#118

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2010-404-000029

BETWEEN	DONOVAN DRAINAGE & EARTHMOVING LIMITED Appellant
AND	HALLS EARTHWORKS LIMITED Respondent

Hearing: 13 May 2010

Appearances: R J Bowden for Appellant
P J Dale and D W Grove for Respondent

Judgment: 10 November 2010 at 11:00 am

JUDGMENT OF COURTNEY J

This judgment was delivered by Justice Courtney
on 10 November 2010 at 11:00 am
pursuant to R 11.5 of the High Court Rules.

Registrar / Deputy Registrar
Date.....

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Introduction

[1] The appellant, Donovan Drainage & Earthmoving Ltd, appeals Judge Sharp's decision giving judgment in favour of the respondent, Halls Earthworks Ltd (in liquidation).[1] Donovan had engaged Halls to undertake construction work on a subdivision for which Donovan was the head contractor. The issue between the parties was whether they had contracted on a lump-sum basis or a measure-and-value basis. The Judge accepted Halls' argument that the contract was on a lump-sum basis.

[2] Donovan raised 15 points on appeal. The first was the general premise of the appeal that the Judge was wrong to find that the contract was entered into on a lump-sum basis rather than a measure-and-value basis. The remaining grounds can be conveniently summarised as follows:

a) The Judge made an error of fact in finding that the head contract was a lump-sum contract;

b) The Judge's conclusion that the total price claimed by Halls included a margin was against the weight of evidence which pointed to the figure actually being the result of a mistake in adding line items;

c) The Judge misinterpreted Donovan's letter to Halls 21 December 2005 as evidence of a lump-sum contract rather than a measure-and-value contract;

d) The Judge was not entitled to draw the inference she did that Mr Donovan was happy with the price until he realised it contained a large margin;

e) The Judge misinterpreted and placed too much weight on Halls' finance application to Nationwide which referred to its profit margin;

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[1] District Court Auckland CIV-2008-004-000006, 1 December 2009

f) The Judge's credibility assessment of the witnesses Adrian Halls, Andrew Bax and Allen Gordon could not be justified;

[3] One witness, Mr Sweeney, had given evidence (then unknown to the Court) on the basis of a success fee in the event of Halls prevailing at trial.

[4] The approach to a general appeal such as this is explained in *Austin Nicholls & Co Limited v Stichting Lodestar*.[2] The appellant has the burden of satisfying the appellate court that the lower court's decision was wrong. If the appellate court reaches that conclusion, the appellant is entitled to a fresh assessment by the appellate court.

Background and relevant principles

[5] In late 2005 Donovan obtained the head contract for civil engineering works for a residential subdivision in Whangarei. The principal was Blitzen Investments Ltd. In November 2005 Donovan invited Halls to tender for part of the contract works. It sent Halls a draft contract schedule showing various line items that Donovan had contracted to provide under the head contract but with Donovan's prices removed. Greg McLeod of Halls completed the schedule, handwrote what might have been subtotals at the foot of each page and inserted at the top of the first page figures showing a GST exclusive figure of $557,811.58, the amount of GST and a GST inclusive total (these two latter figures are not relevant for present purposes). Donovan queried specific items where Halls' rates had differed from Donovan's own rates. Halls provided a revised contract schedule which had only handwritten totals at the top. The revised GST exclusive total was $550,070.50. Donovan advised its acceptance of Halls' tender orally by early January 2006.

[6] For reasons connected with the resource consent applications work did not commence until July 2006. This is when the dispute between the parties began. Donovan forwarded sub-contract documentation to Halls for signature in accordance with the terms of the head contract. Halls, however, advised that the agreed price for

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[2] *Austin Nicholls & Co Ltd v Stichting Lodestar* [2008] 2 NZLR 141

the sub-contract was $557,811.58 (presumably intending to refer to $550,070.50 in accordance with the revised schedule).

[7] It was around this time that a quantity surveyor engaged by Halls, Mr Sweeney, added up the amount on the revised schedule and found a difference of $108,688.87 between the scheduled work items and the handwritten GST exclusive total at the top of the page. On enquiring as to the difference he was told that it represented "preliminary and general and margin" and he prepared the next payment claim on that basis.

[8] Donovan insisted that the contract had been on a measure-and-value basis and that it had contracted on the basis of the various line items identified in the revised contract schedule (which totalled $441,381.63 plus GST). Halls maintained that the contract was on a lump-sum basis and the contract price was $550,070.50. The parties referred their dispute to arbitration under the Construction Contracts Act 2002. The adjudicator determined that the contract was a lump-sum contract for a fixed price of $550,070.50 plus GST. Donovan brought proceedings in the District Court seeking a declaration that the sub-contract was on a measure-and-value basis.

[9] The parties were agreed that the contract was reflected in Halls' revised schedule. The question whether the parties had agreed on a lump-sum contract or a measure-and-value contract required the Court to ascertain the meaning that the document would convey to a reasonable person having all the background knowledge reasonably available to the parties at the time they entered into the contract. Such background knowledge would include "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man", provided it was reasonably available to the parties at the time.[3]

[10] Previous negotiations between the parties and declarations of subjective intent have always been and still are excluded from the background information the Court can take into account. However, it would now appear from the Supreme

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[3] *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 AllER 98 (HL) at 114-115 adopted in New Zealand in *Boatpark Ltd v Hutchinson* [1999] 2 NZLR 74

Court's decision in *Gibbons Holdings Ltd v Wholesale Distributors Ltd* that the parties' subsequent conduct can be taken into account, provided it is mutual or shared conduct objectively capable of assisting in the ascertainment of the shared intention of the parties.[4]

Nature of the head contract

[11] Donovan's position was that the head contract was a measure-and-value contract and that any sub-contract would have been entered into on the same basis. But the Judge found that:

> ...The evidence however reveals that whether it was treated as a measure-and-value contract or not, the head contract was actually a lump-sum contract...

[12] This finding was based on a letter from Lands & Survey Ltd (subdivision and resource consent consultants) 15 June 2006 confirming Donovan's success as the tenderer for the construction works on the subdivision. That letter stated:

> The tendered price for the works is $1,063,108.31 inc GST.

[13] Attached to the letter was the first schedule of the contract, clause 2.1.1 of which recorded that the contract was a lump-sum contract.

[14] Mr Donovan, however, asserted in his evidence that, although the contract was originally agreed as a lump-sum contract, as the design progressed that agreement changed and it became a measure-and-value contract. There was nothing recorded in writing to that effect but Mr Donovan's evidence was supported by Mr Bax, the engineer's representative on the head contract. He said that when he became involved in the contract in early January 2006, it was being run on a measure-and-value basis.

[15] In addition, Donovan's general manager, Mr Gordon, said that Donovan was asked for prices on the same basis as a measure-and-value contract and since the

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[4] *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2008] 1 NZLR 277 at 296-297

design had not been completed it was not possible to give a reasonable assessment of volumes or quantities.

[16] Mr Donovan also asserted that his employee, Mr Gordon, had made Halls aware before starting work that the contract was a measure-and-value contract. Mr Halls, however, denied any such advice and Mr Gordon did not give evidence to that effect. I note that Mr Halls was not responsible for the sub-contract tender and Mr McLeod did not give evidence. There is, however, no evidence that Donovan made Halls aware of the nature of the sub-contract.

[17] It is clear from the evidence that by January 2006 Donovan had already obtained the head contract and the agreement between Donovan and Halls had also been concluded by early January 2006. The letter from Lands & Survey, written six months later, is not a contractual document. It was not written by either party and is therefore not subsequent conduct by the parties to the sub-contract that could assist in interpreting the sub-contract. The letter was therefore inadmissible and should not have been taken into account at all. The weight of the remaining evidence clearly did not support the Judge's finding that the head contract was on a lump-sum basis, with both parties to the head contract confirming that it was on a measure-and-value basis.

Did the GST exclusive total reflect a margin or was it the result of errors in adding?

[18] Donovan argued that the GST exclusive total on the first page of the revised schedule was the result of errors by Mr McLeod in adding the "amounts" columns. Halls argued that the figure reflected the total of the "amounts" columns together with a margin. Donovan's approach to this issue relied in part on showing that Mr McLeod had made errors in adding the "amounts" columns in the draft schedule and had effectively carried through those errors to the revised schedule. Therefore, the difference between the actual total of the "amounts" columns and the GST exclusive total on the first page was more likely to be the result of arithmetical error than the deliberate addition of a margin.

[19] Mr McLeod, who now lives in Australia, did not give evidence. However, Mr Bowden, for Donovan, conducted the following analysis of the schedules; in Halls' draft schedule the "rate" and "amount" column was completed by hand with a handwritten figure at the bottom of each page. Out of the six pages, three have totals at the foot of them that reflect the actual total of the amounts shown on that page of the schedule. The other three, however, have totals at the foot of the page which do not reflect the total of the amounts. On page 1 there is a difference between the actual total and the total shown of $11,010. On page 4 there is a difference of $48,907.50. On page 6 there is a difference of $1,170. The actual total of the line amounts was $476,724.08 but the handwritten sub-totals came to $525,631.58. Neither of those figures appeared anywhere but the GST exclusive total of $557,811.58 shown on the first page of the schedule was so close to the total of the incorrectly recorded sub-totals as to make it more likely than not that the incorrect sub-total figure was the basis of the GST exclusive total.

[20] In response to Halls' claim that the difference of $81,087.50 between the $476,724.08 and $557,811.58 represented the added margin, Mr Bowden argued that this was inconsistent with the way Mr Halls later explained his (and presumably Mr McLeod's) method of preparing a schedule such as this, which was to include the line item at cost and add whatever margin was desired to the sub-total at the bottom of the page. Mr Bowden pointed out that, on this approach, no margin at all would have been added to the sub-total at pages 2, 3 and 5, which exactly reflected the total of the line items. On page 4 the difference between the correct and handwritten sub-total was $48,907.50. The similarity between that figure and the correct total on page 6 of $47,207.50 suggests that Mr McLeod had mistakenly added the totals of pages 4 and 6 together.

[21] The Judge gave no real weight to this argument, which Mr Bowden submitted was an error. Rejecting the expert evidence supporting Mr Bowden's argument as unhelpful, the Judge held:

> [26] In particular, I found it of no assistance that the plaintiff's witnesses attempted to take the Court on a lengthy and complicated arithmetical analysis of Halls' schedules in order to prove its premise that the preliminary and general and profit figure was not that but merely a mistake of calculation. They could not prove such a thing since they did not create the

> calculation, were not present at the time that the relevant schedules of workings were composed, nor was their author (Greg McLeod) present to be cross-examined. Thus the plaintiff's premise was nothing more than supposition which could not be proved on the balance of probabilities.

[22] I do not think that the argument being advanced was merely supposition; had the draft schedule been a contractual document, Mr Bowden's argument could have had merit. However, the draft schedule was part of the pre-contractual negotiation and therefore inadmissible. The contractual document was the revised schedule and it was that which the Court was required to interpret.

[23] The revised schedule, unlike the draft schedule, did not show handwritten sub-totals on each page. It showed only the various line items and, on the first page, a handwritten GST exclusive figure of $550,070.50, a GST amount and a GST inclusive total of $618.829.31. Mr Bowden's argument could therefore not be advanced in relation to the revised schedule. The question of whether the figure of $550,070.50 was a mistaken attempt to record the total of the "amounts" columns or whether it was a figure deliberately selected to reflect the "amounts" columns and a margin had to be determined solely by reference to that document and the relevant surrounding circumstances (which did not include the draft schedule for the reason just given).

[24] The fact that Halls had completed the schedule by including rates for each line item did not indicate one way or the other whether the contract was a lump-sum or measure-and-value; rates for line items might be given in both situations. However, Donovan's second argument was that, by reference to its own prices on the head contract and industry practice it was more likely than not that the rates for the various line items already included a margin, therefore the difference was not explicable as a margin. Conversely, if the rates did not contain a margin the difference between the total of the rates prices and the GST exclusive figure on the first page was explicable as a margin.

[25] The first piece of evidence on this issue came from Mr Halls, who said that Mr McLeod had completed the schedule of quantities and given them to him to review:

> I specifically discussed the schedule with Greg. He confirmed that the prices in the schedules had been inserted as a cost price. This meant the profit margins such as set-up, insurance and general overheads had to be added. If these sums were not added Halls would not have made a profit on the works.

[26] There was no objection recorded to this hearsay evidence and I assume that it was accepted that Mr McLeod was unavailable within the meaning of the Evidence Act 2006.

[27] Mr Gordon, Donovan's general manager, addressed this issue in his evidence. He referred to a rate comparison (which document was not before me but apparently formed part of the common bundle at trial) which set out prices at which Donovan had obtained material and estimated labour costs. I perceive the effect of Mr Gordon's evidence to have been that by comparing the known materials and labour rates used by the plaintiff with Halls' rates, a margin in each case would have been available at between 5% and 20%. Mr Donovan gave evidence along the same lines, identifying various examples of rates, known by him to be available in the industry, with Halls' rates, which all suggested that there would have been a margin built into Halls' rates.

[28] However, this evidence was countered by Mr Bax, the engineer's representative on the head contract, who said that Donovan had certified under the head contract for payment of $615,158.74 plus GST for work completed by Halls. In comparison, Halls had claimed for the same work the amount of $544,688.43 plus GST. If Donovan had paid this amount its profit on this work would have been 13%. This would be within the industry standard of 10-15% profit margin. In comparison, he calculated that Donovan's profit, in the event that it is liable to pay $441,252.44 (the actual total of the line items in the revised schedule), would be 39% which is well over the industry standard.

[29] In addition to Mr Bax's evidence, Mr Sweeney gave quite extensive evidence aimed at establishing that, contrary to Mr Gordon's and Mr Donovan's evidence, his rate comparison (which included a comparison by reference to the industry handbook, *Rawlinsons*) showed that the rates used by Halls were well under the industry average, suggesting a reflected costs only. I have to say that Mr Sweeney's

witness statements were quite unsatisfactory in that there appeared to be more argument and speculation than evidence.

[30] The comparisons made by Mr Donovan, Mr Gordon and Mr Sweeney were very difficult to reconcile. I felt unable to undertake that task adequately because I did not have the exhibits on which some of these comparisons were based. The Judge appeared not to have attempted a reconciliation at all. She seemed to be influenced, however, by Mr Bax's evidence. Her findings in relation to the margin argument were:

> [28] ...the evidence reveals that if Halls is paid the amount for which summary judgment was given in the High Court, Donovans will still have made a a15% profit on the sub-contract, the usual margin on a job such as this (Andrew Bax's evidence accepted) to a contractor on a sub-contractor's costs at the time being between 10 and 15%. This evidence was not challenged by the plaintiff's witnesses.
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> [29] Interestingly, if I had found that the contract was a measure-and-value (in which case there would be no allowance for Preliminary and General and margin) the profit to Donovans would have been 39%, a profit rate which the evidence revealed as "good if you could get it". The actual profit to Halls on this lump-sum contract would have been 24% without the legal costs involved in all the litigation which has been occasioned over this dispute.

[31] Although a real issue was taken with Mr Bax's credibility (which I come to later) there is no challenge to these findings and no challenge to Mr Bax's evidence regarding the respective profit calculations. Although it would have been desirable for the Judge to have referred in some way to the conflicting evidence on rates comparison, given the confused state of that evidence it was unlikely to provide any basis for determination of the issue. The evidence from Mr Halls that Mr McLeod had told him the line items were based on costs only, coupled with Mr Bax's evidence as to the probable profit on the respective positions, provides an adequate basis for finding that, more likely than not, the line items did reflect costs only and did not include a margin.

Letter 21 December 2005

[32] The revised contract from Halls was provided in response to a letter from Donovan 21 December 2005 (effectively a counter-offer). The Judge attributed

some significance to this letter in concluding that Halls had quoted for a lump-sum contract:

> [27] On the balance of probabilities I am satisfied that Halls quoted for a lump-sum contract. On 21 December 2005 Donovans wrote to Halls stating "Thank you for your price…." Whilst Donovans queried some of the rates, asking Halls to submit a further schedule (which Halls did with a varied price at the top) I find that Donovans knew the basis upon which Halls had quoted (i.e. lump-sum) and when ultimately the revised schedule with the revised contract sum on the top was proffered Donovans was happy with the price because there was a profit in it for them…

[33] Mr Bowden submitted that the Judge had failed to take account of the letter as a whole and, by focusing on the opening words "thank you for your price" had failed to properly appreciate the meaning of the letter.

[34] The full sentence read:

> Thank you for your price concerning these works. Some queries concerning the rates that you submitted particularly where the rates differ significantly from ours…
>
> Traffic management plans, insurance and management plans are our responsibility as the head contractor…

[35] There followed a list of several items from the schedule in which Donovan had advised its price (which would have been previously unknown to Halls) and asked whether Halls would be interested in matching its price. In the revised schedule that was sent by Halls in response to that letter the rates on the queried items had been changed from the draft schedule to match those proposed by Donovan.

[36] Mr Bowden submitted that these changes to rates would only occur in the context of a measure-and-value contract. Mr Dale, for Halls, had no response to this point. I consider that the Judge erred in placing weight on this letter as showing that Donovan had appreciated that Halls' quote was on a lump-sum basis. It did not have that effect.

Inference that Donovan had knowingly accepted a lump-sum offer

[37] In evidence Mr Donovan said that although he checked the rates in the Halls' quote "meticulously" he did not add them together to reach a total and assumed that the figures at the top of the two schedules were, in fact, the total of the amounts columns. On the basis of this evidence the Judge made the following finding:

> [20] What is also apparent from Mr Donovan's evidence is that it was not until Donovans received Halls' Payment Claim No 2 which identified the margin and he added the amounts column on the revised schedule, that he ever queried the total price. Therefore the evidence justifies the inference that Mr Donovan was quite happy with that price until he realised that it contained a large margin.

[38] Mr Bowden submitted that the evidence did not justify the inference drawn by the Judge because Mr Donovan's evidence was clear that his only interest was the rates for the individual items. He did not pay any attention to the total at the top of the page, simply assuming that it was the total of the rates. I accept this submission.

[39] It is obvious from Donovan's letter 21 December 2005 that he had carefully reviewed the various rates proposed by Halls, and that his interest was obtaining the best possible rate. An assumption that the total figure on the front of the schedules reflected the total of the amounts columns was consistent with this. Further, this evidence ought to have been considered in the context of the evidence I have already referred to regarding Donovan's rates compared to Halls' rates.

[40] Nor did the evidence regarding when the price was first queried justify the inference that the Judge drew. Mr Bowden submitted that the first payment claim made on 14 July 2006 was presented on a measure-and-value basis and it was not until the second payment claim was received on 31 July 2006 that it was apparent that a figure of $108,688.87 was being claimed for preliminary and general and margin.

[41] The fact that it was not apparent from the face of the revised schedule that a figure of this size was included as margin is evidenced by the fact that Mr Halls himself said that he did not realise there was a difference at the time he discussed the schedule with Mr McLeod and Halls' consultant, Mr Sweeney, and only realised

there was a difference when he worked through the schedule himself and drew the difference to Mr Halls' attention. In these circumstances, the fact that Donovan did not query the price until July 2006 does not indicate anything about the state of the parties' minds at the time they entered into this contract.

Nationwide finance application

[42] One of the pieces of evidence that the Judge accorded weight in finding that Halls had tendered on a lump-sum basis was a document prepared by Halls and included its application for finance with Nationwide. This document showed a summary of the Blitzen sub-contract and contained a breakdown of the items (metals, concrete, miscellaneous, drainage and hire equipment) and a summary of labour costs. At the foot of the summary was noted "contract price incl GST $618,829.31" and "profit margin $100,063.44".

[43] The figure shown as the profit margin was slightly over $100,000. This compares with the figure of $108,688.87 which Halls asserted throughout the trial was the correct margin figure. Mr Sweeney, Halls' expert witness, suggested that the inconsistency was explicable by the apparent addition of GST to the expenses figure prior to deducting that figure from the contract price to reach the profit margin which is probably right (and which explanation the Judge accepted).

[44] At [22] the Judge concluded that:

> ...The inclusion of a profit margin in the document indicates that Halls believed they had entered into a lump-sum contract.

[45] Mr Bowden, however, submitted that the fact that a profit margin is referred to cannot, in itself, indicate whether the contract was a lump-sum contract or a measure-and-value contract because one would expect there to be profit in both types of contracts. This must be right. But there is a more fundamental issue with this letter. Like the Lands & Survey letter, it is evidence of subsequent conduct which lacks mutuality. Further, it is offered solely as evidence of Halls' subjective belief as to the basis on which it had contracted. It was inadmissible on both grounds and should not have been taken into account.

Credibility findings

[46] Donovan challenged three credibility findings that the Judge made. The first was her favourable assessment of Mr Halls:

> [23] I found Adrian Halls to be a thoroughly credible witness. His evidence was consistent and he never deviated from the central proposition of the defence case – that this was a lump-sum contract. He admitted that because the calculations were all done by his employee Greg McLeod he only knew the total price and not the specific amount of the preliminary and general and profit margin until his consultant quantity surveyor Mr Ian Sweeney pointed out the difference between the schedule of rates column addition and contract price. He was just satisfied that it was a lump-sum contract containing a profit margin and that Halls' price had been accepted by Donovans.

[47] The fact that Mr Halls had not been involved in the preparation of the contract schedule and, judging from the fact that he missed the significant arithmetical errors in the subtotals in giving approval to the final total, means that the scope of relevant evidence that he could give was very limited. Indeed, the only directly relevant piece of evidence he could give was his evidence that Mr McLeod had confirmed to him that the prices in the schedule had been inserted at cost price.

[48] Mr Halls could give other evidence that was of indirect relevance about how lump-sum and measure-and-value contracts operate. But Mr Bowden submitted that his evidence on these issues was inconsistent. For example, Mr Bowden pointed to Mr Halls' evidence that a margin could only be contained in a lump-sum contract (clearly wrong), that he knew there was a margin in the draft contract schedule and what that margin was, but on the other hand he later said that he did not know what the margin was but knew that there was one. Mr Dale did not dispute these inconsistencies in argument.

[49] Whilst an appellate court is often hesitant to interfere with a credibility finding in deference to the trial Judge's advantage of having seen and heard the witness, it does seem to me that the inconsistencies and uncertainties in Mr Halls' evidence did not justify the Judge's wholehearted endorsement of his credibility. This leads to a concern that, given the limited amount of relevant evidence that