

GROWING PAINS IN CONSTRUCTION JOINT VENTURE AGREEMENTS

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IN A CASE WHICH HIGHLIGHTS SOME OF THE KNOTTY ISSUES THAT CAN ARISE BETWEEN PARTIES TO JOINT VENTURE AGREEMENTS IN A CONSTRUCTION CONTEXT, THE ENGLISH TECHNOLOGY AND CONSTRUCTION COURT HAS HELD THAT THE OPERATION OF A PAIN/GAIN MECHANISM IN AN NEC3 OPTION C (TARGET COST) FORM OF CONTRACT WAS ONLY TO BE APPLIED ONCE WORKS HAD COMPLETED, AND NOT ON AN INTERIM BASIS.

INTRODUCTION

In *Doosan Enpure Ltd v Interserve Construction Ltd*^[1], the English Technology and Construction Court (“TCC”) recently held that the operation of a pain/gain mechanism in an NEC3 Option C (target cost) form of contract was only to be applied once works had completed, and not on an interim basis. In its decision, the TCC determined that a claimant was entitled to declarations sought under a joint venture agreement, and the release of its share of the interim payments made into a joint venture account (the “JV Account”). The case highlights some of the knotty issues that can arise between parties to joint venture agreements in a construction context.

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THE PAIN/GAIN MECHANISM

Option C of the NEC3 suite of contracts includes provision for the sharing of risk and rewards between a contractor and an employer, often referred to as the “pain/gain” mechanism. The operation of this mechanism determines, on completion of a project, whether a contractor will share in any savings, or have to contribute to, the difference of any final costs. The purpose of the mechanism is to encourage efficiency and to ensure that, during the life of a project, a contractor’s interests are closely aligned with those of the employer.

BACKGROUND

The claim arose out of a joint venture agreement (the “JVA”) entered into in March 2016 for the purpose of carrying out upgrade works at the Horsley Water Treatment Works. Doosan and Interserve, as parties to the JVA, entered into an NEC3 Option C (target cost) form of contract with Northumbrian Water Limited (the “Construction Contract”). The JVA contained a mechanism allowing for Doosan’s and Interserve’s respective shares of the pain/gain calculation to be apportioned at completion of the works. However, a dispute arose between Doosan and Interserve concerning interim payments to be released from the JV Account.

Works had begun in March 2016, with Northumbrian Water making monthly interim payments into the JV Account. Up until October 2018 monthly payments out of the JV Account were made to both Doosan and Interserve in amounts equal to sums certified by the independent project managers in response to Doosan and Interserve’s respective Interim Cost Statements. However, in November 2018, Interserve contended that interim payments made out of the JV Account must be adjusted to reflect the likely share of the pain/gain mechanism following completion of the works. Interserve was concerned that pursuant to the pain/gain sharing mechanism in the JVA, Doosan’s projected failure to complete its part of the works within the defined cost would lead to a pain calculation at completion for which Doosan would be solely (or at least significantly) liable. As such, Interserve contended that further payments to Doosan should not be released from the JV Account.

Doosan commenced proceedings, arguing that interim payments could only be suspended with the unanimous agreement of the JV committee, and that by refusing to authorise the release of such payments, Interserve had acted in breach of the JVA. Doosan thus sought an order requiring Interserve to release £5 million to it from the JV Account, or alternatively, an order for the amount to be paid as a debt or by way of damages.

However, Interserve contended that the pain/gain mechanism in the Construction Contract applied not only on completion, but in relation to each interim payment. In support of this argument, Interserve submitted that there was nothing in the JVA which prevented the pain/gain share from being applied at an interim stage.

DECISION

As a starting point, and notwithstanding that the dispute concerned the terms of the JVA only, Mrs Justice Jefford considered the meaning of the Construction Contract, commenting that the relevant provisions were “convoluted”, but that their intention was nevertheless clear. In her view, under the Construction Contract the allocation of pain and gain should only occur *after* the completion of the works, and not on an interim basis. Contrary to Interserve’s argument, there was no indication in the Construction Contract of any mechanism by which the pain/gain share could be applied at any earlier stage.

The JVA reflected the pain/gain regime in the Construction Contract, and Mrs Justice Jefford considered that, again, that allocation was to be undertaken following completion and not before. She concluded that in her judgment the operative part of the relevant clause, on a natural reading, did not allow for a mechanism to adjust interim payments out of the JV Account to reflect the pain/gain mechanism. As such, as with the Construction Contract, the allocation of the parties’ respective shares of the pain/gain calculation could not be applied to interim payments out of the JV Account and Doosan was entitled to payment based on the certified sums in its Interim Costs Statement.

The TCC therefore granted declarations that, by preventing the release of the interim payments, Interserve had acted in breach of the JVA. As such, Doosan was entitled to the release of over £5m from the JV Account.

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CONCLUSION

Whilst much of this judgment concerned the specific terms of the JVA, Mrs Justice Jefford's comments also provide useful guidance on the operation of the pain/gain mechanism in the NEC3 Option C (target cost) form of contract, confirming that the pain/gain mechanism does not operate until the completion of the project.

The decision highlights the importance for parties, when entering into construction joint ventures, to ensure that they are clear about the apportionment of any interim payments between them. This is especially important for contracts which operate the pain/gain mechanism, where rewards or penalties may not be allocated until completion of the works.

In addition, this case demonstrates the need for JV agreements relating to construction projects to have clear unambiguous mechanisms for (1) determining payments out of funds controlled by the JV; and (2) for resolution of payment disputes where unanimity cannot be achieved at the JV committee level. In that way, parties should minimise the risk of such disputes causing lasting damage to relationships within the JV which may have to continue for many years after the resolution of a dispute.

[1] [2019] EWHC 2497 (TCC)

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