Russell McVeagh

Breaking Ground

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Industry spotlight

Limiting liability under construction contracts

Most people involved in the construction industry will be well aware of the proposed review of the NZS 3910 construction contract.[1] The intention is to review and amend NZS 3910 in order to align it with recent law changes, and make it more responsive to the practical requirements of the industry.

The key issues of limitation of liability and indemnity have been tabled for consideration as part of that review. In a sector-wide survey conducted by Standards New Zealand in early 2021, 69.5% of respondents either agreed or strongly agreed that the ideal outcome for a revision of NZS 3910 would be a contract which included optional caps on liability and indemnity.[2]

The clauses

Clauses which create indemnities or limit liability are included in commercial contracts as a way of allocating risk between the parties. Limitation clauses allocate risk by either limiting a party's obligations under the contract, or limiting the availability of remedies where the contract is breached. Indemnity clauses allocate risk by specifying which party will be liable in the event that certain losses are incurred. This means that even if 'Party A' has to pay the upfront costs of that event, 'Party B' will be obliged to repay them.

Under NZS 3910 the contractor gives wide indemnities under clause 7. In some cases, under clause 10, the contractor also agrees to pay liquidated damages in the event of late completion.

There is no limitation or liability cap included within either section. Nor is there an exclusion for indirect or consequential loss. It is rare to see a commercial contract without such caps or exclusions. The introduction of caps and exclusions to NZS 3910 has been discussed for some time, and is increasingly being sought by contractors.[3]

Changes proposed

Adjustment to the standard terms has the potential to significantly alter the allocation of risk under the contract and should be confirmed only after very careful consideration of the ramifications involved.

In particular, parties should bear in mind the legal requirements which must be met for a limitation of liability clause to be enforceable:

- A party who wishes to rely on such a clause would need to show that it is intended to cover the relevant obligation or liability.[4] In every case, it will be a question of the construction of the contract as a whole.
- Clear words will be necessary before a court would be willing to conclude that a party did intend to limit or abandon its remedies in this way.[5]
- This means that the more restrictive the exclusion or limitation clause, the clearer the wording will need to be in order for it to have effect.

Deliberate breach?

An issue which can arise is whether a limitation or exclusion clause is intended to apply where the party deliberately breached the contract. This might become relevant in the context of a construction dispute if, for example, the contractor, in breach of contract, deliberately withheld documentation necessary for code compliance certification, and then sought to rely on a limitation clause to limit a claim for damages arising from that breach.

To address that issue, the court (or arbitrator) would be primarily focused upon the interpretation of the limitation or exclusion clause in question.

A recent High Court decision typified the approach taken in England and Wales. In *Mott MacDonald Ltd v Trant Engineering Ltd* (TEL), the Ministry of Defence had engaged TEL to construct a new power station.[6] TEL then engaged Mott MacDonald to provide consultancy services. When a dispute developed, the parties entered into a settlement and services agreement (Agreement), designed to resolve their existing dispute and to clarify each party's ongoing obligations.

The Agreement included a limitation clause. It provided that Mott MacDonald would only be liable to pay compensation to TEL under or in connection with the Agreement if a breach of the Agreement by Mott MacDonald was established.

It also limited Mott MacDonald's total liability, including "in contract or in tort, in negligence or for breach of statutory duty or otherwise" to £500,000, and provided that it would have no liability for indirect, special or consequential loss.

The parties' working relationship did not improve. Mott MacDonald sued TEL, seeking payment of around £1.7m in fees. In response, TEL said that Mott MacDonald had "fundamentally, deliberately and wilfully" breached its obligations under the Agreement, including by:

- refusing to complete the required design deliverables;
- refusing to provide TEL with native data files and detailed calculations it had created; and
- failing to carry out independent reviews of its design.

TEL said that the limitation clause therefore did not apply. It claimed around £5 million in losses.

Mott MacDonald applied for summary judgment to determine whether TEL's claim was subject to the limitation and exclusion clause.

The Court said that the limitation and exclusion clause applied, whether or not the breaches were deliberate, as alleged. This was because the relevant clauses were:

- in clear terms and capable, when read naturally, of applying to the alleged breaches;
- contained in a bespoke agreement entered into between two commercial entities; and
- designed both to resolve an existing dispute and set out a regime governing further dealings with a view to avoiding renewed disputes.

To adopt TEL's preferred interpretation in those circumstances would amount to implying exceptions into the clear terms of the contract's limitation clauses. There was no basis for doing so.

In our view, the same result would be likely in the New Zealand Courts.

Conclusion

The introduction of limitation or exclusion clauses and caps on liability can have a profound impact on the rights and remedies available under the contract, and will alter the risk profile of a project significantly. It is worth taking legal advice before considering such changes, to ensure that the parties' intentions are captured accurately, and are legally enforceable.

Two key points to bear in mind:

- If such clauses are to be included, the parties, especially principals, should carefully consider their scope. It may be necessary to specify that the limitations or caps will not apply in certain circumstances, for example, where there are deliberate breaches, insured losses, breaches of confidentiality, or intellectual property obligations.
- Clarity will go a long way towards avoiding a dispute. Use specific language to clearly state which losses are recoverable, and which are not.

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Endnotes

1 First proposed by the New Zealand Construction Industry Council and Standards New Zealand in 2020.

2 See Standards New Zealand Scoping Report: NZS 3910 Conditions of contract for building and civil engineering, March 2021

3 See Advisian Worley Group, An examination of issues associated with the use of NZS Conditions of Contract, prepared for Treasury's Infrastructure Transactions Unit, August 2019, at 6.4.

4 *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd* [1983] 1 All ER 101; *DHL International (NZ) Ltd v Richmond Ltd* [1993] 3 NZLR 10 (CA).

5 *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] AC 689 at 717; *i-Health Ltd v iSoft NZ Ltd* [2011] NZCA 575, [2012] 1 NZLR 379 at [45].

6 *Mott Macdonald Ltd v Trant Engineering Ltd* [2021] EWHC 754 (TCC).

Case Law Update

New Zealand

Hellaby Resources Services Limited v Body Corporate 197281 [2021] NZHC 554

This recent case is of particular interest for two key reasons:

- it is a rare example where a stay of enforcement was granted for a debt due under the Construction Contracts Act 2002 (CCA); and
- it clarifies that the mandatory dispute resolution process set out in NZS 3910:2013 ceases to apply one month after the final payment schedule is issued (unless the dispute has been referred to adjudication).

Background

TBS and the Body Corporate entered into a NZS 3910:2013 construction contract. The apartment complex managed by the Body Corporate had suffered weather damage issues, and TBS was engaged to undertake the necessary remediation work. The Body Corporate later refused to pay the balance of the agreed price to TBS, on the basis that certain areas of work remained incomplete or defective.

TBS applied for:

- summary judgment against the Body Corporate for payment of the balance; and
- a stay of the counterclaim raised by the Body Corporate as to the allegedly incomplete or defective work, on the basis that it had to be referred to arbitration.

Summary judgment

The Court considered that the Body Corporate had no arguable defence to TBS's application for summary judgment. This was because the amount claimed was a scheduled amount, and therefore a debt due pursuant to section 24 of the CCA.

The Court accordingly granted the summary judgment, but then took the unusual step of ordering that its enforcement be stayed, meaning that the Body Corporate was not yet required to make the payment. This was on the basis that:

- the Body Corporate had a credible counterclaim that the remediation work was defective;
- there was a real risk that, were the summary judgment enforced (and the Body Corporate immediately required to pay) it would be unable to pursue the counterclaim against TBS due to a lack of funds; and
- the Body Corporate's ability to hold TBS accountable for the allegedly defective work could also be frustrated by the fact that TBS had been sold to an Australian-owned company (Hellaby), was now a shell company, and would immediately pay the judgment sum to Hellaby – meaning that, to the extent it was ultimately determined that the Body Corporate could claim some of the money back from TBS, it would be unable to do so.

Dispute process under NZS 3910

TBS had also sought that the Body Corporate's counterclaim be stayed, on the basis that it was required, under the terms of the contract, to refer that dispute to arbitration. The Court disagreed. It held that:

- for one month after issuance of the final payment schedule, the mandatory dispute resolution process under cl 13 of the contract would continue to apply; but
- after that one-month period was complete, unless the dispute had been referred to adjudication, the dispute resolution process contained in cl 13 ceased to be operational, and either party would be free to pursue their claims in court.

Takeaways

- Under the High Court Rules, a liable party may apply to the court for a stay of enforcement or other relief against the judgment if it considers that a "substantial miscarriage of justice would be likely to result" if the judgment were enforced. While the stay of enforcement in this case related to a summary judgment, it may also be exercised in the context of an application to enforce an adjudication determination. In that case, the application would be made to the District Court, with the application for a stay of enforcement made under the court's inherent jurisdiction.
- The case provides useful clarification of the application of cl 13 dispute resolution processes at the conclusion of the construction contract. It effectively gives the parties an option to litigate disputes under the contract, if the parties are content to wait for the one-month period after issuance of the final payment schedule to lapse.
- A reminder, however, that parties can always agree to arbitrate at any stage.

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Case Law Update

Australia

Valmont Interiors Pty Ltd v Giorgio Armani Australia Pty Ltd (No 2) [2021] NSWCA 93

The New South Wales Court of Appeal recently applied the doctrines of waiver and estoppel in the context of a construction contract. Where either doctrine applies, the parties may not be able to rely on the wording of their formal agreement, and the case provides a useful summary of the factors to bear in mind.

Background

In early 2016, Valmont Interiors agreed to perform certain construction and fit out works for a new Armani store. The contract singled out some of the joinery as "client supply" items, meaning it was to be supplied separately by Armani. Armani engaged another company, Sun Bright Construction, to supply that additional joinery.

Partway through the project, Sun Bright informed Armani that it would not be able to complete all of the joinery in time. Armani asked Valmont to supply the items that Sun Bright could not. When Valmont invoiced Armani for that additional work, Armani refused to pay. Armani said that Valmont had not followed the variations procedure set out in the contract.

Valmont sued Armani asking for damages for breach of contract, or alternatively quantum meruit (reasonable payment for work performed outside of a contract), in relation to the cost of the joinery, and some other work it considered to have fallen outside of the contract's fixed price.

In the New South Wales District Court, the judge agreed that the variations procedure under the contract ought to have been followed. However, the judge considered that, until 11 April 2016, Armani's own failure to follow that procedure meant that it had waived the requirements and was "estopped" from being able to use Valmont's failure as a reason not to pay. From 11 April 2016 on, however, the judge considered that the waiver no longer applied. This was because he held that Armani had given Valmont reasonable notice in an email that the contractual variations procedure would be followed in future. Unfortunately for Valmont, most of the costs it had incurred in relation to the joinery occurred after that crucial email, meaning it was not entitled to payment.

Valmont appealed.

Outcome

The Court allowed the appeal.

The Court of Appeal agreed that an estoppel had effect in the period prior to 11 April 2016, but also held that it continued to operate past that date. It took a different view of the 11 April 2016 email, holding that it was not sufficient notice to revert to the contractual terms. This was because:

- The email did not make it clear that Armani no longer intended to pay for the additional joinery. If it did not intend to pay, either because of non-compliance by Valmont with the variations procedure, or for any other reason, it was incumbent on Armani to say so.
- It was reasonable for Valmont to assume that Armani would meet the cost of the additional joinery it had been requested to supply. The email was not clear or specific enough to displace that assumption.
- It was in all the circumstances unconscionable for Armani to resist payment for the provision of the balance of the joinery by Valmont.

Takeaways

- When a contract clearly sets out a procedure for the approval of variations, be careful to comply with that procedure. While reaching agreement informally may help to keep the project moving at the time, it could be interpreted as a waiver of the contractual requirement, removing the other party's obligation to follow it (and removing your ability to rely on the clause if they don't).
- If you suspect that another party may be acting on a false assumption, the onus is on you to clearly correct that assumption. If they continue to act on that assumption without being corrected, and incur costs or other detriment as a result, the doctrine of estoppel may apply.
- It is often possible to revert to your strict legal rights under the contract, even after you have led the other side to think you will not rely on them. However, you must first give reasonable notice that the relevant contractual provisions will come back into effect, and reinstating them must not be unfair.

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