

BuildLaw

An aerial photograph of a construction site, showing a grid of concrete slabs with rebar reinforcement. Scaffolding and construction equipment are visible on the left side. The image serves as a background for the entire page.

ISSUE 29 / SEP 2017

Supreme Court clarifies meaning of 'due debts' in voidable transaction regime

How "final and binding" is an expert determination?

**NEC CONTRACTS
How Not To
AMEND THEM**

**ERITH V MURPHY: ORAL CONTRACTS
AND KNOWING WHO YOU ARE
CONTRACTING WITH**

FROM THE EDITOR

Welcome to the 29th 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 some of the challenges that are the hallmark of oral construction contracts. We also look at whether a duty of good faith applies to granting extensions of time, how final and binding is an expert determination, how not to amend NEC contracts, and the recent UK Supreme Court decision in which the Court upheld an appeal in the MT Højgaard litigation restoring the TCC's original decision and finding the contractor liable to comply with a fitness for purpose type obligation contained in a technical schedule despite obligations elsewhere in the contract to exercise reasonable skill and care and to comply with an international standard.

In 'Case in Brief' Sarah Shaul and Simon Hart from RPC discuss the recent UK High Court decision in Erith Holdings Limited v Murphy ([2017] EWHC 1364 (TCC)) in which Court held that an oral contract for waste removal services had been entered into by a company and not by the company's owner in his personal capacity. The case highlights how important it is that parties ensure that they understand who the parties are with whom they are contracting; as this case demonstrates, any misunderstanding in that regard can have significant adverse consequences.

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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contents



01 FROM THE EDITOR

03 BUILDLAW® IN BRIEF & THE NEW RETENTION REGIME

07 Supreme Court clarifies meaning of 'due debts' in voidable transaction regime

09 EMT Højgaard: Supreme Court rules on fitness for purpose dispute

13 NEC Contracts how not to amend them

18 Erith v Murphy: oral contracts and knowing who you are contracting with

23 The prevention principle and implied duty of good faith in construction contracts

29 Oral construction contracts: RCS Contractors Ltd v Conway, a costly affair

32 How "final and binding" is an expert determination?

37 Granting extensions of time in construction contracts - a duty of good faith may apply

41 **BINGHAM'S CORNER**
Too Many Contract Documents: The bumf machine

44 Letters to the Editor

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BuildLaw: In Brief

Building slows

Stats NZ reports that total building activity, in seasonally adjusted volume terms, fell 0.5 percent in the June 2017 quarter. Non-residential building activity was down 0.7 percent and residential building activity was down 0.4 percent, compared with the March 2017 quarter.

"This is the second quarter in a row that building activity has fallen, as the post-earthquake residential rebuild in Canterbury winds down," prices and construction senior manager Jason Attewell said. "In unadjusted terms, building activity in Canterbury slipped to just under \$1 billion a quarter for the first time in almost three years."

In Auckland, overall building activity was almost \$2 billion in the June 2017 quarter, including \$1.3 billion on residential buildings. Non-residential building activity rose a seasonally adjusted 18 percent, following an 18 percent fall in the March 2017 quarter. The actual value in the June quarter was \$671 million, near the December 2016 quarter high-point of \$703 million.

Nationally, the actual value of building work on new homes was \$2.8 billion in the June 2017 quarter, making a total of \$3.4 billion of residential work including alterations and additions. There was also \$1.8 billion of work on non-residential buildings.

Building consents for new homes continued to fall in July. The seasonally adjusted number of new homes consented fell 0.7 percent in July 2017, following a 1.3 percent fall in June 2017.

"July's fall was driven by the number of consented apartments, townhouses, and retirement units, which fluctuates from month to month," construction statistics manager Melissa McKenzie said. "The fall for multi-unit dwellings was partly offset by an increase for stand-alone houses."

The seasonally adjusted number of stand-alone houses consented rose 8.5 percent in July 2017, more than reversing a 4.0 percent fall in June.

The actual number of new homes consented was 2,762 in July 2017 (down 1.7 percent from July 2016), comprising:

- 1,900 houses (up 7.9 percent from July 2016)
- 367 apartments (down 14 percent)
- 350 townhouses, flats, and units (down 20 percent)
- 145 retirement village units (down 23 percent).

Auckland region had the largest fall in July 2017, with 313 fewer new homes consented compared with July 2016 (down 29 percent to 774 new homes consented). The fall was driven by decreases in the volatile apartment and townhouse categories. Auckland's numbers are quite volatile because almost half the homes consented are in multi-unit projects. On average, the region currently consents over 800 new homes a month.

Otago region had the largest rise from July 2016, with 114 more homes consented – up 68 percent to 282 in July 2017, driven by a spike for apartments in Queenstown.

In the year ended July 2017, 30,404 new homes were consented across New Zealand, including 10,051 in Auckland.

The value of building work put in place estimates the dollar value and volume of construction work on residential and non-residential buildings each quarter, also known as building activity. The monthly data in building consents issued reflects an intention to build, while building activity starts after the consent is issued.



Senate inquiry into cladding in Australia following Grenfell disaster

Following the Grenfell disaster in London, the Australian Government has recently announced an inquiry into the use of cladding. Following the Grenfell fire which killed nearly 60 people, the focus of blame has been on the building's non-compliant and flammable cladding. There are concerns that a high number of buildings around Australia are also suspected of having cladding which does not comply with Australian Standards. The Government had already initiated an existing inquiry into non-conforming building products, which has been expanded to cover the use of cladding.

The Senate's inquiry into non-conforming building products has been ongoing since June 2015. A copy of the interim report on aluminium composite cladding can be [found here](#). The deadline for the final report has been extended to 30 April 2018.

First sentence under new Health and Safety at Work Act 2015

The first sentencing decision under the new Health and Safety at Work Act (**HSWA**) was handed down recently and confirmed that the Courts will apply much higher penalties than under the previous regime.

The outcome of the case has been keenly awaited because it was the first successful prosecution under the new Act and people were looking for guidance on what to expect from the Courts.

A worker at Budget Plastics (**New Zealand**) Limited (**Budget**) was loading waste plastic into an unguarded plastic extrusion machine, when his left hand was dragged into the machine, which partially severed his hand.

Budget had pleaded guilty to failing in its duty as a PCBU (person conducting a business or enterprise) to ensure the health and safety of its workers "so far as was reasonably practicable".



The Palmerston North District Court found that Budget had failed to fit the machine with appropriate guards and emergency stops or have adequate hazard identification systems, operating procedures and safety processes in place for worker training.

WorkSafe sought a starting point of \$900,000, arguing that the culpability of Budget was high/medium. Budget sought a starting point of \$200,000. The Judge fixed reparation for emotional harm at \$37,500. Unusually, there was no discussion whatsoever about the consequences to the victim which the Judge took into account in reaching this figure.

In setting the fine, the Court specifically declined "to make sentencing guidelines". The Judge observed that the available starting point under the new Act was between \$400,000 and \$600,000 with its six fold increase in fines, but did not fix a starting point. Instead he reduced the fine by giving credit for mitigating factors and then said "the end sentence will therefore be between \$210,000 and \$315,000, depending on the starting point adopted". He then considered the ability of Budget to pay, taking into account submissions that a fine of over \$100,000 would mean that Budget would be put out of business and reduced the penalty to \$100,000 – this being, in his assessment "the maximum Budget can realistically pay namely the sum of \$100,000".

Under the previous legislation, moderate culpability would have had a starting point for a fine of between \$50,000 to \$100,000.

The sentencing decision confirms the new HSWA has teeth.

BuildLaw: In Brief

MBIE publishes Practice Note for supervision by LBPs



MBIE has published a licensed building practitioner (LBP) Supervision Practice Note outlining what LBPs need to know about supervising unlicensed people.

Supervision in the building and construction sector has become increasingly important as the amount of building work across New Zealand has increased. Supervision is a key feature of the LBP scheme where LBPs oversee unlicensed people undertaking restricted building work in different contexts.

The Practice Note provides practical guidelines for LBPs working with builders with varying skill levels, as well as varying difficulty levels of work. It also outlines the value and importance of LBPs' responsibility when it comes to supervision. It's important that all LBPs read and understand the Supervision Practice Note.

Practice Notes are administered by regulators and set out expectations for licensed people on key subject matters.

If you have any questions about the Practice Note, please feel free to contact the LBP team at licensing@lbp.govt.nz

[LBP Practice Note](#) – Supervision is available on MBIE's LBP website.

Single payment schedule can respond to more than one payment claim

In a recent decision in *Lot 8 Investments Limited v RPS Construction Limited* [2017] NZHC 1400, the High Court has adopted a flexible approach to the payment claim/payment schedule regime under the Construction Contracts Act 2002 (Act) and what will be regarded as a complying document.

Lot 8 Investments Ltd (**Lot 8**) contracted with RPS Construction Ltd (**RPS**), to undertake certain building work. RPS issued two separate payment claims to Lot 8 for work done during different periods. Lot 8 disputed both payment claims in a single payment schedule. RPS argued that Lot 8 failed to comply with the payment regime under the CCA and made a statutory demand for the claimed amounts.



The question for the Court was whether Lot 8's approach in providing only a single payment schedule in response to more than one payment claim came within the requirements of the Act. Ultimately, the Court held that it could. However, the other requirements must be complied with.

In reaching this conclusion, the Court considered the case of *Loveridge Ltd v Watts & Hughes Construction Ltd* which emphasised the reference in the Act to "the" payment claim in the singular. However, the Court was satisfied that *Loveridge* concerned the question of payment claims rather than payment schedules and distinguished it on that basis.

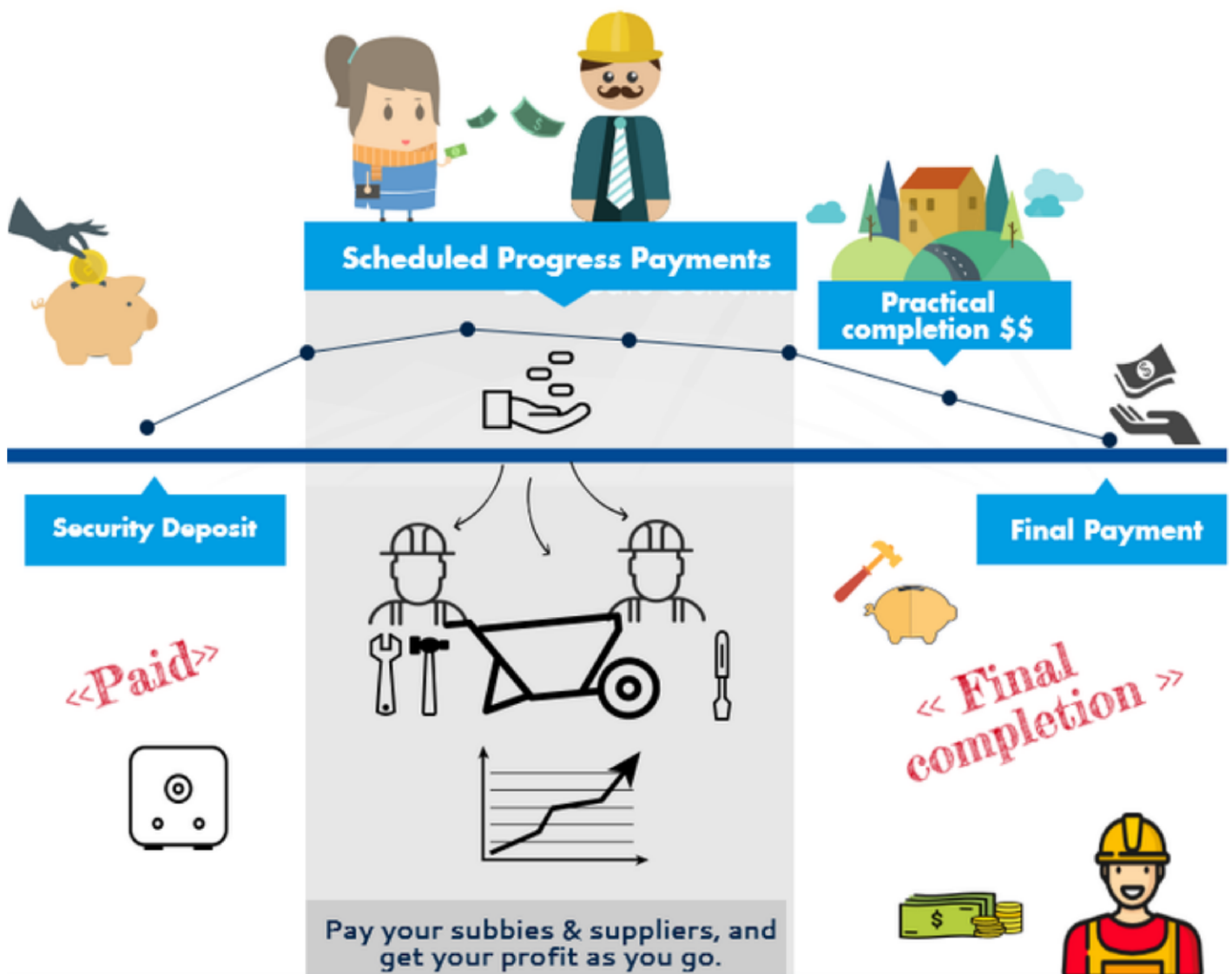


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SUPREME COURT CLARIFIES MEANING OF 'DUE DEBTS' IN VOIDABLE TRANSACTION REGIME

JOHN GREEN

In a judgment issued last month in *David Browne Contractors Ltd v Petterson Ltd* [2017] NZSC 116, the Supreme Court clarified the meaning of 'due debts' in s292 of the Companies Act and, in doing so, upheld the Court of Appeal's decision setting aside two transactions made by a company to related companies. The case has significant implications for those working the construction sector.

In a judgment issued last month in *David Browne Contractors Ltd v Petterson Ltd* [2017] NZSC 116, the Supreme Court clarified the meaning of 'due debts' in s292 of the Companies Act and, in doing so, upheld the Court of Appeal's decision setting aside two transactions made by a company to related companies. The case has significant implications for those working the construction sector.

The claim involved three related companies controlled by David Browne. Polyethylene Pipe Systems Ltd (in liq) (**Polyethylene**) was part of that group of companies. In March 2007, Polyethylene entered into a subcontract with McConnell Dowell to weld pipes for a sewer outfall on the seabed of Lyttelton Harbour. In late 2007 and early 2008, two of the welds failed and there were further concerns about a third weld. Various experts were called in to investigate the failures and in June 2008 McConnell Dowell notified Polyethylene that its investigations indicated that the weld were at fault and gave notice of its intention to seek recovery of its costs because of the failures.

Ten days after McConnell Dowell's notification, the directors of Polyethylene put in place a scheme to restructure the company's affairs and strip Polyethylene of its assets. Polyethylene repaid unsecured advances from three related parties, David Browne Contractors Ltd (**DB Contractors**), David Browne Mechanical Ltd (**DB Mechanical**), and Mr Browne totalling \$1,253,537. Polyethylene then granted a General Security Agreement

(**GSA**) to Mr Browne in return for \$450,000 of new funding.

The directors signed a certificate of solvency stating that the contingent liability to McConnell Dowell was disputed, would be offset by extras and variation claims, and, in any event, would be covered by McConnell Dowell's contract works insurance policy.

In late August 2008, McConnell Dowell wrote to Polyethylene with a detailed breakdown of the losses it claimed, which totalled \$2,552,671. Three days later, Mr Browne transferred \$700,000 to Polyethylene on the basis that it would be secured by the GSA. On 2 September 2008, Polyethylene paid the debts owed to Mr Browne (\$340,600), DB Contractors (\$565,303) and DB Mechanical (\$347,634).

In an adjudication by a BDT appointed adjudicator under the Construction Contracts Act 2002, McConnell Dowell's losses were assessed as \$2,965,334. Mr Browne responded to the adjudication by appointing receivers to Polyethylene, which was subsequently put into liquidation. The liquidator, David Petterson, sought to set aside the payments made on 2 September 2008 as insolvent transactions under s292 of the Companies Act 1993 (**the Act**).

Mr Peterson was unsuccessful in the High Court. Associate Judge Mathews held that the transactions were part of a legitimate business restructure. The Court of Appeal and the Supreme Court held that their purpose was to safeguard Mr Browne and his interests from

The Court of Appeal set aside the GSA and ordered that DB Contractors and DB Mechanical repay the amounts of \$565,303 and \$347,634 respectively to Polyethylene. Mr Browne was also ordered to repay \$201,316 to the company, which he received as a creditor under the GSA.

The Supreme Court unanimously upheld the Court of Appeal's decision that DB Contractors and DB Mechanical return the 2 September payments to Polyethylene. The primary issue on appeal was whether payments to Contractors and Mechanical occurred at a time when Polyethylene unable to pay its 'due debts'.

DB Contractors and DB Mechanical unsuccessfully argued that 'due debts' under s292(2)(a) of the Act must be legally due. The Supreme Court disagreed. It said that 'debt' can mean both present and contingent debts. It also accepted that contingent debts can be due debts if there is "reasonable temporal proximity" (what constitutes reasonable temporal proximity will depend on the facts of the case). Here there was sufficient certainty for the McConnell Dowell contingent claim to be treated as a debt due in a cash flow solvency assessment. The Court said at [91] that:

Solvency in a cash flow sense must be assessed objectively, taking a practical business prospective. What is reasonably temporally proximate will, as indicated above, fall to be considered in light of the facts of the particular case. If a reasonable and prudent business person would be satisfied that there is sufficient certainty that a contingent debt will, within that relevant period, become legally due then it must be taken into account.

The Court rejected arguments by DB Contractors and DB Mechanical that they had defences available under s296(3) of the Act, as Mr Browne was aware of the risk that Polyethylene was liable to McConnell Dowell, and of the high risk of insolvency. The Court held at [126] that Mr Browne did not act in good faith, which meant that DB Contractors and DB Mechanical also did not act in good faith when their loans were repaid.

DB Contractors and DB Mechanical also argued that s295 of the Act provided the Court with a residual discretion to deny a liquidator recovery if that would cause unfairness to a creditor. It was not necessary for the Court to decide this point, but it doubted whether there remains such a discretion when no defences are available.

The Court placed significant emphasis on the adjudicator's finding that there was no defence to McConnell Dowell's claim. The Court noted that a damages claim under a construction contract can be determined by adjudication within a short timeframe, and if the outcome of the determination has reasonable temporal proximity to the transaction under scrutiny, the damages claim may be a 'debt due'.

The Court outlined the following test: a damages claim may be a debt due for the purposes of s292 if a reasonable and prudent business person would be satisfied that there is a sufficient certainty that a claim will crystallise into a judgment debt in the "relevant period", being a period of reasonable temporal proximity to the transaction, determined on the facts of the case.

The Supreme Court's test for a 'due debt' introduces significant uncertainty for directors when assessing the solvency of a company. The flexibility allowed by the concept of



John Green 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, involving domestic and internationally based parties, complex technical and legal matters, and sums in dispute exceeding \$100M.

To request the appointment of John Green, email
registrar@buildingdisputestribunal.co.nz

MT HØJGAARD: SUPREME COURT RULES ON FITNESS FOR PURPOSE DISPUTE

Adrian Bell, Victoria Peckett, Steven Williams & David Parton

In a decision issued today, the Supreme Court has upheld an appeal in the MT Højgaard litigation restoring the TCC's original decision and finding the contractor liable to comply with a fitness for purpose type obligation contained in a technical schedule despite obligations elsewhere in the contract to exercise reasonable skill and care and to comply with an international standard. The decision will have significant ramifications for the interpretation of construction contracts, which commonly incorporate technical schedules and other specification documents within their terms.

MT Højgaard A/S v E.ON Climate and Renewables UK

MT Højgaard ("MTH") was engaged by E.ON to design, fabricate and install the foundation structures for 60 offshore wind turbines in the Solway Firth. Shortly after completion, grouted connections incorporated within the foundation structures failed. The parties agreed that E.ON would develop a scheme of remedial works, the cost of which amounted to €26 million. Litigation proceeded in order to determine who should bear that cost.

In April 2014, the TCC held that MTH was liable to E.ON for breach of contract because the design of the foundations was not fit for purpose. The court's reasoning was based on two paragraphs in the Technical Requirements section of an Employer's Requirements schedule to the contract which required that the design of the foundations "*shall ensure a lifetime of 20 years in every aspect without planned replacement*" (the "TR Paragraphs"). This provision applied in addition to MTH's other less onerous obligations such as a requirement to exercise reasonable skill and care and to comply with an international standard for the design of offshore wind turbines known as J101.

Compliance with J101 was also intended to bring about a service life of 20 years, subject to a

probable rate of failure of between 1 in every 10,000 to 100,000 installations. As a matter of professional design practice, the adoption of J101 was consistent with a desire to achieve a design life of 20 years and MTH reasonably relied on the standard in preparing its design. However, J101 contained a significant error, not known about at the time the contract was entered into, which dramatically reduced the service life of the foundations. Compliance with J101 did not therefore provide a design life of 20 years in reality.

The Court of Appeal overturned the TCC's decision, finding that the TR Paragraphs were inconsistent with the rest of the contract and the obligation to comply with J101 in particular. Those paragraphs were "*too slender a thread*" upon which to hang a finding that MTH gave a warranty of 20 years for the life of the foundations. The Court of Appeal emphasised the fact that an ordinary person in the position of the parties would have known that J101 was the normal design standard required of offshore wind farms. More was required, therefore, than two paragraphs described as being "*tucked away*" in the Technical Requirements if a much more onerous obligation was to be imposed warranting a 20 year lifetime come what may. To read our original Law-Now on the Court of Appeal's decision, [click here](#).



The Supreme Court

In a unanimous decision, the Supreme Court has overturned the Court of Appeal's decision and restored the decision of the TCC:

- Whilst the TCC and the Court of Appeal had interpreted the TR Paragraphs as a warranty that each of the foundation structures would have a minimum lifetime of 20 years, the Supreme Court was minded to give those paragraphs a slightly narrower interpretation requiring only that they be designed to last for 20 years. This narrower interpretation would allow scope for probabilistic failures of the kind envisaged by J101 (i.e. 1 in 10,000 to 100,000). It was ultimately unnecessary for the court to rule on this issue as either interpretation would have placed MTH in breach of contract: both are in the nature of fitness for purpose obligations which require the achievement of a result rather than the exercise of reasonable skill and care.

- The Supreme Court disagreed that the TR Paragraphs were inconsistent with the balance of the contract. The court referred to a number of previous decisions in the UK and in Canada where contractors had accepted obligations to achieve certain performance criteria whilst at the same time agreeing to implement a certain design or specification. No inherent inconsistency arises where the performance criteria proves impossible to achieve if the agreed design or specification is to be adhered to. Whilst each case depends on its own facts, *"the message from decisions and observations of judges in the United Kingdom and Canada is that the courts are generally inclined to give full effect to the*

requirement that the item as produced complies with the prescribed criteria, on the basis that, even if the customer or employer has specified or approved the design, it is the contractor who can be expected to take the risk if he agreed to work to a design which would render the item incapable of meeting the criteria to which he has agreed."

- The Supreme Court noted that the requirement to comply with J101 was expressed as being a minimum requirement and that MTH was obliged to identify any areas where a more rigorous design was needed. This would also have been the position even without express wording in this particular case. It could not have been envisaged that MTH would have been in breach of contract if it had sought to improve on the requirements of J101. There was therefore no actual inconsistency between the TR Requirements and the rest of the contract.

- The Supreme Court also disagreed that the TR Paragraphs were insufficiently prominent or *"too slender a thread"* to support the more onerous fitness for purpose obligation alleged by E.ON. The court was particularly unimpressed by an argument that paragraphs such as these contained in a technical schedule should not be readily interpreted as imposing additional onerous obligations above those spelled out in the primary contract conditions. Given that the technical schedule in question had been given contractual force by the parties, it was to be taken at face value.

Conclusions and implications

This decision will have significant ramifications for the interpretation of construction contracts, which routinely incorporate schedules and technical documentation often with less than complete harmonisation as to intended legal standards of design and workmanship. The Supreme Court agreed with the Court of Appeal's characterisation of the contract in this case as being comprised of documents of "multiple authorship", which contained "much loose wording". Despite this, it found no reason not to give effect to the natural meaning of the two TR Paragraphs, imposing a more onerous fitness for purpose type obligation in addition to MTH's other obligations to exercise reasonable skill and care and to follow the J101 standard.

The decision may be seen as a further example of a return in emphasis to the literal meaning of contract provisions observed by many commentators since the Supreme Court's earlier decision in *Arnold v Britton*. Although no overall change in the approach to interpretation has occurred, arguments which depend upon a reading down of particular parts of a contract because of their commercial implications or because they are less prominent than might be

expected will face an uphill battle. More than ever, parties will be taken to mean what they say in their contracts.

In light of this decision, parties should consider making clear in their general contract conditions whether and how technical schedules are to affect overall obligations as to design and workmanship. Contractors may wish, for example, to include paramountcy provisions which state that nothing in any of the schedules to the contract is to impose a design obligation of a greater standard than reasonable skill and care. Employers wishing to impose fitness for purpose type obligations in combination with obligations to adhere to certain standards or designs should make clear that those standards or designs represent minimum obligations as found by the court in this case.

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MT Hojgaard A/S v E.ON Climate and Renewables UK Robin Rigg East Limited [2014] EWHC 1088 (TCC)

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NEC CONTRACTS: HOW NOT TO AMEND THEM

Ian Griffiths

The new edition of the New Engineering Contract ("NEC") suite of contracts was launched this June: the NEC4. Rather than comment on the new contracts and changes introduced by NEC4 the purpose of this article is to address key failings often seen in the preparation and amendment of these standard forms of contract, whether the NEC3 or NEC4.

In this article the NEC is referred to generally and references are also made to the following two contracts from within the NEC suite: the Engineering and Construction Contract ("ECC") and the Professional Services Contract ("PSC")

Five key errors are made either singly or more often together when NEC document packages are collated.

- Incorrect use of the main pricing options
- Misunderstanding the role of the Works Information, Site Information and Contract Data
- Structuring amendments to the core and optional clauses incorrectly
- Inconsistent language and drafting style to the NEC
- Incorrect incorporation of specification

Incorrect Use of the Main Pricing Options

The most common problem is that monthly interim payments can be made as if the activity schedule used in Option A (Priced contract with activity schedule) is merely a breakdown of work to be undertaken similar to a contract sum analysis. It is not. The activity schedule (within Option A only) is a pricing document and the contractor's entitlement to interim payments arises only when the activities listed in the activity schedule are completed. The

document used to describe the works is the Works Information under the ECC.

Consultants new to the NEC approach sometimes simply group the services they are to provide under Option A of the PSC as set out in the RIBA Plan of Work Stages with each stage representing an activity. Unless corrected this could have a hugely adverse impact on the consultant's cash flow as some RIBA Work Stages take many months to complete on sizeable projects.

Confusion also arises when parties confuse the use of the activity schedule in Option C (Target contract with activity schedule) with its use under Option A. In Option C the Contractor is paid the Defined Cost plus the agreed Fee. In this Option the activity schedule is used to assess compensation events and as a management tool.

Misunderstanding the role of the Works Information and Site Information

The ECC Works Information Guidance is a good place to start to understand the different purposes of the Works Information, Site Information and Contract Data and the relationship between them. The information to be set out in the Works Information is defined in the ECC as information "*which either*

- specifies and describes the works or
- states any constraint on how the Contractor Provides the Works" (ECC3 Clause 11.2 (19))

Conversely, Site Information should only comprise objective information on the physical condition of the Site, its access points, subsoil conditions, service media and surroundings. The purpose of the Site Information document is to assist the Contractor in preparing his tender, his method of working, design and programming.

Why is this important? The only document which, if varied by the Project Manager, entitles the Contractor to a compensation event is the Works Information (ECC3 Clause 60.1 (1)). Additionally, in judging the physical conditions on site in order to assess a compensation event, the Contractor is assumed to have taken account of the information in the Site Information (ECC3 Clause 60.2). It is important for these reasons and others, therefore, that the content of both documents are distinct and as comprehensive as possible.

Structuring Amendments to the core and optional clauses incorrectly

The NEC (in the Contract Data) provides that additional clauses (known as Z Clauses) may be used to supplement the standard form of contract. The parties are clearly also free to amend the core clauses or optional clauses of the NEC. I have seen several examples of contract packages which have separate schedules of amendments to the NEC core and optional clauses and then separate Z clauses which deal with issues the core clauses or optional clauses ostensibly do not cover. In order to provide a clear understanding of the nature of the amendments to the standard form and to obtain a clear view of how the amendments to the core clauses and the additional provisions relate to each other, it is important that both should be located in the same document.

Z clauses should still reference the clause structure used by the NEC and where possible



should be added to the appropriate clause. For instance, additional obligations or responsibilities on the Contractor in providing the works should generally be added to clause 2. Specific performance or output tests required for energy projects should be inserted within the testing and defects framework of clause 4. Additional risk items or the requirement for professional indemnity insurance should reference clause 8, and so on. Failure to do this makes the administration of the contract more difficult and increases the prospect of discrepancies within the applicable terms.

Inconsistent language and drafting style to the NEC

There are many who dislike the style and language used in the NEC contracts. In the case of *Anglian Water Services v. Laing O'Rourke Utilities Ltd* [2010] Edwards-Stuart J stated that the use of the present tense "represent[s] a triumph of form over substance". It should be stated also that other members of the judiciary have been very supportive of the aims and content of the NEC over the years. Whatever your view, the task of putting together the Works Information and Z Clauses is not an opportunity to change the drafting style.

The NEC uses a consistent drafting style in an attempt to be as simple as possible. The use of short sentences, bullet points, indentation and the avoidance of adverbs are all covered in drafting guidance notes. It is necessary for those who seek to amend the NEC to be consistent with its ethos. This is not simply an issue of style or consistency for its own sake. There are potential problems in administering or interpreting the contract if an inconsistent approach is adopted.

One example would be the use of tense in the contract. Despite the criticism of the NEC's use of the present tense mentioned above, it is at least used consistently and therefore the intentions of the parties are understood by those adjudicating, arbitrating or otherwise deciding on its terms. What would happen, however, if Z clauses changed the tense? In the event that a new obligation was inserted to state "The Contractor **shall** in carrying out the works..." How would the NEC provision of "The Contractor Provides the Works..." (ECC Clause 20.1) be then interpreted? Would the latter obligation now be seen as simply an objective statement of fact rather than an obligation given the conflicting style of the earlier provision?

Incorrect Incorporation of Specification

Many practitioners will have seen parties seek to use a generic standard specification used on previous projects for different standard forms of contract on an NEC project without making the necessary changes to reflect the NEC form. The person drafting the contract simply sought to incorporate the specification by using a short cut statement of "all references to Specification shall mean Works Information". Sometimes the shortcut states that the

specification is intended to comprise "both the Works Information and Site Information". This less than diligent drafting ignores, amongst many issues:

- the fact that the positions of Project Manager and Supervisor are likely to be different to Architect or Contract Administrator or Engineer within the specification;
- the roles and responsibilities of Client and Contractor may differ and the authority given to the NEC role of Project Manager will differ also; and
- the acceptance of a communication by a Project Manager under ECC Clause 14.1 will differ from an Engineer's approval in other contract.

Conclusion

As the NEC is becoming more prevalent throughout the construction industry examples of bad practice in structuring and amending the contract should be less frequently seen. Whilst there are different ways to structure Works Information, Site Information documents and Z clauses consistency in form and structure are required to maximise the project management benefits of the contract and avoid embarrassing ambiguity.

About the Author

Ian specialises in construction and engineering law, working closely with utility and engineering companies, energy and water industry suppliers, contractors and developers. He normally works on standard form and bespoke construction and engineering contracts in addition to international plant supply and installation, power and fuel supply, and collaboration and research development agreements.



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#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.



CASE IN BRIEF

ERITH V MURPHY: ORAL CONTRACTS AND KNOWING WHO YOU ARE CONTRACTING WITH

SARAH SHAUL & SIMON HART

In Erith Holdings Limited v Murphy ([2017] EWHC 1364 (TCC)) the High Court held that an oral contract for waste removal services had been entered into by a company and not by the company's owner in his personal capacity. The waste removal company, which had provided its services to a company that had gone into liquidation, was therefore unable to recover outstanding sums payable to it.

Facts

The claimant (**Erith**) was a group of companies which provide enabling services to the construction industry, including waste removal and haulage services. Erith was owned by Mr Darsey. The defendant (**Mr Murphy**) was the owner of a site located on the east side of Horn Link Way, Greenwich, operated by his company, Murphy's Waste Limited (**MWL**) (now in liquidation), which operated as a waste collection and transfer station.

Erith contended that in August and September 2014 Murphy entered into an oral agreement with Erith that Erith would supply waste clearance services for which Murphy would pay or indemnify the Erith group (referred to in the proceedings as the 'works agreement'). This was in conjunction with the parties entering into negotiations for Erith to purchase the site and MWL. No specific price was agreed for Erith's services, but Erith estimated that the costs would amount to approximately £500,000 based on Darsey's visual assessment of the quantity of waste. In October 2014 MWL paid £109,507.17 in respect of the services provided by Erith (using funds provided by Murphy) following invoices received by MWL from Erith. Erith did not issue any further invoices on the understanding that further waste removal costs incurred by Erith would be reflected in the price for the site and MWL.

Erith asserted that between November 2014 and January 2015 the parties entered into a revised agreement (referred to in the proceedings as the 'revised works agreement') under which Erith agreed to provide further waste clearance services (up to a value of £1 million), for which Murphy would pay. Erith contended that the agreement had been that payment for these services would be deferred and treated as part of the purchase price and that in event that the sale did not proceed, Murphy would be personally liable.

Ultimately, the sale of the site and MWL to Erith did not proceed, as the parties were unable to agree terms. Shortly thereafter MWL went into liquidation. The sum outstanding for the services provided by Erith was £630,053.82. Erith stated that additionally, it had made a loan of £85,000 to Murphy for staff costs, for which it was entitled to be repaid.

Murphy disputed Erith's claim on the basis that the works agreement was made between Erith and MWL (not Murphy in his personal capacity). He stated that there was no revised works agreement and no indemnity or enforceable guarantee, and that the loan of £85,000 was made to MWL and not to Murphy in his personal capacity.

Issues

The agreed list of issues between the parties was as follows:

- Was the works agreement made by Erith with MWL or with Murphy (in a personal capacity)?
- Did the parties enter into a revised works agreement?
- Did Murphy agree to be personally liable to pay for the services and, if so, was such agreement enforceable?
- Was the loan of £85,000 made by Erith to MWL or to Murphy and did it fall within the scope of any indemnity or guarantee by Murphy?
- Did Murphy's solicitors, on his behalf, acknowledge and admit in correspondence with Erith's solicitors that he personally owed any, and if so what, sums to Erith?
- Was Erith entitled to recover the sums claimed from Murphy:
 - under, or for breach of, any of the agreements;
 - pursuant to the alleged indemnity or guarantee; or
 - by way of a claim for unjust enrichment?

Decision

Works agreement

The court found that the works agreement was entered into by Darsey on behalf of Erith and by Murphy on behalf of MWL. The court concluded that the fact that the invoices submitted in October 2014 by Erith in respect of the services provided were made out to MWL was "strong evidence" that both parties considered the agreement to be with MWL (not Murphy). This was despite the fact that the funds paid out to Erith from MWL were funds provided by Murphy which had been deposited into MWL's account. Further, Darsey had accepted in cross-examination that the initial agreement for waste removal services was with MWL.

Erith had relied on the terms of the sale and purchase proposal sent by Darsey to Murphy on October 27 2014 as evidence that Murphy accepted personal responsibility for payment. Erith stated that as owner of the site and the business, Murphy would have all purchase moneys paid to him. There was a provision in this proposal for £600,000 to be deferred for 12 months as a contingency against sums owed to Erith in respect of the waste removal services. Erith argued that the inclusion of such contingency in respect of sums otherwise payable to Murphy indicated that Murphy would be liable for such sums. If, as anticipated by the parties at that time, the sale

and purchase agreement was concluded, the costs of the waste removal would be deducted from the contingency. If the transaction did not proceed, Murphy would pay the sums due in respect of those services.

By late 2014 into early 2015, just before the parties' negotiations broke down and the sale fell through, the proposed



agreement had been that Erith would purchase only the site as Darsey had concerns about the financial condition of the business. In an email from Mr Pini of HSBC dated December 5 2014 (which was not contradicted by Erith when received), it was stated that the contingency of £600,000 would be held against the purchase price for the business only and would not affect the purchase price of the land, which was £3 million. This was also reflected in the terms of a revised proposal for the sale of the land without the business in January 2015, which remained at £3 million (ie, it was not affected by any of the site clearance costs). The court therefore disregarded this aspect of Erith's claim.

Revised works agreement

The court concluded that it was not credible that there had been an agreed increase in the waste removal costs of up to £1 million in November 2014 (to be dealt with by way of deferred consideration or direct payment by Murphy) when there was no evidence that this revision had been communicated to the funders or the solicitors conducting the negotiations. The court came to this conclusion despite the fact that he accepted that it was clear from the evidence that Darsey and Murphy conducted most of their dealings in meetings or by telephone (rather than by email or other documented means).

Indemnity/guarantee

While the court noted that Erith had sought assurance from Murphy that he would be paid for the site clearance services if the sale did not go ahead, it concluded that such assurance was given to Erith from MWL and not from Murphy in his personal capacity. All of the invoices which Erith submitted were only ever addressed to MWL and not to Murphy. Murphy may have provided the requisite funds by depositing money into MWL's account, but it was always paid out from MWL's account.

On this basis, the court stated that the arrangement amounted to a guarantee rather than an indemnity, as Murphy's liability arose only to the extent that MWL failed to pay. Guarantees must be made in writing or evidenced in writing and signed. Therefore, if there was a guarantee, it was only ever made orally and in such circumstances the court concluded that it was unenforceable.

Loan

Erith argued that Murphy had assured him that in the event that MWL was unable to pay back the £85,000 loan that he provided to alleviate MWL's cash-flow issues, Murphy would reimburse Erith personally. Murphy stated that this was not the case. Once again, there was no documentary evidence of a personal assurance from Murphy. As with the above analysis, based on the evidence before the court, it concluded that the arrangement would have amounted to a guarantee in any case and without such guarantee being in writing or evidenced in writing and signed, it was not enforceable.

Admissions

Erith asserted that the wording in the email exchanges between the parties' solicitors admitted that Murphy was personally responsible for payment of the outstanding removal costs. Erith pointed to the fact that the solicitors for Murphy had referred to the fact that their client was in the process of "raising funds to settle the costs due to your client " and "arrangements will be put in place to settle costs due to your client". However, the court noted that in the context of Murphy's financial support of MWL in 2014-2015, the arrangements could be a reference to an injection of funds into the MWL account to enable it to discharge its debts. It stated that an admission must be "clear and unambiguous" in order to bind a party. The words exchanged between the parties' solicitors therefore did not amount to an admission of personal responsibility on Murphy's behalf.

Unjust enrichment

In the alternative, Erith had argued that it had a claim for the costs of the waste removal service in unjust enrichment. In order to establish such a claim, Erith had to establish that:

- Murphy had been enriched;
- the enrichment was at the expense of Erith;
- the enrichment was unjust; and
- there were no available defences to Murphy.

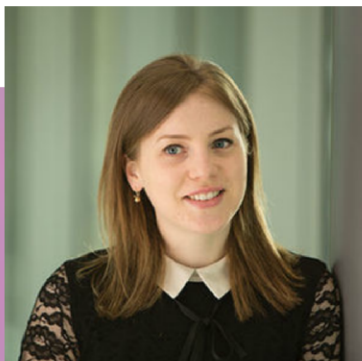
The court agreed that Murphy was enriched at Erith's expense. The waste removal had enabled Murphy to benefit from the maintenance of MWL's licence (which otherwise would have been withdrawn or suspended) and the increased value of the site. However, it stated that it was common ground that a claim for unjust enrichment will not succeed where there is a subsisting, enforceable contract. In this case, there was a works agreement made between Erith and MWL in respect of the waste removal services. As such, the claim in unjust enrichment failed.

Comment

In conclusion, the court found that there was a valid contract for the waste removal services between Erith and MWL. However, Murphy was never a party to this contract in his personal capacity. Therefore, he did not undertake any personal responsibility for the costs. The court thus dismissed Erith's claims.

This case demonstrates the importance of ensuring that parties agree contractual terms in writing and document their negotiations with sufficient detail. It also indicates the importance of informing all parties involved in the negotiation of a transaction of the details of discussions or amendments to the arrangement or terms. In this case, much of the crucial detail of the evolving deal was discussed only between Darsey and Murphy, either on the telephone or in person, and there were therefore no third parties with whom to verify or corroborate the content of their negotiations at trial. It further highlights how important it is that parties ensure that they understand who the parties are with whom they are contracting; as this case demonstrates, any misunderstanding in that regard can have great adverse consequences.

**This article was originally edited by, and first published on www.internationallawoffice.com.*



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THE PREVENTION PRINCIPLE AND IMPLIED DUTY OF GOOD FAITH IN CONSTRUCTION CONTRACTS

BRENDAN REILLY, JEREMY MUNCE & TIM O'SHANNASSY

The recent decision of *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd* [2017] NSWCA 151 emphasises the ongoing importance of the "prevention principle" in the New South Wales and broader Australian construction industry and found that an implied term of good faith can govern the unilateral power to extend time commonly found in standard form construction contracts.

Key Findings

- Probuild directed its contractor, DDI, to perform variations after the date for practical completion.
- DDI did not within the contractual time frames claim an extension of time to the date for practical completion for delays arising out of the variations.
- Probuild was nevertheless obliged to grant DDI an extension of time because of a discretionary contractual clause which permitted Probuild to grant extensions of time even where no claim had been made.
- The court found that Probuild was obliged to exercise its discretion because the requirements of honesty and fairness in the context of the prevention principle dictated as much and, separately, because it was operating under an implied duty of good faith to do so.

Background

The appellant, Probuild Constructions (Aust) Pty Ltd (Probuild), was the head contractor for the refurbishment of the popular Tank Stream Hotel in Sydney. On 19 May 2014, Probuild subcontracted with DDI Group Pty Ltd (DDI), pursuant to an amended form of the General Conditions of Subcontract for Design and

Construct (AS4303-1995) (the "Subcontract").

The date for practical completion of the works was 5 January 2015, with the date of practical completion being the date certified by the head contractor, or some other date as allowed by clause 41 of the Subcontract. Clause 41 of the Subcontract provided a mechanism by which DDI could seek an extension of time in the event that it envisaged a delay in carrying out the works, including delay caused by a variation to the Subcontract works. Importantly, clause 41.9 also conferred on Probuild a discretionary power to extend time, notwithstanding that DDI was not entitled to or had not claimed an extension of time.

Despite the intended application of clause 41 for use in circumstances such as those that materialised before Probuild and DDI, neither party sought to employ its function, meaning that when the actual Date of Practical Completion was reached on 28 May 2015 – some 144 days after the intended Date for Practical Completion – the seed for what would soon become a source of dispute between the parties had already been sown.

The Dispute

On 27 July 2015, DDI lodged a payment claim in the amount of AU\$2,175,267 (including GST) (the "Payment Claim"), pursuant to s13 of

THE PREVENTION PRINCIPLE AND IMPLIED DUTY OF GOOD FAITH... -CONT...

the Building and Construction Industry Security of Payment Act 1999 (NSW) (**SOP Act**), to recover monies it said were due under the Subcontract. Relevantly, a large component of the Payment Claim was in respect of variations that DDI said Probuild directed it to undertake after the Date for Practical Completion.

In opposition, pursuant to s14 of the SOP Act, Probuild provided DDI with a payment schedule which scheduled an amount of AU \$nil by reason of a set-off for liquidated damages in the amount of AU\$2,328,998, based on DDI's failure to complete the work by the Date for Practical Completion.

Adjudication

On 15 October 2015, DDI made an application for adjudication of its Payment Claim pursuant to s17 of the SOP Act, asserting that it was Probuild that instructed it to depart from the Subcontract construction program and that Probuild was clearly aware of the delays by reason of the revised construction programs that it issued. To this end, DDI argued that Probuild's liquidated damages claim was unreasonable and merely an "invention of convenience".

The adjudicator dismissed Probuild's claim for liquidated damages, noting that 80% of the contract variations being directed by Probuild and submitted for approval by DDI came after the Date for Practical Completion. Accordingly, it was determined that it would be "totally inconsistent and unreasonable" for Probuild to be directing DDI to perform significant additional work under the Subcontract after the intended Date for Practical Completion and then claim for liquidated damages against DDI after it had followed Probuild's express directions. In reaching this decision, the adjudicator explained that whilst there may have been some DDI-caused delays, he was not satisfied that Probuild was entitled to a liquidated damages claim for the total 144 days. Accordingly, the adjudicator determined

that Probuild was liable to DDI for payment of an amount of AU\$475,716.20 (including GST), plus interest.

Primary Judgment

On 10 December 2015, Probuild commenced proceedings in the Equity Division of the Supreme Court of NSW seeking an order to quash the adjudicator's purported determination on the basis that the determination had been infected by a denial of natural justice, namely, procedural fairness. Specifically, Probuild contended that the adjudicator had rejected its liquidated damages claim on bases which neither party had contended for, and which the adjudicator had not notified the parties of. To this end, Probuild asserted that, had the adjudicator intended to so act, he should have invited the parties to make further submissions pursuant to s21(4) of the SOP Act.

The primary judge dismissed Probuild's summons, stating that there had been no denial of procedural fairness and that the adjudicator had dealt with Probuild's argument "as made".



Court of Appeal

On appeal, Probuild contended that the primary judge had erred in his decision because underpinning the adjudicator's rejection of the liquidated damages claim was the application of the prevention principle which had not been argued. Subsequently, the primary issue on appeal was whether the adjudicator had applied the prevention principle and, if so, whether he had denied Probuild procedural fairness.

Decision

The Court of Appeal found that Probuild had not been denied procedural fairness because, in the circumstances of the arguments put before the adjudicator, it "should not have come as a surprise" to Probuild that the adjudicator would apply the prevention principle.

McColl JA delivered the leading judgment and, in so doing, embarked upon a useful discussion of the prevention principle, which we discuss below. Her Honour also highlighted the commercial function of the SOP Act; that being to ensure that any person who undertakes to carry out construction work under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services.

Application of the Prevention Principle

Her Honour identified that the premise of the prevention principle is that a party cannot insist on the performance of a contractual obligation by the other party if it itself is that cause of the other party's non-performance.¹ By reference to the present case, the prevention principle applies to delays in practical completion caused by variations that result from the act or default of the principal.

Ordering variations after the due date that substantially delays completion will, unless the contract provides otherwise, and in the absence of an applicable extension of time clause, disable the proprietor from recovering or retaining liquidated damages which might otherwise have accrued after the giving of the order.²

Therefore, in the context of variations to construction works, whether ordered before or after the due date for completion, the prevention principle "is grounded upon considerations of fairness and reasonableness".³

Where the prevention principle is employed in extension of time cases, the contractual date for practical completion ceases to be the proper date for the completion of the works and if there is no contractual mechanism for the substitution of a new date, then there is no date from which liquidated damages can run and the right to liquidated damages is lost.⁴ Accordingly, the time for performance is set "at large"⁵ and the time for completion of the work is then to be undertaken within a reasonable time.⁶

The implied operation of the prevention principle can be modified or excluded by contract,⁷ including by way of extension of time provisions such as those at clause 41.5 – 41.6 of the Subcontract, which provided DDI with the opportunity to claim an extension of time for delay. Probuild argued that DDI's failure to exercise its contractual right meant that the prevention principle ought not to have been a relevant consideration of the adjudicator.⁸

However, Her Honour McColl JA held, by reference to Probuild's own submissions, that the inferential application of the prevention principle by the adjudicator could not, or should not, have come as a surprise to Probuild.



THE PREVENTION PRINCIPLE AND IMPLIED DUTY OF GOOD FAITH... -CONT...

necessary” there was an implied duty on Probuild to act in good faith in exercising the unilateral power to extend time.

Good faith contemplates good standards of both commercial morality and practice. In particular, it requires contracting parties to exercise their rights in such a way that the parties in question may enjoy the benefits anticipated to come from the contract. As previously established, this duty is founded upon the broad doctrines of contract law and forms a general duty to cooperate and limit unconscionable behaviour so as to maintain loyalty to the contract and builds upon fundamental expectations between contracting parties, such as:

- To act reasonably, honestly and fairly
- To do all things necessary as to co-operate in achieving the contractual aim
- Not to prevent, impede, fetter or hinder the other party in the performance of the contract

The exact scope of the duty of good faith in commercial contracts in Australia is an unsettled and developing area of law. This present case, and particularly the manner in which her Honour referred to the implied duty of good faith as essentially being a matter of course, tends to suggest that the courts, or at least the NSW Court of Appeal, is prepared to find a duty to act in good faith in the exercise of contractual discretions. This is quite a development and ought to be borne in mind when drafting such discretions.

On one view, this implied duty compelled Probuild to perform its contractual obligations and to exercise the discretion conferred on it by clause 41.9 of the Subcontract because it was beneficial towards the overall performance of the bargain to do so.

Probuild’s appeal was unanimously dismissed with costs.

Further, pursuant to the operation of clause 41.9 of the Subcontract, the Court of Appeal extended the principles espoused in *Peninsula Balmain Pty Ltd v Abigroup Contractors Pty Ltd* [2002] NSWCA 211, holding that Probuild ought to have exercised its reserve power to grant extensions of time, both honestly and fairly, having regard to the underlying rationale of the prevention principle.

Notably, the contract in this case did not contain the usual amendments that modern construction contracts generally contain to counter the effects of *Peninsula Balmain*, namely that the unilateral power to extend time is for the benefit of the principal (or in this case, the head contractor) only and that the power need not be exercised for the benefit of the contractor. If such a provision had been included, it would have been more difficult for DDI to ultimately succeed, although it is questionable whether the outcome in the immediate appeal would have been any different given it was dealing with an application to set aside an adjudication determination under the notoriously “rough and ready” regime provided by the SOP Act.

Application of the Implied Duty of Good Faith

Separate to the rationale of the prevention principle, and by reference to *Alcatel Australia Ltd v Sarcella*,⁹ which followed the seminal case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works*,¹⁰ Justice McColl held, and Beazley ACJ and Macfarlan JA agreed, that “if

End Notes

1 *Spiers Earthworks Pty Ltd v Landtec Projects Corp Pty Ltd* (No 2) [2012] WASCA 53 at [47].

2 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 397-398); app *Turner Corp Pty Ltd* (recv & mgr apptd) v *Austotel Pty Ltd* (1997) 13 BCL 378 (at 384) per Cole J (as his Honour then was).

3 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 397-398).

4 *Spiers Earthworks Pty Ltd v Landtec Projects Corp Pty Ltd* (No 2) [2012] WASCA 53 at [49].

5 *Holme v Guppy* (1838) 150 ER 1195 (at 1196); 3 M&W 387 (at 389) per Parke B; *Hudson's Building and Engineering Contracts* (13th ed, 2015, Sweet & Maxwell) (at [6-028]).

6 *Multiplex Constructions (UK) Ltd v Honeywell Control Systems Ltd* (No 2) [2007] EWHC 447 (at [61]); *Hudson's Building and Engineering Contracts* (13th ed, 2015, Sweet & Maxwell) (at [6-028]).

7 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 395).

8 app *Turner Corp Pty Ltd* (recv & mgr apptd) v *Austotel Pty Ltd* (1997) 13 BCL 378 (at 384-385) per Cole J (as his Honour then was).

9 *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 (at 369) per Sheller JA (Powell and Beazley JJA agreeing).

10 (1992) 26 NSWLR 234.

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ORAL CONSTRUCTION CONTRACTS: RCS CONTRACTORS LTD V CONWAY, A COSTLY AFFAIR

Nikita Lalla, Ricardo Pillay & Zama Ngcobo

Certainty in a construction contract is all the more important when adjudication is envisaged to have to take place under a demanding timetable. The adjudicator has to start with some certainty as to what are the terms of the contract. This creates some difficulty when an adjudicator is faced with an oral construction contract. Referring a dispute under an oral construction contract leaves it squarely in the hands of an adjudicator or the court (persuaded by oral evidence) to determine this issue. This was a costly lesson learned in *RCS Contractors Ltd v. Conway* [2017] EWHC 715 (TCC).

Certainty in a construction contract is all the more important when adjudication is envisaged to have to take place under a demanding timetable. The adjudicator has to start with some certainty as to what are the terms of the contract. This creates some difficulty when an adjudicator is faced with an oral construction contract. Referring a dispute under an oral construction contract leaves it squarely in the hands of an adjudicator or the court (persuaded by oral evidence) to determine this issue. This was a costly lesson learned in *RCS Contractors Ltd v. Conway* [2017] EWHC 715 (TCC).

The issue which the court was asked to decide was a simple one. Either there was one contract between the parties to cover all three sites, in which case the final account dispute was a single dispute, and the adjudicator had the necessary jurisdiction. Alternatively, there were three separate contracts, one in respect of each site, and the dispute was actually three different disputes, being a claim for the sum allegedly due under each separate contract. If that was the case the adjudicator did not have the necessary jurisdiction.

RSC carried out groundworks for Conway as a subcontractor at three sites. RSC maintained

that there was one oral contract for the work at these three sites. Conway maintained that there were three separate oral contracts and, in consequence, the adjudicator lacked the necessary jurisdiction to adjudicate on all three disputes. For the purposes of the dispute, RSC was seen as the subcontractor and Conway the contractor.

On the balance of probabilities, the judge sided with RSC and found that there was one single contract between the parties concerning the three different sites. The judge reasoned as follows:

- Mr O'Rourke for RSC was an honest and credible witness. He was clear that, in the relevant conversation, on 19 December 2012 he was told, and he agreed, that there was one contract covering all three sites. This was corroborated by the fact that later that day he arranged a payment to Conway. The documentary evidence showed that the money was paid into Conway's account the following day. This was effectively a down payment on the commission which RSC had agreed to pay Conway if he secured them work.

The issue which the court was asked to decide was a simple one: were there one or three contracts between the parties?



- Conway served both a payment and payless notice on RSC. This notice responded to RSC's single final account claim in respect of the three sites. Conway did not serve three payment notices and three separate payless notices. Again, this suggested that there was only one contract. It also ran contrary to Conway's assertion that the documents for each project were kept separate.

- Conway's previous advisers, in a letter, referred to the overall situation in this case as "a job that was sub- contracted". That was again consistent with there being a single contract.

- Conway was not an entirely satisfactory witness. He raised matters which were irrelevant. He repeatedly referred to documents which were not provided. Most important of all, he had no positive case about the conversation on which Mr O'Rourke relied so heavily. He seemed unable to recall that conversation at all.

- Conway's case amounted to no more than the assertion that, because there were three separate sites, and three separate bills of quantity and other valuation documents, there must have been three separate contracts.

- It did not follow that, because there might have been different documentation pertaining to the different sites, there were three separate contracts. That was not the burden of the authorities, neither can that be right as a matter of law. All that matters were whether the parties agreed that there

was one contract or three. Mr O'Rourke's evidence on this point was accepted i.e. that, on 19 December 2012, it was agreed that there would be one single contract.

There was one contract in respect of the three sites and a single dispute about what was due under that contract. The adjudicator was to have the necessary jurisdiction to decide that claim. Since that was the only point which prevented the enforcement of the adjudicator's decision it meant that RSC was entitled now to the sum sought.

The judgment turned on the facts, the oral evidence and the credibility of the witnesses led by both parties – an expensive price to pay for not reducing the construction contract to writing in the first place. This bears relevance to the South African construction sector as well. The South African Supreme Court of Appeal in *Stellenbosch Farmers' Winery Group Ltd. and Another v. Martell & Cie SA and Others 2003 (1) SA 11 (SCA)* set out the technique generally employed by courts in resolving a factual dispute about the terms of oral agreements (whether it be construction contracts or otherwise). This general enquiry typically involved a consideration of the credibility and the court's perceived veracity of a witness; the witness' reliability; and the probability or improbability of the witness' version regarding each dispute. A costly affair indeed. To avoid this unnecessary cost and the uncertainty that ensues, parties should, in accordance with best practice, reduce their construction contracts to writing.

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HOW “FINAL AND BINDING” IS AN EXPERT DETERMINATION?

ANDREW LACEY & NATHAN JONES

Expert determination is becoming an increasingly common Alternative Dispute Resolution (ADR) process provided for in the terms of contracts between parties. In general terms it involves an independent third party, with recognised expertise in the subject matter, resolving an issue or issues in dispute between the parties by making a determination. It has been referred to as “a relatively quick and effective way of resolving disputes which are simple in content or are essentially technical in nature” (Resolution Institute). The process affords those parties involved confidentiality and privacy.

The provision under an existing contract for a matter to be referred to expert determination is generally expressed to be “final and binding” on the parties to the dispute. But what exactly does “final and binding” mean in this context?

The role of an expert

In *Holt v Cox* (1994) 15 ACSR 313, Santow J referred (at 332) to “the distinction is that an arbitrator exercises a quasi-judicial function to whom is submitted for decision a formulated dispute to be decided between the competing contentions of the parties, while an expert determines matters from the expert’s own experience and expert knowledge, making his or her own investigations”.

The courts have held that a failure to specify a procedure to be adopted by the expert will not render void for uncertainty an agreement to enter into an expert determination process. The procedure to be

followed is a matter for either agreement between the parties, or determination by the expert. See *Heart Research Institute v Psiron* [2002] NSWSC 646 at [28]-[29].

The Law Society of New South Wales has developed Rules for Expert Determination to be used in the absence of specifically designated rules, as has the Resolution Institute. Thus it is not uncommon for a contract to state that any dispute is to be submitted to expert determination to be “conducted in accordance with the [specify Rules] which set out the procedures to be adopted, the process of selection of the expert and the costs involved and which terms are deemed incorporated” (or similar).

Setting aside an expert determination
The classic statement of the legal principles to be applied, which continues to be often cited by courts today, was made by *McHugh JA in Legal & General Life*

HOW "FINAL AND BINDING" IS AN EXPERT DETERMINATION? -CONT...

Australia v A Hudson (1985) 1 NSWLR 314 at 335-6. After noting that the terms of the contract usually provide, as a lease in that case did, that the decision of the expert is 'final and binding on the parties', McHugh JA stated:

"While mistake or error on the part of the valuer is not by itself sufficient to invalidate the decision or the certificate of valuation, nevertheless, the mistake may be of a kind which shows that the valuation is not in accordance with the contract ... In each case the critical question must always be: Was the valuation made in accordance with the terms of the contract? If it is, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value. Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account or has failed to take into account matters which he should have taken into account. The question is not whether there is an error in the discretionary judgment of the valuer."

Determinations attended by fraud, collusion, dishonesty or impartiality will not have been made in accordance with the terms of the contract. Otherwise, in the case of mistake, as stated by McHugh JA above, an expert determination may only be set aside if it goes beyond a mistake in the process adopted by (or reasoning of) the expert, and departs from the contractual description of what the expert was required to determine.

Holt v Cox (1994) 15 ACSR 313

Mr and Mrs Holt were the controlling shareholders of a long established advertising business. Mr Cox, a key employee, was issued with five "A" class

shares as an incentive to stay with and develop the business. The rights, duties and restrictions attaching to the shares included the right of Mr Cox on a winding up to receive twenty percent of any distribution of any capital and, upon termination of his employment, the right to receive "a fair price" determined by the auditor of the company" for his shares. Mr Cox was ultimately dismissed and he refused to transfer his shares at the value determined by the auditor (\$171). As a consequence, Mr and Mrs Holt commenced proceedings in the Supreme Court of New South Wales.

It was not in dispute that the agreed plan was for the business to be sold in the future when turnover reached \$8m-\$10m. Mr Cox's principal complaint was that the valuation exercise paid no regard to this prospect. Santow J agreed, concluding that given the intention to sell in the future and, further, that turnover had already reached the target range for possible sale of \$8m to \$10m, it was not in conformity with the contract, requiring a fair price, to disregard the future chance of sale and Mr Cox's consequential access to 20% of the surplus assets (as the auditor had done in reaching the nominal figure of about \$200).

Candoora No. 19 v Freixenet Australasia [2008] VSC 367

Candoora and Freixenet were the only shareholders in Wingara, a substantial wine producer. They owned 25% and 75% of the issued shares respectively. Candoora exercised an option to require Freixenet to purchase its 25% shareholding. The parties were unable to reach agreement in respect of the price. In these circumstances, the deed provided for the appointment of a valuer to determine the "fair value" of Candoora's shares and for such

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determination to be final and binding on the parties.

Candoora applied to the Supreme Court of Victoria to have the valuation report and certificate, which concluded that the valuation of Candoora's shares was \$962,500, set aside. That application was successful. Hargrave J found that the valuer had essentially based his determination on the value of Wingara as a going concern, or the "market" value (an objective standard). The report contained no reference to the need for the valuer to ensure that the value which was determined was "fair", being the required contractual standard and one which allowed the valuer to take into account a wider range of circumstances than those relevant to "market" valuations (i.e. a largely subjective test).

More recently, in *Australian Vintage v Belvino Investments No 2* [2015] NSWCA 275, the NSW Court of Appeal held that if an expert acts upon the wrong meaning of a contractual clause or formula which forms part of the task which he or she is required to undertake, this being an objective matter outside the expertise of such a person, then the determination will not be in accordance with the terms of the contract and may be subject to review.

Take home points

1. Expert determination has the potential to provide an informal, speedy and effective way of resolving disputes, however in practice this will largely depend on the particular wording which the parties have adopted in the relevant clause in their contract. If the expert determination clause is not carefully worded, it may leave one or both of the parties dissatisfied with the process and/or outcome and lead to further dispute.
2. Ensure that the contract is explicit as to the procedures to be adopted by the parties and the expert in relation to disputes falling within the expert determination clause.
3. The contractual standard which the parties choose for the expert to determine may have serious ramifications and is therefore worthy of careful consideration. For example, in the valuation context there is a well-established distinction between a "market value", "fair value" and "fair market value" test. See, further, *MMAL Rentals Pty Ltd v Bruning* [2004] NSWCA 451 commencing at [52].
4. It will likely be extremely difficult to have a court set aside an expert determination which the parties have agreed in advance will be "final and binding".



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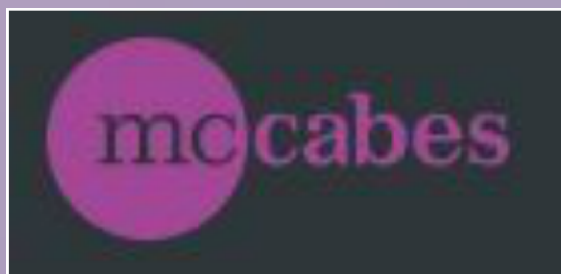


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GRANTING EXTENSIONS OF TIME IN CONSTRUCTION CONTRACTS - A DUTY OF GOOD FAITH MAY APPLY

Dado Hrustanpasic

The NSW Court of Appeal's recent decision in *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd* [2017] NSWCA 151 (*Probuild v DDI*) considers the prevention principle and finds that a duty of good faith may be applied to the discretion to extend time in construction contracts.

It is a common scenario in the Australian construction industry...

The contractual date for completion between a head contractor and a subcontractor comes and goes, without complaint or an extension of time claim.

Later, the head contractor orders variations, which are carried out. The subcontractor claims for the variations. For one reason or another, the parties find themselves in a different commercial position and the head contractor seeks to set off liquidated damages for delay.

Arguments then ensue about whether an extension of time should have been granted. So then what?

The New South Wales Court of Appeal has recently affirmed in *Probuild v DDI* that in this situation, generally speaking, the head contractor is not entitled to levy liquidated damages in respect of periods of delay it has caused. The head contractor was obliged to grant an extension of time for delays it had caused, despite the subcontractor not having made a timely claim.

In doing so, it is the latest court to consider how the prevention principle applies in typical construction contracts. In a new development, however, the court said the obligation to extend time could be based on an implied duty of good faith.

The application of extension of time clauses continues to be one of the main sources of uncertainty in the industry. It is common for contracts to place restrictive conditions on the entitlement to claim extensions of time. Most construction contracts do nevertheless provide a power to unilaterally grant an extension of time.

The case of *Probuild v DDI* continues a line of cases requiring this unilateral power be exercised to extend time for delay caused by the owner (or head contractor, as the case may be), where the owner seeks to impose liquidated damages. It is suggested, though, the reference to good faith should not lead to a fundamental change to the contractual risk allocation.

The prevention principle and the typical structure of extension of time clauses

Almost all standard form contracts (and sophisticated bespoke contracts) include a clause allowing the contractor an extension of time as of right for certain causes of delay, including but often not limited to delay caused by the owner (or head contractor, as the case may be).

These usually have a requirement to give notice of the claim within a certain period of time and are often a trigger for a claim for delay costs. Most contracts also include a clause allowing the owner's representative or an independent certifier to extend time for completion unilaterally at their discretion. The latter clause is not there as some sort of codified waiver. It exists to account for the prevention principle.

The prevention principle says that a party cannot rely on a breach of contract where its own actions have caused the breach. Therefore if the reason, or one of the reasons, a contractor has failed to reach completion by the date specified is it was prevented from doing so by the owner, the owner cannot levy liquidated damages from that date. The prevention principle has been recorded in the common law for centuries, in both a construction context and more generally in all commercial contracts.

One of the functions of extension of time clauses is to provide a contractual mechanism to avoid the operation of the prevention principle and so preserve the owner's right to liquidated damages. That is, if the delay caused by the owner can be separated out from the overall delay which has occurred, the owner can still hold the contractor responsible for the remaining delay, without offending the prevention principle.

So, in the typical contract being considered, if prevention occurs, a contractor may claim an extension of time. That may also give the contractor a right to claim delay costs. But if the contractor does not validly claim an extension of time, the unilateral extension of time power nevertheless allows the owner to grant an extension of time for delay caused by prevention, in order to separate out that delay. The owner can then insist upon completion by the new, extended date. If the contractor fails to complete by the extended date for completion, that is no fault of the owner. The owner can levy liquidated damages without offending the prevention principle.

In *Peninsula Balmain*,^[1] followed by *620 Collins Street*,^[2] the courts held that, where the contractor failed to make a valid claim for an extension of time, the independent certifier (in those cases, the superintendent) was obliged to

exercise the unilateral extension of time power^[3] for the period of delay caused by the owner. This was because of an express contractual obligation for the independent certifier to act honestly and fairly in the administration of the contract.

The decision in *Probuild v DDI*

The matter before the court

DDI was a plasterboard subcontractor on a hotel redevelopment for which Probuild was head contractor.

DDI completed 144 days after the date for completion. It made a significant Security of Payment claim for costs on account of variations (around \$2.2 million on an original contract value of around \$3.4 million). DDI had not made claims for extensions of time, nor complied with strict notification procedures for variations. Probuild responded to the claim by setting off liquidated damages. DDI argued the contractual mechanisms had been abandoned. The parties' submissions pointed to a range of potential causes of delay.

The adjudicator decided that in circumstances where variations had been directed after the date for completion had passed, it was 'unreasonable' for Probuild to not have granted an extension of time.

Even if some delays had been caused by DDI, this meant Probuild had not established its claim for liquidated damages. The adjudicator decided Probuild was liable for around \$0.5 million.



“The content of an implied duty of good faith must not be inconsistent with the express terms of the contract.”

Probuild sought to quash the adjudication on the basis that the adjudicator had not allowed procedural fairness, by deciding the matter on a basis which had not been argued. While that was a relatively narrow issue before the court, the court’s reasoning on the prevention principle is more widely applicable.

The court’s reasoning

McColl JA (with whom Beazley JA and Macfarlan JA agreed) examined the line of cases dealing with the prevention principle. The court explained it by reference to McLure P’s observation (in *Spiers Earthworks*)[4] that the prevention principle may be a manifestation of the obligation to cooperate implied as a matter of law in all contracts.

The court went on to affirm that the reasoning in *Peninsula Balmain* applied to this case. That is, in order to claim liquidated damages, Probuild was obliged to extend time for delays it had caused. Importantly, though, the contract in this case did not have a superintendent or some other independent certifier. Rather, it was Probuild itself which held the power to unilaterally extend time. There was (it seems) no express obligation on Probuild to act honestly and fairly.

The court held that the obligation to extend time arose ‘having regard to the underlying rationale of the prevention principle or, if necessary, because there is an implied duty of good faith in exercising the discretion’ conferred by the unilateral power.

Ultimately, the court found the adjudicator’s decision and the material before the adjudicator encompassed that underlying rationale, and so Probuild had not been denied natural justice. Probuild had not made a case about what would have been an appropriate extension of time.

The court cautioned that Probuild’s ultimate entitlement to liquidated damages depended, of course, on the proper construction of the subcontract in the events that occurred.

Probuild v DDI: the wider implications

The court’s decision in *Probuild v DDI* is aligned with the logic of *Peninsula Balmain*.

There are, however, two important matters resulting from the decision of which parties to construction contracts should be aware.

Firstly, the court suggested that a party to a construction contract may be obliged to exercise its discretion to extend time because of an implied duty of good faith. The court did not, however, elaborate on the extent of the duty or its content.

One can imagine that an open ended duty would give rise to practical problems. For example, a superintendent is obliged to make a decision based on his or her independent knowledge of the project and whatever material is put forth by the parties. But a party to the contract is not independent and has its own commercial interests. So, is a party to the contract acting in good faith obliged to make a decision based upon its own knowledge rather than only the claim of the contractor? Is it obliged to inform the contractor of the basis of its good faith decision? If the obligation to exercise the unilateral power in good faith arises where the contractor has failed to make a timely claim, what other conditions precedent should, in good faith, be disregarded, and is there a spectrum? What if the contractor is claiming delay costs rather than the owner claiming liquidated damages?

The answer to these problems is perhaps provided by the second element of the court's logic. That is, that the discretion is to be exercised having regard to the 'underlying rationale' of the prevention principle. The underlying rationale is that a party cannot rely on a breach of contract that it has caused. The unilateral extension of time power allows the delay caused by the owner to be separated out from the overall delay to completion, so all that remains is delay that the owner has not caused. Therefore, because of the extension of time, the breach has not been caused by the owner and the prevention principle does not apply.

If the obligation to act in good faith aligns with the 'underlying rationale' of the prevention principle, the owner's obligation is only to allow for the delaying effect of its own conduct, and no more. In this way, the implied duty of good faith is not open ended but harmonises with the purpose of the unilateral extension of time power. Together, they produce an interpretation of the obligations in the contract consistent with one another and long-standing principles.

There remains one difficult question: what happens if there is no unilateral extension of time power or the discretion is limited so that it cannot be exercised to remove the delay caused by the owner?

On one reading of *Probuild v DDI*, the owner is better off without there being any discretion at all. On the other hand, that would be a return to the very situation which gave rise to the existence of the unilateral extension of time power: to avoid the risk of 'all or nothing' on delay liability. This is not the place to analyse this complex topic in detail.

What is clear, however, is that where there is an available unilateral extension of time power, an owner is usually obliged to grant extensions of time for delays it has caused in order to preserve liquidated damages for delay.

The prudent course, in 'normal' risk allocations, would usually be to make a fair and independent assessment of the delay caused by the owner. That may include, it is suggested, taking into account any causative effect of the failure to make a timely claim by the contractor.

The content of an implied duty of good faith must not be inconsistent with the express terms of the contract. It is suggested that *Probuild v DDI* should not lead to a different risk allocation.

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Construction people just want to build. The forms are what the lawyers pretend to know all about once they poke clauses up your nose - ammunition to exploit the other bloke in the blame game.

Was I being a bit of a tyke? The guest lecturer at this year's JCT Povey Lecture was yours truly. I mean to say that the lectern over all these years hitherto has been occupied by the great and the good. There have been government chief construction advisers galore; gurus on carbon free green whatsits; an MP or two; and chairmen and women of tip-top construction firms.

Then me; a tyke. And given I was the guest of JCT, I decided to bring along all of the current NEC contract documents. And just to sort of balance things up, I brought all of the current JCT contract documents. Then it was time for a smidgeon of audience participation. Each of those standard forms had been put on their seats until there were no forms left. Once settled I asked all those who had found on their chairs an NEC or JCT standard form to stand up, then hold up and wave their form.

Guess, please, how many people were now standing and waving? Blow me, it was 86! Yes, my dear friends, there were 86 printed standard, yes, standard contract documents and all different and all to do a different job. My point? Need I say? O hell's bells, this is beyond lunacy. Nor have we finished counting standard forms: add the CIOB "complex contract" forms, the ACA, and the ICC forms. All of these are ordinary construction forms being used in this country. On top of all these (yes, there's more) is an entire suite of energy contract forms from IChemE and IMechE. Even the international FIDIC form is used in the UK. Let me tell you this: my daily diet is reading or hearing dispute submissions, which have endless numbers of thumbs thumbing all these squillions of pages of bumf, which no one can keep up with. It's gone potty.

Bingham's Corner Cont...

Let me tell you about the bumf we had to supposedly keep up with when I first came to this industry. I worked as a baby QS with a super construction outfit; we turned out really good work. My job was to measure the bricklayers and the carpenters who were "on the tape". My boss told me where to shove the bumf - it was that famous bottom draw. Did it hold 86 forms? No. We had JCT 63, ICE 5th, GC works 1 (a very one-sided government form) and the favourite minor works form. That's that. Subcontracts were the blue form and green form (for nominated work) and finally the FCEC subcontract for civils work. And did we read them? No, of course not. Nor does anyone nowadays read and understand those 86 forms. Construction people just want to build. The forms are what the lawyers pretend to know all about once they poke clauses up your nose. These forms are ammunition to exploit the other bloke in the blame game.

Well now, said I, in the prestigious lecture, let's make friends with reality: we are stuck with this lunacy. Over these decades the forms have come down the conveyor belt like chocolates to be loaded by Lucy into boxes. The damn conveyor belt has got faster and faster, and she has stuffed them in her shirt, her mouth - and still they keep coming. The boys and girls at JCT, NEC (and more) won't stop the belt. So now what? Reality: no one reads them; no one likes them; no one understands them; no one, repeat no one, follows the rules in them (lawyers pretend that's a sin). So? Put up with it. Just run the risk that one day a rule in all this stuff will jump up and bite you ever so hard. Reality tells me that if you are a builder or a subby or architect or engineer or project manager, the thing to do is just do your best.

Wait, I haven't finished. Hitherto, I have been going on about standard forms as printed and sold (at too high a price). What about the game of amending the forms? It was my turn to wave. In my waving hand is the contract document for works at one of our London railway stations. It is an amended NEC. They are called Z clauses ... there are 220 amendments. Beautifully crafted amendments. That barge-pole isn't long enough.

But wait, I still haven't finished. All day I read in-house home made forms of contract. The authors have long since left behind amending standard forms in favour of these tykes. Come on, let's make friends. If you are running a public enterprise, spending public money, but using these forms to coerce, then you can't whinge about the want of good faith and fair dealing. If you are a private enterprise and using these forms to coerce, then you can't lament the want of collaboration, co-operation and teamwork. All this beating each other over the head with all these forms hasn't worked; isn't working except for people like me. I love all the forms dearly, they create masses of disputes and conflict - and I sit here reading them. That's the reality.



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- * Avoid personal attacks (even if you perceive you are responding to a personal attack).

We look forward to hearing from you.

A stylized, handwritten signature in purple ink that appears to read 'J Green'.

John Green



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