FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2022] CSIH 32
CA23/21 and CA56/21

Lord President
Lord Malcolm
Lord Woolman

OPINION OF THE COURT

delivered by LORD CARLOWAY, THE LORD PRESIDENT

in the reclaiming motions by

NETWORK RAIL INFRASTRUCTURE LIMITED

Pursuers and Reclaimers

against

(FIRST) FERN TRUSTEE 1 LIMITED, (SECOND) FERN TRUSTEE 2 LIMITED and (THIRD) McLAUGHLIN & HARVEY LIMITED

Defenders and Respondents

and

THE SCOTTISH MINISTERS

Pursuers and Reclaimers

against

(FIRST) McLAUGHLIN & HARVEY LIMITED, (SECOND) FERN TRUSTEE 1 LIMITED, and (THIRD) FERN TRUSTEE 2 LIMITED

Defenders and Respondents

Pursuers (Network Rail): DM Thomson QC, Steel; Dentons UK and Middle East LLP
Pursuers (Scottish Ministers): Massaro; Morton Fraser LLP
Defenders (Fern): Barne QC; MacRoberts LLP
Defenders (McLaughlin & Harvey): GJ Walker QC; Balfour and Manson LLP

8 July 2022

Introduction

[1] This litigation concerns remedial works which contractors (McLaughlin & Harvey) agreed to carry out on an office block in Glasgow in terms of what has become known as the Remedial Works Agreement between them, the owners (Fern) and the tenants (the Scottish Ministers and Network Rail). The tenants argue that the RWA: (i) gave them the right to have their views, on whether the remedial works had been completed, conveyed by the owners to the contractors, and (ii) obliged the owners not to agree that Completion had been achieved until the tenants were content that it had been. The commercial judge rejected these arguments ([2021] CSOH 107). By interlocutors dated 21 October 2021 he dismissed the tenants' actions against the owners and the contractors. The issues in these reclaiming motions (appeals) against those interlocutor centre on the correct construction of the RWA, which set out the mechanism for determining whether and when Completion was achieved.

The original works and the RWA

[2] Between 2002 and 2004, the contractors carried out works on the office block in terms of a building contract which they had entered into with the previous owners. The current owners bought the block in 2006. The contractors granted collateral warranties to the new owners and the tenants.

[3] Defects in the original works became apparent in 2008. The owners and the tenants raised actions against the contractors. Those actions were settled. Separate settlement agreements were entered into by the contractors on the one hand and the owners and the tenants on the other. The agreements provided that the contractors were to carry out remedial works in terms of the RWA and to pay sums by way of damages. Network Rail

were also entitled to liquidate damages of £52,500 per week if Completion had not occurred by 30 September 2018, or a later agreed date. The Scottish Ministers were to be paid a monthly sum until Completion. Their agreement contained an express provision whereby, for the avoidance of doubt, they were entitled to claim damages in the event of a breach of the RWA.

[4] Completion was "the date on which satisfactory completion of the Remedial Works shall be deemed to have taken place in accordance with clause 3.30 of this Agreement" (cl 1.1.8).

[5] The RWA set out the process to be followed:

> "3.26 Within 7 days of completion of the Remedial Works, the [contractors] shall notify [the owners and tenants] … that it considers that the Remedial Works have been completed … ('the Defender's Completion Notice').
>
> 3.27 Within 7 days of receipt of the Defender's Completion Notice, the Owner shall confirm … whether or not it accepts that the Remedial Works have been satisfactorily completed ('the Owner's Completion Notice'). The Owner shall liaise with the Tenants regarding acceptance of whether or not the Remedial Works have been satisfactorily completed and shall add any elements of the Remedial Works it considers have not been completed satisfactorily to the Owner's Completion Notice.
>
> 3.28 If the Owner does not accept that the Remedial Works have been satisfactorily completed:
>
> > 3.28.1 the Owner shall specify in the Owner's Completion Notice what elements of the Remedial Works it considers have not been completed satisfactorily and why;
> >
> > 3.28.2 the [contractors] shall within 7 days of receipt of the Owner's Completion Notice notify the Owner in writing whether it agrees or disagrees with any of the matters raised by the Owner;
> >
> > 3.28.3 if the [contractors] agrees with any of the matters raised by the Owner it shall carry out and complete such works that are reasonable to address the matters raised by the Owner and then issue a fresh Defender's Completion Notice …;
> >
> > 3.28.4 if the [contractors] does not agree with any or all of the matters raised in the Owner's Completion Notice then the [contractor] may refer the question of satisfactory completion of the Remedial Works to adjudication ...
>
> 3.29 The Parties agree that the existence of snagging items, minor defects or omissions, or minor incomplete works which … do not interfere with the occupation

> and use of the Property … shall not … cause the Remedial Works to be incomplete … All such Snagging shall be specified in a list to be completed by the contractors for the Owner's approval and issued along with the Defender's Completion Notice. The [contractors] shall complete and make good all Snagging within 10 Working Days of the date on which satisfactory completion the Remedial Works [*sic*] is deemed to have taken place.
>
> 3.30 The date on which satisfactory completion of the Remedial Works shall be deemed to have taken place shall be:
>
> > 3.30.1 the date of the relevant Defender's Completion Notice, when accepted by the Owner; or
> >
> > 3.30.2 a date determined by the Adjudicator…".

[6] Clause 3.31 provided that the effect of Completion was that the owners assumed responsibility for the insurance and ongoing care of the works. The defects period of one year commenced. Any defects which appeared during this period, and were caused by the contractors, were to be specified by the owners in a schedule to be delivered to the contractors no later than 14 days after the expiry of the period (cl 3.34). The owners were: to liaise with the tenants regarding the identification of defects (cl 3.36); to add into the schedule any defects so identified (cl 3.36.1); and to issue any instructions to make good the defects, if requested to do so by the tenants (cl 3.36.2).

The Remedial Works

[7] Remedial works were carried out. On 17 December 2019, the contractors issued a Defender's Completion Notice. The tenants wrote to the owners stating that various works were defective or incomplete. On 23 December 2019, the owners issued an Owner's Completion Notice, setting out that they did not accept that satisfactory completion had been achieved. They appended the correspondence from the tenants.

[8] The contractors disagreed with the OCN. They commenced negotiations with the owners. Some matters were agreed, but others remained contested. In September 2020, the owners told the tenants that they were inclined to agree that Completion had been achieved on 29 May 2020. The tenants replied that Completion had not occurred. On 1 February 2021, the contractors referred the question of whether, and when, Completion had occurred to adjudication. The tenants were not convened as parties to that process. The adjudicator held that Completion had occurred on 17 December 2019 (the date identified by the contractors).

[9] The tenants raised the present actions. They seek declarator that Completion has not occurred and has not been deemed to occur in terms of the RWA. The Scottish Ministers seek an additional declarator that the contractors "are yet to discharge" their obligation, under both the RWA and their settlement agreement, to complete the works. They aver that the owners were not entitled, without their consent, to reach a compromise on the matters in the OCN which had not in fact been remedied. No new OCN was issued. There was therefore, according to the tenants, a live dispute on whether Completion had occurred.

The commercial judge

[10] The commercial judge applied well-established principles of contractual interpretation as derived from *Arnold* v *Britton* [2015] AC 1619 (at paras 14 – 23) and *Ashstead Plant Hire Co* v *Granton Central Developments* 2020 SC 244 (at paras [9] – [17]). The use of commercial common sense was appropriate where a phrase was capable of bearing more than one meaning. Clause 3.27 was not capable of bearing more than one meaning. Its terms were unambiguous. The owners' obligation was to liaise, ie to consult, with the tenants before intimating to the contractors whether or not they accepted that the works had

been satisfactorily completed. The decision on whether to add any elements to the OCN was one for the owners alone. This form of phraseology was continued in clause 3.28, with the reference to what should happen if "the Owner" did not accept that the works had been completed. There was no reference to the tenants in clauses 3.28 to 3.31.

[11] Clause 3.36, in contrast to 3.27, gave the tenants a right not only of liaison but also to have any additional elements added to the schedule of defects. It made commercial sense to treat the two clauses as affording different rights. It made sense to place the decision on whether to accept that the works had been completed in the hands of the owners, given their responsibility for the ongoing care of the works, the commencement of the defects period and that the incidence of insurance fell on them.

[12] The various settlement agreements formed part of the context against which the RWA fell to be construed. Nothing in them, including the fact that the tenants' differing rights to liquidate damages were effectively terminated by the occurrence of Completion, pointed towards the tenants' interpretation of clause 3.27 being correct. They had no contractual entitlement to challenge the owners' decision to accept that the works had been completed on 29 May 2020, to enter into an adjudication with the contractors on that basis, and to accept the adjudicator's determination that Completion had occurred on 17 December 2019.

[13] The Scottish Ministers had not pled a separate case in support of their argument that their settlement agreement conferred a stand-alone right to make a claim against the contractors for a breach of the RWA.

Submissions

Network Rail

[14] The RWA had to be read in a manner which ensured that the tenants' reasonable and well-founded views on Completion were included in the Owners' Completion Notice. There could be no departure from the OCN until satisfactory completion of the matters raised by the tenants had been achieved. The works had not, as a matter of fact, been completed because the building was not wind and watertight. The tenants had made relevant averments to that effect. An inquiry was required. Clause 3.27 had to be read in the context of the RWA and the settlement agreements between the tenants and the contractors. The obligation to carry out the works was established by the settlement agreement, whilst the scope of those works was defined by the RWA.

[15] The commercial judge erred in concluding that clause 3.27 had only one meaning and that therefore commercial common sense was not relevant. The literal meaning of the clause was recognised, but the clause was ambiguous. Commercial common sense supported the tenants' construction. Completion affected the tenants' rights. A reasonable person would not attribute a meaning to the clause which undermined these rights.

[16] The commercial judge's construction violated several principles of contractual interpretation (*Arnold* v *Britton*; *Wood* v *Capita Insurance Services* [2017] AC 1173). The parties to a contract must act reasonably. An obligation to liaise must be intended to have meaningful content (*Apcoa Parking (UK)* v *Crosslands Properties* [2016] CSOH 63 at para [20]). One party should not be able to determine the parties' rights and liabilities (*Van Oord UK* v *Dragados UK* 2021 SLT 1317 at para [20](iii); *R E Brown* v *GIO Insurance* [1998] CLC 650 at 659). Clear words were required to signal a party's intention to give up valuable rights. Contractual powers must be exercised in good faith, and not capriciously (*Braganza* v *BP*

Shipping [2015] 1 WLR 1661, at paras [23], [27],[42] and [52]-[53]; *Socimer International Bank* v *Standard Bank London* [2008] Bus LR 1304). Therefore, even if the RWA did not entitle the tenants to insist on the inclusion of their complaints in the OCN, the owners were obliged to serve the notice in good faith, and not to depart from its terms until the matters raised in it were satisfactorily completed.

The Scottish Ministers

[17] The Scottish Ministers adopted Network Rail's submissions. The RWA should be construed as giving the tenants rights: (a) to insist that the contractors carried out the works; and (b) to seek to establish that the works had not been carried out. The commercial judge's construction of clause 3.27 made no sense. It gave the tenants no means by which to challenge the owners' decision that the works had been satisfactorily completed. The contractors had given collateral warranties to each of the parties whereby they would carry out the works in compliance with the RWA. The judge's construction made a nonsense of those warranties. It placed the tenants at the mercy of the owners. The Scottish Ministers had been granted a collateral warranty in respect of the original refurbishment when they took up their tenancy in 2006. The judge's construction gave the Ministers no right of recourse against the contractors. That would mean that the Ministers had surrendered valuable rights. The overall scheme of the agreements had to be considered, rather than the natural meaning of the words in the clause (*Re Sigma Finance Corp* [2010] BCC 40 at para 12).

[18] Network Rail were correct in their alternative argument that, even if the tenants had no entitlement to secure inclusion of matters in the OCN, the owners had an obligation to serve, and insist upon, the notice in good faith. They had failed to do so.

[19] If Completion was only a construct of the RWA, the warranties and other contractual undertakings given to the Scottish Ministers by the contractors under the settlement agreement must still be capable of enforcement. There was a separate relevant case pled in support of the Ministers' second conclusion.

Owners

[20] The commercial judge's construction of the RWA was correct. The essential features of contractual interpretation were set out in *Wood* v *Capita Insurance Services* (at paras 13-15). Business common sense only applied where there were "rival meanings". There was only one possible meaning of clause 3.27. Care was taken throughout the RWA to differentiate between the parties in order to ensure that specific rights and obligations were directed towards particular parties. There was no term which supported the proposition that the owners could not depart from the terms of their OCN without the agreement of the tenants. Clauses 3.26 – 3.28 made it clear that the determination of the date on which Completion occurred was a matter between the owners and the contractors. This was in contrast to the tenants' rights under clause 3.36 relative to the schedule of defects. Having multiple parties arguing over the content of the OCN would be unworkable.

[21] In any event, commercial common sense did not assist the tenants. Completion in the overall scheme of the RWA signalled the owners' responsibility for insurance. It was without prejudice to the contractors' other obligations under the RWA, including those during the defects period. Completion had important consequences. It made no sense for the owners to be obliged to determine an issue which was raised by the tenants but with which they did not agree. Unlike the tenants, the owners did not have an interest in delaying Completion in order to secure liquidate damages or other similar benefits.

[22] A duty to act not only in good faith but also without being arbitrary or unreasonable arose only in limited situations; typically where one party was acting as a decision maker on a matter that affected both parties. Such a duty was likely to be found where there was a significant imbalance of power. It was less likely where both parties were sophisticated and had legal advice. The tenants had not advanced a case based on such an implied duty or how that duty had been breached. A duty on a contracting party to act reasonably was a novel concept.

Contractors

[23] The contractors adopted the owners' submissions. The commercial judge interpreted clause 3.27 correctly. The owners had the sole entitlement to determine whether or not the works had been satisfactorily completed. Clauses 3.26 – 3.28 treated the owners differently from the tenants and gave different rights to each. The contents of the OCN were under the control of the owners, in contrast with the rights given to the tenants in relation to the schedule of defects.

[24] There was no ambiguity in the wording of clause 3.27 and it was not appropriate to rely upon commercial common sense. The words chosen were the most obvious source for ascertaining the intention of the parties (*Arnold* v *Britton*, at para 17).

[25] The consequences of Completion, whereby the owners assumed liability for the insurance and care of the works, were consistent with them having the right to determine whether it had occurred. By serving an OCN, the owners did not avoid their liabilities as landlords. The tenants' positions were not prejudiced. One party was not at the mercy of the another. The tenants' settlement agreements could not be an aid to interpretation of the RWA as their terms were confidential.

[26] The tenants did not plead a case of implied duty. They did not aver facts from which it could be inferred that the OCN was not both drafted and served reasonably and in good faith. If such a duty did exist, it was not incumbent upon the contractors. At best the tenants would have a right of action against the owners for breach of that duty.

[27] There were no averments in support of the Scottish Ministers' submission that they had a stand-alone case of a breach of the obligation to carry out the works.

Decision

[28] In construing clause 3.27, the court must strive to ascertain the intention of the parties by determining what a reasonable person, having the background knowledge of the parties, would have understood from the language selected by them (*Midlothian Council* v *Bracewell Stirling Architects* 2018 SCLR 606 LP (Carloway), delivering the opinion of the court, at 615, following *Arnold* v *Britton* [2015] AC 1619, Lord Neuberger at para 15, cited in *Scanmudring* v *James Fisher MFE* 2019 SLT 295, LP (Carloway) at para [47]). The meaning of the words must be assessed having regard to the other relevant parts of the contract. If there are two possible constructions, the court is entitled to prefer one which is consistent with business common sense (*Arnold* v *Britton*, Lord Hodge at para 76; *Wood* v *Capita Insurance Services* [2017] AC 1173, Lord Hodge at para 11). The exercise involves balancing, on the one hand, the language with the factual background and the consequences of any alternative meanings on the other. "Textualism and contextualism are not conflicting paradigms" (*ibid* at para 13).

[29] Clause 3.27, when read in the context of the Remedial Works Agreement as a whole, is only capable of one meaning. It is for the owners, and the owners alone, to decide whether the works have been satisfactorily completed for the purposes of issuing an

Owner's Completion Notice. The owners require to liaise with the tenants; that is to say, they need to consult with them. They may add on matters raised by the tenants, but they are not obliged to do so. This is made clear by the words "the Owner shall confirm … whether or not *it* accepts" (emphasis added) that the works have been satisfactorily completed. That interpretation is in turn strengthened by clause 3.28 which refers to what is to happen if "the *Owner* does not accept" (emphasis added) that the works have been completed. Looking more broadly, this meaning is confirmed by the contrasting provision, in what was a complex contract negotiated and prepared by professionals, in clause 3.36. This states that the owner must include elements identified by the tenants.

[30] Commercial common sense does not assist the tenants. Completion is an important stage in the progress of the contract. Although, in broad terms, the tenants have an interest in the works being carried out in terms of their own settlement agreements, the primary interest in Completion is that of the owners and the contractors. It would not make sense to have the date of Completion fought over by what might be competing views raised by one or other of the tenants and the owners. Rather, the limited interest of the tenants in this aspect of the RWA is deemed sufficiently covered by the obligation to liaise. That is no doubt on the basis that, if there were any substantial matters raised by the tenants, the owners would take them on board and include them in the OCN. Since the owners are in control of what goes into the OCN, it follows that they can reach a compromise with the contractors on its content or refer the issue to an adjudicator. Put another way, the tenants cannot insist in their concerns being taken to adjudication.

[31] The purpose of Completion is to commence the defects liability period and to impose responsibility for insurance and the ongoing care of the works on the owners. It is important that the owners are able, perhaps in negotiation with the contractors, to fix a

Completion date to enable these matters to progress without undue delay or dispute. The tenants continue to be protected by the provisions in the RWA in relation to defects. Commercial common sense favours an interpretation of the contract which accords with the natural meaning of the words used, in their context. The court thus agrees with the commercial judge (Opinion para [37]) that the tenants have no right to challenge the owners' decision to accept that the works were satisfactorily completed and to enter into an adjudication with the contractors about the date when that occurred.

[32] The court also agrees with the commercial judge that there is no separate case based upon the contractors' failure to complete the works in terms of clause 2.1 of their settlement agreement. The Scottish Ministers' second conclusion is not one for damages, based upon averments of breach of contract. It is for a bare declarator that the contractors have "yet to discharge" their obligations under the RWA and the settlement agreement. If the Scottish Ministers wish to found upon the clauses which require the contractors to complete the works, they should do so by way of an action for specific implement or damages for breach.

[33] The court will refuse the reclaiming motions and adhere to the commercial judge's interlocutors of 21 October 2021.