "teeth" as a defendant's offer.

Disclosure

The disclosure process can generate significant costs, and "standard" disclosure (where the parties disclose the documents on which it relies and any adverse documents found in the course of a reasonable search) will no longer be the default position. Instead, the emphasis is to be on the parties considering the extent of disclosure necessary at a much earlier stage. The Jackson reforms require the courts to be more conscious of the need to limit disclosure to what is actually needed to deal with the case justly and at proportionate cost. To enable the court to decide this, parties are now required to file a "disclosure report" *before* the first case management conference and to attempt to agree the scope of disclosure between themselves, and a new CPR rule 31.5 contains an extensive "menu" of possible disclosure orders the court may make.

Fee agreements

From 1 April 2013, if parties fund their claims using conditional fee agreements (CFAs) and after-the-event (ATE) insurance, the associated success fees and premiums are no longer recoverable from the losing party and will instead have to be borne by the claimant.

At the same time, a new form of contingency fee agreement, called "damages-based agreements" (DBAs), have been introduced. These allow lawyers to conduct litigation in return for a share of the damages, capped at 50% in commercial cases. Unlike traditional conditional fee arrangements which typically take a "no win, lower fee" approach, DBAs are intended to be "no win, no fee" and this may discourage their use.

Experts and witnesses

From 1 April, the court has new powers to control witness evidence, including identifying and limiting the witnesses who may give evidence and limiting the length or format of witness statements (CPR 32).

Practice Direction 35 has also been amended to allow experts from "like disciplines" to give evidence concurrently, with each expert to express his or her view in turn, for the lawyers to ask

them questions, and culminating in scope for the judge to summarise the experts' positions at the end. Benefits of this approach may include efficiency in terms of both time-saving and clear identification of areas of disagreement, although there are potential downsides, such as concessions being made in the heat of the moment, which will need to be borne in mind in deciding whether this approach is suitable for any given case.

New NEC3 forms

The NEC published its April 2013 edition "box set" on 22 April. As well as incorporating the amendments made to each form to reflect the 2011 Construction Act changes, the new box set includes the new Professional Services Short Contract and a detailed new series of "how to" guides designed to assist users of the contracts. The "how to" guides includes guides on writing Works Information, Scope and Service Information (for use with the ECC, PSC and TSC respectively) and a guide to using BIM with NEC contracts.

The NEC has said that its 2005 box sets will no longer be available to purchase after 22 April.

Interest on late payments

Changes to the Late Payment of Commercial Debts (Interest) Act 1998 (the Act) were made by the Late Payment of Commercial Debts Regulations 2013 and came into force on 16 March 2013. The changes apply to commercial contracts entered into after that date.

The key changes are set out briefly below, but it is important to note two things which have *not* changed:

- the default rate of statutory interest (currently 8%) imposed on debts which fall due under commercial contracts; and
- the parties' ability to contract out of the statutory interest provisions by including a provision in their contracts to the effect that the payment of interest at the agreed contractual rate is a "*substantial remedy*" for the purposes of the Act.

The substantial remedy exemption only applies if the remedy is sufficient to compensate the supplier for late payment or to deter late payment and if it is fair and reasonable to oust or vary the right to statutory interest. Subject to this, parties who have agreed substantial remedy provisions in their contracts will not be affected by most of the recent changes.

Key changes made to the Act which will affect commercial contracts which *are* subject to the statutory interest regime include the introduction of:

- set periods after which statutory interest will begin to run (generally 30 days, with scope for non-public authority purchasers to agree longer periods provided such periods are not "*grossly unfair*" to the supplier);
- criteria for assessing whether an extended payment period is grossly unfair, including whether the arrangement is a "*gross deviation*" from good commercial practice and contrary to good faith and fair dealing; and
- fixed payments (ranging from £40 for debts under £1,000 to £100 for debts over £10,000) to suppliers to cover their reasonable debt recovery costs, with scope for an additional top-up payment if actual recovery costs are higher.

Foreseeability of loss

A consulting engineer was held liable to pay damages to a developer for a residential development's dimunition in value in *John Grimes Partnership Ltd v Gubbins* [2013] EWCA Civ 37. Completion of the development had been delayed by the engineer's breach of contract in

failing to complete road and drainage design on time. The court held that such a loss had been reasonably foreseeable at the time of contract and hence not too remote to recover.

The court applied the standard test for establishing whether or not a loss is too remote to recover (*Hadley v Baxendale)* and implied a contractual term (in the absence of an express contract term dealing with categories of recoverable loss) regarding responsibility for reasonably foreseeable losses. In a decision of particular interest in light of recent downturns in the property market, the Court of Appeal upheld the first instance decision that there was no evidence of any general understanding in the property world that a party in the engineer's position would *not* be taken to have assumed responsibility for losses arising from a fall in the property market where there had been a delay to completion.

Good faith?

There is no general doctrine of "good faith" in English contract law, although a duty of good faith can be implied in certain categories of contract (such as insurance contracts), and parties can agree to write an express good faith obligation into their contracts.

The boundaries of an implied duty of – and what the judge in the case described as the "*traditional English hostility*" towards – good faith were considered in the recent case of *Yam Seng PTE Ltd v International Trade Corporation Ltd* [2013] EWHC 111. In particular, the High Court characterised obligations to act honestly, to co-operate and not to exercise a contractual discretion arbitrarily – which the courts routinely imply - as aspects of an implied obligation of good faith.

The court examined the traditional distinction in English law between fiduciary relationships (containing onerous disclosure obligations) and other contractual relationships, and questioned whether this distinction is too simplistic: it said that "*relational contracts*", such as joint venture agreements, franchise agreements and long term distribution agreements, "*may require a high degree of communication, cooperation and predictable performance based on mutual trust and confidence and involve expectations of loyalty which are not legislated for in the express terms of the contract but are implicit in the parties' understanding and necessary to give business efficacy to the arrangements*". The court said that although its requirements are sensitive to context, the test of good faith is objective in the sense that it depends not on either party's perception of whether particular conduct is improper but on whether in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people.

Hence, the *Yam Seng* decision appears to create a "middle category" in a spectrum, with fiduciary relationships at one end, and one-off arms-length commercial deals at the other.

In contrast, the Court of Appeal has recently taken a much narrower approach and overturned last year's broad interpretation of a good faith clause by the High Court in the *Mid Essex Hospital Services NHS Trust* decision.

By way of reminder, the case centred on the deduction of significant service failure points under a hospital catering contract and included (at clause 3.5) an obligation that the parties "… *will co-operate with each other in good faith and will take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust or, as the case may be, any Beneficiary to derive the full benefit of the Contract*."

The High Court had held that this good faith obligation should be read broadly rather than being limited to the 2 specific purposes mentioned in the clause. The Court of Appeal overturned this. It said that the good faith clause was capable of different possible meanings depending on how one punctuates it. Although one interpretation (that taken by the High Court) supports a general duty of good faith, the Court of Appeal preferred the Trust's narrower interpretation, agreeing that if the parties had intended to impose a general duty to co-operate in good faith, they would have stated this in a stand-alone sentence. Commercial common sense does not favour a general

overarching duty to co-operate in good faith in a detailed contract where the obligations of the parties and the consequences of any failings have been spelt out in great detail.

Citing the decision in *Yam Seng* (made only a month earlier) that the content of a duty of good faith is heavily dependent on its context, the Court held that, in the context of clause 3.5 the obligation to co-operate in good faith meant that *"the parties will work together honestly endeavouring to achieve the two stated purposes"*. The Trust was not in breach of that obligation, with the Court saying that (i) although significant deductions had been made, there was no evidence that the Trust was acting dishonestly (and hence in breach of clause 3.5) as opposed to mistakenly applying the provisions of a complicated contract and (ii) the deductions were not relevant to the two stated purposes of the clause and therefore the manner/amount of the deductions could not be a breach of that particular clause (although the Trust was found to have breached other clauses of the contract).

The residential occupier exemption

Section 106 of the Housing Grants, Construction and Regeneration Act 1996 (the Act) exempts construction contracts made with "residential occupiers" from the operation of the adjudication provisions of the Act. Section 106(2) stipulates that, for the exemption to apply, the construction contract must be one "*which principally relates to operations on a dwelling which one of the parties to the contract occupies, or intends to occupy, as his residence*".

The meaning of this "intention to occupy" requirement was examined in *Westfields Construction Ltd v Clive Lewis* [2013] EWHC 376 where the court clarified that the section 106 exemption was intended to protect ordinary householders, not otherwise concerned with property or construction work, from what was (in 1996 at least) a new and untried system of dispute resolution.

Deciding on the facts that the employer in this case was not a residential occupier, the court clarified that an intention to occupy is to be mainly assessed at the time the contract is entered into, although one should avoid a "snapshot" approach, and instead regard residence as a "continuing operation" over time: for example, a genuine residential occupier may move out while the works are carried out and/or may only intend to live in the property once the works are completed. In contrast, a person, such as the employer in this case, who moved out of a house in order to rent or sell it could not rely on the exemption simply because, at the time the contract was entered into, he still happened to be living there.

Enforceability of tiered dispute resolution clauses

Construction and engineering contracts frequently contain multi-tiered dispute resolution clauses requiring some form of alternative dispute resolution (ADR) before the parties proceed to litigation or arbitration. An issue which can arise though is whether one party can short-circuit this (potentially lengthy) process by opting out of the ADR element?

In order to enforce such clauses as a condition precedent to arbitration they must, amongst other things, include a process that is sufficiently certain so that there is no need for further agreement in order to proceed (*Holloway v Chancery Mead* (2007)).

This was the issue with a conciliation clause in the recent *Wah (aka Alan Tang)* case [2012] EWHC 3198. The clause in question contained detailed dispute escalation provisions, commencing with referral to senior representatives for informal amicable conciliation, followed by submission to a panel of board members, who were then to be given a month in which to attempt to resolve the dispute or difference. The ADR clause went on to say that the parties could not refer the dispute to arbitration until the month was up.

The enforceability of this restriction was successfully challenged. Applying the *Holloway* tests, the court held that the conciliation provisions were too equivocal in terms of the processes

required and too nebulous in terms of the parties' obligations. In particular, the lack of guidance in the clause as to the quality or nature of the attempts to be made to resolve disputes or differences, rendered it unenforceable.

To be enforceable in light of this decision, an ADR clause needs to be more than an agreement to agree, or an agreement to negotiate in good faith. The decision suggests that such a clause should prescribe the following, without the need for any further agreement between the parties:

- a sufficiently certain and unequivocal commitment to commence a process;
- from which may be discerned what steps each party is required to take to put the process in place; and
- which is sufficiently clearly defined to enable the Court to determine objectively (i) what under that process is the minimum required of the parties to the dispute in terms of their participation in it and (ii) when or how the process will be exhausted or properly terminable without breach.

The court also said that in the context *"…of a negative stipulation or injunction preventing a reference or proceedings until a given event, the question is whether the event is sufficiently defined and its happening objectively ascertainable to enable the court to determine whether and when the event has occurred"*.

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