On-demand bonds

The case of Murphy v Beckton

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Jeremy Winter on a case where 'huge kudos' should be given to the TCC for its flexibility and response

THE case of *J Murphy & Sons Ltd v Beckton Energy Ltd* is not that new (the decision was issued on 18 March 2016) but it should be interesting to anyone involved in the business of making or defending calls on performance bonds, particularly on-demand bonds.

The background

In 2013, Murphy was appointed design and build contractor for the construction of a combined heat and intelligent power (or CHiP) plant at Beckton in east London. If you think the description of the plant sounds a little strange, the acronym CHiP might give you a clue as to how it works. The fuel for the plant is fats, oils and greases, produced by homes and restaurants.

The supplier of the fuel is Thames Water. Though not stated in the judgment, it seems likely that these fats, oils and greases (FOG) are scraped off the inside of the sewers under London (so-called fatbergs), and/or separated out in the sewage treatment process (Thames Water's Beckton sewage treatment plant is adjacent to the CHiP plant). The FOG is fed to a large diesel engine in the CHiP plant, which is connected to a generator, which has an output of 12MW. Some of the electricity generated goes back to power the sewage treatment plant, and some goes to the grid. A truly remarkable renewable energy concept.

The contract between Murphy and Beckton was a modified International Federation of Consulting Engineers (FIDIC) Yellow Book 1999. The works should have been taken over by November 2014 and completed by January 2015. These dates were not achieved, and by the time of the litigation in March 2016, completion was over 400 days late. The contract provided (under clause 8.7) for liquidated damages to be payable by the contractor for delay in completion at up to £27,000 per day. Beckton contended that Murphy owed £8,274,000 in liquidated damages. Murphy denied this, and said it was entitled to extensions of time which would exonerate it from liquidated damages. Beckton had not deducted the liquidated damages from earlier interim payments, so had to claim them from Murphy. Murphy did not pay and denied that liquidated damages were due.

At this point, the dispute started. As security for the performance of its obligations under the construction contract, Murphy had to provide a performance bond. Quite unusually for a project in the UK, this had to be an on-demand bond. Zurich Insurance provided the bond. The contract required Beckton to give Murphy 23 days' prior notice before calling the bond (this was in a clause amended from the original FIDIC wording). On 25 February 2016, Beckton gave Murphy notice that it was going to make a demand under the bond, for breach of the contract in not paying the £8.274m liquidated damages.

First and second thoughts

One assumes that Murphy immediately consulted its lawyers to try to find the best way to stop the bond call. The first thought might have been to seek an injunction against Zurich to restrain it from

paying under the bond. But the advice will surely have been that the prospects of getting such an injunction would be very slim in the absence of clear evidence of fraud.

The second thought in a situation like this is always; can we get an injunction against the beneficiary of the bond to stop them making a call on the bond? This is often an easier avenue, but it still needs evidence of fraud. Murphy's legal team came up with a plan which had a fair prospect of success. To explain what they did, it is necessary to go into a little detail over the wording of the contract on this job. Clause 8.7 of the contract said:

> *"If the contractor fails to achieve [a specific milestone by the date of that milestone] the contractor shall pay or allow to the employer liquidated damages for such delay."*

The equivalent wording on the printed FIDIC form says:

> *"If the contractor fails to comply with sub-clause 8.2 [time for completion], the contractor shall subject to sub-clause 2.5 [employer's claims] pay delay damages for this default."*

The crucial difference for the purposes of this case was the absence of a reference to sub-clause 2.5 in the Beckton contract.

Clause 2.5 is concerned with employer's claims against the contractor. It requires the employer to give notice to the contractor if it *"considers himself entitled to any payment under any clause of these conditions or otherwise in connection with the contract."* The notice has to be given as soon as practicable, and with sufficient particulars to back it up. The engineer then has to make a determination (under clause 3.5) as to whether the employer is entitled to what it is claiming. In this case, the engineer (from Capita Symonds) had not made a determination under clause 3.5 of Beckton's entitlement to liquidated damages.

Plan of attack

Murphy's plan of legal attack was as follows. The 23-day deadline on Beckton's notice of intention to make a demand on the bond was due to expire on 19 March 2016. On 9 March 2016, Murphy issued a claim form in the Technology and Construction Court (TCC), in which it asked the court for the following:

- A declaration under the contract that Murphy was not obliged to pay any liquidated damages until there had been a determination by the engineer under clause 3.5.
- An injunction preventing Beckton from making a demand on the bond, on the basis that if Murphy was correct that an engineer's determination was required before Murphy was liable for any liquidated damages, it must be fraudulent for Beckton to call the bond if no such determination had been made.

Swift justice?

One typically thinks of litigation lasting years, not months, never mind days. However, in this case, in another example of how flexible and responsive the TCC can be, the parties were able to have a hearing of the arguments as early as 16 March 2016 (a week after the claim form was issued) and the judge, Mrs Justice Carr, delivered her judgment on 18 March 2016.

Notwithstanding the imaginative and efficient course they took to get this issue resolved, Murphy lost. It lost because the judge decided that, on the particular wording of this contract, it was not necessary for there to be an engineer's determination under clause 3.5 before Beckton was entitled to liquidated damages, and so to make a claim on the bond. This conclusion is a little surprising in the light of the clear words of clause 2.5 which require the employer to give notice, and for the engineer to issue a determination, if the employer considered itself entitled to *"**any** payment under **any** clause of these conditions..."* [my emphasis].

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A non-lawyer might think that the outcome was obvious – the printed FIDIC wording made clear that it was necessary to give notice under clause 2.5 (and so get an engineer's determination under clause 3.5), but in the specific and different wording of the equivalent clause in this contract, there was no reference to clauses 2.5 or 3.5. So obviously (a layman might say), no engineer's determination was required. But under English law, there are limits on the weight to be given to a deletion from, or change to, a printed form. The judge thought that clause 2.5 (notice of claim to be given by employer) was inconsistent with clause 8.7, the liquidated damages clause, but considered this inconsistency could be resolved by treating clause 8.7 as an independent regime. So an engineer's determination was not required.

If an engineer's determination under clause 3.5 was not needed before liquidated damages were payable by the contractor, then it could not be fraudulent for Beckton to make a demand on the bond, and so no injunction would be granted against it.

Murphy probably thought it was hard done by with this decision. There were a number of unusual aspects of the judgment – one was to give material weight to a witness statement from a Beckton employee who said that all parties were aware at the time of entering into the contract that Beckton's lender insisted on having an unrestricted on-demand bond. That would not typically be admissible evidence on the interpretation of a contract. Another was an apparent assumption that the wording of the disputed clause was drafted by the parties. In fact, the wording of the contract was very likely drafted and dictated by Beckton, with little room for negotiation by Murphy. If this had been appreciated, the inconsistency the judge considered there to be between clause 2.5 and 8.7 might have been resolved against Beckton, applying the *contra proferentem* rule.

However, the fairer approach is to give the judge huge kudos for hearing the case so quickly after it was started, and

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giving her judgment just two days after the hearing. I assume that Beckton made its demand on the bond on 19 March and got paid. There would have been no chance of persuading the Court of Appeal to hear an appeal quickly enough. Information from the web indicates that the CHiP plant passed some operating tests in August 2015, but it is not easy to establish whether the plant is now in full operation. Murphy may have got some or all of its money back by establishing that it was entitled to extensions of time.

Lessons to be learned

It is always going to be a struggle to stop a demand or payment under an on-demand performance bond, because the law requires evidence of fraud before a court will intervene.

In cases of urgency, the TCC and other parts of the High Court can react very quickly (and therefore cost-effectively) and the procedure used by Murphy in this case (called a part 8 application) is to be borne in mind for such situations where only identifiable points of law need to be decided.

As always, amending carefully crafted standard form contracts can give rise to uncertainty and inconsistency.

Liquidated damages disputes often involve very substantial sums of money. If contractors want to avoid them being levied, they need to give all necessary notices and support for applications for extension of time, and to push the engineer or other employer's representative to decide the applications. If the employer's representative's decision seems wrong to the contractor, adjudication is always an option.

From the employer's perspective, if money is tight, it may be better to deduct the liquidated damages from payments otherwise due to the contractor, though I recognise that this can be seen as a very aggressive act by the employer whose primary concern is usually to get its plant operational, and needs to keep the contractor sweet – at least until that has been achieved.

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