

## Adjudication, Naturally

**ARBITRATION  
AMENDMENT BILL  
2017**

**PAYMENTS MADE UNDER DIRECT  
AGREEMENT NOT VOIDABLE  
TRANSACTIONS**

# FROM THE EDITOR

Welcome to the 28th issue of BuildLaw® in which we draw on the experience and expertise of leading experts in the field to bring you commentary, articles and reviews on topical matters relating to construction law.

In this issue we feature natural justice and adjudications. We also look at representative defect claims and exclusion clauses, further amendments to the Arbitration Act, and the recent New Zealand Court of Appeal decisions in *Ebert Construction v Sansom & Anor* in which the Court found that payments made under a direct agreement by a financier to a builder are not voidable transactions and Torchlight which dealt with the application of the penalties doctrine under NSW law.

In 'Case in Brief' Jeremy Glover discusses the recent UK TCC decision in *Dawnus Construction Holdings Ltd v Marsh Life Ltd* [2017] in which Marsh claimed there had been a breach of natural justice in relation to corrections made under the slip rule.

I wish to take this opportunity to thank all our contributors. We are most grateful for the support we receive from dispute resolution professional, law firms, and publishers, locally and overseas, that allows us to share with you papers and articles of a world class standard, and to bring you a broad perspective on the law and evolving trends in the delivery and practice of domestic and international dispute resolution and construction law.

Contributions of articles, papers and commentary for future issues of BuildLaw® are always welcome. I do hope you find this issue interesting and useful. Please feel free to distribute BuildLaw® to your friends and colleagues – they are most welcome to contact us if they wish to receive our publications directly.

Warmest regards,



**Editor and Director Building Disputes Tribunal**



John Green

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# BuildLaw: In Brief

## **BuildSafe launches new escrow service for prefabricated building components and indent goods**

BuildSafe, the New Zealand building and construction sector specialist escrow service has launched a companion service to its residential security of payment scheme. Tradesafe was recently launched specifically to meet the needs of suppliers and purchasers of prefabricated components and indent supplied goods for building projects such as joinery, windows, fireplaces, flooring, furnishings etc. With a minimum fee of \$10 and a maximum fee of just \$37.50 TradeSafe is already making its mark as a credible and practical means of protecting parties to what can otherwise be high risk transactions for both sides. The recent failure of furniture supplier PK Furniture is a good example of why paying deposits to suppliers/merchants in advance of receiving goods and services is a high-risk game plan.



## **More building companies go bust**

The recent high-profile failures of former Certified Builders member Point to Point Holdings and former Master Builders member Cranston Homes are just further examples of why using BuildSafe's independent escrow services is just 'plain commonsense'. Point To Point is reported to have gone into liquidation owing almost \$2 million to creditors including 30 homeowners who have been left in the lurch, some for the second time, having paid deposits of \$40-50,000 per dwelling and with nothing to show for it. To add insult to injury, it would seem the company operated on a heavily front-loaded milestone payment

system with one couple reported to have paid \$130,000 with only an unusable foundation on their Gulf Harbour section. Cranston is reported to have failed owing creditors about \$1.5 million including customers who paid deposits for houses who are owed about \$160,000.

Despite record building activity levels, residential building remains a high-risk activity with many building companies operating well beyond their capacity, experience and resources in a virtual financial nirvana as a result of iniquitous front-loaded milestone payment regimes. This false sense of 'financial wellbeing' created by taking money in advance of delivering services sees them artificially cash rich until it comes time to finish projects for which there is no longer any money available from their clients and the only source of finance to complete those projects becomes the deposits they take from new clients – it's called robbing Peter to pay Paul and among other things, it's a recipe for disaster for both the builder and its clients.

## **UK Government offers no cost cladding checks in wake of Grenfell Tower fire**

In the wake to the Grenfell tower disaster the Department for Communities and Local Government ("DCLG") is offering to test the cladding of private residential blocks in England. This is due to the public concern about problems with the type of cladding which was used on Grenfell Tower. DCLG has asked owners, landlords and managers of private residential blocks to consider checking their properties to identify whether any cladding panels are made of Aluminium Composite Material. If Aluminium Composite Material is identified, then a sample can be submitted to the Building Research Establishment ("BRE") for testing. Priority is being given to buildings over six storeys or 18 metres high. Initial testing will be paid for by





DCLG and information from the checks will be available to DCLG from BRE. Remedial action would be the responsibility of the owner of the building. The DCLG website explains how to identify the cladding and how to access the testing facilities including a form to be returned with samples and an email address for enquiries.

## Building activity

Total building activity fell in both volume and value terms in the March 2017 quarter, compared with the December 2016 quarter.

For the March 2017 quarter compared with the December 2016 quarter, in seasonally adjusted volume terms:

- residential building activity fell 0.8 percent
- non-residential building activity fell 7.2 percent
- all building activity fell 3.5 percent.

The volatile non-residential building work series led the volume fall, decreasing a seasonally adjusted 7.2 percent, while residential building work decreased 0.8 percent.

"Building activity adjusted for price changes fell for the first time in two years, due to a decrease in commercial and other non-residential building work this quarter," said Jason Attewell, Senior Manager International and Business Performance at Statistics New

Zealand. "Building work has been at historically high levels since late 2015."

The seasonally adjusted value of all building activity fell 2.2 percent, following a 3.0 percent rise in the December 2016 quarter. "When not adjusted for inflation, building activity fell for the first time in five years."

The volume trend for all building work has declined, but is still 68 percent higher than a low point in the September 2011 quarter. It is also 15 percent higher than the earlier series peak in the June 2005 quarter. The volume trend series began in the December 1989 quarter, so does not include the 1970s residential building boom. Building consents for new homes fell in April, partly due to the timing of Easter, Stats NZ said today.

The seasonally adjusted number of new homes consented fell 7.6 percent in April 2017 compared with March, mainly because of Easter, which occurred in April this year. This fall followed a 1.2 percent fall in March, and a 15 percent rise in February.

"Councils don't usually issue building consents on public holidays, so the timing of Easter drove a fall in April's building consents," Business Indicators Senior Manager at Statistics new Zealand Neil Kelly said.

A total of 2,106 new homes were consented in April 2017, compared with 2,361 in April 2016.

"On an annual basis, home consents have reached a 12-year high this year, with more than 30,000 new homes being consented per year," Mr Kelly said.

In the year ended April 2017, 30,371 new homes were consented – up 8.3 percent from the previous 12 months, and the most for an April year since 2004.

Despite all the talk of affordability, QV New Zealand reports that Kiwis still prefer their assets in property form. QV says the value of residential property continues to grow beyond one trillion dollars, dwarfing the value of other asset classes, with residential mortgages secured against 23% of this value.

# BuildLaw: In Brief

## Building (Earthquake-prone Buildings) Amendment Act 2016

From 1 July 2017, the Building (Earthquake-prone Buildings) Amendment Act 2016 (the Amendment Act) is expected to take effect.

It will ensure the way our buildings are managed for future earthquakes is consistent across the country, and provide more information for people using buildings, such as notices on earthquake-prone buildings and a public register.

Earthquake-prone buildings pose a risk to people or other property in a moderate earthquake event. The primary objective in managing these buildings is to protect people. This means that the law focuses on the most vulnerable buildings in an earthquake in terms of the risk to people's safety.

The Building Act 2004 sets up the framework for how to manage buildings for future earthquake risk. Building users, owners, councils and engineers need to be aware of the upcoming changes to how earthquake-prone buildings will be managed, as this will affect you. [New framework for managing earthquake-prone buildings](#) on the MBIE Corporate website has further information.

## MBIE clarifies Commerce Commission ruling on J-Frame Laminated Veneer Lumber

After a period of relative quiet, a couple of decisions have recently been issued by the Courts in relation to the Construction Contracts Act 2002.

J-FRAME is a general purpose structural laminated veneer lumber gauged framing timber manufactured by JNL from 100% renewable Radiata Pine, plantation forest. According to JNL's website, J-FRAME is an independently certified engineered wood product, to AS/NZS4357 (Structural LVL) that is a reliable straight and durable product that can be used in a wide range of applications including residential and commercial framing and truss systems.

On 9 June 2017, the Commerce Commission

issued a compliance advice letter regarding the labelling of J-Frame Laminated Veneer Lumber.



The Commerce Commission stated in that compliance advice letter that J-Frame laminated veneer lumber, manufactured by Juken New Zealand Limited:

- did not meet the requirements of NZS 3640
- was incorrectly labelled as H1.2
- may not have complied with AS/NZS 1604.4 because it does not carry an "E" label signifying that it is an envelope treatment.

On 28 June 2017 MBIE issued Building Controls Update No. 217 to describe the form of the Commerce Commission's action and to clarify some of the wording in relation to the labelling of J-Frame Laminated Veneer Lumber. MBIE says:

The Commission's compliance advice letter is about labelling and makes no judgment about the durability and performance characteristics of Juken's J-Frame product or whether it is fit for purpose.

This advice is intended to clarify the position of building consents involving J-Frame following the Commission's compliance advice letter.





J-Frame has a BRANZ appraisal and a CodeMark certificate. These are unaffected by the Commerce Commission's compliance advice letter. This means that J-Frame is certified for use where the H1.2 hazard class applies. If J-Frame is specified in plans for a use in situations where the H1.2 hazard class applies then a Building Consent Authority is obliged to accept this, on the basis of the CodeMark certificate.

If consented plans specify "H1.2" and a Code Compliance Certificate has not yet been issued then a minor variation to the consent will be needed if the builder uses (or proposes to use) J-Frame.

Minor variations to building consents: Guidance on definition, assessment and granting has further information.

## The Qatar crisis highlights the question of *force majeure*

The Qatari diplomatic crisis highlights the issue of *force majeure* clauses in construction contracts.

Imports of construction materials needed for the State of Qatar to deliver its World Cup and Vision 2030 infrastructure schemes are being severely impacted by the recent closing of borders by key neighbours Saudi Arabia and the UAE, leading to

increased costs and delays on major construction projects.

Under Qatari law, the doctrine of *force majeure*, found at Article 256 of Law No. 22 of 2004 (the Civil Code) states: "If the debtor does not perform the obligation specifically, or is delayed in its performance, he is obliged to compensate the damage caused to the creditor; unless it is proved that the non-performance or the delay was for an extraneous cause for which the debtor is not responsible." Further, parties can agree to take responsibility for the consequences of a *force majeure* event, as Article 258 of the Civil Code states: "It is permissible to agree that the debtor shall bear the responsibility of *force majeure* or sudden incident."

As such, where an agreement contains a *force majeure* clause which specifies the exclusive events that constitute *force majeure*, then such clause will be valid, binding and enforceable between the parties to that agreement.

The question that arises is whether or not the current diplomatic crisis constitutes a qualifying event for the enforcement of a *force majeure* clause in a construction contract?

The definition of *force majeure* events may be drafted widely, or narrowly to include only specific events in construction contracts. The crisis highlights the importance of careful drafting of *force majeure* clauses to carefully define the trigger events for *force majeure* clause to apply.

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# EXCLUSION CLAUSES: COURT OF APPEAL CONFIRMS BROADER APPROACH

Steven Williams, Mark Breslin & Katherine Butler

A Court of Appeal decision handed down yesterday has upheld the applicability of an exclusion clause covering asbestos liability in a consultant appointment. The decision follows other recent Court of Appeal decisions in adopting a natural and unstrained interpretation of exclusion clauses, free from the application of restrictive default rules. The decision also provides important guidance as to the application of the Canada Steamship principles to the interpretation of exclusion clauses.

## **Persimmon Homes Limited and Others v Ove Arup & Partners Limited and Anor**

Persimmon and its fellow Appellants were part of a consortium of house builders (the "Consortium") who bought and developed a large site in Wales known as the Barry Waterfront. The Respondents ("Arup") were also involved with the development, advising and providing professional services initially to the original owners of the Barry Waterfront and then subsequently to the Consortium.

Over a number of years, Arup provided various advisory and design services under a series of contracts; namely:

- The 1996 Appointment – An appointment between Arup and the previous owners of Barry Waterfront;
- The 2007 Contract – A contract between Arup and the Consortium in relation to the purchase of the Barry Waterfront site;
- The 2009 Agreement An agreement between Arup and the Consortium to provide engineering services in 2009 in relation to the development of the site; and

- The 2010 Warranties – Arup provided warranties to each consortium member in relation to services carried out under both the 1996 Appointment and the 2009 Agreement (the "2010 Warranties").

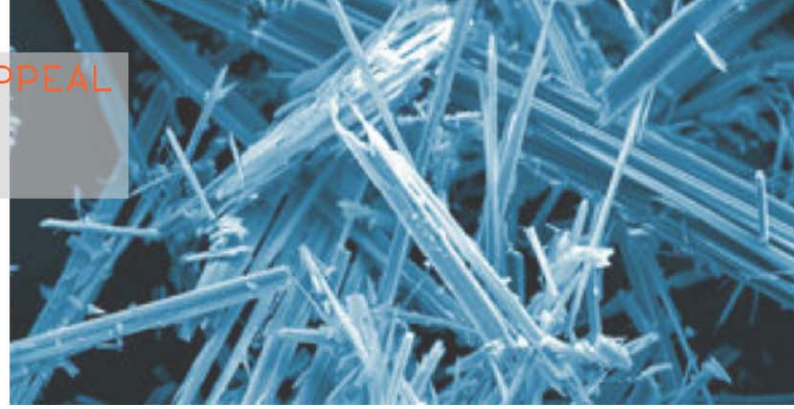
This case concerns clause 6.3 of the 2009 Agreement and clause 4.3 of the 2010 Warranties (the "Clauses") which are, for all intents and purposes, identical providing that:

*'The Consultant's aggregate liability under this [Agreement/Deed] whether in contract, tort (including negligence), for breach of statutory duty or otherwise (other than for death or personal injury caused by the Consultant's negligence) shall be limited to [£12,000,000.00/£5,000,000.00] with the liability for pollution and contamination limited to £5,000,000.00 (five million pounds) in the aggregate. Liability for any claim in relation to asbestos is excluded.'*

After committing itself to the purchase and development of the site, the Consortium discovered asbestos contamination in greater levels than it had expected. The Consortium brought proceedings against Arup alleging that Arup, *inter alia*, ought to have advised the Consortium of the presence of asbestos in the nature, extent and quantities found.



## EXCLUSION CLAUSES: COURT OF APPEAL CONFIRMS BROADER APPROACH APPROACH - CONT.



As part of its defence to the allegations made by the Consortium, Arup applied to have preliminary issues heard with regards to the applicability of the above exclusion clauses, the last sentence in particular. This was on the basis that, if correct, the proper application of these clauses excluded Arup's liability for the vast majority of the Consortium's claim.

The Consortium argued for a restrictive approach to these clauses, contending that they should be restricted to liability "for causing" pollution, contamination or asbestos, and that they should not be interpreted as applying to Arup's own negligence. The Consortium relied in this regard on the "*contra proferentem*" rule which allows unclear contract terms to be construed against the party who drafted them or who seeks to rely on them. The Consortium also relied on a well established line of cases dealing with the circumstances in which exclusion or indemnity clauses are to be interpreted as protecting against a party's own negligent acts (known as the *Canada Steamship* principles). The *Canada Steamship* principles indicate that a party's own negligent acts should not be covered by the general words of an exclusion or indemnity clause where those words are apt to apply to both negligent and non-negligent acts.

### The TCC's approach

As noted in the previous LawNow ([click here](#)), Mr Justice Stuart-Smith agreed with Arup's interpretation of the exclusion clauses and refused to apply the restrictive rules suggested by the Consortium. The TCC noted that the modern approach to exclusion clauses acknowledges that commercial parties to a contract are free to assign risks as they see fit and exclusion clauses should therefore be given their ordinary and natural meaning in the same way as any other clause of a contract. Default rules, such as *contra proferentem* should be reserved for cases of genuine ambiguity.

The TCC's approach in this regard has since been endorsed by the Court of Appeal's decision last year in the *Transocean Drilling* case (to read more on LawNow on that decision, [click here](#)).

### The Court of Appeal

In a unanimous decision, the Court of Appeal (led by Lord Justice Jackson) has upheld the TCC's decision, deciding that:

- Not least for grammatical reasons, the Consortium's reading of the exclusion clauses was unworkable and did not reflect business common sense with regards to the relationship between the parties.
- The meaning of the clauses was clear and unambiguous and should be given effect to.
- Accordingly, the *contra proferentem* rule was not relevant.
- The *Canada Steamship* guidelines are more relevant to indemnity clauses than to exclusion clauses and were "of very little assistance in the present case". In any event, the possible non-negligent acts identified by the Consortium as falling within the present clauses were fanciful or remote and did not give rise to any inference that negligent acts were not intended to be covered.

More generally, the court supported the TCC's unrestrictive approach to the interpretation of limitation and exclusion clauses (at paragraph 56):

*"In major construction contracts the parties commonly agree how they will allocate the risks between themselves and who will insure against what. Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down. Contractors and consultants who accept large risks will charge for doing so and will no doubt take out appropriate insurance. Contractors and consultants who accept lesser degrees of risk will presumably reflect that in the fees which they agree."*



## Conclusion and implications

This decision is the latest in a recent line of authority from the Court of Appeal in relation to the proper interpretation of limitation and exclusion clauses.

In upholding that the wording used to exclude Arup's liability in relation to claims regarding asbestos, the court agreed that (whilst parties must be express about their intention to exclude liability) the wording of the clauses in this case was sufficiently clear to demonstrate the risk allocation agreed by the parties at the time of the agreements in question. Given that the wording was clear, aids to construction such as the *contra proferentem* rule and the *Canada Steamship* principles could not assist the Consortium in arguing that liability had not been excluded.

The decision supports the reasoning in the *Transocean* decision to the effect that limitation and exclusion clauses should be given their natural meaning and that stretched

interpretations should not be used to create ambiguities where there are, in reality, none.

The court's comments in relation to the *Canada Steamship* principles are also of note and we are likely to see their use diminish in disputes over exclusion clauses, although their influence in relation to the interpretation of indemnity clauses will remain.

*\* CMS acted for the successful party in this appeal.*

## References:

*Canada Steamship Lines Ltd v The King* [1952] AC 192

*Transocean Drilling UK Ltd v Providence Resources PLC* [2016] EWCA Civ 372

*Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373



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# ADJUDICATION, NATURALLY

David Wilson

**On 29 March 2017, Lord Tyre of the Outer House of the Court of Session handed down an opinion in *Bell Building Projects Limited v Arnold Clark Automobiles Limited* and addressed the principle of natural justice in the adjudication arena.**

## Background

Bell Building Projects Limited ("BBP") carried out works for Arnold Clark Automobiles Limited ("ACL"), specifically the construction of a new car showroom on Alexandra Parade in Glasgow. The works were terminated by ACL and in doing so an adjudicator decided that ACL was in breach of contract. To recover losses, BBP referred the matter of damages in a separate adjudication. The Adjudicator found in favour of BBP, awarding payment of £1,010,328.08. BBP raised enforcement proceedings in the Court of Session for payment of the awarded sum. It was ACL's defence that the Adjudicator had breached the rules of natural justice.

## Natural Justice and Adjudications

The general principle of natural justice is that each party must be given a fair opportunity to present its case. The adjudicative process is short and sharp due to the tight 28-day timescale (subject to any agreed extension of time) in which parties require to present their case and the adjudicator issues his or her decision. However, Lord Tyre made clear in his opinion that adjudications' distinguishing features do not negate the principles of natural justice. Further, while it is open to parties to overturn an adjudicator's decision in litigation or arbitration, more often than not an adjudicator's decision is the final word on the dispute and as such the principles of natural justice are integral to adjudications.

## Allegation of Breach of Natural Justice

ACL contended that the Adjudicator had breached the principle of natural justice by denying it a fair opportunity to present its case or to respond to BBP's case. It was ACL's position throughout the adjudication that the Adjudicator was following an unfair process. ACL's allegation of a breach of natural justice referenced two main issues:

### 1- ACL's Contra-Charge for Rectification Works

ACL had a contra-charge claim for works required to rectify the car showroom. The Adjudicator requested that ACL provide additional documentation the day before his decision was due. ACL complained that this request did not afford it requisite time and as such was a breach of natural justice. There were a multitude of issues for the Adjudicator to determine and his last minute request of ACL did not, in the opinion of Lord Tyre, open him to criticism. There was no breach of natural justice in this respect.

### 2- BBP's Loss and Expense Claim

The Adjudicator requested an opportunity to visit BBP's offices to inspect documents which evidenced the loss sustained by BBP as a result of ACL's contract termination. ACL accused the Adjudicator of building BBP's case and refused to attend the visit to BBP's offices. Making reference to the principle of natural justice, the Adjudicator declined to make the visit without ACL. As a result BBP produced





the documentation required and this was sent to the Adjudicator and to ACL's solicitors, although received late by the latter. ACL complained that it was disadvantaged and would not be able to respond meaningfully in the timescales to the additional BBP documentation.

Lord Tyre opined that the time afforded to ACL to respond was adequate. ACL's refusal to participate in the visit was unreasonable and was a major factor in the requirement for the additional BBP documentation. Further, the Adjudicator had suggested a two day extension of time and ACL failed to respond. As such Lord Tyre found that ACL could not now complain of unfairness. In other words, you can't have your cake and eat it!

## Severability

BBP's secondary position depended on severability. If a breach of natural justice was determined, the vitiated part of the decision could be severed and an award could be made to BBP based on the remaining part of the decision. Although Lord Tyre did not need to go into detail on this point, he provided a view:

precedent is set against severance and although there were a number of different issues to be determined the matter was a single dispute. Lord Tyre found that deducting an amount from the Adjudicator's award would have effectively re-written his decision and this was not permissible.

## Comment

Lord Tyre's decision is another example of the Court of Session paying deference to adjudicators' decisions and the adjudicative process. Natural justice is important in adjudications, however it is to be balanced with the need for expeditious resolution of disputes. An adjudicator is required to act fairly in all the circumstances, however parties must also be sure they have acted reasonably during the adjudicative process should they intend to rely on a breach of natural justice to challenge an adjudicator's decision.

\*This article was co-written by Shona McCusker.

## About the Author

David Wilson joined MacRoberts in 2000 and specialises in contentious construction law. He is accredited by the Law Society of Scotland in this regard.

He advises in all types of construction projects/ disputes, and has extensive experience of pursuing and defending parties in commercial disputes in the Court of Session, Arbitration and Adjudication as well as providing legal advice to Adjudicators.

He also lectures to the industry and contributes to the MacRoberts Construction Bulletins and e-updates.

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# ADJUDICATION

## building disputes tribunal

### ADJUDICATION IN A NUTSHELL

What to expect in adjudication under the  
Construction Contracts Act?



**#1**

**NOTICE OF  
ADJUDICATION**



**#2**

**APPLICATION  
FOR  
APPOINTMENT**



**#3**

**NOMINATION**



**#4**

**PAYMENT  
OF  
SECURITY**



**#5**

**ACCEPTANCE OF  
APPOINTMENT**



**#6**

**CLAIM**



**#7**

**RESPONSE**



**#8**

**REPLY\***



**#9**

**REJOINDER\***



### **#10 DETERMINATION**

The adjudicator will issue the Determination and confirm or fix fees and expenses. The Determination is released upon payment of fees balance (if any). Determinations are enforceable through a District Court.







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## CASE IN BRIEF

## Dawnus Construction Holdings Ltd v Marsh Life Ltd [2017]

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*by Jeremy Glover*

Marsh had engaged Dawnus to design and build a hotel plus retail and restaurant units in Poole. The project fell into delay and the contract was terminated. A number of disputes arose and there had been four adjudications. This adjudication enforcement case concerned the fourth, a referral by Marsh seeking a valuation of the account upon termination. Although it was Marsh who had made the adjudication referral, the Adjudicator held in favour of Dawnus. The total amount said by the Adjudicator to be due to Dawnus came to just under £1.5 million (inclusive of VAT and interest).

Marsh said there had been a breach of natural justice in that the Adjudicator had failed to consider and deal with various defences that they had put forward. However, as a starting point, HHJ McKenna had to consider whether Marsh, by inviting the Adjudicator to correct errors in the Decision under the slip rule, was accepting the validity of the Decision. By doing this without a general reservation of rights, Dawnus said that Marsh was electing to forego any opportunity it might otherwise have had to challenge the Decision.

Following the issue of the Decision, both parties had written to the Adjudicator raising a number of slips, Dawnus raising mathematical errors but Marsh raised more substantive issues, namely alleged breaches of natural justice going to whether or not the Adjudicator had considered the arguments raised by Marsh during the adjudication. Marsh said that the failure by the Adjudicator to have considered the arguments, must have been a slip. The Adjudicator revised the quantum of his Decision but rejected the more substantial points raised.

HHJ McKenna explained that the doctrine of election prevents a party from "approbating and reprobating" or "blowing hot and cold" in relation to an adjudicator's award. Here Marsh could have, but did not, expressly reserved its right to pursue a claim of breach of the rules of natural justice when inviting the Adjudicator to make corrections under the slip rule. By not doing this, when inviting the Adjudicator to exercise his powers under the slip rule, Marsh had waived or elected to abandon its right to challenge enforcement of the Decision since it had thereby elected to treat the Decision as valid:





**“Assuming that good grounds exist on which a decision may be subject to objection, in the absence of an express reservation of rights, either the whole of the relevant decision must be accepted or the whole of it must be contested...”**

Marsh was therefore precluded from challenging the Decision in the enforcement proceedings. However, in case he was wrong, the Judge did go on to review the natural justice challenge. Before doing so, HHJ McKenna reminded the parties that for a breach of natural justice to be a bar to enforcement, the breach must be plain, significant and causative of prejudice.

Here, the Judge accepted that the Adjudicator may have misunderstood the nature of certain of Marsh's arguments. However, the Judge then reviewed in general terms what it was the Adjudicator had been asked to do. Here, the Adjudicator was specifically asked to determine the issue of loss and expense and that was what he did. Marsh had argued that contractually there was no entitlement to loss and expense and the Adjudicator had rejected that argument. In doing so, the Adjudicator accepted Dawnus' contractual arguments about which were the relevant events that should be taken into account. He had therefore addressed the question that had been put to him. The Judge concluded that Dawnus:

***"may not like that conclusion but to my mind it is stuck with it."***

*\*This article first appeared in Lexology*



## About the Author



Jeremy Glover  
Partner

Jeremy has specialised in construction energy and engineering law and related matters for most of his career. He advises on all aspects of projects both at home and abroad, from initial procurement and strategic project advice to dispute avoidance and resolution. He acts across a wide range of construction sectors in the UK and internationally, including general construction, transport, communications, process plant, oil, gas, nuclear and renewables.

**FENWICK  
ELLIOTT**

# ARBITRATION AMENDMENT BILL

John Green



On 9 March 2017, the Arbitration Amendment Bill (the Bill) was introduced to Parliament. The purpose of the bill is to amend the Arbitration Act 1996 (the Act) to:

- ensure arbitration clauses in trust deeds are given effect;
- extend the presumption of confidentiality in arbitration to a rebuttable presumption of confidentiality in related court proceedings under the Act;
- clearly define the grounds for setting aside an arbitral award and bring New Zealand's approach into line with foreign arbitration legislation; and
- confirm the consequence of failing to raise a timely objection to an arbitral tribunal's jurisdiction.

## Trust related arbitration

Trusts and their civil law equivalents contribute significantly to the global economy generating billions of dollars of revenue and trustee's fees. In recent decades, the increasing use of onshore and offshore trusts has led to increased litigation as arbitration has been viewed by many as too risky due to uncertainty about the enforceability of arbitration agreements in trust deeds.

Arbitration can be a most appropriate and suitable process for resolving disputes relating to trusts and in particular, it has in the international context, the added advantage of enforceability of awards under the New York Convention. However, the nature of trusts has resulted in uncertainty as to whether an arbitration conducted pursuant to an arbitration clause in a trust deed would be binding under the Act for reasons, including that trust deeds incorporating arbitration agreements are not contracts, that there may be a lack of privity to bind non-signatory beneficiaries, and that the interests of certain beneficiaries of a trust *i.e.* minors/those lacking capacity and unnamed and unascertained beneficiaries may not be represented.

This uncertainty has tended to limit the effective use of arbitration in trust disputes. Nevertheless, it can be removed by ensuring that arbitration clauses in trust deeds are treated as arbitration agreements for the purposes of the Act. By clarifying that arbitral tribunals have the same power as the High Court to appoint persons to conduct litigation on the part of minor, unborn, or unascertained beneficiaries (or classes of beneficiaries), those who are unable to represent themselves will be effectively represented ensuring that any decision of an arbitral tribunal will bind all interested parties. Arbitration can be a suitable mechanism for resolving disputes involving trusts as its inherent privacy is more suited to the private nature of most trusts.

Support for trust arbitration is spreading. In recent years, other jurisdictions have moved to reform legislation to expressly provide for arbitration of trust disputes including five states in the USA, the Supreme Court in Texas upheld an arbitration provision in a trust in the absence of specific legislation, Guernsey and the Bahamas enacted reforms in 2007 and 2011 respectively to allow for arbitration of trust disputes, and Switzerland will enforce arbitral awards in respect of trust arbitrations under its conflict of laws provisions.





## Confidentiality of arbitration related court proceedings

The current default position under section 14F of the Act is that court proceedings on arbitral matters are to be public. This approach is inconsistent with the confidentiality normally afforded to arbitral proceedings and with other international legislative approaches that seek to preserve such confidentiality. Other jurisdictions have struck the balance between open justice and confidentiality of arbitral proceedings in a way that preserves confidentiality by default. Section 14F is also inconsistent with the move to preserving the privacy of arbitral proceedings in the Arbitration Amendment Act 2007. Reforming section 14F by introducing a rebuttable presumption of confidentiality will support the existing principles under section 5 by making New Zealand a more attractive destination for international arbitration.

NZDRC and NZIAC have long advocated for a presumption of confidentiality in Court proceedings in relation to arbitral matters. Our arbitration rules expressly provide, in terms of

s14H(d) of the Act, that the parties agree that any Court proceedings related to the arbitration must, to the full extent permitted by the law, be conducted in private. However, the present default position is that a Court must conduct proceedings under the Act in public and any agreement that proceedings be conducted in private such as that provided for in our rules is just one of the matters that the Court must consider in coming to a determination.

## Narrowed grounds for setting aside an arbitral award

Articles 34 and 36 of Schedule 1, concerning the enforceability of an arbitral award, were in issue in the Supreme Court of New Zealand decision of *Carr v Gallaway Cook Allan* [2014] NZSC 75 where the definition of "arbitration agreement" was disputed.

In that case, the Supreme Court held that an arbitration agreement providing for invalid recourse against an arbitral award (appeal on a question of fact) is not a valid arbitration agreement.



- International Commercial Arbitration
- International Arb-Med
- International Mediation

The New Zealand International Arbitration Centre (NZIAC) provides an effective forum for the settlement of international trade, commerce, investment and cross-border disputes in the Australasian/Pan Pacific region.

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The decision in *Carr* highlighted the need for amendment to these articles to move in line with the foreign approaches to the adoption of the Model Law provisions. The narrowing of articles 34(2)(a)(i) and 36(1)(a)(i) will limit the Court's scope to set aside or not recognise/enforce an arbitral award which might otherwise be unenforceable due to procedural provisions being in conflict with the Act in circumstances where there is clear agreement of the parties to submit a dispute to arbitration. The proposed amendment adopts language different from the Model Law but is the minimum change necessary to correct the problem raised in *Carr*.

Amendments to articles 34(2)(a)(iv) and 36(1)(a)(iv) would address the views of the majority in *Carr* that the language regarding non-derogation in article 34(2)(a)(iv) has no wider application beyond Schedule 1, and would bring New Zealand law into line with foreign legislation. The article 34(2)(a)(iv) equivalents in Australian legislation

(International Arbitration Act 1974 and the Commercial Arbitration Acts in each State), Hong Kong's Arbitration Ordinance 2011, and the Singapore International Arbitration Act 1994 apply to the entire Act, not only the Model Law parts of it like our Act. The current limitation under the Act to derogation under Schedule 1 only is flawed and the amendment would ensure that the principle of non-derogation is protected and given proper effect in setting aside and enforcement proceedings.

### **The consequence of failing to raise a timely objection to an arbitral tribunal's jurisdiction**

Clearly defining the consequence of not raising an objection to an arbitral tribunal's jurisdiction to hear and determine a dispute in accordance with article 16(3) of Schedule 1 will ensure that objections are raised in a timely manner and cannot be heard or given effect to out of time.



## New Zealand – increased attractiveness as an international arbitral seat

When the Arbitration Act 1996 came into force on 1 July 1997 it fundamentally changed New Zealand's existing legal framework for arbitrations by incorporating the UNCITRAL Model Law into New Zealand Law.

When the Arbitration Amendment Act 2007 came into force on October 2007, New Zealand became the first country in the world to adopt the whole of the new United Nations Commission on International Trade Law (UNCITRAL) legislative provisions on interim measures and preliminary orders with only a few minor modifications. It also introduced a number of relatively technical amendments to the Arbitration Act 1996 to strengthen arbitration as a means of private dispute resolution in New Zealand and enhance the use of arbitration as an agreed method of resolving commercial and other disputes. It significantly improved the skeletal confidentiality

provisions of the Arbitration Act 1996, eliminated appeals which attempt to “dress up” questions of fact as questions of law and enhanced consumer rights and improved consumer protection.

On 1 March 2017, further amendments to the Arbitration Act 1996 came into force broadening the definition of arbitral tribunal to include arbitral institutions and emergency arbitrators and creating a body to carry out appointment functions instead of the High Court where an appointment needs to be made under s11 of the Act.

These reforms and the further amendments proposed in the Bill are to be welcomed. They have, and will, improve the law, they will set New Zealand apart from other jurisdictions – in particular in relation to trust arbitration, and in doing so, will increase the attractiveness of, and define New Zealand as, an international arbitral seat for parties in the trans-Pacific – Australasian region.

*\* The Bill has passed its first Reading and is currently with the Select Committee*

### JOHN GREEN

John is a professional arbitrator, adjudicator and mediator based in Auckland, New Zealand. He has been appointed in more than 1,200 building, construction and infrastructure disputes over the past 26 years relating to residential, commercial and industrial construction projects, power stations, gas fields, manufacturing and processing plants, stadiums, hotels, land subdivisions, roading, railways, wharves, marinas, drainage, wastewater treatment plants, recycling plants, mining, services, and utilities, involving domestic and internationally based parties, complex technical and legal matters, and sums in dispute exceeding \$100M.

To request the appointment of John Green for adjudication, arbitration or mediation please contact the Registrar:  
[registrar@nzdrc.co.nz](mailto:registrar@nzdrc.co.nz)



# TCC GUIDANCE ON REPRESENTATIVE DEFECT CLAIMS

JAY RANDHAWA FROM CMS LAW-NOW

A recent TCC decision has provided guidance on the bringing of representative defect claims based on sample evidence and expert statistical analysis. This appears to be the first time the TCC has considered the use of statistical evidence to support such claims. The case is likely to be of relevance to parties considering allegations of endemic failings with regard to specific aspects of construction work.

## ***Amey LG Limited v Cumbria County Council***

Amey was contracted by Cumbria to provide highways maintenance and associated services for a term of 7 years. The relationship between the parties subsequently deteriorated and following the expiration of the contract, Amey commenced proceedings to recover sums deducted by Cumbria from Amey's final monthly payment application. In response, Cumbria advanced a number of counter-claims, including a claim for the cost of remedial works to repair a proportion of patching and surfacing works carried out by Amey, which Cumbria claimed to be defective. Cumbria advanced this claim on the basis that it had examined a sample number of patching and surfacing works undertaken by Amey, and that its conclusions as to the defective nature of those samples could be extrapolated to the entirety of the works of that nature undertaken by Amey over the contract period.

The extrapolation of Cumbria's claims meant that the financial value of the losses claimed was much greater than those connected specifically to the samples examined by Cumbria. For one claim, the cost of remedial works for the sampled items was approximately £22,000 but would rise to approximately £1.69 million when extrapolated to the rest of the works.

The key questions for the court to determine in relation to extrapolation were:

1. Whether Cumbria was entitled to advance its case based on a sample of evidence.
2. Whether the method of sampling used by Cumbria was acceptable to advance its extrapolation case.
3. If the method was acceptable, whether the statistical evidence in relation to the sample set was sufficient to discharge the legal burden of proof in relation to its claim.

## **Decision**

The court accepted that the substantial quantities of patching and surfacing works carried out by Amey under the contract made it impractical for Cumbria to have inspected every item of work and to have pleaded and proved its case in relation to each allegedly defective item separately. Cumbria was therefore entitled to advance its case on the basis of sampling. It is unclear from the court's decision whether it would still have been permissible for Amey to rely on sampling if it was not impractical, but simply more expensive or time-consuming, to prove each item of defective work separately.



With regard to the second issue, the court rejected Cumbria's initial position that its sample evidence could be extrapolated with a 95% confidence rate across the whole of the works. The court noted that it was well understood by statisticians that this level of confidence could only be demonstrated mathematically if the sample evidence was obtained by a genuinely random sampling process. Cumbria ultimately accepted that its sample was not sufficiently random and, whilst this ruled out proof of a 95% rate of confidence, the court found that there was no principle of law or statistical theory to suggest that such a claim could only be established by statistically random sampling. Cumbria was therefore entitled to rely upon its sample evidence but was required to demonstrate that, whilst it may not be statistically random, it was still sufficiently representative of the whole of the works.

Ultimately, Cumbria failed to show that its sample evidence was sufficiently representative:

- The sample was initially obtained to ascertain the presence or absence of defects and not a general sample of the works carried out by Amey. Accordingly, the sample was not being used for the intended purpose of its collection.
- The sampling process had been extended over a lengthy period of time.
- Patches from the sample which could not be located on a GPS were excluded from the statistical analysis, thereby excluding samples from works carried out earlier in the project before GPS was being used.
- The sample excluded patches classified as "pre-surface dressing patches" which had subsequently been covered by surfacing.

The court held that each of these matters demonstrated an opportunity for the sample to be infected with bias. Cumbria was also found to have failed to have proper processes for collection of the sample and did not take suitable steps to mitigate and/or avoid the possibility of bias. In these circumstances, it

was held that it would be unsafe to extrapolate the sample evidence relied upon by Cumbria.

## Conclusions and implications

This case provides important guidance for the bringing of representative defects claims under construction contracts. The need for such claims can arise wherever a construction project involves repetitive work, such as welding, bricklaying, glazing or road repairs as in the present case.

Although it will always be preferable for a claimant to prove each item of defective work, the present case shows that where this is impractical or impossible, evidencing a claim by reference to a statistically random or sufficiently representative sample will be permissible. The difficulties involved in doing so should not be underestimated, however. Care is needed from the outset to ensure any sample evidence collected is genuinely random and/or sufficiently representative and that all possible steps are taken to avoid the sample being affected by bias.

## References:

*Amey LG Limited v Cumbria County Council*  
[2016] EWCH 2856 (TCC)



## ADJUDICATION   UNDER CCA

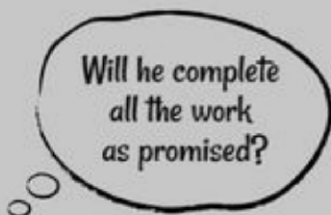
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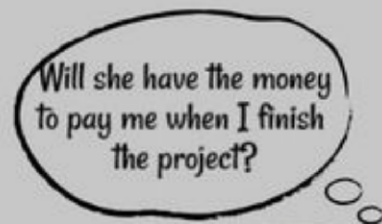
- 1** Agree on the price of your project
- 2** Use a free copy of BuildRight to organise your project and ensure all the essential information is discussed
- 3** Agree on how much will be kept as a deposit with BuildSafe and whether the rest will be paid privately
- 4** Complete BuildSafe application online
- 5** Pay the admin fee (Yes, just this little one-time fee!!)
- 6** The agreed deposit is paid to the BuildSafe trust account. The builder can start working
- 7** Relax and just monitor your project with BuildSafe recommendations



**Jane protects her deposit**



independent  
trust account



**Brad gets paid**



# COURT OF APPEAL CONFIRMS THE CONVENTIONAL OPERATION OF EXTENSION OF TIME PROVISIONS

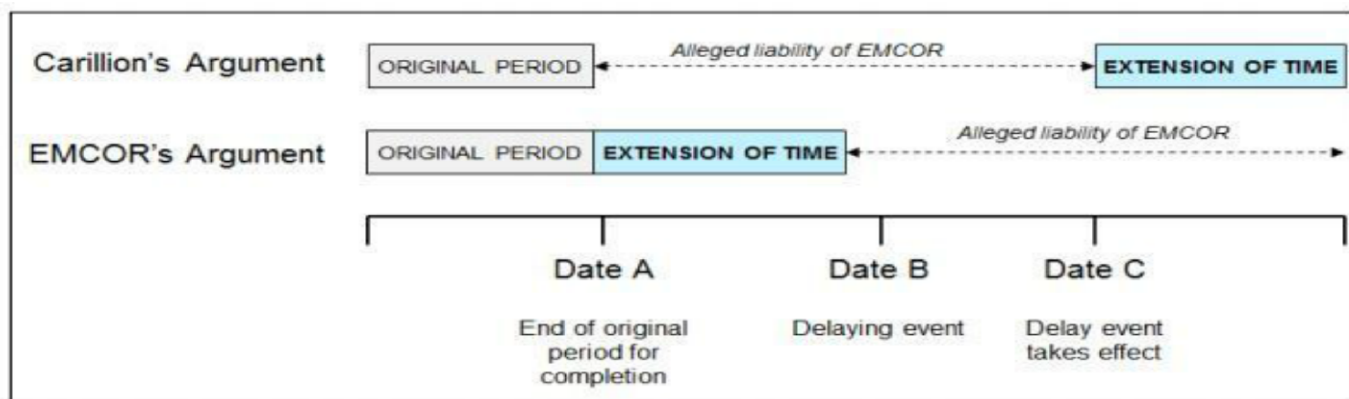
ROBERT WHEAL & ALEXANDER ROWE

The Court of Appeal in *Carillion Construction Limited v EMCOR Engineering Services Limited* [2017] EWCA Civ 65 has confirmed that the industry-wide practice of awarding extensions of time running contiguously from the previous date for completion is the correct approach, including where the delay event occurred after the date for completion. White & Case acted for EMCOR, the successful respondent.

In a unanimous decision that provides welcome certainty to the construction industry, the Court of Appeal has confirmed that extensions of time awarded under a standard form of domestic sub-contract, widely used throughout the UK construction market, must start on what was previously the date for completion. This is so regardless of when the delay occurred in relation to the date for completion and whether doing so may produce a potentially odd result from a commercial perspective.

The dispute concerned the construction and fit-out of the Rolls Building in Fetter Lane, London, which houses the Commercial Court, the Chancery Division and the Technology and Construction Court. The fit-out works were completed late and Carillion, the main contractor, alleged that its consultants and sub-contractors (including EMCOR) were responsible for different delays over different time periods.

EMCOR contended that it was entitled to receive an extension of time for variation works that were instructed after the original date for practical completion had passed and therefore the original period in which EMCOR was obliged to complete its sub-contract works should be extended. Carillion argued that the wording of the sub-contract permitted it to award an extension of time that covered only the distinct and disjointed periods that corresponded with the actual time when EMCOR's sub-contract works were being delayed by the variation works. Carillion submitted that its interpretation was to be preferred as a matter of commercial common sense, in order to avoid the "oddity" of a sub-contractor being exempted from liability during a period when it might actually be in culpable delay, only to subsequently be made liable to the contractor for loss and expense during a period in which the sub-contractor was not actually in culpable delay (as demonstrated in the diagram below).



**“ This judgment confirms that the standard practice of awarding extensions of time by extending the date for practical completion is the correct approach to take. ”**

In delivering the lead judgment, Lord Justice Jackson held that the natural meaning of the words in the contract required Carillion to award extensions of time contiguously. Applying the principle established by *Arnold v Britton* and the subsequent line of cases that followed it, the Court held that the circumstances of the case were not so exceptional as to require considerations of commercial common sense to drive the court to depart from the natural meaning of the contractual provisions. The Court also recognised that this was the first reported instance in which a contractor or sub-contractor had argued that awards of time should be non-contiguous.

The Court dismissed Carillion's appeal, holding that the judge at first instance was correct to find that the natural meaning of the words used in the sub-contract was clear and any extension of time should be added contiguously to the pre-existing date for completion of EMCOR's sub-contract works.

This judgment confirms that the standard practice of awarding extensions of time by extending the date for practical completion is the correct approach to take. Even though such an approach may be open to criticism in particular circumstances, it is a practicable and satisfactory system and will continue to be so.

## About the Authors



Robert Wheal

Robert is a partner in the Dispute Resolution Group in London, whose practice focuses on international arbitration and commercial litigation.

Alexander is an associate in White & Case's Dispute Resolution group based in London. He is experienced in acting in construction and engineering disputes arising out of major energy, infrastructure and resources projects, as well as commercial and residential developments, in the UK, Dubai, Europe and Australia.



Alexander Rowe

**WHITE & CASE**



# PAYMENTS MADE UNDER DIRECT AGREEMENT NOT VOIDABLE TRANSACTIONS

James McMillan

**The Court of Appeal has found that payments made under a direct agreement by a financier to a builder are not voidable transactions recoverable by a liquidator. In doing so, the Court of Appeal has overruled the High Court's earlier decision.**

## Background

In this case, Takapuna Procurement Limited (TPL) developed the Shoalhaven Apartments. It engaged Ebert Construction Limited to build the apartments. BOSI and Strategic Nominees agreed to finance the development and entered into a direct agreement with TPL and Ebert. The apartments were completed and BOSI made payments of more than \$1.6m to Ebert. In late 2008, liquidators were appointed to TPL. They subsequently applied to set aside the payments made to Ebert.

## High Court set aside payments under direct agreement

The High Court set aside the payments. [1] It took the view that the payments to Ebert were made by TPL for the purposes of section 292 of the Companies Act. TPL reduced the debt it owed to Ebert by BOSI making the payment. In a subsequent judgment, the High Court also awarded the liquidators interest on the judgment sum of \$1.6m from the date of liquidation, even though the liquidators had not taken steps to set aside the payments until 2014.

## Court of Appeal says payments were not voidable

The Court of Appeal had to decide whether, if liquidators are appointed to a developer, payments made by the financier to the builder are voidable transactions by the developer. In this

### WHAT IS A 'DIRECT AGREEMENT'?

A 'direct agreement' is a three-way arrangement between a developer, builder and a financier. Under the agreement, the financier can 'step in' and complete the project if the developer defaults. The financier can also make direct payment to the builder.

case, the Court of Appeal said that the payments were not voidable. The Court sought expert evidence from the parties on the development of direct agreements in the New Zealand construction industry. The Court focused on the fact that the direct payment mechanism under such agreements offers significant additional security for builders.

The Court acknowledged that a payment by a third party can be regarded as a payment by the company that subsequently goes into liquidation. In this case, however, it found that the payments to Ebert were not made by TPL, but by BOSI, under its own direct obligation to Ebert. BOSI did not pay Ebert as an agent of TPL. The Court said that the substance and reality of the transaction is more important than its form. It accepted that the payments to Ebert were not made out of funds belonging to TPL and did not decrease the resources available for TPL to pay other creditors. As the Court decided that the payments were not voidable, it did not need to decide from when interest should run. [2]

The Court was also called upon to decide whether the transfer of an apartment was an insolvent transaction. In the circumstances, it decided it was not.

## Our comments

While it remains to be seen whether the liquidators will appeal, this decision will come as a relief to many involved in the construction sector. Builders can take confidence that payments made under a direct agreement like the one in this case will not be clawed back from them by liquidators.

## References:

[1] *Sanson v Ebert Construction Limited* [2015] NZHC 2402.

[2] *Ebert Construction Limited v Sanson & Anor* [2017] NZCA 239.

[Click here](#) to access the original article.

## THE AUTHOR

James McMillan has 14 years' experience in commercial litigation and during that time has advised clients such as insolvency practitioners, banks, developers and construction companies. He manages extremely complex cases through collaboration and attention to detail. In recent years he has been involved in some of the country's most high profile insolvencies and restructurings.

He has appeared twice as lead counsel in the Court of Appeal and has appeared both as a lead counsel and as a junior at numerous defended High Court and District hearings.

James is ranked in Chambers Asia Pacific 2017 as having a growing reputation in commercial dispute resolution with a focus on insolvency and recovery work. He is highlighted by clients for his "technical capability and friendly approach."

To learn more about James, [visit the firm's website](#).







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# NEC LAUNCHES NEW NEC4 SUITE OF CONTRACTS

BY JOHN GREEN

NEC4 has now been launched and the authors have promised "evolution not revolution". The criteria for changes introduced in NEC4 contracts are:

- To support the changing requirements of users
- Stimulate good project management
- Improve clarity and simplicity

Many of the new features added to the existing contracts are optional, allowing flexibility in the procurement choice, for example it still remains possible to create very simple short contracts using NEC4.

It has been 12 years since NEC3 was published, and the authors say the publication of NEC4 responds to demand from users to continually improve the way that their projects and work programmes are delivered. There are a lot of cosmetic changes to the main Engineering and Construction Contract, designed to clarify the terms (ie 'Employer' becomes 'Client'), provide consistency across the suite of contracts ('Works Information' and 'Service Information' become 'Scope') and reduce reliance on Z clauses (BIM, collateral warranties and the Bribery Act). However, there are also some fundamental points that will require thought when adopting the new form including:

A new final accounting procedure (clause 53) is introduced, acknowledging that matters remain outstanding at the end of the contract. It introduces rigorous timescales. The Project Manager must issue his assessment within four weeks of the Defects Certificate. If he fails to do so, the Contractor may submit his version which the Client pays if he agrees with it. If he does not, this quickly escalates into discussions with senior representatives, adjudication and then the courts. The detailed dispute provisions in this clause do not

mention the need for a pay less notice as they rely on Option Y(UK)2 for Construction Act matters, but if the Client wants to avoid paying the Contractor's assessment it should serve a notice.

- Contractors will not be entitled to an assessment unless they submit an application for payment. This is achieved in a new clause 50.4, which states that the Project Manager may issue an interim assessment, but if not, the amount due is the same amount due at the previous assessment date. Again, my initial view is that the way this interacts with the Construction Act requires some careful thought.

- A deemed acceptance of the programmes is introduced. If the Project Manager does not reply within two weeks, the Contractor informs the Project Manager of his failure, and the Project Manager does not reply, the programme is deemed to be the Accepted Programme.

Two new compensation events are introduced to clause 60.1:

- The first is a compensation event which compensates the Contractor for the costs of preparing quotations for changes to the Scope which are not adopted by the Project Manager (clause 60.1(20))

- The second is a DIY compensation event, where parties can introduce new compensation events themselves in the Contract Data (clause 60.1(21)). This sounds like a dangerous concept, and could cause disputes if the wording is not clearly worded. Section 8 of the contract has been amended to try to deal with insurers' concerns about the insurability of section 8 in NEC3.



**“NEC advises that users who are familiar with NEC3 contracts will have no trouble moving to NEC4 as the style, layout, terminology and key project management processes that run through in NEC contracts remain.”**

The Schedules of Cost Components have both been revised and the different fees have been simplified into one. There are new People Rates in options A and B, and people overheads and Working Area overheads have been deleted. The view from the speakers was that Quantity Surveyors will need to work through these changes carefully to avoid being caught out, but that it should reduce the

impression of double dipping taking place. NEC advises that users who are familiar with NEC3 contracts will have no trouble moving to NEC4 as the style, layout, terminology and key project management processes that run through in NEC contracts remain.

## A RECENT NEW ZEALAND STATEMENT ON THE LAW OF PENALTIES

BY JOHN GREEN

Many legal systems worldwide will not enforce contractual provisions which are penalties. However, the courts' desire to enforce parties' commercial bargains has led to inconsistent application and tortuous interpretation of the rule against penalties.

The recent decision of the New Zealand Court of Appeal in *Wilaci PTY Limited v Torchlight Fund No 1 LP (In rec)* [2017] NZCA 152 (2 May 2017) will be of interest to those operating in the construction sector as it provides an indication as to how New Zealand courts might treat liquidated damages clauses.

*Torchlight* was a private equity fund which was established in 2009 to invest in distressed assets. It is no longer active

having transferred those assets to a Cayman Islands' entity. One of its investments involved the purchase of a debt from Bank of Scotland International totalling AUD\$185m, of which Torchlight had repaid all but AUD \$37m by mid-2012. Being in a difficult liquidity position to pay off the debt, Torchlight sought bridging finance from a Mr Grill, a wealthy Australian engineer, businessman and founder of the publicly listed WorleyParsons Limited.

*Torchlight* and Mr Grill entered into a 60-day contract in which Mr Grill would provide AUD\$37m to discharge the debt. In return Torchlight would repay the principal with interest at 5.25% callable on day 60 (a total of \$320,000), and an additional \$5m due 120 days from the day

of the advance. The contract then stipulated for a 'late fee' of \$500,000 per week for each week past the due date in which the principal was not repaid. Torchlight failed to make repayments and in 2013 was placed into receivership. Torchlight then disputed the payment of the 'late fee'. Two issues arose, namely whether the penalty doctrine was engaged at all by the 'late fee' clause, and second, whether the clause was properly characterised as a penalty or as a genuine pre-estimate of loss.

In October 2015, the High Court ruled that a late payment fee claimed by *Wilaci* was a *penalty fee* and was unenforceable. The High Court considered the clause engaged the penalty doctrine because it was collateral to the breach and therefore an obligation arising secondary to the obligation to repay. The defendant's claim that the fee provided for flexible repayment failed because the debt was callable upon day 60 under the contract.

Whilst the Court acknowledged the freedom to contract, it ultimately imposed the doctrine and held the clause unenforceable. On interpretation, the Court considered the surrounding circumstances and the intention of the parties. Although reluctant to deem the clause a penalty, the Court considered it was inserted '*in terrorem*' for the collateral purpose of enforcing repayment of the principal sum. Furthermore, the amount stipulated was considered disproportionate to any conceivable loss flowing from a breach. The clause was deemed a penalty clause and therefore was unenforceable.

It should be noted that this decision applied the law of New South Wales which the loan contract prescribed, rather than the law of New Zealand in relation to the penalties issue.

*Wilaci* appealed and on 2 May 2017, the Court of Appeal delivered its judgment and overturned the High Court ruling holding that the late payment fee in the loan agreement was not a penalty and ordering Torchlight to pay AUD\$31.5 million in late payment fees to *Wilaci* plus interest accruing from 1 August 2015, compounding monthly to the date of payment.

The Court, following the approach of the UK Supreme Court in *Cavendish v Makdessi* and *ParkingEye v Beavis* and the later decision of the high Court of Australia in *Paciocco* (putting aside the question of whether the doctrine is now confined to cases arising out of breach of contract only, the approach taken in the judgments in *Paciocco* are consistent with (and draw upon) those in *Cavendish*) departed from the traditional Dunlop approach and noted the following relevant principles:

First, the dichotomy which Lord Dunedin concerned himself with between penalty and legitimate liquidated damages is a false one — or at least not exclusive. Rather, "*there may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden*". The real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories. A damages clause may be neither or both.

Second, *Cavendish* reinstates the pre-Dunlop focus on whether the substituted obligation is unconscionable or extravagant (said usually to amount to the same thing) i.e the test proposed by Lords Neuberger and Sumption (with whom Lords Carnwath and Clark agreed) in *Cavendish* was *[W]hether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all*



*proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.*

Third, consistent with authorities in the more modern doctrine of unconscionability, relevant considerations include whether both parties are commercially astute, have relatively similar bargaining power and are advised. Compelling reason would be needed why ordinary principles of freedom of contract should not apply to such parties and the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.

Fourth, the fact that a clause substituting one scale of performance for another is designed to deter breach of the former does not mean it is penal. As Lord Hodge noted in *Cavendish*, many (legitimate) contractual provisions are coercive in nature.

Fifth, the justification for the rule against penalties lies in an amalgam of Equity and the common law rule based on public policy. Its essential justification, in the face of the usual (and commercially important) principle of freedom of contract, is that a provision that has its sole or predominant purpose is to punish a contract breaker is contrary to public policy.

Sixth, the purpose of the law of contract is to satisfy performance expectations. It follows that the test for a penalty cannot simply involve a narrow comparison between contractually stipulated and alternative court-imposed damages. Only a gross disproportion compels the inference that the substituted obligation is really "punitive". The threshold, necessarily, is high.

Seventh, the fundamental question to be addressed, as Kiefel J observed in *Piacocco* is whether the substituted obligation is

*"out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation"* or as Keane J observed (drawing on *Cavendish*), whether the substituted obligation *"is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract"* which in combination, express the rule in the law of New South Wales which the Court was required to apply.

Just what will be considered a "legitimate interest" by the courts remains somewhat unclear, but may include protecting a public/national/central government/local authority interest as was the case in the 1903 case of *Clydebank Engineering* (the leading English authority prior to *Dunlop* to which the 'legitimate interest' test may be traced back), protecting the interests and reputation of a person or entity such as a bank as in *Torchlight*, or protecting the reputation/standing of an industry or business sector as in *Cavendish*.

While *Torchlight* was determined by a New Zealand court, it was decided under the law of New South Wales. There are important and significant differences between the UK and Australia in relation to penalties and while *Torchlight* provides helpful guidance and an indicator as to how the courts in New Zealand might apply the penalty doctrine to liquidated damages clauses, vis when a liquidated damages provision is negotiated between legally advised, commercially astute parties with similar bargaining power it will be enforceable irrespective of the relationship between the agreed additional financial burden to be borne by the contract-breaker and the compensatory interests of the innocent party, the position in New Zealand remains to be determined in light of recent overseas authority by New Zealand Courts under New Zealand law.



# Bingham's Corner

TONY BINGHAM

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As well as that, Tony is a renowned writer,  
commentator and lecturer.



## READY FOR THE CHOP

### I WANT MY LEGAL COSTS & LEAVE

*Two parties got into a scrap over what constitutes a construction contract. When the winner asked for its hefty costs to be paid by the loser, that's when the judge got his axe out.*

This is a story about claiming lawyers' costs, when adjudication is followed by litigation on the same dispute. In short, all the effort in the adjudication was lifted by the same lawyers and repeated more or less when it came to litigation in the High Court. What's more, the winner in the adjudication won again when the whole matter was tried afresh in the High Court. So, if the rule, simply put, is that the winner can have its costs paid for by the loser, the issue is "what costs?"

Let me tell you what the quarrel was about. The office supply giant Spicers Ltd has a whopper of a warehouse in Smethwick. They decided to contract with Savoye and Savoye Ltd for a whopper of a conveyor contraption for upwards of £2.5m supply and fix. It was all done but then a row broke out worth £900,000. An adjudication notice pinged its way from Savoye to Spicers. Dear me, no, said Spicers' lawyers, a conveyor system isn't a construction contract, so off you toddle. Construction lawyer adjudicator, Mr Jonathan Hawkswell, said, dear me, no to Spicers' objection and pressed on. His award required Spicers to stump up the £900,000. They refused. So Savoye sought to enforce. There was a trial on the same issue: is it a construction contract? Mr Justice Akenhead said yes.

By now that quarrel, about the scope of the Construction Act and whether you can adjudicate and whether this was a construction contract, had run up legal bills for Savoye alone of £202,000. Assume Spicers' bill is about the same. So, £400,000 has been spent asking about the exclusion in the Construction Act. The exclusion from adjudicating applies to some engineering works but not others. The judge said the exclusions from the ambit of the Construction Act were historical:

"... the arguments of various interest groups persuaded parliament that they should be excluded from its ambit. There is no particular logic in their exclusions other than that the industries in question were considered to be sufficiently important and (possibly) strategic to justify exclusion."



# Bingham's Corner Cont...

To be fair, in 1996 when the bill was going through parliament, a fair number of lawyers were horrified by this 28-day dispute decision-making idea. A fair number of lawyers are still horrified: they want trials, the bigger the better. Though I can't figure why.

So, as to the winner's costs, the judge said:

"It is also clear from reading the adjudication documentation, that the exact same point raised in the court proceedings was raised and argued before the adjudicator with extensive written witness evidence being provided by each party... Essentially, the court proceedings involved a re-run of the same arguments and evidence, albeit I do accept that the later proceedings went into somewhat greater detail and in some respects had a different emphasis. Of course, each party in the adjudication had to pay its own costs. This context would lead to the inference that the costs of the court proceedings could have been relatively modest, taking into account that the legal team knew exactly what the issue was about and what evidence needed to be deployed in the court proceedings to counter the likely jurisdictional challenge."

On the face of things in litigation, Savoye was entitled to its lawyer's fees of £202,000 from Spicers. But the court would not award more than £97,000. First the judge decided that one side spending £202,000 on a claim worth £900,000 was disproportionate. Then he dealt with the overlap between adjudication and litigation: "Savoye was dealing with an issue in the court proceedings, which it had addressed (at its own cost) in detail in the adjudication; it was deploying the same solicitors and principal factual witness as it had deployed in the adjudication. The issues raised in the court proceedings were not complex, as is at least partly evidenced by the fact that the overall hearings ran to less than two court days. Of course, some of the costs, such as those occasioned by Spicers' application to adduce further evidence, were incurred as a result of something which was not in any way Savoye's fault."

"If no other information was available other than the headline costs figure, I would have been minded to identify a figure of about half of the costs some claim as proportionate."

Then he went on to consider the "large amount of partner's time", which was "much more than simply supervise a very competent associate solicitor and liaise with the client". So, the partner's 111 hours were reduced to 20. In fact, he said, the whole time charge of 364 hours was not reasonable. The barrister's fees were even chopped by half.

And all this was brought about by a technicality about what a construction contract is. Isn't it time to bring all and any commercial dispute into scope? Come on parliament, have a think.

Photo by Dan Edwards, UK



# LETTERS TO THE

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- \* Include your full name and contact details.
- \* Keep your letter short, concise and to the point.
- \* Avoid personal attacks (even if you perceive you are responding to a personal attack).

We look forward to hearing from you.

A handwritten signature in blue ink, appearing to read 'John Green'.

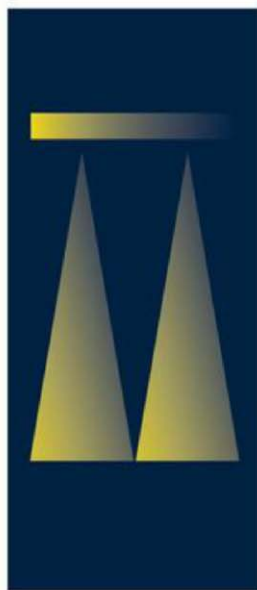
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