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Insights

ASSIGNMENT OF SUB-CONTRACTS – BENEFIT AND BURDEN, RISK AND REWARD IN THE TCC

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SUMMARY

When a project goes so poorly that an employer feels obliged to terminate its main contractor, the employer will often take an assignment of various sub-contracts. But what exactly does it mean to "assign a sub-contract"?

Of course, the employer may also claim against the main contractor for delay damages, additional costs to complete and so on, and the main contractor may wish to pass down its liability to the sub-contractor(s) whom it blames for the problem. But can it do so?

These questions, and more, were addressed by O'Farrell J in the recent TCC case of **Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd**.

The facts

In 2015, EWHL engaged MW to design and build a fluidised bed gasification plant to produce energy from waste. MW in turn engaged Outotec to supply key equipment for the plant. The main contract had a completion date in April 2018, and provided for delay damages up to a cap at 273 days, at which point EWHL could terminate for default.

The project did not complete by the end of the period of the delay damages cap. EWHL terminated for MW's default. MW accepted the termination was effective, but disputed the grounds, saying that the delay was due to EWHL's failing to supply fuel for the plant, and so it took effect as a termination for convenience. EWHL required MW to assign the Outotec sub-contract to it, and MW did.

EWHL claimed damages against MW, estimated at around £133 million for delay damages, the costs of rectifying defects in the plant, and additional costs to complete. MW then sought to join

Outotec to the proceedings, and to pass to Outotec any liability it might have to EWHL, by way of a claim for delay damages and an indemnity in respect of liability for defects.

MW's main case was that the assignment of the sub-contract transferred only the **future** right to performance, and not any accrued rights under the sub-contract, and so MW could still sue Outotec on the basis of those accrued rights. MW's back-up case was that if the assignment did transfer all past and future rights to EWHL, then it also transferred all liabilities **and obligations** and operated as a novation.

Does "assign the sub-contract" mean a transfer of all the rights under the sub-contract, or just some of them?

I blogged before about a dispute over the validity and effectiveness of an assignment (in that case, of a performance bond). The difference with this case is that the parties agreed the assignment was valid, but disputed its scope and effect. Did it transfer all benefits, past and future? And if so, did it also transfer all obligations?

The contract terms, and MW's notice to Outotec, were in clear, but generic language. The main contract, on standard **IChemE Red Book** terms, allowed EWHL to require MW to "assign any sub-contract" to EWHL. The Outotec sub-contract, on amended **IChemE Yellow Book** terms, provided that if required, MW could "assign the sub-contract". MW's notice of assignment to Outotec simply said, "we hereby give you notice that we assign the sub-contract … to [EWHL]".

Such language, referring only to assignment of "the contract", seems vague and ambiguous. But as O'Farrell J noted, ever since the House of Lords judgment in **Linden Gardens Trust v Lenesta Sludge**, when we speak of assignment of a contract, we are understood (even presumed) to mean an assignment of the whole benefit, including accrued and future rights, unless there is a clearly expressed contrary intention. Here, there was no evidence of the parties having a different understanding of the words, or of seeking to divide the accrued and future rights as between MW and EWHL. As a result, the judge found the assignment was effective to transfer all accrued and future rights to EWHL.

MW argued that such an interpretation was implausible, because it meant that MW could be forced to give up its right to sue the party it saw as responsible for causing the vast losses as might arise from a termination for default. The judge saw this submission as going to the commercial purpose of the assignment. She reasoned that since EWHL had a separate right under the main contract to have another contractor complete the works, the purpose of the assignment was not to enable EWHL to take over the sub-contract works. Rather, the purpose must have been to allow EWHL to enforce the sub-contract rights against Outotec to mitigate its losses by seeking rectification of the works, specific performance of particular obligations, or compensation. That logically meant that MW had assumed the risk of not being able to do so.

The judge recognised some of the potential practical difficulties that could arise on assignment, including as to responsibility for payment applications, and the power to instruct additional works. But she thought they could be avoided by MW exercising its right to terminate the Outotec sub-contract, and in any case, such matters would not justify re-writing the agreements to change the allocation of risk.

Does "assign the sub-contract" mean a transfer of all the rights and liabilities, or just the rights?

MW's alternative argument was that if "assign the sub-contract" meant the whole sub-contract, then it should mean a transfer of both benefit and burden, and so in fact a novation. This would mean that EWHL had acquired not only the right to sue Outotec for breaches prior to the assignment, but also the obligation to pay Outotec for equipment supplied and to meet any damages claim.

O'Farrell J dealt with this robustly. She found that the word "assign" was a strong indication that the parties intended an assignment and not a novation, and there were no words elsewhere in the contractual documents indicating an intention to extinguish the sub-contract and replace it with a new sub-contract. While MW sought to rely on Outotec's advance consent to assignment as being consistent with the need for a novation to have the consent of all parties, this failed to convince for a number of reasons, including that the parties had agreed that any new sub-contract between EWHL and Outotec would be on the same terms but with revisions (that is, not the same at all). In those circumstances, said the judge, "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". Here, the parties had agreed to assignment, not novation, and MW had assigned the benefit, but not the burden, of the Outotec sub-contract.

From the point of view of contract drafting and interpretation, therefore, the key lesson is that (whether or not the parties know it) "assignment" of a contract has a recognised and established meaning in law, and once used, it creates a strong presumption as to the effect of the assignment.

So how can the main contractor pass down liability to a sub-contractor?

Where did this leave MW? It had parted with the rights accrued under the sub-contract, so could not make a direct claim against Outotec under the sub-contract for any losses suffered as a result of EWHL suing it for damages under the main contract.

So, the only way MW could pass down any liability to Outotec is by way of a claim for indemnity or contribution under the **Civil Liability (Contribution) Act 1978**. That is more difficult, because it requires MW to establish, in respect of each head of claim, whether the damage for which MW is potentially liable is "the same damage" for which Outotec is potentially liable to MW.

As to this, O'Farrell J held that the "same damage" test was passed in respect of at least part of each of the claims for delay caused by late delivery of or defects in the Outotec plant, and for

defects. So for those claims, MW and Outotec would have a common liability to EWHL, and MW's contribution claim could proceed.

But in respect of the (no doubt very large) claim for damages suffered as a result of termination, including the extra cost to complete, that test was not passed. There was no obvious contractual route by which EWHL could claim such costs from Outotec. Even if (on the assumed facts) Outotec caused all the delay which led to termination, that would establish only culpability and not liability. Accordingly, MW's contribution claim could not include such losses.

The lesson here is, once again, to be conscious at the contract drafting stage of the many ways in which a project can go wrong, what risks that will create, and which options are going to be available at that point. If EWHL makes out its claim against MW, then even if MW can prove it was all Outotec's fault, it will still face a considerable shortfall in recovery. To avoid that shortfall would have required some very careful drafting, and even then may not have been commercially achievable at the outset. The risk of a liability which cannot be passed down the line may well just be the price of doing business.

This article first appeared on the Practical Law Construction blog dated 21 October 2020.

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