tie – Edinburgh Tram Network

Note in relation to interpretation of Pricing Assumption No. 1 – design development

1 The relevant part of Pricing Assumption No. 1 states:

"*The Design prepared by the SDS Provider will not (other than amendments arising from the normal development and completion of designs) in terms of design principle, shape, form and/or specification be amended from the drawings forming the Base Date Design Information…For the avoidance of doubt normal development and completion of designs means the evolution of design through the stages of preliminary to construction stage and excludes changes of design principle, shape and form and outline specification.*"

Infraco's interpretation: the literal meaning of the words

2 Infraco's principal contention is that a literal interpretation ought to be given to Pricing Assumption No. 1, such that "*[tie] assumes the commercial risk for changes to design between the Base Date Design Information Drawings and Issued for Construction Drawings which fall into the categories of design principle, shape, form or specification*".[1]

3 Their analysis proceeds on the basis that consideration should be given to:

"…*whether each change between BDDI to IFC falls within one or more of the four categories of para. 3.4.1.1. - design principle, shape, form or specification. If a change falls within one or more of the above categories, then expressly by contractual definition, it cannot be normal development and completion of the design because para. 3.4.1 excludes these categories from what might otherwise be understood as "normal development and completion of design*[2]".

4 On this analysis, there are few changes to the BDDI which do *not* constitute a Notified Departure: almost any change will be one of design principle, shape, form or specification.

[1] Paragraph 4.5 of Infraco's Referral Notice in the adjudication before Alan Wilson in relation to the Russell Road retaining wall no. 2 ("the Wilson Adjudication")
[2] Paragraph 5.8.8 of Infraco's Referral Notice in the Wilson Adjudication

Has something gone wrong with the words?

5 There are a number of difficulties with Infraco's literal interpretation of Pricing Assumption No. 1, which suggests that something has "gone wrong" with the drafting. In other words, that Infraco's literal reading produces a result which a reasonable person would not have understood tie and Infraco to have intended at the point that the contract was entered into.

6 *Firstly*, Infraco's interpretation would mean that they would be able to recover the costs associated with changes which they themselves had promoted, for example to improve the buildability of the scheme. Such a change would be wholly within Infraco's control, made for their own benefit and at their whim: it is difficult to conclude that a reasonable person would have considered that both tie and Infraco intended that tie would bear the costs of these changes.

7 *Secondly*, Infraco's interpretation yields the result that they would be entitled to additional payment for all elements of the Employer's Requirements not shown on the BDDI. What they say is: "*the Contract Price was fixed on the basis of the design work completed by the designer and the design information drawings issued to the Referring Party up to and including 25 November 2007 only*."[3]

8 That is at odds with the provisions of:

8.1 Clause 3.1 of Schedule Part 4, which states that:

"*The Construction Works Price is a lump sum, fixed and firm price for all elements of work required as specified in the Employer's Requirements as Schedule Part 2 and the Infraco Proposals as Schedule Part 31 and is not subject to variation except in accordance with the provisions of this Agreement*"; and

8.2 Clause 1.2 of Schedule Part 4 which states that:

"*The Construction Works Price is on a lump sum basis that is fixed until completion of the Infraco Works and not subject to variation except in accordance with the provisions of this Agreement*."

[3] Paragraph 5.8.9 of Infraco's Referral Notice in the Wilson Adjudication

9 In support of their position, Infraco rely on, amongst other things, the opening words of clause 3.5 which state that "*the Contract Price has been fixed on the basis of inter alia the Base Case Assumptions*".

10 The words *inter alia* have a significance which Infraco's analysis does not address: the Contract Price includes the Construction Works Price. The Construction Works Price is in turn a lump sum fixed and firm price in respect of the Employer's Requirements. The Base Case Assumptions do not encompass all of the Employer's Requirements, but only those incorporated in the design information drawings issued to Infraco up to 25 November 2007[4].

11 It makes no commercial sense to arrive at a conclusion that the "*lump sum, fixed and firm price*" referred to in clause 3.1 of Schedule Part 4 extends only to that part of the Infraco Works as may have been the subject of design information drawings issued up to 25 November 2007[5]. There is a tension between, on the one hand, the provision for a fixed lump sum for the delivery of the Employer's Requirements, as against, on the other, the risk of the evolution of the design sitting with tie.

12 *Thirdly,* clause 3.5 of Schedule Part 4 identifies a Notified Departure as a situation where facts or circumstances *differ* from the Base Case Assumptions. The term "*differ*" signifies change: it is to *make* unlike, dissimilar, or different. If some aspect of the Employer's Requirements was "missing" from the BDDI, the "issued for construction" design information which subsequently incorporates it cannot be said to have been *made* different from the BDDI.

13 This applies equally to the situation where an aspect of the Employer's Requirements is the subject of an outline design at BDDI stage, and the eventual issued for construction design is not unlike, dissimilar or different from that BDDI outline design.

14 *Fourthly*, Infraco's interpretation does not address the wording of clause 3.5 of Schedule Part 4, which provides that a Notified Departure:

"*will be deemed to be a Mandatory tie Change requiring a* ***change to the Employer's Requirements***…"

[4] See paragraphs 8 and 9 of the draft Opinion of Richard Keen QC dated 14 January 2010
[5] Paragraph 9 of the draft Opinion of Richard Keen QC dated 14 January 2010

15 Where the BDDI fails to take account of something in the Employer's Requirements it would make little sense for the resulting design change to be deemed to require a change to the Employer's Requirements: the essence of the issue is that the design is changed to take account of the Employer's Requirements, and there is no change to the Employer's Requirements. Infraco's interpretation fails to make sense of the 3.5 wording.

[***NB** the section quoted from 3.5 goes on to state "…and/or the Infraco Proposals or otherwise requiring the Infraco to take account of the Notified Departure in the Contract Price and/or Programme in respect of which tie will be deemed to have issued a tie Notice of Change on the date that such Notified Departure is notified by either Party to the other." It is difficult to make sense of the wording that begins "or otherwise…", but it may be that it is intended to be a catch all – along the lines of "the Notified Departure will be deemed to be a Mandatory tie Change which (i) requires a change to the ER's; (ii) requires a change to the IP's, or (iii) requires any other change to the Price and/or Programme."*]

16 *Fifthly*, even on the Infraco's own case, they accept that there must be some departure from the literal meaning of the words.

17 During the course of the Wilson adjudication, Infraco's engineering expert[6] conceded that if a change was *minor* or "*reasonable*" and "*comprising normal development and completion of designs*", then this would not give rise to a Notified Departure.

18 This approach necessitates some re-writing of the literal words in Pricing Assumption No. 1: there is no express derogation for minor or reasonable changes: in other words, the approach appears to accept that, to some extent, something has gone wrong with the words. The question then becomes how those words are to be put right.

19 Furthermore, the concession made by the Infraco leads to the necessity of enquiring into the *reason* for a change. That is at odds to the written submissions which were made on behalf of Infraco during the Wilson adjudication, where it was stated:

[6] Mr Hunt of Hunter Consulting

"*Whilst such information* [the reason for a change] *may in certain circumstances throw light on the background leading to the change it is not a condition precedent or precondition to being able to establish that a Notified Departure has occurred*[7]"…

"*Under the terms of the Contract, and insofar as changes which fall within section 3.4.1.1 are concerned (changes between BDDI and IFC), the Referring Party is not required to prove the reason for any change.*[8]"

20 There has been discussion in relation to the interaction between the operation of clause 80 of the conditions (tie Change) and the Notified Departure mechanism: issues in relation to clause 80 are dealt with [*reference to report on cl80*], but in short, even if it is the case that Infraco are frustrating the proper operation of clause 80 by failing, or delaying, in the production of compliant Estimates, or failing to proceed with work until Estimates have been agreed, that is unlikely to be relevant to a consideration of how the wording of Pricing Assumption No. 1 is to be interpreted in assessing whether a Notified Departure has occurred. The breach by Infraco of their obligations does not affect the underlying interpretation. Conversely, Infraco's argument is likely to revolve around the mutuality of obligations: when faced with Infraco's notification of a tie Change based on a Notified Departure, tie's options are either to agree that a Notified Departure has occurred, or take the issue to dispute resolution. Infraco's approach might well be relevant to apportioning responsibility for delay and cost, but it is not an aid to interpretation.

21 If a literal interpretation of the words is to be avoided, it is not sufficient for tie to establish that the literal interpretation is *unfavourable* to it: the Courts will not intervene simply to save one of the parties from having made a "bad bargain". The test to be applied will be whether the interpretation contended for by Infraco produces a result which is absurd, arbitrary and irrational, in circumstances where an alternative interpretation can produce a rational result[9]

22 For the reasons referred to above, there are a number of bases on which it might be said that Infraco's interpretation produces an absurd or irrational result, either because the outcome cannot be what a reasonable person would consider the parties to have intended (design changes driven by Infraco, missing design) or

[7] Paragraph 5.8.10 of Infraco's Referral Notice in Wilson Adjudication
[8] Paragraph 2.6 of Infraco's Reply to the Response in the Wilson Adjudication
[9] *Chartbrook Limited v Persimmon Homes Limited and others* [2009] UKHL 38 at paragraph 20

because their interpretation cannot readily be reconciled with other provisions of the contract.

23 Accordingly, there is a stateable argument that something has gone wrong with the words used in Pricing Assumption No. 1, in that their literal interpretation produces a result which a reasonable person would conclude cannot have been intended by tie and Infraco when they entered into the contract.

What is the consequence if the words have "gone wrong"?

24 Where it is evident that something has "gone wrong" with the words used, the Court may be prepared to intervene in order to interpret the agreement in its context, in order to get as close as possible to the meaning which the parties intended[10].

25 The question will be: what would a reasonable person (having all the background knowledge which would have been available to tie and Infraco at the time that the contract was entered into) have understood Pricing Assumption No. 1 to mean[11].

26 In practical terms, this means that evidence of the factual background, or matrix, against which the contract was entered into will be relevant. However, there is an important distinction to be made between objective facts known, or reasonably available, to tie and Infraco, and pre-contractual negotiations in which each party set out its respective negotiating positions. The general rule which the Court apply is that the pre-contractual negotiations are not admissible in arriving upon the correct interpretation to be given to the contract.

27 This issue was recently considered by the House of Lords[12], where Lord Hoffmann put it in this way:

"*Whereas the surrounding circumstances are, by definition, objective facts, which will usually be uncontroversial, statements in the course of pre-contractual negotiations will be drenched in subjectivity…It is often not easy to distinguish between those statements which (if they were made at all) merely reflect the aspirations of one or other of the parties and those which embody at least a provisional consensus which may throw light on the meaning of the contract which was eventually concluded.*"

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[10] *KPMG LLP v Network Rail Infrastructure Ltd* [2007] Bus LR 1336 at paragraph 50
[11] *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 page 912 at paragraph H
[12] *Chartbrook Limited v Persimmon Homes Limited* at paragraph 38

28 The detailed factual background to the wording eventually adopted in Pricing Assumption No. 1 is dealt with in [*refer to factual matrix document*]: in short, however, the relevant wording first arose in the Wiesbaden Agreement executed on 20 December 2007. It was then incorporated, almost verbatim, into Schedule Part 4. The context, in turn, of the execution of the Wiesbaden Agreement was that of negotiations between tie and Infraco as to who should bear the risk of the development of the design. Various statements were made by each party in relation to their position in that negotiation[13], but those are unlikely to be accepted by the Court as relevant aids to interpretation.

29 It should be noted that, although the court may refuse to consider the pre-contract negotiations in interpreting the words of the contract, those negotiations may nonetheless form part of the evidence given during the proceedings. They would be admissible in an action for rectification, and even in an action where rectification is not an issue, they may appear in evidence before the Court for other reasons. Infraco may press for the negotiations to be admitted, as evidence that the words were introduced to satisfy their own objective of minimising their risk profile in relation to design. To set against that, there does appear to have been a series of premiums added in to the price to reflect the risk that tie believed that Infraco were taking on.

30 A relevant factor in the court's consideration may be the way in which the particular words came into existence: put simply, if the words were drafted and proffered by tie, it will be more difficult for tie to argue that they are absurd, irrational or arbitrary. The forensic exercise carried out has not so far revealed whether the relevant words were tie's or Infraco's.

What meaning should the words be given?

31 It is not sufficient for tie to establish that something has gone wrong with the wording of the contract; they also require to establish what it is that a reasonable person would have understood the parties to have intended when they signed up to Pricing Assumption No. 1.

32 The courts have held that, in principle, "*there is not a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed*"[14]. In practical

[13] For example, tie's letter of 11 December 2007, Bilfinger Berger's letter of 12 December 2007 and Bilfinger Berger's e-mail to tie sent at 6.07am on 20 December 2007
[14] Lord Hoffmann in *Chartbrook Limited v Persimmon Homes Limited* supra at paragraph 25

terms, a court is likely to be more attracted to a simple re-working of the relevant words, rather than a complicated and lengthy formulation.

33 In consultation with Richard Keen QC, one formulation of the "redlining" that could be done to the clause was considered, as follows:

For the avoidance of doubt normal development and completion of designs means the evolution of design through the stages of preliminary to construction stage and excludes changes of design principle, shape and form and outline specification due to any change in the Employer's Requirements."

34 However, a change in the Employer's Requirements which necessitated a change in the design of the Infraco Works would give rise to a tie Change. Accordingly, no purpose is served if the exclusionary words were to be amended by the additional words referred to.

35 In any event, if this formulation is tested against the factual matrix it becomes much more difficult to sustain. The Employer's Requirements were a functional specification. The changes in the BDDI have not in most cases been driven by changes in the Employer Requirements, which are relatively high level output requirements of the functioning tram system, and do not address the design solutions which might deliver those requirements.

36 The factual information gathered so far suggests that those involved at tie did not consider that Infraco's ability to make recovery in respect of change would be tied to changes in the Employer's Requirements.

37 In considering the possible formulation of words, there would appear to be three categories of change that are relevant:

(a) Change driven by Infraco (buildability);

(b) Change in relation to matters required by the Employer's Requirements but not shown on the BDDI;

(c) Change which is not substantial, or material.

38 The first two of these three categories have been addressed above, and in conclusion, there is a stateable argument that Pricing Assumption No. 1 should be

interpreted in such a way as to mean that Infraco should not be entitled to additional payment for those categories of change.

39 The third category is more difficult. Those at tie involved in the formation of the Wiesbaden Agreement and the contract itself are of the view that what was intended was that Infraco would be entitled to additional recovery only where the change in design was *substantial* (this has also been put by witnesses as *significant* or *material*). An example of what was discussed between the parties (verbally) as constituting a *substantial* change has been described by one tie witness as the difference between one type of bridge (*e.g.* a suspension bridge) to another (*e.g.* a slab and beam bridge).

40 There is evidence that it was tie's *intention* that substantial changes to the design would be excluded from the lump sum price. That can be seen from tie documents generated in the context of the Wiesbaden discussions. By way of example:

40.1 The "script" for the Wiesbaden negotiations refers to the following proposition:

"*Your* [*i.e.* BBS] *price based on prelim design includes risk for emerging detailed design changes (accepted not fundamental design changes).*"

It is not understood that this document was shown to BBS, although it is likely that the proposition was put verbally to BBS during the course of the Wiesbaden discussions.

40.2 What appears to have been the first draft of the Wiesbaden agreement dated 14 December 2007, prepared by tie and sent to Infraco on 17 December 2007 contains the following wording at clause 3.3:

"*3.3 Detailed designs – BBS included in their price for the construction cost risk in the development and completion of detailed designs being prepared by SDS, save for:-*

a) Any future changes to elements of the design for civils works that are substantially different compared to those forming the current scheme being designed by SDS. "

40.3 That wording was broadly retained in the subsequent draft of the Wiesbaden Agreement sent by tie to Infraco on 19 December 2007, although some amendments were made as follows:

"*3.3 Detailed designs – BBS included in their price for the construction cost risk in the development and completion of detailed designs being prepared by SDS, save for:-*

a) Any future changes to elements of the design intent for civils works that are substantially different compared to those forming the current scheme being designed by SDS as typically represented by the drawings issued to BBS with the design information drop on 25 November 2007".

41 For the reasons referred to above, a court is unlikely to have regard to communications which represent statements of subjective intent, or a party's negotiating position, and these will not be regarded as valid aids to interpretation. In other words, simply because tie *thought* or *desired* there to be an element of materiality in the definition, that does not mean that a reasonable person would conclude that this is how the words should be interpreted. Indeed, BBS' position may well be that the reason for the substantial change in the wording of the formulation which appears to have taken place on 20 December 2007 was precisely because BBS were not prepared to agree to a definition based on the notion of what was substantial: there is witness evidence that BBS objected to the initial formulation on exactly those grounds.

42 In this context, however, it is possible to interpret the wording eventually adopted as an attempt to bring a greater degree of precision or granularity to the original wording: the references to "*normal development*", "*design intent*" and "*evolution of design*" all being intended to express that anything other than a substantial change of direction would fall within the firm price. On this interpretation, the exclusionary words should be seen as a way of *explaining* what was meant by what had previously been described as *substantially different*.

43 In his draft report, tie's engineering expert (Robin Blois-Brooke) explains the definitions that he has utilised for the exclusionary words[15]:

"*In the past the Adjudicators, assisted by Parties' Experts, have sought to define "design principle, shape, form and/or specification". To an extent these definitions depend on a degree of engineering experience and judgement, but in broad terms I have, where necessary in Sections 4 and 5 below, adopted the following definitions which take account the submissions made by the other Experts to date*:

[15] Paragraph 3.18

(a) *The **design principle** is the design philosophy or way in which the intended objective is achieved.*

(b) *The **shape** is the total effect produced by the outline of a component.*

(c) *The **form** is the overall external appearance of a component.*

(d) *The **specification** is the required characteristics of the component in terms of features such as performance, materials, etc.*"

44 In the Wilson adjudication, the Adjudicator reached the following view:

"*As to 'normal' development, I consider that this is the progression towards the Employer's Requirements as would be expected by an experienced contractor and his designer. If this results in amendment of the design principle, shape, form and/or specification shown on the BDDI drawings then it becomes a Notified Departure…*[16]

I think the correct interpretation lies in the proper application of the definitions to the facts; to which I return under the relevant issues. By way of indication:

i) The design principle is a fundamental principle rather than a design detail; for example a change from in situ to precast concrete changes the principle of the design

ii) The shape, being the total effect produced by the outline; I do not consider this necessarily changes due to a dimensional change; for instance a rectangle may remain a rectangle

iii) The form, being the external appearance; I consider that the appearance may or may not change as a result of a small dimensional change; it is a matter of scale

iv) The specification, being the nature and quality of the work; I do not consider that the nature or quality of say an in situ concrete deck, changes because it is thicker or more heavily reinforced."[17]

45 This leads to a formulation where the interpretation of the words is that which would be attributed to them by a civil engineer, within the context of what would be expected by an experienced design and build contractor, having regard to the Employer's Requirements.

[16] Paragraph 101 of the Wilson decision
[17] Paragraph 104 of the Wilson decision

46 In applying this interpretation, it may be that a further relevant consideration is that the words should also be considered as providing particularity in relation to the concept of *substantial* change. Indeed, Mr Wilson's definition of the exclusionary words involves the application of that concept to some extent.

47 The consequence of such a formulation is that there may not be a requirement for any re-writing of the words of contract: they can be given a meaning within the context explained above.

48 The formulation would require to be applied to each design change in turn to assess whether it amounts to a Notified Departure: that application will involve the exercise of expert engineering judgement on a case by case basis.

Dispute resolution

49 It is open to tie to seek the guidance of the courts, in the form of a declarator, as to the proper interpretation to be given to the meaning of Pricing Assumption No. 1.

50 That would involve first following the mechanisms laid out in Schedule Part 9, through internal resolution, mediation and adjudication – unless agreement can be reached with Infraco at an earlier stage that the issue should be referred to the court.

51 Once a court action is commenced, it is likely to be many months before a decision is obtained at first instance; that will particularly be the case if either party wishes to have factual issues considered, beyond issues of strict interpretation. Even if a favourable decision is achieved by tie, it is likely that this decision would be appealed by Infraco, adding considerably to the length of the process.

52 As part of the Schedule Part 9 process, the issue of interpretation could be referred to an Adjudicator on the legal panel. Those legal adjudicators are:

Lord Dervaird (Professor John Murray QC)
Gordon Coutts QC
Robert Howie QC
Nick Ellis

53 tie are entitled to propose which adjudicator they prefer to hear the dispute, but Infraco essentially have the right of veto over that selection.

McGrigors LLP
26 February 2010