

## Construction Law Update

### Challenging Disallowed Cost

Subtle differences in the interpretation of a contract can have a significant impact on the rights and obligations of the parties. In the recent case of *Network Rail Infrastructure Limited* (“Network Rail”) v *ABC Electrification Limited* (“ABC”), over £13million potentially turned on the correct meaning of the term “Disallowed Cost” and, more particularly, the meaning of the word “default”.

#### Background

ABC was engaged by Network Rail to carry out certain works on the West Coast Mainline. Under a contract incorporating the ICE Conditions of Contract, Target Cost version (First Edition) subject to a schedule of standard amendments (the “Contract”), ABC was entitled to payment based in part on the total cost it incurred in carrying out the works less any Disallowed Cost. Disallowed Cost was defined at clause 1(1)(j)(iii) of the Contract as:

*“any cost due to negligence or default on the part of the Contractor in his compliance with any of his obligations under the Contract and/or due to any negligence or default on the part of the Contractor’s employees, agents, sub-contractors or suppliers in their compliance with any of their respective obligations under the contracts with the Contractor.”*

In an interim assessment, the Employer’s Representative categorised over £13million as Disallowed Cost as they resulted from ABC’s breaches in failing to complete the works with due expedition, without delay and by the time for completion.

Network Rail commenced Part 8 proceedings seeking declarations as to the definition of Disallowed Cost. ABC argued that the word “default” in clause 1(1)(j)(iii) only included a “wilful and deliberate failure” by ABC to comply with its obligations under the contract.

#### The meaning of the language used

The court held that clause 1(1)(j)(iii) was clear and unambiguous and that the natural and ordinary meaning of the word “default” was a failure to fulfil a legal requirement or obligation. Very clear evidence from the remaining provisions of the contract, its factual matrix and commercial context was required to deviate from this. Although, “default” was used elsewhere in the contract, there was nothing to suggest that the parties intended its definition for the purposes of clause 1(1)(j)(iii) to be found much later in the Contract nor was the court persuaded that it should have carried a narrower meaning throughout the contract.

#### Commercial Context

Clause 1(1)(j)(iii) was an amendment to a standard form contract and potentially rendered other provisions redundant. However, the court held that this was insufficient for it to adopt an unnatural construction.

*“Before accepting an unusual interpretation restricted by the addition of words which would need to be read into the Contract, the court would need to be satisfied, not only that the parties had made a mistake in referring to ‘default’ without qualification, but also as to precisely what words they had intended to use”.*

#### Commercial Common Sense

The court held that this was not a case where it was faced with two conflicting interpretations in which it would be appropriate to adopt the interpretation most consistent with business common sense. The words of clause 1(1)(j)(iii) were clear and the court had to apply them as such. In any event, ABC’s interpretation was not consistent with commercial common sense. Accordingly, the court concluded that “default” meant any failure by ABC to comply with its obligations under the contract.

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### Granting Part 8 Declarations

In deciding whether to exercise its discretionary power to grant declarations, a court should consider the justice to the parties, whether the declaration would serve useful purpose and whether there are any other special reasons why it should or should not grant the declarations. The court held that the declaration would clearly serve a useful purpose as Network Rail would rely on it to deduct over £13million from payment and was unpersuaded that the declarations would negatively impact on other Network Rail contracts which contained the same provision. The court considered that, if anything, it would provide certainty in those contracts. Accordingly, it granted the declarations sought by Network Rail.

### Analysis

There have been a number of recent decisions concerning the interpretation of contracts including the Supreme Court decisions in *Arnold v Britton* and *Wood v Capita Insurance Services Ltd*, both of which the court referred to in this case. Words are to be given their ordinary and natural meaning and, if the words are clear the court had to apply them as such. Against this backdrop, ABC was always facing an uphill task to persuade the court that it should interpret 'default' as being restricted to 'wilful and deliberate' breaches of contract and the decision reiterates the difficulty a party will face in seeking to persuade the court to apply an unusual interpretation. Accordingly, parties should exercise particular care when drafting a contract to ensure that it properly reflects their intentions.

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