Talking Point: Construction and Engineering
(December 2015 – February 2016)
2015 Case Law for the Construction and Industry (Part One)

Now the dust has settled on 2015, we have taken a little time to digest some of the more important decisions relating to the construction industry from the past year. In this first instalment, we look at contract interpretation, good faith, and guidance on ground conditions, variations and set-off in the FIDIC forms (which rarely come before the courts because most FIDIC disputes are arbitrated).

1. A contract's plain meaning may override commercial good sense

The English Supreme Court in *Arnold v Britton* [2015] UKSC 36 delivered a significant judgment on interpreting contracts. Where contractual wording is clear, the courts are reluctant to depart from its plain meaning to invoke considerations of commercial good sense. This reinforces a recent trend, with the courts downplaying commercial common sense unless there is ambiguity or lack of clarity in the language used. Where an event occurs that was not intended or contemplated by the parties, judging from the contract language used, the courts will only give effect to the parties' intention when it is clear. This decision meant tenants had to pay a service charge much higher than they ever anticipated. Despite the harsh outcome, Lord Neuberger was clear that "there is no principle of interpretation which entitles a court to rewrite a contractual provision simply because the factor which the parties catered for does not seem to be developing in the way in which the parties may well have expected".

2. Implying terms into contracts: the old rules revived

Almost the same panel of Supreme Court judges as the one in *Arnold v Britton* clarified the law on when the courts can imply a term which the parties have not expressly included in their contract. In *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72, the Court unanimously endorsed the traditional approach that an implied term must either be so obvious as to go without saying (sometimes called the "officious bystander" test) or be necessary to give "business efficacy" to the contract (effectively, to make the contract work properly). The business efficacy test may also be expressed as a requirement that the implied term be necessary for the commercial or practical coherence of the contract. Lord Neuberger commented that a term should not be implied into a detailed commercial contract merely because it appears fair or because the court considers that the parties would have agreed it if it had been suggested to them.

A majority of the Court said that academics and judges had wrongly understood the decision in *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10 as meaning that a term may be implied just because it is reasonable to do so. In addition, the Court found that some comments in Belize were misleading, because they suggested that implying terms is part of the process of interpreting a contract (namely the exercise of asking whether a reasonable reader of the contract would, with the relevant background knowledge, understand the term to be implied). Only once the express terms of the contract have been construed can the subsequent process of implying terms (which is subject to stricter controls) begin. *Belize* should now be viewed as providing a helpful discussion, but not authoritative guidance, on the law of implied terms.

3. Good faith duties are still narrowly construed in English law…

The debate about the extent of a good faith duty in English law rumbled on in 2015, with the courts continuing to construe express good faith obligations narrowly. In the context of a general good faith obligation to be independent, impartial and fair in a long term PFI road maintenance contract, the judge in *Portsmouth City Council v Ensign Highways Ltd* [2015] EWHC 1969 (TCC) found the council was not subject to that duty when it came to its contractual obligation to assess the award of service points, which required the exercise of a discretion. Instead, the council was subject to an implied obligation to make the contract work, namely that it would exercise its discretion by not

acting in an arbitrary, irrational or capricious manner (a formulation frequently used to describe the behaviour of a party required to exercise a discretion) and also by acting honestly and on proper grounds. It seems that the good faith clause was used to import into the implied term these two extra, fact-specific duties. This meant the council could not simply award the maximum number of points for each contractor default (which it was accepted was being done to force Ensign to negotiate the original contract as the council could no longer afford it). (Note that as the hearing in this case took place before *Arnold v Britton* was decided, the court followed *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 by interpreting the contract using commercial common sense.)

4. …but possibly not when it comes to termination

However, the battle for a broader implied duty of good faith in contracts was evident in a shipping context in the Commercial Court case of *MSC Mediterranean Shipping Company SA v Cottonex Anstalt* [2015] EWHC 283 (Comm), which applied a test of good faith to an innocent party's decision whether to terminate or affirm a contract following a counterparty's repudiatory breach. The innocent party was not entitled to keep a contract alive indefinitely to claim ongoing liquidated damages for delayed performance following its counterparty's repudiatory breach.

Cottonex agreed to sell cotton to a customer in Bangladesh. MSC contracted to ship it to the customer. Under the contract, Cottonex had to return the containers to MSC within 14 days of discharge from the vessel, otherwise a daily late delivery tariff applied. The customer never collected the cotton due to a price collapse. The containers remained full of cotton in Bangladesh. MSC affirmed the contract following Cottonex's repudiatory breach of failing to return the containers and, after 14 days, sought to claim the tariff for each day it was without use of the containers. Cottonex refused to pay, arguing it no longer had title to the cotton and was therefore unable to empty and return the containers. The court held that MSC was entitled to be paid after the 14-day period had elapsed but only up to the point when Cottonex repudiated the contract.

The judge said that the established constraints on MSC's choice of whether to accept Cottonex's repudiation or affirm the contract could be seen in the wider context of the growing recognition of the need for good faith in contractual dealings. He did not see why the choice of whether to terminate or not in response to a repudiatory breach was different from the exercise of a contractual discretion. Both should be exercised in good faith. On the facts, MSC had not done this as it had no legitimate interest in keeping the contract in force once there was no realistic prospect of Cottonex returning the containers. In addition, MSC suffered no financial loss as a result of being deprived of the containers and affirmed the contract wholly unreasonably, namely to generate a new revenue stream by continuing to charge the daily tariff.

MSC has sought permission to appeal as other recent court decisions have taken the opposite view to the judge in this case. The debate about whether the right to choose between affirming or terminating a contract following repudiatory breach is more constrained than previously thought is likely to continue in 2016.

5. FIDIC contractors must carefully assess third party information on ground conditions and know the effect of the engineer's instructions

The FIDIC Yellow Book 1999 case concerning Gibraltar Airport we reported in early 2015 reached the Court of Appeal later in the year. Whilst the trial judge's finding remained (that a contractor may issue a notice of an event giving rise to a claim for an extension of time 28 days either from when it realises the event will lead to delay or when the delay starts to be incurred), the appeal was dismissed unanimously.

On ground conditions, the Court held that the Yellow Book requires the contractor at tender stage to assess the third party information supplied to it independently, using its own expertise and experience. It cannot simply accept the third party's interpretation of the data as all that was foreseeable. The Court was reluctant to dismiss the trial judge's findings of fact that the contractor had failed sufficiently to consider the contamination issues likely on an airport site formerly used for munitions storage. He had judged objectively whether the contractor had, as required by the contract, appropriately interpreted the site data in the tender documents.

The appeal also addressed whether the engineer's instructions amounted to variations. These instructions took the form of (i) certain guidelines sent to the

contractor after signing the contract and (ii) a withdrawal of the employer's offer to allow the contractor to stockpile contaminated material on a nearby site. The Court held that neither of the instructions was a variation, the first because the contractor never acted on the guidelines and the second because the employer had allowed the contractor to stockpile material only as a concession. Withdrawing a concession did not constitute a variation and the instruction required the contractor to follow its own waste disposal plan which was already set out in the contract.

The Court also held that the obligation to proceed with due expedition and without delay is not directed to every task on a contractor's to-do list but principally directed to activities which are or may become critical.

The Yellow Book obligations considered by the Court appear in the other FIDIC 1999 forms. The interpretation the Court gave to them may well affect how international construction contractors execute and price their works in future.

6. Employers under FIDIC should promptly notify set-offs against contractor entitlements

A month after the above decision, *NH International (Caribbean) Ltd v National Insurance Property Development Company Ltd (Trinidad and Tobago)* [2015] UKPC 37, an appeal on points of law from an arbitration award in respect of the construction of a hospital in Trinidad and Tobago, saw the pendulum for contractors under FIDIC contracts swing back, highlighting some potentially onerous obligations for employers.

Under clause 2.4 of the FIDIC Red Book 1999, an employer can be asked to provide reasonable evidence of its financial arrangements. When the employer in this case, a government department, provided insufficient detail following the contractor's request, the Privy Council held that the contractor was entitled to suspend performance and terminate. At the time of the request, the employer was actively obtaining formal confirmation of the project's funding, but had not told the contractor this approval was being sought. It merely gave assurances of the government's commitment to the project. Employers may now need to be prepared to provide evidence of funding to contractors before FIDIC contracts are signed.

Potentially more significantly, the Privy Council also held that the employer was able neither to raise by way of set-off or cross claims any claims which had not been notified "as soon as practicable" under clause 2.5 nor to raise such claims by way of an originating claim. The clause was clear in this effect, but did not preclude the employer from raising an abatement argument (for example, that the work was so poorly carried out that it did not justify any payment or was worth significantly less than the contractor was claiming). The Privy Council did not discuss in detail what "as soon as practicable" means, although it clearly envisaged a cut off at some point. This case warns employers promptly to notify contractors of an intention to set off within the contractual framework. Clause 2.5 in the Red Book also appears in the Yellow Book, although the wording in the Silver Book cross refers to clause 14.6, which assists employers.

Trio of Trophies at the African Legal Awards

Finally, towards the end of 2015, we celebrated success at the African Legal Awards, winning in the following three categories:

- Transportation and Infrastructure Team of the Year for work led from our Paris office advising the States of Niger and Benin on the 1850 km-long, $3 billion Cotonou-Niamey and Niamey-Burkina Faso sections of the West African rail loop project;
- Property and Construction Team of the Year for advising on the Maboneng District mixed-use developments in East Johannesburg; and
- Assistant/Associate Solicitor of the Year for Johannesburg associate Ghassan Sader who was singled out for his work on the acquisition of various mining and quarry rights in the Democratic Republic of the Congo and Algeria.

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