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Dispatch

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

Dispute resolution clauses

Ericsson AB v EADS Defence and Security Systems Ltd [2009] EWHC 2598 TCC

In 2007 the Secretary of State of the Department for Communities and Local Government ("CLG") appointed EADS Defence and Security Systems Ltd ("EADS") to provide an emergency communications system to the Fire and Rescue Service in England, known as FiReControl, which would involve a much quicker and more coordinated response to emergency calls to the Fire Services. On 20 June 2007 EADS employed Ericsson AB ("Ericsson") as a subcontractor to develop and supply software and provide related support services.

Ericsson agreed to supply a key element in the overall system, the Initial Supplied Software ("ISS"). The subcontract agreement highlighted certain Milestone Dates. In particular, Milestone 5 required that the release of the ISS and contractual delivery date was to be 7 January 2009. By November 2008, Ericsson was reporting that delivery of the ISS would be January 2010, rather than January 2009. Both parties discussed the need to share risk and agreed on an earlier delivery date of 31 August 2009. This date however continued to slip and EADS expressed concern that this delay would impact upon EADS' delivery programme to CLG, and ultimately CLG's ability in turn to deliver a safe and reliable system before the London Olympic Games in 2012.

At the end of September 2009, Ericsson served notices of its intention to mediate the dispute as to whether or not Ericsson was contractually obliged to deliver the ISS by 30 September 2009. One day later EADS wrote to Ericsson notifying it of Material Default, invoking its rights to terminate the contract. On that same day, Ericsson also gave notice of two adjudications pursuant to the multi-tier dispute resolution clause in the agreement. EADS responded stating that adjudication was not open to Ericsson as it had elected to pursue mediation. Subsequently, both parties applied to the Court for interim relief. Ericsson sought to prevent EADS from terminating the Agreement at least before the adjudication had taken place and EADS sought an order preventing Ericsson from taking any further steps in the adjudications, seeking a declaration that any decision would be invalid.

In order to determine whether or not Ericsson was entitled to an injunction to prevent termination prior to the outcome of adjudication, the Court had to determine if Ericsson had a real prospect of success in its claim for a permanent injunction at trial and whether or not damages would be an adequate remedy.

Mr Justice Akenhead refused Ericsson's application for an injunction to prevent termination. He did this having considered the principles to be applied when granting an interim injunction as set out in *American Cyanamid Co. v Ethicon Ltd.* Were Ericsson able to show that it had real prospects in succeeding in its claim for a permanent injunction at trial. Second, on the balance of convenience was it appropriate to grant the interim injunction; and third if an injunction was granted would EADS suffer any loss which could not be compensated in damages. The Judge found that there were serious arguable issues regarding the delivery of the ISS system. He was also not satisfied that damages would not be an adequate remedy. Both parties were commercial parties, in a commercial context, with a sophisticated contract. Under the terms of the contract, the potential damages were not difficult to quantify. Mr Justice Akenhead:

"[could not] see that it is unjust that a party is confined to the recovery of such damage as the contract, which is has entered into freely, permits it to recover."

Clause 31.3 of the subcontract agreement stated that either party "may" (rather than "shall") give notice of its intention to mediate or to adjudicate. This meant that in relation to EADS' injunction to prevent Ericsson from continuing with the adjudications, the Court had to determine whether or not mediation and adjudication were mutually exclusive alternatives under the contract. If a party commences one type of dispute resolution in relation to a specific dispute, can it also, at the same time or later, embark upon the other? Here, Mr Justice Akenhead formed the view that it is open to either party on a given dispute either to mediate or to adjudicate or to do both. Logically, the use of the word "may" suggested that the parties wanted flexibility. Further, the wording in Clause 31.6 stated:

"Unless and until revised, cancelled or varied by a decision of the courts, the Adjudicator's decision shall be final and binding on both Parties save for manifest error."

This was further evidence that Clause 31 as a whole was intended to provide for various forms of dispute resolution. On the facts of this case, Mr Justice Akenhead stated that:

"the effect of an injunction to restrain termination would be in effect to require two parties who have fallen out with each other … to continue to work together in circumstances where they have a sophisticated contract which purports to provide commercial solutions and remedies when a lawful or unlawful termination occurs."

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Adjudication enforcement - application for a stay

JPA Design & Build Ltd v Sentosa (UK) Ltd

[2009] EWHC 2312 TCC

Following an adjudication enforcement hearing, Mr Justice Coulson decided that judgment would be entered in JPA's favour in the sum of £169,784.48, this sum representing £180,000 less than the sum sought. He then went on to consider the question of a stay of execution. Sentosa said that JPA would not be able to repay the £169k, if the respective positions were subsequently reversed. Mr Justice Coulson has of course given guidance on the principles to be adopted in these circumstances in the case of Wimbledon v Vago. This guidance included that:

"...f) Even if the evidence of the claimant's present financial position suggested that it is probable that it would be unable to repay the judgment sum when it fell due, that would not usually justify the grant of a stay if:
i) The claimant's financial position is the same or similar to its financial position at the time that the relevant contract was made (see Herschel); or
ii) The claimant's financial position is due, either wholly or insignificant part, to the defendants failure to pay those sums which were awarded by the adjudicator (see Absolute Rentals)"

JPA relied on these two exceptions. It was agreed that JPA's current financial position was such that the court must conclude that they would be unable to repay the £300,000. One reason for this was that JPA are a shell company. Now it appeared that Sentosa were not fully aware of the "hollowness of that shell" when they entered into the contract. Had Sentosa carried out a credit check they would have found out that JPA had no fixed assets and, at most, two employees. Their accounts for the period up to 31 October 2007 (shortly after the contract was let) show a net profit for the year of £53,237 on a turnover of just under £500,000. The accounts for the year ending 31 October 2008 showed a loss on the year of £307k on a turnover of almost £3 million. Within that, the sum falling due to creditors in one year was about £400,000.

Further, the court was told that JPA had not ceased trading and they are currently bidding for work, although they have no work on-going. There were other difficulties but one key question for the court was whether JPA's financial position had changed since the contract was let.

Some aspects of JPA's financial position were as they were at the time that the contract was entered into. In particular, JPA was and remained a company with a share capital of one share and a single shareholder who is resident overseas. The Judge commented that at the time of the contract, Sentosa should have known that JPA represented a greater credit risk than many, perhaps most, other contractors. However, he rejected the suggestion that JPA's financial position had not significantly altered during the last two years; that was clear from the accounts. At the time of the contract, JPA were making a modest profit on a modest turnover. Since then they had increased their turnover but made a significant loss. There had been a serious and significant deterioration in their financial position.

Then the Judge had to consider whether Sentosa were responsible for JPA's financial position. JPA had suggested that the refusal to pay the sum of £300,000, meant that they were. However , on the facts, this was thought by Mr Justice Coulson to be a difficult submission to make. This was because for over a year, JPA had not mentioned the £300,000 at all, and they failed to issue an adjudication claim in relation to that sum until after the underlying contract had been terminated.

Further, the present position was that JPA owed a total of £700,000 to trade creditors (i.e. not including Sentosa). If they received the £300,000 from Sentosa, then they could reduce that indebtedness to £400,000. But that would not significantly affect the underlying problem. Therefore the Judge concluded that the financial position of JPA would justify a stay.

He did, however go on to consider one further point and this was the argument that there should be a stay because the sum of £300,000 was unequivocally due to be paid back to Sentosa at the time of the resolution of the Final Account. It was submitted that, but for the unwarranted delays on the part of JPA, the Final Account ought to have been sorted out by now and the £300,000 repaid. The Judge agreed.

On the facts, it was an "an unquestionable entitlement". In the Judge's view, the Final Account process should have been completed or at least be well underway. Responsibility for the delay seemed to rest with JPA. It would therefore be "unjust and inequitable" for Sentosa to pay the sums sought in circumstances where there was an overwhelming risk that they would not be reimbursed that sum by JPA in accordance with the contract.

The Judge concluded by making the following comment about the dispute between the parties:

"Finally, I should add this. As I explained to the parties during the hearing, this is a situation where every possible feature of a building case is in play: defects, delays, valuation disputes and termination/ repudiation. In such circumstances, absent ADR or a swift settlement, I do not consider that serial (and nakedly tactical) adjudications are the best method of achieving a comprehensive and binding resolution of the disputes between the parties."

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.

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