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What the Scottish Courts have told us about NEC contracts

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Fraserburgh Harbour Commissioners –v- McLaughlin & Harvey Ltd (2021)

- NEC3 contract for deepening the North Harbour at the Fraserburgh port.
- **Dispute resolution W2**
  - "(1) A dispute arising under or in connection with this contract is referred and decided by the Adjudicator. A Party may refer a dispute to the Adjudicator at any time."
- **Review by the tribunal W2.4**
  - "(1) A Party does not refer any dispute under or in connection with this contract to the tribunal unless it has first been decided by the Adjudicator in accordance with this contract.
  - (2) If, after the Adjudicator notifies his decision a Party is dissatisfied, that Party may notify the other Party of the matter which he disputes and state that he intends to refer it to the tribunal. The dispute may not be referred to the tribunal unless this notification is given within four weeks of the notification of the Adjudicator's decision.
  - (3) The tribunal settles the dispute referred to it…
  - "in the contract data the "tribunal" is defined as "arbitration".

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Fraserburgh Harbour Commissioners
–v- McLaughlin & Harvey Ltd – the facts
FHC raised a court action for damages in October 2020.
The parties subsequently went to adjudication and a decision was reached in early 2021.
MHL argued that the court action should be dismissed because when the action was raised there was no adjudication decision.
In any event, the tribunal is arbitration, not court.
The judge at first instance agreed with MHL and dismissed the action
FHC appealed
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Fraserburgh Harbour Commissioners
–v- McLaughlin & Harvey Ltd
– what the appeal court said
"The right of access to the courts is the most basic of principles."
"Whether the action is of any utility or purpose is not a matter which the court is required to determine at this stage."
The Court found that the initial judge was wrong to dismiss the action, so the action was re-instated and then put on hold to allow the parties to arbitrate.
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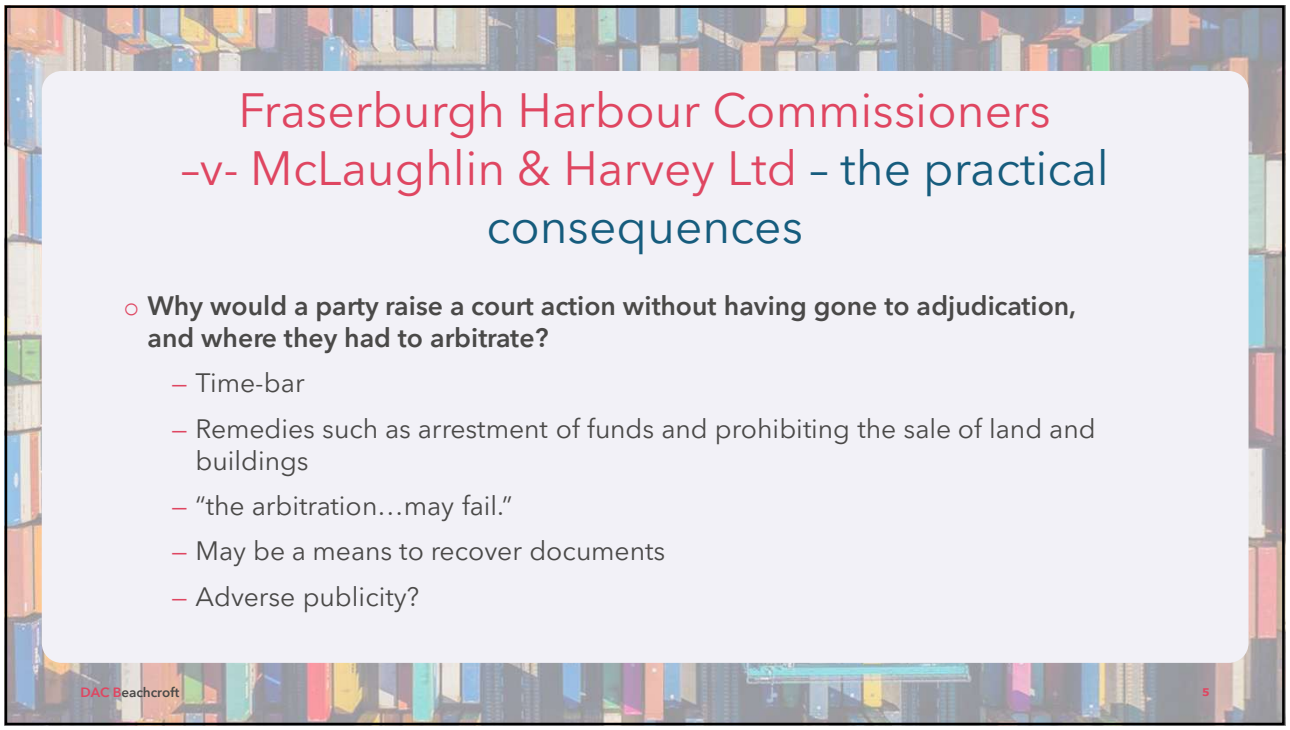
Fraserburgh Harbour Commissioners –v- McLaughlin & Harvey Ltd – the practical consequences
Why would a party raise a court action without having gone to adjudication, and where they had to arbitrate?
Time-bar
Remedies such as arrestment of funds and prohibiting the sale of land and buildings
"the arbitration…may fail."
May be a means to recover documents
Adverse publicity?
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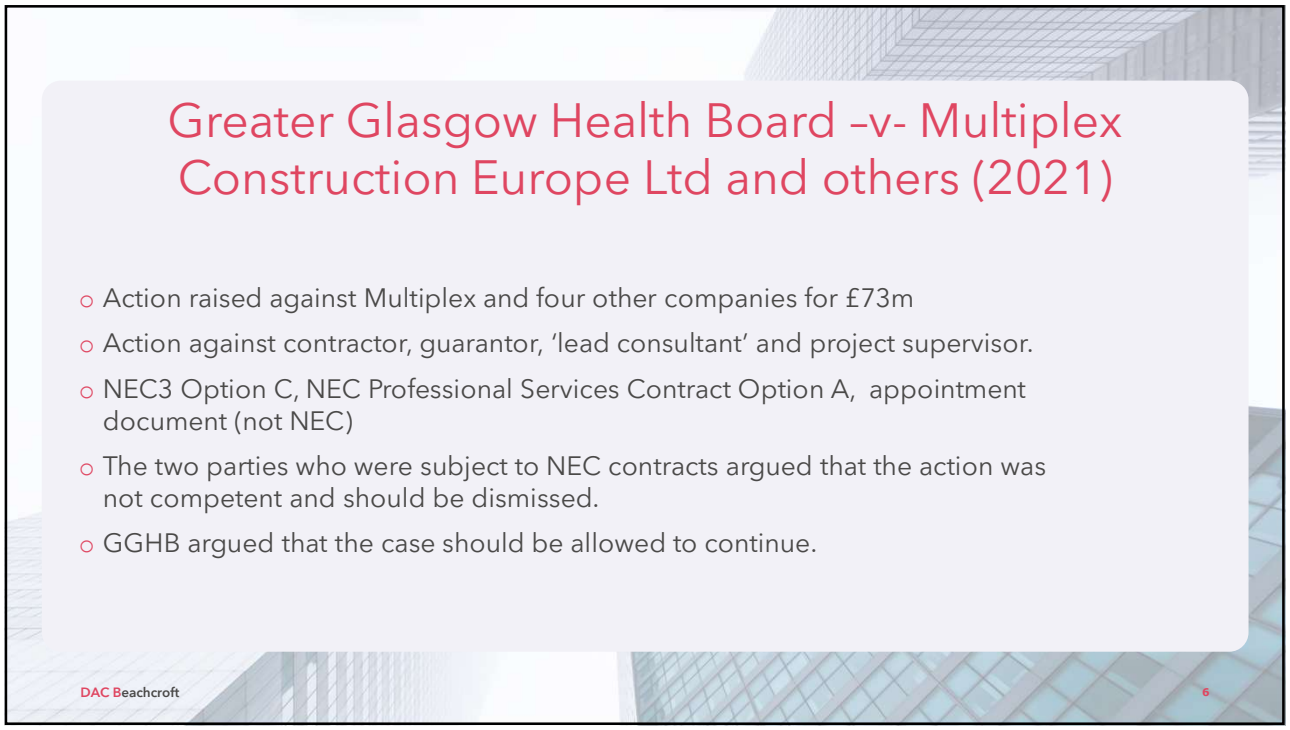
Greater Glasgow Health Board –v- Multiplex Construction Europe Ltd and others (2021)
Action raised against Multiplex and four other companies for £73m
Action against contractor, guarantor, 'lead consultant' and project supervisor.
NEC3 Option C, NEC Professional Services Contract Option A, appointment document (not NEC)
The two parties who were subject to NEC contracts argued that the action was not competent and should be dismissed.
GGHB argued that the case should be allowed to continue.
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Greater Glasgow Health Board –v- Multiplex Construction Europe Ltd and others – the arguments for GGHB

- The parties did not intend for adjudication to deal with a case of this complexity.
- Adjudication has its limitations:
  - Only one claim could be referred at any one time
  - Here, there could be 22 adjudications, and the decisions might be inconsistent
  - Adjudications can't deal with joint and several liability
  - "The parties should not be taken to have agreed such an obviously inappropriate means of dispute resolution."

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Greater Glasgow Health Board –v- Multiplex Construction Europe Ltd and others – what the appeal court decided

The contract terms were clear – adjudication was required where there was an NEC contract.

If the adjudications failed, the court (being the *tribunal*) could resolve the matter following a Notice of Dissatisfaction.

The action was not 'incompetent', however it would have to put on hold until the adjudication process had concluded (in line with the Fraserburgh Harbour case)

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Greater Glasgow Health Board –v- Multiplex Construction Europe Ltd and others – the practical consequences

A dispute must be referred to adjudication under the W2 procedure regardless of its scale and complexity.

There may be benefits to raising court proceedings in advance of any decision.

There may also be benefits in the parties waiving the requirement to adjudicate first – for example if there are joint wrongdoers and if the case is complex.

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Clause 10

NEC 3

- "10.1 The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation"

NEC 4

- 10.1 "The Parties, the Project Manager and the Supervisor shall act as stated in this contract.
- 10.2 "The Parties, the Project Manager and the Supervisor act in a spirit of mutual trust and cooperation."

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JCT 2024

Article 3 Collaborative working

- 'The Parties shall work with each other and with other project team members in a co-operative and collaborative manner, in good faith and in a spirit of trust and respect. To that end, each shall support collaborative behaviour and address behaviour which is not collaborative.'

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Northern Ireland Housing Executive –v- Healthy Buildings (Ireland) Ltd (2017)

- NEC 3 Professional Services Contract
- Instruction changed scope of works and Employer failed to notify as a CE.
- Consultant subsequently notified, and quotations were requested and given.
- Employer rejected quotations and assessed the effect as being zero.
- Quotations were issued after the actual work was done, but Consultant insisted the basis of the assessment was on forecasted cost.
- Issue before the Court:
  - "Is the assessment of the effect of a CE calculated by reference to the forecast Time Charge or the actual cost incurred by the Consultant?"

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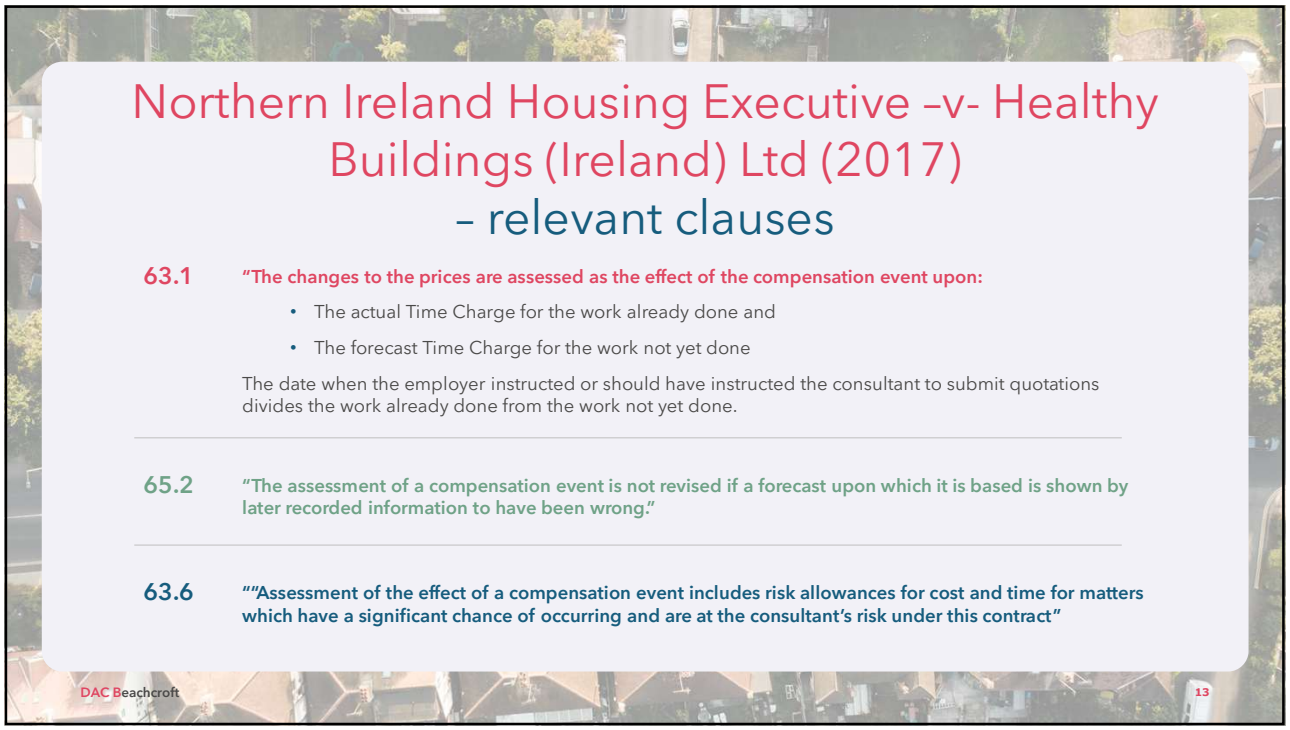
Northern Ireland Housing Executive –v- Healthy Buildings (Ireland) Ltd (2017)
– relevant clauses
63.1
"The changes to the prices are assessed as the effect of the compensation event upon:
• The actual Time Charge for the work already done and
• The forecast Time Charge for the work not yet done
The date when the employer instructed or should have instructed the consultant to submit quotations divides the work already done from the work not yet done.
65.2
"The assessment of a compensation event is not revised if a forecast upon which it is based is shown by later recorded information to have been wrong."
63.6
""Assessment of the effect of a compensation event includes risk allowances for cost and time for matters which have a significant chance of occurring and are at the consultant's risk under this contract"
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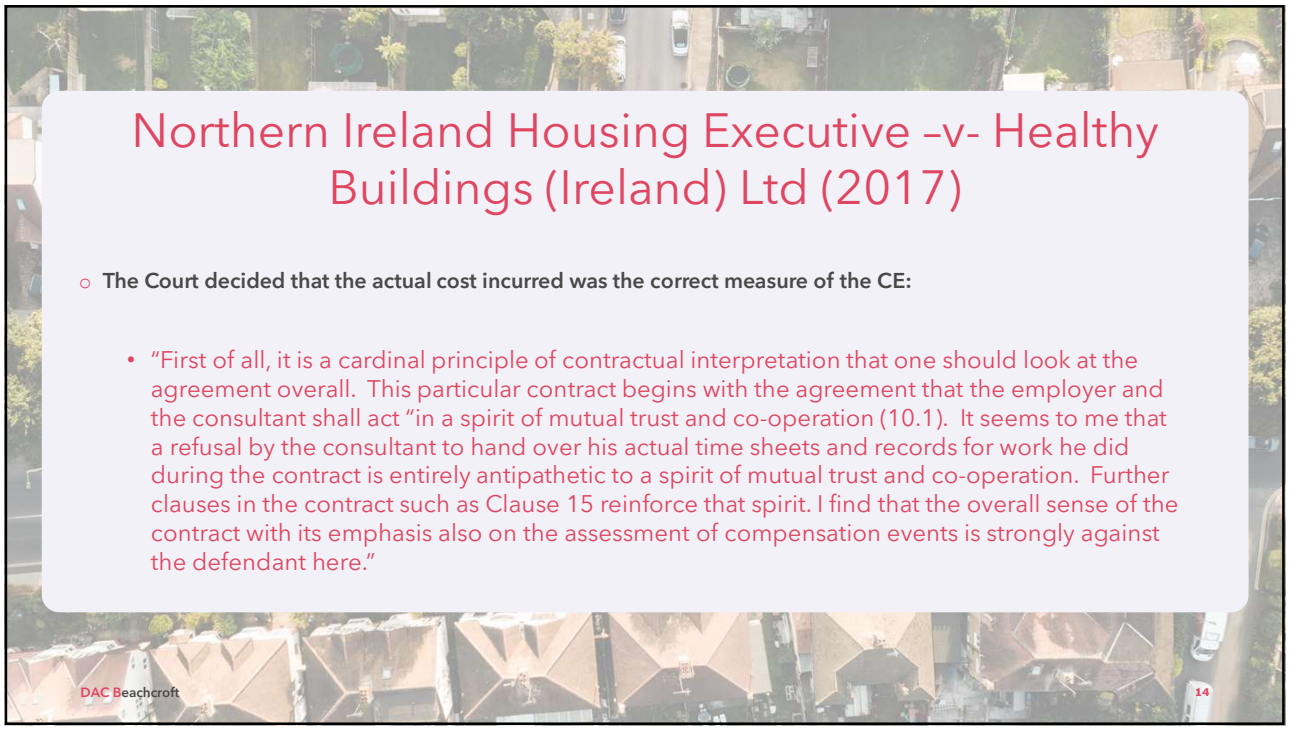
Northern Ireland Housing Executive –v- Healthy Buildings (Ireland) Ltd (2017)
The Court decided that the actual cost incurred was the correct measure of the CE:
• "First of all, it is a cardinal principle of contractual interpretation that one should look at the agreement overall. This particular contract begins with the agreement that the employer and the consultant shall act "in a spirit of mutual trust and co-operation (10.1). It seems to me that a refusal by the consultant to hand over his actual time sheets and records for work he did during the contract is entirely antipathetic to a spirit of mutual trust and co-operation. Further clauses in the contract such as Clause 15 reinforce that spirit. I find that the overall sense of the contract with its emphasis also on the assessment of compensation events is strongly against the defendant here."
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Van Oord UK Ltd –v- Dragados UK Ltd (2021)

- NEC3 subcontract Option B, with Z clauses, regarding a new harbour at Nigg Bay, Aberdeen.
- Dragados proposed transferring 1/3 of the dredging to two other companies.
- Dragados informed Van Oord that it would reduce the sum payable by way of a compensation event.
- The bill rate for dredging was £7.48 per cubic metre. Dragados proposed reducing it to £5.82 per cubic metre.
- In its tender, Van Oord included a blended dredging rate which averaged out the cost of easier and more difficult works. It proposed one rate on the basis that it would undertake all of the dredging work.
- Van Oord sought payment at the original bill rate.
- Was Van Oord entitled to do this?

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Van Oord UK Ltd –v- Dragados UK Ltd (2021) – the key clauses

Clause 11.2(31): "The Prices are the lump sums and the amounts obtained by multiplying the rates by the quantities for the items in the Bill of Quantities"

14.3 "The Contractor may give an instruction to the Subcontractor which changes the Subcontract Works Information or a Kay Date. The Contractor may, in the event that a corresponding instruction is issued by the Project Manager under clause 14.3 of the Main Contract only, also give an instruction to omit (a) any Provisional Sum and/or (b) any other work, even if it intended that such work will be executed by Others.

63.10

- "If the effect of a compensation event is to reduce the total Defined Cost and the event is a change to the Subcontract Works Information…the Prices are reduced."

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Van Oord UK Ltd –v- Dragados UK Ltd (2021) – the original Court decision

- Was the omission of work and giving that work to others a breach of contract?
- Yes
- Van Oord argued – "The defender's conduct in entering into the contracts with WASA and Canlemar, and then exploiting the compensation event procedure to reduce the rate payable was a breach of clause 10.1"
- The judge decided that:
  - The omission was a change to the Works Information and therefore the Prices
  - "Under clause 61.3, a change in the Prices is given effect by changes to the bill of quantities. The practical consequence is to reduce the rate payable for the work remaining to be done…"
  - "…a reduction in bill rates to give effect to a change in the Prices produced by the compensation event mechanism does not necessarily imply that the subcontractor is worse off."
  - "I do not consider that the pursuer's argument based on clause 10.1 adds anything to what has already been discussed."

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Van Oord UK Ltd –v- Dragados UK Ltd (2021) – the appeal Court decision

"The theme of unfairness underpins Van Oord's position. It contends that Dragados is seeking to manipulate the contract in its favour. Had Van Oord known that it would be left with a disproportionately higher share of the more difficult work, it would have increased the dredging bill rate in its tender. Van Oord claims that Dragados (a) insisted on a blended rate in the tender; (b) transferred more of the easier work to the other two companies and (c) did so to avoid having to pay standby charges"

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Van Oord UK Ltd –v- Dragados UK Ltd (2021) – the appeal Court decision

Did Dragados act in good faith?

18. Clause 10.1 provides a useful starting point. The commercial judge concluded that this term did not add much. He instead based his decision on the cluster of clauses that regulate compensation events. Mr Walker invited us to take the same approach.

19. We decline to do so. In our view clause 10.1 is not merely an avowal of aspiration. Instead it reflects and reinforces the general principle of good faith in contract: McBryde, *The Law of Contract in Scotland* 3rd edition paras 17-23 to 17-34.

20. In particular, clause 10.1 aligns with three specific propositions:
(i). A contracting party "will not in normal circumstances be entitled to take advantage of his own breach as against the other party": *Alghussein Establishment v Eton College [1988] 1 WLR 587* , 591D-E, per Lord Jauncey.
(ii). A subcontractor is not obliged to obey an instruction issued in breach of contract: *Thorn v The Mayor and Commonalty of London (1876) 1 App. Cas. 120* , per Lord Cairns (LC) at 127-128.
(iii). Clear language is required to place one contracting party completely at the mercy of the other: *Parkinson (Sir Lindsay) & Co. Ltd v Commissioners of His Majesty's Works and Public Buildings [1949] 2 KB 632, 662* per Asquith LJ.

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Van Oord UK Ltd –v- Dragados UK Ltd (2021) – the appeal Court decision

23. We conclude that clauses 10.1 and 63.10 are counterparts. Unless Dragados fulfils its duty to act "in a spirit of mutual trust and co-operation", it cannot seek a reduction in the Prices. Accordingly, Van Oord has pled a relevant case to go to proof. Evidence can be led to evaluate Dragados' conduct. Did it act in a spirit of mutual trust and co-operation? Or did it act in a contrary manner?

27. The commercial judge held that clause 63.10 governed the situation. He held that the sole remedy available to Van Oord was to have that change assessed in accordance with the compensation event pricing mechanism (clause 63.4).

28. Mr Walker urged us to accept that approach, which he amplified as follows. Recalculation arises because of Van Oord's pricing strategy and its failure to achieve its productivity rates. It would have made a loss if it had completed the omitted work. Payment at the original bill rate would result in it receiving a windfall benefit. The aim of the recalculation is to place both parties in the same position as they would have been in if the breach had not occurred. Neither would be better or worse off. So Dragados gains no advantage by this procedure.

29. We reject that argument. NEC3 states that all compensation events are *valued* in the same way (clause 63.1), but continues that if

> "the effect of a compensation event is to reduce the total Defined Cost, the Prices are not reduced except as stated in this subcontract" (clause 63.2).

We conclude that, properly construed, clause 63.10 applies only to a *lawful* change. It excludes instructions issued in breach of contract. They are invalid, because they are not given "in accordance with this subcontract" (see clauses 14.3 and 27.3). The natural synonym for "in accordance with" is "consistent with". A breach is plainly inconsistent with the contract.

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What conclusions can be made?

30. We add these points in support of our interpretation. First, it means that all breaches are treated equally. None produces a reduction in the Prices. Second, it avoids the suggestion that Van Oord was bound to obey a "breach instruction". That cannot be right. To take a fanciful example, it would have been under no obligation to build a hotel if Dragados had issued such an instruction. Third, the NEC3 should not be charter for contract breaking.

Clause 10 means something and will have consequences in limited situations:

- Prohibit knowingly lulling the other party into a false belief
- Prohibit knowingly providing false information
- Prohibit negotiating behind the other party's back
- Require the disclosure of material facts
- Taking advantage of its own breach of contract
- Correcting a false assumption

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What conclusions can be made?

- Does not require a party to give up its commercial interests
- Does not cut across the express terms of the contract
- Does not apply to every breach of contract
  - Distinction between 'innocent' breach and 'underhand' breach
- "…likely to prohibit conduct that reasonable and honest people would regard as commercially unacceptable…"

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Any Questions?

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