Note for tie Limited in relation to Pricing Assumption No.1

Supplemental to report dated 23 March 2010 on certain contractual issues concerning Edinburgh Tram Project

1 Introduction

1.1 Infraco claim to be entitled to recover the time and cost consequences associated with changes in the design between the BDDI and IFC through the Notified Departures mechanism. That claim is based on a literal interpretation of Pricing Assumption No.1, and, in particular, that tie bears the risk of all changes of "*design principle, shape and form and outline specification*". The literal meaning of Pricing Assumption No.1 substantially narrows the scope or content of what would otherwise form part of normal design development, for which Infraco would bear the risk.

1.2 There is a stateable argument that something has gone wrong with the words of Pricing Assumption No.1, in that a 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, because that result is absurd, irrational or arbitrary.

1.3 However, this is only part of the test that is required to be overcome: tie must also identify the changes that would be required to the literal wording of Pricing Assumption No.1 in order to render it commercially rational. This involves arriving at a formulation which captures what 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) must have understood Pricing Assumption No.1 to mean.

1.4 There are a number of ways in which the wording could be amended, or redlined, to apportion the risk of changes to the BDDI in different ways between tie and Infraco: a court will question why any one of these interpretations is to be preferred over the others. The court will not sanction a change simply to give effect to the subjective intention, or negotiating position, of one or other of the parties. Nor will the court intervene in order to relieve a party from the consequences of having made a bad, commercially unattractive, bargain.

1.5 The issue has been discussed further with Richard Keen QC at a consultation which took place on 25 March 2010.

2 The interpretation to be given to Pricing Assumption No.1

2.1 The key touchstones in construing the Pricing Assumptions include the following provisions:

(a) Clause 3.1 of Schedule Part 4, which states that "*the Construction Works Price is a lump sum, fixed and firm price for elements of the work required as specified in the Employer's Requirements*"; and

(b) Clause 3.5 of Schedule Part 4, which states that "*the Contract Price has been fixed on the basis of inter alia the Base Case Assumptions noted herein*".

2.2 The introduction to the Infraco Proposals[1] states that:

"*1.1 BBS Proposals for Civil Works are the SDS Design, to be developed and finalised to Issued for Construction (IFC) status under the Design Management Plan…*

1.2 The Design is, at present, incomplete or not issued to BBS for some Sections of the Works…

1.4 The Design will, where possible, be developed and finalised in accordance with Section 3.4, Pricing Assumptions…".

2.3 Clearly the development of the design prepared by the SDS Provider through to completion was of central importance in relation to the civils works. Prior to contract formation, it was recognised that there were areas of inconsistency or misalignment between the BDDI and the Infraco Proposals. The risk in relation to those areas was catered for by clauses 4.7 and 4.8 of the SDS Novation Agreement. Beyond this, as is recorded in clause 3.2.1 of Schedule Part 4, "*in order to fix the Contract Price at the date of this Agreement certain Pricing Assumptions represent factual statements that the Parties acknowledge represent facts and circumstances that are not consistent with the actual facts and circumstances that apply. For the avoidance of doubt, the commercial intention of the Parties is that in such circumstances the Notified Departure mechanism will apply*."

2.4 The purpose of the Pricing Assumptions was to protect Infraco in the context of a lump sum, fixed and firm price for delivering the Employer's Requirements by a certain date. It is clear from the pre-contract discussions that Infraco were concerned about the SDS Design, and its level of completion – hence *inter alia* Pricing Assumption No. 1.

2.5 It is difficult to see why the protection referred to above would, given the terms of clause 3.1 quoted above, apply to a change in BDDI which was required to reflect something which was in the Employer's Requirements, but not in the BDDI (the bat box example). This is reinforced by clause 1.4 of Schedule Part 4, which states that "*no provision within this Part 4 of the Schedule shall entitle the Infraco to more than one payment for any item or other entitlement under the Infraco Contract.*" What appears to be intended by this wording is that there should be no double-counting. Equally, it is difficult to see why any changes which Infraco or the SDS Provider make for their own reasons, such as buildability, should trigger a Notified Departure. It can be seen therefore that the reason for a change is relevant to the interpretation to be given to Pricing Assumption No.1.

2.6 Pulling the foregoing threads together the following conclusions can be proposed:

2.6.1 To interpret Pricing Assumption No.1 in the way in which Infraco contend for which involves utilising the exclusionary words at the end of the clause in a literal way in effect deprives "normal development and completion of design" of any material content.

2.6.2 The absurdity of Infraco's interpretation is exposed by the two examples referred to above.

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[1] Schedule Part 30

2.6.3 Approaching the matter from the standpoint of the protection which was intended to be afforded by the Pricing Assumptions and Pricing Assumption No.1 in particular it can be seen that the wording of Pricing Assumption No.1 ought to be construed in a manner which does not result in the two examples triggering a Notified Departure. Equally it can be seen from the treatment of misalignments that were identified that Infraco sought protection in relation to changes to BDDI which would be required to bring them into alignment with the Infraco Proposals.

2.7 On the basis of the foregoing conclusions, we discussed a form of wording with Richard Keen which would appear to address the issues referred to above. This would involve amending Pricing Assumption No.1 as follows (amendments shown in red):

"*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 due to any change in the Base Date Design Information which is necessary to meet the Employer's Requirements."

3 Prospects

3.1 Whilst this formulation of words appears to satisfy the considerations discussed above, the prospects of this wording being upheld by a court are uncertain. This is because it can be said that the contract does not contain express wording which apportions the risk of change in the way contended for: the express wording places almost the whole of the risk of design change on tie. The pre contract discussion does not disclose any clear intimation to allocate risk in the way that would be achieved by the redlining. Those communications disclose that Infraco's position was that they were not prepared to take on the risk of design development in circumstances where the design was less complete than both parties had originally envisaged that it would be. tie sought to introduce a test of materiality. It is not clear how the eventual wording arose – and in particular whether it was proposed by tie or by Infraco.

3.2 Furthermore, there was an opportunity (between the execution of the Wiesbaden Agreement in December 2007 and the execution of the contract in May 2008) for tie to raise and resolve the issue that "something had gone wrong with the words".

4 Further consideration

4.1 Further consideration is required in order to develop tie's position in relation to the way in which Pricing Assumption No.1 ought to be revised. That will include a consideration of how the proposed formulation sits with the provisions of the contract as a whole, and its overall commercial objectives: for example, the misalignment workshops referred to at clause 4.7 of the SDS Novation Agreement, or the development, review and finalisation of Deliverables provided for in clause 10 of the contract.

4.2 As part of this enquiry, it would be helpful to have a leading counsel in London to consider these issues in conjunction with Richard Keen QC. It is proposed that instructions are given to Helen Davies QC of Brick Court Chambers to give an opinion. She has worked closely with Jonathan Sumption QC for some years. She also recently successfully resisted a "commercial absurdity" type argument in the Commercial Court[2], in one of the first cases to consider *Chartbrook* v *Persimmon Homes*, and is very highly recommended.

5 Timescale

5.1 Helen Davies would be available to consider the papers in this matter during the week commencing 12 April 2010, with a view to a further report being issued in relation to this issue during the week commencing 19 April 2010.

6 Dispute resolution time limits in relation to Pricing Assumption No.1

6.1 We discussed the question of time limits referred to in our report with Richard Keen QC who agreed with the conclusion set out therein. His view was that, whilst there are circumstances where the right to have recourse to the courts will be irretrievably lost, these will only apply in the circumstances specifically envisaged in paragraph 10.1 of Schedule Part 9 – namely where the Chief Executives of tie and Infraco agree that a dispute should be referred to litigation, but that litigation is not then commenced.

6.2 However, there is no reason to conclude that there is an immediate time limit in relation to the raising of court proceedings following the issue of the adjudicator's decision. Beyond the wording of Schedule Part 9 itself, this would be consistent with a regime whereby parties go to adjudication on disputes during the course of the works in order to obtain a binding interim decision – but are free to litigate those same disputes in due course, possibly after the works have concluded.

6.3 On this basis, tie are not required to raise court proceedings in relation to the Wilson adjudication in accordance with any immediate time limit[3].

McGrigors LLP
31 March 2010

[2] BP Exploration Operating Company Ltd v Dolphin Drilling Ltd [2009] EWHC 3110

[3] Other than the ordinary rules of prescription