Neutral Citation Number: [2020] EWCA Civ 1645

Case No: A1/2019/1792

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM QUEEN'S BENCH DIVISION
TECHNOLOGY AND CONSTRUCTION COURT
Miss Joanna Smith QC (sitting as a Deputy High Court Judge)
HT-2019-000047

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 04/12/2020

Before :

LORD JUSTICE COULSON
LORD JUSTICE MALES
and
LADY JUSTICE CARR DBE

- -

Between :

ABC Electrification Limited	**Appellant/ Defendant**
- and -	
Network Rail Infrastructure Limited	**Respondent /Claimant**

- -
- -

Marcus Taverner QC and William Webb (instructed by **Trowers & Hamlins LLP**) for the **Appellant**
Piers Stansfield QC (instructed by **Eversheds Sutherland (International) LLP**) for the **Respondent**

Hearing date: 25 November 2020

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Approved Judgment

"Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals Judiciary website. The date and time for hand-down is deemed to be 10.00am Friday 4 December 2020."

Lady Justice Carr DBE:

Introduction

1. This appeal concerns the proper construction of a Target Cost Contract based upon the standard Institute of Civil Engineers Conditions of Contract, Target Cost Version, First Edition ("the ICE Conditions") and subject to standard amendments commonly used in the rail industry, namely standard amendments used by Network Rail Infrastructure Limited ("Network Rail") and known as "Network Rail 12" ("the NR 12 Amendments"). Specifically, the appeal concerns the proper interpretation of the word "default" as it appears in the wider definition of the term "Disallowed Cost".

2. In February 2019 Network Rail brought proceedings under CPR Part 8 against ABC Electrification Limited ("ABC") for declaratory relief. By order dated 5 July 2019 Miss Joanna Smith QC (sitting as a Deputy High Court Judge) ("the Judge") granted judgment in favour of Network Rail and the following declaratory relief:

> "(1) The defined term 'Disallowed Cost' in the Contract (as more particularly defined in the Judgment) includes any cost due to a failure by [ABC] to comply with its obligations under the Contract;
>
> (2) A cost incurred due to a failure by [ABC] to comply with the terms of the Contract including the following is a Disallowed Cost:
>
> (a) Any failure by [ABC] to start the Works on or as soon as reasonably practicable after the Works Commencement Date and/or thereafter to proceed with the Works with due expedition, contrary to clause 41(2) of the Contract;
>
> (b) Any failure by the Defendant to substantially complete the [W]orks within the time stated for completion (or such extended time as may be allowed under clause 44 or revised time agreed under clause 46(3)) calculated from the Works Commencement Date, contrary to clause 43 of the Contract."

("the Order")

3. ABC is entitled to payment by Network Rail based in part on the "Total Cost" (defined so as to exclude, amongst other things, Disallowed Cost). ABC has not completed the contract works in accordance with the contractual timetable. Network Rail has categorised costs amounting to some £13.43 million as Disallowed Cost on the basis that this sum was incurred due to ABC's breaches in failing to complete with due expedition, without delay and by the time for completion. If Network Rail's assessment is correct, the practical effect of the Order is therefore that Network Rail is not liable to pay ABC that sum.

4. ABC appeals against the Order (and judgment below) on the basis that the Judge erred in law: she ought to have found that, on a proper construction, a cost is only to be treated as a "Disallowed Cost" if there has been an element of fault on the part of the contractor

"in the sense of blame or culpability" (as opposed to a breach of contract for which there has been no such blame or culpability). It seeks to vary the Order so as to read that:

> "…the word "default" as it appears in the defined term "Disallowed Cost" in the Contract connotes fault in the sense of blame or culpable behaviour on the part of the Contractor in compliance with any of his obligations under the Contract."

5. As ABC fairly recognises, this proposition is a materially modified version of the (more extreme) construction advanced below, namely that a cost was only to be treated as a "Disallowed Cost" if there had been "wilful" or "deliberate" conduct on the part of the contractor. That construction is no longer relied upon. There is no challenge on appeal to the granting of declaratory relief consequent upon the ruling on construction in principle, although that was resisted by ABC below.

6. As indicated, the use of the ICE Conditions as amended by the NR 12 Amendments is widespread in the rail sector. It is one of the most widely used forms of contract within Network Rail's suite of contracts. The outcome of this appeal is therefore significant for many contractors operating in the railway engineering industry.

7. To assist resolution of the issue, the court has had the benefit of written and oral submissions from Mr Marcus Taverner QC and William Webb for ABC, neither of whom appeared below, and Piers Stansfield QC for Network Rail (who did appear below).

The Contract

8. ABC is an incorporated joint venture between Alstom Transport UK Holdings Limited, Babcock Rail Limited and Costain Limited ("Costain"). By a contract dated 20 December 2012 Network Rail engaged Costain to carry out works for Phase 3B of the West Coast Power Supply Upgrade Project Phase 3 ("the WCPSUP"). Phase 3B involved works to a section of the West Coast Main Line running between Whitmore in Staffordshire and Great Strickland in Cumbria. The contract incorporated the ICE Conditions subject to the NR 12 Amendments.

9. By a deed of novation dated 31 March 2014 the contract was novated by Costain to ABC. By a deed of variation executed by ABC on 22 September 2014 and by Network Rail on 19 January 2015 the works were varied so as to include works within Phase 3A of the WCPSUP, involving a section of the West Coast Main Line running between North Wembley and Whitmore ("the Deed of Variation").

10. I refer in this judgment to the contract as novated and varied as "the Contract". References to "the Works" are references to the Phase 3A and 3B works that ABC was contracted to perform under the Contract.

The definition of Disallowed Cost

11. As indicated, the Contract was a Target Cost Contract. Thus ABC is entitled to payment based on the costs of the works carried out, rather than on the basis of any pre-agreed lump sum price or unit rates. Specifically, ABC is to be paid the following sums:

i) The Total Cost (see Clause 60(1)(a));

ii) Incentive Payments (if any) (see Clause 60(2)(a);

iii) The Fee, broadly intended to cover head office overheads and profit (see Clause 60(3));

iv) The Contractor's Share arising from what is described as the pain/gain share mechanism (see Clause 60(5)).

12. "Total Cost" is defined in Clause 1(1)(x) of the Contract as follows:

> ""Total Cost" means all cost (excluding Disallowed Cost and items covered by the Fee) incurred by the Contractor for the carrying out of the Works ascertained in accordance with the Appendix - Part 4."

13. There is no limit on the amount of Total Cost. Instead, pursuant to Clause 60(5), the Total Cost falls to be measured against the Target Cost. Broadly speaking, if the Total Cost is lower than the Target Cost, ABC is entitled to be paid a "gain share"; if the Total Cost is higher than the Target Cost, ABC is required to pay a "pain share" (at varying levels depending on the applicable differential percentage band).

14. "Disallowed Cost" is defined in Clause 1(1)(j), which is central for present purposes:

> ""Disallowed Cost" means
>
> (i) the cost of work of repair amendment reconstruction and rectification or making good defects where such work is carried out to parts of the Works supplied or carried out by sub-contractors and is required under the terms of the sub-contract to be at the sub-contractor's expense
>
> (ii) the cost of repair amendment reconstruction rectification and making good defects after the date of substantial completion which in the opinion of the Engineer is necessary solely due to the use of materials or workmanship not in accordance with the Contract
>
> (iii) any cost due to negligence **or default** on the part of the Contractor in his compliance with any of his obligations under the Contract **and/or due to any negligence or default on the part of the Contractor's employees, agents, sub-contractors or suppliers in compliance with any of their respective obligations under their Contracts with the Contractor**
>
> (iv) any cost which cannot reasonably be justified by the Contractor's accounts and records
>
> (v) the cost of plant materials equipment and resources not used in carrying out or providing the Works

> (vi) any such cost identified in the Contract as a disallowed cost or as part of the Fee or which does not form part of the Total Cost and
>
> (vii) any cost which was not properly and necessarily incurred in carrying out or providing the Works."

15. The words in bold above were introduced pursuant to the NR 12 Amendments.

The judgment below

16. In summary, the Judge held that, applying the relevant principles of construction, the word "default" in Clause 1(1)(j)(iii) carried its natural and ordinary meaning:

    i) The language of the clause is clear and unambiguous. A meaning of "wilful and deliberate" failure would only usually be achieved by the addition of extra words. The concept of default in Clause 65, a termination provision, did not support such a construction, any more than did the use of the word "default" in Clauses 39 and 43A(4);

    ii) There was no proper basis for concluding that the parties must have intended the word "default" in the clause to carry a different meaning from its natural and ordinary meaning by reference to its context or the background of the Contract as a whole;

    iii) The fact that the Contract was a Target Cost Contract did not affect the approach to be taken to interpretation;

    iv) Considerations of commercial common sense and/or commercial reality could not lead to a different interpretation when the words of the clause were clear.

Relevant general legal principles

17. The well-known general principles of contractual construction are to be found in a series of recent cases, including *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900; *Arnold v Britton and others* [2015] UKSC 36; [2015] AC 1619 and *Wood v Capita Insurance Services Ltd* [2017] UKSC 24; [2017] AC 1173.

18. A simple distillation, so far as material for present purposes, can be set out uncontroversially as follows:

    i) When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean. It does so by focussing on the meaning of the relevant words in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the contract, (iii) the overall purpose of the clause and the contract, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions;

ii) The reliance placed in some cases on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision;

iii) When it comes to considering the centrally relevant words to be interpreted, the clearer the natural meaning, the more difficult it is to justify departing from it. The less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning;

iv) Commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made;

v) While commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party;

vi) When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time the contract was made, and which were known or reasonably available to both parties.

19. Thus the court is concerned to identify the intention of the parties by reference to what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. This is not a literalist exercise; the court must consider the contract as a whole and, depending on the nature, formality, and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning. The interpretative exercise is a unitary one involving an iterative process by which each suggested

interpretation is checked against the provisions of the contract and its commercial consequences investigated.

20. Two additional specific canons of construction have been referred to in context by the parties:

    i) ABC submits, so far as necessary, that it is legitimate to consider the (unamended) ICE Conditions as an aid to interpretation: see *Team Services plc v Kier Management & Design Limited* [1993] 63 BLR 76 at [87] and [88]; *Bovis Lend Lease Limited v Cofely Engineering Services* [2009] EWHC 1120 (TCC) at [23];

    ii) Both parties have made submissions by reference to the concept of "redundancy" or "superfluity". Whilst the redundancy argument has a role to play in the exercise of contractual interpretation, it all depends on the construction issue in question, the effect of the alternative interpretation and the contractual context as a whole. The mere fact that a natural interpretation of a contract could render another term redundant is an insufficient basis for an unnatural construction, especially where a standard form is involved: see *Beaufort Developments v Gilbert Ash* [1999] 1 AC 266 at 274B; *Secretary of State for Defence v Turner Estate Solutions Limited* [2015] EWHC 1150 (TCC) (*"Turner"*) at [62]; *Mutual Energy v Starr Underwriting Agents* [2016] EWHC 590 (TCC) BCLR 312 at [35]; *Spire Healthcare v Royal & Sun Alliance Insurance* [2016] EWHC 3278 at [15]).

A summary of ABC's challenge and Network Rail's response

21. In overview, ABC now contends that the Judge was wrong to find that the word "default" in Clause 1(1)(j)(iii) includes any failure by the contractor to comply with its contractual obligations. She gave too much attention to the dictionary definition as opposed to the use of the word in context and insufficient weight to the consequences of her interpretation.

22. Under the ICE Conditions (unamended), Clause 1(1)(j)(iii) provides that "Disallowed Cost" includes "any cost due to negligence on the part of the Contractor in his compliance with any of his obligations under the Contract". ABC submits that there is thus a two-stage process whereby:

    i) It must first be shown that there has been some contractual non-compliance;

    ii) The nature of that non-compliance must be assessed to determine whether it amounted to "negligence".

    Under the (unamended) ICE Conditions, therefore, the contractor is entitled to be paid for work consequent upon a breach of contract, provided that the breach was not negligent.

23. ABC submits that the NR12 Amendments to Clause 1(1)(j)(iii) were not intended to create a wholesale shift from this position, such that the allocation of risk in the ICE Conditions was "fundamentally changed". Under the NR 12 Amendments, the structure of Clause 1(1)(j)(iii) remains the same: it is still necessary to carry out a two-stage

process, determining whether there has been contractual non-compliance and, if so, whether that non-compliance was the product of "negligence" or "default". "Default" in the context of Clause 1(1)(j)(iii) does not merely mean the same as breach. Otherwise the two-stage nature of the test would be collapsed into a single question. Instead, "default" "connotes some measure of fault in the sense of blame or culpability on the part of the contractor". It is said to require "personal conduct which is in the nature of a breach of duty". Reliance is placed on *City of Manchester v Fram Gerrard Limited* [1974] 6 BLR 70 ("*Fram Gerrard"*) at 90.

24. ABC contends that an approach whereby the addition of the word "default" does not alter radically the balance of a Target Cost Contract is to be preferred for the following reasons:

i) It leads to less redundancy in other parts of the Contract: by reference to other words within Clause 1(1)(j)(iii) itself (i.e. the reference to "negligence"); other words in Clause 1(1)(j) (Clauses 1(1)(j)(i), 1(1)(j)(ii) and 1(1)(j)(vi)); and other provisions more generally (Clauses 20(3), 47(3), 49(3) and 49(4)). As Mr Taverner put it, either individually or cumulatively, these matters demonstrate that Network Rail's interpretation "goes against the grain" and is a "retro-fit";

ii) It is not inconsistent with other provisions of the Contract and consistent with Clause 50 prior to the Deed of Variation (which referred to "Contractor's default or from failure on the part of the Contractor to observe and perform his obligations under the Contract"). Reference was made below to the termination provisions in Clause 65(e) to (j) which provide for termination by reference to particular sub-categories of culpable breach, but Mr Taverner made it clear that he did not pursue any argument by reference to Clause 65 on appeal;

iii) It is in accordance with the commercial purpose of a Target Cost Contract. There are specific circumstances where the contract provides for a contractor entitlement to an adjustment to the Target Cost and where he is not. In either case, though, the contractor is paid any additional costs arising as part of the Total Cost (see Clauses 13(3), 14(8), 38, 46(1), 50, and 51(5)). Centrally, non-compliance with the contract does not result in adjustment to the Total Cost;

iv) Overall, it is the correct interpretation of the parties' intentions, as manifested by the wording in the Contract read as a whole. Construing the meaning of the word "default" as requiring blame or culpability in the nature of a breach of duty would preserve the two-stage process set out in Clause 1(1)(j)(iii). There are numerous instances where the Contractor may have failed to comply with a contractual obligation in the contract for reasons beyond its control. The Contractor would not be in "default" and no costs caused by the fact that the Contractor was disrupted or its progress delayed would be disallowed as a result.

25. ABC submits that there is nothing unworkable about its interpretation, and in any event no more difficulty in practice than would arise upon the application of Network Rail's construction (which would require minute analysis under Clause 41(2) of the Contract as to whether every item of work had been carried out with due expedition and without delay).

26. Network Rail's positive case, as it was below, is in summary that:

i) The word "default" is commonly used in construction and other commercial contracts. Its natural and ordinary meaning is "a failure to fulfil a legal requirement or obligation";

ii) Since the word "default" was added to Clause 1(1)(j)(iii) by amendment, it is evident that the parties intended to add something to the unamended clause. The starting point for the interpretation of the clause, as amended, is the language used, which is clear and unambiguous and should be given its natural and ordinary meaning;

iii) There is no basis to conclude, from the terms of the Contract, its factual matrix and commercial context, that the parties' intention was that the word "default" should bear something other than its ordinary meaning;

iv) The consequence of giving the word "default" its natural and ordinary meaning is that its effect is clear and straightforward – and a commercially sensible outcome.

Analysis

27. Given the change of tack in ABC's position, a close critique of the Judge's analysis would not be a useful exercise. ABC expressly does not seek to criticise the Judge's conclusion on the arguments deployed before her. ABC's case below, namely that "default" was to be construed as meaning "deliberate" or "wilful" default was, if not hopeless, then on any view a very difficult interpretation to maintain. Amongst other things, as the Judge held, such a meaning would only usually be achieved by the addition of extra words.

28. Rather, the question of construction falls to be assessed on the basis of ABC's re-formulated position and by reference to new submissions. Network Rail has taken no procedural objection to ABC advancing a fresh position on appeal and has responded to it substantively, including by way of Respondent's Notice.

29. ABC's modified contention, namely that "default" is to be construed as meaning a default where there has been an element of fault on the part of the contractor, breathes some new life into ABC's position.

30. However, I have reached the clear conclusion that that interpretation is also to be rejected in favour of the interpretation that the word "default" in Clause 1(1)(j)(iii) means just what it says, namely a failure to fulfil an obligation, here a failure on the part of ABC to comply with any of its obligations under the Contract. That is to say that the words "default on the part of the Contractor in his compliance with any of his obligations under the Contract" mean a breach of contract by ABC. There is, as a matter of proper construction, no basis for the introduction of any qualification or embellishment such as to import a requirement for the breach of contract to carry (an unspecified degree of) personal blame or culpability (or conduct) on the part of the contractor.

31. It is common ground that the ordinary and natural meaning of the word "default", a word commonly used in construction (as well as other commercial) contracts is "a failure to fulfil a legal requirement or obligation".

32. I do not accept ABC's submission that this definition of "default" makes no linguistic sense in the context of the wording of Clause 1(1)(j)(iii): it reads across as follows (given the already existing words of "on the part of the Contractor in his compliance with any of his obligations under the Contract): a "failure on the part of the Contractor in his compliance with any of his obligations under the Contract". Equally, I see nothing in the submission that the relevant NR 12 Amendment did not simply say "breach" of contract instead of "default" (as appears for example in Clauses 3(4), 60(6)(a), 60(8), 75(5) and 75(6)). Given the existing reference to "negligence" (followed by "on the part of the Contractor in his compliance with any of his obligations under the Contract") in the clause, the insertion of the word "default" was the simplest (and obvious) manner in which to reach the same result without carrying out more extensive amendments.

33. Nor do I accept ABC's submission that the fact that the words "or default" follow the word "negligence" means that "default" is to be read so as to concern itself only with the manner or quality of performance, not outcome. This submission was made in the context of ABC's suggestion that there was a "two-stage process" to be carried out, as set out above. The two-stage process contended for by ABC seems to me to be something of an artificial construct: Clause 1(1)(j)(iii) simply refers to "negligence…on the part of the Contractor in his compliance with any of his obligations under the Contract" and/or "default on the part of the Contractor in his compliance with any of his obligations under the Contract".

34. Even if there were a two-stage process to be carried out in a search for negligence, there is no reason why, as a matter of construction, a two-stage process falls to be carried across to the exercise in contract - where (leaving aside causation) there is a single question, namely whether or not the contractor acted in breach. As part of its submissions, ABC also suggests that it cannot have been intended that a single word, such as "default", could have such a "major impact" on the approach in Clause 1(1)(j)(iii) as unamended. I disagree. There is no reason why a single word cannot have a major impact. In the course of the hearing, Lord Justice Coulson referred by way of example to an amendment inserting the word "not". The word "default" which the parties chose to agree was clear and simple.

35. ABC refers to a number of authorities in which the meaning of the word "default" has been considered, although Mr Taverner made it clear in the event that ABC relies on them only for the limited (and uncontroversial) proposition that the word "default" can mean different things depending on its context: *In re Bayley-Worthington & Cohen's Contract* [1909] 1 Ch 648 (*"Bayley-Worthington"***)** (at 654-656 and 660) (concerning the sale and purchase of land); *Fram Gerrard* (at 90 and 92) (concerning an indemnity triggered by "negligence, omission, or default of the contractor" in a RIBA standard form); *Greater London Council v The Cleveland Bridge and Engineering Company Limited and another* [1984] 34 BLR 50 (at 69 and 70) (concerning the correct interpretation of a price fluctuation clause in a contract for the provision of gates for the Thames water barrier) (and approved in the Court of Appeal [1986] 34 BLR 72).

36. ABC appears to have drawn on the statement by Parker J (as he then was) in *Bayley-Worthington* (at 656) to the effect that "default" refers to "personal conduct and is not the same thing as breach of contract". ABC echoes this phrase in its suggestion that "default" here "requires personal conduct which is in the nature of a breach of duty". However, the reference by Parker J to "personal conduct" was in the context of defining "default" in circumstances where a party could be in breach of contract in failing to

complete a sale and purchase contract of land even if the cause of non-completion was the failure of the other party; he was determining the meaning of default "within the meaning of the contract" in "these circumstances". The reference to a requirement of "personal conduct" is understandable in such a scenario. But such reasoning has no part to play in the Contract which has nothing to do with the purchase and sale of land and the particular principles and provisions applying to liability for non-completion. (The reference to "personal conduct" as being part of the meaning of "default" was not, for example, taken up in the subsequent case of *Fram Gerrard* even though (at 90) Parker J's comment as to "personal conduct" was expressly cited. Kerr J (as he then was) in *Fram Gerrard* also recognised in terms that the context in *Bayley-Worthington* was "very different").

37. In my judgment none of these authorities materially advances the present argument of construction: not only did the provisions in question fall to be construed in entirely different contexts, in each case the duty to be breached in order to give rise to a default was not expressly identified in the relevant contract term. Here, the converse is true. The relevant obligation (i.e. ABC's obligations under the Contract) was expressly linked to the "default" in question. Where the clause itself identified the relevant duty, the default is most naturally to be construed as referring to a breach of that duty.

38. The accuracy of that proposition is reflected in *Perar BV v General Surety & Guarantee Co Limited* [1994] 66 BLR 72 (*"Perar"*), a case where the relevant clause identified the relevant duty and which is of assistance. *Perar* concerned the interpretation of a bond in the context of the automatic termination of a building contract where an administrative receiver had been appointed to the contractor. The claimant, an assignee of the employer under the building contract, contended that it was entitled to the bond monies, arguing that, even if there was no breach of contract on the part of the contractor, there was nevertheless a "default" within the meaning of the bond, which provided as a condition that the contractor would "well truly and faithfully comply with all the terms and conditions of the...Contract". On "default" by the contractor, the surety would satisfy and discharge damages sustained by the employer (up to a specified limit). The bond contained a condition precedent which read materially as follows:

> "The Surety shall be notified…of any variation of or breach of or default in any of the terms and conditions contained in the said Contract …within fourteen days after such variation breach or default….."

39. The Court of Appeal rejected the claimant's argument. Peter Gibson LJ stated (at 84) that the meaning of default in the bond had to be derived from the language of the bond:

> "The condition of the bond was either that the contractor complied with the terms and conditions of the contract, or that on default by the contractor the surety should satisfy the damages sustained thereby. In that context it seems to me perfectly plain that the default referred to is a failure by the contractor to honour the first part of the condition….To my mind, the ordinary meaning of "default" in a contractual document is to connote a breach of contract…"

40. Likewise, Staughton LJ (at 86) stated that it was "quite clear to [him] that default there means failure by the contractor to comply with all the terms and conditions of the contract". Peter Gibson LJ also stated (at 84) that the fact that both "breach of" and "default" were mentioned in the notification requirement of the condition precedent did not necessitate construing "default" in its different context in the condition of obligation as having a wider meaning than breach.

41. Having identified the natural and ordinary meaning of the word "default" in the Contract (both alone and in its immediate context in Clause 1(1)(j)(iii)), I turn to consider the wider context, the exercise which lies at the heart of ABC's challenge. As the authorities identify, any contractual clause, however clear, is not to be read in a vacuum. Its meaning has to be assessed in the light not only of its natural and ordinary meaning but also any other relevant provisions of the contract, the overall purpose of the clause and the contract, the facts and circumstances known or assumed by the parties at the time that the document was executed and commercial common sense (within the confines set out above). I therefore move, from the natural and ordinary meaning of the words "default on the part of the Contractor in his compliance with any of his obligations under the Contract" as discussed above, to consider the other provisions in Clause 1(1)(j) itself, and then in the Contract more generally.

42. Mr Taverner's most striking examples in terms of contextual analysis were Clauses 1(1)(j)(i) and (ii). If Network Rail's construction be right, he contends, both those provisions are not only redundant but positively misleading. Put crudely, they provide that the cost of remedying certain defects will be "Disallowed Cost", which at least implies that the cost of remedying other defects will not be, unless specifically provided for elsewhere. On Network Rail's construction of (iii), all costs due to the contractor's breach of contract will be disallowed and the distinctions drawn in sub-paragraphs (i) and (ii) are irrelevant.

43. There are, however, three difficulties with this line of argument.

44. First, I am unattracted here to propositions of construction based on redundancy. As the authorities make clear, caution needs to be exercised in relying on such a line of reasoning, particularly in the context of extensive amendments to a lengthy standard form agreement. A close reading of the Contract reveals multiple duplication and redundancy, perhaps to be expected. It is unsurprising that the NR 12 Amendments may have rendered certain terms of the ICE Conditions unnecessary, duplicative, or superfluous. (Thus, for example, "Disallowed Cost" in clause 49(3) will fall within the definition of "Disallowed Cost" in Clause 1(1)(j)(ii) and Clause 1(1)(j)(vi)). By the NR 12 Amendments the drafters appear to have focussed on targeted changes, rather than a wholesale, line by line reconsideration of the Contract as a whole.

45. Secondly and relatedly, the redundancy identified by ABC in fact existed even on the basis of the contract in unamended form in any event, given the reference to "negligence" in Clause 1(1)(j)(iii). In this sense, there was already an overlap: a cost could survive Clauses 1(1)(j)(i) and (ii) and then fail at Clause 1(1)(j)(iii).

46. Thirdly, the fundamental difficulty in ABC's position is that it has no realistic alternative construction. This difficulty is reflected in what were the shifting sands of ABC's case as presented below (as noted by the Judge) and its new case on appeal. To an extent, as Mr Taverner submits, this may be no more than a forensic point and what

ultimately matters is an analysis of the proper construction; but the fact that it is difficult to alight on a true meaning (other than the natural and ordinary meaning) is a strong indicator that the natural and ordinary meaning is the correct one. As Mr Stansfield put it, the fluctuation is "a symptom of the fact that, when one pulls up the anchor of natural and ordinary meaning, one drifts in the tide".

47. ABC accepts that it cannot identify a "bright line definition" of "default". By reference to what benchmark, on ABC's construction, is the question of breach to be judged? When will a breach be blameworthy or culpable for the purpose of this definition (or not)? It cannot be equated with negligence, since that is an express and separate limb in the clause. As Network Rail submits, the parties must be taken to have intended to add something by the introduction of the word "default".

48. In the absence of any clearly defined measure of blame or culpability, the construction advanced by ABC is so vague and uncertain that it cannot have been (objectively assessed) what the parties intended.

49. This final difficulty is the ultimate answer to the balance of ABC's submissions in relation to inconsistencies in use of the word "default" elsewhere in the Contract on Network Rail's construction, and also redundancy by reference to other clauses in the Contract. I address them in the circumstances only briefly.

50. ABC points to the use of the word "default" in Clauses 43A(4) and 44(1) (dealing with extensions of time) and 50 of the Contract (contractor search obligations). There is no reason why the word "default" in either Clause 43A(4) or 44(1) needs to be given anything other than its ordinary and natural meaning (and it is difficult to see how, for example, the concept of "blameworthy" or "culpable" breach would work in practice for the purposes of assessing delay for the purpose of an extension of time under Clause 44). As for Clause 50 (introduced by the Deed of Variation), where there is reference to "default" and "failure on the part of the Contractor to observe and perform his obligation under the Contract", the point is at best neutral, since on ABC's construction there would be no need for any reference to the word "default": any "default" would also be a failure to observe and perform the contractor's contractual obligation.

51. ABC identifies what it says are additional redundancies (on Network Rail's construction); specifically in Clauses 20(3), 47(3), 49(3), 49(4) and 81(4). I have already indicated my reservations about reliance on this line of reasoning in the circumstances. Network Rail does not take issue in broad terms with the suggestion that redundancies, strictly speaking, can be identified (on its construction).

52. I accept that it would have been clearer if, for example, clause 48(3) of the ICE Conditions (unamended) and other clauses in the Contract had been amended to reflect the amendment to Clause 1(1)(j)(iii) more accurately. However, none of that justifies the suggested interference with the natural and ordinary meaning of the word "default" which the parties specifically chose to introduce by way of amendment. Even if the other clauses are no longer necessary in the light of the amendment to Clause 1(1)(j)(iii), none of the clauses identified are inconsistent with Network Rail's construction. The situation is very far removed from that in *Turner* where (at [56]) the court rejected a construction that "changed [the] 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". Further, there is force in Network

Rail's submission that the clauses can be said nevertheless to serve a useful purpose in the sense that they confirm or clarify the position on discrete issues (such as allocation of risk for loss or damage, liquidated damages and costs of works required by an instruction of the Employer's representative).

53. Finally, the fact that the Contract was a Target Cost Contract does not militate in favour of ABC's construction. The Contract made it plain that the contractor was intended to bear the risk of its own breach of contract. "Disallowed Cost" is deducted from the Total Cost before the contractor's share is calculated. The parties were free to agree cost and risk allocation as they did. There is also little, if any scope, for submissions by reference to commercial common sense that can assist ABC. Where, as here, the words used are unambiguous, the task of the court is to apply them. But in any event Network Rail's construction does not offend commercial common sense. The aim of the Target Cost mechanism, namely to provide incentive to the contractor not only to perform but also to control costs, is achieved if costs due to a breach of contract by the Contractor are "Disallowed Cost".

54. I therefore do not consider that there is anything arising out of the wording in Clause 1(1)(j)(iii) itself, any other provisions of the Contract, the overall context of the Contract or by way of commercial background, that militates towards a different construction than that of the natural and ordinary meaning of the word "default" as identified above.

Conclusion

55. For these reasons, I have reached the conclusion that the correct interpretation of the word "default" in Clause 1(1((j)(iii) is "a failure [by ABC] to comply [with its contractual obligations]". The defined term "Disallowed Cost" in the Contract includes any cost due to a failure by ABC to comply with its obligations under the Contract. I would not interfere with the terms of the Order and would dismiss the appeal.

Lord Justice Males:

56. This appeal is about the meaning of the words "or default", introduced into clause 1(1)(j)(iii) of the ICE standard form contract by the (also standard) NR12 Amendments commonly used by Network Rail.

57. It is common ground that the search is for the objective meaning of these words. The principles of construction are well settled and not in dispute.

58. It was common ground below (see the judgment at [28]) that the natural and ordinary meaning of the word "default" is a failure to fulfil a legal requirement or obligation – or, as it was put in some of the cases cited to us, a breach of duty. While the cases cited show (and really show no more than) that the meaning of "default" in any particular contract will depend upon the context, this natural and ordinary meaning represents an obvious starting point. That is not to say that it is also the finishing point. Sometimes words as apparently straightforward as "any breach" turn out to mean something different (e.g. *The Antaios* [1985] AC 191). But it is nevertheless the place to start.

59. So far as clause 1(1)(j)(iii) itself is concerned, there is no linguistic difficulty in reading the amended clause as providing that cost caused by the Contractor's breach of contract

will be disallowed. That is, on the face of it, what the clause appears to say, giving the words their natural meaning. Accordingly, if we are to hold that the clause means something else, a compelling case would need to be made, either from other terms of the contract or from the commercial context, that the word "default" in this clause does not mean "breach of duty". But even that would not be enough. It would also be necessary to show what the clause does mean.

60. ABC has made a forceful case by reference to other terms of the contract that "default" in clause 1(1)(j)(iii) may not mean "breach of duty" or "breach of contract". Its most powerful argument, to my mind, is that such a meaning renders the immediately preceding paragraphs of clause 1(1)(j) redundant. As Carr LJ has explained at [42] above, paragraphs (i) and (ii) provide (in short) that the cost of remedying certain defects will be "Disallowed Cost", which at least implies that the cost of remedying other defects will not be, unless specifically provided elsewhere in the contract. Paragraph (iii) in its unamended form provides that cost due to the Contractor's negligence will be disallowed. Thus the cost of remedying defects which do not fall within paragraphs (i) or (ii) will be disallowed if they are due to the Contractor's negligence, but not otherwise (subject of course to the remaining paragraphs of the clause). That leaves a category of cost caused by some breaches of contract by the Contractor which are not disallowed. However, if Network Rail's construction of the amended version of paragraph (iii) is correct, all cost due to the Contractor's breach of contract will be disallowed and the distinctions drawn in paragraphs (i) and (ii) between defects which fall within those paragraphs and those which do not become irrelevant.

61. I am therefore sympathetic to the argument that "default" in the amended paragraph (iii) does not mean "breach of duty" – or, strictly speaking, that it may be intended to refer only to some such breaches. But the difficulty is to say what it does mean.

62. As the judge pointed out at [20] to [24], ABC's case about this has fluctuated. Originally, it did not dispute Network Rail's construction, accepting that the word "default" bore its ordinary meaning. Subsequently, it contended that any breach had to be "serious, significant and material", alternatively that it had to be "wilful, significant and material". Later still it added the word "persistent" so that the breach had to be "wilful, deliberate, persistent and material". Finally, in the course of the hearing below, it settled (although as it turned out, only for the time being) on the words "wilful and deliberate", expressly abandoning any requirement that the breach should be "serious", "significant and material" or "persistent". I agree with what the judge said about these changes of case at [24]:

> "Whilst I accept Mr Sears' submission that the changes in ABC's case are not relevant to the exercise of interpretation that I must undertake in resolving this dispute, nonetheless, ABC's various changes of position seem to me to illustrate the difficulty it has encountered in identifying precisely how the word 'default' should be narrowed so as to reflect what it now says must be the objective intentions of the parties. …"

63. Before us ABC has abandoned the construction which was advanced below and has not sought to resuscitate constructions which, in their turn, were abandoned below. Instead it proposes an entirely new construction, namely that the word "default" must include an element of blame or culpability on the part of the Contractor as opposed to a breach

of contract for which there is no such blame or culpability. I cannot accept this. It provides no standard by which such blame or culpability additional to the fact of a breach of contract can be measured. As Carr LJ points out at [47], blame or culpability, according to this construction, cannot be equated with negligence because that is already covered by the clause. It must therefore mean something else. But what it does mean is vague and uncertain. To my mind it is highly unlikely that the parties would have agreed an express term to the effect that cost due to "culpability" on the part of the Contractor would be disallowed without specifying some standard by which such culpability was to be assessed. That is a powerful, and in my judgment overwhelming, reason to reject the submission that when they used the term "default", the parties intended to depart from its natural meaning and to introduce vague concepts of blame and culpability. There is nothing else in the contract to suggest that this was their intention.

64. I conclude, therefore, that no good reason has been shown to depart from the natural meaning of "default". If, as I would accept, this means that some other provisions of the contract become redundant, the parties must live with that result. It is not suggested that the Network Rail construction causes the contract to become unworkable in any way, merely that it operates substantially more advantageously to Network Rail. But that is another matter. It was in any event the purpose of the NR12 amendments to clause 1(1)(j) to change to Network Rail's advantage the regime for Disallowed Cost for which the unamended version of the contract provided.

65. I agree, therefore, that the appeal should be dismissed.

Lord Justice Coulson:

66. I agree that, for the reasons given by my Lady, Lady Justice Carr, and my Lord, Lord Justice Males, this appeal must be dismissed.

67. On behalf of ABC, Mr Taverner QC argues that clause 1(1)(j)(iii), in its unamended form, requires a two-stage process: Has there been a failure to comply with the contract? If so, was that failure due to negligence on the part of the contractor? Only if both questions are answered in the affirmative would the cost incurred as a result be disallowed. He argues that the addition of the word "default" can make no or no discernible difference to that two-stage process, and the addition of the word cannot, as he put it, collapse the two-stage process into one, leaving the only relevant question being whether or not there has been a breach of contract.

68. It is unnecessary for the purposes of this appeal to decide whether the clause in its unamended form should be construed in the way outlined by Mr Taverner. I am prepared to accept that it may do, although it remains somewhat oddly worded.

69. However, whatever the unamended clause may mean, I am in no doubt that the proper interpretation of the amended clause is clear: a cost incurred as a result of negligence or a breach of contract on the part of ABC is a Disallowed Cost for the purposes of the calculation of the Total Cost. There are three principal reasons for that conclusion.

70. First, that is the ordinary meaning of the words "negligence or default in his compliance with any of his obligations under the contract…". If a party defaults in complying with his contractual obligation, the ordinary meaning is that he is in breach of that obligation. In my view, there is no room for any alternative construction of the words actually used in the clause.

71. Secondly, I consider that that is also the legal meaning of the word "default". I accept that "default" has been given a variety of meanings in the authorities to which we were referred, and it has not always been equated with a breach of the underlying contract. But that is because, in most of those cases, the word "default" has been used in isolation. Unlike the present case, the standard against which any such "default" was to be measured had not been expressly identified.

72. But the position was different in *Perar*, where the clause referred to "…any variation of or breach of or default in any of the terms and conditions referred to in the said contract…" This court held that "default in any of the terms and conditions" meant a breach of contract. *Perar* appears to be the only one of the authorities in which "default" was tied to a particular standard, namely the terms of the underlying contract. The clause in *Perar* is similar to clause 1(1)(j)(iii) in the present case because that too expressly ties the notion of "default" to the contract terms. Accordingly, I consider that the judge's conclusion was in accordance with the relevant caselaw.

73. Thirdly, I consider that this is a commercial construction, because it creates certainty, and it gives rise to a common sense result. It creates certainty because it is the contract terms which form the basis of any assessment of default. And it is a common sense result because it means that, if the contractor is in breach of contract, then it is the contractor who is liable for the cost consequences of that breach.

74. Of course, I accept Mr Taverner's point that, under the unamended form of Target Cost contract, the contractor would ordinarily recover at least some of the costs incurred as a result of its own breach (in that they would be part of the Total Cost and not comprise an item of Disallowed Cost), but even then the contractor would not recover every element of the Total Cost. In its unamended form, the Disallowed Cost mechanism might be said to exclude the most egregious of the costs due to the contractor's poor performance; under the amended version, that category of Disallowed Cost is extended to include all such costs. That was a modification to the allocation of risk between them which the parties were quite entitled to make.

75. By contrast to this certain and commercially sensible construction, ABC could not point to a workable alternative construction of clause 1(1)(j)(iii). They argued that they would only be liable if there was first a breach of contract, and in addition "personal conduct which is in the nature of a breach of duty", a phrase that comes from an authority (*Bayley-Worthington*) which is more than a century old. No clue is given as to how such conduct is to be measured or policed under the Target Cost contract. There is nothing to indicate what the standard might be that is to be applied to the conduct in question, in order to see whether it is "in the nature of a breach of duty", therefore giving rise to an item

of Disallowed Cost. To my eye, that would be an uncertain and uncommercial result.

76. As both My Lady and My Lord have indicated, Mr Taverner's best point concerned the redundancy of various parts of the contract if the judge's interpretation was correct. This argument even affected sub-clause 1(1)(j)(i) and 1(1)(j)(ii), the two preceding sub-clauses before 1(1)(j)(iii). He argued with some force that there was no purpose in the fine gradations between different types of repair and rectification work in those two sub-clauses if clause 1(1)(j)(iii) meant that all costs incurred because of ABC's breaches of contract were excluded.

77. In my view, the structure of clause 1(1)(j) makes a certain amount of redundancy inevitable, even under the unamended form. So an item of cost may survive the scrutiny of clauses 1(1)(j)(i) and (ii), and thus look to be an item of cost that would not be excluded, but if it was incurred due to the appellant's negligence then (even if that clause had not been amended) it would fall to be excluded as an item of Disallowed Cost at the hurdle of sub-clause 1(1)(j)(iii). In that way, the fine gradations in sub-clauses 1(1)(j)(i) and (ii) would be rendered redundant. Thus the highest it can be put is that, when applied to a cost of repair or rectification work, under the unamended version, the preceding sub-clauses might be rendered redundant by sub-clause 1(1)(j)(iii), whilst under the amended version, they would be redundant. Given all the other difficulties with ABC's construction of the clause, I do not consider that this difference, even when taken together with the other redundancies to which Mr Taverner referred and with which My Lady has dealt, could lead to a different construction to that which this court has already indicated.

78. More widely, as the Judge pointed out, there are redundancy arguments available on both sides here, and such arguments are almost inevitable when a lengthy standard form of contract is then the subject of wholesale amendments. Accordingly, like the Judge, I am not persuaded that any of the redundancy points affected, or could affect, the straightforward construction which she adopted and which I consider to be correct.

79. For the reasons set out in these judgments, this appeal will be dismissed. We should, however, record our gratitude to Leading Counsel and their teams for the excellence of their written and oral submissions.