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Dispatch highlights some of the most important legal developments during the last month, relating to the building, engineering and energy sectors.

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Dispatch

Contract interpretation: disallowed cost

Network Rail Infrastructure Ltd v ABC Electrification Ltd
[2019] EWHC 1769 (TCC)

Network Rail sought a declaration as to the interpretation of a contract with ABC, an incorporated joint venture, relating to the West Coast Main Line. The contract incorporated the terms of the ICE Conditions of Contract, Target Cost version, 1st edn, subject to a schedule of standard amendments used by Network Rail known as NR12. ABC's entitlement to payment was based in part on the Total Cost ABC incurred in carrying out the works less any Disallowed Cost. Under clause 1(1)(x) of the contract, *"Total Cost means all cost (excluding Disallowed Cost and items covered by the Fee) incurred by the Contractor for the carrying out of the Works..."* Pursuant to clause 1(1)(j)(iii), Disallowed Cost means:

"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 their contracts with the Contractor."**

The words in bold were inserted into the ICE Conditions pursuant to the NR12 Amendments.

Network Rail sought a declaration, using the Part 8 Procedure, as to the meaning of Disallowed Cost in clause 1(1)(j)(iii) and in particular, the meaning of the word "default". Network Rail said that a "*default on the part of the Contractor in his compliance with any of his obligations under the Contract*" in clause 1(1)(j)(iii) included any failure by ABC to comply with its obligations under the Contract. This was said to be based on the plain and obvious meaning of the language used. The ordinary meaning of the word "default" was, or included, a failure to fulfil a legal requirement or obligation. Network Rail said that: "*on a proper construction of the Contract, any cost incurred due to ABC's failure to comply with its obligations under the Contract by ABC is a Disallowed Cost.*" In an interim assessment of sums due to ABC, the Employer's Representative included as Disallowed Cost sums incurred due to ABC's breaches in failing to complete the Works with due expedition, without delay and, by the time for completion. This Disallowed Cost amounted to over £13million.

ABC accepted that the ordinary and natural meaning of the word "default" was "a failure to fulfil an obligation". However, ABC said that it could not have been the parties' intention at the time of entering into the Contract that Network Rail should be allowed to deduct any cost incurred by ABC as a result of any failure to fulfil its contractual obligations. Instead, ABC said that (i) when viewed against the background of other relevant clauses in the Contract; (ii) when consideration was given to the overall purpose of the clause and of the Contract (specifically, in this case, a Target Cost Contract) and (iii) when regard was had to commercial common sense, it was plain that the word "default" was intended to carry a narrower meaning.

One difficulty for ABC was that its approach to precisely what this narrow meaning should be changed over time, with a new interpretation being advanced during the course of the hearing. The Judge said that ABC's various changes of position illustrated the difficulty it had encountered in identifying precisely how the word "default" should be narrowed so as to reflect what it said must be the objective intentions of the parties. This, in turn, tended to suggest that the other provisions of the Contract on which ABC relied do not provide a clear or obvious answer.

The Judge agreed with Network Rail. Disallowed Cost in clause 1(1)(j)(iii) included any cost due to any failure by ABC to comply with its obligations under the Contract. In arriving at this conclusion, Deputy Judge Smith QC accepted Network Rail's submissions that the word "default" carried its natural and ordinary meaning. The language of the clause 1(1)(j)(iii) was clear and unambiguous. The fact that the word 'default' was inserted by the NR12 Amendment gave rise to the presumption that the parties intended to add something to the existing clause. It was common ground that the natural and ordinary meaning of the word 'default' was a failure to fulfil a legal requirement or obligation. Any Judge would therefore need very clear evidence from the remaining provisions of the Contract, its factual matrix and commercial context to conclude that it means something different. Lord Neuberger had said in *Arnold v Britton* [2015] UKSC 36:

"The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language used...the clearer the natural meaning the more difficult it is to justify departing from it."

The meaning proposed by ABC, namely a "wilful and deliberate" failure to fulfil a legal requirement or obligation, was a meaning that would only usually be achieved by the addition of extra words. There were no additional words in clause 1(1)(j)(iii), or anywhere else in the Contract, to indicate that this was what the parties to the Contract really meant by the word "default". Further, the references to other contract provisions featuring the word "default" did not help. They were found in the heading, but not substance, of an unconnected termination provision and in any event the Contract said that headings were to be ignored for the purposes of construction.

Finally, the Judge rejected the suggestion that as a matter of commercial common sense and/or commercial reality, the word 'default' cannot have been intended to cover any failure by ABC to comply with its contractual obligations, no matter how small. The words here were clear. This was not a situation where there were two conflicting interpretations in an ambiguous clause. The intention of the parties was apparent from all of the terms of the contract, including the provisions of clause 1(1) as to the meaning of Disallowed Cost which, the Judge considered, made it plain that the contractor was intended to bear the risk of his own breach of contract. Disallowed Cost was deducted from the Total Cost before the Contractor's Share was calculated. Words used in a contract will be given their natural and ordinary meaning.

Bonds and Guarantees

Rubicon Vantage International Pte Ltd v Krisenergy Ltd

[2019] EWHC 2012 (Comm)

Rubicon chartered a Floating Storage & Offloading Facility to Kegot, a wholly owned subsidiary of Krisenergy. As part of the contractual arrangements, Krisenergy provided a guarantee. Rubicon sent a series of four invoices to Kegot, totalling some US$1.8m. No payments were made. On 3 September 2018 Rubicon made a demand on Krisenergy under the guarantee for the total sum outstanding. Proceedings were commenced and a second demand was made on 29 January 2019.

Rubicon said that the Guarantee was, at least in part, an on-demand instrument, that it had made compliant demands, and that Krisenergy was therefore liable to pay even though the underlying claims were in dispute and had not been adjudicated upon. Krisenergy said that it was only an on-demand instrument where liability had been admitted and that had not happened. Krisenergy further said that the demands did not comply with the terms of the Guarantee, so that no liability had arisen. The key terms were as follows:

"3. Any demand under this Guarantee shall be in writing and shall be accompanied by a sworn statement from the Chief Executive Officer or the Chief Financial Officer of the Contractor stating as follows: (a) that the amount(s) demanded are properly claimed and due and payable in accordance with the terms of the Contract; (b) the calculation of such sums together with any supporting documentation reasonably required to assess such demand; and (c) that the Company was duly notified of the amount(s) demanded in accordance with the terms of the Contract.

4. In circumstances where the amount(s) demanded under this Guarantee are not in dispute between the Company and the Contractor, the Guarantor shall be obliged to pay the amount(s) demanded within forty-eight (48) hours from receipt of the demand.

5. In the event of dispute(s) between the Company and the Contractor as to the Company's liability in respect of any amount(s) demanded under this Guarantee:
(a) the Guarantor shall be obliged to pay any amount(s) demanded up to a maximum amount of United States Dollars Three Million (US$3,000,000) on demand notwithstanding any dispute between the Company and the Contractor [...] until a final judgment or final non-appealable award is published or agreement is reached between Company and contractor as to the liability for the disputed amount(s)."

Deputy Judge Vineall QC referred to the CA case of *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* (see *Dispatch* Issue 164) where the court held that, where an instrument (i) related to an underlying transaction between the parties in different jurisdictions, (ii) is issued by a bank, (iii) contains an undertaking to pay "on demand" (with or without the words "first" or "written") and (iv) does not contain clauses excluding or limiting the defences available to a guarantor, there is a presumption that the instrument is a demand guarantee.

In the Judge's view, the correct approach was to begin simply by considering the words the parties chose to use to record their agreement, free from any presumption as to what meaning they were likely to have, or as towards a wide or narrow construction. Doing that, the meaning of clauses 4 and 5 was clear. Both were predicated on the assumption that there was a valid demand, i.e. a demand complying with clause 3.

By clause 4, if the amounts demanded were not in dispute as between Rubicon and Kegot, then Krisenergy must pay them within 48 hours of receipt of the demand. The operative wording used was "... where the amount(s) demanded are not in dispute". That must mean that the amounts demanded are not in dispute either as to liability to pay, or as to the quantum of what must be paid. So, if a there is a demand for US$3m, and Kegot does not dispute liability to pay US$2m of that sum, it must, under clause 4, pay US$2m, but it is not obliged, under clause 4, to pay the other US$1m.

Clause 5 was directed to what was left over from clause 4. It was engaged if and insofar as there was a dispute as to Kegot's liability to pay some part of the sums demanded. There was an important limitation which applied to clause 5 liabilities, namely that Krisenergy was only obliged to pay, under clause 5, up to a maximum of US$3m. Further, clause 5 was not limited to disputes about quantum. A "dispute ... as to liability ..." means what it says: a dispute as to liability. It was not limited to disputes as to quantum. The on–demand liability arose with regard to the first $3m worth of claims in relation to which Krisenergy disputed that it was obliged to pay. It did not matter whether the dispute is as to liability or merely as to quantum.

What was required by clause 3 to make a valid demand? The parties agreed that the demand here was accompanied by a sworn statement satisfying limbs (a) and (c). Limb (b) was more problematic. The Judge said that it was clear that something had gone wrong with the wording because it did not make good grammatical sense. Accordingly the Judge could not apply the literal meaning. Following, the case of *Rainy Sky SA v Kookmin Bank* 2011 UKSC 50, and given that this was a commercial contract, the Judge had to determine what the parties meant by the language used. This involved ascertaining what a reasonable person would have understood the parties to have meant. The relevant person here, was one who has available all the background knowledge which would have been reasonably available to the parties. The Judge had no doubt that such a person would understand the parties to have intended a requirement that the demand actually be accompanied both by the calculation of the sums demanded and by any supporting documentation reasonably required to assess the demand. That amounted to no more than a reordering of the actual words used, and it makes good commercial sense. When Krisenergy received a demand it would need to decide within 48 hours whether to pay. To do that, Krisenergy needed the calculation and needed the documents.

Did the demands comply with clause 3? It was common ground that a calculation of the sums due accompanied the demands, but what about the "supporting documents reasonably required to assess such demands". The Judge said that what was needed included documents reasonably required for Krisenergy to be able to find out quickly from Kegot whether the claim was admitted or disputed, and to form a provisional view as to whether the claims that gave rise to the demands were bona fide or fraudulent. Here all four Rubicon invoices were accompanied by a breakdown of the sums invoiced. There were some 270 pages of supporting documents, presented in a logical order which were "amply sufficient" to satisfy the requirements of clause 3. Therefore the first demand was a valid demand within the meaning of clause 3 and Krisenergy was obliged to pay the sum demanded within 48 hours.

Dispatch is produced monthly by Fenwick Elliott LLP, the leading specialist construction law firm in the UK, working with clients in the building, engineering and energy sectors throughout the world.

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