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Insights

GOOD FAITH, NEC CLAUSES 10.1 (AND 10.2) AND ASPIRATIONS

Nov 18, 2021

Here we go again. *Good faith* is a concept that some lawyers do not like but industry people don't seem to have a problem with, which is highlighted by the widespread use of the *NEC form of contract*. I first *blogged on good faith and NEC3* in 2014, looking at what clause 10.1 is for and *again in 2015*, looking at some other NEC3 cases and clause 10.1 and what was then the newly emerging concept of relational contracts.

I said watch this space and, if you did, you may have noticed the great excitement that followed a few years later in 2019 with the decision in *Bates v Post Office Ltd (No.3)*. Commenting on this case, Richard Benn and Rachel Dale *told parties* choosing to use express good faith obligations that they would be expected to conduct themselves in a manner likely to be regarded as "commercially acceptable".

This was good advice then and remains good advice now, as highlighted by the Inner House decision in *Van Oord Ltd v Dragados Ltd* where, as in other earlier cases, the court tried to explain the practical effect of *NEC3 clause 10.1* (*10.2 in NEC4*).

The story so far

Looking at other *cases* that considered NEC3 and clause 10.1, this is where we got to:

- In *Mears Ltd v Shoreline Housing Partnership Ltd*, it was held that the obligation to act in a spirit of mutual trust and co-operation could not prevent a party from relying on any express terms of the contract, but the judge used estoppel to get to the same result.
- In *Costain Ltd* v *Tarmac Holdings Ltd*, the judge recognised a good faith obligation could exist but was:

"*… uneasy about a more general obligation to act 'fairly'; that is a difficult obligation to police because it is so subjective.*"

- In *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd*, it was held clause 61.1 should be interpreted in line with clause 10.1.

- In *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd*, it was held that a refusal to provide records of actual cost went against the obligation in clause 10.1.

These decisions suggest that the obligation to act in a spirit of mutual trust and co-operation may be seen as re-enforcing and supporting other obligations but not as a way to get around express obligations.

The theme of unfairness

The facts in the *Van Oord* case were unusual. At tender stage, the sub-contractor used blended rates for dredging works, based on an average of the rates for easy and more difficult works. This was on the assumption that it would undertake all works so overall the average rate was suitable.

Soon after it started the works in May 2019, the contractor started omitting parts of the works and giving them to two other sub-contractors who were also involved in the project. The sub-contractor did not discover this for some time and in March 2020 the subcontract was terminated. The issue was how to value the omissions.

The contractor accepted the omissions were compensation events and sought to assess them, under clause 63.1, by looking at the effect on the Defined Cost. This meant a reduction of the original rate in the bill of quantities from £7.48 m^3 to £5.82 m^3 and then to £3.80m^3, a 49.2% reduction. The sub-contractor argued that this was unfair because the contractor had manipulated the contract in its favour, leaving the sub-contractor with a disproportionately higher share of the more difficult work.

In the *Outer House of the Court of Session*, it was held that the instructions to omit the works were a breach of contract, but that the instruction still had to be followed. This meant this was a breach of contract but also a compensation event, assessed like any other compensation event, in an objective and mechanical way looking at the effect on the Defined Cost. The judge did not think clause 10.1 added anything, because even if there was a breach then it would be assessed in the very same way and have the same result.

It is not surprising that on appeal it was noted that the theme of unfairness underpinned the sub-contractor's position.

What does clause 10.1 add?

On *appeal*, the argument that clause 10.1 added nothing was rejected. Lord Woolman held that clause 10.1 was not "merely an avowal of aspiration" but instead reflected and reinforced the general principle of good faith in contract (referring to *McBryde, The Law of Contract in Scotland, 3rd edition*). He then identified three specific propositions in that context:

- A contracting party "will not in normal circumstances be entitled to take advantage of [its] own breach as against the other party" (referring to *Alghussein Establishment v Eton College* [1988] 1 WLR 587).
- A subcontractor is not obliged to obey an instruction issued in breach of contract (referring to *Thorn v The Mayor and Commonalty of London* (1876) 1 App. Cas. 120).
- Clear language is required to place one contracting party completely at the mercy of the other (referring to *Parkinson (Sir Lindsay) & Co. Ltd v Commissioners of His Majesty's Works and Public Buildings* [1949] 2 KB 632, 662).

Particular emphasis was placed on the first proposition, which led to the conclusion that unless the contractor fulfilled its duty to act "in a spirit of mutual trust and co-operation", it could not seek a reduction in the Prices.

The interpretation of clause 63.10 and reducing the Prices

Lord Woolman began by rejecting the trial judge's conclusion that clause 63.10, which allowed a reduction to the Prices in the event of an instruction, applied in this case.

This was because in his view, as a matter of interpretation, clause 63.10 only applied to lawful changes. It did not apply to instructions issued in breach of contract, because such instructions are not given "in accordance with this subcontract" (as required under clauses 14.3 and 27.3) and are therefore invalid.

This was also because it meant all breaches are treated equally and none produces a reduction in the Prices. In addition, it avoids any suggestion that a contractor must comply with an invalid instruction. As he put it:

> *"NEC3 should not be charter for contract breaking*."

Conclusions

Some will say that this decision is limited to its facts and Scottish law. Others will point out that the three propositions relied upon (derived from English law), represent accepted principles so nothing is added by describing them as part of a good faith obligation. That may well be the case, but it is also clear that some judges do see the obligation to act in a spirit of mutual trust and co-operation, not as empty words, but as an obligation that has substance and plays a role in how other parts of the contract are interpreted. The fact that in this case, the breach of contract in fact resulted in a lower payment to the innocent party no doubt played a part in the court's thinking.

In *Bates v Post Office Ltd (No 3)* Mr Justice Fraser described good faith as an obligation that requires parties to refrain from conduct that in the relevant context would be regarded as

commercially unacceptable by reasonable and honest people. If parties are unwilling to accept such an obligation, then they need to consider whether the NEC form of contract is suitable for them.

This article first appeared on the Practical Law Construction blog dated 16 November 2021.

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