Reports from the courts

Our latest round up of the court decisions of most relevance to construction comes from Will Buckby and Andrew Beale of Clyde and Company, focussing on a TCC decision relating to set-off against an adjudicator’s decision; and a case that highlights the dangers of using letters of intent.

R and C Electrical Engineers Ltd v Shaylor Construction Ltd [2012] EWHC 1254 (TCC); TCC; Edwards-Stuart J

Facts

R and C Electrical Engineers Ltd (R&C) was appointed by Shaylor Construction Ltd (Shaylor), to carry out M & E works in relation to a LIFT (NHS local investment finance trust) project in Walsall, in relation to which Shaylor had been appointed by Ashley House Plc (Ashley House). The sub-contract between R&C and Shaylor (the sub-contract) included a pay ‘when certified’ provision at cl 21.8(b).

In November 2011 a dispute arose regarding R&C’s financial entitlement under the sub-contract and R&C. The final sub-contract sum was £1,495,034, of which R&C had only been paid £1,298,071. On 15 November 2011 R&C commenced adjudication seeking determination of its final account and damages for delay on the basis that time was at large. Shaylor counterclaimed on the basis that R&C was liable for damages as a result of a failure to complete on time.

The adjudicator determined that time was at large but that, taking into account R&C’s consequential entitlement to a reasonable time within which to carry out the works, R&C was still responsible for at least four weeks of delay. He also found that because Shaylor’s counterclaim was based on the provisions of the sub-contract regarding the time for completion and not based on time being at large, Shaylor had failed to demonstrate any identifiable loss attributable to the delay for which R&C was responsible.

The adjudicator therefore decided that no contra charges had been proven and that R&C was entitled to a payment of £196,963 plus VAT in respect of its final account. However, in accordance with cl 21.8(b) of the sub-contract, R&C was only entitled to such payment following the issue of the final certificate under the contract between Shaylor and Ashley House (the main contract).

Subsequently R&C filed a CPR Pt 8 application seeking a declaration that the sum determined by the adjudicator be paid immediately. R&C argued that the contractual machinery under the main contract had broken down such that it was no longer possible for Ashley House to issue a final certificate and that cl 21.8(b) of the sub-contract was therefore a nullity. Shaylor argued that it was entitled to withhold/set-off against any sums due to R&C damages suffered as a result of R&C’s failure to complete within a reasonable time.

The application required the court to consider: whether the contractual machinery under the main contract had broken down such that it was no longer possible to issue a final certificate; if so, whether R&C was entitled to immediate payment of the sum determined by the adjudicator; and if the contractual machinery had not broken down, whether R&C was entitled to payment without any deduction or set-off of sums owed by it to Shaylor under the sub-contract as a result of R&C’s delay?

Held

Edwards-Stuart J held that there was insufficient evidence regarding the position between Shaylor and Ashley House to infer that the contractual machinery of the main contract had broken down.

The question of whether R&C were entitled to immediate payment of the final contract sum as determined by the adjudicator did not therefore arise.

It was also held that in the circumstances there was nothing to prevent Shaylor setting off against the sum found due by the adjudicator any sum that it would have been entitled to set off in accordance with the sub-contract. Shaylor was not seeking to exercise a
right of set off or counterclaim in the enforcement proceedings but was seeking to exercise its contractual right which, in the judge's view, had been expressly preserved by the adjudicator's decision itself.

**Significance**

This case affirmed the principle established in *Shimizu Europe Ltd v LBJ Fabrications Ltd* [2003] BLR 381 that a party may set off against an adjudicator's decision, provided the set-off relates to a contractual right which was not itself the subject of the adjudicator's decision. It therefore demonstrates the importance of preserving any rights of set off which are not the subject of the adjudication itself.

The decision should also remind parties considering adjudication of the need to ensure that any decision the adjudicator is requested to make has the desired effect.

### Merit Process Engineering Ltd v Balfour Beatty Engineering Services (HY) Ltd

**Facts**

Merit Process Engineering Ltd (Merit) was appointed by Balfour Beatty Engineering Services (HY) Ltd (Balfour Beatty) as its sub-contractor in relation to three different contract packages (the packages). Two of the packages (the main installation package and the vacuum drainage package) were closely related, while the third (the Isis contract) involved a wholly different project at a different site.

Balfour Beatty invited Merit to commence works in relation to the main installation package by a letter of intent dated 2 March 2004 (the letter of intent) which was expressly stated to be subject to contract. It was accepted by both parties that there was no intention to create legal relations until the main contract between Balfour Beatty and Costain was finalised.

The letter of intent provided that if a contract was not concluded Merit was entitled to reimbursement of its costs up to a limit of £500,000. This limit was subsequently increased, however a dispute arose as to the precise limit agreed. Merit maintained that the agreed limit was £1,635,000, whereas Balfour Beatty claimed that it was £1,600,000.

On 21 March 2005 Balfour Beatty sent Merit a sub-contract including an arbitration clause, but the contract price remained in dispute.

Regarding the vacuum drainage package, on 31 March 2005 Balfour Beatty sent Merit two signed copies of contract documents for counter signature, which also included an arbitration clause. These documents were not signed by Merit, but it commenced the works following their receipt and there was no further discussion in relation to their terms.

Merit commenced litigation in relation to the packages, following which Balfour Beatty applied for a stay pending arbitration, on the basis that the sub-contracts in relation to the packages contained an arbitration clause.

Merit argued that the arbitration clause was ineffective as no contract had been concluded in relation to either the main installation or the vacuum drainage packages.

**Held**

Edwards-Stuart J held that the main installation works were not carried out under the terms of any sub-contract that included an arbitration clause.

He further found that: the difference in price between the parties, ie £37,500, was too great to be overlooked as de minimis or non-essential; there was no mechanism for fixing a fair price where the parties were unable to reach agreement; and parties may commit themselves to binding legal relations even though there are further terms still to be agreed.

However, the more important the term is the less likely it is that the parties would have left it for future decision. Price is certainly an important term.

It was also held that an arbitration clause had been incorporated into the vacuum drainage package contract on the basis that Merit had accepted the terms of the sub-contract by conduct. The dispute in relation to that package was therefore stayed to arbitration.

**Significance**

This case underlines the dangers of starting work under a letter of intent and failing to agree a formal contract, which can often lead to dispute as to exactly what has been agreed between the parties.

It also illustrates the difficulty of arguing that a contract has been formed if the price has not been agreed: even a disagreement in relation to a relatively small percentage of the price can prevent a contract coming into existence.