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Don't let assignment get the better of you

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Introduction

In the recent case of *Energy Works (Hull) Ltd* v *MW High Tech Projects UK Ltd* [2020] EWHC 2537, the Technology and Construction Court considered the effect of provisions which require contractors to assign subcontracts on termination. The court's decision is that the contractor in the case had no recourse to its subcontractor under their subcontract in respect of claims from the employer following termination and had only limited alternative recourse. Similar assignment provisions can be found in the JCT, NEC and FIDIC standard forms of contract, making the court's findings of broad application.

Background

In 2015 Energy Works (Hull) Ltd ("EWHL") appointed MW High Tech Projects UK Ltd ("MW") as its main contractor for the design, procurement, construction, commissioning and testing of a waste to energy plant in the north of England. The parties entered into a contract based on the IChemE Red Book, with bespoke amendments (the "Main Contract").

In turn, MW subcontracted certain elements of the project to Outotec (USA) Inc ("Outotec") under a contract based on the IChemE Yellow Book (the "Subcontract"). The subcontractor provided a collateral warranty in favour of the employer, which entitled the employer to step in to the Subcontract if the Main Contract was terminated. In addition, both contracts entitled the employer to require that the sub-contract was assigned to it if the Main Contract was terminated.

The project ran into difficulty, suffering significant delays, and EWHL purported to terminate the Main Contact due to MW's delay in completing its works, including outstanding defects, with the result that delay damages exceeded the contractual cap.

MW disputed EWHL's entitlement to terminate for contractor default on the ground that it was entitled to an extension of time to the date of completion of its works for events which were the responsibility of the employer. MW accepted that there was an effective termination by EWHL but asserted that it took effect as a termination for convenience under the Main Contract. As it was not disputed that termination of the Main Contract had taken place in some respect, MW duly assigned the Subcontract to EWHL.

EWHL duly commenced proceedings against MW, claiming damages of £133 million in respect of the costs of remedying defects, delay damages and the cost of engaging a third party to complete the works. MW disputed the claim and counterclaimed for £46 million for payment due upon termination for convenience.

MW also sought to pass on any liability it might have had in respect of EWHL's claims to its subcontractor, Outotec. MW claimed liquidated damages under the Subcontract and under the indemnity in respect of MW's liability to EWHL for defects in the plant for which Outotec was responsible.

The problem with MW's claim against Outotec, of course, was that MW had already assigned the Subcontract to EWHL. Outotec argued this meant that MW had therefore lost its right to make any claim under that contract.

The dispute was brought before Mrs Justice O'Farrell in the Technology and Construction Court as a preliminary issue, namely whether MW could still pursue any claim against Outotec under the Subcontract or otherwise.

MW's primary case was that the assignment of the Subcontract to EWHL only assigned the future right to performance and did not assign any accrued rights under the Sub-Contract. Accordingly, MW was entitled to pursue its claims against Outotec on the basis of those direct accrued contractual rights which existed prior to the assignment.

MW's alternative contractual argument was that if accrued rights under the Subcontract had been assigned, the assignment also transferred all past and future liabilities and obligations under the Subcontract and took effect as a novation.

Finally, MW argued that if they could not recover against Outotec under the Subcontract, Outotec would be liable to make a contribution to the damages claimed by EWHL under the Civil Liability (Contribution) Act 1978.

The principles of assignment

The judge reviewed the leading authority of *Linden Gardens Trust Ltd* v *Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, in which the House of Lords set out the relevant principles on assignment and novation. O'Farrell J summarised those principles as follows:

(i) Subject to any express contractual restrictions, a party to a contract can assign the benefit of a contract, but not the burden, without the consent of the other party to the contract.

(ii) In the absence of any clear contrary intention, reference to assignment of the contract by the parties is understood to mean assignment of the benefit, that is, accrued and future rights.

(iii) It is possible to assign future rights under a contract without the accrued rights but clear words are needed to give effect to such intention.

These principles were applicable to the relevant clauses in the parties' contracts.

Clause 44.3(d) of the Main Contract provided that upon termination for contractor default:

> "*the Contractor shall, if so required by the Purchaser and to the extent permitted by the subcontract, assign any subcontract to the Purchaser*".

Clause 9.1(b) of the Sub-Contract did permit MW to assign the Sub-Contract, as follows:

> "*if so required by the Purchaser under the Main Contract the Contractor may assign the Subcontract to the Purchaser*."

The judge held that the starting point was to consider the words used by the parties. A natural and ordinary reading of these provisions led to the conclusion that the agreement to "*assign the Sub-Contract*" was an agreement to assign all MW's benefits under the Subcontract to EWHL, both future rights and accrued rights. This is what parties usually mean when they refer to assigning a contract.

There was no indication in the contemporaneous documents under which the assignment was made to indicate that the parties believed assignment to mean something different. Neither was the judge impressed by MW's

argument that it would be uncommercial for it to have freely given up all its accrued contractual rights against its subcontractor in this way. It was not for the court to re-write the parties' bargain if the meaning of the words used in their contracts was unambiguous.

In any event, the judge found that the commercial purpose of assignment of the Subcontract was to allow EWHL to enforce those subcontract rights against Outotec to mitigate its losses by seeking rectification of the works, specific performance of particular obligations, or compensation. Giving the words in the assignment provisions their natural and ordinary meaning achieved that commercial purpose.

Novation had not occurred

MW's secondary argument was that the Subcontract had been novated to EWHL. Novation occurs when the original contract between A and B is extinguished and replaced by the creation of a new contract between A and C. If novation had occurred, MW's obligations under the Subcontract, both future and accrued, would have transferred to EWHL.

The judge, however, quickly dismissed this argument. Assignment and novation were different legal concepts with markedly different requirements. Novation required the consent of all parties to the original and new contract. Further, although such consent can be given in the original contract, clear words are needed to express this intention, and the terms of the new contract must be sufficiently certain to be enforceable.

There was nothing in the parties' contracts to suggest that they had consented to a novation. The Main Contract, Subcontract and contemporaneous correspondence all used words along the lines of 'assign the subcontract', which was a very strong indication that assignment was intended, not novation. Again, the court would be slow to deviate from the ordinary and natural meaning of the words used by the parties.

EWHL had a separate right to agree a new subcontract with Outotec, by virtue of the step-in provisions in its collateral warranty. It was significant that the parties began negotiations concerning step-in, but were unable to reach agreement. In those circumstances, "*the court would be riding roughshod over the freedom of the parties to negotiate their own terms if it imposed on them the original sub-contract conditions by novation*".

Limited recovery by contribution

These conclusions meant that MW had given up its right to seek any direct remedy from Outotec under the Subcontract. Those rights had been validly assigned to EWHL. MW's final argument was that it could claim against Outotec under the Civil Liability (Contribution) Act 1978 (the "1978 Act"). Section 1 of the 1978 Act provides:

> "… *any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise)*."

Claims for contribution may be made under the 1978 Act where two parties are liable for the "same damage" suffered by a third party. The third party is able to claim in full against either of the other parties, who will then be entitled to "contribution" from the other on a just and equitable basis having regard to the extent of each party's responsibility for the damage. Contribution claims are often bought in construction disputes between designers and contractors in relation to allegations of defective work caused both by design and workmanship issues.

Outotec resisted MW's claim for contribution on the basis that any damage caused by breaches of its Subcontract were suffered at the subcontract level and were distinct from the damage suffered by EWHL under the Main Contract. MW claimed that defects in Outotec's work under the Subcontract were the cause of delay under the main contract for which EWHL had terminated and were accordingly for the "same damage" as that suffered under the main contract.

The judge considered the three heads of loss claimed by EWHL against MW and concluded that MW could make a limited contribution claim against Outotec. The heads of loss which constituted the same damage were liquidated damages for delay and damages for defective work.

In respect of liquidated damages for delay, even though the calculation of those damages may be different under the Main Contract and Subcontract, the damage for which MW was potentially liable to EWHL for was "the same damage" for which Outotec was potentially liable.

Similarly, MW and Outotec had a common contractual liability to EWHL for defective work for the plant. Although the claims arose at different contractual tiers, they related to the same damage or harm i.e. a defective plant. MW could therefore also claim contribution from Outotec in respect of such defects.

However, in relation to the likely very substantial termination losses (i.e. the additional costs of completing the work and associated losses), the court could not identify any provisions under either the Subcontract or the collateral warranty which could form the basis of a claim by EWHL against Outotec in respect of these losses. Outotec had no obligation to satisfy MW's time obligations under the Main Contract and there was therefore no route by which EWHL as assignee of the Subcontract could claim the additional costs of completion from Outotec. Accordingly, MW could not claim contribution from Outotec under the 1978 Act for this type of damage.

This meant that MW would only be able to claim limited contribution from Outotec under the 1978 Act. That recovery would be significantly less than MW would have been entitled to under the terms of the Subcontract.

Unintended consequences of assignment?

What is clear from the decision is that assignment provisions such as those considered in this case represent a significant exposure to main contractors in the event of a termination for default. Further, this decision is likely to be of wide application given the similarity of the assignment provisions in many major standard form contracts used in the industry.

For example, the JCT Design & Build Contract, 2016 Edition, states, at clause 8.7.2.3, that the Contractor shall:

> "*if so required by the Employer within 14 days of termination, assign (so far as assignable and so far as he may lawfully be required to do so) to the Employer, without charge, the benefit of any agreement for the supply of materials or goods and/or for the execution of any work for the purposes of the Contract.*"

Similarly, the NEC4 ECC states at clause 92.2:

> "*The Client may instruct the Contractor to leave the Site, remove any Equipment, Plant and Materials from the Site and assign the benefit of any subcontract or other contract related to performance of the contract to the Client.*"

In contracts with these, or similar, provisions, it follows from the *Energy Works* decision that a contractor will lose its accrued and future rights under a subcontract if that subcontract is assigned to the employer on termination. Any claim by the contractor against the subcontractor will in such circumstances have to be made under the 1978 Act, which may only result in a limited recovery.

The position under the FIDIC forms is somewhat different. Rather than conferring an absolute right to instruct assignments, the contractor need only comply with "*reasonable instructions … given by the Employer … for the assignment of any subcontract*" (see, for example, Clause 15.2.3 of the Yellow Book, 2017 Edition).

It might be argued that under such wording that it is "*reasonable*" only to instruct the contractor to assign future rights under their subcontracts and not accrued rights. The contractor would argue that this best strikes a balance between the interests of the employer in securing future performance of subcontractors post-termination and the interests of the contractor in preserving rights against its subcontractors in respect of the employer's termination.

However, such wording would not necessarily lead to that outcome, as the employer could argue that it is reasonable to expect the additional protection which follows from both accrued and future rights under a subcontract being transferred to the employer. On the facts, EWHL was unable to agree step-in arrangements with Outotec, demonstrating precisely why such alternative routes to recovery are sometimes necessary.

As such, the better approach is for parties to amend assignment provisions in their contracts to make clear whether they intend that a contractor will transfer all its rights under a subcontract to the employer on termination, or instead only future rights, leaving accrued rights with the contractor.