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From the Editor

John Green

Welcome to the 39th issue of BuildLaw® in which we draw on the experience and expertise of leading experts in the field to bring you commentary, articles and reviews on topical matters relating to construction law.

In this issue we look at the government guidelines for NZS3910:2013 contracts affected by Covid-19 Alert level 4 restrictions. We discuss adjudication injunctions caused by the virus and how they may help to provide some clarity to a rather cloudy area of law. We look at the recent High Court judgment in *Haskell Construction limited vs Robert Francis Ashcroft* and the clarification it provides as to whether an adjudicator can award damages for breach of contract. We examine the concept of 'buildability' and investigate whether the responsibility to ensure the 'buildability' of a project lies with the designer or the contractor. Elsewhere we discuss warning signs that building guarantee schemes are not financially viable, the use of indemnities in construction contracts and more.

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In Case In Brief we look at *Rintoul Group Ltd v Far North District Council* [2019] NZHC 2577 in which the New Zealand High Court made a clear distinction between retentions and payment claims and suggested that the default provisions in the CCA do not apply to retentions.

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

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

Warmest regards,

Editor and Director Building Disputes Tribunal

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BuildLaw: In Brief

What does 'reasonable endeavours' mean?

In *Focus Construction Interiors Limited v Spaceworks Design Group* [2019] NZHC 2211, the parties had a working relationship, where defendant would refer interior fitouts to plaintiff construction company. After a falling out between parties, mediation lead to a settlement agreement where the defendant agreed it would "make reasonable endeavours, acting in good faith, to refer work" to plaintiff to value of $3M for four years.

The plaintiff claimed insufficient referrals and commenced proceedings claiming the defendant alleging a breach of a contractual obligation in the settlement agreement, that they had failed to make reasonable endeavours, as the referred work only totalled $1,252,255.

The High Court considered the extent of a party's liability to fulfil the 'reasonable endeavours' obligation.

The reference to "it being anticipated that this can be achieved over a period of four years" informed the obligation but did not convert it into an absolute obligation to refer $3 million of work over four years. But nor was it an obligation to make reasonable endeavours for only four years expiring in February 2014 even if the anticipated $3 million had not be achieved.

The Court found that the clause was enforceable, as the objective of referring $3m of work was sufficiently certain. However, no breach was found, as the defendant was found to have acted reasonably in the circumstances.

The Court noted that a 'reasonable endeavours' obligation will not usually require the obligor to sacrifice its own commercial interests, unless the contract requires that certain steps have to be taken.

The Court contrasted 'reasonable endeavours' terms with 'all reasonable endeavours' or 'best endeavours' terms. A 'reasonable endeavours' obligation is less stringent than a 'best endeavours' obligation, in that with a reasonable endeavours obligation, a number of reasonable courses of action are available to achieve the desired outcome, and the obligation probably only requires a party to take one reasonable course, not all of them.

See the Court's decision here.

The Building Amendment Act 2019

The Building Amendment Act 2019 came into force on 18 December 2019. It has introduced some major changes to the regulation of building work and the performance standards for buildings. The Act is a response to deficiencies in previous legislation highlighted by the Christchurch and Kaikoura earthquakes. To this effect, the Act brings into force two key changes.

Special provisions for buildings affected by an emergency

The Act brings improved end-to-end management of buildings affected by an emergency. The most significant change in this regard is that now, after an emergency such as an earthquake has taken

place, Civil Defence Emergency Management officials may 'designate' an area for the purposes of emergency management of buildings. Once the designation is made, authorised people gain a range of powers in relation to building in that area, including:

- Evacuating buildings to prevent death or injury
- Carrying our rapid building assessments
- Placing notices or placards restricting the use of buildings to remove or reduce risks
- Putting in place measures such as hoardings or fences to protect buildings or keep people at a safe distance
- Carrying out or requiring works to be carried out to keep people safe
- Protecting buildings that are causing ongoing disruption to a public thoroughfare, the use of another building or critical infrastructure, and
- Requiring works to make buildings suitable for long-term use or occupation.

Heritage buildings are an exception to these rules. Heritage New Zealand must be consulted before any work may be done and Ministry approval is required before demolition works can be carried out on Category 1 buildings and National Historic Landmarks.

Improved investigative powers for MBIE

The Act imbues greater power for the chief executive of MBIE to, at the Minister's request or of their own initiative, investigate building failures where a building has failed, or not performed as expected, and that failure resulted or could have resulted in death or serious harm. Legal requirements must be considered in deciding to investigate.

Prior to these provisions coming into force, MBIE was required to investigate on an ad-hoc basis. This was subject to the cooperation of building owners, and resulted in investigations being heavily reliant on incomplete information.

Retentions held on trust

In *Bethell, McKay and Gower (as liquidators of Arrow International (NZ) Ltd) v Papanui Properties Limited* [2019] NZHC 3169, the liquidators of Arrow International (NZ) Ltd (**Arrow**) had applied for directions relating to the status of funds paid to Arrow by six of its clients (**Clients**) before Arrow was placed into voluntary administration. The case is of interest here because it included a question relating to the holding of retentions on trust under the Constructions Contract Act 2002 (**CCA**).

In this case, Arrow acted as agent for each Client under a Project Management and Construction Management Contract (**PMCM Contract**). The PMCM Contracts established Arrow as the contracting and payment agent for the Clients. Under these contracts Arrow, as agent for its clients, entered into agreements with trade contractors and consultants for the provision of goods and services for relevant building projects.

The first issue the liquidators wanted a direction on related to the status of funds that the Clients had paid to Arrow in order for on-payment to the trade contractors and consultants. A second issue arose in relation to retentions, which Arrow had deducted from the funds it received from its

BuildLaw:In Brief continued

Clients for payment to the trade contractors. By comparison to the first issue, the Court found the retentions issue to be less controversial, and applied the approach taken by Churchman J in *Bennett v Ebert* – an earlier case that also addressed the retentions scheme under the CCA.

The CCA provisions requiring retentions under commercial contracts to be held on trust came into force on 1 April 2017.

Pre-1 April 2017 retention payments had been paid on trust to Arrow, but were held in Arrow's current account. Those retentions were lost when the current account went into overdraft.

Post-1 April 2017 retentions were treated by Arrow as being trust property (in accordance with the CCA) and were paid into a separate retentions bank account. When Arrow was placed into voluntary administration, those payments were protected. The Court confirmed that the retentions were held on trust for the trade contractor entitled to the retention, and directed that payment be made to the relevant contractor. In cases where the trade contractor had been paid directly by the Client, the Court confirmed that those funds were held on trust for that Client and directed that they be repaid to the relevant Client.

See the Court's decision here.

Enforcing a Construction Contracts Act determination by statutory demand

In *Alpine Prime Properties Limited v Haskell Construction Limited* [2019] NZHC 3223, the plaintiff applied to set aside the defendant's statutory demand of a debt pursuant to an adjudication determination.

In 2019, the property developer plaintiff engaged the construction company defendant to build a residential building. A dispute arose between the parties around the time the stage 2 payment was due, and the developer cancelled the contract. A first adjudication claim determined that the developer should pay the construction company $133,619 as a fair and reasonable sum towards those works. A second adjudication claim determined that the construction company was in breach of the contract and that the developer's cancellation was justified, but was unable to make any amendment to the first adjudication award. The developer sought a third adjudication, to determine its claim for damages. In the meantime, the construction company had issued a statutory demand to enforce the debt due under the first award. A statutory demand is a method to enforce payment and, if not complied with, can lead to a company being placed into liquidation.

The developer did not want to pay the awarded amount because it said it had a valid counterclaim for damages which would likely exceed the awarded amount. The developer applied to the High Court to have the statutory demand set aside under section 290 of the Companies Act 1993 on this basis. The issue for the Court was whether section 290 could be used in light of section 79 Construction Contracts Act 2002 (**CCA**) which prohibits set-off or counterclaims from interim payments except in limited circumstances.

The High Court held that the CCA established a 'pay now, argue later' regime for interim payments. Although the Companies Act allows a statutory demand be set aside if there is a real possibility that a counter claim would shift the burden, section 79 of the CCA overrides that. The Court said

> *'where a statutory demand is served to enforce an adjudication award under the CCA, there is simply no scope for the Court to entertain any counterclaim or set-off (except one permitted under s 79).'*

The developer's request to have the statutory demand set aside was therefore dismissed. However, the Court expressly acknowledged the Court of Appeal's comments in *Laywood v Holmes Construction Wellington Ltd* [2009] NZCA 35, and said that the developer's counterclaim might be relevant to defend any application to place it into liquidation as a result of non-payment of the demanded sum.

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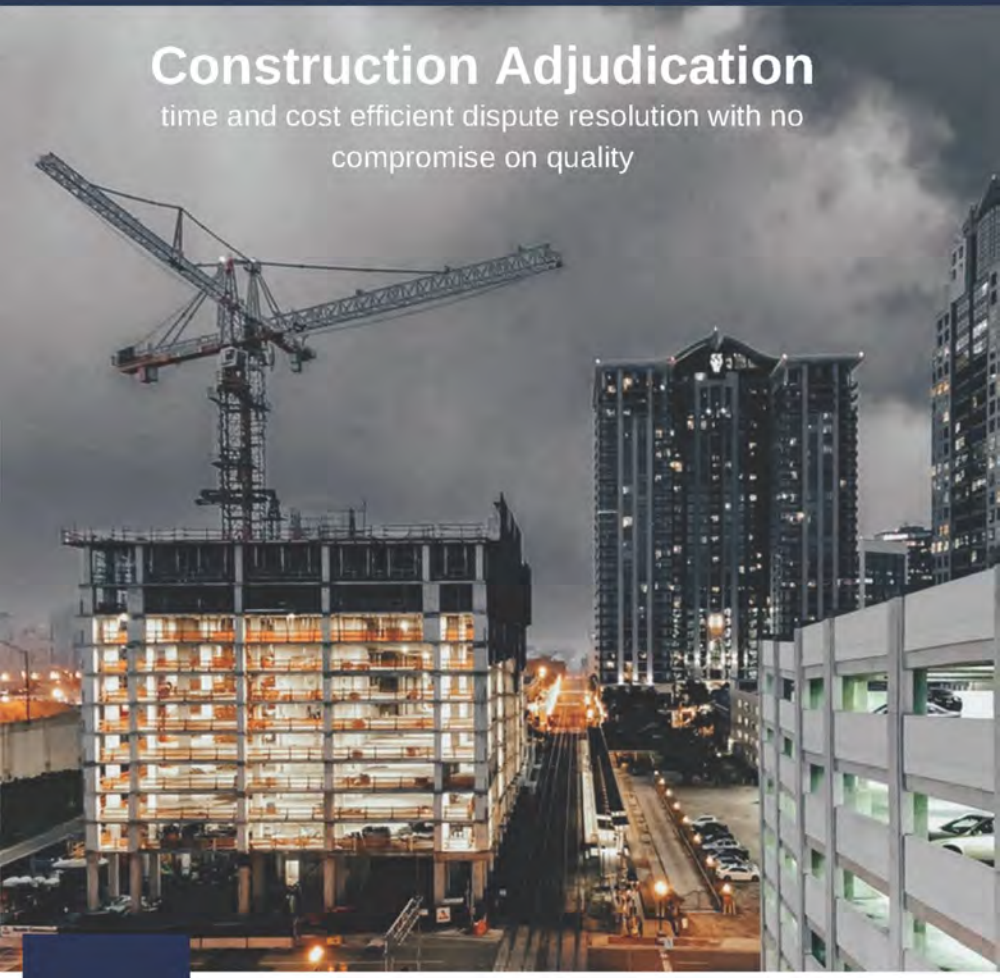

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COVID 19: GOVERNMENT CONTRACT GUIDELINES FOR NZS3910:2013

By Nick Gillies, Glen Holm-Hansen, Christina Bryant

The Government has announced contract guidelines to help support the construction industry during the Covid-19 restrictions. These apply to contracts based on NZS3910:2013 (un-amended), being the most common form of contract for construction projects in New Zealand.

The guidelines were developed by the Construction Sector Accord steering group with the support of the Building and Construction Minister, and are the first action from the Accord's Covid-19 Response Plan. Strictly speaking, they only apply to government agencies working with the construction industry. Nevertheless, they send a very clear message to the entire industry about the Government's interpretation and expectation, which will be hard to ignore.

The issues

Since New Zealand moved to Level 3 and then Level 4 restrictions, much of the sector has been grappling with two immediate issues under NZS3910:2013:

a. Whether the Engineer was obliged to suspend the whole or part of the works in response to these restrictions under clause 6.7.1; and

b. Whether these restrictions amounted to effectively a change of law under clause 5.11.10.

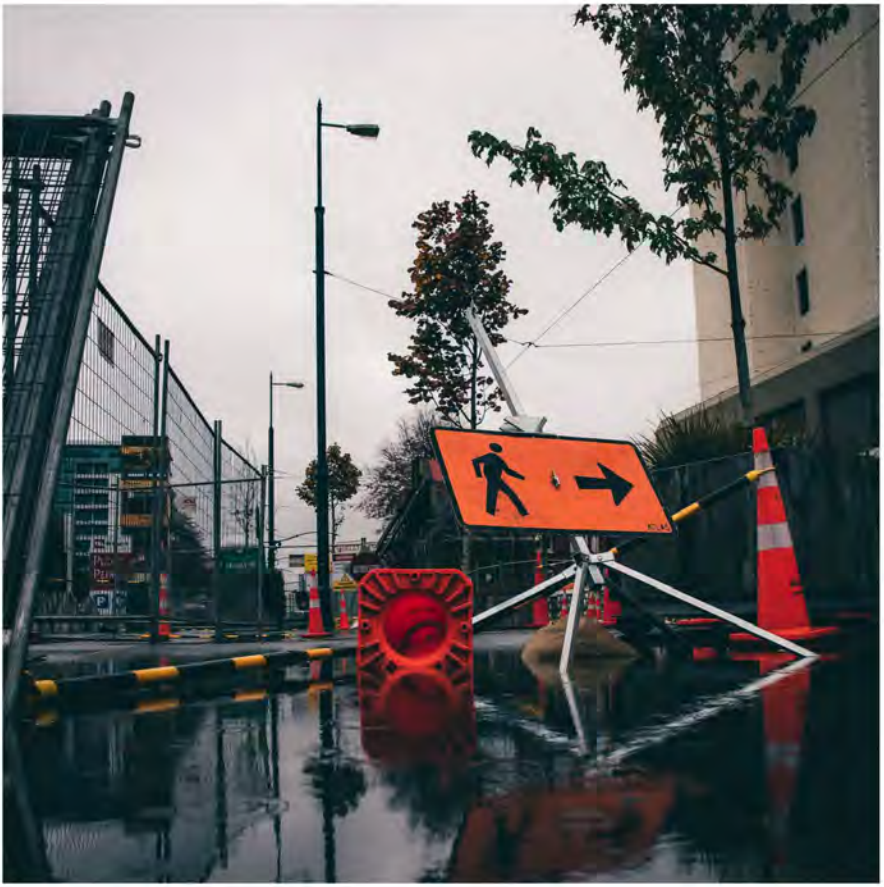
The significance of these issues is that in each case the Contractor becomes entitled to a Variation (if there is a suspension or a change of law), which in turn enables the Contractor to recover time-related costs for the period of the restrictions.

There seems to have been little, if any, dispute that the restrictions, being entirely unforeseeable events if the contract was entered before Covid-19 arose, would lead to an extension of time under clause 10.3.1(f). While that may provide a Contractor with relief against liquidated damages, an extension for an unforeseen event does not give rise to time-related costs. Under clause 10.3.7, time-related costs are only available where an extension is granted for the net effect of a Variation (10.3.1(a)) or for a default by the Principal (10.3.1 (g)). Since the restrictions are not due to the default of the Principal, any entitlement to time-related costs rests on whether there is Variation, which is why a suspension (6.7.1) and/or a change of law (5.11.10) becomes relevant.

Contractual Guidelines

Engineer Suspension

The guidelines suggest, but fall short of stating expressly, that suspension of the Contract Works has "*become necessary*" because of the Covid-19 restrictions (ie that the Engineer was obliged to suspend). They do, however, affirm that where a suspension notice has been issued by the Engineer, the Contractor is entitled to a Variation under clause 6.7.3 for the suspension.



Change in Law

In any event, the guidelines state that the Government's actions to enable the establishment of the Alert Level 4 directive "*constitute the making of a statue and/or regulation*" that gives rise to a Variation under clause 5.11.10. In other words, it was a change of law. This is the Government's interpretation of 5.11.10 in the circumstances.

Entitlement to a Variation

The upshot is that, where the guidelines apply, a Contractor will be entitled to a Variation – because the Engineer has issued a suspension notice under 6.7.1 and/or as a result of new Covid-19 laws or regulations under 5.11.10. Any increase in costs, including any time-related costs, will therefore be treated as a Variation and recoverable by the Contractor on that basis.

The quantification of such costs is a separate issue, which the industry is still working through given the unique circumstances. That aspect will be contract-specific to some extent and best resolved by agreement between the contracting parties in each case. The guidelines intended to remove in many cases unnecessary disagreements about whether there is an entitlement in the first place.

Cashflow and additional hardship

Despite the above clarifications, the guidelines also recognise that there is still likely be significant financial consequences for Contractors from the Covid-19 restrictions, which stands to affect the industry and economy as a whole. To that end, they ask government agencies to consider:

a. Other mechanisms to improve cashflow and remobilisation. Specific suggestions include: forward ordering, payment in advance/prepayment, faster payment cycles, issuing purchase orders for costs incurred, interim payments, or for results-based contracts, basing payment values on previous months; and

b. Whether additional extra-contractual financial relief for individual Contractors is warranted and in the public interest. MBIE says it is developing processes for considering and approving requests for special relief.

Relevant links

Government Announcement

Contract Guidelines

Government guidelines contact: procurementplanning@mbie.govt.nz

Hesketh Henry Covid-19 Webpage

ABOUT THE AUTHORS

Nick Gillies
Partner

Christina Bryant
Partner

Glen Holm-Hansen
Senior Associate

Hesketh Henry The Art of Law

Damages for breach of contract under the CCA: a welcome clarification

By Laura Bawden-Hindle

The recent High Court judgment in *Haskell Construction Limited v Robert Francis Ashcroft* lays to rest any residual doubt as to whether an adjudicator can award damages for breach of contract.[1] It is a welcome clarification of the position.

This article will outline the background to the issues that have emerged in relation to the extent of an adjudicator's power to award damages under the Construction Contracts Act 2002 (the **Act**) prior to *Haskell*, and summarise the remedies available to an adjudicator in light of this development.

Payments under and in respect of a contract – a real difference?

It is perhaps surprising that the issue as to whether an adjudicator can award damages for breach of contract has been the subject of as much debate as it has.

When the Act came into force, one of its aims was to provide remedies for the recovery of payments under a construction contract.[2] Where an amount of money is claimed by one party, section 48 requires the adjudicator to determine whether or not any parties to the adjudication are liable to make a *payment under the contract* and to determine any questions in dispute about *the rights and obligations of the parties under the contract*.[3] Before the 2015 amendments to the Act, determinations under as to payments under the contract could be enforced under section 59 of the Act, but determinations as to rights and obligations could not.[4]

In *M Van Der Wal Builders & Contractors Limited v Dunphy* the High Court considered that a claim for contractual damages was not a claim for payment under the contract, but a determination as to rights and obligations. As a result, contractual damages claims could not be the subject of an enforceable binding determination:[5]

> *…a liability to pay damages for a "breach of contract" is not a liability to "make a payment under" that contract. The differentiation between liability to pay a debt and liability for damages is a well-established one. …for a damages for breach of contract determination to come within s 48(1)(a) one would either need to treat an award of damages as being an obligation to pay money under the contract (which could not be the case) or to treat "under the contract" as meaning "arising out of", which would be contrary to the distinction between matters "under" and "arising out of" an agreement.*
>
> *Therefore a claim for damages falls within the scope of a "rights and obligations determination" and is not a claim for payment under a construction contract and as such is not a s 48(1)(a) determination nor is enforceable pursuant to s 59.*

Although the case was distinguished, the reasoning in M Van der Wal was viewed as readily reconcilable in Clark v Central Lakes Homes Limited.

This result was unsatisfactory, if adjudication was to be an effective clearing house for disputes concerning the performance of construction contracts.

When the Commerce Committee reported back on the Construction Contracts Amendment Bill 2015, it recommended amending the requirements for enforcement of an adjudicator's 'judgment' to *remove the distinction between payment and other types of determination*.[7] This amendment was proposed as being in line with the Act's purpose. Parliament accepted the recommendation and amended the Act to provide that all determinations made by an adjudicator, including those relating to payments under the contract and those relating to rights and obligations, are enforceable by entry as a judgment of the Court.

In addition to amending the enforcement provisions to make it clear that determinations as to rights and obligations are enforceable, the 2015 amendments went further. They expanded on the list of examples of disputes that can be referred to adjudication to include reference to a dispute as to *whether there has been a breach of a term of that contract* (including a term implied under another enactment).[8] Further, a new definition of 'payment' was also inserted, defining 'payment' as a progress payment *or any other type of payment for or relating to construction work for which a party is entitled to payment*.[9] The amendments clearly went some way to clarify the scope of an adjudicator's jurisdiction, and clearly signalled that the disputes that might be the subject of an enforceable determination were to be wider than simply disputes as to what payments may be due under the contract.

On their face, the 2015 amendments might have been thought sufficient to make it clear that adjudicators were empowered to award damages for breach of contract as well as in respect of payments due under a contract, and that those awards are equally enforceable under section 59 of the Act.

However, the debate as to whether an adjudicator could make an enforceable award of damages for breach of the contract under section 48(1) persisted. While the scope of an adjudicator's jurisdiction was clearly widened, there remained a school of thought that the amendments had not gone far enough to empower an adjudicator to do so.[10] While proponents of this view accepted that the purpose of the amendments was, in part, to resolve the issue as to whether an adjudicator had jurisdiction to give an enforceable determination for payment of damages for breach of contract, it was argued that the issues raised in the High Court, in cases such as *M Van Der Wal*, had not been fully addressed by these amendments.[11] It was suggested that a determination which finds that a party is obliged to pay damages for breach of contract is not a determination about the rights and obligations of the parties under the contract because, unless there is some special provision in that contract which requires damages to be paid for breach, the obligation to pay damages for breach of contract is not a primary obligation under the contract.[12]

Haskell Construction Limited v Robert Francis Ashcroft

This debate has now been finally settled in *Haskell*. The judgment makes it clear that adjudicators do have the power to make enforceable determinations in respect of claims for damages as well as payment claims.

Haskell Construction Limited (**Haskell**) entered into a contract to construct a home for Alpine Prime Properties Limited (**Alpine**). Shortly after works commenced, complications arose which required further work. The further work became the subject of a variation, and added to the cost of the work significantly. A payment claim for the variation was disputed, and the contract was cancelled. This led to a number of adjudications. The third of those adjudications included, amongst other things, a claim for damages arising out of a breach of contract. Haskell sought a declaration from the High Court that the damages claim was outside the scope and jurisdiction of an adjudication under s38 and 48(1(a) and (b) of the Act.[13]

The High Court dismissed the application for judicial review on this point, finding:[14]

> *The text of the legislation and the relevant purpose support the ability of an adjudicator to not only make rights and obligations determinations for breaches of the implied warranties but also to determine that a statutory remedy applies. Such remedies include the award of damages and compensation for any reduction in value of the product of the building work, below the price paid or payable for that work, and any loss or damage to the*

client resulting from the breach, that was reasonably foreseeable, as liable to result from that breach.

As a result of *Haskell*, an adjudicator clearly has jurisdiction to make enforceable determinations both as to:

- Whether or not parties to the adjudication are liable to make payment under a contract
- Whether or not parties to the adjudication should be awarded damages for breach of contract or any other statutory obligation.

Although it did seem obvious that the 2015 amendments were intended to make it clear an adjudicator had the power to award damages for breach of contract, *Haskell* is a welcome clarification of these issues.

End Notes

[1] Haskell Construction Limited v Robert Francis Ashcroft HC Wellington CIV-2019-485-593, 21 April 2020.

[2] Section 3(1)(c) of the Act.

[3] See section 48(1)(a) and (b) of the Act.

[4] See section 58 of the Act as originally enacted. This section was amended by the Construction Contracts Amendment Act 2015.

[5] M Van Der Wal Builders & Contractors Limited v Walker [2011] CIV 2011-004-000083 [2011] NZHC 1052 at [98]-[99].

[6] Clark v Central Lakes Homes Ltd [2016] HC Christchurch CIV-2016-425-25 NZHC 1694 at [34].

[7] Construction Contracts Amendment Bill 2015 (97–2) (select committee report) at 4.

[8] See section 25(2)(b) of the Act.

[9] Section 19, definition of "payment".

[10] See, for example, Andrew Skelton "Construction adjudication case law: some interesting issues" (paper presented to AMINZ, November 2018-Feburary 2019).

[11] Andrew Skelton "Construction adjudication case law: some interesting issues" (paper presented to AMINZ, November 2018-Feburary 2019 at 14.

[12] Skelton, at 15.

[13] Haskell, at [14].

[14] At [60].

ABOUT THE AUTHOR

Laura Bawden-Hindle

Laura is a law clerk at Building Disputes Tribunal. She is studying at Victoria University of Wellington

BUILDING DISPUTES TRIBUNAL
TE TARAIPIUNARA MŌ NGĀ TAUTOHE WHARE

BUILDABILITY – WHO BEARS THE RISK?

By Travis Tomlinson

A common provision in build-only construction contracts is the requirement for the contractor to warrant to the principal that the contract works are *"buildable in accordance with the contract documents"*.

This type of provision codifies the position at common law, which is that, save for any express terms in the construction contract to the contrary, as between the principal and the contractor "buildability risk" lies with the contractor.

So what is "buildability" and what risk does the contractor carry? This article examines these aspects and provides some practical considerations relating to buildability to enhance the prospects of project success for all involved.

Buildability – what does it mean?

In the construction context, buildability (or sometimes referred to as "constructability") refers to the capacity of a design to be implemented physically in a manner that is safe, sound and otherwise in accordance with the terms of the relevant construction contract. "Buildability" may embrace both the *physical possibility* of implementing a design, and the *practical ability* to do so.[1] Put simply, contract works are 'buildable' if they are *capable* of being built regardless of the methodology or cost that may be involved in doing so.

It is common in New Zealand to separate the design and construction elements (and risk) of a project; namely, under this traditional procurement model the designers and the builder are under separate contracts with the principal, with the construction contract usually only tendered and let once the design (i.e. plans and specifications) is substantively complete. Under this type of procurement model, the design consultants are responsible to the principal for their design and the contractor's main delivery risk and responsibility is to deliver that design. However, the common law is clear that the contractor is not entirely free from risk and responsibility for that design.

What does the law say?

Despite being over a century old, the case of *Thorn v The Mayor and Commonality of London* provides one of the leading principles on buildability risk. In this case, which involved the building of a new bridge over the River Thames, the House of Lords held that where plans and specifications are prepared for use by a contractor in executing certain construction works, the principal does not give any implied warranty that the work can be successfully executed according to such plans and specifications. The Court held that the contractor *"ought to have informed himself of all particulars connected with the work and especially as to the practicability of executing every part of the work contained in the specification"*.[2]

The contract in question did not contain any express warranty that the bridge could be successfully built in accordance with the principal's drawings and specifications, nor could such a warranty be reasonably implied by the Court in favour of the contractor. This meant that the contractor was held to bear the (significant) cost of additional work that needed to be performed in order to complete the contract works in accordance with the contract terms. The case suggests that no such implied warranty would apply even if the impossibility of building to the

design was not reasonably discoverable by the contractor at the time of entering into the contract, though this would depend on the express terms of the particular contract in question.[3]

What does this mean in practice?

Much has already been said about the importance of achieving appropriate risk allocation settings between contracting parties by ensuring that risk is allocated to the party that is best place to manage that risk. Good risk allocation settings significantly increase the likelihood of project success for all involved.

In the context of buildability risk, to enhance prospects of project success it is incumbent on principals to provide appropriate opportunities for tendering contractors to be able to properly assume buildability risk and responsibility that the law (and potentially contract) imposes on them; and for those tendering contractors to conduct themselves during the tender process in a manner that ensures they're in a position to do so (rather than excessively price or qualify against/re-allocate this risk) should they be awarded the construction contract (the principal's designers clearly also play a fundamental role in preparing a buildable design).

In relation to principals and contractors, this may involve:

- from the principal's perspective, affording suitable tender timeframes that enable tendering contractors to appropriately interrogate the design and establishing a project and design team that are sufficiently available at tender time to respond to tenderer queries in an adequate and timely manner

- from the contractor's perspective, properly interrogating the tender design and positively engaging with the principal and its consultants (e.g. through a tender RFI process) in relation to that design

- interactive tendering workshop opportunities, where tendering contractors are able to work with the principal and its consultants to understand the design and to test the tenderers' proposed methodology to deliver to that design. To maximise the value of such workshops, tendering contractors will likely need the benefit of appropriate confidentiality protections and the principal should consider how this will be achieved

- early contractor (or preconstruction) processes, where a contractor is inserted early into the design process and is able to provide advice from a buildability or constructability perspective as the design develops and the programme and cost is built up

At common law, buildability risk lies with the contractor, and this principle is often included in express terms of construction contracts. While a principal will take comfort in this risk allocation, project success may be reliant on the contractor being sufficiently informed as to the project's design in order to effectively assume and manage this risk. We have identified above some practical examples of how the principal and contractor can front-foot this risk and ultimately facilitate a positive project outcome for all parties.

End Notes

[1] *Pickard Finlason Partnership Ltd v Lock* [2014] EWHC 25 (TCC) at [198], per HHJ Stephen Davies.

[2] *Thorn v The Mayor and Commonality of London* (1876) LR 1 HL 120 at 128-129.

[3] See speeches of Lord Cairns LC and Lord Hatherley in *Thorn v The Mayor and Commonality of London* (1876) LR 1 HL 120 at 128-129 and 137.

ABOUT THE AUTHOR

Travis Tomlinson
Partner

Travis is a specialist transactional construction and infrastructure lawyer and a Partner in MinterEllisonRuddWatts' Construction team.

Travis helps clients on their procurement planning, contract drafting and negotiations, project governance, and project administration across a wide spectrum of industry sectors, including acting for some of New Zealand's largest organisations. He has detailed knowledge of the Government's procurement rules and advises the public and private sector in relation to regulation and compliance.

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WARNING SIGNS EMERGE REGARDING VIABILITY OF BUILDING GUARANTEE SCHEMES

By Gareth Lewis

MBIE's Building System Legislative Reform Package includes a proposal to require compulsory guarantee and insurance products (GIPs) for residential new builds and significant alterations. In August 2019 MBIE published a summary of the public submissions on its Reform Package. 76% of submitters supported the proposal to require GIPs, although some submitters expressed doubts that the insurance market would be prepared to support the proposal and others suggested Government involvement by way of a backstop cover.

The reservations expressed by some of the submitters has been borne out in recent news reports in New Zealand and Australia which cast doubt as to whether building guarantee schemes of this type are financially viable.

The Sydney Morning Herald recently reported that the New South Wales Government paid out more than $200 million in one year to prop up a home warranty scheme with further increases expected. The scheme enables owners of homes and apartment buildings of 3 levels or less to make an insurance claim in respect of defects if the builder becomes insolvent, dies, disappears to has their license suspended. The premiums are paid by builders but over time these have been insufficient to meet claims. In 2010 the NSW stepped in to cover unfunded claims and it has since amassed more than $639 million liabilities. There is no warranty scheme for apartment buildings above 3 levels as both private insurers and the government pulled out due to the risk in 2003.

More recently the Stuff website reported two private guarantees offered by New Zealand building companies, the Stamford Insurance 10-year new build guarantee and the New Zealand Certified Builders' Halo 10-year guarantee, have lost their underwriter and cover will end when the policies expire in December 2019 and January 2020. This has led to some calls for a mandatory nationwide warranty of the type being investigated by MBIE.

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In view of New Zealand's record of poor building work over the last 30 years the prospects of private insurers providing long term cover, whether for private guarantee schemes or industry wide compulsory guarantees, appears to be slim. That leaves the Government as the only funding option, but there is unlikely to be much appetite for taxpayers to foot the bill for the indeterminate liability it would face. If and when the reputation of the New Zealand's building industry improves insurance cover may become available but that is unlikely to be for some time.

In the meantime, a more productive focus for regulatory reform is likely to be the strengthening of the processes within building consent authorities to ensure everything possible is being done to avoid defective building work in the first place.

ABOUT THE AUTHOR

Gareth Lewis
Partner

Gareth has specialist expertise in construction claims, body corporate disputes and employment law. He has over 22 years experience in litigation.

Gareth is proactive in his approach to legal issues, ensuring common goals are clearly understood & expectations managed. He takes a commercially realistic, pragmatic approach with clients.

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ADJUDICATION INJUNCTIONS: WILL COVID-19 DEVELOP THE LAW?

By Adrian Bell, Matthew Taylor & Aidan Steensma

The first recorded case of an adjudication injunction sought as a result of the Covid-19 pandemic emerged earlier this month in the TCC. The law as to such injunctions is presently unsettled. In this Law-Now we consider the extent to which further Covid-19 cases may help to clarify the law.

Adjudication injunctions: the story so far

Injunctions to prevent the continuance of an adjudication generally fall into two categories. In *Dorchester Hotel Ltd v Vivid Interiors Ltd*, a Responding Party sought to injunct a final account adjudication commenced just before Christmas on the basis that the adjudicator could not fairly deal with the detailed nature of the dispute in the time available. Mr Justice Coulson (as he then was) found that the court had jurisdiction to stop an ongoing adjudication, but that the jurisdiction would only be exercised "*very sparingly*" and only in "*clear-cut cases*". Although the court had sympathy for the Responding Party's position, the adjudicator had indicated that he was able to determine the dispute within the time available and it was not clear that the adjudication was incapable of giving rise to a fair result.

The difficulty faced by parties seeking such injunctions is that a certain amount of ambush and even unreasonableness is implicit in the adjudication process itself. As noted by the court in *Twintec Ltd v Volkerfitzpatrick Ltd*:

> *"It has to be remembered that the conduct that must be condemned as unreasonable - the referral of a dispute to adjudication - is conduct that has been sanctioned by Parliament. That is why the facts of the particular case must be exceptional before the court would be justified in concluding that a referral of a dispute to adjudication is unreasonable, even though it may be oppressive. Parliament has in effect expressly approved a party's right to start an adjudication in circumstances that can effectively amount to an ambush of the responding party. That, of itself, does not justify the interference of the court."*

An injunction was granted in *Twintec*, but not on fairness grounds. Instead, the court concluded that the adjudicator did not have jurisdiction as he had not been validly appointed under the applicable contractual provisions. No useful purpose would be served in allowing the adjudication to proceed in those circumstances and it was therefore an "*exceptional case*" where an injunction was justified.

An injunction on jurisdictional grounds was also upheld by the Court of Appeal in *Bresco Electrical Services Ltd v Michael J Lonsdale (Electrical) Ltd* in the following terms:

> *"the court will grant such an injunction if the court concludes that the nascent adjudication is a futile exercise. This is an important power in the context of adjudication. Adjudication is a quick process which can require a responding party to spend a good deal of money in a short space of time, to defend itself from claims which may prove to be utterly hopeless, yet with no prospect of recovering those costs (because adjudication is cost-neutral). It is therefore important that, whatever the theoretical jurisdiction position may be, a responding party has the right to try and put a stop to the adjudication process at an early stage."*

It may be thought in light of these two cases that a strong jurisdictional objection would provide a sound basis for seeking an injunction. However, that appears to have been placed in doubt by *Billingford Holdings Ltd v SMC Building Solutions Ltd*, a decision issued soon after *Bresco*. In that case, an injunction was sought on the basis of what was said to be a very clear jurisdictional objection as to the appointment of an adjudicator by the wrong adjudicator nominating body. Mr Justice Fraser refused to consider the substance of those objections. The argument that it would be wrong for the court to allow an adjudication to proceed if there was no prospect of it reaching a binding decision was in his view not *"the correct approach, nor is it the correct test. This is not an unusual case. The claimant challenges the jurisdiction of the adjudicator on grounds which are, if I may say so, entirely run of the mill. There is nothing in this dispute about the jurisdiction of the adjudicator and whether the correct nominating body was the body that appointed the adjudicator to take this out of the conventional case."*

The suggestion in this decision appears to be that even a very strong jurisdictional objection will not be sufficient to found an injunction unless it is an unusual objection or a very rare case. It is unclear how the peculiarity of an objection is to be assessed or why that should be of critical importance where a strong jurisdictional case is advanced.

MillChris Developments Ltd v Waters

The Covid-19 pandemic has placed greater strain on the logistical and financial resources of a wide variety of businesses. In the construction sector, this has led to the commencement of adjudications as parties seek to shore-up cashflow. Those responding to such adjudications have complained of opportunistic behaviour, suggesting that adjudication is being used to apply greater pressure at a time when they are already under immense strain. An injunction has recently been unsuccessfully sought by a Responding Party on this basis.

The court's judgment is not yet available in full, but the summary shows that the injunction was sought on fairness grounds. The adjudication had been brought by a home-owner against a contractor. The contractor complained that it did not have sufficient time to prepare for the adjudication due to the pandemic and the fact that it was no longer trading. Its solicitor had been forced to self-isolate and the contractor would not be able to secure representation at a site visit proposed by the adjudicator.

The court rejected the application, noting that such an injunction would only be given in rare and clear-cut cases, and that the contractor was required to show a serious case that the adjudication would necessarily be conducted unfairly in breach of the rules of natural justice (i.e. not just that this might occur). None of the matters relied upon rose to this level. The contractor's solicitor could work remotely, as could the relevant witnesses. Natural justice would not always require a party representative to be present during a site visit: the visit could be recorded and the contractor could direct the adjudicator's attention to certain areas of the site in advance.

Conclusions and implications

In the present climate, there will often be a tension between Referring Parties wanting a decision as quickly as possible (as some will rely on this for financial survival) and Responding Parties wanting more time to prepare their submissions (as often documents and personnel will be less accessible). However, it is for the parties and ultimately the adjudicator to find a pragmatic and fair balance.

The contractor in this case failed to show any real unfairness resulting from an adjudication proceeding in the current circumstances. Each of the instances of disruption relied upon were readily able to be overcome and the impression was one of the pandemic being used as an excuse to forestall a genuine adjudication. Other more compelling cases may arise in the future, however, and the conduct of Referring Parties is likely also to be of relevance.

It is expected that an increase in such cases may provide an opportunity for the law in this area to be clarified. The position in relation to injunctions on natural justice grounds is reasonably clear: a party must show a good case that the adjudication *will necessarily* be conducted in breach of the rules of natural justice. That is a very hard ask given the ability for logistical issues to be overcome in a

variety of ways (as this case illustrates). It is not difficult to understand why such injunctions will be given only in very rare cases.

Less clear is whether an injunction on jurisdictional grounds can be given where a series issue or even a strong case is present. Such objections can often be determined summarily, as in *Twintec*. The decision in *Billingford* suggests, however, that the court may not be willing to consider such objections unless an additional element is present which takes the case outside of the ordinary. It is unclear how such an additional requirement would be squared with the Court of Appeal's comments in *Bresco* that Responding Parties ought to have the right to be spared the costs of an adjudication rendered futile due to jurisdictional failings.

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ABOUT THE AUTHORS

CMS Law . Tax

Adrian Bell
Partner, London

Matthew Taylor
Partner, London

Aidan Steensma
Of Counsel, London

Ranked as the world's 6th largest law firm by lawyer headcount and 6th largest in the UK by revenue, CMS works in 42 countries from 74 offices worldwide. Globally 4,500 lawyers offer business-focused advice tailored to clients' needs, whether in the local market or across multiple jurisdictions.

MANN BITES QUANTUM MERUIT

By Tom Grace

The recent High Court decision in Mann v Paterson[1] will raise as many questions as the answers it provides.

Background

Mr & Mrs Mann ("**Mann**") owned land in Blackburn, Melbourne. They entered into a contract with Paterson Constructions Pty Ltd ("**Paterson**") to build two double storey apartments ("**Units**"). The contract sum was $971,000 and the Units were to reach practical completion within 290 days. After about 360 days, only Unit 1 had reached practical completion and Unit 2 remained partly complete. When handing over Unit 1, Paterson claimed variations totalling $48,403.07. Mann did not want to pay for the variations. Paterson said unless Mann paid for the variations, it would not finish Unit 2. Mann then said it was terminating the contract. Paterson said Mann had repudiated the contract by an illegal termination, accepted that repudiation as the end of the contract, and went to Court to get compensation.

Paterson claimed damages under the contract of $446k including $231k for variations and in the alternative a claim in *quantum meruit* for $944,898.

Mann counterclaimed $391k for defective works. Paterson was awarded about $660k, an amount greater than its entitlement under the contract. It would appear the contract sum agreed between Mann and Paterson was lower than the real value of the works.

Quantum meruit

Quantum meruit, literally translated, means "the amount deserved". A builder claiming "the amount deserved" might well be entitled to more than their contract sum if the price agreed in the contract was lower than the real market value. In some cases, builders who have claimed in *quantum meruit* have been awarded much more than the contract sum.

Mann was not happy to be ordered by the Victorian Courts to pay considerably more than the contract price.

Mann goes to the High Court

Mann applied for special leave to appeal to the High Court on three grounds, which can be summarised as follows:

1. It was an error to hold Paterson was entitled to sue on a *quantum meruit* for all the works carried out prior to termination.

2. Alternatively, if Paterson was entitled to sue on a *quantum meruit*, the contract sum capped the amount available.

3. It was an error to allow the variation claims.

The findings of the Court as to the first two of these appeal grounds have application across Australia. The third ground relates to the specific provisions of the Victorian legislation requiring variations to be approved in writing and is not discussed in this Update. In short, the High Court unanimously said Paterson's failure to follow legislative requirements meant it should not be paid for any of the variations it had performed.

Unfortunately, the High Court was not united in its decision as to the other two grounds. Seven judges considered the appeal. Chief Justice Kiefel and Justices Bell and Keane ("**Group 1**") wrote joint reasons as did Justices Nettle, Gordon and Edelman ("**Group 2**"). Justice Gageler was left to make the final call in a four to three split decision.

Group 1: The rescission fallacy

Group 1 named as the "rescission fallacy" a legal doctrine that was clearly set out in a case in New Zealand in 1901[2]. Group 1 said it is a fallacy to say that a contract once terminated by acceptance of a repudiation, is rescinded as from the beginning, such that it is to be treated as though it never existed in the first place. That fallacy, they said, if accepted, means there is no contract left to give guidance as to the contract price. That could lead to injustice because the amount assessed as payable under a *quantum meruit* might substantially exceed the contract price, as has happened in the past.

Respecting contract

Group 1 said that restitutionary claims, of which *quantum meruit* is one example, must respect contractual regimes and their allocation of risk.

Group 1 said where the builder has an enforceable contractual right to money that has become due under the contract, the builder cannot claim reasonable remuneration without reference to the contract sum.

Generally, where a contract is repudiated, the innocent party has a contractual right to damages for loss of bargain. Group 1 said that the contract terms should be primary in determining how much compensation accrues for that loss of bargain.

Group 1 felt that the award as given had allowed a windfall to Paterson that was "distinctly inconsistent with the respect due to the contract made by the parties as the charter whereby their commercial risks were allocated between them and their liabilities limited". Their Honours stressed that restitutionary measures, such as *quantum meruit*, are gap filling remedies.

What about Mann's disregard for the contract?

In response to Paterson's claim that there had been a failure of the contract due to the withdrawal by Mann of the promise to pay and therefore a failure of consideration, Group 1 pointed to the divisible progress payments set out in the contract. They said: "Nothing in the contract was apt to suggest that these payments were only provisional, and subject to a final taking of accounts."

This comment may serve to distinguish the *Mann v Paterson* decision from other construction contract disputes. In any event, for this reason, Group 1 said Paterson's obligations to construct each stage were able to be considered as "severable rather than entire".

Paterson said that due to the termination of the contract, it would not now be able to finish the next stage and could not bring a claim for payment for that work. On that basis, Paterson's team said it

should be entitled to a *quantum meruit* for at least the part completed portion of the next stage. Group 1 disagreed and said normal contractual principles should apply.

Paterson's legal team then said that the repudiation of the contract by Mann was of such a nature that Mann should not be allowed to benefit by relying on one term of the contract as to the price while disregarding the rest of the contract terms.

Group 1 said there is nothing wrong with a defaulting party enjoying the protection of the contract's ceiling on the amounts recoverable by way of damages.

However, Group 1 concluded by qualifying their decision with the following statement: "It may be that in some cases justice will not be done without a restitutionary claim."

Group 2: The total failure of contract

The three Justices comprising Group 2 said that where a contract remains open, there is no room for *quantum meruit*. However, they disagreed with Group 1 and said where the contract is closed, such as this type of terminated contract, a claim in *quantum meruit* remains an option, although they agreed with Group 1 that the contract is not rescinded as from the beginning.

Group 2 said that it would be necessary for there to be a total failure of the contract to give rise to an obligation on the part of an enriched party to make restitution. They spoke of such a failure occurring by way of a total failure of consideration, in other words, a total failure to deliver the purpose of, or motivation for, the contract. A total failure of consideration had not occurred in relation to the divisible progress claim stages that had been completed before the termination. The contractor had rights to keep its payment for the stages completed and Mann had received some of the completed work.

However, they said there had been a total failure of consideration in respect of the progress claim stages that have not been completed. The contractor's right to complete the performance and earn the rest of the contract price had failed. In relation to those uncompleted stages, the contractor had a claim for restitution in *quantum meruit* in respect of the work and labour done towards part completion of the uncompleted stages as an alternative to damages for breach of contract.

So how much can be claimed?

However, their Honours considered that the general rule should be that the amount that could be claimed by way of a restitutionary *quantum meruit* claim, should be calculated by reference to the contract sum. They felt that the parties had, by their contract, reached an agreement as to the price at which the services were to be provided.

They were not persuaded by the concept that the conduct of the Mann's in repudiating the contract, should give rise to an immediate rejection of the price aspect of the bargain. They felt that the contract price remained important in evaluating the amount due in *quantum meruit*.

Gageler J. What rescission fallacy?

Gageler J agreed there was no entitlement to a *quantum meruit* for the completed stages of the contract. However, in relation to the partly completed work for which no milestone stage had been reached, His Honour found a *quantum meruit* is available. In effect he agreed with Group 2, although for different reasons.

His Honour referred to a 1934 judgment of Jordan CJ, in which His Honour had left open a claim in *quantum meruit* where a wrongful repudiation had the effect of preventing a party from becoming entitled to receive payment for services already rendered.

His Honour noted that Jordan CJ did not rely on the rescission fallacy and said, somewhat pointedly, "The [rescission fallacy] notion had been discarded then, as it remains discarded now."

Gageler J pointed out that the repudiation by Mann and the acceptance of that repudiation resulting in the termination of the contract had deprived Paterson of the opportunity to take the work to the next stage, thereby entitling it under the contract to the further payment. Gageler J said allowing a claim in *quantum meruit* for this aspect of the work was necessary to avoid the otherwise unjust outcome.

However, His Honour was firmly of the view that the contract price should act as a cap on the amount recovered under a *quantum meruit*.

The amount recoverable is a liquidated amount representing reasonable remuneration for the work. That amount cannot exceed the portion of the overall price set by the contract that is attributable to the work.

Conclusion

It seems clear now that the contract price will provide a ceiling to claims in *quantum meruit* except in unusual cases, for example, where the conduct of the principal has contributed to the cost of construction.

The omission from the Mann contract of the common term that payments are "on account" until completion may lead to this case being distinguishable from others.

What is not clear is how the quantum of an award for the uncompleted portion of the contract would be calculated. Would there be a need to enquire as to whether the staged progress payments that have been made represent a fair percentage of the contract price?

Questions also arise as to how to deal with contracts where the staged progress payments specified do not match the value of the work performed to that stage. Many standard form domestic building contracts set fixed percentages of the contract sum, regardless of individual variations of specification. Generally, the payments are "on account" and the true value of the work completed at any stage can vary significantly from the amount stated in the contract as due to be paid for that stage. It is only when the final stage is completed, and the full contract sum paid, that the parties' agreement as to price is fulfilled. The decision in *Mann v Paterson* does not consider this difficulty.

ABOUT THE AUTHOR

Tom Grace
Partner

Construction & Engineering, Commercial Dispute Resolution, Environment and Planning, Administrative Law

FENWICK ELLIOTT GRACE
CONSTRUCTION AND ENGINEERING LAWYERS

CASE IN BRIEF

DISTINGUISHING PAYMENT CLAIMS FROM PAYMENT OF RETENTIONS

Rintoul Group Ltd v Far North District Council [2019] NZHC 2577

In a recent judgment, the High Court upheld a decision by the District Court declining to grant summary judgment to Rintoul for alleged non-payment for various works. Instead it accepted a protest to jurisdiction made by the Far North District Council, finding that the contracts were the subject of genuine disputes that must be arbitrated. In reaching this decision, the High Court drew a distinction between claims for retentions and payment claims.

Background

In 2014, the Rintoul Group Limited (Rintoul) and the Far North District Council (the Council) entered into a number of contracts under which Rintoul undertook to carry out roadworks for the Council. The contracts were on the forms of NZS3910:2003 and NZS3910:2013, and thus incorporated conditions which allowed the council to hold retention monies at a specified rate.[1] Works were completed under the contracts. Rintoul then presented payment claims in respect of the retention monies. The Council failed to serve payment schedules in response.

Payment Claims v Retentions

Rintoul sought summary judgment on the basis that the Council had failed to serve payment schedules within the time frame provided by the Construction Contracts Act 2002 (the CCA). The CCA governs payments between parties to a construction contract. If a party seeking payment presents a valid payment claim under s 20 and the paying party fails to respond by presenting a valid payment schedule, then the payment claim becomes, by default, a debt due and owing under s 23 of the CCA. The debt can be enforced by the Court. This is the essence of the "pay now, argue later" philosophy of the CAA.

Retentions are defined as *an amount withheld by a party to a construction contract (party A) from an amount payable to another party to the contract (party B) as security for the performance of party B's obligations under the contract.*[2] In *Rintoul*, the High Court considered whether a claim for retention monies could be dealt with as a payment claim.

Rintoul argued that the Council's failure to issue a payment schedule in the correct time frame meant that it had incurred default liability under the CCA. In making this argument, Rintoul relied on s23 of the CCA which states that where a valid payment claim has been served by the parties and there has been no response, the validity of the payment claim can no longer be questioned.[3]

The argument for the Council was that the stay of proceedings made in the District Court should be

upheld, because the proceedings were the subject of a bona fide dispute which the High Court was required to refer to arbitration under the relevant provisions of NZS3910.

The High Court ultimately agreed with the Council's submissions, and held that there was a bona fide dispute as to whether Rintoul could recover the retentions under s 23 of the CCA.

In reaching this conclusion, the High Court indicated a preference for treating payment claims as being of a *different species* to claims for retentions. In doing so, it noted the findings of the Court of Appeal in *George Developments Ltd v Canam Construction Ltd* [2005] NZCA 84.[4] The High Court considered that the statutory scheme supported that conclusion, on the basis that there were indications elsewhere in the CCA to suggest that Parliament did not intend funds held as retentions to be capable of being claimed under the default liability provisions of the CCA.[5] In illustrating this, the High Court noted, for example, s18E(2)(b) which allows retentions to be held on trust and invested in accordance with the Trustee Act 1956.

Looking forward

Rintoul Group Ltd v Far North District Court is a summary judgment proceeding, and so the High Court's differentiation between retentions and payments claims remains obiter. As noted, the payment claim procedure is designed to protect cashflow, which has been identified as the *lifeblood of the enterprise in the construction industry*.[6] At least arguably, retention payments serve a different purpose, ensuring that works are up to the standard contracted between the parties.

There would, however, be significant implications if the High Court's inclination that the default provisions of the CCA do not apply to retentions were to be adopted. The purpose of the default provisions is to ensure cashflow. It would seem to be at odds with the philosophy of the CCA if the default liability provisions were not applied to claims for payment of retention monies. After all, there is nothing in the default liability provisions that would allow a claimant to present a valid payment claim if it is not presented in accordance with the arrangements for progress payments as either agreed in the contract or provided for in the CCA. The position is unclear. It will be interesting to see whether the High Court's suggestion that the default provisions in the CCA do not apply to retentions is adopted.

End Notes

[1] The High Court held there were no material differences between these forms in respect of the issues in the case.

[2] Section 18A.

[3] At [30].

[4] At [39].

[5] At [40].

[6] George Developments Ltd v Canam Construction Ltd [2006] 1 NZLR 177 (CA) at [41].

ABOUT THE AUTHOR

Laura Bawden-Hindle

Laura is a law clerk at Building Disputes Tribunal. She is studying at Victoria University of Wellington

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THE USE (AND MISUSE) OF INDEMNITIES IN CONSTRUCTION CONTRACTS

By Edward Colclough

Meeting agendas often give good notice of the topics that will get negotiations heated. Watch out for: limitations on liability, rights to terminate for convenience, exclusions of loss of profit, time bar clauses to claims, and, not to be forgotten, liability for Brexit. Frequently, indemnities fall within this category.

Having watched indemnities bounce backwards and forwards in contract negotiations, Edward Colclough has often wondered if parties are fully aware of the implications that the much sought after "indemnity" brings with it.

Aside from securing the trophy of an "indemnity" in your construction contract, what extra does an indemnity get you and is it worth the fight?

Back to basics

Why are indemnities so desired? In short, they are a promise to pay money on the occurrence of a specified event.

Properly used, an indemnity allows the parties to a contract to allocate the risk of an event occurring and the losses that flow from it (which can be a fixed sum or an amount of damages to be determined). The indemnified event may be triggered by Party A (the indemnitor) either:

- breaching a term of the contract (e.g. a confidentiality undertaking); or
- taking on responsibility for a specified event occurring (e.g. a change in VAT law).

The trigger event can therefore be either "fault based" or neutral. If, however, Party A would already be responsible at law for a fault-based breach of the contract, what additional reward does the indemnity get Party B (as the indemnitee)?

Advantages of indemnities?

Full recovery of loss. The true intent behind an indemnity is normally that Party B wants 100% recovery from Party A for any losses it incurs as a result of the trigger event occurring. The aim is to fully apportion the risk of the trigger event onto Party A.

Party B will argue that any losses it incurs as a result must be covered by Party A, and should not be subject to the usual legal hurdles of remoteness, foreseeability or reasonableness which can whittle down what it can recover. The goal is for Party A, as the indemnitor, to pick up the tab for whatever losses arise. This is seldom the case. Lord Justice Staughton[1] identifies two classes an indemnity can fall within in a contract:

> "The word 'indemnity' is … used in two senses. It may mean simply damages awarded for tort or breach of contract. … Alternatively the word 'indemnity' may refer to all loss suffered which is attributable to a specified cause, whether or not it was in the reasonable contemplation of the parties. There is precious

> little authority to support such a meaning, but I do not doubt that the word is often used in that sense."

As can be seen, the courts are cautious to depart from the well-established approach of not awarding unforeseeable or not properly mitigated losses, especially in the context of a breach of contract claim. There is little authority to support such an interpretation of an indemnity.

Therefore persuading a court to interpret an indemnity to allow recovery of any and all losses incurred will be an uphill task and would need to rely on express wording in the indemnity showing a very clear evidence that this is the true intention of the parties.[2]

Legal costs. Linked to 100% recovery is the belief that Party A will pay in full for all of Party B's legal costs. Again, this is unlikely to be the case.[3]

The starting point of the English courts is to award reasonable costs to the winning party. While the courts will generally look to uphold terms freely negotiated in contracts, the Court of Appeal has held that it would offend public policy to allow 100% recovery of legal costs where unreasonable costs have been incurred or in instances where the successful party is required to pay the losing parties' costs.

In contrast, indemnities covering legal costs incurred by way of third party claims can, and have managed to, obtain full recovery.

The courts themselves do distinguish between the ability to recover legal costs on a "standard basis" and "indemnity basis". CPR 44.3(3) states:

> "Where the amount of costs is to be assessed on the indemnity basis, the court will resolve any doubt which it may have as to whether costs were reasonably incurred or were reasonable in amount in favour of the receiving party."

On a standard basis any doubt falls in favour of the paying party. In addition, on an indemnity basis the court may disregard whether costs have been

proportionately and reasonably incurred or whether they are proportionate and reasonable in amount. It must, however, still consider whether the costs have been unreasonably incurred or are unreasonable in amount.[4]

In adjudications under the Construction Act,[5] parties to a construction contract are prohibited from pre-allocating liability for litigation costs of the adjudication, unless such agreement is made in writing after the giving of the notice of intention to refer the dispute to adjudication.[6]

Limitation on liability. Whether or not an indemnity falls within a cap on liability depends on how the limitation on liability is drafted. Good drafting should expressly state whether the indemnity falls within the cap or not, the risk being that indemnities do not necessarily fall outside of the cap. Contracts that seek to impose unlimited liability for an indemnity should make this clear in the drafting.

Debt claim. Debt claims are immune from issues such as remoteness, mitigation and foreseeability. While some view indemnities as giving rise to a simple debt claim this again all depends on the drafting and is not automatically the case. An indemnity in relation to a specified amount due is much more likely to be seen to give rise to a debt claim than an indemnity against general losses for a breach of the contract.

Extending liability periods. The limitation period for an indemnity starts to run from the date the loss is established and can therefore provide a longer period of liability for the claimant. It is common for indemnities to be stated as being "on demand" which can further increase the liability period, with time starting to run from the date the demand is actually made.

In summary, notwithstanding the commonly perceived advantages that an indemnity is believed to bring with it, there is no superpower to use of the word indemnity in a contract. As is more often the legal answer, the scope of the indemnity depends on the specific drafting of the clause and the context in which it is used. It is for this reason that careful attention is required by both the party giving and the party receiving the indemnity in contract negotiations.

Blanket indemnities

Commonplace in US contracts, wide-ranging blanket indemnities have crept into construction contracts this side of the pond (e.g. where Party A is forced to indemnify Party B for any loss suffered as a result of Party A breaching the contract).

This year Build UK, the representative organisation for the UK construction industry, published a list of recommendations to form a common ground between clients and the supply chain on good contractual practice. Its recommendation on negotiating indemnities is quite clear: "*Do not include a blanket indemnity for breach of contract*".

Blanket indemnities reflect bad practice, lazy drafting and, more often than not, will not even get the receiving party the upside they may be anticipating.

Specific indemnities

Specific indemnities, on the other hand, are not uncommon in construction contracts and can typically be found to cover the likes of:

- third party claims for infringements of the IP licence;
- loss or damage to third party property or persons in carrying out the works;
- breaches under the Bribery Act;
- breaches of confidentiality undertakings or data protection;
- liability caused as a result of actionable nuisance and trespass claims; and/or
- infringements of environmental law.

The best starting point is always to adopt a narrower and more tailored approach in considering which risks should be covered by indemnities given the nature of the project.

Professional indemnity insurance

A practical concern in construction contracts littered with indemnities or containing blanket indemnities is that they risk invalidating the cover of the professional indemnity insurance and, in

turn, putting the company's balance sheet in the firing line. Any indemnity should be viewed with caution if the intention is for it to be backed up by an insurance policy. Ideally, the insurer should be made aware of the indemnity being requested to ensure that the policy will respond.

Standard form contracts

The standard form construction contracts contain indemnities.

JCT. The JCT Design and Build 2016 edition contains the usual Contractor-specific indemnities for:

- intellectual property infringement (clause 2.19); and
- injury or damage to property or persons in carrying out the Works due to negligence, breach of statutory duty omission or default of the Contractor or Contractor's Persons (clause 6.2).

NEC. The position under the NEC contracts has not always been clear for contractors. Clause 83.1 of the NEC3 contained a reciprocal indemnity whereby: "*Each party indemnifies the other against claims, proceedings, compensation and costs due to an event which is at his risk.*" The problem was that Contractor's risks were very widely defined as all "*risks which are not carried by the Employer*".

On a plain reading of clause 83.1 the indemnity appears to be extremely wide and commentators have noted that an "uncommercial" reading could suggest that "*because not all compensation events are Employer's risks some of them may be Contractor's risks with the result that there may be an increase in the prices under clause 60 which the Employer then recovers under his indemnity under clause 83.1*".[7]

Fortunately, this ambiguity has been clarified under the new NEC4 editions where Contractor's liabilities (previously called *Contractor's risks*) are now listed in clause 81, rather than being defined by exception as done in the NEC3. These indemnified liabilities now relate to specific risks for which the Contractor is responsible:

- claims from Others in connection with providing the works;
- loss or damage to the works, Plant, Materials,

- loss or damage to property owned or occupied by the Client other than the works which arise in connection to the works; and

- death or bodily injury to the employees of the Contractor.

FIDIC. FIDIC has recently had to revisit its approach to indemnities. The early pre-release of the Yellow Book Second Edition 2017 created a stir amongst contractors when the new clause 17 (now called "Care of the Works and Indemnites") contained an indemnity from the Contractor to the Employer in relation to any breach of its design obligations that results in the Works not being fit for the purpose identified. This indemnity was drafted to sit outside of the limitation of liability.

Although the design-related fitness for purpose indemnity remains in the new edition, it is now included within the reciprocal limitation of liability at clause 1.15.

The usual FIDIC indemnities remain in the new 2017 editions in relation to intellectual and industrial property infringement; bodily injury, sickness, disease or death; and damage or loss to any property (other than the Works).

When negotiating any standard form contract parties should look out for bespoke amendments seeking to incorporate additional and/or enhanced indemnities.

A way forward?

Indemnites should remain a red flag on the page. That said, they are likely to be one of the most misunderstood terms used in construction contracts. Without doubt indemnities can be a powerful tool to allocate risk and recover loss – this, however, requires careful thought, negotiation and drafting. Any hope that the word "indemnity" provides for a straightforward and easy case is wrong as the case may well focus on what the indemnity actually means.

End Notes

1.Total Transport Corporation v Arcadia Petroleum Ltd. ("the Eurus") [1998] Lloyds Rep 351

2.Church Commissioners v Ibrahim [1997] 1 EGLR 13.

3.Woodford v AIG Europe Ltd [2018] EWHC 358 (QB).

4.CPR 44.4.

5.Housing Grants, Construction and Regeneration Act 1996 (as amended).

6.Section 108A(2).

7.David Thomas QC, Keating on NEC3: Clause by Clause Commentary on the Engineering and Construction Contract, Sweet & Maxwell, 2012, 9-003.

ABOUT THE AUTHOR

Edward Colclough
Senior Associate

Edward has experience advising on all stages of construction and engineering projects.

FENWICK ELLIOTT

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