WELCOME

By all accounts it has been a busy start to the year for those involved in the resolution of building and construction disputes and as summer ever so slowly drifts into autumn it is perhaps timely to reflect on some of the more significant decisions from the Courts over the past few months which will undoubtedly affect the way cases are run and arguments are structured for many years to come.

Notable amongst these were of course, the much awaited Court of Appeal decisions in the Sunset Terraces and Byron Avenue cases. As expected, the judgments contained extensive legal analysis and reasoning of the issues put before the Court on appeal. Importantly, the Court held that owners of apartments in substantial complexes have the same right to claim damages against a local authority for carelessness in the performance of their functions as Hamlin held was available to the owner of a modest house. Other issues of interest related to the accrual of causes of action and reliance on the Council’s inspection regime notwithstanding that a code compliance certificate may not have been issued.

In an unusual step, William Young P and Arnold and Baragwanath JJ were all moved to express their concern about the unsuitability and inadequacy of litigation as a mechanism for addressing and resolving the leaky home problem in a logical and fair way.

Chee v Stareast Investment Ltd was a case involving appeal proceedings brought in the High Court under the Weatheright Homes Resolution Services Act 2006. Wylie J held that the subject WHT adjudication proceedings had failed the parties. Wylie J was critical of procedural shortcomings, breaches of natural justice, failure to provide adequate reasons in crucial areas and other aspects of the Member’s conclusions. His Honour observed that there was insufficient information before the court to enable him properly exercise any of the powers conferred by section 95(1) of the WHRSA and as a result, the
matter was remitted back to the WHT for a rehearing. The case will be of interest to those parties and their representatives who have been critical of procedures adopted by the WHT in relation to interlocutory and procedural matters.

The recent decision of the Supreme Court in Vector Gas Limited v Bay of Plenty Energy Ltd has caused some interesting debate on contractual interpretation in circumstances of mistake, ambiguity and special meaning and whether New Zealand has moved too far in relation to the extent that extrinsic evidence, particularly evidence concerning pre-contractual negotiations and post contract conduct, may be taken into account for the purpose of establishing what meaning parties intended their words to have. There was also an interesting side issue concerning the desirability of practitioners not acting as counsel in litigation where they have been personally involved in the matters at issue. (To read the full judgments in these and other recent cases, please visit the Resources section of our website www.buildingdisputestribunal.co.nz).

The Tribunal recently filed comprehensive submissions in relation to the Building Act Review Discussion Document produced by the Department of Building and Housing for the purpose of seeking feedback on proposed measures to update the building control system. The Tribunal’s submissions were directed to addressing the issues related to Improving Contracting Practices and Dispute Resolution. Unsurprisingly, the Tribunal is opposed to any (additional) form of government intervention in relation to the delivery of dispute resolution services on the basis that parties to construction contracts and disputes arising thereunder are already well served by the Tribunal’s effective and efficient specialist nationwide services. Any barrier to access to justice for parties to disputes involving relatively modest amounts has effectively been addressed through our LVC fixed fee low value claims service.

The purpose of the proposed measures was stated as being to rebalance responsibility toward building professionals and tradespeople who are making decisions about building work away from an undue over-reliance on building consent authorities. However, one would be most surprised if there were any broad community support for self certification and diminished BCA responsibility in circumstances where the quality, standard and compliance of building work has been found seriously wanting with that additional layer of independent certification. The leaky building crisis is clear evidence of that.

Nonetheless, we, along with the rest of the building industry, now wait with baited breath to hear the Government’s decisions on proposed measures to update the building control system.

I am pleased to report that work is progressing on a possible review of the Construction Contracts Act. We will keep you posted as to progress.

Derek Firth’s article on leaky buildings in the last issue of BuildLaw generated considerable interest and caused me to reflect on my own experience as a WHRS adjudicator over the past seven years. That in turn caused me to put pen to paper (well at least fingers to the keyboard) and I composed an article that I titled “The Great Shame”. That article resulted in television interviews on Campbell Live and the Breakfast Show and radio interviews on Radiolive and National Radio.

What is clear is that the leaky building crisis remains a major social and economic problem for the community of unparalleled proportion, penetration and destructive effect. It is simply untenable given the size and scope of the problem and the contributory role of the BIA in the crisis that the government should just sit there with its head in its hands saying “Well I just don’t know how to do this”.

The WHRS initiatives and court processes applied to the problem to date are palpably unsuitable and
inadequate for addressing the crisis in ways which are fair to all parties and resolve the underlying problem.

As Baragwanath J said in the recent Sunset Terraces case, the leaky building crisis is a systemic problem presented to the community which requires initiatives beyond those to which the courts can contribute.

What is required is a commonsense solution based on practical considerations. Unless the government takes the lead nothing will change. Let’s hope that the budget announcements this month bring new hope for all leaky building victims, claimants and respondents alike.

Consistent with our commitment to excellence and to constantly reviewing and improving our procedures and DR services, I am pleased to report the launch of our new arbitration programme that was signaled in the last issue.

The development of the new suite of expedited commercial arbitration processes is the culmination of months of work. The new processes represent a significant departure from conventional arbitration procedures in New Zealand and will provide a credible and effective alternative to adjudication and litigation. I am absolutely certain that the new procedures will increase the efficiency, potency and the use of arbitration as a modern dispute resolution process. They will enable us to provide parties to disputes with a number of alternative and fully administered processes that are truly capable of delivering a proportionate response to the amounts in dispute and the complexity of the issues involved.

There are a number of other exciting initiatives that we are currently working on to improve and enhance the way in which parties to building projects conduct and regulate their relationships and to resolve disputes when they occur - but more about that later!

We have really been pleasantly surprised by the large number of requests that we have had from people wishing to be added to our distribution data base for BuildLaw® and BuildLaw®:In Brief (our free email alert service).

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We are passionate and proud of serving the industry and the community. We are grateful as always to our contributors. I do hope you find this Issue of BuildLaw interesting and useful.

John Green
Alternative Dispute Resolution Conference
Christchurch, 5-7 August 2010

The Arbitrators’ and Mediators’ Institute of New Zealand (AMINZ) is holding its annual alternative dispute resolution conference jointly with the Institute of Arbitrators and Mediators Australia (IAMA). Members and non-members are welcome.

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If you are interested in or involved in dispute resolution, this conference is a must

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Early-bird registration is now open online at www.aminz.org.nz. Click on “conference”. Please note: A Bledisloe Cup rugby match is on in Christchurch the evening conference finishes on Saturday 7 August. It is therefore recommended that accommodation and travel are booked now.

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 Associates Beware – Flogging the construction site may not be the answer

- Katrina Van Houtte

Introduction
The Construction Contracts Act (‘Act’) provides machinery for contractors to resolve disputes and recover debts in what was intended to be a fast-track, rough and ready dispute resolution procedure. What happens when title in the construction site (generally the only asset owned by the development company) is transferred away to a related party, to frustrate a contractor’s efforts at recovery?

Associate Owner Liability
The Act has put in place a regime (unique to New Zealand) whereby liability to pay the contractor is carried over to subsequent owners of the construction site, provided that the new owners fall within the definition of ‘associate’ under the Act.

‘Associate’ is defined in s 7 of the Act. The definition is wide and includes family members, trustees and related companies and subsidiaries.

The procedure is this. A contractor obtains an adjudicator’s determination against the developer. The Act provides a mechanism for an adjudication award to be enforced through the registration of charging orders over the construction site. But charging orders are worthless where the developer no longer owns the construction site. Enter associate owner liability. Provided that the associates are joined in the notice of adjudication, section 50 of the Act empowers the adjudicator to determine that an ‘associate’ owner of the construction site is jointly and severally liable with the developer for the debt.

Parliament’s rationale was clear. Unscrupulous property developers cannot avoid liability to the contractor by simply transferring titles in the construction site to a related party.

Powers of the District Court on Review
Associate owners may apply to the District Court under section 52 of the Act for a review of the adjudicator’s finding of joint and several liability. The scope of the review power was the subject of a recent pre-trial ruling by Judge Sharp (Sonsram Development Holdings Ltd & Anor (DC Auckland) 26 November 2009, CIV 2009-
If you purchase some or all of the land to a construction site or subdivision, you may find yourself liable to the contractor for the cost of unpaid works on the land, regardless of whether you purchased one section or one hundred.

044-1266). Liability is founded on the adjudicator’s determination that the new landowner fits within the definition of ‘associate’. It is only this aspect of the determination that is reviewable. The review is not an opportunity to revisit the finding of primary liability against the developer.

There is some judicial discussion (although the point has not yet been finally determined), that the powers of the District Court on review may extend to examining whether the associate ought to be liable for only a portion of the amount claimed. It has been suggested that this type of situation might arise where an associate has purchased only a few sections in a subdivision and the amount that the contractor is claiming relates to works carried out on the whole of the site. (See Redhill Development (NZ) Ltd & Anor v Green & Anor (HC Auckland), 5 August 2009, Lang J).

A close reading of the relevant sections suggests otherwise. It comes down to the meaning of the words ‘(whether in whole or in part)’. In a related part of section 50, the words ‘(whether in whole or in part)’ refer to the adjudicator’s finding as to how much of the original claim the developer is liable to pay; the whole or part of the amount claimed. The wording in respect of associate owner liability is precisely the same. It follows that the adjudicator has no jurisdiction to find associate owners liable for a different or lesser amount.

There are limited exceptions found in sections 50(3) and 50(4), however, it appears, and this is consistent with comments made by Lang J in Redhill, that s 50(3) contemplates payments made from the associate to the contractor directly. It does not follow that the owner’s joint and several liability is extinguished by paying the purchase price for the land to the respondent.

**Conclusion**

The message for associates is beware! If you purchase some or all of the land to a construction site or subdivision, you may find yourself liable to the contractor for the cost of unpaid works on the land, regardless of whether you purchased one section or one hundred.
MEDIATING CONSTRUCTION DISPUTES: A REPORT FROM THE UK

Between 2006-2008, Kings College in London conducted research on the use of mediation in the Technology and Construction Court. The Report was written by Nicholas Gould and Claire King of Fenwick Elliott LLP and Phillip Britton, a professor at the Centre of Construction Law and Dispute Resolution at King’s College, London.

The key points that can be drawn from the report, and the TCC survey in particular, are as follows:

- Where mediation is successful the cost savings attributed to the mediation were significant; providing a real incentive for the parties to consider mediation. Only 15% of those who participated in the survey reported savings of less than £25,000; 76% reported savings in excess of £25,000; and the top 9% saved over £300,000. The cost savings are generally proportional to the cost of the mediation suggesting higher value claims spend more money on mediation, presumably because they realise that the potential savings resulting from mediation will be greater. Even where the mediation was unsuccessful, few respondents thought it to have been a waste of time or money; many regarded it as a positive experience.

- Mediation was undertaken on the parties’ own initiative in the vast majority of cases. Only 22% of mediations in the TCC survey were taken as a result of the Court suggesting it or due to an Order of the Court. This suggests that the incentive to consider mediation provided by the Civil Procedure Rules (namely cost sanctions) are effective and that advisors to parties to construction disputes now routinely consider mediation to try and bring about resolution of the dispute.

- The parties themselves generally decided to mediate their dispute at 3 key stages: as a result of exchanging pleadings; during or as a result of disclosure; or shortly before Trial. Of successful mediations, a higher percentage of respondents whose mediations had taken place during exchange of pleadings and shortly before trial believed that the dispute would have progressed to judgment if mediation had not taken place.

To read a full copy of the report, please visit the references section of our website at www.buildingdisputestribunal.co.nz
If during the contract the Contractor encounters on the Site physical conditions which ... could not reasonably have been foreseen when tendering by an experienced contractor and which will ... substantially increase its Costs ... the effect of such conditions ... shall be treated as if it was a Variation.

Clause 9.5

Conditions of Contract for Building and Civil Engineering Construction

(NZS3910:2003)

1. Introduction

In the construction industry, we hear many adages like “project risk should be allocated to the party best able to manage it”. While commendable, truisms like this do not do justice to the complexities or the subtleties of allocating risk in large construction projects.

Risk is not static. It changes through the construction process at a number of different levels – likelihood, avoidability, severity, downstream impact, foreseeability, manageability and value spring immediately to mind, and yet traditional tendered lump sum contracting procedures force contractors to commit to certain outcomes at a time of greatest uncertainty in a competitive environment.

The critical issue in any analysis of allocation of risk is identifying initial uncertainty, how responsibility for that uncertainty is allocated, and what to do if the risk associated with that uncertainty does eventuate.

Uncertainty

For tunneling, the greatest uncertainty is the geotechnical condition to be encountered. Only once the ground condition is understood, and the uncertainties identified with as much clarity as possible,
can the parties engage in a productive discussion about allocating responsibility for dealing with those risks. The quality of that discussion will depend on the information available and the skills the parties bring to the table.

 Allocation

It is incumbent on all parties to a construction contract to reduce the level of uncertainty so far as they can.

This may not lend itself well to traditional fixed price competitive tendering, under which bidders price for uncertainty in a competitive environment. This regrettably rewards aggressive or even reckless tendering, and can translate into more aggressive attitudes towards recovering costs during construction, or managing risk through the claims procedures. One of the main objectives in any award process should be removing (or reducing) uncertainty, allocating risk sensibly and providing a framework to manage the genuinely unknown in a manner which maximises the skills of the parties, and is in the best interests of the project.

This is best done with a thorough understanding of the extent of the uncertainty, and contracts and processes which deal with those uncertainties as necessary. A broad brush approach, whether using blanket allocations or more general collaboration frameworks, have the potential not to properly address the parties needs for certainty or to make the most of the skills the parties bring to the project.

 Ownership of Risk

We often hear of ownership of risk, whether by the employer or the contractor. While this is accepted shorthand for whether or not the contractor will be entitled to be paid or given more time if a certain risk eventuates, it also creates a misleading assumption that the parties are in some way equal partners. They are not; they bring different skills and expectations to the table.

The employer is paying for the development of an asset, whatever the cost may ultimately be. The entirety of the project is at the employer’s risk, reflected in price and quality. I’m sure we all hear too often the statement “it’s not my problem” from owner’s representatives. Sadly, this is not at all true; when an event occurs which is not properly managed, and may not have been priced for, it is every one’s problem. It may be principally one the contractor’s responsibility to deal with, but it is still a problem for the project.

The contractor is providing a service to the employer for payment. The issue of foreseeability is whether or not it is sensible for the contractor in providing those services to accept certain risks. In determining that issue, the objective should be to maximise value from the contractor’s skill and resources. It is not sensible to
allocate risks to the contractor which it cannot properly assess, manage or price, simply because you can (because of market forces, or any other opportunistic reason).

While the contractor may not be entitled to claim under the contract, this does not mean that it won’t claim, or that it won’t seek to recover losses elsewhere in the contract though reducing costs and resources, or making claims elsewhere.

**Habitual Allocation**

As creatures of habit, all involved in the construction industry are inclined to follow established patterns, preferring formal tender processes for fixed price contracts using standard forms. These have the benefit of familiarity, if not certainty. In a similar vein, the industry complains about the overuse of special conditions and we are warned that departing from the printed word in published forms can have unintended consequences, destroying the niceties of the original drafters’ intentions.

Far be it for me as a contract draughtsman to disagree with this injunction, but it does assume that a one-size-fits-all approach is always appropriate. An unintended, consequence of slavishly following standard forms or any standard procedure for that matter is that critical decisions are then made for us without realising what they are, or why we make them.

Once risk has been identified and properly explored and considered, the contract should provide a framework for dealing with that uncertainty. That framework will vary from project to project, and the contract should be revised accordingly.

**Change in Approach**

It is also important to acknowledge that we are in a period of change.

There is now greater acceptance that a robust and realistic allocation of risk will ultimately result in a lower overall project cost. Some level of mutual risk “sharing” is now becoming the norm in major overseas projects, and here.

I appreciate that reviewing each project from a clean sheet of paper is not for the faint hearted, but then it does make life more interesting. Hopefully it also means that we fully use the skills that we are paid for.

2. **Standard Approach**

The common law position is that, without an express provision to the contrary, ground condition risk rests with the contractor like any
other physical condition or buildability issue.2

The standard approach, as shown from the selective quote of NZS3910 above, is for the contractor to be compensated with an extension of time and payment of direct cost, overhead and profit for unforeseen physical conditions which cause delay or cost. Similar wording is used in most standard forms.

Issues will revolve around what an experienced contractor might or might not foresee, and once foreseen, whether or not the risk is likely to eventuate. The difficulty with this formulation is that the test of foreseeability will be undertaken after the event. As we all know – hindsight is a dangerous thing.

A number of factors can be taken into account when assessing foreseeability:

(1) information in the public domain at the time of tender;
(2) information provided by the employer, typically in the form of geotechnical investigation data, and perhaps interpretations of that data;
(3) the results of the contractor’s own pre-tender investigations; and
(4) the mythical contractor with all the above information, experienced in similar projects with the time, resources and inclination to consider what might or might not be foreseeable (this is a hard beast to pin down).

There is little or no case law on this point, and regrettably the opinions of experts have rarely assisted in resolving this issue. All too frequently in arbitration the most compelling evidence of what was foreseeable is what the contractor actually allowed for! While convenient, this rather flies in the face of the contractual intent.

The Unexpected

The underlying policy of the standard clause is that the contractor is to manage and price for everything, apart from what would be unreasonable to allow for – the genuinely unexpected.

If the event, and the extent of its impact, was reasonable to expect, then the contractor is not entitled to compensation. However, to the extent that such things are objectively not foreseeable, then the contractor is paid its direct costs, overheads, profit and delay costs and is granted an extension of time. While there will be some fighting in the trenches over what is unforeseen, ground conditions are effectively “at the employer’s risk”.

All too frequently in arbitration the most compelling evidence of what was foreseeable is what the contractor actually allowed for! While convenient, this rather flies in the face of the contractual intent.

The underlying policy of the standard clause is that the contractor is to manage and price for everything, apart from what would be unreasonable to allow for – the genuinely unexpected.

2 See Thorn v London Corp (1876) 1 App Cas 120.
There are a number of difficulties with this policy:

(a) concerns about liability for misleading data or faulty interpretation of it has lead to a reluctance on the part of many employers to carry out thorough investigations, preferring to leave it to the contractors to carry out such investigations as they consider necessary. While this may seem rash, the contractor invariably has the best knowledge of his equipment, and what he can expect;

(b) while opportunities may be given by employers for contractors to undertake geotechnical and other investigations during the tender phase, these are effectively controlled by the employer, who may be disinclined to incur the cost and delay of carrying out additional tests, or to accept responsibility for the accuracy of such tests. At best, many contractors will carry out a visual surface inspection, and will leave it at that;

(c) there is no clear obligation or incentive on the employer to carry out extensive investigations prior to tender. While in New Zealand we have relatively good protection from misrepresentation under the Contractual Remedies Act 1979 which extends to omissions, there is no generally recognised duty of disclosure;\(^3\)

(d) the lack of clear definition of what the contractor ought to have foreseen has lead to major and costly disputes, particularly in relation to tunnelling; and

(e) there is no clear incentive on the contractor to minimise the effect of adverse ground conditions; quite the reverse. The ability to recover all costs, be granted an extension of time and be paid day rates for delay and profit on such costs encourages inefficiency.

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\(^3\) See US case of *Morrison-Knudsen v State of Alaska* (1974) 519 P.2d 834 and in Canada *The Canadian Red Cross Society v WN Developments (Ottawa) Ltd* and *McLean & McPhadyen* Ontario Superior Court (1983) 1-CLD-02-09), and the concept of an overriding obligation to act in good faith in a contract is an open issue (see the discussion of the justiciability of good faith by Tipping J in *Wellington City Council v Body Corporate 51702 (Wellington)* [2002] 3 NZLR 486. This must also be read in the context of the implied obligations to co-operate and not to prevent completion, discussed in *Keating on Construction Contracts*, 8th Ed at paras 3-052 to 3-055.
While the standard approach seems to chart a reasonable middle ground for contracts with minimal ground condition risk, for projects with significant ground condition elements the clause is neither workable nor efficient as drafted.\(^4\)

The employer frequently has little or no expertise in contracting, let alone the complexities of ground conditions. The contractor will have some expertise, and should certainly be able to identify the uncertainties if nothing more.

3. **Duty of Disclosure**

In most published standard forms, the unforeseen physical conditions clause is accompanied by a recognition that site investigation information will be provided by the employer, if not the interpretation of it.\(^5\)

NZS3910:2003 goes further by providing:

> The Principal warrants that it has made available to the Contractor before the submission of the Contractor's tender all information of which it is aware, which has been obtained by or on behalf of the Principal or Engineer for the purposes of the contract, on the nature of the physical conditions relevant to the Contract Works. The Principal makes no warranty as to the sufficiency or accuracy of such information. The Contractor shall be responsible for the interpretation of all such information for the purposes of the Contract Works.

This clause appears to try to have it both ways by dealing with the lack of a common law duty to disclose, but trying to avoid any liability for misrepresentation. It fails on both counts.

While it contains a warranty that the employer has provided all the information it has, it provides no incentive for the employer to carry out sufficient investigations to identify any risks particularly relevant to the project. Further, the express disclaimer on sufficiency or accuracy provides an illusion of protection against misrepresentation.

Ultimately, if the information proves to be incorrect or inaccurate, the issue of foreseeability will probably resolve the matter, unless of course an optimistic employer seeks to argue that an experienced contractor should have know that the information was wrong!

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\(^4\) For a fuller discussion of this point, see *Keating* at para 20-069 et seq

\(^5\) See clause 5.1.6 of NZS3910:2003
US Position

The obligation to disclose is different in the US. The case of *Morrison-Knudsen Co v State of Alaska*\(^6\) provides a helpful illustration, and tells a strikingly familiar tale.

The State of Alaska appointed the firm of Morrison-Knudsen to carry out runway extensions at the Sitka Airport. Prior to award, the State had carried out site investigations, including as to whether or not seabed material taken from “borrow pits” would be appropriate. Those investigations concluded that the material was “apparently dredgable”, and they were made available to bidders.

While some site investigation information about the borrow pits was provided, it was disclaimed and bidders were to carry out their own site investigations and the contractor was to select its dredging equipment and could chose an alternative source of material.

Morrison-Knudsen’s bid manager reviewed the documents and viewed the site from the shore, but did not go over the borrow pits in a boat or take any samples or make any detailed survey. Based on his inspection and the material provided by the State, Morrison-Knudsen bid on the basis of hydraulic dredging of the material, which at that time was cheaper than the alternative methods, but reasonably sensitive, requiring relatively uniform material to dredge, little if any wind and a calm sea state.

The other bidders carried out more extensive investigations, including going out in a boat to examine the presence and size of boulders and generally assess the suitability of the material. They came to the conclusion that hydraulic dredging would not be appropriate, and one bidder declined to bid based on the lack of certainty of cost effective fill material. This view was communicated to the State.

In the event, all bids were outside the budget allowance. Morrison-Knudsen, as low bidder, sought an opportunity to negotiate. During those negotiations, there was evidence that a State representative asked Morrison-Knudsen if they would claim if the borrow pits were not as represented. Ultimately, a contract was concluded with Morrison-Knudsen, with the State not having shared the views of the other bidders that the statements in the site investigations, that material was suitable for dredging, were wrong.

It is apparent that the State went ahead with the contract with Morrison-Knudsen, knowing that their methodology for recovering the fill material may have been inappropriate, and in reliance on their disclaimers of the investigation information. Presumably this was for price reasons. Not surprisingly, the proposed hydraulic

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\(^6\) (1974) 519 P2d 834

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\(^7\) (1974) 519 P2d 834
recovery from the borrow pits failed and Morrison-Knudsen had to source their materials from a considerable distance away. They lodged a claim for the additional cost of acquiring the material against the State.

Morrison-Knudsen argued that the State led it to believe that hydraulic dredging was feasible when it had information proving that it was not. Further, the state did not dissuade Morrison-Knudsen when it became apparent that they would use hydraulic dredging. The State denied making any representations, and argued in the alternative that Morrison-Knudsen did not rely on the representations.

The majority of the Supreme Court of Alaska considered the extent to which the State had a duty to disclose. Accepting that such a duty existed, citing with approval earlier dictum:

*It is well settled … that where the Government possesses special knowledge, not shared by the contractor, which is vital to the performance of the contract, the Government has an affirmative duty to disclose such knowledge*

the majority found that the State did not possess such special knowledge. In the court’s view, the State did not hold the information from a favoured position. It simply knew what two other bidders had discovered, and what Morrison-Knudsen could have discovered, if it had exercised more diligence in its pre-tender investigations.

The facts are interesting from a New Zealand law perspective. Even though this case was decided in the early 1960s, similar issues arise all too frequently today with many of us erring on the side of caution and either not releasing such information, or seeking warranties from those conducting the investigations and endeavouring to limit or exclude liability for errors in such information.

From a New Zealand law perspective the ability of the State of Alaska to rely on the exclusionary statements would be dependent on the State discharging its persuasive burden that it is fair and reasonable for the exclusion to be conclusive of the relationship between the parties, in terms of section 4 of the Contractual Remedies Act 1979. That is a considerably different question from that posed by the State Supreme Court.

In lieu of a limitation of liability provision, the court would then consider the range of remedies available to it under sections 6 to 10 of the Act. In all probability, the remedy would be to follow the contractual entitlements to payment of cost, overhead, profit and the allowance of time; or in terms of NZS3910, to grant a variation.
When providing geotechnical, site or other background information, is the employer seeking to provide flesh to clothe the bones of foreseeability in terms of clause 9.5? in which case there is little point in trying to exclude the information, or is the employer trying to provide as much information as it can to get a good price? while reserving its position to argue later that the contractor should have foreseen something else.

In that context, the concern about liability for the provision of such information is misguided. Further, good contracting practice requires the parties to fully consider the background information, to ensure that there is a full exchange of information and to agree what the contract should contain in that context.

Alternatives to the Standard Approach

There are a number of alternatives to the standard approach. No option is universally correct, and each may be entirely suitable in the appropriate circumstances. The converse is also true!

(1) Client takes entire risk

This serves more to round out the full spectrum of possibilities, than to provide a sensible option for major projects. Under this arrangement, the contractor is paid the actual cost of completing the work, plus agreed margins and overheads, regardless of the ultimate cost.

The difficulty with this arrangement is that, much like the standard clause, it provides no incentive to the contractor to use its skills or knowledge to resolve problems with ground conditions cost effectively when they arise.

(2) Define the reference condition

This is an approach which is common in tunneling contracts (see below). By defining the reference or baseline condition, the uncertainty of foreseeability is reduced, leaving only the issue of whether or not there is actually a departure from the reference condition, and whether or not it is significant.

Sadly, the difficulty with foreseeability is not removed entirely.

In a recent geothermal project, the reference conditions defined such wonderful things as moisture content, ph, grit content, temperature, pressure and enthalpy (a word which is beyond even my copy of the Shorter Oxford Dictionary). Like all attempts to define the natural condition, it was a fine attempt at crystal ball gazing, but it inevitably came up short. When the bore produced such levels of pumice grit that it scoured the steam and geothermal fluid separator, trying to interpret two lines of technical data to
establish what might or might not reasonably have been foreseen was no easy task! I should add that on the interpretation of those two lines rested millions of dollars in claims.

(3) **Painshare/Gainshare**

Used variously in alliance, collaborative working arrangements and partnering agreements, and in NEC 3 with the target contract options, painshare/gainshare contracts acknowledge that you cannot achieve total certainty, so they set up an alternative framework.

Under these arrangements, the contractor’s margin for the entire project based on the budget is typically assured, the actual cost of construction is paid on an open book basis and savings from target cost is shared between the parties. While there is reference to painshare, most contracts inevitably allocate the lion’s share of the pain to the employer (who continues to pay), while the contractor’s pain is more in the nature of profit foregone. This is not really the same thing.

Where there are appropriate project uncertainties, such arrangements may be entirely suitable, provided the uncertainty is significant and its extent is properly defined. However, an arrangement where the contractor’s margin is guaranteed, but overall project outturn costs are not, is understandably viewed by many as being slanted in the contractor’s favour.

(4) **Contractor takes all ground condition risk**

The following clause was included in the HK Government’s General Conditions of Contract for Airport Core Programme projects, in substitution for a clause very similar to clause 12 if the ICE 5th Edition:

… the Contractor shall be deemed prior to submitting the Tender to have … inspected and examined the Site … [and] satisfied itself as to the nature of the ground and subsoil … No claim by the Contractor for additional payment or any extension of time shall be allowed on the ground of misunderstanding or misapprehension of [these] matters …

There was understandable concern from the contracting community when the first contracts containing this clause were issued for tender.

There are two particular difficulties with this approach:

(i) the allocation of risk can be less a reflection that the parties have carried out thorough
investigations and are comfortable with what they might encounter (and could price for it accordingly), than of the overriding desire by employers to have fixed prices and certain completion dates, and perhaps of unequal bargaining power; and

(ii) the bidders are unable to price for the risk with any certainty; any contingency would be guesswork. Ultimately, if the risk does not eventuate the contingency is wasted, and if it did, there would be no certainty that the contingency would be enough, resulting in costs to the project elsewhere (even if simply in legal fees).

This gives a gloss on the truism about allocation of risk, that a project which goes off the rails benefits no one. If your project is going to be late, rights in contract aren’t necessarily going to help; much like Neville Chamberlain returning from Munich in 1938, there is little practical benefit in holding up a piece of paper. Once a project has become a loss maker, most contractors will understandably look for ways to reduce that loss, rather than complete the project as well as the employer might have hoped. A right to sue won’t necessarily help any one other than the lawyers.

Conversely, where there is considerable, high quality geotechnical information available, the contractor has the skill and the resources to deal with what they might find and all parties are comfortable with what will actually be encountered, this can be a very effective allocation of risk.

Conclusion

A successful project is one where both parties make money, rather than one party driving another to the wall but forcing it to complete the project at a loss.

While risk should certainly be allocated to the party best able to manage it, that allocation will vary from project to project, and party to party. If there are approaches that can be applied to all projects, which will assist:

(a) carry out as thorough ground investigation as time, money and resources allow,
(b) take the time to understand and become comfortable with each other’s position,
(c) have a clear contract (this does not mean plain or short, or containing a myriad of “for the avoidance of doubt” provisions; it means clear),
(d) actively manage the risk, don’t just rely on contractual responsibility, and

A successful project is one where both parties make money, rather than one party driving another to the wall but forcing it to complete the project at a loss.
(e) have a dispute resolution process which the parties can have faith in, and which promotes resolution, rather than entrenching parties' positions (though it may appear so to you or your client, very few people go into litigation or arbitration knowing they are wrong). Make the process prompt and roughly right – the finer points of natural justice matter little to most parties, particularly if they have to pay for them to be debated.

One size does not fit all, and risk varies from project to project. Successful projects identify those risks, and what to do if they eventuate. They also encourage the parties to establish a level of trust that enables them to deal with the unexpected in a way which is appropriate – it is not possible to legislate for trust, but poor drafting can inhibit its development.

The Great Shame

By - John Green –
John Green  F.AMINZ(Arb/Med), F.CIarb(UK), A.IAMA
Chartered Arbitrator, Adjudicator, Mediator

The leaky home crisis has been labeled as NZ’s worst catastrophe. A catastrophe that the Minister for Building and Construction, Maurice Williamson, is reported to have described as having grown so “ginormous” that the government has almost despaired of finding a solution and has to just sit there with its head in its hands saying “Well I just don’t know how to do this” (NZ Herald 27 February 2010 – Andrew Laxon).

That must come as some consolation to the thousands of New Zealanders whose lives have been devastated by the crisis and who, without government assistance, simply have no prospect of getting things back on track.

The scale of the crisis is without comparison by any contemporary or historical standards. It is estimated to lie somewhere between $11billion and $23 billion and to affect up to 89,000 homes – it could conceivably be much greater than that and affect approximately 10% of all new New Zealanders.
Neither the WHRS nor the courts can deliver prompt and cost effective resolution of leaky building claims such that will enable homeowners to repair their leaking and rotting homes.

In the circumstances the need for a fresh approach has never been greater

could conceivably be much greater than that. The impact of the crisis conceivably affects the lives of several hundred thousand New Zealanders – maybe around 10% of the entire population if respondents and their families are included. They should be, they are victims of the crisis also. There is unsurprisingly much conjecture as to the true scale of the crisis and no one really knows the answer, but what is clear is that the extent of the problem at any level within or about the estimated range is simply beyond the means of any entity other than the government to solve.

The WHRS was established in 2003 to provide owners of leaky homes with access to speedy, flexible and cost effective procedures for assessment and resolution of claims. The notion was laudable but the reality has proven to be anything but. Claims have taken years to resolve, the legal and expert costs are huge and disproportionate by any standards (upward of a 1/3 of the repair cost in many cases), often well beyond the financial means of most parties, and in the end the net financial result achieved by claimants after costs is simply insufficient to repair the damage.

I must not be taken to be criticising what was done at the time, I am not. I was a part of it. A response was required and the WHRS was established with the very best of intentions. The service is arguably quicker and less costly than court, but in the result, homes are not repaired and lives are destroyed as the delays and the costs of the process quickly exhaust the average party’s spirit and resources. In short, neither the WHRS nor the courts can deliver prompt and cost effective resolution of leaky building claims such that will enable homeowners to repair their leaking and rotting homes. A ‘win’ is not even remotely a win for many claimants who are either crunched in mediation for a quick settlement to avoid additional costs or go on to formal proceedings where any additional amount awarded is extinguished by the costs of achieving it.

The only real beneficiaries of the crisis and the procedures for resolving leaky building claims are the lawyers and the building consultants who have built up substantial and profitable businesses off the backs of the parties to these proceedings and most of whose practices or businesses would not exist but for the leaky home crisis (one might also add the government to the list if the argument re GST and tax revenue is added to the mix). The cost of their services places a huge and unbearable burden on claimants and respondents alike and contributes nothing of substance to the repair or value of New Zealand’s housing stock.

That is not meant as a general criticism of lawyers and consultants or their services which are only made necessary by the very nature of the processes currently available for resolving leaky building claims.
Whilst the government does not, and of course will not, accept liability for the leaky building crisis, it is responsible for the physical, emotional and financial wellbeing of the community at large and therefore it must accept responsibility for resolving the problem.

So what are the options? Well, none that don’t involve the government funding and/or underwriting the repair of leaking and rotting homes to some extent.

The government’s offer to meet 10% of the repair costs if the Councils chipped in 25% would leave claimants meeting 65% of the repair bill and was never going to fly without some padding around it. Why would a claimant accept such an offer when it could pursue potentially liable parties through any of the extant state funded processes and potentially recover 100% from the Council if it were liable, less costs. That is unless of course the council was not involved and there was no other party still standing to pursue – 10% being better than nothing.

The reason why the councils would be attracted to such a proposal is immediately obvious because it would place a cap on their liability. In the absence of any other culpable party a council is potentially liable for the whole of the repair costs on the basis of joint and several liability notwithstanding its limited role and share of responsibility for the actual loss and damage suffered.

The difficulty for claimants is that even if such an offer were accepted (whether the government’s 10% or an aggregate 35%), it would go no way to repairing the damage and the cause of the water ingress and many homeowners would simply be unable to borrow and/or to fund additional mortgage monies to effect the necessary repairs. The short point being that the government’s and the council’s contribution if any, would amount to nothing more than a handout in the circumstances that would serve no practical purpose in terms of resolving the real and underlying problem. The
owners would get money, the money would be insufficient to repair the dwelling and the leaky home would remain a leaky home - a bittersweet pill indeed for government, councils and homeowners alike.

A further problem that would inevitably arise as a result of the government’s earlier proposal lies in how the value of the repair work would be determined in order to assess each party’s contribution – 25% of what? Who would value the owner’s loss and damage? The Owner, the Council, or the Crown? I am absolutely certain that the answer would be all three and the very same unprincipled debates that have raged for the past 7 years would continue unabated causing delay and unnecessary expense for all parties involved.

The only way to resolve the problem effectively is for the government to initially fund and/or underwrite the repair costs by way of means tested loans or suspensory loans on the basis of repair first, argue later. That way, all monies obtained by owners would be used solely for the purpose of repair, the leaky homes would be repaired promptly and properly allowing owners and their families to get on with their lives. Moreover, the cause(s) of water ingress, the extent of the damage and the actual cost of repair would be credibly established by the physical evidence gathered during the repair process. The benefits are obvious, but most importantly 90% of the lengthy and costly arguments in leaky building claims as to the cause, scope and likely cost of repair work would be almost entirely eliminated.

The government may well enter into an agreement with councils to limit their liability to a proportionate amount of say 25%. The government may also contribute an equal amount (or any other amount) on the basis that it has a moral and fiduciary responsibility for, and a vested interest in, ensuring the emotional, physical and financial health and well being of all New Zealanders.

In such a process, an application to use the government service would continue to suffice for limitation purposes, the evaluation and monitoring of the remedial work could be undertaken by assessors engaged by the service for that purpose and on completion of the remedial works when all the facts as to damage, cause and cost of repair are established, claims for contribution against potentially liable parties could be heard by specialist adjudicators. Such claims would be relatively straightforward to resolve by comparison to what now presents with only issues of betterment, liability and contribution to be determined. These issues could be readily and quickly disposed of with the benefit of the factual evidence obtained through the remediation process. There is no reason why all such claims could not be brought on behalf of the owners by a team of Crown appointed prosecutors which would increase efficiency and reduce costs for homeowners dramatically.
In time, inflation would likely take care of most, if not all of that increased borrowing/liability for homeowners. But in the meantime, and most importantly, the value and quality of New Zealand’s housing stock would be improved and owners of leaky buildings could get on with their lives free from the debilitating stress and related health issues caused by the physical and financial helplessness of their plight.

Such a scheme is open to any number of variants including that any government contribution could be clawed back as a result of the government taking a share in the recovery of any monies obtained from culpable parties. An initial government contribution of say 25% could be reduced to 15% by the government taking a 50% share of the first 20% of repair costs recovered from other liable parties (if any) with any further recovery credited to the owner’s loan account. Such an approach maintains an effective incentive on the part of all parties involved to prosecute claims effectively. Claims for general damages might also be eliminated as a condition (and a result) of using the service.

In the event that there was no council involvement in the build process due to the use of independent certifiers, a fixed government contribution of 25% of the repair cost would be seen by most New Zealanders as ‘fair dues’ given the abject failure of the misconceived independent certification process and what is generally perceived to have been the Government’s flawed and abysmal handling of that scheme through a dysfunctional and impotent BIA.

In the event of Council involvement, a 25% contribution from the Council based on its likely proportionate liability together with a further 25% from the government would leave homeowners funding at worst, 50% of the repair costs over the period of the suspensory loan. The loan would likely mature on sale of the property or the passing of the owners. The owner’s contribution would be further reduced if there were other liable parties still standing. The government would be best placed to institute means tested payment options for liable parties and to administer and monitor the collection process through its various departments thus increasing and aiding recovery of loss.

In time, inflation would likely take care of most, if not all of that increased borrowing/liability for homeowners. But in the meantime, and most importantly, the value and quality of New Zealand’s housing stock would be improved and owners of leaky buildings could get on with their lives free from the debilitating stress and related health issues caused by the physical and financial helplessness of their plight.

One immediate and obvious benefit of completing the remedial work promptly on assessment would be to reduce the scope and thus cost of the damage. Delay, which in most current cases is several years, leads to more extensive damage and greater repair costs.

Another obvious upside of getting on with the repair of leaky buildings would be to kick start growth, or at least maintain a
Another obvious upside of getting on with the repair of leaky buildings would be to kick start growth, or at least maintain a functional level of operational activity in the residential building sector.

A further upside of the remediation of leaky buildings on the scale contemplated by the proposed response to the crisis is that it would create a valuable and unique opportunity for the industry to undertake research on an unprecedented scale through taking apart, inspecting, analysing and reconstructing large samples of existing dwellings that have failed. The research would provide the foundation for the reassessment of building standards and the development of appropriate and relevant best building practice. The remedial work would provide a much needed opportunity to upskill the industry through first hand observations of the causes and effects of building failure and the transfer of skills and knowledge that would result from closely supervised and monitored remediation and construction work.

In conclusion, the leaky building crisis is a major social and economic problem for the community of unparalleled proportion, penetration and destructive effect that arose in the wake of the government’s building control reforms of the early 90’s. Quite simply, the outcomes and safeguards anticipated by the Building Act 1991 did not materialise. Contrary to the stated purpose of the reforms, the revised statutory scheme and regulatory environment left consumers exposed to unacceptable risk and without protection when compliance regimes proved to be misconceived and ineffective and insurance schemes became unattainable.

The reforms failed to satisfy reasonable community expectations and the BIA proved to be impotent when it could and should have intervened to put an end to practices that led to the leaky building crisis. Whilst the BIA was not held to have any legal liability to owners of leaky buildings in the Sacramento case, it is a commonly held view that it should nonetheless bear some measure of responsibility for what has happened.

The WHRS initiatives and court processes applied to the problem to date are palpably unsuitable and inadequate for addressing the functional level of operational activity in the residential building sector to prevent further erosion and losses of skilled resources.
It is simply untenable given the size and scope of the problem and the contributory role of the BIA in the crisis that the government should just sit there with its head in its hands saying “Well I just don’t know how to do this”.

As Baragwanath J said in the recent Sunset Terraces case, the leaky building crisis is a systemic problem presented to the community which requires initiatives beyond those to which the courts can contribute.

Unless the government takes the lead nothing will change. Let’s hope the heads come out of the hands and start to do the job they were designed for. What is required is a commonsense solution based on practical considerations.

IS THERE ANY PLACE FOR EXPERTS IN ADJUDICATION?
- Liam Holder

Liam Holder is a Senior Managing Director in FTI’s Forensic and Litigation practice and is based in London. Mr Holder is a specialist in construction claims, expert witness services, forensic support, dispute resolution services and contractual advice.

Going back 12 years or so, before the Housing Grants, Construction and Regeneration Act 1996 (the Act) came into effect on 1 May 2008, there was a widespread expectation that the introduction of adjudication would allow disputes to be determined by “experts”, and that the construction industry as whole would be better off as a result of the reduced involvement of lawyers and the law in the resolution of its disputes. The “expert”, of course, was imagined to be adjudicator – a wise all knowing person who would not have the wool pulled over their eyes and who would not hesitate to make use of their power to take the initiative in ascertaining the facts and the law.

Whilst that may have been the expectation, the reality turned out to be somewhat different. For all the right reasons it was pointed out that adjudicators could not ride roughshod over either the law or natural justice and that, whilst they may well hold opinions and expertise that they were free to use, they must nonetheless make sure that the parties had the opportunity to challenge those opinions and views before any decision was reached. In consequence most adjudications are now essentially adversarial in nature with the arguments and explanation being proffered by the parties, and any inquisitorial element being strictly limited in its extent.
With perhaps larger disputes being referred to adjudication than were ever anticipated by those behind
the Act, it was also inevitable that many of the parties to a dispute would want the benefits that can be
obtained from professional representation, whether that is provided by solicitors or claims consultants,
and this has been a further force pressing towards the fairly formalised procedures we now tend to see
adopted.

So if adjudicators are not going to be the “expert”, they will be looking to decide on the basis of the
information placed before them. In a court or in arbitration this information would be termed evidence
and it is convenient to use the same terminology in relation to adjudication; although it is always worth
remembering that the rules of evidence as they might exist in court and/or arbitration do not have any
standing as such in relation to adjudication.

The information presented to an adjudicator can and does take many forms, including claim
submissions, witness statements, expert reports, submissions on the law, site inspections, contemporary
documents, programmes, photographs, information gleaned at meetings and so on. It is largely up to
the parties to determine what information they consider relevant and, unlike litigation or arbitration,
permission is not required before putting forward expert evidence. From all of this information the
adjudicator will have to form a view of its relevance and veracity and, hence, what weight to attach to it.
This will also need to done quickly, so that the adjudicator can press on and produce a decision in
whatever limited time is left after the parties have made their submissions.

In court all of this information would be tested, the witnesses would be cross examined and the
documents carefully explained and deliberated over. These are features that either do not exist at all or
are very much curtailed in adjudication. If there is any form of meeting or hearing (and many
adjudicators, as a matter of practice, avoid meetings with the parties) it will be of limited duration and
unlikely have the structure of a formal hearing. In particular, whatever evidence is put forward by the
parties is unlikely to be tested in cross examination, and although some searching questions might be
asked, they will not be answered under oath or affirmation.

Against this background of an adjudicator striving to come to grips with the cases of the two parties
within a limited timescale, what might be the role of the expert and their evidence? In truth their role and
contribution must be significantly different from that in litigation or arbitration.

Because an expert gives evidence of their opinion, based upon the facts, the evidence they give can be
characterised as “this is how it is, because that’s what I think”. In some construction cases that might be
the start and the end of the opinion (for example, whether workmanship meet a subjective criteria such
as “to the architect’s reasonable satisfaction”). However in most cases there will also be much
explanation and justification provided to support the opinion ultimately given, meaning that the
explanation and analysis underlying the opinion is often as important and as relevant as the opinion
itself.

In litigation or arbitration (at least in this country) experts are under a formal duty to assist the tribunal by
providing objective, unbiased opinions on matters within their expertise. Any evidence must be
independent and not influenced by the pressures of the litigation, and be based upon a consideration of
all material facts, including those which might detract from their opinions (CPR 35, Practice Direction,
paragraphs 2.1 to 2.3). Any expert who is tempted to disregard this duty needs only to remind
themselves that they face the prospect of very clever people, sometimes in wigs, holding them to
account in cross examination and also the possibility of a few well chosen (and potentially career ending)
comments from a judge. Aside from whatever professional standards and personal integrity the expert
may possess, these two added incentives help to focus the expert’s mind and opinion when preparing a
report, when meeting with other experts, when preparing joint statements and when actually giving evidence.

In adjudication the procedures adopted mean either that none of these checks and balances exist or, if they do exist, they are in a very limited form. Any expert appointed by a referring party may prepare their report having only a limited understanding of the other party’s case (i.e. without the benefit of formal pleadings identifying the points that are actually in issue), and even if the other party is able to appoint an expert timescales are such that anything other than the most perfunctory of experts’ meetings are unlikely to take place, and will certainly not be an opportunity for each to scrutinise and consider the position of the other. Finally, and perhaps most importantly, any opportunity to test the work of the expert in a meeting or hearing is likely to be limited and, because of the potential imbalance in preparation times that is likely to exist as between the referring and responding parties, may be ineffective due to a possible absence of corresponding expertise proffered by the other party.

All of this places a heavy duty upon both the adjudicator to determine what weight to attach to any particular expert evidence and also upon the expert to ensure they are mindful of their overriding duty to the tribunal. Additionally they must be aware that if they fall short of the required standard, the natural inclination of an adjudicator faced with the pressures of producing a timely decision may be to disregard or discount evidence from any source considered to be unreliable, and not waste time trying to dissect the good points from the bad.

Whilst the process of adjudication does not lend itself to the checks and balances of, for example, litigation, potential experts should not overlook the fact that their various professional bodies may impose requirements upon their conduct in such situations. Thus, for example, the RICS publishes a practice statement and guidance note entitled “Surveyors acting as expert witnesses” (currently in its 3rd edition) which applies whenever an RICS member gives expert evidence to any tribunal in the United Kingdom. The definition of tribunal expressly includes adjudication under the Act, and a failure to comply with the practice statement may have disciplinary consequences for RICS members.

So, how should either an adjudicator or expert approach the use of expert evidence in adjudication? I suggest the expert is likely to be most effective when explaining as opposed to simply stating an opinion, and that when this occurs there is the opportunity for a competent expert to analyse and present factual information to the adjudicator in a manner which helps the adjudicator to reach their own decision, as opposed to actually relying upon any opinion expressed by the expert.

When analysing and presenting factual information in this manner the expert will still have to be conscious of the duty to do so independently and in an objective and unbiased manner, such that the analysis and presentation will properly assist the adjudicator. This will include a consideration of any arguments advanced by the other party or, where none have been advanced, those that might be anticipated. In other words, it must consider all points of view, not only those favourable to the expert’s client. Unless the process of analysis and explanation is clearly undertaken in an open and balanced manner, the expert’s work will be seen to be partisan and run the risk of being discounted altogether. Whilst there is a place for partisan submissions in adjudication, and whilst they might be prepared by the same person who on other occasions would be appointed as an expert, they should not be presented as expert reports lest they be disregarded altogether.

All of which can well place the expert in a more difficult position than in either litigation or arbitration as, instead of the pressures imposed by the prospect of cross examination and/or censure by the tribunal, the only pressure imposed (be it implicit or explicit) will be by the client. To be successful, and to give the client the service it deserves, the expert will need to resist these pressures and be able to clearly
demonstrate the independence of the analysis and explanation that is put forward.

So yes, in appropriate cases there is definitely a place for experts in adjudication, but the parties must appreciate that any expert evidence is likely to play a different role in the proceedings (more explanation, less pure opinion) and also that to be effective any expert they appoint must be both allowed act independently and be seen to be acting independently, if the adjudicator is to attach any weight to what is said.

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**Betterment – A Balancing Act**

By Julia Batchelor-Smith,
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Picture this: four years ago, you bought a six-year-old house. The original owners had painted it an unattractive shade of terracotta. You intended to re-paint it in the next few years – and perhaps replace the tiles on the balcony at the same time – but you certainly had no imminent plans to launch into large-scale maintenance when the house was still relatively new.

Fast forward a couple of years. To your absolute horror, you discover that your home, like many thousands of others in New Zealand, leaks. After a protracted and stressful process of procuring an assessor’s report, remedying the extensive defects and finally, submitting and progressing your claim, you find yourself at a mediation with the defendants and their lawyers.

From your perspective, the incomprehensible is happening: not only are these people responsible for your leaking home, but they now have the gall to mercilessly dissect your breakdown of quantum and argue that they should not be responsible for the full cost of the repairs. Why should we have to pay for that pricey replacement plaster complete with cavity system that you (and most likely, your expert) selected, they ask? Was the change in tiles on the balcony really necessary? And why should we have to subsidise your premium paint choice of Karen Walker Cliff Face Grey, when the original paint was ten years old and at the end of its usual life?

Fair enough, you may say – you were going to re-paint anyway. But what if you weren’t? Maybe the paint still had a few years left...

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Betterment occurs when a plaintiff’s compensation exceeds the loss that has been suffered. This fractious issue often crops up in leaky building cases, when it is difficult (and sometimes impossible) to repair a property without putting it into a better condition than it was prior to the damage occurring.
in it. And why should you be penalised for having updated plaster and cavity system when that was now required by the Council?

**What is betterment?**

Betterment occurs when a plaintiff’s compensation exceeds the loss that has been suffered. This fractious issue often crops up in leaky building cases, when it is difficult (and sometimes impossible) to repair a property without putting it into a better condition than it was prior to the damage occurring.

The question of betterment goes to the measure of damages. The fundamental object of damages is to financially restore the plaintiff, as best as possible, to the position it would have occupied – but no more – if the defendant had not breached its duty to the plaintiff.

The issue of whether a plaintiff is entitled to a bonus (be it perceived or real) of an increment in value is far from clear cut. The perceived windfall that the plaintiff has received as a result of the award against the defendant must be weighed against the cost to the plaintiff of that unplanned investment, which is often a difficult and emotionally-fraught task.

**The traditional view**

Until comparatively recently, the established common law rule was that no deduction should be made from the plaintiff’s damages to offset necessary betterment. The general principle was set out in Harbutt’s Plasticine Limited v Wayne Tank and Pump Co Limited [1970] 1 All ER 225 (EWCA): the plaintiff should be entitled to the full replacement cost without deduction for betterment if due to the defendant’s wrongdoing, the plaintiff had no other option but to purchase the substitute item that it did.

In Harbutt’s, the plaintiff replaced its destroyed factory without adding any additional features in the process. Whilst the plaintiff ended up with a superior asset, Widgery LJ held that a deduction for betterment was not appropriate as it would be tantamount to forcing the plaintiff to invest its money, which might be highly inconvenient. In the subsequent decision of Bacon v Cooper (Metals) Limited [1983] 1 All ER 397, Justice Cantley opined that this approach would be inappropriate where it would lead to an “absurd” result.

**Betterment in New Zealand**


Mr and Mrs Caldwell owned the land and buildings and Caldwell Limited (Caldwell) owned the rest-home business. Mr and Mrs
Caldwell agreed to sell the business and property to Logan House Retirement Home Limited (Logan House). It was subsequently discovered that Caldwell had breached the sale and purchase agreement by, amongst other things, removing certain chattels and leaving chattels in an unacceptable condition.

The District Court found that Caldwell had indeed breached the sale and purchase agreement and awarded $34,639 to Logan House for missing chattels. Caldwell appealed to the High Court, arguing that the District Court erroneously applied a reasonable replacement cost measure of damages and ought not to have adopted adjusted book values over valuation evidence.

In the High Court, Fisher J described betterment as “the unexpected improvement in the plaintiff’s position”. His Honour considered three key issues pertaining to betterment:

- Would a plaintiff be entitled to a full indemnity where new replacement items were purchased, or must a plaintiff credit for betterment?
- What was the measure of betterment?
- Who had the onus of proving or disproving the presence and extent of betterment?

Fisher J examined the competing ways in which overseas Courts have dealt with betterment. At one end of the spectrum, no allowance for betterment was made; however at the other, it was held to be appropriate to deduct in full the increase in value of the restored or substituted asset with little or no recognition of the cost of the unplanned and unwelcome investment of capital forced upon the plaintiff.

Fisher J concluded that neither extreme properly accords with the fundamental object of damages. His Honour instead adopted a “middle ground”, which deems a deduction for betterment appropriate only after allowance to the plaintiff for any disadvantages associated with the involuntary nature of any additional investment that has been made.

The result in Caldwell was sub-optimal for the appellants: Fisher J concluded that they had failed to prove the existence and extent of betterment given their failure to lead evidence on the subject beyond establishing that the valuer knew the meaning of the word “betterment”.

**Caldwell in a leaky homes context**

The Caldwell decision was considered in a leaky homes context in La Grouw v Cairns (2004) 5 NZCPR 434.
La Grouw involved a successful appeal by Ms La Grouw against quantum of damages awarded in the District Court. Ms La Grouw (in her capacity as trustee) originally commenced proceedings against Mrs Cairns, alleging Mrs Cairns misrepresented to her at the time of purchase that there were then no leaks in the house. Ms La Grouw sought judgment of a total of $93,700.82 ($84,000 for remedying leaks based on report by her expert, Mr O’Sullivan, and costs already incurred) and $20,000 general damages for distress and inconvenience. Judge Cadenhead awarded Ms La Grouw $30,000 for damages but declined to award any sum for general damages.

On appeal, O’Reagan J decided that the appropriate way of calculating damages was to start with providing a solution which will clearly make the house one which is appropriately constructed to avoid water damage (as proposed by Ms La Grouw’s expert, Mr O’Sullivan). Mr O’Sullivan had accepted that the proposal to replace the roof was more than remedial. This led to the consideration of whether an allowance for betterment ought to be made, because the house would be built to higher standards than those applied in the building of the house.

O’Reagan J referred to Caldwell as summarising the law relating to betterment. Applying that case, O’Reagan J held that it was necessary to determine whether the property, after the completion of the work suggested by Mr O’Sullivan, would be more valuable than a property complying with the contract (that is, a house which did not have a leaking problem, but which otherwise had the characteristics of the property purchased by Ms La Grouw). His Honour held that the next step was to make allowance for the involuntary nature of what would effectively be an additional investment in the property by Ms La Grouw. O’Reagan J noted that Fisher J held in Caldwell that a defendant had the onus of showing that betterment had occurred and that in His Honour’s view, the defendant had failed to discharge that onus.

Whilst O’Reagan J concluded that the evidence advanced by Mrs Cairns did not establish betterment in a Caldwell manner, His Honour did make allowance for betterment of less than $2,000 in calculating the breakdown of costs for the net repair of the building.

When acting for a plaintiff, counsel will need to ensure that their client’s claim is as best insulated against an assertion of betterment as possible. In a leaky homes context, steps that can (and should) be taken include appointing an appropriately qualified expert to assess and implement remedial decisions and preemptively deducting any known betterment (such as re-painting, when such painting was clearly appropriate) from the claim quantum.

**Issues for counsel**

As the vast majority of leaky homes cases never go to trial, it often falls to lawyers to battle out the issue of betterment across the mediation table. Clearly, counsel will need to consider quite different factors when acting for a plaintiff than when acting for a defendant.

So who does establishing the onus of proof fall to - the plaintiff or the defendant? In *Caldwell*, Fisher J concluded that once the
plaintiff has discharged the onus of proving the existence and amount of the unexpected expenditure caused by the defendant’s default, the onus shifts to the defendant to prove not only the presence of betterment, but also its quantum or value. In other words, the plaintiff has the onus of proving both the presence and quantum of its loss, while the defendant has the onus of showing that betterment has occurred.

From a defendant’s point of view, counsel will need to be vigilant in assessing claims for betterment and taking appropriate analytical steps to prove that betterment has occurred. In La Grouw, O’Reagan J held that the defendant must advance an analysis of the respective values of the house which did not leak (but was built of the original materials in accordance with the building codes applying at the time of the house’s construction), against the house as it would be after the completion of the work suggested by Mr O’Sullivan. That would allow for a quantification of betterment and then an appropriate allowance would be made for the involuntary investment required on the part of Ms La Grouw in achieving that betterment in accordance with the approach outlined by Fisher J in Caldwell.

When acting for a plaintiff, counsel will need to ensure that their client’s claim is as best insulated against an assertion of betterment as possible. In a leaky homes context, steps that can (and should) be taken include appointing an appropriately qualified expert to assess and implement remedial decisions and pre-emptively deducting any known betterment (such as re-painting, when such painting was clearly appropriate) from the claim quantum.

**A balancing act**

After deciding that a defendant is liable and the quantum of that liability, the Court, Weathertight Homes Tribunal (or more often than not, lawyers and experts at mediation) must ascertain whether remedial works will do (or have done) more than merely restoring the property to the condition that it would have been in if it had not been a leaky home.

Fairly identifying and quantifying betterment is a balancing act which will continue to challenge the judiciary, counsel, plaintiffs and defendants alike.
Letters to the Editor

In response to the article by Mr. Derek Firth on Leaky Home Liability in the BuildLaw Issue No 5, Mr Len Cadzow Life Member MBF & OMPA FNZIOB provided an interesting commentary on the interrelationship between the history of the building industry and the problems now faced by home owners. We have reproduced an abridged version of the article below:

WHERE THE PROBLEM COMMENCED

In the mid 1960's redundancy pay became an issue with the Carpenters Union and on March 24, 1968 a redundancy pay agreement was signed between the N.Z. Carpenters Union and the N.Z. Master Builders Federation on behalf of all N.Z. builders.

In 1970 the first (of many to follow) commercial construction companies became bankrupt due to redundancy pay demands made against it by the Carpenters Union. The concerns of housing builders then became paramount, and labour only contracting caught on and soon became the norm, particularly in the North Island. This system of employment had a devastating effect on New Zealand carpentry apprenticeships and by 1974 the traditional New Zealand apprenticeship system virtually collapsed.

By 1976 the Master Builders Federation came to realise there was a huge problem looming within the housing sector. Non tradesmen were becoming labour only contractors, and the avalanche of work demanded of Local Authorities became the norm as unskilled owners acting as contract managers and as labour only contractors, fought for the attention of Local Authority Building Inspectors as they sought construction advice.

Following the 1979 Annual Conference a submission was presented to the Minister of Housing the Hon Derek Quigley. In support of the submission a list of ten matters were prepared in which it was argued that unless the registration of builders was introduced and put into effect, ten serious problems would occur. Master Builders received a negative response from the Government including a veiled suggestion that the MBF was attempting to create a cartel for the Building industry.

In 2002 the then Prime Minister Helen Clark announced her Government was going to introduce the Licensing Of Building Practitioners, and she supported the Governments move by reading a list of ten matters which she claimed "had happened" as a result of faulty domestic construction work. It was the same list and in the same sequence as had been presented to the Government of the day, twenty three years earlier by the late Mr Les Street, Executive Director of NZMBF.

I am compelled to ask why Helen Clark's Government have come in for so much stick for the leaky home issue when the primary problems associated with leaking and rotting homes were so well established when her Government took office.

Take the issue of the use of untreated timber where I hold a different view to Mr. Derek Firth.

On the issue of untreated timber and the B.I.A., the writer's involvement knows the situation to be as follows. In the early 1990's while the writer was a member of M.B.F. Management Council, the Auckland Master Builders Association brought a submission to Management Council seeking Federation's support for the use of untreated Radiata timber in house frame construction. The three South Island members on the Council at that time, from Malborough, Canterbury and Otago, were aghast at the idea, however, the rest of the North Island members supported the Auckland proposal, and as a result an application was made to the BIA for an amendment to the N.Z.Building Code. From my understanding of what happened, and contrary to Mr Firth I do not believe the BIA deemed untreated timber suitable on its own volition.

CONCLUSIONS

How is it that what was once a simple agreement between two parties where one party would agree to erect a building for the other party, for a specified sum of money, paid over the period of
construction, could have become such a complicated ritual, employing hoards of people (75% of whom are non producers) over the last 40 years, surely begs the question, how did they manage over the previous 1970 years?

And when we read the proposals for rectification, how much is aimed at protecting the consumer, and how much is aimed at keeping the non producing hoards in employment at the expense of the consumer? New Zealand’s housing problem developed from the refusal to control the unskilled. Did past administrations never learn, that a little knowledge is a dangerous thing. Instead of supporting the old theory of those who can, will, those who can't, will inspect, perhaps it would be better to clearly understand and get to grips with the fundamental problem.

Len Cadzow

Dear Len,

Building (and getting paid for building work) has always been problematic and in recent years it would seem it has got a whole lot harder and more bureaucratic. But underlying those difficulties, be they real or perceived, the same basic issues present in almost every building dispute.

It would seem that successive governments and tradespeople have simply failed to learn the valuable lessons to be taken from history – indeed the same sentiment could equally apply to the entire ‘civilized’ world!

However, irrespective of responsibility for decisions that were made in the past, decisions most likely to have been made by very well intended and professionally informed people, the real judgment will always bear on those who come to learn of the shortcomings of such decisions and do nothing with that knowledge. That is the criticism universally directed at the BIA in relation to the leaky building problem. Arnold J’s comments in Sunset Terraces at para [210] are right on point.

In the end, to err is human - to fail to intervene to eliminate a known problem of potentially disastrous proportion is simply unconscionable – even for bureaucrats!

Ed.

We welcome letters to the editor

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- Include you full name and contact details
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