Reports from the courts

In our latest round up of the court decisions of most interest to construction Andrew Croft and Will Buckby of Beale and Company focus on a case that could cause a rise in jurisdictional challenges to adjudicators’ decisions; and one that shines light on ‘good faith’ obligations in contracts.

Working Environments Ltd v Greencoat Construction Ltd
[2012] EWHC 1039 (TCC) TCC; Akenhead J

Greencoat Construction Ltd (Greencoat) engaged Working Environments Ltd (WE) to install mechanical services in relation to the fit out of an existing office block. The sub-contract between the parties (the sub-contract) incorporated the adjudication provisions set out in the Scheme for Construction Contracts (England and Wales) Regulations 1998.

WE’s tenth interim application under the Subcontract, submitted on 24 November 2011, claimed £488,153. Greencoat’s tenth payment certificate (the tenth certificate) only certified £16,686 as being due, withholding sums in relation to ten different items, including an unspecified sum for liquidated damages. Payment was not due until 14 January 2012, but on 14 December 2011, WE commenced adjudication, seeking a declaration that WE should be paid for the undervalued contract work and variations it had properly completed.

Greencoat’s response, dated 5 January 2012, sought to substantiate the amounts withheld in the tenth certificate and appended a withholding notice (the withholding notice) which was said to supersede the sums withheld in the tenth certificate. The withholding notice contained 12 different grounds, the first 9 of which were as per the tenth certificate. It also included a figure for liquidated damages and two new grounds. Greencoat argued that the withholding notice was not within the scope of the dispute because it was issued after adjudication had commenced.

The adjudicator found that WE was due £250,860 and that the scope of the adjudication concerned what was due on 14 January 2012 and the extent of any set off. He addressed the additional items in the withholding notice, although Greencoat’s attempts to set-off these items were rejected due to lack of evidence.

WE ultimately issued enforcement proceedings, in response to which Greencoat argued that the adjudicator did not have jurisdiction to deal with the withholding notice because it was issued after the adjudication had commenced and therefore the dispute had not crystallised. WE argued that all items in the withholding notice fell within the scope of a crystallised dispute regarding what sum was due on 14 January 2012.

Held
Akenhead J held that the first nine items in the withholding notice and the liquidated damages fell within the crystallised dispute, having been included in the tenth certificate.

The remaining two items were not part of the crystallised dispute, as they were raised 22 days into the adjudication, so the adjudicator did not have jurisdiction to consider them. The court severed these items from the sum the adjudicator had decided was due and ordered Greencoat to pay £229,711 plus VAT and a percentage of the adjudicator’s fee.

Significance
This decision confirms that an adjudicator’s decision can be severed (ie only part of a decision enforced). Previously, decisions had only been severed if they related to more than one dispute. However, in reaching his decision Akenhead J did not consider this issue. Akenhead J simply looked at part of the adjudicator’s decision and decided that this did not fall within the scope of the crystallised dispute.

This case could therefore result in an increase in jurisdictional challenges to only part of an adjudicator’s decision even when only one dispute has been referred. It is also likely that requests from the parties that an adjudicator breaks his decision down into the various
issues so as to enable any decision to be severed will
become increasingly common.

**Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust**

[2012] EWHC 781 (QB); QBD; Cranston J

On 1 April 2008 Medirest entered into a contract with Mid Essex Hospital Services NHS Trust (the Trust), whereby Medirest agreed to provide facilities management services (the contract) for an initial term of seven years. Clause 3.5 of the contract required the parties to ‘co-operate with each other in good faith [and to] take all reasonable action as is necessary for the efficient transmission of information and instructions and to enable the Trust … to derive the full benefit of the Contract’. The contract also required Medirest to maintain a documented system of quality control (cl 5.2), which could be inspected by the Trust. Clause 5.8 gave the Trust discretion to levy payment deductions and award service failure points.

Clause 28 of the contract enabled the Trust to terminate if Medirest failed to remedy a breach of a material term or if Medirest incurred more than 1,400 service points in any six month period. Medirest had the right to terminate if the Trust failed to remedy a material breach.

Between April and September 2008, Medirest substantially failed to comply with cl 5.2 and failed to perform the services in accordance with the contract.

The parties met between August and December 2008 in an attempt to resolve these issues and in January 2009 the Trust informed Medirest that it intended to deduct approximately £590,000 from the contract price. Medirest rejected the Trust’s calculation and, after significant delays in the Trust providing information, argued that the Trust was only entitled to deduct £37,000. As at August 2009 the Trust maintained that the outstanding deductions came to over £700,000.

By 23 October 2009 both parties had purported to terminate the contract and it was agreed that it would terminate on that date, without prejudice to whose termination had been effective. By this point, the Trust had revised its calculation of deductions to approximately £200,000 and had repaid over £200,000 deducted from previous invoices. Medirest issued proceedings to recover its post-termination losses and the Trust counterclaimed for its post-termination losses. Medirest alleged that cl 3.5 imposed a general obligation of good faith and that in administering the contract and imposing service failures and deductions the Trust was in breach of this clause, which entitled Medirest to terminate.

The Trust argued that the duty of good faith was limited to the specific purposes set out in cl 3.5; that a breach of this clause did not entitle Medirest to terminate and that it was entitled to terminate as accrued service points had exceeded the threshold in cl 5.8.

**Held**

It was held that cl 3.5 imposed a general duty of good faith given the length of the contract term. Whilst the scope of such a duty would depend on the specific circumstances, on a long term contract it required the parties to work together constantly, at all levels of the relationship. It was also held that the Trust had wrongfully abused its contractual powers in its administration of the contract in its absurd calculations of service points and its failure to respond positively when Medirest sought to resolve the dispute and was therefore in breach of cl 3.5.

This went to the heart of the contract, as given the length its term it required significant co-operation. Accordingly, Medirest could terminate for material breach pursuant to cl 28 and repudiatory breach at common law. However, at the time of termination, the Trust was also entitled to terminate as Medirest had exceeded the service failure points threshold. Neither party was therefore entitled to its post-termination losses.

**Significance**

This case suggests that: (a) a duty of good faith (which may be analogous to the duty of ‘mutual trust and co-operation’ in the NEC3 suite of contracts) requires full co-operation between the parties, even following the outbreak of a dispute; (b) co-operation will be required at all levels on long term contracts even in the absence of such an express duty; and (c) the wrongful imposition of service charges and arbitrary application of the payment regime can constitute repudiation in some circumstances. This is perhaps helpful in demonstrating how the duty of good faith obligation (which may arise expressly or impliedly) is to be applied to commercial contracts. The writers believe that this case is likely to be relied upon by parties seeking to allege a breach of the duty of good faith going forward. CL