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Breaking Ground

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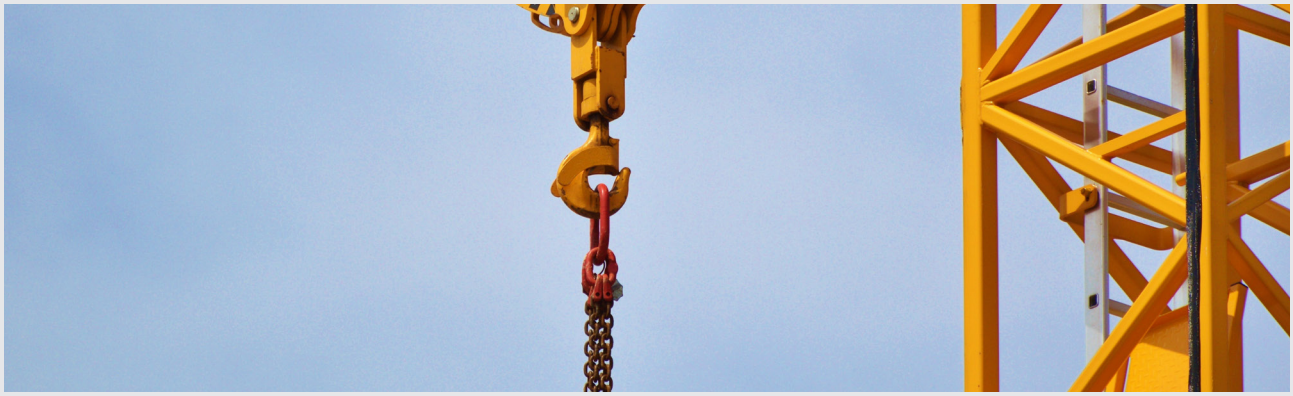
New Zealand – Case Law Update

Rau Paenga Ltd v CPB Contractors Pty Ltd [2023] NZHC 2974

The High Court granted interim orders restraining a contractor from suspending or terminating a contract pending resolution of the dispute by arbitration. In effect, this means that the contractor has to continue with the works pending further order.



Background

In 2019, Rau Paenga Ltd, a Crown owned enterprise, engaged CPB Contractors Pty Ltd to construct the Parakiore Recreation and Sports Centre in Christchurch for $220 million, pursuant to a NZS 3910:2013 standard form build only contract with modifications.

There was subsequently a breakdown in the relationship between the parties with each alleging breach of contract by the other, causing delay (of nearly four years) and increased construction costs.

In September 2023, the contractor issued three default notices under cl 14.3.1(f) of the contract alleging that RPL had "persistently, flagrantly, or wilfully" neglected to carry out its obligations under the contract. By the notices, the contractor required the principal to remedy its alleged breaches by way of paying damages of approximately $450 million and awarding an extension of time, within 10 working days. Non-compliance would purportedly allow CPB to terminate or require the engineer to suspend the contract.

The principal disputed the alleged breaches and the validity of the notices. It applied to the High Court for interim measures to restrain the contractor from suspending or terminating the contract.

Outcome

There are well established tests the courts apply when considering whether to grant interim relief.

Applying these, the judge found that:

- There was a reasonable possibility that the principal would succeed on the merits of the claim (ie show that there was no basis for termination):
  - The default notices were, on their face, arguably invalid because they were unable to be remedied by performance alone. They demanded sums of money but the sums demanded had not been certified by the Engineer as payable under the Contract.
  - Arguments that the contractor was entitled to cancel under sections 36 or 37 of the Contract and Commercial Law Act 2017 also faced challenges. In particular, the bar for repudiation is a high one; and as for representations – the contract included an entire agreement clause.

- The harm to the principal was not adequately reparable by damages:
  - Suspension would risk the loss of key personnel and loss of project knowledge. The position would be exacerbated if the contractor terminated the contract. An alternative contractor would have to be engaged and would be unlikely to provide warranties for works they did not initially start. The project would inevitably be further delayed.
  - There would be a loss of reputation in relation to the project generally.
  - The costs associated with any suspension or termination would be difficult to calculate and would not be restricted to the increased price of finishing the project.
  - There may also be harm to third parties, including participants and spectators for various sports, and cost implications for the Council, which would be forced to maintain and keep open other facilities it had intended to close.
- The likely harm to the principal if the interim measures were not granted outweighed the likely harm to the contractor if the interim measures were granted:
  - The harm to the contractor in continuing construction would be mainly economic (and could be met by an award of damages), whereas the harm to the principal would be difficult to quantify (as noted above).
  - An arbitration could be completed in a matter of months. The contractor's right to terminate was dependent on the conditions of cl 14.3.1(f) being met, which was disputed in this case. The parties agreed in the event of a dispute the matter would be referred to the engineer and then subsequently to arbitration – and therefore accepted that such a process would take time.

Leave to appeal denied by High Court

The contractor's application for leave to appeal from the High Court was dismissed on 22 November 2023 (*Rau Paenga Ltd v CPB Contractors Pty Ltd* [2023] NZHC 3329). However, the contractor may pursue its application for leave to appeal with the Court of Appeal.

Observations

This case applies the usual test for the granting of interim relief. However, the outcome may be surprising – it demonstrates that a contractor looking to terminate a construction contract might find that they are unable to and the Courts may well require them to continue to perform the contract pending arbitration or litigation.

Some of the Court's apparent findings and conclusions are questionable and may need to be revised, including that:

- a default specified in a default notice must be capable of being remedied;
- damages claimed by a contractor against a principal must be certified as being payable by the Engineer; and
- a party seeking to terminate is expected to wait for any dispute regarding the right to terminate to be resolved by the Engineer and/or arbitrator (the implication of which is that attempted termination could effectively be prevented, or at least delayed, by the counterparty issuing a notice of dispute).

How far the case affects the wider industry remains to be seen. A different outcome might well have been reached on different facts, for example if it was a private project and/or there were concerns around the principal's liquidity.

Finally, this case is another reminder that great care must be taken whenever a party is seeking to terminate a contract. Please contact your usual contact at Russell McVeagh if you need any assistance.

CONTRIBUTORS:
Michael Taylor, Michelle Mau, and Angela Yang

Dalton v Reeves [2023] NZHC 2779

No equitable lien arises in respect of generic products that can be applied to other projects.

Background

The Reeves Family Trust (Trust) contracted with a construction company (FirstBuild) to build a modular house, which involved FirstBuild building the modules in its warehouse and then transporting them to the construction site.

The contract provided that:

- legal and equitable ownership of materials brought onto the land was to remain with FirstBuild until all monies were paid under the agreement; and
- if either party cancelled the agreement, then the Trust was to pay FirstBuild for all materials delivered and all building work performed up to the date of cancellation.

Plywood and shiplap cladding (both generic materials available from wholesale suppliers) were acquired for the project. It had been specified by the Trust and was not used on any other FirstBuild contract.

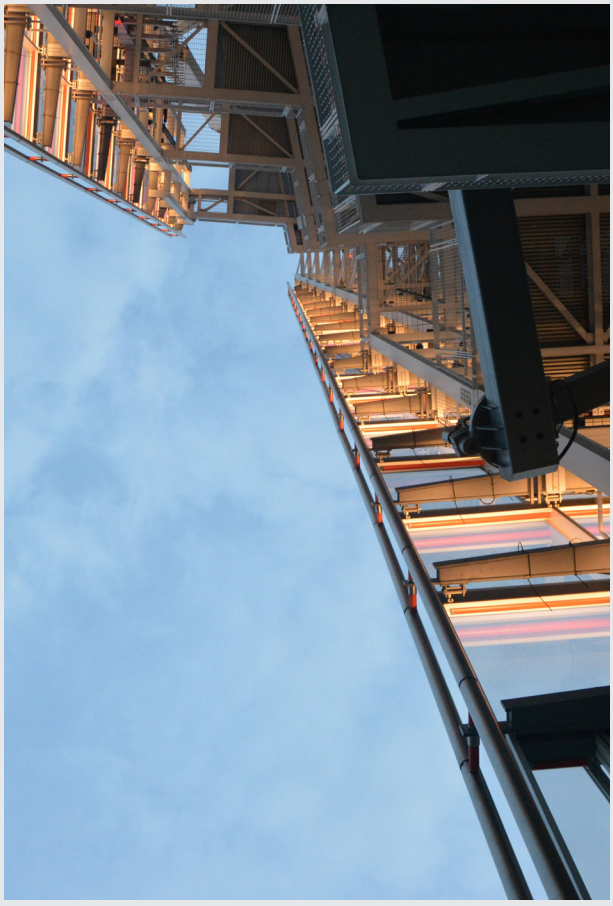
After FirstBuild had completed the foundation on the Trust's site, it was put into liquidation. At that point:

- the Trust had paid over $500,000 but the value of the works on the Trust's site was under $100,000;
- most of the plywood and shiplap cladding that FirstBuild had bought was still stored in its warehouse.

The Trust claimed an equitable lien over the plywood and cladding. The liquidator applied for directions from the Court on this issue.

What is an equitable lien?

An equitable lien recognises that in some circumstances, it is just and conscionable for a party (eg a purchaser) to have a priority interest (over and above other creditors, including secured and preferential creditors) in an asset. In effect, the person entitled to an equitable lien becomes a secured creditor with super priority.



In what circumstances do equitable liens arise?

Where a building is constructed on the principal's site, there is usually no question that the principal owns the partially completed building if a contractor becomes insolvent part way through the project (subject to the principal paying for the works that have been completed to date). However, that is not the case where a modular building is comprised of components manufactured and stored offsite, to be eventually transported and installed at the principal's site.

In a series of recent decisions concerning failed modular housing companies (*Maginness & Booth v Tiny Town Projects Ltd (in liq)* [2023] NZHC 494 and *Francis v Gross* [2023] NZHC 1107), the High Court has held that purchasers of "tiny homes" and "pods" have an equitable lien over their partially completed modular building(s), to the extent of the money paid by them. While the title in the incomplete building had not passed to the purchaser, the purchaser had an equitable lien over it because the buildings were identifiable to each separate contract and could not sensibly have been sold to anybody else.

With reference to these decisions, Anderson J held that no equitable lien arises for the plywood and cladding notwithstanding that the products were ordered for the Trust, on the basis that they were generic and so could have easily been applied to another construction project (in contrast to the partially completed tiny homes and pods in the previous cases).

Observation

Dalton is the latest in a line of New Zealand cases to confirm that an equitable lien may (in principle) come to the rescue for purchasers of bespoke items where the manufacturer becomes insolvent before the items are delivered. Whether a lien arises will depend on how bespoke or generic an item is – which requires a level of subjective assessment.

This uncertainty no doubt creates difficulty for both insolvency practitioners (who will likely need to continue to seek directions from the Court) and lenders to manufacturers of bespoke goods (who will need to assess the risk to their security interest).

CONTRIBUTORS: Michelle Mau, and Angela Yang

England and Wales – Case Law Update

AZ v BY [2023] EWHC 2388 (TCC)

Placing without prejudice information before an adjudicator can result in a finding that the adjudicator's award is unenforceable.

Background

AZ (a contractor) and BY were parties to an adjudication as to whether a contract for stair pressurisation works had been finalised between them. A decision was issued in favour of AZ. AZ sought to enforce that decision via a summary judgment application.

BY sought a declaration that materials produced by AZ in the adjudication were subject to without prejudice privilege, and therefore that the decision was unenforceable (for having relied on inadmissible material).

Key principles

The following principles were relevant to the decision:

- the without prejudice rule is founded partly in public policy (to encourage settlement of disputes without reference to litigation) and partly in the agreement of the parties;
- the Court has to determine whether or not a communication is bona fide intended to be part of or to promote negotiations;
- the fact that a document is marked "without prejudice" is not conclusive as to its status, although it is often a strong pointer;
- where negotiations are expressly made without prejudice to begin with, the burden is upon the party who wishes to change the basis of such negotiations to do so clearly;
- once a communication is covered by without prejudice privilege, the court is slow to lift the cloak of that privilege unless the case for making an exception is absolutely plain;
- one such exception relates to when the issue is whether without prejudice letters have resulted in an agreed settlement. However, where the without prejudice letters have not in fact resulted in an agreed settlement which has replaced the original dispute about which the parties were negotiating, the decision-maker, having seen the without prejudice material, must then assess their own ability to go on to decide the remaining dispute fairly, in accordance with the principles which govern apparent bias and the rules of natural justice; and
- the test is whether, in all the circumstances, a fair-minded and informed observer would conclude that there was a real possibility that, having seen the without prejudice material, the adjudicator was biased.

Outcome

The Court concluded that the fair-minded and informed observer considering all of the circumstances of this case would conclude that there was a real possibility that, having seen the without prejudice material, the adjudicator was unconsciously biased. This is because:

- the without prejudice material was placed front and centre within the adjudication by AZ, and played a significant role in AZ's case. It was put in terms such that the material demonstrated BY was taking a position materially inconsistent to its previously expressed views. The very purpose of without prejudice privilege is to prevent this from happening; and
- regardless of the manner in which the adjudication decision was expressed, there is in the circumstances of this case an inevitable question mark about whether the result of the adjudication, however inadvertently or sub-consciously, was shaped by the adjudicator's knowledge of the concessions/admissions in relation to key aspects of the open dispute made by BY in negotiations.

Observation

This is one of the few cases in which a breach of natural justice, by reason of apparent bias, has rendered an adjudication decision unenforceable.

It serves as a reminder for users of adjudication, and adjudicators, to tread carefully when dealing with any documents or other evidence that may be subject to settlement privilege.

If a similar situation arose in New Zealand, a party wishing to challenge the adjudication determination could apply to judicially review the determination.

CONTRIBUTORS: Michelle Mau

Breaking Ground is produced quarterly by Russell McVeagh. It is intended to provide summaries of the subjects covered, and does not purport to contain legal advice. If you require advice or further information on any matter set out in this publication, please contact one of our experts.

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Key contacts:

Michael Taylor
Partner
Litigation/Construction
+64 9 367 8819
michael.taylor@russellmcveagh.com

Editor:

Michelle Mau
Senior Associate
Litigation
+64 9 367 8713
michelle.mau@russellmcveagh.com

Construction law experts:

David Butler | Ed Crook | Anna Crosbie | Nick Saxton