Fenwick Elliott
The construction & energy law specialists

Issue 172 October 2014

Dispatch

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

Costs: failure to mediate

Northrop Grumman Mission Systems Europe Ltd v BAE Systems (Al Diriyah C41) Ltd

[2014] EWHC [2955] (TCC)

In Part 8 proceedings Mr Justice Ramsey ruled in favour of BAE. In relation to costs NGM accepted the principle that BAE was entitled to its costs to be assessed on a standard basis if not agreed, but argued that those costs should be reduced by 50% by reason of BAE's unreasonable refusal to mediate the dispute. Following the *Halsey* case, courts can (and do) penalise parties who are considered to have unreasonably refused a request to mediate.

NGM said that because of their long-standing and continuing commercial relationship, NGM approached BAE on several occasions at management level to try and resolve the dispute amicably but those efforts were "spurned". NGM's claim was about money and that whilst it was necessary to construe two agreements, the issue of interpretation did not alter the financial basis for the claim which made the case suitable for mediation.

BAE was convinced that if a mediation had taken place, the case would not have settled. The in-house lawyer commented that if he had thought there had been a realistic possibility of there being a settlement which would have plainly been in the legal and commercial interests of BAE, he would have strongly recommended it. BAE said they rejected mediation for proper and sensible reasons. The dispute was about contractual interpretation so that the outcome was "all or nothing" in that if NGM were right it would recover in excess of £3 million, but if it were wrong it would receive nothing. As a result of legal advice received from solicitors and leading counsel, BAE was confident of its legal position and was aware that NGM was a successful company which could afford to litigate and could afford to lose and that this meant that it had no reason to settle the case for financial reasons.

Each time NGM contacted BAE suggesting mediation, an assessment was made. On each occasion, BAE concluded that mediation did not have a prospect of leading to a resolution of the dispute. BAE was not prepared to countenance paying a sum of money on the basis of the commercial relationship which, if anything, tended the other way. If BAE paid money on what it considered to be an unmeritorious claim, this might lead to other unmeritorious claims and may have wrongly provided NGM with the view that BAE was not prepared to defend itself in cases where it had strong grounds for doing so. BAE thought that the mediation had been suggested in order to put BAE under pressure to make a settlement payment with respect to a claim which BAE considered had no real prospect of success.

BAE therefore considered it unreasonable to expend resources on a mediation. Mr Justice Ramsey considered that this was a case like many others, where points of construction were major issues at the centre of a financial claim. In all such claims a skilled mediator can assist the parties in resolving the dispute by finding a solution to disputes which each party would regard as incapable of being settled and would be unable to settle without such assistance.

In terms of the merits, this was a strong case by BAE. It was not a borderline case or one which was suitable for summary judgment. It was a case where BAE reasonably considered that it had a strong case. This provided some if limited justification for not mediating. This was not a case where there was an offer to mediate and no response or, where the parties did not have some communication with a view to settlement. There were for example, two occasions when attempts to settle were made and an exchange of "without prejudice save as to costs" offers. BAE offered to settle on the basis of no payment, with each party bearing their own costs. This was an offer which, if it had been accepted by NGM, would have put NGM in a better position than it now found itself in, in terms of the outcome of the hearing. NGM has received no payment and accepts that it will have to pay BAE 50% of its costs. This factor was neutral or marginally in BAE's favour in its impact when assessing the refusal to mediate.

The costs of mediation may well have been of the order of £40k in comparison with the overall costs incurred by both parties which are said to total about £500k. The claim was for some £3m. The costs of ADR cannot be said to be disproportionately high. There were two parties who had a commercial relationship. One party, NGM, clearly felt aggrieved, while the other party, BAE, clearly felt that it had the right to act as it did. Therefore this was just the kind of situation where a mediator could assist the parties in resolving the dispute and avoiding wasted management time and soured relationships even if,because they were large commercial entities, the effect would not be so long-lasting.

The Judge therefore concluded that this was a case, the nature of which, was susceptible to mediation and where mediation had reasonable prospects of success. However, BAE reasonably considered that it had a strong case. On that basis was it unreasonable for BAE to reject NGM's offer to mediate? The Judge concluded that it was. Whilst BAE's view of their claim provided some justification for not mediating, other factors showed that it was unreasonable for BAE not to mediate the dispute. Where a party to a dispute, which has reasonable prospects of being successfully resolved by mediation, rejects mediation on grounds which are not strong enough to justify not mediating, then that conduct will generally be unreasonable. That was the position here.

However, the refusal to mediate was not the only factor at play here. There was a "without prejudice save as to costs" letter. The existence of the letter did not justify a refusal to mediate, but it was independently a relevant factor that BAE made an offer which NGM was not successful in bettering. NGM's conduct in not accepting that offer was similarly a matter to be taken into account.

The refusal to mediate meant that the parties had lost the opportunity of resolving the case without a hearing. The failure to accept the offer equally meant that the parties had lost the opportunity of resolving the case without a hearing. Whilst mediation at an earlier stage might have avoided costs, if BAE had mediated even at a later stage, its conduct would not have been unreasonable. Therefore the fair and just outcome was that neither party's conduct should be taken into account to modify what would otherwise be the general rule on costs.

Adjudication: third party rights

Hurley Palmer Flatt Ltd v Barclays Bank plc

[2014] EWHC 3042 (TCC)

As Mr Justice Ramsey explained, this claim raised the issue of the extent to which the rights of a third party enforceable under the Contracts (Rights of Third Parties) Act 1999 ("the 1999 Act") enabled that third party (Barclays Bank plc) to adjudicate a dispute arising under a professional appointment entered into between HPF and (the client) Barclays plc.

By a deed dated 28 January 2008 between the client, Barclays plc and HPF, HPF agreed to provide mechanical and electrical engineering design services in relation to the design and construction of a new data hall at a data centre. Disputes arose concerning the chilled water system. This led to a claim against HPF valued at over £4 million. Clause 14 of the appointment provided for assignment by the client and third party rights. Clause 14.3 contained the following provision:

"Any Affiliate with a direct interest in the Project shall be entitled to enforce the terms of this Agreement as "Client" always provided that the Consulting Engineer shall be entitled [to] rely on the equivalent defences in respect of such liability which it has against the Client."

Clause 2.3 of the agreement, noted, as is not uncommon, that:

"Unless expressly stated otherwise in this Agreement, nothing in this Agreement confers or is intended to confer any rights on any third party pursuant to the Contracts (Rights of Third Parties) Act 1999."

The appointment also provided for adjudication. The third party gave a notice of adjudication, seeking damages against HPF in relation to the claim of defects in the chilled water system based on rights as an Affiliate under the Appointment. HPF then sought declarations at the TCC that the third party was not entitled to commence adjudication proceedings which meant that the adjudicator lacked jurisdiction.

The Judge considered that clause 2.3, on its true construction, means that, with the express exception in this case of clause 14.3, no rights were conferred on a third party which are enforceable under the 1999 Act. He noted that the appointment contained some 31 clauses some of which related to substantive terms and gave rise to the potential liability of HPF to the client. Other provisions contained rights which may be characterised more as procedural rights, for example the right to suspend or terminate. The wording of clause 14.3 strongly indicated that it was the terms of the appointment that relate to HPF's liability to the client, and not the procedural rights which are intended to be enforced under the terms of clause 14.3. There was therefore no freestanding right to enforce the adjudication provision.

Section 1(4) of the 1999 Act sets out the basis on which a third party can enforce a term of a contract such that a third party's right of enforcement is subject to the contract terms and conditions and here the Judge gave as an example, the "classic case" where this provision would be engaged, namely, where there was an arbitration clause.

However, adjudication, unlike arbitration, is not a mandatory alternative way in which a party to a contract can enforce its rights. Adjudication is a voluntary method of dispute resolution in the sense that one party to a contract may, but is not obliged to, have a dispute temporarily resolved, pending a final determination by the courts or, if applicable, arbitration. It therefore differs in nature from the terms of an arbitration clause under which a party's rights can only be determined by arbitration. Here, the adjudication provisions merely said that the Scheme should apply.

Without provision making adjudication applicable to the relationship between Barclays Bank plc as third party and HPF, the terms of the adjudication provision would not be applicable. The Scheme refers, in paragraph 1(1) of Part I, to a party to a construction contract being able to give written notice to refer disputes to adjudication. Barclays Bank, the third party, was not a party to a construction contract. Equally, paragraph 1(2) states that the notice of adjudication should be given to every other party to the contract. This could not apply to the third party.

This is the first time the TCC has been asked to consider whether a third party was granted a right to refer a dispute to adjudication under a contract's adjudication clause. The clear answer to the question raised is no. Therefore if parties wish to grant a third party the right to refer a dispute to adjudication they must expressly agree to it as part of the contractual arrangements.

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.

Follow us on and

Edited by Jeremy Glover, Partner, Fenwick Elliott LLP
jglover@fenwickelliott.com
Fenwick Elliott LLP
Aldwych House
71-91 Aldwych
London WC2B 4HN

www.fenwickelliott.com