

Insights

SCOTTISH APPEAL COURT SAYS NEC IS NOT A CHARTER FOR CONTRACT BREAKING

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In the March 2021 edition of the NEC Users' Group Newsletter Issue No. 111 I covered the September 2020 decision by the Scottish Court of Session in *Van Oord UK v. Dragados UK* [2020] CSOH 87, which has now been appealed. The dispute centred on the ability of Aberdeen Harbour expansion main contractor Dragados to omit works to dredging subcontractor Van Oord, and how such omissions should be valued under an amended NEC3 Engineering and Construction Subcontract (ECS) option B (priced contract with bill of quantities).

The trial judge held in 2020 that the main contractor's omission of works and awarding them to other subcontractors was a breach of contract, but the subcontractor still had to comply with the instruction and the rates could be reduced if that was the effect of the omission. The judge also held that even if there was a breach of the clause 10 obligation to act, 'in a spirit of mutual trust and co-operation,' it would still result in the same reduction to rates.

The trial decision was appealed in October 2021 in *Van Oord UK v. Dragados UK* [2021] CSIH 50. The Scottish Inner House confirmed that the instruction was a breach of contract but reversed the other findings. The appeal court highlighted the importance of clause 10 and found rates cannot be reduced if a compensation event is based on a breach of contract.

Clause 10.1

The appeal court started by rejecting the trial judge's view that clause 10 did not add much. It observed that the obligation to act, 'in a spirit of mutual trust and co-operation,' is not merely an avowal of aspiration but also reflects and reinforces the general principle of good faith in a contract. The court identified three existing authorities for this:

- a contracting party will not in normal circumstances be entitled to take advantage of its own breach as against the other party
- a subcontractor is not obliged to obey an instruction issued in breach of contract
- clear language is required to place one contracting party completely at the mercy of the other.

It was recognised that ECS clause 68.10 allows the prices to be reduced. But the appeal court considered that clauses 10 and 63.10 are counterparts, so a party which does not act, 'in a spirit of mutual trust and co-operation' cannot seek a reduction in prices. It was therefore necessary to evaluate the contractor's conduct in instructing the omissions.

Instruction not in accordance with the contract

The appeal court noted each breach of contract was a compensation event under clause 60.1(18) and the parties agreed the effect of the omission was to reduce the defined cost. This was because at tender stage a 'blended' rate was used for dredging, which averaged out the cost of easier and more difficult works. The subcontractor argued the omissions took out the easier work, leaving a disproportionately higher share of the more difficult work. In this case, there was first a reduction of the original rate in the bill of quantities from £7.48/m³ to £5.82/ m³ and then a further reduction to £3.80/m³, reducing the rate by half.

The issue however was whether such reduction was possible under clause 63.10. Here the appeal court accepted that all compensation events are valued in the same way under clause 63.1. But this places a reliance on clause 63.2, which states 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'. The appeal court concluded that clause 63.10 applies only to a lawful change and does not apply where an instruction is issued in breach of contract. This is because such an instruction would not be given, 'in accordance with this subcontract,' as required under clauses 14.3 and 27.3, and would therefore be invalid.

The appeal court also noted that in addition to all breaches of contract being treated equally (as none produces a reduction in the prices), there is no obligation to obey an instruction given in breach of contract. 'NEC3 should not be charter for contract breaking,' it concluded.

Conclusions

Care needs to be taken when considering the omission of work, especially when the standard provisions are amended. The facts in this case were unusual in terms of the bespoke amendment and the way the omission affected the defined cost, but it is clear the appeal court was also influenced by these facts and the 'theme of unfairness' relied on by the subcontractor.

What is interesting is that the appeal court saw clause 10 as having a real function. It is not merely an avowal of aspiration, and it affects how other provisions operate – in this case the ability to reduce the prices under clause 63.10. Similarly, it is useful to have confirmation that the obligation to obey instructions is limited to valid instructions issued under the contract, and that a compensation event which is a breach of contract cannot result in a reduction of the prices.

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