Newsletter

BURGES SALMON

Quaystone

March 2014

Welcome to the March edition of Quaystone. This month we highlight a couple of recent decisions from the Court of Appeal that have particular relevance to the construction industry. We also update you on the HSE's current thinking on the overhaul of CDM.

Court of Appeal confirms that on-demand bonds are payable... on-demand

All jokes aside, a recent case in the Court of Appeal has confirmed that demands made under an *on-demand* performance bond remain valid even if there are questions as to whether the person calling the bond is entitled to the money claimed.

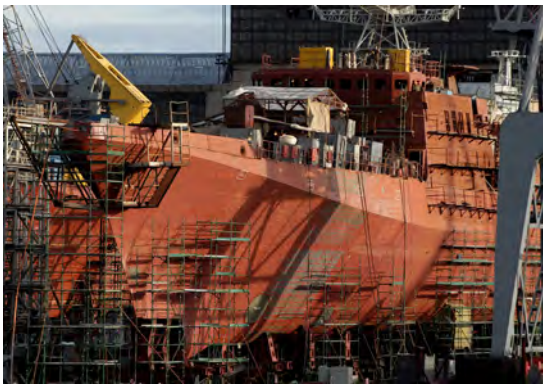
The case highlights once again the autonomous nature of *on-demand* bonds and their independence from disputes arising out of the underlying contract. Therefore, parties to construction contracts should be clear whether it is an *on-demand* bond (payable immediately without enquiry) or a performance *guarantee* (payable in accordance with certain conditions relating to the main contract) which is required in order to protect against default or non-payment.

In the case *(Wuhan v Emporiki Bank)* a document referred to as a "payment guarantee" had been issued by the bank as security for the payment of the second instalment of the contract price for the construction of bulk carrier ships. The payment guarantee stated that the bank irrevocably, absolutely and unconditionally guaranteed the due and punctual payment of the second instalment in the event that the purchaser failed to pay for a period of 20 days after the instalment fell due.

Following a period of dispute between the purchaser and the contractor over whether the second instalment had fallen due, the contractor shipbuilder submitted a demand to the bank for payment under the payment guarantee. The bank declined to pay, arguing that it was not clear that the second instalment was in fact due.

The contractor commenced proceedings against the bank for non-payment. In a previous hearing the Court of Appeal confirmed that the bank was in default. The court decided that the wording of the payment guarantee made it an *on-demand* bond and the only scenario in which payment under an *on-demand* bond could be resisted was where the demand was presented in an invalid form or in the clear case of fraud. As neither case applied, the bank was obliged to pay the sum to the contractor without delay.

Following the earlier hearing, and subsequent payment by the bank to the contractor, the arbitration tribunal dealing with the underlying contractual dispute made a binding award that the second instalment had not in fact fallen due. Perhaps partly encouraged by postscript



comments made by the judge in the original hearing, the bank returned to the Court of Appeal and asked the court to declare that the sum paid to the contractor be held on trust either for the bank or for the purchaser as the contractor knew that it was not entitled to the money.

In rejecting this notion, the Court of Appeal described such an argument as a *"heretical proposition which, if accepted, would be subversive of the basis upon which international trade is routinely financed"*. That is a pretty strong "no". The court concluded that monies paid out under an on-demand bond could never be subject to a trust in this way, reiterating that on-demand bonds are independent contracts containing obligations that are entirely separate to the position between the parties under the underlying contract. The bank, on receiving a valid demand was obliged to pay the claimed sum immediately without question or enquiry. It was irrelevant whether the presenter of such demand was, in fact, entitled to the sum.

Part of the problem with bonds, and one highlighted by this case, is the often loose use of terminology. In this case the document issued by the bank was called a "payment guarantee" but, on analysis, the actual wording of the document made it an on *demand* bond. This reemphasises the point that many in the construction industry often get wrong: it is not sufficient to read what it says on the front of the document (be that "performance bond", "performance guarantee", "guarantee bond", "letter of guarantee", "on-demand bond" etc.) but it is always essential to read the document in full to understand what it actually does.

Further information

For further details on the issues raised in this bulletin or generally on the services we offer please email **marcus.harling@burges-salmon.com**, **william.gard@burges-salmon.com** or **steven.james@burges-salmon.com** or your usual Construction and Engineering Group contact.

Court of Appeal disagrees with itself on the status of Adjudicators' decisions

What is the status of an Adjudicator's award in the period following the decision but before any subsequent court judgment? Just how "binding" is it?

Last year, in *Aspect Contracts v Higgins Construction*, the Court of Appeal (reversing the first instance decision) decided that where a paying party wanted to recover money paid in accordance with an Adjudicator's decision a new cause of action arose at the date of payment. This decision has the effect of restarting the limitation clock and giving the paying party a further period in which to bring a claim in court for the recovery of money paid out pursuant to adjudication.

Then, earlier this month, a differently constituted Court of Appeal gave its decision in another case (*Walker Construction v Quayside Homes*) in which it found the polar opposite to the Court of Appeal in *Aspect.*

Quayside's argument was that the court, when considering a claim that had already been the subject of adjudication, was required to turn the clock back to the position prior to the adjudication. While only expressing *obiter* comments, which will not generally bind future courts, the Court of Appeal agreed with the first instance judgment in *Aspect* in particular because section 108(3) of the Construction Act 1996 provides that an Adjudicator's decision is binding "until" final determination by the Court.

However, between the October 2013 hearing in *Walker* and the publication of that judgment in February 2014, the Court of Appeal decision in *Aspect* held that "the accrual of a cause of action is the date of overpayment" and the limitation clock starts then for the paying party.

Walker had already decided that no such new cause of action accrues and so the limitation clock does not start to run afresh.

The law is currently as stated in *Aspect* as the relevant part of the decision in *Walker* was obiter and was made without the benefit of the intervening *Aspect* decision.

It is a widely held view that this produces an unfair result because the party that was originally successful at adjudication does not get the benefit of a restarted limitation clock. It may well be that by the time a paying party decides to challenge an Adjudicator's award in court, the limitation period in respect of the original dispute has already expired. In that case the originally successful party will be prevented from running the arguments it made in the adjudication and will be unable, for example, to start a counter claim for more than the Adjudicator originally awarded.

Hopefully a definitive answer will be reached by the Supreme Court if permission to appeal the *Aspect* decision is granted. Of course, construction contracts may themselves contain contractual time bars in terms of when arbitration or litigation may be commenced following an Adjudicator's decision. These should always be checked carefully to see what, if any, implications there are in relation to statutory limitation periods applying to the underlying dispute and how these may impact on a party's dispute resolution strategy.

CDM update

We have, over the last couple of years, written extensively on CDM and the proposed changes.

While there remains no definite timetable for any changes but it now seems far more likely that we will all be getting to grips with a new set of CDM Regulations at some point in **2015**.

Although the actual changes themselves are not yet fixed (a consultation will be launched later this year) the following seems likely[1]:

1. The CDM-Coordinator role will be replaced by a "**Principal Designer**". The PD can be anyone who is a "designer" under the Regs. One of the aims of this change is that clients should not be forced into appointing another 3rd party (such as a CDM-C) when one of its existing team (or indeed itself) can fulfil this role.
2. The ACoP will undergo major changes and will probably be replaced by Guidance. The HSE's view appears to be that the current ACoP is over-interpreted and is not, in practice, helpful in managing risk.
3. The requirement for "**Competence**" (one of the underlying duties/themes of CDM) is going to be revamped or maybe removed. The detail of its replacement remains to be seen.

In terms of what this actually means, it is likely that most high profile and complex projects will already be co-ordinated in a way that will fit with the new PD role. Given the confusion that can arise in relation to when (or indeed whether) to appoint a CDM-Coordinator, the change to PDs may be a welcome one.

In summary, the detail of the changes remains up in the air, but a consultation will be launched shortly. Areas of debate will be how to "sell" the PD role to the designers who will actually have to fulfil the role, settling what replaces "competence", drafting the replacement for the ACoP (a potentially huge piece of work in itself) and how the new regulations will be practically delivered, although the latter is most likely to be more of a problem on smaller sites and projects.

[1] From a speech given by Anthony Lees, Head of Construction Policy at the HSE, on 29 January 2014 at RenewableUK's Health and Safety Conference.

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