Good faith, mutual trust and cooperation: recent judicial insights.

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Good faith, Mutual Trust and Cooperation: Recent Judicial Insights

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Abstract

The recent Scottish Inner House decision in the case of Van Oord UK Ltd v Dragados UK Ltd has rekindled discussions about the role of good faith and the duty to act in the spirit of mutual trust and cooperation under the NEC Contract Conditions. The meaning, significance, and scope of this duty under the NEC Conditions of contract have been the subject matter of academic inquiry since the standard forms for engineering, construction and professional services were developed. The different iterations of the contract conditions have all avoided an explanation of the scope of this duty. All eyes are on the courts to provide the needed clarity, but judicial contribution to this discourse has been patchy and has focused on the link between the clause 10 duty and good faith. In this piece, both the Outer and the Inner House decisions in Van Oord are critically examined for further insights into the significance of the clause 10 duty, behaviours or conducts which will constitute a breach of the clause 10 duty and consequence or remedies for breach.

Key words: construction, cooperation, good faith, mutual trust, NEC3 and 4

Introduction

In the article "Mutual trust and co-operation under NEC 3&4: a fresh perspective", published in 2018[2] I examined the meaning and implications of the duty to act in the spirit of mutual trust and cooperation as encapsulated by clause 10.1 and 10.2 of the NEC3 ECC and the NEC4 ECC, respectively. In the conclusion to that piece, it was argued that duty to act in the spirit of mutual trust and obligation is at the heart of the cultural change agenda of the NEC Conditions. Unfortunately, neither the NEC Conditions of contract nor subsequent commentaries on them has provided an adequate explanation of what this duty entails. Three specific

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[2] Const. L.J. 2018, 34(4), 231-252

observations were made in the said conclusion. The first was that the courts have yet to engage in a detailed analysis of the clause 10 duty. Secondly, the courts had not, at the time, provided a detailed analysis of behaviours or conducts which may or may not constitute a breach of the clause 10 duty. Thirdly, the courts were yet to provide indication as to the consequences of breach of the clause 10 duty and remedies. The recent Scottish Inner House decision in the case of *Van Oord UK Ltd v Dragados UK Ltd*[3] (Van Oord) provides a glimpse into how the courts in Scotland, and more broadly, the United Kingdom are likely to address some of the observations highlighted above. In this piece, both the Outer and the Inner House decisions in *Van Oord* are critically examined for responses to the three observations, namely the significance of the clause 10 duty, behaviours or conducts which will constitute a breach of the clause 10 duty and consequence or remedies for breach.

Relevant Facts

Dragados UK Ltd (Contractor/defender),[4] the main contractor for the Aberdeen Harbour Expansion Project (AHEP), subcontracted certain works including soft dredging works to Van Oord UK Ltd, a subcontractor and the pursuer)[5] in this case (here after called "Van Oord") in March 2018. Both the main contract and the subcontract were based on the NEC3 Engineering Construction Contracts. The subcontract was made up of the core clauses, the Main Option B, and the shorter schedule of cost components. At various times during the Van Oord subcontract, different components of that package awarded under the subcontract were omitted and re-awarded to two other subcontractors, namely WASA Dredging UK Ltd (WASA) and Canlemar SL (Canlemar). Van Oord disputed the validity of the instructions omitting the work packages. It remains disputed whether these omissions were made with Van Oord's knowledge and consent. The main contractor and defendant (hereafter called Dragados) also sought to reduce the sum payable for the remaining work at various times, as more work was omitted. The initial bill of quantities specified the rate of dredging per cubic meter as £7.48. This rate was reduced to £5.82 per cubic meter and subsequently to £3.80 per cubic meter in June and September 2019, respectively. Again, Van Oord contended that the reductions (like the omission instructions) were invalid. Dragados pointed to the NEC3 subcontract in support of the reductions. Displeased with both the instructions to omit works and the reduction in payment, these matters were referred to adjudication. Following adjudication decisions in favour of Dragados, Van Oord filed notice of dissatisfaction and subsequently

[3] [2021] CSIH 50, 2021 WL 04533227
[4] Defender
[5] Claimant

commenced an action in the Court of Session (Outer House) seeking a declarator[6] that the contractor was (i) in breach of contract, (ii) not entitled to reduce the rates for work done after the instructions to omit work, and (iii) Van Oord was entitled to payment for the work done based on unreduced rates.

The matter came before the Lord Ordinary for a debate of the parties' preliminary pleas to relevancy.[7] The Lord Ordinary identified three legal issues for determination. First, whether Dragados was entitled under the NEC3 ECC Option B clauses to omit work already awarded and subsequently re-award that work to different sub-contractors? The second issue was, by far, the most controversial. It was about the effect of the omission of works on the calculation of sums due under the sub-contract. The court had to determine whether on a proper application of the terms of the subcontract, the effect of the omission of work should result in a reduced bill rate for the work executed after the omissions. The third issue related to wave measurement under the contract and the effect of this on the determination of the issue of whether there was an adverse weather condition. This last issue was overshadowed by the importance of the preceding issues. The focus of this piece is on the first and second issues.

Arguments of the Parties

On the first issue, Van Oord argued that on proper interpretation of the subcontract, Dragados did not have the right to omit work and re-award same to other contractors. Van Oord relied on the decision in *Abbey Developments Ltd v PP Brickwork Ltd*.[8] This case supports the principle that without an express provision to the contrary, a contractor cannot omit work from a subcontractor so that it could be done by others. The omissions, according to Van Oord, were outside the scope of clause14.3 of the subcontract which mentioned the circumstance under which work could be omitted.[9] The instructions to omit work therefore constitute a breach of contract. In response, Dragados rejected Van Oord's interpretation of clause 14.3 of the sub-contract. It argued that accurately interpreted, the subclause did not preclude it from further omissions for other reasons. In any case, according to Dragados, the compensation event procedure under the NEC3 ECC provides a fair means of calculating compensation for any such omission of work. Consequently, Dragados argued that the decision in *Abbey Development* was distinguishable from the current scenario.

[6] Declaration

[7] As a preliminary issue.

[8] [2003] EWHC1987(QB)

[9] That is, where the Project Manager under the main contract had given instructions which change the Works information or a key date – see Clause 14.3.

On the second issue, Van Oord contended that the omission of works and subsequent transfer of same to other subcontractors was a breach of clause 10.1 of the subcontract. Using the compensation events clauses to reduce payment for work already done by a party under the subcontract was also against the spirit of mutual trust and cooperation obligation under the same clause. If Van Oord knew work will be omitted and transferred to other subcontractors, it would not have agreed to the use of Defined Cost. It contested the validity of the instructions which had triggered the use of the compensation event clauses. Further, Van Oord argued that the contractor had manipulated the NEC3 ECC subcontract in its favour. Dragados had demanded a blended rate from Van Oord during the tender. Acting on the premise that it was to execute the entire work, Van Oord had set the bill rate accordingly. The omission of works by Dragados had left it with the more difficult part of the work, with the easy aspects omitted and transferred to the new subcontractors.

In response, Dragados argued that transferring the omitted works to other subcontractors was irrelevant to the outcome of the compensation event process. The omission is a compensation event. In any case the compensation event process places Van Oord in the same position in which it would be if the breach never occurred. Consequently, whether the omissions constituted breach of contract made no difference. Under clause 61.3, the breach of contract was to be valued by the contractual mechanism under the subcontract. To do otherwise, Dragados argued, will constitute a breach of contract, which will benefit Van Oord. Changing the rate is merely a mechanism to spread increase or reduction in 'prices resulting from the compensation event mechanism.'[10]

Decision of the Lord Ordinary

On the issue of omission of work, Lord Tyre reviewed *Abbey Development* which had addressed a similar question. The Lord Ordinary noted that the question of whether works may be omitted depends on the interpretation of the provisions of the relevant contract. As noted by HHJ Lloyds QC in *Abbey Development*, a contractor awarded works does not only have a duty to execute the works according to agreed specification; it also acquires the right to do so and be remunerated accordingly. Consequently, any intention to omit work awarded must be clearly articulated in the relevant contract document. Applying these principles to the dispute, Lord Tyre found that the subcontract (particularly clause 14.3 thereof) did not give Dragados the right to omit work from the scope of the work originally awarded to Van Oord. Under clause 14.3, the parties had specified the circumstance under which Dragados may be entitled to such an omission; that is, where the Project Manager under the main contract had given

[10] Van Oord UK Ltd v Dragados UK Ltd, 2021 S.L.T. 1267 (2020), para 28 (Outer House)

instructions which change the Works information or a key date. The omissions in this case were not claimed to have been made under the permitted circumstance. Consequently, Dragados was in breach of contract. This conclusion from the Lord Ordinary is undisputable. However, his additional comments on the significance of the clause10.1 duty (to act in accordance with the terms of the contract and in the spirit of mutual trust and cooperation) to the contract interpretation process was controversial and became the subject of the reclaiming motion before the Inner House:

> I reach this conclusion without, at this stage of the argument, having to place any significant weight upon cl.10.1. I have already noted that one of the conclusions of HHJ Lloyd QC in Abbey Developments, following observations made in the earlier case of Amec Building Ltd v Cadmus Investments Co Ltd, was that the contractor's motive for omitting the works is irrelevant. It is not therefore necessary in this context to inquire into whether the omission of the works amounted to a breach by the defender of its obligation under cl.10.1 to act in a spirit of mutual trust and co-operation. It is sufficient to hold that the subcontract, read as a whole and construed in accordance with the principles applicable to the interpretation of commercial contracts, did not contain any provision entitling the defender to omit works with a view to having them carried out by an alternative subcontractor.[11]

The issue here, according to Lord Tyre, was a question of contract interpretation. In the view of the learned judge, motive of the party in breach (and by extension clause 10.1 of the NEC3) was not a necessary consideration. It was not surprising that the Inner House rejected this statement. The essence of the obligation that the parties 'shall act as stated in this subcontract and in a spirit of mutual trust and co-operation.' as captured by clause 10.1 of the Van Oord subcontract went beyond the letter of the Conditions. It implied that the parties were to approach the contract with

> a **frame of mind** which acknowledged the ethos of the contract and the fact that it will only work as intended if the parties acted in in a certain manner: having confidence in each other's credibility and on that basis, engaging each other actively, consistently, and collaboratively on every facet of the contractual process.[12]

Acting 'in a spirit...' implied that motive of the parties in complying with the contract is a relevant consideration. The behaviour or attitude of the

[11] See Van Oord UK Ltd v Dragados UK Ltd, 2021 S.L.T. 1267 (2020) para25

[12] Emphasis added. See J. Mante, Mutual trust and co-operation under NEC 3&4: a fresh perspective Const. L.J. 2018, 34(4), 231-252 at 243

parties resulting in the alleged breach was not to be overlooked when interpreting the contract conditions. If that was not the case, the obligation to act in the spirit of mutual trust and cooperation will have no real significance; then the clause 10 duty would have sufficed simply by stating that 'the parties shall act as stated in the contract.' The Lord Ordinary's position downplayed the importance of the ethos of the NEC3 Conditions. The Lord Ordinary took the view that a perfectly defensible contract interpretation of the alleged omission was possible without any reference to clause10.1 of the subcontract.

On the second issue regarding the consequence of the breach on the calculation of the sum due for work done, the Outer House held that the starting point was the subcontract. The subcontract specified 'the remedy — and indeed the only remedy — available for a breach of contract, namely that it is a compensation event'.[13] Based on this understanding, the court noted as follows:

> Properly characterised, the defender's instructions omitting work from the scope of the pursuer's subcontract **were compensation events within cl.60.1(1) (instruction changing the subcontract works information), rather than cl.60.1(18) (a breach of contract which is not one of the other compensation events)**. In any event, cl.63.4 made clear that the pursuer's rights to changes to the prices and the subcontract completion date were its only rights in respect of a compensation event. Common law remedies were excluded. Breaches of contract required to be valued in accordance with cl.63 in the same way as any other compensation event.[14]

It is unclear why the Lord Ordinary decided to treat the breach of contract as 'instruction changing the subcontract Works Information' rather than as a 'a breach of contract under clause 60.1(18)'. The Court's focus was on the consequence of the instructions by Dragados and not the nature of it; the instructions constituted breach of contract which resulted in change of the subcontract works information. To the Lord Ordinary, irrespective of how the breach was characterised the remedy remained the same; change to prices and the completion date. The changes were to be calculated in accordance with clause 63 of the subcontract. In the words of the court, 'there is nothing unusual about compensation event consisting of a breach of contract. It would therefore be surprising if different rules applied to valuation of breaches of contract effected by the giving of instructions and to valuation of other breaches of contract.'[15]

[13] Ibid Paragraph 26

[14] Emphasis added. Para 30

[15] Para 40

It is important that the Lord Ordinary's perspective on this issue is not dismissed *in limine* or as being without merit. This view has support in the NEC Conditions and relevant literature. Clause 60.1(18) states that a breach of contract by the Employer which is not one of the other compensation events in this contract is a compensation event. In his commentary on this provision, the author of 'Keating on NEC3' wrote that, 'this clause makes it clear that any breach by the Employer is a compensation event. This will include breach of implied terms.'[16] Clause 63·4 of the NEC3 Condition provides that '[t]he rights of the Employer and the Contractor to changes to the Prices, the Completion Date and the Key Dates are their only rights in respect of a compensation event.' The NEC Guidance Notes explains this clause as follows:

> 'if any of the compensation events occurs the Parties' sole remedy is to use the compensation event procedure. Therefore, if the Employer breaches the contract the Contractor must use this route (see clause 60.1(18)), rather than pursuing damages. This prevents the Contractor trying to circumvent the time limits in the contract.

From the foregoing, Lord Tyre's view on the effect of breach of contract under the NEC3 appears to be mainstream. That said, the guidance note envisages that breach of contract will be dealt with under Clause 60.1(18) and not under Clause 60.1 (1). The importance of this distinction is amplified and becomes clear when viewed in the context of clause 63.10 of the Van Oord Subcontract which states that, 'if the effect of a compensation event is to reduce the total Defined Cost and the event is (i) a change to the Subcontract Works Information or (ii) a correction of an assumption stated by the Contractor for assessing an earlier compensation event, the Prices are reduced.' This subclause makes the distinction between classifying the breach as a change of the subcontract works information or a breach under clause 60.1(18) significant. The former will make a reduction of the Prices possible whilst the latter will not have such an impact.

Further on calculating the consequence of the breach of contract, the Lord Ordinary was of the view that arguments invoking clause10.1 will not make any difference to the eventual conclusions reached:

> I do not consider that the pursuer's argument based on cl.10.1 adds anything to what has already been discussed. For a breach of cl.10.1 to have practical consequences, it would have to fall within one of the categories of compensation event in cl.60.1: presumably, cl.60.1(18) if nothing else. Any such breach would thus be brought into the compensation event mechanism in the usual way. Any

[16] David Thomas QC, Keating on NEC3 (London, Sweet and Maxwell, 2012) 249

> decision taken by the pursuer in relation to pricing at the time of contracting does not seem to me to make any difference: the whole of my discussion of the second issue proceeds on the basis that the defender is in breach of contract.

In reaching this conclusion, the court of first instance again, ignored the significance of clause10.1 to the contract interpretation exercise. As far as the court was concerned, clause 10.1 was to be treated like any other clause in the subcontract. A breach of the clause had the same consequence as any other clause under the NEC3 ECC. Any such breach should be considered under clause 60.1.(1) or clause 60.1(18). The remedies available to the aggrieved party is as stated under clause 64.3 namely, changes to the Prices, the Completion Date, and the Key Dates. These are their only rights in respect of a compensation event. The Lord Ordinary failed to consider the question whether clause10.1 of the subcontract was breached by Dragados.

Dissatisfied with the outcome, Van Oord reclaimed[17] against the decision of the Lord Ordinary in the Inner House of the Court of Session. The parties repeated many of the arguments made in the Outer House. The Inner House summarised the party's arguments on appeal at paragraphs 14 and 15 respectively of its decision.

Decision of the Inner House: The Clause 10.1 Conundrum

As the issue of breach was not in contention, the main question for the Inner House was whether the contractor was entitled to reduce the bill rate, and therefore the sums payable to the subcontractor? Lord Woolman, the Lord President Carloway and Lord Menzies in the Inner House agreed with the judge of first instance that this was a question of contract interpretation but had a distinct perspective on how this should proceed.

On Clause 10.1

Contrary to the Lord Ordinary's approach of side-lining clause 10.1 of NEC3, the Inner House considered the duty to act in the spirit of mutual trust and cooperation central to its interpretation of the NEC3 Subcontract. The Court stated that, 'clause 10.1 is not merely an avowal of aspiration. Instead, it reflects and reinforces the general principle of good faith in contract.'[18] This was the furthest the court went in its express reference to the concept of good faith. The court proceeded to interpret clause 10.1 as aligning with three well-known common law principles namely: (i) a party will not under normal circumstances be allowed to profit from his own

[17] appealed
[18] Paragraph19

breach,[19] (ii) a subcontractor is not under obligation to obey instructions issued in breach of contract,[20] and (iii) clear language is required to put a contracting party at the mercy of the other.[21] In the view of the court, the first of the three principles articulated by Lord Jauncey in *Alghussein Establishment v Eton College,*[22]reflected the doctrine of mutuality.[23] Accordingly, '[a] party cannot enforce a contractual stipulation in its favour, if it is the counterpart of another obligation which it has breached'.[24] On the significance of the clause 10 duty, the Inner House concluded as follows:

> We conclude that clauses 10.1 and 63.10 are counterparts. Unless Dragados fulfils its duty to act "in a spirit of mutual trust and co-operation", it cannot seek a reduction in the Prices. Accordingly, Van Oord has pled a relevant case to go to proof. Evidence can be led to evaluate Dragados' conduct. Did it act in a spirit of mutual trust and cooperation? Or did it act in a contrary manner?[25]

On the consequence of the breach

The appellate court also rejected the Lord Ordinary's interpretation of the NEC3 in relation to the effect of the breach. The court emphasised the distinction between reduction of the Defined Cost (which both parties agreed with) and reduction of the Prices and the bill rate. The disagreement was about whether there should be a corresponding reduction in Prices and the bill rate. On this issue, the Lord Ordinary held that clause 63.10[26] applied. This was a natural conclusion flowing from his prior decision to regard the omission of works by Dragados as 'a change to the Subcontract Works Information' rather than as a breach of contract under clause 60.1(18). The former will lead to reduction of both Defined Cost and Prices whereas the latter will not. The Inner House agreed with the view that all compensation events are to be treated equally but also noted that although

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[19] *Alghussein Establishment v Eton College [1988] 1 WLR 587*, 591D-E, per Lord Jauncey.

[20] *Thorn v The Mayor and Commonalty of London (1876) 1 App. Cas.120*, per Lord Cairns (LC) at 127-128.

[21] *Parkinson (Sir Lindsay) & Co. Ltd v Commissioners of His Majesty's Works and Public Buildings [1949] 2 KB 632, 662* per Asquith LJ.

[22] n7 above

[23] The decision in *Alghussein* is a classic example of how English and Scottish legal principles have influenced each other over the years. Mutuality is a prominent concept in Scottish contract law. *Alghussein* is an English decision by a Scottish judge, Lord Jauncey

[24] The court referred to the following authorities in support of its reliance on the doctrine of mutuality: *Macari v Celtic Football and Athletic Co Ltd 1999 SC 628* at 640G- 641D, per the Lord President (Rodger), and *Bank of East Asia v Scottish Enterprise 1997 SLT 1213,* per Lord Jauncey at 1216L-1217K.

[25] Para 23

[26] If the effect of a compensation event is to reduce the total Defined Cost and the event is (i) a change to the Subcontract Works Information or (ii) a correction of an assumption stated by the Contractor for assessing an earlier compensation event,
the Prices are reduced.

the effect of a compensation event is to reduce the total Defined Cost, it does not follow automatically that there should be a corresponding reduction in Prices; that is made subject to the provisions of the subcontract.[27] In the view of the appellate court,

> properly construed, clause 63.10 applies only to a *lawful* change. It excludes instructions issued in breach of contract. They are invalid, because they are not given "in accordance with this subcontract" (see clauses 14.3 and 27.3). The natural synonym for "in accordance with" is "consistent with". A breach is plainly inconsistent with the contract.

Clause 27.3 of the subcontract expressly states that,' [t]he Subcontractor obeys an instruction which is **in accordance with this subcontract** and is given to him by the Contractor.'[28] The instructions related to the omission of works were not issued in accordance with the subcontract. They were not lawful. Van Oord had no obligation under the subcontract to obey such instructions.[29] The appellate court argued that this interpretation is consistent with the ethos of the NEC3. The contract interpretation process should not lead to a conclusion that encourages parties to comply with instructions which are issued in clear breach of contract. 'The NEC3 should not be charter for contract breaking…'[30] All breaches under the NEC3 are to be treated equally, none should lead to reduction in Prices. The decision of the Lord Ordinary was reversed, interlocutors recalled and proof before answer allowed.

Discussion

The decision of the Lord Ordinary at first instance[31] hung on two main points namely: (i) the status of the instructions which omitted various aspects of the originally awarded works and subsequently transferred them to the other subcontractors and (ii) the characterisation of these instructions for the purposes of the compensation event calculation. On the first, breach of contract was the logical conclusion on the authority of *Abbey Developments.* The subcontract did make express provision for a specific type of omission (that is, where the Project Manager under the main contract had given instructions which change the Works information or a key date[32]) but not the type made by Dragados. In the absence of a

[27] NEC3, cl63.2: 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.
[28] Emphasis added.
[29] *Thorn v The Mayor and Commonalty of London (1876) 1 App. Cas.120*, per Lord Cairns (LC) at 127-128.
[30] Para 30.
[31] Now overruled
[32] Clause 14. 3 of the subcontract states: "The Contractor may give an instruction to the Subcontractor which changes the Subcontract Works Information or a Key Date. The Contractor may, in the event that a

contractual basis, express or implied, for the omissions to the works awarded, that process constituted a breach of contract.

At the heart of the differences in the opinions of the Lord Ordinary and the Inner House is the reduction of Prices and bill rate. Both courts agreed that following the omission of works some changes to the Defined Cost was inevitable. In addition to this, the Outer House was convinced that the omissions should also result in reduction in Prices. Having classified the omission of works (compensation event) as a change of Works Information under clause 60.1(1), that brought the compensation event within the scope of clause 63.10 of the subcontract. The reasoning of the Lord Ordinary was that if the instructions to omit resulted in a change of works information under the subcontract, then Dragados was entitled under clause 63.10 to both reduction in the Defined Cost and Prices.[33] It was unclear why the Lord Ordinary characterised the event which it ruled constituted a breach of contract as change of Works information under the subcontract. The Inner House disagreed with this characterisation. The breach of contract resulted in an 'unlawful' instructions leading to an 'unlawful' change of the works information. In sum, when the subcontract referred to the contractor's instructions changing the subcontract Works Information under clause 60.1(1) as a compensation event, it meant lawful instructions - that is, instructions given in accordance with the subcontract. Similarly, when the subcontract under clause 63.10 referred to 'a change to the Subcontract Works Information,' it meant lawful instructions. The instructions from Dragados leading to the omissions, and consequently, the change in Subcontract Works Information, flowing as they were from a breach of the same subcontract, were unlawful; they were not issued in accordance with the subcontract. Consequently, the said instructions could not trigger the application of clause 63.10 to reduce Prices or the bill rate. The position of the Inner House on Price reduction is consistent with the operation of the legal principle which frowns on a party profiting from its own breach.

A broader point here is that the Inner House decision suggests that the compensation event clauses in the NEC3 and NEC4 must be interpreted on the basis that they arise from activities carried out in accordance with the terms of an agreed NEC Condition. This broader position may run into some difficulty when considered in the context of clause 60 on compensation events. Most compensation events are related to activities the Employer

corresponding instruction is issued by the Project Manager under clause 14.3 of the Main Contract only, also give an instruction to omit a) any Provisional Sum and/or b) any other work, even if it is intended that such work will be executed by Others. The Subcontractor has no claim for loss of revenue, loss of opportunity, loss of any contract, loss of profit or for any indirect loss or damage against the Contractor in relation thereto."

[33] Breach of contract under clause 60.1.(18) is not mentioned as one of events allowing for Price reduction under clause 63.10

fails to perform under the contract and thus will not be in accordance with the Contract. For instance, if an Employer fails to give access to the Site on an agreed access date, that will be a compensation event under clause 60.1(2). Such a failure on the part of the Employer could be construed as a breach of a contractual term. A compensation event calculation based on this 'breach' should be appropriate. What then makes the situation with clause 60.1(1) distinct? Again, it may be argued that the practical consequence of the 'unlawful' instructions in this case was that it resulted in a change of the Works Information. To ignore that is to ignore reality.

However, such an argument ignores the enormity of the breaches, refuses to acknowledge them as reprehensible under the subcontract (at least, potentially, according to clause10.1) and normalises the consequences of the breach. The implication of this perspective is grave. It means Contractors under the NEC3 Conditions could be compelled to comply with unlawful instructions in clear breach of the contract. Further, stronger parties could opt to honour the provisions of the NEC Conditions in breach than in compliance especially when it is obvious, they can profit from the alleged breach. This is where the behaviour of the parties under the NEC3 and 4 becomes an important consideration. The NEC Conditions have been crafted/fashioned to work at their optimum when parties act as stated in the contract and in the spirit of mutual trust and cooperation.[34]When parties deliberately ignore the ethos of the contract conditions, the edifice is severely impaired. Consequently, interpreting the clauses of the NEC3 and 4 with the clause 10 duty in mind is not an option but an imperative.

Significance of Clause 10.1 duty

On the broader point of contract interpretation, failure of the Lord Ordinary to consider the duty to act as stated in the contract and in the spirit of mutual trust and cooperation was criticised by the judges in the Inner House. Clause 10 describes the nature and manner of conduct expected of parties using the NEC edifice. The first edition of the NEC Conditions had no such duty. According to the Guidance Notes, the clause 10 duty was added to the second edition of the NEC Conditions on the recommendations of the Latham Report[35] and has since remained a key part of subsequent editions of the NEC Conditions. At paragraph 5.20 of the Latham Report, the following suggestion was made:

> A statement should be written into Core Clause 1 that the employer and the contractor affirm that they both intend to establish a fair and reasonable agreement with each other to undertake the project in

[34] Clause 10.1 NEC3 ECC and Clauses 10.1 &2 NEC4 ECC

[35] See Guidance Notes for the NEC3 Engineering and Construction Contract, p.31;
M. Latham, Constructing the Team, Final Report of the Government/Industry Review of Procurement and Contractual Arrangements in the UK Construction Industry (London: HMSO, 1994), p.39.

a spirit of mutual trust and co-operation, and to trade fairly with each other and with their subcontractors and suppliers. Core Clause 16.3 should be strengthened to make it clear that 'win-win' solutions to problems will be devised in a spirit of partnership. Identical wording should be included in the appropriate Core Clauses in the subcontract document.

Beyond the above, the authors of the NEC Conditions have added no further explanation of the Clause 10 duty, thereby passing the responsibility to the courts to explore the meaning, scope and import of the duty. Given its origin, it makes sense that any effort to understand the clause 10 duty looks back at the report from which the idea was derived. From paragraph 5.20 of the Latham Report, one can glean several ideas which the clause 10 duty may encapsulate. Firstly, there is the affirmation of an intention 'to establish a fair and reasonable agreement'.[36] Secondly, there is an assurance of a willingness to carry out obligations under the contract in mutual trust and cooperation. Then there is the intention to 'trade fairly' with each other 'in the spirit of partnership' to achieve the best possible solution for any problem that might arise. Other probable meanings of the clause 10 duty under the NEC3 and NEC4 Conditions have been explored elsewhere.[37]

Judicial examinations of the clause 10 duty are rare. In *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd*[38] where the court was called upon to resolve a dispute about the compensation event provisions in the NEC3 Professional Services contract, Deeny J underscored the importance of considering the contract as a whole during the interpretation process. That meant it was imperative to consider the clause 10 duty as part of the process. He found that the consultant's behaviour was contrary to the obligation to act in the spirit of mutual trust and cooperation. Other judicial decisions appear to have followed the approach adopted by the judge in *Northern Ireland Housing Executive;* regardless of the final decisions on whether the clause 10 duty had been breached or not, in all instances, there seem to be an acknowledgement that the clause 10 duty was an important consideration in the contract interpretation exercise.[39]

[36] ibid

[37] See Joseph Mante, Mutual trust and co-operation under NEC 3&4: a fresh perspective Const. L.J. 2018, 34(4), 231-252

[38] [2017] NIQB 43; [2018] B.L.R. 157; [2017] 4 WLUK 476 (QBD (NI))

[39] See Costain Ltd v Tarmac Holdings Ltd [2017] EWHC 319 (TCC); TSG Building Services Plc v South Anglia Housing Ltd [2013] EWHC 1151 (TCC); Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS
Trust [2013] EWCA Civ 200; Mears Ltd v Shoreline Housing Partnership Ltd
[2015] EWHC 1396 (TCC);160 Con. L.R. 157 at [72].

Further, there has been a willingness to consider the extent to which the clause 10 duty applies to specific provisions of the relevant contracts. In *Monk v Lago*, the Court held that an absolute right to terminate is not hindered by an obligation of good faith.[40] On the basis of current judicial practice, it appears that courts have considered the clause 10 duty as part of the contract interpretation process. This conclusion suggests that the Lord Ordinary's approach of side-lining the clause 10 duty is contrary to the burgeoning judicial practice on the subject. In any case, it seems appropriate that any interpretation of the NEC Conditions consider the context in which the parties have contracted and the intentions undergirding the agreement they signed.

Proponents of the decision of the Lord Ordinary may argue that the Inner House decision similarly relied on general principles of contract interpretation and could have been reached without any regard to Clause10.1. It may be argued further that the Inner House did not explain in detail what the duty to act in the spirit of mutual trust and cooperation mean or indeed, what specific role it played in its decision. This argument is countered by the significance of the appellate court's pronouncement on the status of the clause 10.1 duty. In relation to the duty, the court noted as follows: 'In our view cl.10.1 is not merely an avowal of aspiration. Instead, it reflects and reinforces the general principle of good faith in contract.' This statement, at least, in the Scottish context, puts to rest the view held by some that the clause 10 duty is mere aspirational and thus lacks specific legal implications.[41]

The decision of the Inner House on the clause 10 duty is significant for other reasons. Firstly, it confirms the view in existing case law that clause 10 connotes a willingness of parties to the NEC Conditions to embrace, if not all, some good faith principles.[42] The recognition that clause 10 is the starting point when considering good faith in the NEC3 Condition is important. Parties to the NEC Conditions who agree to include clause 10.1 of the NEC3 ECC or clause 10.1 and 2 of the NEC4 ECC in their contract conditions must understand that they are incorporating some elements of good faith into their contract.

How much of the broader concept of good faith is incorporated into the NEC Conditions by the embrace of the clause 10 duty? The answer to this

[40] Monk v Largo Foods Ltd [2016] EWHC 1837 (Comm)

[41] Different authors have assigned different implications to the clause 10 duty. See David Mosey and Robert Horne, "NEC contracts: Love and Understanding" (10 June 2011) available at https://www.building.co.uk/comment/nec-contracts-love-and-understanding-/5018931.article. Christie referred to it as a 'rhetorical reminder' - see David Christie 2017 How can the use of "mutual trust and cooperation" in the NEC 3 suite of contracts help collaboration? International Construction Law Review 34(2) pp 93 -112

[42] See Justice Coulson's decision in Costain Ltd v Tarmac Holdings Ltd [2017] EWHC 319 (TCC) where he quoted Keating on NEC3 to affirm the good faith connotations of the clause 10 duty.

question remains unclear. There is no definitive judicial statement on the meaning, scope, and confine of the duty to act in the spirit of mutual trust and cooperation. This is what makes the decision of the First Division of the Inner House in *Van Oord* interesting as it provides some insight into what the 'mutual trust and cooperation' clause could entail in appropriate situations.

Secondly, the Inner House did not apply generic good faith ideas of honesty, fair dealing, disclosure etc. Indeed, the court made no effort at all to explain the concept of good faith. Instead, it relied on well-established common law principles of contract interpretation which promote fairness. Clause 10.1 was regarded as 'aligned' with three common law principles, namely, (i) a party should not under normal circumstances benefit from its own breach as against the other party, (ii) a party is under no obligation to obey an instruction issued in breach of contract and (iii) plain language is required to place one contractual party at an express disadvantage. The approach of relying on distinct common law principles to achieve the ends of justice – in the same way the application of good faith will do - is also in line with judicial practice in the United Kingdom as aptly captured by the dicta of Lord Bingham in *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd*[43] and Moore-Bick LJ in *MSC Mediterranean Shipping Co SA v Cottonex Anstalt.*[44]

Thirdly, the Inner House did not feel hindered by the express terms of the NEC Condition from applying the above listed well-known common law principles. On the first principle, the court relied on Lord Jauncey's statement in *Alghussein Establishment v Eton College.*[45] The principle that a party should not benefit from its own breach is part of the 'negative prevention principle'.[46] This principle is variously formulated in the case law. For instance, in *Roberts v Bury Commissioners*[47] the court[48] noted that*, '[i]*t is a principle very well established at common law that no person can take advantage of the non-fulfilment of a condition the performance of which has been hindered by himself*."* It is also significant that Lord

[43] [1988] 2 W.L.R.615; [1988] 1 All E.R. 348 at [439D]–[439G]

[44] [2017] 1 All E.R. (Comm) 483; [2016] 2 C.L.C. 272 at 290–291 [45B]–[45C]. See also Severine Saintier, "The elusive notion of good faith in the performance of a contract, why still a bete noire for the civil and the common law?" (2017) 6 J.B.L. 441 and Joseph Mante, Mutual trust and co-operation under NEC 3&4: a fresh perspective Const. L.J. 2018, 34(4), 231-252 at 235-237.

[45] *[1988] 1 WLR 587*, 591D-E

[46] Hudson's Building and Engineering Contracts 14th Ed. Para 3-079. Please note that the mention of prevention here does not imply a full-scale discussion of the prevention principle in the context of delays and the North Midland v Cyden Homes- not directly relevant here.

[47] *(1870) L.R. 5 C.P. 310* at 326

[48] Kelly, C.B., read the judgment of Blackburn and Mellor, JJ.

Jauncey made it clear that the principle applies as much to a situation where a party seeks to rely on his own breach to avoid a contract as it does in a situation where a party seeks to benefit from the continuing contract based on his own breach.[49] The principle has been followed in many commercial cases since *Alghussein*,[50] and in most instances, it has been used as a rule of construction.

It is therefore not surprising that the First Division of the Inner House followed this trend. On the facts of *Van Oord*, the changes to the prices and the bill rate sought by Dragados were occasioned by its own breach of the contract. Treating such a breach as change in the Works Information will enable Dragados to take advantage of clause 63.10 to trigger price reduction. This interpretation of the subcontract will mean Dragados benefits from its own breach under the continuing contract. The Inner House frowned on this interpretation on the authority of *Alghussein.* In *Van Oord*, Dragados had argued that the NEC3 Conditions allowed such an interpretation. However, the Inner House disagreed with this position. It argued that Dragados should not benefit from its own breach. A related principle is that a party in breach of contract may be unable to enforce the contract against the innocent party. McKendrick[51] notes, 'where the obligations of the parties are dependent, then a contracting party must generally be ready and willing to perform his obligations under the contract before he can maintain an action against the other party for breach of contract.'[52] This is a crucial point as the Inner House expressly links the common law rule preventing a party from benefitting from its own breach to the doctrine of mutuality.

In the Scottish context, the doctrine of mutuality[53] encapsulates the need for parties to perform their counterpart duties.[54] It has been stated that the doctrine entails five key ideas namely:[55] (i) A party who is in breach of obligations cannot enforce performance by the other party.[56](ii)the party who is not in breach may withhold performance until the other has

[49] *Alghussein, p594*

[50] See TMF Trustee Ltd v Fire Navigation Inc [2019] EWHC 2918 (Comm); Otuo v Brierley [2015] EWHC 1938 (Ch); Transocean Drilling UK Ltd v Providence Resources Plc [2014] EWHC 4260 (Comm); Doosan Babcock Ltd v Comercializadora de Equipos y Materiales Mabe Lda (formerly Mabe Chile Lda) [2013] EWHC 3201 (TCC).

[51] Ewan McKendrick, Contract Law, 11ed Palgrave, London 2015) 331-332

[52] Ibid p.332

[53] This is a concept with civil law antecedents derived from the concept of the defence of the unperformed contract- See Aberdeen City Council v McNeill, 2014 S.C. 335 (2013) at para 21. See also G.H. Treitel, Remedies for Breach of Contract: A Comparative Account (1988), pp.245, 300, 305–306, 312 & 319; *W.W. McBryde, "The Scots Law of Breach of Contract: A Mixed System in Operation" (2002) 6 Edin. L.R. 5*

[54] McBryde, The Law of Contract in Scotland, 3rd Ed (W. Green, Edinburgh 2007) para 20.70

[55] McBryde, The Law of Contract in Scotland, 3rd Ed (W. Green, Edinburgh 2007) para 20.47

[56] Turnbull v McLean & Co (1874) 1 R. 730

performed or is seen to be willing to perform the counter stipulations.[57] (iii) the mutuality concept only applies if the obligations of the parties are the causes of one another or are reciprocal undertakings.[58] (iv) the operation of the principle can be affected by the express terms of the contract.[59] and (v) it may not be for every trifling breach, or every breach, that a party can withhold performance of part of the contract.[60]

Where there is interdependence and reciprocity of obligations, the doctrine of mutuality ensures that all parties perform or neither does. At the heart of the doctrine is the idea that these obligations are counterparts of each other.[61] The emphasis is not on how the obligations are packaged but the obligations themselves.[62] Consequently, it does not matter where the obligations are found, so long as they can be considered as counterparts, mutually dependent on each other and reciprocal, their performance will be conditional. This explanation of the doctrine of mutuality was confirmed in the Supreme Court decision of *Inveresk Plc v Tullis Russell Papermakers Ltd.*[63] That said, the timely reminder in the case of *Macari v Celtic Football and Athletic Co Ltd*[64] is worth bearing in mind. It is not every obligation of a party to a contract that is 'necessarily and invariably the counterpart of every obligation by the other.'[65] This then raises the question as to how a court determines whether an obligation is a counterpart of another. This may be done by recourse to express terms of the agreement or by reference to the intention of the parties.[66]

On the issue of mutuality, the Inner House held as follows: 'We conclude that cll.10.1 and 63.10 are counterparts. Unless Dragados fulfils its duty to act "in a spirit of mutual trust and co-operation," it cannot seek a reduction in the prices.'[67] Very little analysis is provided by the court on how it came to the decision that the two clauses – clause10.1 and clause 63.10 are counterpart obligations. From the law as summarised, this conclusion should flow from either an express term of the NEC3 Condition or intention of the parties gathered from the contract as a whole. In the absence of a detailed analysis by the Inner House, it is unclear what considerations informed the conclusion. This opens the issue to speculation. Is clause 10.1 only a counterpart of clause 63.10 or which

[57] National Homecare Ltd v Belling & Co Ltd 1994 S.L.T. 50
[58] Bank of East Asia v Scottish Enterprise, 1997 S.L.T. 1213, HL; Macari v Celtic Football and Athletic Co Ltd, 1999 S.C. 628.
[59] Skene v Cameron, 1942 S.C. 393; Brand v Orkney Islands Council, 2001 S.C. 545
[60] Barclay v Anderston Foundry Co (1856) 18 D. 1190 at 1198.
[61] McBryde, *The Law of Contract in Scotland*, para 20.70
[62] *Inveresk Plc v Tullis Russell Papermakers Ltd.* [2010] UKSC 19 para 35-38
[63] [2010] UKSC 19 para 35-38
[64] 1999 S.C. 628
[65] Macari, p640 per Lord President Rodger
[66] Ibid,
[67] Van Oord, Inner House decision, para 23

other clauses is it a counterpart of? Are the two clauses interdependent? Are they reciprocal obligations? Clause 10.1 provides that '[t]he Contractor and the Subcontractor shall act as stated in this subcontract and in a spirit of mutual trust and co-operation." Clause 63.10 states:

> If the effect of a compensation event is to reduce the total Defined Cost and the event is a change to the Subcontract Works Information or a correction of an assumption stated by the Contractor for assessing an earlier compensation event, the Prices are reduced.

It is unclear from the NEC Conditions that the parties intended that the performance of the clause 10.1 duty will be a counterpart of clause 63.10. In fact, it could be posited that by making breach of contract a compensation event, there is a recognition under the NEC Conditions that the compensation event clauses could operate independently of performance or compliance with clauses in the sub-contract. Breach of any clause in the NEC3 Conditions, when it occurs, does not stop the parties from performing their duties under the contract. There is no indication that enforcement of Clause 63.10 depended on compliance with Clause 10.1 of the NEC3 ECC Subcontract. This may suggest that compliance with clause10.1 is not reciprocal obligation or necessary condition to the application of the compensation event clauses. The preceding arguments are in line with Lord Tyre's approach which saw the provisions (clauses 10.1 and 63.10) as operating independently.

On the other hand, the obligation to 'act as stated in the contract and in the spirit of mutual trust and cooperation…' under Clause 10.1 of NEC3 and Clause 10.1 and 2 of NEC4 ECC is broad and literally makes every breach of a clause in the NEC Conditions an automatic breach of the Clause 10 duty. If a party is in breach of a clause in the NEC Conditions, it will be because it did not act as stated in the contract. If the breach was the result of a unilateral act (not otherwise sanctioned in the contract), it is likely that it would not have been carried out in the spirit of mutual trust and cooperation. Consequently, and in a sense, it can be argued that all other obligations in the NEC3 are connected in a fundamental way to Clause 10.1 and thus constitute counterpart obligations. Taking such an argument to its logical conclusion will imply that all clauses under the NEC3 Conditions are counterparts of clause 10.1. The implication of such an argument will be profound as it will elevate the clause 10.1 duty to the status of an overarching principle underpinning every interpretation of the NEC3 Conditions. In fact, is this not what the NEC3 drafters intended? That said, it is helpful to highlight that precedent points to a different approach; where such express clauses (such as clause 10.1) have been incorporated into contracts, the UK courts' approach has been to limit the application of such clauses to specific provisions. For instance, in *Mid Essex NHS Trust*,

the court held that the provision on co-operation applied to the provision on transmission of information but not the discretion to award service failure points.[68] The challenge in *Van Oord* is how to determine which specific provisions of the NEC ECC Subcontract is affected by the clause 10 duty. Detailed reasoning from the Inner House on this aspect of its decision would have been extremely helpful.

Lest one argues that this is a distinctively Scottish perspective, it is important to emphasise that the doctrine of mutuality is common to many civil law jurisdictions[69] where the NEC Conditions are in use. The importance of a clarification of the connection between the doctrine of mutuality and clause 10 of the NEC ECC goes beyond the UK; it will be of persuasive value in civil law jurisdictions where the NEC Conditions are in use.

The Inner House decision is also significant for another reason. By allowing the appeal, the Inner House paved way for the possibility of a rare judicial enquiry into the behaviours which will constitute a breach of clause10.1. According to paragraph 23 of its decision, the appellate court hoped that 'evidence can be led to evaluate defender's conduct'. Did it act in the spirit of mutual trust and cooperation or in a contrary manner? It is expected that if such an enquiry is to proceed it will provide an opportunity for a rare judicial insight into the sort of behaviours that will be considered a breach of the duty to act in the spirit of mutual trust and cooperation.

Consequence of breach of the Clause 10 duty

Another knotty issue with the duty to act in the spirit of mutual trust and cooperation is the consequence of breach of the duty. Should breach of the clause10.1 NEC3 duty be treated like any other breach under the contract conditions; with consequences limited to the stipulated express remedies under the contract conditions? Or given its importance, should breach of the clause 10 duty attract additional repercussions. Conversely, what will be the loss that such a breach of clause 10 duty will occasion? In both the Outer and Inner Houses, the discussion on the consequence of the breach focused on other clauses of the NEC subcontract such as clauses 14, 27, 60.1, and 63.10. The Lord Ordinary limited the effect of breach of provisions of the sub-contract to remedies provided under the contract. He noted in his decision that,

[68] See *Mid Essex NHS Trust [2013] B.L.R. 265. See also Tan, "Keeping faith with good faith? The evolving trajectory post-Yam Seng and Bhasin" (2016) 5 J.B.L. 420, 432.*

[69] See Aberdeen City Council v McNeill, 2014 S.C. 335 (2013) at para 21.

> in terms of NEC3 the omission of work does constitute a breach of contract. But the matter is not left there, because the contract goes on to specify the remedy — and indeed the only remedy — available for a breach of contract, namely that it is a compensation event.[70]

The Lord Ordinary did not examine whether there has been a breach of clause 10.1. Thus, the opportunity to explore the consequence of such a breach was missed.

The Inner House, on the other hand, emphasised the importance of clause 10.1 of the NEC3 sub-contract. Breach of the duty triggers the application of good faith or equivalent principles in the common law. For instance, in the specific instance of *Van Oord*, Dragados should not benefit from its breach; any interpretation of the contract which yields a contrary result will be inconsistent with good faith. Van Oord should not be made to participate in a breach of contract by Dragados by complying with unlawful instructions. Again, any interpretation of the contract which reaches a contrary conclusion will conflict with the essence of clause10.1 of the NEC3. The appellate court was unwilling to accept Dragados' argument without an express provision in the NEC3 Subcontract which places Van Oord in a clear disadvantage. The consequence of breaching clause10.1 is not limited to a compensation event with time or price consequence; it triggers series of good faith, common law and equitable principles which may shape the interpretation of the contract as a whole. It may disable the contract breaker from enforcing rights under the contract, especially where the right to be enforced is judged to be a counterpart to the clause 10 duty. This may not only be the case in Scotland under the mutuality principle but also in England and Wales as explained by McKendrick.[71]

Failure by the courts to give effect to clause 10.1 will lead to an absurdity; the NEC3 will become a 'charter of contract breaking…'.[72] Stronger parties could issue unlawful instructions in breach of contract and take advantage of the compensation event provisions. That will fly in the face of the clause 10.1 obligation to comply with the clauses in the NEC3 Conditions and to act in the spirit of mutual trust and cooperation. The existing NEC Conditions (NEC 3 and 4) and the guidance notes lack clarity on some of the issues discussed. Future editions could benefit from some clarifications on the above issues.

Conclusion

The concept of mutual trust and cooperation is a notion in search of meaning and scope. The decision of the First Division of the Inner House

[70] Van Oord UK Ltd v Dragados UK Ltd, 2021 S.L.T. 1267 (2020) (Outer House decision) para 26
[71] Ewan McKendrick, Contract Law, 11ed Palgrave, London 2015) 331-332
[72] Van Oord UK Ltd v Dragados UK Ltd, 2021 S.L.T. 1317 (2021), para 30

is a welcome addition to the growing jurisprudence on the import of the clause 10 duty under the NEC3 and NEC4. The decision emphasised the good faith elements of the clause 10 duty. It stays true to the UK approach of using common law and equitable principles to satisfy demands of good faith. It demonstrates that in appropriate situations, aligned common law rules may be deployed to achieve fairness and compliance with the clause10 duty. From the Scottish and a broader civil law perspective, it would have been helpful if the Inner House had explained in detail how and by what principles it concluded that clause 63.10 is a counterpart obligation of the clause 10 duty. Is the clause 10 duty counterpart to all other core clauses in the NEC Conditions? If not, which ones? The court adopted an expansive approach to the meaning and scope of the clause 10 duty. It was not willing to place limits. This will make it possible for future courts to consider which principles may be deemed 'aligned' with the clause 10 duty. Interesting as this approach is, it hardly provides insight into the confines of the duty. For a contract which has certainty, clarity and simplicity as central tenets, a definitive statement on the scope and meaning of the clause 10 duty is overdue.

In terms of its significance, the Inner House decision has demonstrated that the clause 10 duty brings perspective to interpretation of the clauses of the NEC3 and 4 Conditions. It is not acceptable to simply ignore the duty as irrelevant in such exercises. Its consequence goes beyond the compensation event process; it may prevent a contract breaker from taking advantage of its own breach. It may disable such a contract breaker from enforcing its rights under the very contract it has breached unless there is an express provision to the contrary. It remains to be seen whether other courts will follow the perspective of the Inner House on the consequence of breach of the clause 10 duty or they will follow the Lord Tyre approach of limiting any such consequence to the compensation events. A lot remains to be learnt about the meaning and scope of clause 10 of the NEC3 and 4 Conditions of contract.