Neutral Citation Number: [2015] EWHC 1150 (TCC)

Case No: HT-2015-000040

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
TECHNOLOGY AND CONSTRUCTION COURT

Royal Courts of Justice

Rolls Building

Fetter Lane, London, EC4A 1NL

Date: 30th April 2015

Before:

THE HONOURABLE MR. JUSTICE COULSON

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Between:

Secretary of State for Defence **Cla**

- and -

Turner Estate Solutions Limited **Respo**

- -

- -

Ms Sarah Hannaford QC, Ms Rose Grogan and Mr Charlie Thompson

(instructed by **The Treasury Solicitor**) for the **Claimant**

Mr Richard Keen QC, Mr Garry Borland QC and Mr Martin Richardson

(instructed by **Pinsent Masons LLP**) for the **Respondent**

Hearing date: 30 March 2015

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Judgment

The Hon. Mr Justice Coulson:

1. INTRODUCTION

1.

Pursuant to a contract dated 31 March 2003, the claimant (“SSD”) engaged the respondent (“TES”) to carry out design and construction works at HMNB Clyde. The contract was a Maximum Price Target Cost (“MPTC”) contract. The Target Cost would be adjusted if there were delays entitling TES to an extension of time, or if there were Changes. TES’ remuneration would be based on their actual costs, plus profit, although the Final Price Payable (“FPP”) was calculated by a comparison of the Actual Costs with the Target Cost, in order that the parties could share any costs over-runs or under-runs. This is commonly referred to in the construction industry as a ‘pain/gain’ mechanism. Moreover there

were also provisions stipulating a Maximum Price which, although capable of adjustment, could not be exceeded.

2.
In the present case, TES' actual costs have so far outstripped any likely Maximum Price that any implementation of the Target Cost/Maximum Price provisions would leave them with a significant loss, possibly as much as the contractually-stated maximum of £50 million. They maintain that, because the parties stopped implementing the Target Cost adjustment process at a certain point during the currency of the contract (because they stopped implementing the Change Proposal procedure), the contractual arrangements relating to the Target Cost, the Maximum Price and the entire pain/gain-mechanism can now be ignored, and that instead TES are simply entitled to their actual costs and an allowance for profit, without any restrictions, caps or loss-sharing requirements whatsoever. This claim is denied by SSD. As set out below, the dispute is one of contract construction.

3.
TES' claims, for some £68 million over the current Maximum Price, and SSD's counterclaim for overpayment, are being pursued in arbitration (the second such arbitration between the parties). SSD has been anxious for some time to have the contractual issues resolved in advance of the final hearing, which is due to take place in June 2015, because of the potential savings that will ensue, whichever way the issue is decided. Accordingly, on 4 February 2015, they made an application under section 45 of the Arbitration Act 1996 ("the 1996 Act") for the court to determine two preliminary questions of law.

4.
TES accept that some of the preconditions within s.45 are fulfilled but reserve their position as to others. Thus, when the matter came before me on 30 March 2015, there were two separate areas of dispute: whether or not s.45 was engaged and, if so, what the answers were to the two preliminary questions raised by SSD. It was made plain that answers to these issues were required as a matter of urgency, because (for example) the parties had deferred exchanging witness statements and expert's reports for the June arbitration hearing until after the court hearing.

5.
Accordingly, as a result of this significant time pressure, and in order to help the parties as far as possible, at the end of the hearing on 30 March 2015, I indicated the court's answers to these issues. I found that the application was properly made under s.45 of the Arbitration Act 1996 and that all the statutory conditions were fulfilled. In addition, I found that, for a number of different reasons which I outlined, SSD's construction of the contract was correct, TES' construction was wrong, and the Target Cost/Maximum Price provisions in Condition 10.13 were not redundant. I then answered the two questions in favour of SSD. I expressly reserved the right, when I produced my detailed written reasons for those conclusions, to modify, add and/or subtract from my brief oral observations. This Judgment sets out in detail my reasons for those conclusions.

2. THE APPLICATION UNDER S.45: THE LAW

2.1 2.1 S.45

6.
Section 45 of the 1996 Act provides as follows:

"**45 Determination of preliminary point of law.**

(1) Unless otherwise agreed by the parties, the court may on the application of a party to arbitral proceedings (upon notice to the other parties) determine any question of law arising in the course of the proceedings which the court is satisfied substantially affects the rights of one or more of the parties.

An agreement to dispense with reasons for the tribunal's award shall be considered an agreement to exclude the court's jurisdiction under this section.

(2) An application under this section shall not be considered unless—

(a) it is made with the agreement of all the other parties to the proceedings, or

(b) it is made with the permission of the tribunal and the court is satisfied—

(i) that the determination of the question is likely to produce substantial savings in costs, and

(ii) that the application was made without delay."

7.
It seems to me that, in those circumstances, there are five critical ingredients of an application under s.45. There must be:

(i)
A question of law;

(ii)
Which substantially affects the rights of the parties;

(iii)
Which is being referred to the court either with the agreement of the parties or with the permission of the tribunal; and (if the latter):

(iv)
The determination of the question is likely to produce substantial savings in costs; and

(v)
The application is made without delay.

2.2 Authorities

8.
There are surprisingly few authorities relating to s.45. The principal case to which I was referred was a decision of Jackson J (as he then was) in **Taylor Woodrow Holdings Ltd and Another v Barnes and Elliott Ltd** [2006] BLR 377. That too was a TCC case dealing with a dispute about change orders and the correct construction of the contract. The claimant referred the matter to the court pursuant to s.45, whilst the defendant suggested that the matter should be left to the arbitrator. Jackson J held that the court had a discretion to decide whether to determine an issue of law agreed by the parties pursuant to s.45(2)(a) and that, on the facts of that case, it was appropriate for the court to determine the agreed issue of law. At paragraph 61 of his judgment, Jackson J said:

"61. Let me now turn to Mr. Fernyhough's third ground. The question of law which has been identified goes to the heart of the dispute between the parties. If the Employers are correct in their interpretation of the Contract, this will mean that the majority of the Contractor's claim (as presently

pleaded) cannot succeed. It seems to me highly desirable to establish what is the legal basis of the Contractor's claim, before the parties spend substantial sums of money on marshalling and presenting both factual and expert evidence on the individual heads of claim. In my view, it is cost-effective from the point of view of both parties to resolve the question of law now, and this course is likely to lead to a saving of costs. It should also be noted that the 'cost saving' test only applies to cases which fall under paragraph (b) of section 45(2) of the 1996 Act. This case falls under paragraph (a) and not paragraph (b)."

3. THE APPLICATION UNDER S.45: ANALYSIS

3.1 Question of Law

9.
The questions which have been formulated are agreed between the parties. The wording is taken from TES' own pleadings in the second arbitration, although it is not a precise quotation. The questions are in this form:

"(1) As a matter of construction of the Contract, if a Change occurred and ought to have been the subject of Target Cost adjustment during the design and construction period and was not, can the Target Cost now be adjusted by the Tribunal in respect of such a Change?

(2)
If the Target Cost cannot now be adjusted, how is FPP determined pursuant to the Contract? Without limitation to the foregoing:

(a)
Is FPP determined without applying Condition 10.13? and

(b)
Is FPP determined pursuant to Condition 10.12?"

10.
These are questions of law. They concern the proper construction of the contract. The only factual assumption that the court is obliged to make is that there were at least some Changes, which ought to have been the subject of a Target Cost adjustment during the design and construction period, but were not. Beyond that, the questions focus entirely on the proper interpretation of the contractual arrangements between the parties. Just as in **Taylor Woodrow** therefore, I conclude that these are manifestly questions of law.

3.2 Substantially Affecting the Rights of One or More of the Parties

11.
There can be no doubt that the questions substantially affect the rights of both parties. They concern the central issue of how the FPP is calculated. That is the issue at the heart of the second arbitration.

12.
TES claim their actual costs plus profit in the total sum of £186,271,784. That is almost £70 million more than the currently agreed Maximum Price (although I understand that the Maximum Price might ultimately be adjusted upwards). On that basis alone, the questions substantially affect the rights of both parties: the sums at stake are very significant.

13.

The determination of these issues substantially affects the rights of the parties in other ways. TES appear to have no alternative pleaded claim in the second arbitration: in other words, their whole claim is predicated on the basis that they are entitled to ignore the Target Cost/Maximum Price provisions of the contract, and can instead claim a simple entitlement to actual cost and profit. They do not seek, as an alternative, an adjustment to the Target Cost. They plead that the Change Proposals (and therefore the alleged Changes) "simply have no relevance". On the face of it, therefore, the determination of these questions against TES would conclude the entirety of their claim in the arbitration, and leave only SSD's counterclaim for determination.

14.
As for SSD, they are currently obliged to prepare two alternative cases for the second arbitration hearing in June. One is on the basis that TES are right in their construction of the contractual provisions; the other is on the basis that they are wrong. There is always a large amount of wasted work for a defending party in a case of this sort, when it has to prepare two very different cases on quantum, depending on which interpretation of the contract is correct. Thus, from SSD's point of view, the determination of the questions of law would affect their rights significantly. If they win, then the pleaded claim fails and all that is left is their counterclaim for overpayment. If they lose, they can then prepare to meet TES' claim on the proper interpretation of the contract.

15.
Accordingly, I find that the determination of these questions substantially affects the rights of both parties. Indeed, I did not understand Mr Keen QC seriously to argue the contrary.

3.3 Agreement or Permission

16.
Although the parties are not agreed, the Arbitral Tribunal granted permission to refer the questions to the court in their directions on 28 January 2015. This was subject to the condition that the application would be made by 5 February 2015. It was in fact made on 4 February 2015.

3.4 Savings in Costs

17.
The savings in costs that will flow from the determination of these questions will be substantial. The reasons for that mirror the reasons in **Section 3.2** above as to why, in my judgment, the determination of these questions substantially affects the rights of both parties.

18.
If the questions are resolved in favour of SSD then, on the face of the pleadings, TES has no alternative case in the arbitration and the only matter remaining for the June hearing would be SSD's counterclaim. If the questions were not determined in SSD's favour until the arbitration itself, TES would incur a huge amount of costs in putting forward their claim, only to have it resolved against them as a matter of principle. So even a decision against TES now would save them significant costs.

19.
On the other hand, if the questions are resolved in TES' favour, then both parties would be able to deal with liability and quantum at the arbitration hearing in June on a clear and fixed basis. Indeed, given the nature of TES' case – to the effect that they are entitled to their actual costs and profit, without more – there would be no need to look at or value the individual alleged Changes, because those would be irrelevant. Neither would it be necessary to do the comparisons between actual and

target costs. All that would appear to remain would be TES' claims for actual costs and profit for everything done, regardless of whether it was a legitimate Change or not (subject to the exclusions contained in Condition 10.16). There would obviously be a concomitant saving to SSD because SSD would know the basis on which it would have to prepare its defence.

20.
In addition, although I consider it is of less significance, I accept the argument put forward by Ms Hannaford QC to the effect that, if these questions were only determined in the final arbitration award, it is likely that the losing party would apply for permission to appeal. There is authority for the proposition that that is also a relevant factor in determining whether there would be substantial savings in costs in having the issue decided in advance: see **Toyota Tsusho Sugar Trading Ltd v Prolat SRL** [2014] EWHC 3649 (TCC).

21.
For all these reasons, therefore, I am in no doubt that the early determination of these questions would lead to a substantial saving in costs by both parties.

3.5 Without Delay

22.
For the reasons set out in paragraph 16 above, the application was made without delay. Indeed, I note from the material before the court that SSD wished to refer these issues to the court in September 2014, but the Arbitral Tribunal refused permission, saying that such an application was premature until the pleadings had been finalised. TES' case as to the construction of the contract was only formulated on the service of its Reply served in January 2015 (which mirrored some of its answers to the request for further information served in October 2014) [1] . Thereafter, SSD made the application promptly and complied with the Tribunal's time limit for issuing the application itself. In those circumstances, I find that the application was made without delay.

3.6 Summary

23.
It follows from paragraphs 9-22 above that I conclude that the application made by SSD falls firmly within s.45. I ought however, to address one connected matter which caused me some concern during the hearing. Throughout his oral submissions, Mr Keen QC persisted on referring to disputed matters of fact. I was obliged to point out that, not only was I unable to resolve such matters of fact but that, on the basis of the questions themselves (which I have already said were agreed), and on the material before the court, it was quite unnecessary for me to resolve such issues in order to decide the issues of construction. It was not always apparent to me that these propositions had been fully taken on board.

24.
Accordingly, for the avoidance of doubt, I stress that, not only are the ingredients of s.45 made out here, but there is no need for the court to resolve any matters of fact which may arise between the parties in the arbitration. It is common ground that, earlier on in the project, the MPTC Pricing Provisions were adjusted by the parties, in accordance with the contract. At a certain point, that co-operation ceased. TES blame SSD in particular for failing to operate their element of the contractual Change Proposal machinery either properly or at all. There are cross-allegations, including SSD's case that TES did not act in accordance with the interpretation of the contract that it now puts forward. But none of these allegations matter for present purposes. As Mr Keen QC himself said, all that

matters is that the Change Proposal procedure should have been operated throughout the contract and was not. The question is: what is the effect of that on the parties' contractual obligations and entitlements? That is quintessentially a point of law; indeed paragraph 41 of TES' reply in the arbitration puts the entire argument "as a matter of contractual construction…".

25.
I therefore go on to deal with the two questions of law. I do so by setting out the relevant conditions of the contract (**Section 4** below); looking at the nature of TES' claims in the arbitration (**Section 5** below); summarising the parties' respective cases on the relevant contractual provisions (**Section 6** below); before providing my own analysis of the contract and the way in which it worked (**Section 7** below).

4. THE CONTRACT

26.
The contract was designed to work on an 'open-book' basis. In other words, TES' books would be open to SSD, thereby enabling the actual costs of the works to be ascertained and verified. As set out below, those actual costs, together with an allowance for profit, would form the basis of TES' remuneration. However, the payments made to TES, and crucially the calculation of the final sum due to TES (the FPP), were controlled or restricted in two ways: through the Target Cost mechanism, and through the Maximum Price.

27.
I have considered the contract as a whole. It is voluminous (in places, unnecessarily so). I have only set out below what I consider to be the critical provisions for the purposes of determining these questions of law.

28.
The following Definitions are relevant:

"**"Actual Cost"** means either Actual Costs as defined in Condition 10.5 or Actual Costs as defined in Condition 11.2.

"Final Price Payable" means the final price payable to the Prime Contractor in respect of the Core Works calculated in accordance with Conditions 10.12 to 10.17."

29.
Condition 2 was headed 'The Contract' and was in the following terms:

"**2. THE CONTRACT**

The Project and Strategic Brief

2.1
Within a period, to be agreed with the IPTL, from the date of the Contract, the Prime Contractor shall produce the Project Brief and send it to the Authority for comment. The Project Brief will provide full details of how the Prime Contractor will meet the requirements of the Strategic Brief and will contain the information set out in the Project Execution Plan and be based upon the Outline Brief provided by the Prime Contractor prior to the Contract award, including the Prime Contractor's proposals for the completed design of the Core Works.

2.2

The Prime Contractor shall not be entitled to proceed to the next Stage of the Core Works unless and until the Authority has commented on the Project Brief and these comments have been discussed.

2.3
Notwithstanding Condition 2.2 above, the Prime Contractor accepts entire responsibility for the Project Brief and for any mistake, inaccuracy, discrepancy or omission contained in the same."

30.
Condition 10 is the critical provision for present purposes, because it is concerned with the Maximum Price Target Cost ("MPTC") Pricing Provision. It was in the following terms:

"10. MAXIMUM PRICE TARGET COST PRICING PROVISIONS

10.1
The Authority and the Prime Contractor have agreed that the following MPTC Pricing Provisions shall apply to the Core Works. The Target Cost for the Compliance Period Services is set out in the Joint Equality of Information and Pricing Statement and shall form part of the Core Services under the Main Contract on satisfactory completion of the Core Works.

10.2
The MPTC Pricing Provisions for Core Works under Contract comprise the following as detailed in the Joint Equality of Information and Pricing Statement at Appendix 3.1.4.

Core Works

(a)
Target Cost £103,513,231

(b)
Target Profit £7,225,224

(6.98% of Target Cost)

(c)
Target Price £110,738,455

(a+b)

(d)
Maximum Cost £113,567,978

(Target Cost + 9.71350%)

(e)
Maximum Price £117,776,785

(Target Cost + 13.77945%)

(f)
A sharing arrangement for cost under-runs between the Authority and the Prime Contractor of 50:50 (the Authority's share shown first) between the Target Cost and Actual Costs incurred and ascertained in accordance with Conditions 10.4 to 10.11.

(g)

A sharing arrangement for cost over-runs between the Authority and the Prime Contractor of 70:30 (the Authority's share shown first) between the Target Cost and Actual Costs incurred and ascertained in accordance with Conditions 10.4 to 10.11 up to the Maximum Cost, beyond which the Prime Contractor shall be liable for all costs incurred in satisfying his Core Works obligations up to the agreed liability cap under the Contract.

(h)
The maximum liability of the Prime Contractor for any loss, claim or additional costs over the Maximum Price in connection with this Contract or arising from any breach of Contract or under any indemnity hereunder, breach of statutory duty, in tort or otherwise at common law or otherwise howsoever arising shall not exceed:

(i)
a further sum equivalent to the Maximum Price; or

(ii)
the Maximum Price plus £50m (fifty million pounds sterling)

whichever is the lesser in respect of each Core Works Project and shall in no circumstances exceed a maximum aggregate liability of £50m (fifty million pounds sterling) above the Maximum Prices for all of the Core Works.

10.3
The Authority and the Prime Contractor acknowledge in reaching agreement on the details of the MPTC Pricing Provisions that both have, to a substantial extent, relied upon the representations contained in the Joint Equality of Information and Pricing Statement at Appendix 3.1.4.

Assessment of Actual Costs Incurred

10.4
For the purposes of assessing Actual Costs incurred by the Prime Contractor, the Prime Contractor shall, in accordance with Condition 10.12, furnish such particulars of costs properly incurred in providing Core Works under the Contract as may be reasonably required by the Authority. Such costs shall be allocated in accordance with the Prime Contractor's Cost Allocation Statement in accordance with the provisions of Condition 10.18 to 10.20. The Prime Contractor shall permit such particulars of costs to be verified by the Authority by inspection of his books, accounts, documents and other records.

10.5
Actual Costs properly incurred against the Core Works MPTC Pricing Provisions, for the purpose of agreeing the Final Price Payable, shall include but shall not be limited to:

(a)
wages, salaries, constituting a direct charge to the Core Works performed under the Contract;

(b)
materials constituting a direct charge to the Core Works performed under the Contract.

(c)
indirect charges appropriate to the Contract;

(d)

sub-contractor, consultant and supplier costs within the Supply Chain constituting a direct charge to Core Works performed under the Contract.

Supply Chain Incentivisation & Open Book

10.6
The Authority requires open book accounting from work performed by all Supply Chain members where prices are to be determined in accordance with MPTC pricing provisions where the value of the order exceeds £250,000. The Prime Contractor undertakes to ensure that such particulars are made available when the Authority requests them and in the format required by this Condition 10. For the sake of clarity any supplier who has access to more than £250,000 or work over the life of the Contract shall be covered by this provision.

10.7
The costs incurred by all members of the Supply Chain where prices, irrespective of value, are to be determined by the Prime Contractor in accordance with the provisions of MPTC shall be included within the Actual Costs reported to the Authority by the Prime Contractor in accordance with Conditions 10.4 and 10.5. These costs shall be included in the overall assessment by the Authority of the Actual Costs incurred against the Core Works MPTC Pricing Provisions and the calculation of the Final Price Payable for the provision of Core Works in accordance with the provisions of this Condition 10.

10.8
For avoidance of doubt, the open-book accounting requirements for the Prime Contractor's Supply Chain members as described in Condition 10.6 above, require Actual Costs incurred by the Supply Chain member in carrying out the order to be reported on which should exclude any element of profit/ VAT.

10.9
The Prime Contractor undertakes to maintain and on request furnish such particulars as the Authority may reasonably require in order that he may be satisfied that the prices paid by the Prime Contractor to members of his Supply Chain, (where not subject to separate MPTC pricing provisions agreed between the Prime Contractor and Supply Chain member) are fair and reasonable.

10.10
In addition to the provisions of Condition 10.6 above, the Prime Contractor shall seek to secure similar open book arrangements from his Supply Chain where prices that exceed £250,000 have not been or will not be determined by the Prime Contractor in accordance with the MPTC Pricing Provisions and were not placed through effective competition.

10.11
The Prime Contractor shall ensure that the provisions of this Condition 10 are passed on and included in his Supply Chain Contracts to ensure that the Authority has full open book arrangements with the Prime Contractor's Supply Chain members to the extent required by the provisions of this Condition 10. The Prime Contractor shall provide copies/extracts of the same on request.

Assessment of Final Price Payable

10.12
The Final Price Payable to the Prime Contractor for the provision of Core Works under this Supplementary Contract shall be based upon the Actual Costs incurred and verified in accordance

with Conditions 10.4 to 10.11. The Prime Contractor shall submit to the Authority, within 3 Months of completion of the provision of Core Works under the Contract, a Certified Cost Statement (in the form shown at Schedule 8) detailing all costs incurred in providing the Core Works under the Supplementary Contract.

10.13
The Final Price Payable shall be calculated as follows:

(a)
if the Actual Costs incurred and determined in accordance with Conditions 10.4 to 10.11 are equal to the finally adjusted Target Cost, then the Prime Contractor shall be paid the finally adjusted Target Price (i.e. finally adjusted Target Cost plus finally adjusted Target Profit);

(b)
if the Actual Costs incurred and determined in accordance with Conditions 10.4 to 10.11 are less than the finally adjusted Target Cost the Prime Contractor shall be paid a sum equal to:

(i)
the Actual Cost incurred determined in accordance with Conditions 10.4 to 10.11; plus

(ii)
the finally adjusted Target Profit; plus

(iii)
50% of the difference between the finally adjusted Target Cost and the Actual Costs incurred determined in accordance with Conditions 10.4 to 10.11.

(c)
if the Actual Cost reasonably and properly incurred and determined in accordance with Conditions 10.4 to 10.11 are greater than the finally adjusted Target Cost then the Prime Contractor shall be paid a sum equal to:

(i)
the finally adjusted Target Cost; plus

(ii)
the finally adjusted Target Profit; plus

(iii)
70% of the difference between the finally adjusted Target Cost and the Actual Costs reasonably and properly incurred and determined in accordance with Conditions 10.4 to 10.11.

PROVIDED that the Final Price Payable to the Prime Contractor shall not exceed the contractually agreed finally adjusted Maximum Price.

10.14
If, when assessing the Final Price Payable in accordance with Conditions 10.12 and 10.13, it appears to the Authority or Prime Contractor that the information referred to in the Joint Equality of Information and Pricing Statement at Annex 4 has proved to be materially inaccurate or incomplete or if there are any misinterpretations, negligence or other breach of legal duty in or in connection with that statement other than a breach of confidence, and the parties cannot reach agreement by negotiation, then neither party shall have any right of remedy against the other save that it may make

a reference to the DRB for determination of what adjustment (if any) should be made to the MPTC Pricing Provisions and whether any payment or repayment should, as a consequence, be made.

10.15

Neither party shall, however, be entitled to a rescission or avoidance of the Contract by reason of any misrepresentations or breach of the Joint Equality of Information and Pricing Statement.

10.16

The Final Price Payable excludes the following:

(a)

any costs incurred by the Prime Contractor by reason of any default or breach on the part of the Prime Contractor and without prejudice to the generality of the foregoing;

(b)

any sum allowed or paid by the Prime Contractor as damages for breach of contract;

(c)

any sums allowed or paid to the Authority resulting from any loss or damage caused to the Authority, its employees or agents as a result of a default by the Prime Contractor;

(d)

any costs relating to remedial works as a consequence of defects in the Prime Contractor's Works and/or Services as a result of negligence or gross error, or of defects noted by the IPTL in reviewing and inspecting the Works and/or Services submitted for final inspection, or of construction defects becoming apparent during the compliance Period for which the Prime Contractor is responsible to make good.

(e)

Any costs associated with removal of a sub-contractor and or supplier from the Supply Chain in accordance with Condition 39.4.

10.17

Assessment of the Final Price Payable shall take into account any amendments to the MPTC Pricing Provisions made in accordance with the Contract."

31.

Condition 12 was concerned with compliance period payments and was in the following terms:

"**12. COMPLIANCE PERIOD PAYMENTS**

12.1

Milestone Payments for the Compliance Period Services will be subject to the Performance Recovery System as defined in and set out under the Main Contract and will be made in accordance with the terms and conditions of the Main Contract."

32.

Condition 13 is the other important part of the contract for present purposes, because it was concerned with changes. It was in the following terms:

"13. CHANGES

13.1

The Change procedure shall equally apply throughout the design and construct period of the Contract. A Change means:

(a)
a change to the Strategic Brief which involves the addition to, omission from, or substitution of any of the Core Works instructed by the Authority in writing; or

(b)
a change in the timing or sequence of the Core Works requested in writing by the Authority; or

(c)
a change to the Project Brief or Strategic Brief proposed by the Prime Contractor, accepted by the Authority and confirmed by the Authority in writing; or

(d)
a change to the Project Brief caused in whole or in part by the occurrence of an Accepted Risk as defined in Condition 8.19; or

(e)
changes caused in whole or in part by the occurrence of any contingent risk as identified in the Risk Log.

(f)
changes resulting from review of the Joint Equality of Information and Pricing Statement.

(g)
changes to Authority procedures which IPTL requires the Prime Contractor to implement and which have an impact on time and or costs.

PROVIDED always that no such Change in (a) to (g) above will be issued to allow the Prime Contractor management of or an active strategic role in military or defence activities which remain under the control of the Authority.

13.2
Either the Authority of the Prime Contractor may propose Changes under Condition 13.1 on the Change Proposal Form at Schedule 4. If the Prime Contractor proposes a Change he shall also provide the Authority with a statement containing the Following supporting information:

(a)
the reason for the proposed Change;

(b)
a revised Master Programme demonstrating the impact of the proposed Change on the Completion Date and on the sequence or timing of the Compliance Period Services.

(c)
Where Changes are proposed by either the Authority of the Prime Contractor, the Prime Contractor shall provide:

(i)
estimates of the costs and/or the time involved in, or required for effecting the Change and the impact on the MPTC Pricing Provisions and/or the Milestone Payment Schedule and on the Target Cost for the Compliance Period Services. In the quotation the Prime Contractor shall use the rates and prices

contained in the Joint Equality of Information and Pricing Statement and used to calculate the MPTC Pricing Provisions;

(ii)
confirmation of, and clarification where appropriate, of how the Prime Contractor proposed Change would be of significant benefit to the Authority;

(iii)
any impact (detrimental or positive) that the proposed Change would have on the design of the Core Works;

(iv)
any other data or information whether financial or otherwise that the Authority may reasonably require in order to decide whether or not to authorise the Prime Contractor to proceed with the Change;

(v)
confirmation as to how the proposed Change will affect the Main Contract, other Supplementary Contracts and any interface contracts operating simultaneously during the course of the Core Works;

(vi)
Where the Change to the scope of the Core Works and/or Compliance Period Services would represent new works which the Authority proposes should be the subject of this Contract the Prime Contractor shall also provide such further information as the Authority shall request.

Valuation of Changes

13.3
Where the proposed Change relates to the design and construction period of the Contract, the Prime Contractor shall also indentify to the Authority the impact, if any, on the Prime Contractor's Through Life Cost Model and the target Cost.

13.4
Exceptionally, where the prime Contractor and the Authority agree that the basis of pricing contained in the Joint Equality of Information and Pricing statement and the MPTC breakdown are not appropriate for pricing the proposed Change, the Prime Contractor shall submit his proposed revision. In such exceptional circumstances, the Prime Contractor must demonstrate to the satisfaction of the Authority that the rates and prices quoted are the most advantageous available and represent best value for money for the Authority.

13.5
Upon receiving the Target Cost of any change from the Prime Contractor, the Authority shall be entitled to reject, accept the same or negotiate with the Prime Contractor with a view to reaching an agreement on any adjustment to the MPTC Pricing Provisions, Milestone Payment Schedule and/or any revisions to the Master Programme. The Authority shall pay those additional costs incurred by the Prime Contractor in preparation of those changes that are not proceeded with, provided they have been incurred in good faith and within the spirit of the overall collaboration arrangements;

13.6
Subject to Condition 13.8, if the rates or prices cannot be agreed, the Prime Contractor or Authority shall be entitled to refer the matter to the DRB within 20 Working Days of a dispute arising, after

which time subject to Condition 13.7 no challenge to the adjustments proposed by the Authority shall be capable of being made. The Authority shall have discretion whether or not to proceed with and approve the Change following any determination in accordance with the Dispute Procedure.

13.7
In the absence of any acceptance or agreement with 20 Working Days of receipt of the quotation, then the Authority may at its sole discretion and in writing:

(a)
elect not to proceed with the Change; or

(b)
elect to proceed with the Change following determination of the adjustment to the MPTC pricing provisions by the DRB. Where speed is of the essence, the Authority may require the work to proceed, with subsequent determination by the DRB.

13.8
In the event that the Authority makes a request in accordance with Condition 13.7(b) then the Prime Contractor shall forthwith comply with the said Change.

13.9
All Changes shall be approved in writing by the Commercial Officer on the Change Proposal Form at Schedule 4 hereto. Any work undertaken by the Prime Contractor prior to such approval shall be undertaken entirely at the Prime Contractor’s own risk except where such work is required to be undertaken in accordance with the provisions of 13.7(b). No approved Change shall in any way vitiate or invalidate the Contract.

13.10
The Authority may call a meeting with the Prime Contractor to discuss any Changes proposed by the Prime Contractor.

13.11
There shall be periodic reviews by the Authority and the Prime Contractor of the MPTC Pricing Provisions which may be affected by Changes pursuant to this Condition 13 to ensure that the MPTC Pricing Provisions and Joint Equality of Information and Pricing Statement remain realistic and reasonable in light of the baseline assumptions within the Strategic Brief and upon which the MPTC Pricing Provisions and Joint Equality of Information and Pricing Statement were based. If, in the reasonable opinion of the Authority, the MPTC Pricing Provisions have been significantly affected by reason of any approved Change or Changes pursuant to this Condition 13, the Authority shall have a discretion to negotiate an adjustment to the MPTC Pricing Provisions.

Revision to Contract to reflect approved Change

13.12
Within 10 Working days following approval of any Change in accordance with Condition 13.9, the Commercial Officer shall formally amend the Contract to reflect the impact of the Change and shall also make any consequential amendments to the Main Contract.”

33.
Condition 29 was concerned with the resolution of disputes. It was headed ‘Disputes Review Board’. It was in the following terms:

“**29. DISPUTES REVIEW BOARD**

29.1
The Authority and the Prime Contractor shall each appoint their DRB Members (one each) and jointly appoint the DRB Chairman by 1 July 2003 in accordance with the Dispute Procedure set out in Schedule 1.

29.2
In the event of a “Dispute” as defined in the Dispute Procedure arising or a matter being referable to the DRB in accordance with the specific conditions of the Contract, the Prime Contractor and the Authority agree to follow the Dispute Procedure set out in Schedule 1.

29.3
The Prime Contractor and the Authority shall keep the DRB properly informed of all progress in respect of the Core Works and Compliance Period Services by way of regular 6 Monthly updates in writing or orally and subsequently recorded in writing.”

Schedule 1 contained a lengthy Disputes Resolution Procedure. It should be noted that the current Arbitral Tribunal are, to all intents and purposes, the DRB identified in the contract, the parties having chosen to resolve these disputes by arbitration in accordance with Schedule 1.

34.
Condition 36 was concerned with the costing of the contingent risk. It was in the following terms:

“**36. COSTING CONTINGENT RISK**

36.1
The Authority has agreed with the Prime Contractor a specific catalogue of risks (other than the Accepted Risks) in respect of the Core Works which are particularised in Annex 4, Joint Equality of Information. Each risk has an identified and agreed estimate of the indicative costs at Target Cost levels allocated to it. If this Contract has been entered into pursuant to a Change under the Main Contract, the Authority may agree with the Prime Contractor agreed risks in respect of the Compliance Period Services to the extent such risks are additional to the risks already agreed in the Risk Logs for either the Main Contract or the Core Work. Such risks shall be incorporated as an amendment to the Risk Log for the Main Contract on completion of the Core Work. Risks for the Compliance Period Services where the Supplementary Contract does not result from an approved Change must be included in the Risk Log for the Main Contract at the start of the Contract.

36.2
The risks set out in the Risk Log are excluded from the MPTC Pricing Provisions. The Prime Contractor shall immediately notify the Authority on his becoming aware of a potential risk arising which is included within the Risk Log.

36.3
The Authority shall then decide through the IPTL whether such risk is a risk capable of resulting in an adjustment to the MPTC Pricing Provisions. If the Authority decides that the risk is capable of resulting in such an adjustment, the Authority and the Prime Contractor shall agree the appropriate adjustment to the MPTC Pricing Provisions. In the absence of any such agreement the Authority may, at its sole discretion, request the Prime Contractor to proceed forthwith with all necessary action on the basis of the estimated indicative cost at target Cost level subject to the final resolution of the DRB.”

35.
Condition 65 was concerned with severability. It was in the following terms:

"**65. SEVERABILITY**

65.1
The invalidity in whole or in part of any of these terms shall not affect the validity of any other provision and all remedies available to either party for breach of contract are cumulative and may be exercised concurrently or separately."

36.
Other relevant contract documents include the Joint Equality Of Information and Pricing Statement ("JEOIPS"). This included detailed information in respect of the MPTC and explained the benefits of cost-sharing. It also included the Commercial Risk Register referred to in Condition 36.

5. TES' CLAIMS IN THE ARBITRATION

37.
In the second arbitration, TES are claiming all of their actual costs pursuant to Condition 10.12, subject to the exclusions in Condition 10.16. This is in respect of both the original contract works, and all works which have been said in the past to constitute Changes, but the costs of which are now claimed whether they are valid Changes or not. In addition, they claim profit at 6.98% by reference to Condition 10.2 (albeit that that is a provision concerned with the calculation of the MPTC, a mechanism which TES now say is redundant). They argue that Condition 10.13 is "inoperable" because the mechanism under Condition 13 to deal with Change Proposals was not operated throughout the design and construction period of the contract (it was to start with, but then fell into abeyance). TES maintain that the contractual provisions relating to the calculation and adjustment of the Target Cost and the FPP cannot be operated after the event (i.e. after the Target Cost had stopped being some kind of incentive for TES) and that therefore the entire pain/gain mechanism has become redundant. They say that the Maximum Price proviso, which would otherwise provide a limit on SSD's overall liability (subject to the cap in Condition 10.2(h)(ii)), would also fall away entirely.

38.
I note at the outset that this is a radical position for TES to adopt. It involves ignoring some parts of the contract altogether (including, as we shall see, the contractual 'Definitions' section); it relies on an alternative – and very different – entitlement to payment, which is not expressed as such in the contractual conditions; and it changes in a fundamental way the whole basis of the bargain between the parties, because it replaces the original pain/gain agreement with a cost-plus contract. On any view, TES have set themselves an onerous task, in order to persuade the court that their singular construction of this contract is correct.

39.
To make a forensic point, Ms Hannaford QC, on behalf of SSD, endeavoured to point out the extreme consequences of TES' position. She observed that, on their pleaded case in the arbitration, if there had been a Change on the last day before practical completion, even one of low value (say £5,000), so that the Change Proposal procedure under Condition 13 (and adjustments to the MPTC Pricing Provisions) could not be operated before practical completion, it would follow that that Change would not have been dealt with during the "design and construct period". On the logic of TES' case, that would then mean that this Change (even though it happened too late to create a meaningful incentive for TES in respect of the Target Cost, and even though it was worth just £5,000), would have the

result that neither the Target Cost nor the FPP (Condition 10.13) could be operated at all. In consequence, no matter what had happened about Change Proposals in the preceding years, this late Change would suddenly entitle TES to their actual costs plus profit for the entirety of the Contract works, with no regard either to the pain/gain mechanism inherent in the Target Cost, or to the provisions concerned with the calculation of the FPP, or the Maximum Cost.

40.
Other variations on this theme are at paragraph 51 of her written submissions. She notes that the effect of TES' case is that an adjustment to the MPTC on the very last day before practical completion would somehow still have provided them with a meaningful target. And an adjustment on the day before practical completion, in respect of a Change carried out years before, would be possible, but a similar adjustment the day after practical completion would not.

41.
Although these examples are extreme to make the point, they are also entirely plausible. TES expressly plead that one Change not dealt with under Condition 13 suffices for their case as to the inoperability of the MPTC Pricing Provisions to succeed: see paragraph 31 of their Reply in the arbitration. The examples illustrate all too clearly the stark consequences of TES' submissions on the contractual issues.

6. SUMMARY OF THE PARTIES' SUBMISSIONS

6.1 TES' Submissions

42.
It is convenient to take TES' submissions first because, although they are the respondent to this application, it is their claim in the arbitration out of which all these issues arise.

43.
There are four essential submissions on which TES' claim rests. They are:

(i)
The reference in Condition 13.1 to the 'design and construct' period;

(ii)
The alleged inability of the DRB to become involved in disputes under Conditions 13.4-13.6;

(iii)
The absence of a meaningful target or incentive if Changes are considered/valued after the works have been completed; and

(iv)
The alleged impossibility of any sort of retrospective adjustment to the MPTC Pricing Provision.

I expand briefly on each of those submissions below.

44.
As to submission (i), TES point to the reference in Condition 13.1 to the "design and construct" period. They therefore argue that adjustments for Change Proposals could only be made during the design and construction period and that, if the works had been completed and change proposals had not been dealt with in accordance with Condition 13 by that date, then subsequent adjustments to the MPTC could not be agreed or determined.

45.
As to (ii), TES argue that Condition 13.7 gave SSD a significant right of election and it was only at that point that the DRB ‘entered the picture’, as it was described. It was said that the rest of the provisions – and Condition 13.5 in particular - amounted to no more than an agreement to agree and were therefore themselves unenforceable.

46.
As to (iii), TES argued that the whole point of having a target was to provide them with an incentive to keep costs to a reasonable minimum. Thus it was said that alterations to the Target Cost were meaningless if they were made after the works had been completed. That was another reason to say that, if the change proposal mechanism under Condition 13 had not been activated, then Condition 10.13 fell away.

47.
As to (iv), TES argued that, since Condition 13 depended on agreements between the parties at the time as to the value of particular Changes, the Tribunal could not determine what agreement the parties would or should have reached, and that therefore there was no basis on which the Tribunal could now identify a reasonable sum for a particular change proposal.

6.2 SSD’s Submissions

48.
As to (i), SSD maintained that the actual reference to the Change procedure in Condition 13, is that it shall “equally apply throughout the design and construct period”. In other words, this applied just as much to the design as to the construction period. It did not mean that adjustments for Changes could only be made during that period. The words were not intended to act as a guillotine and there is nothing about them which could justify such an interpretation. The dispute resolution provisions point the other way.

49.
As to (ii), SSD argued that the fundamental dispute between the parties is not about Condition 13, but Condition 10. In any event, TES’ construction of Condition 13, by focusing on Conditions 13.5 and 13.7 and ignoring the other Conditions, failed to address the cohesive nature of Condition 13 as a whole. Ms Hannaford QC denied that the provisions amounted to an agreement to agree and that, moreover, the DRB plainly had jurisdiction to deal with any dispute arising in respect of Condition 13, either pursuant to the express provisions of Condition 13 or the wider power under Condition 29.

50.
As to (iii), SSD argued that the contractual provisions and the dispute resolution provisions envisaged possible adjustments to the MPTC after the completion of construction. It was in respect of that submission that the £5,000 Change on the day before practical completion was invoked.

51.
As to (iv), SSD argued that the premise of TES’ submission was incorrect: the contract did not envisage that the Arbitral Tribunal would determine what agreement the parties would or might have reached, but would instead simply determine the appropriate adjustment under the contract. It was said that there were various ways in which the adjustments could be made by reference to the contract documents, including in particular the JEOIPS and the MPTC breakdown.

7. ANALYSIS

7.1 Overview

52.
I have already explained at **Section 5** above that, in my view, TES have set themselves an onerous task in endeavouring to persuade the court that their construction of the contract is correct. For a number of reasons, some general, some specific, I am in no doubt that they are unable to discharge that burden. On the contrary, I consider that SSD's submissions, ably marshalled by Ms Hannaford QC during the course of the oral argument, are to be preferred. I set out below the various reasons why I have reached such an unequivocal conclusion.

7.2 Business Common Sense

53.
The leading case on the modern approach to the construction of contracts is the Supreme Court decision in **Rainy Sky SA v Kookmin Bank** [2011] UKSC 50; [2011] 1 WLR 2900. At paragraph 21 of his judgment, Lord Clarke said:

"21. The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other."

54.
Lord Clarke referred to a number of authorities in which this approach is explained, including **Barclays Bank PLC v HHY Luxembourg SARL** [2010] EWCA Civ 1248; [2011] 1 BCLC 336 in which Longmore LJ said at paragraph 26:

"...If a clause is capable of two meanings, as on any view this clause is, it is quite possible that neither meaning will flout common sense. In such circumstances, it is much more appropriate to adopt the more, rather than the less, commercial construction."

55.
SSD's construction of the contract as a whole is that the MPTC Pricing Provisions could be adjusted after the completion of the works and that, in particular, the FPP was to be calculated in accordance with Conditions 10.12-10.17 of the contract. SSD say that there is nothing within Condition 10 that allows for or permits an alternative calculation of the FPP which ignores Condition 10.13 of the contract, and nothing in Condition 13 which suggests that, if the Change Proposal procedure was not always operated throughout the contract period, the detailed provisions relating to the FPP and the adjustment of the Target Cost would somehow become irrelevant or immaterial. That interpretation is accordance with business common sense: it would be a very odd thing if a procedural failure in respect of, say, one low value Change Proposal, suddenly meant that the commercial bargain between the parties had been fundamentally altered.

56.
For those same reasons, it follows that I conclude that TES' case does flout business common sense. Complex, high-value construction contracts of this sort last for many years. They therefore contain

detailed provisions, such as Condition 13, which set out what are essentially administrative provisions so as to ensure, wherever possible, the smooth running of the works. These contracts are onerous enough as it is. Those who enter into them would be astonished to learn that one procedural failing – a failure to follow the Change Proposal procedure once, over a five year period - would change this contract from a carefully-calibrated arrangement whereby cost over-runs and under-runs were shared between the parties, to a simple, straightforward, cost plus contract.

57.
That is why I have set out the nature of TES' case, and the admittedly extreme examples put forward by Ms Hannaford QC to exemplify it, at paragraphs 37-41 above. They demonstrate eloquently the absence of any business common sense in the TES construction of the contract. I note that, apart from the thin argument as to the incentive provided to them by the prompt adjustment of the Target Cost, which I address below, TES identified no basis on which it could be said that the SSD approach flouted common sense.

58.
There is, I think, a wider point here. If you trawl through the authorities over the last century or so, you will find a number of cases in which contractors have sought to argue that, because of subsequent events (usually variations of one sort or another) the remuneration provisions should be altered (or done away with altogether) so as to result in the contractor recovering on some sort of cost-plus basis. Some of those authorities are dealt with in the Court of Appeal decision of **McAlpine Humberoak Ltd v McDermott International Inc (No. 1)** [1992] 58 BLR 1. In that case, although the contractor had not actually argued it, the judge found that the numerous alleged variations gave rise to a kind of frustration. Ms Hannaford QC submitted that, before TES clarified their case as being one of contractual construction in October 2014 and January 2015, SSD wondered if the case here was being run along similar lines.

59.
The Court of Appeal had little difficulty in rejecting the judge's approach. And even though quasi-frustration was not an argument which Mr Keen QC adopted, I consider that, in the judgment of Lloyd LJ (as he then was), there are a number of observations which are of direct relevance to TES' case on construction in the present case. Amongst other things, Lloyd LJ said that it was impossible to hold that the contractual machinery between the parties had all been displaced by subsequent events, in precisely the same way as I consider that, in the present case, it cannot be said as a matter of business common sense that the provisions relating to the calculation of the FPP have also been displaced.

60.
The judgment of Lloyd LJ in **McAlpine** also supports Ms Hannaford QC's proposition that it would be absurd that a change made on the last day before practical completion, which could therefore not meaningfully affect the Target Cost as a matter of incentive, and which could not be dealt with in accordance with the Condition 13 procedure before practical completion, would render the Target Cost/Maximum Price provisions void and inapplicable. In a similar vein, when talking about delay, Lloyd LJ said that "if a contractor is already a year late through his culpable fault, it would be absurd that the employer should lose his claim for unliquidated damages just because, at the last moment, he orders an extra coat of paint." The point at issue might be different but the principle is the same: the contract has to be construed in accordance with business common sense.

61.

On that basis alone, I consider that the TES construction cannot be supported.

7.1

7.3 Giving Effect to All Parts of the Contract

62.

One of the canons of construction is that, in order to arrive at the true interpretation of a document, a condition must not be considered in isolation, but in the context of the document as a whole. A related principle is that the court should always lean towards a construction which validates the contract, on the basis that the parties are unlikely to have intended to agree to something that was legally ineffective. "Where a clause is ambiguous a construction which will make valid is to be preferred to one which will make it void": Kay LJ in **Hayne v Cummings** (1864) 16 CBNS 421. And perhaps the most important canon of construction for the purposes of the present case is that, in construing a contract, all parts of it must be given effect where possible, and no part of it should be treated as inoperative or surplus. Whilst the presumption against surplusage is unlikely to be useful in interpreting a standard form of contract (see **Beaufort Developments (NI) Ltd v Gilbert Ash (NI) Ltd** [1999] 1 AC 266) this is not of course a standard form contract but a bespoke contract carefully drafted by the parties to meet the exigencies of this particular and significant commercial arrangement.

63.

In its starkest form, I consider that TES' construction is contrary to all these principles. It would have the court ignore Condition 10.13 and at least some of the remaining Conditions 10.14-10.17. It would instead insist that the court read Condition 10.12 as providing an alternative method of calculating the FPP, even though there is nothing in Condition 10.12 to suggest that it is any such thing. Furthermore, this approach to construction, of picking and choosing those parts of Condition 10 which are to apply, and those which do not, is said to be based on a failure to comply with Condition 13, to which there is no reference in Conditions 10.12 or 10.13. Moreover, as noted below, the TES approach even picks and chooses which parts of Condition 13 it relies, whilst ignoring other parts.

64.

It is therefore a construction of the contract which fails to give effect to all the relevant Conditions: indeed it is based on some Conditions being entirely redundant. That is wholly contrary to the principles of construction noted above. On the other hand, SSD's construction construes the contract as a whole, saves the entirety of the document, and gives effect to all parts of it. Again therefore, as a matter of basic construction, I am bound to prefer SSD's approach.

7.4 The Central Importance of the FFP

65.

What lies at the heart of the second arbitration between the parties is the proper approach to the calculation of the FPP. How is the FPP to be calculated in accordance with the contract?

66.

In my view, the position is straightforward. First, the FPP is a critical part of Condition 10, which is headed 'The MPTC Pricing Provisions'. Condition 10.1 says that SSD and TES "have agreed that the following MPTC Pricing Provisions shall apply to the Core Works". They are therefore mandatory. The contract does not say that there may be circumstances in which they do not apply at all, much less that they do not apply on the happening of a procedural failing under Condition 13. At no stage did TES deal with the mandatory nature of Condition 10.1 in their submissions. On one view, it is

therefore unnecessary to consider their case further because Condition 10.1 provides a complete answer to the question. But in my view, the remainder of the MPTC Pricing Provisions dealing with the FPP only make that conclusion even clearer.

67.
The contractual definition of the ‘Final Price Payable’ (paragraph 28 above) is “the final price payable to the Prime Contractor in respect of the Core Works calculated in accordance with Conditions 10.12-10.17.” If one then turns to Conditions 10.12-10.17 one sees that:

(a)
The starting point is the reference to Actual Costs (a defined term) in accordance with Condition 10.12, which provides that the FPP ‘shall be based’ upon the Actual Costs. But it says no more than that.

(b)
What matters is how the FPP is to be calculated. The contract says that the FPP “shall be calculated” in accordance with Condition 10.13 (not Condition 10.12). Again it is mandatory. This calculation involves a comparison between the Actual Costs and the finally adjusted Target Cost. That is the agreed pain/gain mechanism;

(c)
Furthermore, there is the critical proviso in Condition 10.13 that the FPP “shall not exceed the contractually agreed finally adjusted Maximum Price”.

Conditions 10.14-10.17 then contain various discrete provisions intended to regulate the fairness of the comparison exercise (such as the provisions in Condition 10.14 if the JEOIPS is materially inaccurate or incomplete).

68.
In my view, therefore, the calculation of the FPP has to take place in accordance with Condition 10.13 and therefore has to involve the comparison with the finally adjusted Target Cost and the Maximum Price. That is what Condition 10.13 says. There is nothing in either Condition 10.12 or Condition 10.13 which suggests that there is any other way in which the FPP could be calculated, much less an indication that, on the happening of certain events, the entire pain/gain machinery and the cap provided by the Maximum Price proviso, would both fall away.

69.
In addition, it is clear from Condition 10.12 that the necessary adjustments and the comparison exercises all take place in the months after practical completion. That is entirely normal. But that provision is also ignored on TES’ construction of the contract, because they say that the Target Cost could not be adjusted in respect of Changes after completion of the works.

70.
I emphasise the terms of Conditions 10.12 and 10.13 because at no time during his oral submissions did Mr Keen QC indicate how or why the court should either ignore the contractual definition of the FPP (with its express references to Conditions 10.12-10.17 inclusive, thus including the critical Condition 10.13) or how, in looking at Conditions 10.12 and 10.13, the words used provided two alternative bases on which the contractor was entitled to be paid. I regard these omissions as significant; they indicated to me that TES were simply unable to address head-on the fundamental difficulties of contract construction created by their claim in the second arbitration. They were unable

to explain, by reference to the critical Conditions themselves, how and why the FPP could be something so different to that defined and provided for in the contract. All of their oral submissions were made by reference to Condition 13, to which (as previously noted) there is no express reference in either Condition 10.12 or Condition 10.13.

71.

It is convenient to deal here with one of the submissions that TES did make concerning the Target Cost element of the FPP. They argued that, if the procedure under Condition 13 was not followed, then the adjustments to the Target Cost as a result of Changes would not be up to date and would therefore fail to provide any sort of meaningful incentive to TES. Indeed, on a number of occasions Mr Keen QC inferred that the whole point of the Target Cost arrangement was to give TES an incentive as they went along; at one stage he asked rhetorically, 'if that did not happen, then what on earth was the point of any subsequent adjustment to the Target Cost?'

72.

In my view, there was a clear answer to Mr Keen QC's question. Subsequent adjustments to the Target Cost, following completion of the works, and during the subsequent period when the contractor's overall entitlement to extensions of time and final sums due are usually calculated, had a very real and significant 'point'. Such adjustments were required so as to be able to calculate the FPP in accordance with Condition 10.13. The payment provisions in this contract led up to the calculation and payment of the FPP. Adjustments to the Target Cost, whenever they arose, were required in order to calculate the FPP. Thus subsequent adjustments to the Target Cost had a very real significance for both parties.

73.

Furthermore, I considered that Mr Keen QC's submissions as to the purpose of the Target Cost were somewhat one-eyed. Of course it is true that one of the benefits to a contractor of a target cost being adjusted throughout the works is to provide an incentive to ensure that the works were carried out properly and at competitive cost. But there are also advantages in such an arrangement for the employer. The adjustment of the Target Cost provides a measure of certainty. And the comparison and the eventual cap provided by a finally adjusted Maximum Price also provides certainty that a certain figure (or perhaps range of figures) will not be exceeded. Those advantages, of certainty and price cap, are maintained by the subsequent adjustment of the Target Cost and the comparison exercise. They were not mentioned by Mr Keen QC but, so it seems to me, they were real and substantial.

74.

In my view, a retrospective adjustment of the MPTC Pricing Provisions (including the FPP) was envisaged by the terms of the contract. It would be required where, for example, there had been a Change which had not been valued in accordance with the Condition 13 procedure during the currency of the construction works; as explained below, it did not depend upon what the parties might have agreed before or at the time of the Change and was instead a straightforward valuation process based on contract documents; and (also as explained below) it fell fairly and squarely within the remit of the DRB, and therefore the Arbitral Tribunal.

75.

Accordingly, it was inevitable that, even if the Change Proposal procedure had been operated fully in accordance with Condition 13, there would always have been post-completion adjustments to the MPTC Pricing Provisions in accordance with the contract which may not have been capable of acting as any sort of incentive to TES.

76.
The proper calculation of the FPP is the central issue raised in the second arbitration. For the reasons noted above, TES' case, that in order to calculate the FPP you ignore Condition 10.13 altogether (because it was said to be inoperable) and derive some sort of alternative basis for the FPP out of Condition 10.12, could not be, and was not, made out as a matter of contract construction.

7.5 The Relevance of Condition 13

77.
Condition 13 is set out at paragraph 30 above. In my view, its provisions are clear, and are typical of bespoke contractual arrangements concerned with changes and change proposals on a complex construction contract. In essence:

(a)
Under Condition 13.2 either the Authority or the Contractor can propose Changes and, wherever the Change has originated from, they are to be the subject of estimates/quotations pursuant to Condition 13.2(c). The effect, if any, on the Target Cost must also be identified (Condition 13.3).

(b)
The quotation will be based on the JEOIPS (Condition 13.2(c)). It will only be in exceptional circumstances (Condition 13.4) that that document would not be used to value the Changes.

(c)
When the Authority receives the proposed change to the Target Cost from the Contractor, it is entitled to reject, accept, or negotiate the adjustment (Condition 13.5). If the relevant rates and prices cannot be agreed, either party is entitled to refer the matter to the Dispute Resolution Board (Condition 13.6).

(d)
In the absence of acceptance or agreement of the quotation then the Authority has a complete discretion to decide either not to proceed with the Change, or to proceed with the Change following determination of the adjustment by the DRB (Condition 13.7).

(e)
The same Condition also provides that, where speed was of the essence, the Authority could require the work to proceed, with the determination by the DRB being made subsequently. In the event that there was such a request, then Condition 13.8 provides that the Contractor has to comply with it forthwith.

(f)
All the remaining provisions, from Condition 13.9 onwards, are procedural and administrative, although I note that Condition 13.11 allows for periodic reviews and gives the Authority the discretion to negotiate an adjustment to the MPTC Pricing Provisions if it reasonably thought that they had been significantly affected "by reason of any approved Change or Changes". Condition 13.12 allowed for the formal amendment of the contract in respect of approved Changes.

78.
I am bound to say that I see nothing difficult or controversial in these provisions. They are designed to ensure that, so far as possible, neither party is taken by surprise by requests or claims for work which are said (either then or later) to be a Change, and to try and ensure that the carrying out of any

Changes, and the mechanism by which those Changes would be valued and paid for, would be operated as the contract went along.

79.
But of course, anyone with any experience of contracts of this sort knows that, in the scurry and scramble of a major construction project, these kinds of procedures can often fall into disuse. That is particularly so where, as here, the procedure is a little cumbersome and convoluted. The fact that the machinery is not operated contemporaneously may be the fault of one party; it may be the fault of both parties; it may be the fault of neither. But the fact remains that, from time to time, disputes as to whether or not a particular item is a change at all, and if it is, how it is to be valued, will be matters which fall to be resolved after the construction works have been completed. The question here is whether the contractual provisions here prevent that common situation from arising. In my view they do not. I demonstrate that by reference to the particular arguments advanced by TES.

7.5.1 "The Design and Construct Period"

80.
The first point taken by TES is that, by reason of the words in Condition 13.1, the Change Procedure only operated during the design and construction period. It is argued that it did not apply thereafter so that, if a Change had not been dealt with by the end of the construction period, it could not be dealt with under Condition 13 at all, and the Target Cost (with its pain/gain arrangement) and the Maximum Price cap, would both fall away.

81.
I reject that submission for a number of reasons. The words in Condition 13.1 are that the Change Proposal procedure "shall **equally** apply throughout the design and construct period of the contract" (emphasis added). In other words, all Condition 13.1 was doing was saying that the Change Proposal procedure applied not only to the construction period (which would be normal) but also to the design period (which might be thought to be less normal). The critical word in the first sentence of Condition 13.1 is "equally". The provision cannot be read as some sort of guillotine, providing that the Change Proposal procedure would no longer apply once the construction period had come to an end, or that adjustments to the MPTC Pricing Provisions for Changes could only be made during the design and construction period. There are a number of reasons for this.

82.
First, that is not what the words say. There is nothing within Condition 13.1 that could be read as some sort of guillotine, much less a guillotine with the draconian consequences contended for by TES. Secondly, the remainder of Condition 13 contains no provisions which could be sensibly suggested as supporting the alleged guillotine in Condition 13.1. On the contrary, the various provisions in Condition 13 can only sensibly be read as encompassing the possibility that some elements of the Change Proposal procedure, including any necessary adjustments to the MPTC Pricing Provisions for Changes, may well be operated after the construction period had come to an end.

83.
I take just two examples of this although, in my view, the entirety of Condition 13 can only be read in that way. The first example is by reference to Condition 13.3. That contains an obligation on the contractor to identify the impact of the proposed change on the Target Cost "where the proposed change relates to the design and construction period of the Contract". Such words presuppose that proposed changes which did not relate to the design and construction period of the contract were also possible.

84.

Secondly, there are the provisions in Conditions 13.7(b) and 13.8. These are the provisions that allow SSD, where speed was of the essence, to require the work involved in the change to proceed, prior to any determination by the Dispute Resolution Board. TES were obliged to comply with such a request ‘forthwith’; the determination by the DRB would come later. There is nothing to say that their determination had to be concluded prior to the completion of the construction works. On the contrary, these Conditions plainly encompass the possibility that the determination by the DRB (and therefore any adjustments to the MPTC Pricing Provisions) could be made later. Indeed, I understood Mr Keen QC to concede that adjustments under Condition 13.7 could indeed occur after the construction works had been completed.

85.

That view is supported by reference to other Conditions. For example, Condition 10.13 talked repeatedly of “the finally adjusted” Target Cost, Target Price, Maximum Price etc. That therefore envisaged a final adjustment at least three months after completion of the construction works (Condition 10.12). Similarly, Condition 10.14 expressly allowed the parties and/or the DRB to make retrospective adjustments to the MPTC Pricing Provisions. Condition 36.3 was to similar effect.

86.

In his oral submissions, Mr Keen QC placed great emphasis on the opening words of Condition 13.1. As I hope is plain, I consider that emphasis to be misplaced. There was nothing in Condition 13 which provided that, if the Change Proposal procedure had not been operated by the completion of the construction works, not only was it inoperable, but it had the draconian knock-on effect of wiping away the whole of the MPTC Pricing Provisions.

87.

There is one final point to be made on this part of the submissions. Let us assume, contrary to my firm conclusion, that the opening words in Condition 13.1 meant that the change procedure set out in Condition 13 would no longer operate following practical completion of the construction works. Such a conclusion would not then mean that, in some way, the Target Cost and Maximum Cost arrangements were void or inoperable. The second proposition simply does not flow from the first. If the Change Proposal procedure in Condition 13 did not operate after practical completion then that would have one of two consequences. Either TES would not be entitled to any sums for changes which had not been resolved under the Condition 13 procedure (which seems to me to be an entirely draconian consequence) or, much more likely, the parties – possibly with the assistances of the DRB – would operate a simple system (derived from the principles of quantum meruit and perhaps implied terms) whereby TES received a reasonable sum in respect of any Change carried out and that such a sum would then be “plugged in” to the adjustments of the MPTC Pricing Provisions.

88.

In other words, even if Condition 13.1 was a guillotine, it would not have the effect contended for by TES. The contractual mechanisms in respect of Target Cost, Maximum Cost, and the calculation of the FPP in accordance with Condition 10.13, were each separate from the valuation of Changes under Condition 13. They were not subject to Condition 13.1. So even if TES are right about the guillotine (and I do not believe they are) it does not support their contention that the parties were entitled or obliged to ignore Condition 10.13 and the critical parts of the MPTC Pricing Provisions.

7.5.2 The Jurisdiction of the DRB

89.

The next point advanced on behalf of TES was that the DRB (and therefore the Arbitral Tribunal, who are effectively one and the same body) had a very limited jurisdiction in respect of the valuation of Changes. This was part of the submission that, in consequence, Changes could not be valued after the end of the works, and that therefore the Target Cost/Maximum Cost/FPP calculation could also not operate. By reference to Conditions 13.5 and 13.7, Mr Keen QC argued that there could only be a reference to the DRB (at SSD's election) under Condition 13.7(b) and that even that was not in connection with rates and prices. In my view this submission was wrong for a number of reasons.

90.
The first reason can be found in Condition 29. The DRB had jurisdiction to deal with all disputes. Those disputes were defined in Condition 29.2 as either a dispute as defined in the Dispute Procedure, or a matter being referable to the DRB in accordance with the specific conditions of the contract. The Dispute Procedure (which comprised Schedule 1 of the contract) said:

"a dispute or difference will be deemed to arise when one party notifies the other in writing (with a copy to the DRB) of its grievance, dispute or claim of whatever nature arising out of, in connection with, or in relation to the negotiation, execution, interpretation, performance or breach of this agreement, including but not limited to any claim based on contract, tort, equity or domestic or international statue ("the Dispute")."

91.
That is a very broad definition of 'a dispute'. It plainly covers any dispute between the parties as to whether or not a particular item of work was a Change or not, and if so, what its value would be. Moreover, there is nothing in that definition or in the Dispute Procedure generally which limits when a dispute might arise or when it might be determined; in particular, there is nothing that prohibits the DRB from addressing alleged Changes and their value and effect long after the completion of the works. Any such restriction would, of course, have had to have been clearly spelt out.

92.
Accordingly, TES' submission as to the alleged limits on the DRB's jurisdiction under Condition 13 was predicated on a misassumption that their jurisdiction derived only from the express words in Condition 13. Condition 29.2 makes clear that that is incorrect. A dispute can arise under the specific conditions of the contract but it can also arise in accordance with the general definition to which I have previously referred. On that basis, therefore, there is no reason why the DRB could not deal with any dispute in respect of the Change Proposal procedure, howsoever and whensoever arising. The Arbitral Tribunal, therefore, has complete jurisdiction to decide any appropriate adjustment under Condition 13 and the MPTC Pricing Provisions.

93.
Secondly, Mr Keen QC's oral submissions ignored the specific provision in Condition 13.6. That made plain that, if the parties could not agree a figure, then the question of valuation would be referred to the DRB. The DRB therefore had the appropriate jurisdiction to decide the valuation of a Change under an express Condition of the contract. Therefore, contrary to Mr Keen QC's submissions, Condition 13.7 envisaged disputes as to rates and prices being referred to the DRB.

94.
As I understand it, in the first arbitration, SSD argued that Condition 13 was a condition precedent to the effect that, where TES had not complied with the Change Proposal procedure, there could be no claim and no adjustment to the MPTC Pricing Provisions. That argument was rejected in the first arbitration (see paragraph 21 of the first part award). Accordingly, because (for example) the time

limit in Condition 13.6 was not a condition precedent, then it follows that the DRB had and retained the jurisdiction to deal with the necessary adjustments at any time, subject presumably to any arguments that either side may have as to damages caused by and recoverable from the other in failing to operate the process within the 20 day period.

95.

Accordingly, for both of these reasons, the jurisdiction of the DRB was in no way constrained or confined, and the Arbitral Tribunal can deal with any issues that arise as to the valuation of Changes and the adjustment that such valuation may have on the MPTC Pricing Provisions.

96.

I ought also to deal expressly with one further point on jurisdiction which arose at paragraph 48 of Mr Keen QC’s written submissions. He suggested there that the Arbitral Tribunal could only intervene in the assessment of the FPP in the very limited circumstances set out in Condition 10.14. Of course, if that is right, it is difficult to see how the Arbitral Tribunal had the jurisdiction to deal with TES’ claims in the first arbitration, let alone the second arbitration, in which the correct assessment of the FPP is the paramount issue raised by TES. Happily, however, this potentially significant change of case on the part of TES (that the Arbitral Tribunal may not have the jurisdiction to consider its own claim) does not need to be considered further, because it fails to take account of Condition 29 and the jurisdiction thereby arising, as explained in paragraphs 90-92 above.

7.5.3 The Nature of the DRB’s Task

97.

The next submission advanced on behalf of TES was that the Arbitral Tribunal could not carry out a proper adjustment exercise after the event because it would be impossible for them to value what the parties would have agreed under Condition 13.5 if the procedure had been operated properly, so that no proper adjustment process can now be undertaken in the second arbitration.

98.

In my judgment, this is a mischaracterisation of the valuation provisions. True it is that, like numerous similar contracts, the emphasis in Condition 13 is on the parties agreeing (wherever possible) the sums referable to the Change. Contemporaneous agreement saves so much time and money and cuts down on extensive debates after the event. But if agreement is not reached, and the matter is referred to the DRB, then the DRB simply have to value the Change in accordance with the terms of the contract. Even if they were doing it during the currency of the construction work, the DRB would not be valuing what the parties would or might have agreed; they would be valuing the Change in accordance with Condition 13. The same is true for other Conditions too: for example, Condition 10.14, which allows for the DRB to determine the appropriate adjustment to the MPTC Pricing Provisions. This would not be by reference to a hypothetical agreement which the parties never made.

99.

Furthermore, under this contract, the process of subsequent valuation was clear and certain. That is because in the first instance the rates and prices had to come from the JEOIPS. Indeed, it was only if that document and/or the MPTC breakdown, were in some way inappropriate that other rates and prices might be considered. Thus (contrary to paragraph 41 of TES’ arbitration Reply) I find that there were plenty of objective criteria on which the DRB could base any post-event valuation. As I have said, such an exercise was expressly envisaged by Condition 13.7(b).

100.

Accordingly, the Arbitral Tribunal are in no different position now to that which the DRB would have been in then, in circumstances where there is an alleged Change but the validity of that Change and/or the valuation of that Change is not agreed. The contract provides a clear mechanism by which the Change can be valued and that valuation could either be contemporaneous or after the event. There is nothing in Condition 13 which prevents that process from being carried out or completed after the construction work.

101.
As demonstrated, other Conditions expressly envisage adjustments after completion of the works themselves. So, for the avoidance of doubt, I find that the same analysis applies to all the MPTC Pricing Provisions.

7.5.4 An 'Agreement to Agree'?

102.
Finally on Condition 13, Mr Keen QC suggested in his oral submissions that Condition 13 was unenforceable because it was a mere agreement to agree. He said that Condition 13 as a whole, and certainly Condition 13.5, therefore had no legal effect. In my view, this argument (which was first foreshadowed only shortly before the hearing) is a bad one. There are four reasons for this.

103.
First, Condition 13.5 cannot be read in isolation. It needs to be considered as part of a detailed process. Once the Contractor has provided the necessary pricing information, then it is up to the Authority to decide whether or not to accept the quotation and reach agreement. Condition 13.5 sensibly stresses that the attempt at agreement should come first. But if there is no agreement, then the matter is referred to the DRB. That is a perfectly sensible and normal valuation arrangement. It is not an agreement to agree.

104.
Secondly, I consider that my conclusion is in accordance with the authorities. The provisions in this case are not dissimilar to those considered by the Court of Appeal in **Petromec Inc v Petroleo Brasileiro SA** [2005] EWCA Civ. 891 in which Longmore LJ rejected the submission that such a provision was unenforceable. Indeed at paragraph 121 of his judgment he said:

"It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered. I have already observed that it is of comparatively narrow scope. To decide that it has 'no legal content' to use Lord Ackner's phrase would be for the law deliberately to defeat the reasonable expectations of honest men…"

105.
Other earlier authorities, such as **The Didymi** [1988] 2 Lloyds LR 108 and **Mamidoil Jetoil Greek Petroleum SA v Okta Crude Oil Refinery AD** [2001] EWCA Civ. 406 (where Rix LJ noted at paragraph 69 that the courts "will assist the parties [and] preserve rather than destroy bargains") support the same conclusion. The authorities on which Mr Keen QC sought to rely, such as **Courtney and Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd** [1975] 1 WLR 297 and **Walford v Miles** [1992] 2 AC 128 were carefully distinguished in **Mamadoil** and **Petromec** for reasons which, in my judgment, apply equally here. For example, in both **Courtney** and **Walford v Miles** there was no contract at all. That is not this case.

106.

Thirdly, and it is linked to the previous point, I am bound to note that, although the procedure under Condition 13 fell into abeyance during the contract works, it was operated at least for a while. That is common ground. Thus the effect of Mr Keen QC's submission is to rule that a Condition which both parties have relied on and operated, at least to an extent, was of no legal effect at all. It seems to me that that offends against the principle, outlined by Steyn LJ (as he then was) in **Percy Trentham v Archital Luxfer Ltd** [1993] 1 Lloyd's Rep 5. If a contract has been performed, it makes it much more difficult to say, after the event, that some provision within it was inoperable or that indeed there was no contract at all. That is, amongst other things, contrary to common sense.

107.

Fourth and finally, even if (which I do not accept) Condition 13.5 was an agreement to agree and even if (which I also do not accept) it should now be said to have no legal effect, that would again not lead to the conclusion that the Target Cost or Maximum Cost mechanism should be obliterated. As Ms Hannaford QC put it rhetorically in her reply, it was impossible to get from a finding that Condition 13.5 was an agreement to agree to a finding that TES were entitled to a 'costs plus' contract. She said there were far too many logic leaps in such a submission. For the reasons I have already explained in relation to the MPTC Pricing Provisions as a whole, I agree.

108.

For all those reasons, therefore, Condition 13.5 was not an agreement to agree and in any event, however it was intended to or was operated, it did not affect the validity of the Target Cost and Maximum Cost provisions, or the calculation of the FPP.

8. ANSWERS TO QUESTIONS

109.

It follows from **Section 7** above that, for the reasons set out there, the answer to question 1 is Yes, the Target Cost can still be adjusted, and that there is nothing to prevent such adjustment continuing following the actual completion of the works.

110.

On that basis, question 2 does not arise. But for the reasons that I have explained, it is a wholly impermissible reading of the contract to conclude that the FPP could be determined without applying Condition 10.13. Indeed, on a proper construction of the contract, the FPP can only be calculated by reference to Condition 10.13.

111.

However I should say this. If, contrary to all of my conclusions, Condition 10.12 founds some form of alternative basis for the FPP, then it could be based solely on Actual Costs. There is nothing in Condition 10.12 that would allow recovery of any profit. The entitlement to profit is part of the MPTC Pricing Provisions which, if TES had been right on question 1, would have become inoperable.

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[1] Although TES maintain that their case on construction was clear from the Points of Claim served in October 2013, I disagree. The basis of the claim there is opaque. Doubtless that was why the tribunal did not agree to hear the s.45 application until after TES had closed their pleaded case.