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Lendlease v *Aecom* – a pencil sketch

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Simple? Yet, not a single person on the face of this earth knows how to make me.

I, Pencil Leonard E. Read (1958)

Introduction

Lendlease Construction (Europe) Ltd v *Aecom Ltd (Rev1)* [2023] EWHC 2620 (TCC) is a first instance decision arising out of a £173 million project to design and build a new oncology centre at St James' University Hospital in Leeds. Work began in 2004 with practical completion certified in 2007. Disputes later arose between employer and contractor about fire safety and electrical engineering defects in a basement plant room. The contractor agreed to pay £2.9 million in respect of some defects. Others remained in issue and were the subject of a judgment of Joanna Smith J in *St James's Oncology SPC Ltd* v *Lendlease Construction (Europe) Ltd & Ors* [2022] EWHC 2504 (TCC) with the contractor ordered to pay the employer around a further £5 million.

The contractor next sought to pass on these liabilities to the subcontractor said to have been responsible. This raised (amongst other things) questions about the extent to which the subcontractor was entitled to dispute what had been agreed in the settlement, and to relitigate the issues which had been before the previous judge. While the detail of the judgment is mostly of interest only to the parties involved, it does offer a useful exploration of the law around this issue of when and to what extent a settlement or dispute resolution process should bind a non-party and illustrates some pitfalls contractors face in this situation.

In the event, while the contractor would have been entitled to rely on the judgment and settlement to prove its loss as against the subcontractor (as discussed further below), the contractor was ultimately unsuccessful because its claims against the subcontractor were time-barred, having been commenced more than six years after the breach, and because the contractor had agreed a settlement with the subcontractor in connection with another matter but which was worded in such a way as to have also settled the defects claim.

When a party seeks to pass on liability to a third party, background principles which underpin our system of dispute resolution pull in different directions. There is the desire to resolve disputes quickly and cheaply and avoid relitigating the same issues. There is the desire to demonstrate procedural fairness, and give parties facing claims the right to present fresh arguments and test the evidence against them. And then there is the need to respect whatever choices the parties may themselves made about how their disputes are to be resolved.

Facts of *Lendlease* v *Aecom*

Leeds Teaching Hospitals NHS Trust retained St James's Oncology SPC Limited ("**Project Co**") to design, construct, operate and maintain the Oncology Centre. Project Co retained **Lendlease** as design and build contractor. Project Co retained **Engie** to maintain the Oncology Centre. Lendlease retained **AECOM** to provide M&E and fire engineering services under what was termed the "**Consultancy Agreement**". Practical completion was achieved in December 2007. A dispute arose between AECOM and Project Co over Aecom's fees which was the subject of a settlement in September 2012.

Defects were discovered. On 11 December 2019 Project Co and Engie commenced proceedings against Lendlease. On 9 November 2021 Project Co, Engie and Lendlease entered into a settlement agreement with respect to some of the defects pursuant to which Lendlease paid £2.9 million. The remaining claims were the subject of Joanna Smith J's judgment of 12 October 2022 holding Lendlease liable for around £5 million.

Lendlease's claim against AECOM was commenced on 30 May 2019 (i.e. before the claim against AECOM by Project Co / Engie). It is unclear why the claims were not heard together. It is also unclear why Lendlease's claim against AECOM, despite having been commenced seven months earlier that Project Co's claim against Lendlease (30 May 2019 vs 11 December 2019) was decided a year later (1 November 2023 vs 12 October 2022).

Lendlease was unsuccessful for two principle reasons. The Consultancy Agreement was a deed, so subject to a twelve-year limitation period from breach. Any breach on AECOM's part had occurred, at the latest, when the work was completed to AECOM's defective design. That had occurred in August 2006, so any proceedings would have required to be commenced by August 2018 to avoid the time-bar. Lendlease had only commenced the proceedings on 30 May 2019, so Lendlease's claim was time-barred. Lendlease was unsuccessful in an argument that AECOM had owed and breached duties beyond August 2006, to keep its design under review and warn about defects in its design.

The second principle reason for Lendlease's lack of success was the settlement agreement which Lendlease had entered into with AECOM in September 2012. This had said (emphasis added):

> "*The Parties agree to waive and unconditionally and forever release each other, their insurers, their parents, subsidiaries, affiliates and associate companies (included but not limited to their respective directors, officers, employees, agents, successors, assigns and heirs) from (a) the Notified Claims and/or (b) <u>any other claims and counterclaims, liabilities or debts (of whatever nature) which are known to the Parties or which ought reasonably to have been known to the Parties as at the date of this Agreement</u> arising out of or in connection with AECOM's provision of services pursuant to the Appointment*".

Several of the defects were held to have been such that Lendlease should have known of them at the date of the Settlement Agreement.

Notwithstanding these dispositive points, the court did consider whether and to what extent Lendlease could otherwise have relied on Joanna Smith J's judgment, and on its settlement agreement with Project Co / Engie, to establish the scope of Lendlease's loss consequent upon the defects.

Complexity

In Leonard Read's 1958 essay *I Pencil* a pencil describes its family tree. To produce even so apparently simple an object, it turns out, requires an unimaginably vast web of work, knowledge, people and materials – cedar wood, lacquer, graphite, ferrule, factice, pumice, wax glue, tools and machines, lumberjacks, factory cleaners, lighthouse keepers who guide shipments of pencils into port and so on. Each object used in the process has, lying behind it, a similarly extensive family tree of its own: "*untold thousands of persons had a hand in every cup of coffee the loggers drink*".

Much the same point emerges from the 2011 book *The Toaster Project* in which artist Thomas Thwaites recounts his doomed efforts to procure and process all the raw material required to manufacture a toaster. However resourceful and knowledgeable the artisan, such endeavours will always – at some level – depend on the labour

of others. Thwaites may have chipped mica for his toaster out of a Welsh hillside, but did not forge the geological hammer he used, or refine the oil that powered his car to drive there.

In the 66 years since *I Pencil* was written our world has, of course, only grown exponentially more complex, with skills and knowledge required to make and fix things ever more specialised, compartmentalised and thinly distributed.

The facilitative role of law

Read's point, of course, is to illustrate the remarkable ability of the free market – Adam Smith's 'invisible hand' - to organise this endeavour without any overall direction: "*No one sitting in a central office gave orders to these thousands of people. No military police enforced the orders that were not given. These people live in many lands, speak different languages, practice different religions, may even hate one another—yet none of these differences prevented them from cooperating to produce a pencil. How did it happen? Adam Smith gave us the answer two hundred years ago*".

But while this unfathomable complexity might not require to be *managed* by the state, the state does nonetheless, play a crucial role in facilitating it. Underpinning the web of transactions which bring loggers coffee and lighthouse keepers Fresnel lenses and everyone everything in between are chains of contracts. And as true as that is with pencils, how much more so with more complex endeavours like (say) building oncology centres. Whenever an employer retains a contractor to deliver some such complex project, that contract is merely the last link in a series of contractual supply chains extending off towards the horizon in every direction.

Absent state enforcement of such chains of promises, we would likely be reduced, at least when dealing with strangers, to instantaneous transactions of cash and carry and thus to much less impressive endeavours, to the detriment of our society. Per Hobbes *Leviathan* (1651) "*he that performeth first, has no assurance the other will performe after; because the bonds of words are too weak to bridle mens ambition, avarice, anger, and other Passions, without the feare of some coercive Power*". The state, using its monopoly on force and violence, enforces promises. Knowing there is a mechanism by which contracts can be enforced lends self-interested parties enough confidence in one another's promised performance that they are willing to invest the time, effort and resources required to deliver complex, collaborative projects – sufficiently confident goods will be delivered and work will be done, and of being paid, or of a remedy if work, goods or payment are not forthcoming.

Fidelity and efficiency

Read was a libertarian, an associate of Ayn Rand, a critic of government and of the New Deal. Nonetheless, his pencil does acknowledge, albeit fleetingly obliquely, the role of law in this grand edifice, concluding: "*The lesson I have to teach is this: … Let society's legal apparatus remove all obstacles the best it can. … Have faith that free men and women will respond to the Invisible Hand*". The pencil neatly captures what are arguably the foremost goals of our legal systems for resolving commercial disputes - **fidelity** and **efficiency** i.e. (i) give effect to what the parties have agreed, and do not interfere with or seek to improve upon their bargain, trusting that they will have been guided by the Invisible Hand; (ii) deliver that result as quickly and cheaply as possible.

Balancing efficiency and procedural fairness

Alongside efficiency may be added a competing value – that of formal procedural fairness or, to put it another way, justice being seen to be done. Even a system which could invariably deliver the right outcome (i.e. a result which perfectly matched what was agreed) quickly and cheaply would probably be considered unsatisfactory, by

most people, if it rendered such result by opaque fiat, without reasoning or explanation and without input from the interested parties. After all, people may reasonably disagree about what has occurred and what a contract requires and any system of dispute resolution is inherently fallible. Contracting parties need to be confident of being given a 'fair shot' - a sufficient opportunity to put their case, present their evidence and interpretation, even at the expense of some efficiency, and even if they are ultimately held to be wrong. Undoubtedly there comes a point where making dispute resolution cheaper and quicker at the expense of procedural fairness will have negative consequences in terms of people's willingness to trade and enter into contracts and to entrust their fortunes to such a system, however swift, cheap and reliable the outcome.

The formal status of fidelity in English law

It is easy to find case law espousing freedom of contract and fidelity to what parties have agreed. *Clarke* v *Watson* (1865) 18 CB (NS) 27 at 284 [141 ER 450 at 452] per Erle CJ "*every man is the master of the contract he chooses to make*". *Arnold* v *Britton & Ors* [2015] UKSC 36 per Lord Neuberger (with whom Lords Sumption and Hughes agreed) at [19-20] "*The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language*" and "*a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party*".

The common law shielded children and people with mental handicaps from the vicissitudes of this doctrine because it treated them as lacking capacity to bind themselves to any contracts at all. Statute, enacted by parliament, now also provides competent, adult consumers with some protections against the consequences of their entering into imprudent contracts. For commercial disputes, however, freedom of, and fidelity to, contract remains the touchstone. Per Moore Bick LJ (with whom McFarlane and Brigg LJJ agreed) in *Transocean Drilling UK Ltd* v *Providence Resources Plc* [2016] EWCA Civ 372 [RL-3] at [28] "*The principle of freedom of contract, which is still fundamental to our commercial law, requires the court to respect and give effect to the parties' agreement*".

'Giving effect' to a contract rarely means forcing a party to render the promised performance, of course, but, rather, ordering them to pay damages by way of compensation. Per Baron Parke in *Robinson* v *Harman* (1848) 1 Ex Rep 850: "[W]*here a party sustains loss by reason of breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed*".

The formal status of efficiency and fairness in English litigation procedure

What about the need for efficiency and fairness in dispute resolution? England's Civil Procedure Rules ("**CPR**") are stated to be "*a procedural code with the overriding objective of enabling the court to deal with cases justly and at proportionate cost*" defined, so far as practicable, to include both "*saving expense*" and "*ensuring that* [cases are] *dealt with expeditiously and fairly*". The rules require the court to give effect to that overriding objective when it exercises any power conferred by the rules or interpreting any rule. As Jacob LJ memorably put it in *Nichia Corp* v *Argos Ltd* [2007] EWCA Civ 741 at [50-51] (albeit he was dissenting in the result): ""*Perfect justice" in one sense involves a tribunal examining every conceivable aspect of a dispute. All relevant witness and all relevant*

documents need to be considered. And each party must be given a full opportunity of considering everything and challenging anything it wishes. No stone, however small, should remain unturned. Even the adversarial system at its most expensive in this country has not gone that far. … But a system which sought such "perfect justice" in every case would actually defeat justice. The cost and time involved would make it impossible to decide all but the most vastly funded cases. The cost of nearly every case would be greater than what it is about. Life is too short to investigate everything in that way. So a compromise is made: one makes do with a lesser procedure even though it may result in the justice being rougher. Putting it another way, better justice is achieved by risking a little bit of injustice".

Formally, any role for party choice in English litigation ends at the threshold. Where a party, who would not otherwise have been subject to the court's jurisdiction, has chosen to agree to confer jurisdiction on the court, then that is effective to confer jurisdiction and the court has no discretion to decline it. Thus, party choice may determine whether parties are subject to the court's jurisdiction in the first place. But, once jurisdiction is established whatever else the parties might agree concerning procedure enjoys no formal status, and judges are not bound to do as parties have agreed – efficiency trumps party choice.

The day-to-day reality is more nuanced and there are inevitably exceptions at the margins. Parties routinely agree all sorts of procedural matters *ad hoc* and courts, though not bound to do so, routinely make procedural directions in accordance with what the parties have agreed. The process, though, is very much *ad hoc* and turns on agreements after litigation has been commenced. An agreement made in a contract about how any future disputes will be resolved – for example, about what expert evidence will be permitted or the scope of disclosure – would not bind a court and would probably be given little weight by a judge.

The formal status of fidelity, efficiency and fairness in arbitral procedure

Section 1 of the Arbitration Act 1996, by contrast with CPR 1.1, enshrines both efficiency **and** fidelity to party choice: "*1. The provisions of this Part are founded on the following principles, and shall be construed accordingly – (a) the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay or expense; (b) the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest*". Section 33 imposes on a tribunal a duty to "*adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay and expense* …". Numerous provisions of the Arbitration Act 1996 merely set out what are to be the tribunal's powers and what is to the be the procedure absent any agreement, with party choice taking priority.

It is, ultimately, unsurprising that arbitration, being an elective form of dispute resolution, places a greater emphasis on party choice. Parties are paying arbitrators directly for their time, and so one might expect arbitrators, as party appointees rather than public servants, to be more indulgent of the parties' mutual wishes. There are supply and demand dynamics in play too. Ultimately, there are many more prospective arbitrators than serving judges, so judicial time is a scarcer commodity for which the parties to any given dispute are, in a sense, competing with other litigants. It is, however, too simplistic to conclude from this that arbitration = party choice and litigation = efficiency because, often, what parties choose when they choose arbitration is itself a pared-down procedure, with few prescriptive rules and a great deal of discretion for the decision maker. To see this, one need only compare the immense doorstop of the CPR against the modest pamphlet of the ICC or LCIA rules.

The role of fidelity in furthering efficiency

By far the cheapest, quickest and most efficient possible outcome is for there never to be any dispute at all and for parties to just perform their contract, or else elect not to perform but promptly pay instead an agreed amount

by way of compensation. Such amount may either be agreed *ad hoc* or fixed in advance in the form of a liquidated damages clause.

If decision makers consistently exhibit fidelity to contracts, that goes a long way in promoting such outcomes. If one can be confident that the court or tribunal will enforce what the contract says, then the outcome is easier to predict, and the need to litigate correspondingly rare. Thus, per Lord Bingham in *Golden Strait Corp* v *Nippon Yusen Kubishka Kaisha (The Golden Victory)* [2007] UKHL 12; [2007] 2 Lloyd's Rep 164; [2007] 2 AC 353, [23] "*the importance of certainty and predictability in commercial transactions has been a constant theme of English commercial law*" and at [1] "*a traditional strength and major selling point of English commercial law*". Similarly, per Lord Briggs in *Vauxhall Motors Ltd (formerly General Motors UK Ltd)* v *Manchester Ship Canal Co Ltd*. [2019] UKSC 46 at [41]: "*certainty is equally important in the law of commerce, and one of the reasons why English commercial law is chosen around the world by commercial counterparties to govern their contracts, even when neither they nor the subject matter have any connection with England*".

The temptations of intuition

A difficulty is that while positive impacts of fidelity may be enormous, they are subtle, invisible, hard to measure, lacking in immediacy and **cumulative**. Giving effect to what this or that contract says, and thereby delivering yet another predictable outcome, arguably makes some small, cumulative contribution to preventing thousands or tens of thousands of unidentified future disputes and facilitating the entering into of hundreds of thousands of unidentified future contracts, but these positive benefits are never before the decision maker's eyes, and so lack the emotional immediacy of the issues in the individual case. A few rogue decision makers, who make unpredictable decisions, have a disproportionate impact because the knowledge that such people exist may make parties willing to gamble on litigating what should, by rights, be unwinnable cases, because the possibility of the case being allocated to a rogue decision maker makes it worth the gamble.

Fidelity to the contract does demand a certain self-discipline and self-awareness on the part of decision makers. In any given case, it may be tempting to make an exception 'just this one time' and depart from the contract, and (as Lord Neuberger put it) "*relieve a party from the consequences of his imprudence*". Allowing one unpredictable result to do justice in the instant case 'just one time' may have no detectable impact, just as releasing a little 'out of sight out of mind' pollution may appear to do no harm, but the cumulative effect of multiple decision makers succumbing to such temptations is undoubtedly greater than the sum of its parts.

When a case tugs at the heart strings, professional decision makers do well to heed the lessons of behavioural psychology and have in mind the experience of charities and the so-called 'identifiable victim effect'. Prospective charitable donors respond very differently to saving the life of a specific identifiable victim than to saving the lives of people in general. Or, as misattributed to Stalin "*The death of one man is a tragedy, the death of millions is a statistic*". Thus raising money for a single costly operation for a single, identifiable child may be far easier than raising an equivalent amount to save the lives of many more, anonymous, children by way of cheaper interventions (mosquito nets, drinking water treatment or similar). Charities seeking to raise funds for disaster relief thus routinely focus not on the scale of the need, and the many people who will benefit, but on portraying individual victims. Decision makers do well to also have in mind the bigger picture.

Liability as loss

The interconnectedness of the world means it will very often be the case that the loss a claimant is seeking to recover for some breach of contract is contingent upon what a claimant has itself promised some third party. A Defendant (D) promises to deliver some goods or services to a Claimant C. C, in turn, has made a promise to a third party (T) which was contingent on C receiving the promised goods or services. D fails to perform as

promised, placing C in breach of its subsidiary promise to T. C's loss caused by D's breach is (or includes) C's liability to T.

This common scenario creates great potential for duplication and inefficiency. C suffers loss due to some defect in goods supplied by D, who bought them from T1, who bought them from T2 who bought them from T3 and so on. If dealt with by way of a series of discrete trials / arbitrations each supplier has to bring a claim against the preceding supplier to pass on both the loss suffered by C, and all the costs suffered by every party in the chain up to that point. It is obviously inefficient to re-litigate the issue of C's loss multiple times, but each successive defendant may have some interest in trying to do so. After all, the C's loss is never going to get bigger than the amount awarded in the original claim, but each supplier in the chain may think they have some chance of cutting it down in some way.

In the context of contractual chains, fidelity to contracts aids both justice and efficiency. Each participant in the chain can be reasonably confident of what its particular contract means and does and that the allocation of risks will be that which was intended. A single aberrant decision, disrespecting the contracts in an attempt to achieve a more 'desirable' result as between particular parties may deliver injustice further down the chain, lead to liabilities which cannot properly be passed on which could have been if the contracts had been respected, and encourage parties further down the chain to relitigate these disputes rather than accepting the earlier outcomes.

Avoiding duplication

Broadly, there are two ways in which duplication might be avoided. A seemingly obvious approach would be to resolve all disputes in a single procedure before the same tribunal, so that the issue of C's loss need only be considered once and by one tribunal.

Such an option may sometimes be available in litigation, where T brings a claim against C, and C can join D as a Part 20 Defendant. Or the claims may start as separate proceedings but then be combined into a single proceeding because they concern the same subject matter.

Whether to pursue a Part 20 claim against D can, however, involve some difficult calculations for C. Overall, a single set of proceedings - T v C v D – is almost always going to be quicker and cheaper overall than two sets of proceedings - T v C then C v D. But joining D as a Part 20 Defendant can be something of a double edged sword, particularly if C thinks it has a good defence to T's claim. If C joins D as Part 20 Defendant but beats T's claim then C may be stuck paying D's costs. And the costs to C of fighting a war on two fronts will invariably be greater that just defending T's claim and winning.

In *Lendlease* v *Aecom*, however, C (Lendlease) had already commenced its claim against D (AECOM) seven months before T (Project Co) began its claim against C. It is unclear why these proceedings ran separately, rather than being combined into a single proceeding given the overlapping issues.

While Part 20 claims and consolidation of claims are options which are open to courts, there will rarely be any such option open to arbitrators, absent consent of all the parties involved. Typically there will be one party in any chain of arbitration agreements (or mixed chain of arbitration and litigation agreements) who perceives it to be in their interests to avoid a conjoined hearing and resist joinder or consolidation.

When contracts provide for arbitration then, absent some express agreement, the parties to each contract will be entitled to insist on a separate arbitration. In a sense, deference to the parties' arbitration agreement takes precedence over the time-cost saving which might be achieved if the proceedings were determined together.

If proceedings between T, C and D are not, for whatever reason, to be combined then the other means by which to avoid duplication and inefficiency is to treat facts established as between T and C as being, in some sense, binding or determinative as between C and D.

Spectrum of certainty

C's obligations to T may take various forms, and there is a spectrum in terms of how confident one can be of what C's liability to T is.

Judgment or Award	At one end of the spectrum are those cases where C's liability for breach of its contract to T has been determined by a court or tribunal and set out in a judgment or award, and C is simply seeking to pass on that liability. Within that category might be said to be some further gradations which have a bearing on the question of whether C can recover the liability from D. For example, a judgment or award which was the result of bitterly fought trial might bear rather more weight in that regard that a judgment in default, where the underlying claim was never really tested or scrutinised.
Settlement	The situation where C has agreed to pay T some amount in settlement of T's claim for breach of contract.
Contract	Somewhere below that is the situation where T has a claim against C for breach of contract which has not yet been settled or decided. Within that category, there will be further gradations for example. • C's liability to T may be clear from an agreed damages clause or some other contractual mechanism. • C's liability may not be fixed by the contract, but may be relatively easy to calculate or, at least, limited to a small number of possibilities. An example may be failure to deliver under a contract for sale of generic goods, where there was an available market so that T's claim will be for the difference between the contract price and the market price, T being expected to go into the market and procure replacement goods to mitigate its loss. • Alternatively, C's liability to T may be far more uncertain because the contract is unclear and/or because the factual position is open to dispute. Contracts for bespoke goods and work are more likely to give rise to disputes in this category, where the range of possible outcomes is greater.
No contract	At the other end of the spectrum is the situation where T has suffered a loss through D's non-performance and C owes no contractual liability to T with respect to that loss, but still wishes to recover T's loss from D.

The treatment of each situation is discussed in turn below.

Awards

A starting point for considering what is to be the effect of a judgment or award is *The Sargasso* [1994] 1 Lloyds LR 412. The claimant, Stargas, claimed the defendant was in breach of a time charter and that this breach had caused the plaintiff to be in breach of a voyage charter with another party. The claim for breach of the voyage charter had gone to arbitration with an award being made against Stargas. Stargas then sought damages in the amount of the arbitration award saying this should be seen as the measure of its loss in the absence of evidence of a failure to mitigate or of the arbitration award being perverse. The defendant said that the arbitration award was inadmissible as evidence of the plaintiff's loss (save to provide a cap on the recoverable amount) alternatively that it was no more than *prima facie* evidence of the loss.

Clarke J, found that the applicable rule was that the plaintiff was entitled to recover damages in the amount of the arbitration award unless the defendant proved that it had failed to take reasonable steps to mitigate its loss or "*that the award was such that no reasonable arbitrators could reach on the evidence or was in some other respect perverse*".

Judgments

Lendlease v *Aecom* concerned, in part, a similar situation, but with a judgment rather than an award. As noted in the introduction, the contractor had been held liable to the employer for defects in the work by way of a previous judgment and sought to pass that liability on to the subcontractor alleged to be responsible for the defects. The contractor said the subcontractor's actions had placed the contractor in breach of its obligations to the employer and that the consequence of this was the liability in the amount of Joanna Smith J's judgment. The claim was not for the cost of rectifying the defects, but for the **liability** expressed in that judgment.

The contractor argued that "*a judgment reached after a contested trial is to be seen as carrying rather more weight than an arbitration award and that the approach set out in The Sargasso applies a fortiori to such a judgment*".

The subcontractor argued that the effect of the decision of the Court of Appeal in *Ward & others* v *Savill* [2021] EWCA Civ 1378 was that notwithstanding the judgment of Joanna Smith J, the contractor was required to prove all the elements of its claim including the amount of the loss caused by the defects which were the subject of that judgment.

In that case, Cs had obtained a declaration that they had been induced to invest in particular schemes by deceit; that they had a beneficial interest in the monies which had been paid over; and that they were entitled to trace into property acquired with that money. Cs sought to say against D that as a result of the declarations in the earlier proceedings Cs had a beneficial interest in monies they had paid over and were entitled to trace into property representing the proceeds of those monies including into property held by D. At first instance it was held that the declarations in the earlier proceedings had not taken effect *in rem* (i.e. a judgment establishing a proprietary right, enforceable against the whole world, rather than an *in personam* liability) so could not be relied upon to establish Cs' beneficial interests in the relevant funds.

The Court of Appeal considered whether the earlier declarations had been a judgment *in rem* but it also considered the defendant's alternative argument that the earlier declarations had no effect against her because she had not been a party to the proceedings in which they had been made.

At [34] Sir Julian Flaux C (with whom Elisabeth Laing and Warby LJ agreed) set out the statement of principle enunciated thus at 596 – 597 of *Hollington* v *Hewthorn* [1943] KB 587 (emphasis added).

> "*A judgment obtained by A against B ought not to be evidence against C, for, in the words of the Chief Justice in the Duchess of Kingston's Case (I), "it would be unjust to bind any person who could not be admitted to make a defence, or to examine witnesses or to appeal from a judgment he might think erroneous: and therefore ... the judgment of the court upon facts found, although evidence against the parties, and all claiming under them, are not, in general, to be used to the prejudice of strangers." This is true, not only of convictions, but also of judgments in civil actions. If given between the same parties they are conclusive, but not against anyone who was not a party. If the judgment is not conclusive we have already given our reasons for holding that it ought not to be admitted as some evidence of a fact which must have been found owing mainly to the impossibility of determining what weight should be given to it without retrying the former case. A judgment, however, is conclusive as against all persons of the existence of the state of things which it actually affects when the existence of that state is a fact in issue. Thus, if A sues B, alleging that owing to B's negligence he has been held liable to pay xl. to C, the judgment obtained by C is conclusive as to the amount of damages that A has had to pay C, but it is not evidence that B was negligent: … and B can show, if he can, that the amount recovered was not the true measure of damage*."

It was said that this principle remained good law. At [82] Flaux C explained that the penultimate sentence of the quoted passage created a narrow "carve-out" from the general principle, accepting counsel's submission that "*the amount of damages awarded in the first proceedings would be an incontrovertible fact in the second proceedings which could not prejudice a party to the second proceedings who had been a stranger to the first proceedings*". Flaux C explained the effect of the *Hollington* v *Hewthorn* principle in the circumstances of *Ward & others* v *Savill* in this way at [92] and [93]:

> "*The appellants should be required to plead and prove all the elements of their case against the respondent that they have a beneficial interest in her property … Accordingly, applying … the rule in Hollington v Hewthorn … I consider that the respondent is entitled to require the appellants to plead and prove all the elements of their case against her and that they cannot simply rely upon the Butcher Declarations against her.*"

The judge in *Lendlease* v *Aecom* held that:

> "*… this claim falls within the "carve-out" identified in Hollington v Hewthorn. That is because the quantum of pcontractor's] liability to [employer] is a matter of fact which is in issue here and which was determined by Joanna Smith J. The last sentence of the passage quoted from Hollington v Hewthorn explains how the "carve-out" operates. With the substitution of "breach of contract" for "negligence" in that sentence the circumstances here are precisely those which are being addressed.*"

> "*Joanna Smith J's judgment is not relevant to the question of whether [subcontractor] was in breach of its obligations to [contractor]. It is, however, conclusive as to the fact that [contractor] was in breach of its obligations to [employer]. Subject to the qualification I will address in the following paragraphs it is also conclusive as to the fact that [contractor] was as a consequence liable to [employer] in a particular amount. [Contractor] has to show without reference to the judgment that [subcontractor] was in breach of the latter's obligations and that this breach caused [contractor] to be liable to [employer]. However, provided [contractor] does that then Joanna Smith J's judgment provides the starting point in relation to the amount of that liability and the onus is then on [subcontractor] to show that the amount of the judgment is not the true measure of [contractor's] loss by reason of [subcontractor's] breach.*"

The qualification concerned one part of Joanna Smith J's judgment where she had made a global award. The employer was claiming certain costs which related to the remedying all the defects, and did not seek to allocate

or apportion those costs to particular defects. If the subcontractor was liable for all the defects to which that global award related, it would not matter. But if the subcontractor was only liable for some defects and not others, the contractor would not be entitled to rely on the judgment as conclusive as to the amount of damages payable as a consequence of any particular breach.

Settlements

In *The Sargasso*, Clarke J (referring to *Biggin & Co Ltd* v *Permanite Ltd* [1951] 2 KB 314, a decision of the Court of Appeal concerning a settlement agreement) said:

> "*In my judgment there are significant differences between the case where the plaintiff's liability is fixed by agreement and the case where it is fixed by an arbitration award. In the case of an agreement the amount depends entirely upon the decision of the parties to agree to a particular sum, whereas in the case of an arbitration award the amount depends upon the determination of the arbitrators. Thus in the case of an agreement it makes sense to hold that the agreement is at best prima facie evidence of the plaintiff's loss and to impose on the plaintiff the burden of pleading and proving that the settlement was reasonable. That is in my opinion the effect of the decision in Biggin v. Permanite*."

In *Siemens Building Technologies FE Ltd* v *Supershield Ltd* [2009] EWHC 927 (TCC) at [62] – [79] Ramsey J reviewed the authorities addressing the situation where party A seeks to recover from party C the sum which the former had paid in settlement of a claim made against it by party B. He summarised the applicable principles at [80]:

> "*(1) For C to be liable to A in respect of A's liability to B which was the subject of a settlement it is not necessary for A to prove on the balance of probabilities that A was or would have been liable to B or that A was or would have been liable for the amount of the settlement.*
>
> *(2) For C to be liable to A in respect of the settlement, A must show that the specified eventuality (in the case of an indemnity given by C to A) or the breach of contract (in the case of a breach of contract between C and A) has caused the loss incurred in satisfying the settlement in the manner set out in the indemnity or as required for causation of damages and that the loss was within the loss covered by the indemnity or the damages were not too remote.*
>
> *(3) Unless the claim is of sufficient strength reasonably to justify a settlement and the amount paid in settlement is reasonable having regard to the strength of the claim, it cannot be shown that the loss has been caused by the relevant eventuality or breach of contract. In assessing the strength of the claim, unless the claim is so weak that no reasonable party would take it sufficiently seriously to negotiate any settlement involving payment, it cannot be said that the loss attributable to a reasonable settlement was not caused by the eventuality or the breach.*
>
> *(4) In general if, when a party is in breach of contract, a claim by a third party is in the reasonable contemplation of the parties as a probable result of the breach, then it will generally also be in the reasonable contemplation of the parties that there might be a reasonable settlement of any such claim by the other party.*
>
> *(5) The test of whether the amount paid in settlement was reasonable is whether the settlement was, in all the circumstances, within the range of settlements which reasonable people in the position of the settling party might have made. Such circumstances will generally include:*

(a) The strength of the claim;

(b) Whether the settlement was the result of legal advice;

(c) The uncertainties and expenses of litigation;

(d) The benefits of settling the case rather than disputing it.

(6) The question of whether a settlement was reasonable is to be assessed at the date of the settlement when necessarily the issues between A and B remained unresolved."

Contract

Somewhat different is the situation where a claimant is seeking to recover for a liability owed to a third party which has **not** yet been established by a court or tribunal, or been the subject of any settlement.

It is relatively uncommon for C to bring a claim against D seeking to recover for liability to T in circumstances where that liability has not yet been the subject of any claim, judgment / award or settlement. Usually C will have little incentive to bring such a claim, and will prefer to have the amount of its liability established rather than risk bringing a claim and hoping what is recovered is sufficient in circumstances where C has no detailed information about T's losses. Nonetheless, this scenario does arise on occasion, usually where C's liabilities to T are clear:

- A contractor may finish work late, causing an employer to levy liquidated damages by set-off or by calling on a performance bond. Or it may simply be clear that the liquidated damages will be levied eventually, even if the employer has not yet done so. In such circumstances the contractor may pursue a claim against the subcontractor it blames for the delay, in circumstances where the liability to pay liquidated damages is not yet established by any judgment or award, and where the contractor is, in fact (as against the employer) disputing that liability. The contractor must prove that some breach by the subcontractor caused the delay in question. Often the subcontract will itself feature a liquidated damage clause, and that will define the subcontractor's liability. But, if not, then the subcontractor's liability will include the contractor's liability to the employer. That liability will not have been established by an award / judgment, but there can be little dispute as to the amount.

- A similar situation is where C is claiming that some breach by D has prevented C redeeming a loan, causing C to be liable to T for interest it would otherwise have avoided. T may not yet have taken any enforcement steps but, again, the liability will be straightforward to calculate.

- Another situation where this arises is where T is a related party. D's breach may have placed C in breach of a duty owed to (say) another party in a company group. D will have access to detailed information about T's loss, and T's cooperation in proving it.

When C's liability to T is less certain, it will rarely be in C's interest to make a 'stand alone' claim against D, save perhaps where it is necessary to do so to avoid a limitation period. The time period for a contractor's claim against a subcontractors will often begin to run before the employer's claim, because the subcontractor's liability will run from when its part of the work was completed, whereas the contractor's liability will tend to run from practical completion of the overall project, or by reference to the end of a contractual defects liability period.

So-called 'no loss' cases

In *The Albazero* [1977] AC 744 C chartered D's vessel. A cargo of crude oil was loaded on the vessel and D issued C a bill of lading. The vessel and its cargo were lost. C brought a claim against D seeking damages for the loss of the cargo.

Just before the loss, C had passed the bill of lading, and thus property in the cargo, to T. The cargo had ceased to be at C's risk, and C owed T no liability in respect of it. The bill of lading had incorporated the terms of the charterparty so (assuming the loss of the cargo was a breach of the charterparty) T had the right to bring a claim directly against D for the loss. This right was, however, subject to a one year limitation period under the Hague Rules and T had failed to bring its claim within that period. The issue was whether C could claim for T's loss, notwithstanding that C owed T no liability. Duplication of proceedings is not an issue in these cases, because C owes no liability to T, and so there is no prospect of a claim by T against D and C is not seeking to 'pass on' a liability.

An older case called *Dunlop* v *Lambert* had provided that, where C enters into a contract of carriage with D, in circumstances where title in the goods is entitled to pass before delivery, and C passes title to T, C can claim for T's loss. The House of Lords identified that principle remained good law, with the rationale being that T's loss would otherwise vanish into a 'black hole' – C, having suffered no loss, would have no claim and T, having suffered loss would have no claim. This rationale did not apply in *The Albazero*, however, because T had a claim against D (albeit it had become time-barred).

These same principles were held to apply to construction cases in the conjoined appeals in *Linden Gardens Trust Ltd* v *Lenesta Sludge Disposals Ltd and St Martin's Property Corporation Ltd* v *Sir Robert McAlpine Ltd* [1993] UKHL 4. C, the lessee or a building, retained D to remove asbestos. The contract provided contained a prohibition on assignment. C purported to assign the lease and purported to assign the benefit of the contract to T. Further asbestos was discovered and the issue arose as to whether T could claim against D. The prohibition on assignment was held to be effective and so T had no claim.

The other case decided in the same appeal was similar. C retained D to carry out work to property. The contract contained a prohibition on assignment. C transferred the property to T. Defects were discovered, with respect to which C owed T no liability, and the question arose of whether C could claim against D for T's costs of remedying the defects. The House of Lords held that C could claim for T's loss, based on the *Dunlop* v *Lambert* / *Albazero* principle. The parties knew the development very likely to be occupied or purchased by third parties, and any costs of remedying the defective works would fall on the subsequent owner rather than the original developer. Because of the specific contractual provision that rights of action were not assignable without the defendants' consent, the parties could properly be treated as having entered into the contract on the basis that C would be entitled to enforce against D contractual duties on behalf of T.

The apex of the no 'loss cases' is arguably *Darlington Borough Council* v *Wiltshier Northern Ltd* [1994] EWCA Civ 6. Darlington wished to build a sports centre on land it owned. The straightforward thing would have been for Darlington to enter into a building contract with a construction company, and raise the finance to pay for the work by borrowing. As a local authority, however, Darlington was subject to restrictions on its ability to borrow. To evade these, Darlington entered into a finance agreement with Morgan Grenfell, whereby Morgan Grenfell was to retain the contractor to procure the work and Darlington was to reimburse Morgan Grenfell the cost, but Morgan Grenfell was to have no liability to Darlington for any defect. The work proved defective. Morgan Grenfell assigned its rights against to the contractor to Darlington. Darlington, standing in Morgan Grenfell's shoes, sought to recover the cost of rectifying the defects but Morgan Grenfell had suffered no loss by reason of the contractor's breaches,

and owed no liability to Darlington. Unlike in the *Albazero, Linden Gardens* and *St Martins* cases, there had been no transfer of the property and none had been in contemplation. Nonetheless Morgan Grenfell was held to be entitled to claim Darlington's loss.

Alfred McAlpine Construction Ltd v *Panatown Ltd (No.1) [2001] AC 518* concerned a similar situation to St Martins, where the employer under a construction contact had sold the development, owed no liability itself to the buyer, and had sought to claim for the buyer's costs of remedying defects in the work. The difference in that case was that the buyer in fact had the benefit of a collateral warranty provided by the contractor, so had its own claim directly against the contractor. As in *The Albazero*, therefore, the rationale for permitting the employer to claim for the transferee's loss was absent and the employer could not do so. One can see that, in these 'no loss' cases, fidelity to contracts and the overall contractual structure put in place by the parties, tends to take precedence.

Lessons

What lessons emerge from all this? Some commonly heard advice is to aim to make one's contracts 'back-to-back', so that if your supplier / subcontractor lets you down and you incur liability to your customer as result, you can be confident of being entitled to recover 100% of that liability from the suppler, subject to their being solvent. Realistically, achieving truly back-to-back contracts is rare and, in truth, it will rarely be in one's commercial interest. A truly back-to-back transaction is pure arbitrage – buy low, sell the same thing for a bit more but add no value and take no risk. Such opportunities are rare, the mark-up tends to be modest and such contracts are unsustainable because, eventually, the buyer and supplier will find one another, and bypass the intermediary. Most commercial endeavours therefore involve doing at least some work oneself, adding some value, and so taking on some risk and responsibility which cannot be passed down the chain.

Any transaction, of course, involves some element of competing interest. Everyone is looking to 'buy low' (pay as little as possible for as much as possible) and 'sell high' (be paid as much as possible for as little as possible), so that one is always looking to minimise one's potential liability to one's customer and maximise one's supplier / subcontractor's potential liability arising out of any potential breach.

The better advice might be not to aim for the overly conservative paradigm of back-to-back contracts, but to try to be alert to exactly how great is the difference between one's 'up-chain' exposure and 'down-chain' cover and to have clearly in mind what will happen if things do not work-out as planned, and what one's exposure might be and to price accordingly. Just as people who buy lottery tickets spend a lot more time thinking about what they will do with their winnings than contemplating the alternative, there is a human tendency to focus on the upside of transactions and this, arguably, lies behind many contracts which, with the benefit hindsight, appear singularly imprudent.

Broadly speaking, contractual chains tend to get more complex, and the promised performance becomes less readily 'substitutable' as the chain progresses towards the end purchaser (for example, raw materials - bulk materials - standardised components – bespoke components – a particular package of work and materials supplied by a subcontractor – an overall project to delivered by a contractor). The closer to the end of the chain, the more thought requires to be given, at the time of contracting, to one's potential liabilities and whether, and if so how, these might best be passed on.

At the level where substitute performance is readily available, the risks are lower than where one is seeking to procure, or offering to supply, some bespoke component or piece of work which is critical to your delivery of a wider project.

This is not a universal rule, however and it is useful to be alert to a distinction, in that regard, between risks of **delayed** and **defective** performance. Usually, if someone fails to deliver some generic material or standard component or simple / non-specialist work on time, you can obtain a substitute in the market relatively quickly. The impact in terms of delaying whatever performance you have yourself promised 'up the chain' will be modest. The exposure tends to increase considerably when the component is more complex. When some bespoke, highly specialised, critical work or component which you are responsible for procuring is delivered late, or lost in shipping, the impact can be vast because the likelihood of its being on or near the critical path, and because the time required to source a replacement will be greater.

The position differs where the shortfall in performance is that work / goods are defective rather than late. Substantial (and hard to predict) liabilities can arise if even simple components or simple work is defective in a way that tends not to happen when the same components or work are merely late, or not provided at all. The *Siemens* v *Supershield* case referenced above illustrates this. D had to install a ball float valve and lever (as in a toilet cistern) so that water in a tank connected to a sprinkler system would refill when the water level dropped. The nut and bolt connection between the valve and the lever failed post-installation and the bolt fell out, because it had not been screwed in tightly enough, causing the valve to remain open and causing extensive flooding and damage because of the failure of other safety measures (defective drains and alarm system), exposing the installer to a very substantial liability.

It is worth having clearly in mind this delay/defect distinction when considering prospective contracts, one's exposure and one's remedies. A contract which provides for a mix of simple / generic / substitutable performance and bespoke performance, but imposes just one catch-all limit on liability whether for delay or defects may be less competitive than a contract which separates out delay and defect breaches and makes separate provision for the consequences of each. Failing to do this can, in effect, mean that one is 'overinsuring' against some higher probability / lower impact risks (simple / substitutable performance being late) while 'underinsuring' against lower probability / higher impact risks (simple / substitutable performance performed defectively causing disproportionate loss / damage). This is undesirable both from the 'supplier' and the 'purchaser' side of the transaction. 'Fine tuning' these provisions and pricing for the risks more precisely tends to result in a lower price for the purchaser, but also makes the supplier able to offer a lower price so to be more competitive.

Whatever level of risk / liability one's supplier / subcontractor is prepared to undertake there are, undoubtedly, some unrelated contractual steps which one can take, as a contractor, or an analogous party near the 'customer' end of a contractual chain, to make it easier to pass that liability down the line should the need arise. None of these is rocket science. One should ensure that one's upstream and downstream contracts are in the same language, use compatible terminology, and are subject to the same law. Ideally one should aim to have both contracts provide for the same jurisdiction, or both provide for arbitration with the same seat and under the same rules and consider making provision for joinder, so as to preserve the possibility of joining the supplier / subcontractor in the event that one faces a claim as a result of their non-performance. One should seek to ensure that the limitation periods are symmetrical, though this is often easier said than done and requires careful consideration. One should consider obtaining some form of collateral warranty for the customer's benefit, and ensure that time-bar and dispute resolution provisions are aligned with the main contract, giving the employer an option to 'cut out the middleman' and spare you the need to fight on two fronts.

After a contract has been entered into, there are three principal dangers for the party 'in the middle': **settlement**, **limitation** and **inconsistency**. The problems of settlement and limitation are both evident in *Lendlease* v *Aecom*. One should be wary, whenever settling an account with a supplier / subcontractor, always to have in mind the possibility of some undiscovered defect in their work and whether one is unwittingly giving up one's rights to claim for it (agreeing a settlement in respect of "*all breaches known and unknown*", or similar, is particularly dangerous

– though that was not the issue in *Lendlease*). Beyond that, one should have in mind whether the settlement is a reasonable one, and how one will go about justifying it in order to pass it up the chain.

As for limitation, one should check immediately when an issue arises what the limitation position as against the next party in the chain is, and take any protective steps which might be required to preserve one's position.

The problem of **inconsistency** is where one becomes involved in both upstream and downstream litigation or arbitration, and takes inconsistent stances. For example, bringing a claim against a subcontractor for delay or defects while disputing an employer's claim for liquidated damages and seeking extension of time, and taking inconsistent positions in the two proceedings as to the critical path, the causes of the delay and the extent of the defects. Examples of both settlement and inconsistency risk can be seen in *Fluor* v *Shanghai Zhenhua Heavy Industry Co, Ltd* [2018] EWHC 1 (TCC). A contractor had entered into a settlement agreement with a supplier in respect of the costs of testing for latent defects suspected to be present in structural components of offshore wind turbines. The contractor had unsuccessfully pursued an arbitration claim against the employer, seeking extension of time and additional payment including on the basis that testing measures which the employer had insisted upon were not reasonable / justified and that these had been the cause of the critical delay. The contractor failed in that claim, and then sought to recover from the subcontractor. The contractor faced the problem that, in the previous arbitration, it had been arguing that the delay had been caused by the testing regime but now, to avoid the conclusion that this had been settled, was forced to argue that this was not the cause. Witnesses were criticised for the inconsistent evidence they gave in the respective proceedings.

Ultimately, such lessons are easy to state and hard to apply. If the allegory of the pencil and cases like *Lendlease* v *Aecom* and *Fluor* v *Zenhua* teach us anything it is that complexity is everywhere, and one cannot foresee every possibility.