

PRACTICE NOTE 1: COMMERCIAL CONTRACTS GUIDANCE

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1. Introduction

1.1 There are a number of standard form contracts in use in New Zealand. These include:

- (a) NZS3910:2013. The most common standard form contract in use. It is a traditional 'build only' construction contract.
- (b) NZS3915:2005. Derived from NZS3910:2013 but used where there is no "Engineer to the Contract" and instead the Principal administers the contract.
- (c) NZS3916:2013. A design and construct contract.
- (d) NZS3917:2013. A fixed term contract used for maintenance or other items suited to a fixed term.
- (e) NZIA SCC 2018. A standard form contract which can only be used where an Architect is administering the contract. Published by the New Zealand Institute of Architects.
- (f) National Building Contract. Derived from NZIA SCC 2018 but used where there is no Architect administering the contract.
- (g) NEC4. The New Engineering Contract is now in its 4th Edition. The contract is owned and published by the Institute of Civil Engineers (UK) and comes with a variety of options.
- (h) FIDIC. There are various standard form main contracts published by the International Federation of Consulting Engineers. FIDIC would be the most common suite of contracts used worldwide.

1.2 These standard form contracts are published by reputable organisations and they have been finalised following a rigorous consultation and peer review process. The intent of any standard form is to appropriately and fairly allocate the risks of a project as between the Principal and the Contractor.

1.3 Unfortunately many clients, including the Crown, seek to redistribute the risks, inevitably away from the Principal to the Contractor, through the use of numerous, often poorly drafted, special conditions.

1.4 The first question a Contractor should be asking on tendering for a project where the risk profile of the standard form contract has been altered in this way, is why this is necessary. Too often Contractors accept the terms put forward by the Principal on the basis that they are non-negotiable.

1.5 The purpose of this guidance note is to assist commercial contractors who encounter day to day issues with the interpretation and administration of commercial contracts. The Association would like to see better understanding of commercial terms by all parties, Principals and Contractors, so that where the risk allocation is changed parties are aware of this and can factor this into their tendering as appropriate.

1.6 This guidance note does not provide a detailed commentary on the merits of any particular standard form, nor is it intended to be a substitute for a Member obtaining its own legal advice.

2. The Role of the Principal

2.1 The Principal (sometimes called the Employer or Client) is the party for whom the project is being undertaken. The Principal determines the basis upon which it wishes the project to proceed which will usually be either:

- (a) Traditional construction only, where the Contractor is provided with a design undertaken by the Principal's consultants; or
- (b) Design and Build, where the Contractor is required to design and build the project.

2.2 There are numerous pricing structures.

2.3 The Principal supplies the information which allows the Contractor to set its price for the project.

2.4 The Principal pays the Contractor the contract price.

2.5 The Principal will owe the Contractor two implied obligations, which are usually not stated in a contract but which are worth remembering:

- (a) The Principal shall not do anything which will hinder the Contractor from completing its works (sometimes called the Prevention Principle - and it should be noted that the Contractor also owes this duty to the Principal);
- (b) The Principal owes a positive obligation to do anything which may be necessary to allow the Contractor to fulfil its works. For example, give possession of site, provide timely information.

3. The Role of the Contractor

3.1 The Contractor constructs the project in accordance with the information provided by the Principal to the appropriate standard. It is important to note that in bidding for a project the Contractor warrants that it can construct the project. It is therefore no excuse for a Contractor, after it has entered into a contract, to complain that the project is more difficult and hence more expensive to construct than it had allowed for.

3.2 The Contractor will be required by virtue of implied terms to:

- (a) undertake the work in a tradesman like manner;
- (b) use materials of good quality;
- (c) ensure the work employed and materials selected (from those specified eg straight weatherboards without knots) are reasonably fit for the purpose for which they are required at the time they are installed (unless the circumstances of the contract are such that this obligation can be excluded - generally where the facts are such that

there has been no reliance upon the Contractor, for example because the materials appear fit for purpose at the time of installation and the Contractor has no choice over the product installed).

3.3 Contractors need to understand the part they play in design.

- (a) In a traditional construction project:
 - (i) A Contractor constructs works so that they are fit for purpose at the date of completion. That is that the works will meet their intended purpose.
 - (ii) A design professional designs the works with reasonable skill and care. This is a lesser standard to fitness for purpose. If a design professional can show that s/he acted in accordance with the usual practice and standards of the reasonable professional current at the time the design was undertaken then they will not be liable.
- (b) Nearly all professional indemnity policies will not respond to a claim for fitness for purpose. So even if a Contractor holds professional indemnity insurance a Contractor will not be insured for a design which is does not meet a fit for purpose obligation.
- (c) Where a Contractor designs the works, then unless the contract states otherwise, it must still achieve a result that is fit for purpose. This includes temporary works. Sometimes design obligations are contained in the specification which might, for example, require the design and construct of discreet works only, eg lifts, seismic restraints, fire protection.
- (d) Fortunately, NZS3910:2013, NZS3916:2013 and Option X15 of NEC4 all state that the Contractor shall design the works with reasonable skill and care. If Option X15 of NEC4 is not used, then arguably a fitness for purpose obligation is imposed because the Contractor is required to comply with the Works Information. Contractors should be cautious in accepting amendments that make their design obligations one of fitness for purpose.
- (e) Even when a contract states that the Contractor shall design the works with reasonable skill and care Contractors should carefully check specifications to see if they are required to achieve set standards for any design they are required to undertake. Be wary of specifications that state the Contractor must design something to allow to achieve a performance standard as it may import a fitness for purpose obligation.
- (f) In a design and build contract a Contractor should carefully consider its engagement of a design professional who is required to act with reasonable skill and care. If the end product is not fit for purpose the Contractor will be liable to the Principal, but will have no recourse against the design professional. Even if the design professional were to be liable, any damages payable would be limited by any cap contained in design professional's terms of engagement.

3.4 The Principal and the Contractor are required to comply with the express terms of the contract. In addition to the standard of work, the express terms in a standard form will cover other aspects including:

- (a) Administration of the Contract;
 - (b) Time for performance;
 - (c) Variations;
 - (d) Payment provisions;
 - (e) Insurance and Indemnity;
 - (f) Disputes.
4. Sometimes the Contractor is requested to become involved in a negotiated process whereby the Contractor commits time and resources in developing a project alongside a Principal and its design team. This is sometimes termed Early Contractor Involvement or “ECI” and separate agreements can be entered into detailing what a Contractor’s role is to be. There are no standard form ECI Agreements in use in New Zealand and a Contractor needs to understand the obligations that it is entering into when signing such an agreement and that if necessary it has appropriate professional indemnity insurance cover.
5. **The Contract Administrator**
- 5.1 In NZS3910:2013 this is “the Engineer”, in SCC 2018 this is “the Architect”, in NEC 4 it is the “Project Manager”. In this guidance note the neutral term “Contract Administrator” is used.
- 5.2 The Contract Administrator is normally appointed by the Principal. The Contract Administrator is responsible for the tasks entrusted to them under the contract. There are normally provisions allowing a delegate or assistant of the Contract Administrator and for a replacement Contract Administrator to be appointed. These are all matters that the Principal usually has control over.
- 5.3 The Contract Administrator (and any assistant) is the Principal’s agent. This means that for tasks allotted to the Contract Administrator where s/he is not making decisions under the contract s/he has to act in the interests of the Principal. It follows that most of the time the Contract Administrator acts on behalf of the Principal and the Principal is bound by the actions of the Contract Administrator.
- 5.4 However, if the Contract Administrator is entrusted with making decisions in a quasi-judicial role (e.g. a decision on a dispute between the Principal and Contractor) then s/he has an obligation to act fairly and impartially. This is confirmed by caselaw. In *Brown & Doherty v Whangarei District Council*¹ the High Court stated:

I commence this section of the judgment by emphasising that no criticism is intended of the personal subjective honesty of either Mr Beck or Mr Brennan. Both struck me as competent Engineers honest and reasonable men, who sought to discharge their duties under this contract in a proper and fair manner. But as the cases I have quoted emphasise it is not a matter of subjective fairness. Rather it is a matter of looking at the whole situation objectively from the point of view of a reasonable contractor and asking whether what occurred appears to be fair and whether, in carrying out his duties, the Engineer appeared

¹ Unreported CP 3/86 Smellie J, Auckland, 13 February 1987

to act with independence and impartiality. To borrow words from the judgment of Woodhouse and Cooke JJ in the Canterbury Pipe Lines case I have reached the conclusion that "both as to a matter of fact and degree" it cannot be said objectively that Mr Beck's conduct in this case was fair and impartial in the sense that is required by the law.

5.5 It is to be noted that this case has been subsequently quoted with approval² and is consistent with overseas cases.

5.6 If the Contract Administrator does not act fairly and impartially when making quasi-judicial decisions under the contract that will be a breach of contract. As the Contract Administrator is the agent of the Principal, then that breach is the breach of the Principal. It follows that the Principal can be liable for damages for such a breach.

6. Variations

6.1 All commercial standard forms will have a variations clause. This allows the Principal, often via the Contract Administrator, to order a variation to the works.

6.2 A clause under which a Principal can order a variation will set out:

- (a) What can be varied;
- (b) The process to be followed;
- (c) How the variation is to be valued.

6.3 It is the works under the contract that are varied in some way. Arguments occur when the scope is not clear, and one party states that a variation has occurred and the other party disagrees. This is one reason why it is important to define what works are included in a contract with precision. Depending upon the contract wording work can be implied as being a part of the specification if it is incidentally required for the performance of the works.

6.4 In design and build contracts the Contractor should carefully consider the Principal's power to require variations if this could impact the Contractor's design.

6.5 A variation should be within the scope of the works originally required. It should not be of such different character or quality as to be totally different to the works originally contemplated. If that is the case, then the Contractor can argue that it is not a variation.

6.6 Unless there are express words to the contrary a Principal cannot order a variation which omits work, and then enter into a separate contract with another contractor to undertake that work. Principals sometimes introduce amendments into standard forms to permit this to happen. Contractors should consider such provisions carefully as it can allow a Principal to order the omission of high margin items to be undertaken be more cheaply by another contractor.

² See *Mcbreen Jenkins/Hauraki Piling Ltd Joint Venture v Kerikeri Cruising Club Inc* (1996) 5 NZBLC 104

- 6.7 It is important to follow any process set out in the contract when ordering or claiming variations. Contractors should check any timeframes, and make sure that there are no conditions precedent (see below) to being able to claim a variation.
- 6.8 The process will normally involve an instruction (usually written but can be oral). Usually, but not always, the Principal will state that the instruction is a variation. If the Contractor considers that the instruction is a variation, but this is not clear from the instruction the contract should set out a process that the Contractor shall follow in order to claim the variation.
- 6.9 Supporting information is critical when claiming and valuing the variation.
- 6.10 Standard form contracts will have clauses setting out how a variation is to be valued. Normally the contract will state that the primary method of valuation is by agreement. If parties agree on a value then this should be recorded in some way which should prevent arguments at a later date.
- 6.11 Arguments occur when one party attempts to revalue a variation after it has been agreed. Usually, if there is a documented agreement on the value of a variation it will not be possible for one party to attempt to revalue the variation at a later date.
- 6.12 A Principal may schedule for payment some or all of the value of a variation in a payment schedule. An interim payment of this nature is not necessarily an agreement as to the value of the variation. Payment schedules exist so that the works are paid progressively and the Contractor's cashflow is maintained. There are normally specific clauses that expressly allow a Principal to amend any payment schedule by provision of a subsequent payment schedule right up until the final payment schedule is issued. So, unless a Contractor gets some, preferably written, assurance from the Principal that the value is agreed, scheduling a sum for payment will generally not comprise an enforceable agreement as to value.
- 6.13 Many disputes occur because parties do not correctly follow the valuation procedure set out in the contract. Contractors should ensure that they properly support their valuation claims with reference to the contract documents. In a measure and value contract there will be a schedule of rates that will apply to most variations. In a lump sum contract if there is a schedule of rates its usual purpose is to assist in the valuing of variations. The contract will set out alternative methods to valuation if a schedule of rates, if supplied, is inappropriate for some reason. A Contractor should check at the time of tender the valuation process and entitlements such as on-site and off-site overhead, processing fees, and profit.
- 6.14 Contractors should note that it is increasingly common to find 'early warning' provisions in contracts. The purpose of these provisions is to provide an open dialogue between Contractor and Principal to minimise the risk of cost implications of variations. If a Contractor does not provide early warning as required, the usual sanction is that the value of any variation will be made as if notification had been given. This can impact the value recoverable by the Contractor. In the circumstances Contractors should diligently observe early warning requirements.
- 6.15 In addition to variations being specifically ordered, there are times when variations are claimable under specific contractual terms. These include:
 - (a) NZS3910:2013

- (i) 2.2.5 - a significant discrepancy.
- (ii) 2.3.2 - In a measure and value contract work clearly omitted in error from the schedule of prices.
- (iii) 2.3.4 - In a measure and value contract where the quantity differs to such an extent as to make the scheduled price unreasonable.
- (iv) 2.7.4 - Complying with instructions in the event of an ambiguity.
- (v) 2.7.7 - late instructions.
- (vi) 4.2.6 - where a nominated subcontractor defaults.
- (vii) 5.4.6 - damage to adjoining property where the Contractor has an indemnity from the Principal under clause 7.1.2.
- (viii) 5.5.2 - separate contractors.
- (ix) 5.6.5 - repair to loss or damage resulting from an excepted risk.
- (x) 5.8.5 - incorrect set out information supplied by the Principal.
- (xi) 5.11.7 - compliance with licence conditions.
- (xii) 5.11.10 - change in royalty, fee or toll caused by Government or Local Government after closing of tenders.
- (xiii) 5.13.4 - utilities not in substantially the position indicated.
- (xiv) 5.14.2 - treasure.
- (xv) 5.16 - late supply of Principal's materials, services or work.
- (xvi) 6.2.3 - failure of the Engineer to properly carry out his or her duties.
- (xvii) 6.4.2 - samples and tests not provided for unless the work fails.
- (xviii) 6.4.4 - delay in inspection/testing.
- (xix) 6.4.7 - opening up or exposing for testing unless the work fails.
- (xx) 6.6.4 - failure to issue practical or final completion certificate on time.
- (xxi) 6.7.3 and 6.7.4 - suspension.
- (xxii) 9.5.4 - unforeseen physical conditions.
- (xxiii) 10.7.4 - early occupancy by Principal.
- (xxiv) 11.2.6 - search for defects.

- (xxv) 12.12.2 - contingency sums.
- (b) Under NZIA 2018
- (i) 2.2.4 - Inconsistencies in documents.
 - (ii) 4.2.1 - Architect not properly administering the contract.
 - (iii) 4.6.1 - Conditions on consents or approvals.
 - (iv) 7.3.4 - Utilities not as shown.
 - (v) 7.5.4 - Errors in setting out not the Contractor's fault.
 - (vi) 7.7.4 - Access to other properties.
 - (vii) 7.8.5 - Unforeseeable physical conditions.
 - (viii) 8.3.3 - Subcontractor nominated post tender.
 - (ix) 8.3.9 - Nominated subcontractor repudiates or refuses subcontract.
 - (x) 8.4.7 - Separate Contractors.
 - (xi) 8.7.3 - Making good loss or damage to the works.
 - (xii) 9.4.2 - Change in circumstances (though the Contract uses the term "Adjustment" for this).
 - (xiii) 9.4.5 - Change in law.
 - (xiv) 10.5.1 - Use of contingency sum.
 - (xv) 12.4.3 - Principal's early occupation.
 - (xvi) 13.1.3 - Search for defects and none found.
 - (xvii) 13.2.6 - Correcting defects where Contractor not at fault.
 - (xviii) 16.4.3 and 16.4.4 - Suspension of work by Architect.
 - (xix) 18.9.4 - Treasure.
- (c) Under NEC4 variations are referred to as "compensation events". These are equally as varied as those appearing in NZS and NZIA, and in some circumstances allow for greater areas of recovery. Contractors should refer to section 6 of the contract.

7. Extensions of Time (EOT)

- 7.1 Standard forms provide for a set time period to be used in calculating the date by which the works should be complete.

- 7.2 If the work is not completed within the contract period then the Contractor will be in breach of contract and will be liable to pay such damages as the Principal can prove it has lost as a consequence.
- 7.3 If the contract information is properly completed then it should include a start date and finish date, often calculated by adding the number of working days allowed for the works to the start date.
- 7.4 Issues arise when this information is not properly completed. If the Principal cannot show a start date or the duration allowed for the works, then there is no way of calculating what the correct completion date is. In those circumstances, the Contractor's obligation will be to complete the works in a reasonable period of time.
- 7.5 Similarly if actions of the Principal prevent the Contractor from completing on time *and there is no ability for the Principal to grant an extension of time for its own default* then time will be 'set at large' and the obligation to complete will be within a reasonable period of time.
- 7.6 A 'reasonable' period of time will be assessed according to all the relevant facts that exist. It *does not* mean that the Contractor can take as long as it wants. For example, if there is no fixed start date expressed in the contract, but the contract period is stated to be 50 working days, then a reasonable period of time would be calculated taking into account the stated period 50 working days from commencement together with any other relevant facts that might apply.
- 7.7 Where there is a defined contract period then this may be extended under the terms of the contract and standard forms provide grounds upon which an EOT can be granted.
- 7.8 Contractors need to ensure that they follow the process set out in the contract for making timely applications for an EOT, and provide the information that supports any extension claimed which will depend upon the requirements of the contract between the parties.
- 7.9 Generally an EOT will be available to a Contractor where an event occurs which causes the Contractor delay and which is not its fault.
- 7.10 Often a contract will require a Contractor to demonstrate it has been delayed with reference to a contract programme, showing how the critical path for the works has been impacted by the event causing delay. If this is a requirement of the contract then the Contractor should pay close attention to the content of its programmes from the outset to ensure that an impact caused by a delay event for which an EOT is available can be recorded so as to show the entitlement to additional time.
- 7.11 It is frequently the case that Contractor's claims for an EOT are themselves made late and are poorly supported. It cannot be stressed highly enough that contemporary records of matters giving rise to delay are the best source of information when compiling a claim for an EOT. These can include, instructions, communications between parties, diary notes, minutes of meetings, day sheets, copies of text messages and photographs preferably with embedded digital information.
- 7.12 A Contract Administrator is normally charged with determining what EOT is due. S/he should do so fairly and impartially, and in accordance with the terms of the contract.

- 7.13 The contract will set out what claims for EOT entitle the Contractor to claim for additional cost by virtue of the additional time that the Contractor will spend executing the works. Where this occurs the contract will set out the process by which the cost of any additional time is to be valued.
- 7.14 When making an application for an extension of time it is in the Contractor's interests to do so under a provision in the contract that also entitles the Contractor to payment of additional overhead where that is available. For example, under NZS3910:2013 the only clauses that entitle a Contractor to additional payment for the EOT are 10.3.1(a) - Variations, and 10.3.1(g) Principal's default. Therefore if the causes of the EOT could be covered by more than one subclause in 10.3.1(a) to (g), use either (a) and/or (g) if it is available because this provides an entitlement to additional value.
- 7.15 The provisions in NZIA SCC 2018 at Rule 11.6.1 set out when an extension will entitle a Contractor to additional payment for time related costs where delay has been caused. These are:
- (a) A delay in the issue of a consent or approval that the Principal had to obtain;
 - (b) Unforeseeable physical conditions on site which materially differ from the physical conditions which an experienced Contractor should have reasonably seen at the time of Tender. They do not include climatic conditions on the Site.
 - (c) The Contract Works are suspended in a way allowed under the Contract;
 - (d) Variations;
 - (e) The Architect does not give a Direction within a reasonable time after being asked by the Contractor in writing to do so;
 - (f) The Principal does not supply materials, work or services on time;
 - (g) A separate contractor's act or omission.
- 7.16 Contractors should bring any claims within the scope of Rule 11.6.1 to claim time related costs. Rule 11.6.2 sets out specific examples of when a Contractor is not entitled to time related costs.
- 7.17 If additional money is payable, then the Contractor must prove its loss usually by reference to the processes set out and mandated by the Contract. Contractors should consider carefully how time related costs are to be valued under the Contract and Contractors should check and follow this process carefully.
- 8. Damages for Delayed Completion**
- 8.1 If completion does not occur within the contractually stated time for completion, or if none is stated within a reasonable period of time, then the Principal is entitled to damages for breach of contract for delayed completion.
- 8.2 Sometimes the level of damages that a Contractor will be liable for is predetermined and expressed in the contract as a fixed sum payable at a set interval such as per day or per

week. These are liquidated damages and a Contractor should check what level, if any, liquidated damages are set at prior to signing a Contract.

- 8.3 A liquidated damage clause is an attempt to set a predetermined amount of damages payable based on the estimated loss that a Principal will suffer as a consequence of a Contractor's delay. A calculation should take account of such matters as additional consultants time required for contract administration, interest on loans and/or lost rent etc.
- 8.4 There is much caselaw directed at challenging the validity of liquidated damages as being void for being a penalty as opposed to a genuine pre-estimate of loss.
- 8.5 This area of law is particularly fluid at present and the Courts have indicated more of a willingness in recent years to find that higher liquidated damages, even though they may have the appearance of being a penalty, can be enforced in certain circumstances.
- 8.6 Two tools that Contractors can employ to mitigate against the risk of liquidated damages are:
- (a) To agree on a level of liquidated damages that is lower than the anticipated loss that the Principal will otherwise recover. A court will not generally inquire as to the level of liquidated damages in such a case and the Principal will be restricted to recovery of the stated sum.
 - (b) Insist on a cap on liquidated damages, for example a percentage of the contract price, or a stated figure.
- 8.7 If liquidated damages are not provided for in a contract then a Contractor can still be liable for the actual loss that a Principal may suffer and can prove.
9. **Time Bars or "Conditions Precedent"**
- 9.1 A Contract can stipulate that one party must take a step, usually the lodging of a notice or claim, within a stated period of time as a "condition precedent" to an entitlement.
- 9.2 The three most common areas where these type of condition precedent clauses are found are:
- (a) Requiring a Contractor to lodge a claim to a variation within a fixed period of time, usually an unreasonably short period, *failing which the Contractor loses the right to claim.*
 - (b) Requiring a Contractor to lodge a claim to an extension of time within a fixed period of time, usually an unreasonably short period, *failing which the Contractor loses the right to claim.*
 - (c) Requiring either party to take defined steps in a dispute resolution process *failing which the claim cannot proceed.*
- 9.3 In all cases, if the timeframes or process are not followed then the purported effect of the condition precedent is to prevent the party in breach of it from advancing its claims further. This must be clearly and unambiguously stated.

- 9.4 Interpretation of these type of clauses is a matter of law, and whether they have effect at all can also turn on the facts in any given situation, for example, one party might waive its right to rely on a condition precedent. An example would be of a Principal agreeing to accept and consider a claim for a variation lodged after the time frame set in the contract had expired.
- 9.5 If the clause is not a condition precedent then breach of it will only give rise to a claim in damages. For example, if a clause states that a claim for an extension of time has to be lodged within 20 working days, but that clause does not prevent a late claim from being assessed, and therefore is not a condition precedent, a Contractor late in lodging such a claim may be liable for damages. In such a case the Principal must demonstrate that the delay in lodging the claim caused it loss, for example by the Principal losing the ability to re-organise and avoid a loss or order acceleration of the works if entitled to do so.
- 9.6 However, if a clause applies, it is plain and unambiguous, that is if it makes it clear by its language that it is a condition precedent, a failure to observe the clause will be prevent the party wishing to pursue a claim from doing so.
- 9.7 The only conditions precedent routinely found in New Zealand standard forms are clauses concerning the notification and pursuit of disputes.
- 9.8 Other conditions precedent, preventing the pursuit of claims for variations or extensions of time if not lodged within a set timeframe are not found in standard forms in routine use. Contractors should carefully check the special conditions of any Contract for conditions precedent. If they exist:
- (a) Consider whether to accept the clause at all;
 - (b) If the Contractor takes the risk of accepting the clause amend any unreasonable timeframes to those that are more acceptable;
 - (c) Price the risk.
 - (d) During the contract period be prepared to submit notices out of an abundance of caution so as to preserve contractual entitlements.
10. **Warranties/Guarantees**
- 10.1 Contractors often use the term “warranty” and “guarantee” interchangeably. The reality is that there are different legal meanings and derivations of each.
- 10.2 **Warranties**
- (a) Even if your contract is silent the law will imply certain warranties into your contract as “minimum standards”. In commercial contracts these are most commonly that work will be undertaken in a tradesman like manner, and that materials supplied are new and fit for purpose. Other warranties can be implied depending upon the factual background of a contract.

- (b) The usual rule is that if a warranty is breached then the person (such as the Principal) having the benefit of that warranty has 6 years from the date of the breach on which to sue for damages that the breach may have caused.
- (c) Therefore given that a commercial contract that a Contractor enters into will most likely have these implied terms, which generally can be sued on for a period of 6 years from any breach of those warranties, then it is only express warranties (ie warranties written into the contract) that exceed these requirements which need to be scrutinised for both their scope and duration (ie what risk they pose to the contractor and for how long any exposure lasts)
- (d) Express warranties are found frequently in contracts. They normally appear in the body of a contract; that is within the general terms and conditions. Sometimes however they are hidden in other documents such as the employers requirements or specifications.
- (e) A warranty is a stipulation - a type of term. For example a contract may state that the contractor has to complete its work in a tradesman like manner. Often, but not always the contract will state that the stipulation is a warranty. For example the contract could specifically state *“the contractor warrants that it will complete its work in a tradesman like manner”* which is simply a restatement of what the law will imply into a contract in any event.
- (f) The real danger for a Contractor is when it is asked to sign more onerous warranties than the law would otherwise imply. That is because if a warranty is breached, it allows the aggrieved party to claim damages. The more onerous the warranty, the more exposed to a damages claim a Contractor will be. Claims for damages for breach of warranty can be significant.
- (g) Normally breach of a warranty would not give rise to a right to terminate the contract. Using the same example, if work is not done in a tradesman like manner, the damages payable (at its simplest) would be the cost of rectifying the substandard work. However, if the warranty provided was *“to undertake the work to the highest trade standards using the very best materials available on the market”* then not only is it easier to breach the warranty, but a breach would likely lead to a greater claim in damages because the warranty requires the *“very best”* materials to be used.

10.3 Weathertightness Warranties

- (a) There has become a trend for Principals to demand weathertightness warranties from a Contractor in which the Contractor warrants that the building constructed is weathertight and will remain weathertight for a period of time after the works are complete. These warranties are usually in the form of a deed.
- (b) If there is a leak to the building and the warranty is breached the Contractor is required to rectify any defect and/or pay any damages to the Principal, often on the basis of an indemnity.
- (c) A Contractor should bear in mind that even without a weathertightness warranty it may be liable to a Principal in negligence if defective work occurs (for example is not in accordance with the Building Code) which causes the Principal loss. A Contractor

might be sued in negligence for a period of up to 10 years from the date of practical completion.

- (d) In the circumstances, the only benefit that a weathertightness warranty provides to a Principal is more certainty around the requirement for the Contractor to remedy defects, and to claim damages on the basis of an indemnity which increases the financial exposure that a Contractor might face.
- (e) Contractors should consider:
 - (i) whether it appropriate at all to sign a weathertightness warranty. For example if the Contractor is not working on the envelope of the building no weathertightness warranty should be required.
 - (ii) the implications of signing any warranty that is expressed to last longer than 10 years, or which contains onerous provisions regarding the payment of damages.
 - (iii) the exclusions to its liability which should be expressly stated. These should include design where the Contractor is not responsible for this.
 - (iv) any warranty should include a right for the Contractor to subrogate (take over) the rights of the Principal against others who might have caused or contributed to any issue.

10.4 Workmanship Warranties

- (a) Remember at the completion of a project a Contractor's work should be fit for purpose. That obligation does not extend beyond the date for completion unless expressly provided for in the contract. That is why it is common for contracts to include defect liability periods - so that poor workmanship has an opportunity to be identified and remedied.
- (b) A Contractor should think very carefully before agreeing to any extended workmanship warranty because at some point such a warranty ceases to be a warranty as to workmanship and starts to become a maintenance contract without further remuneration.

10.5 Collateral Warranties

- (a) A collateral warranty is a form of warranty which is contained within a separate agreement. These types of agreements are signed when there is otherwise no direct contractual link between the parties. They are used when one party wishes to ensure that there is an enforceable obligation with the other party. An example is the 13th Schedule to NZS3910:2013 which can require a subcontractor to warrant to the Principal that its works are in accordance with the contract or in accordance with good trade practice.
- (b) Great care should be taken in the wording of any warranty. In the case of the 13th Schedule of 3910 there is a space to be completed identifying the "*Warranted Works*". This should be checked carefully to ensure that it accurately sets out what

the party signing it is prepared to warrant. Beware of a broadly worded description of the “*Warranted Works*” which exceeds the actual role or responsibility undertaken.

10.6 Guarantees

- (a) A guarantee is a separate contractual agreement by which one party is bound to another to fulfil the promise or contract of a third party. So, for example, it may be that a main contractor might seek a director’s guarantee for the due performance of a contract by the company that is contracted to undertake subcontract works. Forms of guarantee are common in supply agreements. A supplier might require a guarantee from a director before advancing credit for supplies to a company for example. Guarantees will have their own terms and conditions.

10.7 Continuity Guarantees

- (a) Continuity Guarantees are forms of guarantees whereby a subcontractor will guarantee to a Principal that if the [main] Contractor becomes insolvent or otherwise fails to complete the project that the subcontractor will complete its work direct for the Principal. Continuity Guarantees are usually drafted by the Principal and often are highly favourable to the Principal and hence are unfavourable to the subcontractor. Subcontractors are becoming more aware of onerous provisions in Continuity Guarantees, in particular:
 - (i) It is increasingly common however to encounter a Continuity Guarantee that states if the Principal elects to take over the subcontract of a subcontractor then it is not required to pay any money to the subcontractor which is due and owing prior to that election being made. That means that, in the event of the main contractor’s insolvency, the subcontractor must return to site without recompense for earlier completed work. That is unfair, particularly as the Principal usually has a bond from the contractor.
 - (ii) Many documents described as Continuity Guarantees frequently contain collateral warranties as well which expand the liability of the subcontractor to the Principal.
- (b) A Contractor should be careful not to assume that a subcontractor will sign up to an onerous continuity guarantee. Often subcontractors are appointed *after* a contractor’s bid is accepted. If the contractor cannot get the subcontractor to agree to the form of continuity guarantee then if this is a requirement of the head contract the Contractor will be in breach.
- (c) Therefore a Contractor should not assume that just because a Continuity Guarantee (or any other document) is to be signed by a subcontractor that it should not be concerned about its content.

11. Bonds

- 11.1 Bonds and bank guarantees are instruments, usually underwritten by a bank or other financial institution, which contain an undertaking, enforceable at law, to make payment to the beneficiary on the happening of an event(s).

- 11.2 Bonds or bank guarantees can have a specific purpose. For example, on large infrastructure projects payments are sometimes front loaded to pay for specialist equipment. An advance mobilisation bond will be put in place to cover repayment of any advance sum in the event of the early insolvency of the Contractor.
- 11.3 However, the most common form of bond encountered will be a general performance bond effected to ensure the performance of the person giving the bond - usually the Contractor.
- 11.4 A performance bond entitles the beneficiary, usually the Principal, to make a demand for payment for the sum of the bond monies. A bond can only be called upon for payment by the Principal if the Contractor is in breach of its obligations such that the Principal is entitled to call up the bond. If the Contractor is not in breach and the bond is called then the Principal will be liable in damages to the Contractor.
- 11.5 Some contracts have requirements in them which must be observed before a bond can be called. A common requirement is that the Contractor must be given a period of notice of the intention to call the bond. This period of notice can afford the Contractor the opportunity to correct any breach which is the source of the demand, or if the Contractor considers it is not in breach to apply to the High Court for an injunction to prevent the bond being called.
- 11.6 A prudent Contractor would be sensible to ensure that the contract contains provisions requiring a period of written notice to be given before a bond is called to allow for any default to be remedied, or for an injunction to be applied for.
- 11.7 A contract should also set out clearly when the bond will be released back to the Contractor and that would normally be on practical completion because that is when performance can be said to have occurred.
- 11.8 Most bonds provided are “on demand” bonds. That means that the bond (as opposed to the contract) contains no conditions that have to be observed before the bond can be called. All the Principal has to do is to make written demand of the bank and the bond should be paid. They are effectively the same as cash.
- 11.9 Banks are reluctant to provide bonds that contain conditions that must be satisfied before the bond can be paid. For example, a bond could be conditional on the Principal demonstrating the Contractor’s breach. Banks do not like these types of conditional bonds because it places them in the position of having to assess who is correct on the wording of the bond - the Principal who alleges default, or the Contractor who alleges there is no default. Having to make such an assessment draws the Bank into the threat of litigation if the bond is wrongly called.
- 11.10 Each Contractor will need to assess whether a Principal’s demands for a bond are reasonable in the context of the project being undertaken.
- 11.11 Most bonds are provided to secure the Contractor’s performance. When considering the amount of a bond to be lodged, it is appropriate to consider what the cost to the Principal will be if the Contractor defaults, because it is that cost which the bond should cover, and would include such matters as securing the site, letting a new contract, financing costs during the period of prolongation. A bonding figure set too high will have implications for the Principal in that the cost for its project will likely increase, and for the Contractor in

that its exposure will increase, possibly leading to credit lines being reduced. In short it is in neither party's interests to set the amount of a bond that is out of proportion to the anticipated cost to the Principal in the event that the bond has to be called. This calculation should also take into account that at any one time there will also be money owed to the Contractor on account of work in progress.

12. Novation

- 12.1 Sometimes a Principal will enter into contract with a consultant or specialist trade for a set scope of works, often including design, before it enters into the main construction contract with the Contractor. The Principal then wishes for the Contractor to take on responsibility for the earlier contract with the consultant or specialist contractor. This is done by "novating" the earlier contract to the Contractor and the process is known as novation.
- 12.2 In a novation the first contract between the Principal and consultant or specialist trade is extinguished and is replaced by a second contract between the Contractor and the consultant or specialist trade.
- 12.3 Novation is not without its problems.
- 12.4 It is not possible to novate obligations which have already been performed. Consultant's contracts are those novated most often, however an example of the novation of a design & build piling subcontract illustrates one of the most common issues. If a Contractor is asked to enter into a novation of a piling contract and half the piles have already been installed, then the new contract can only cover the obligation of the specialist piling contractor to design and install the second half of the piles. The issue for the Contractor is that the novation will cover the liabilities that might arise for *all* the piles. The Contractor has had no opportunity to oversee or manage the quality control and installation of the first half of the piles.
- 12.5 Similarly if the Principal wishes to novate design consultants to the Contractor where the design is part complete (and the Contractor enters a design and build contract with the Principal), then it is the remainder of the design obligation that the design consultant becomes liable to the Contractor to perform. However, the Contractor becomes liable for the entire design to the Principal under its design and build contract.
- 12.6 With this in mind the Contractor should ensure that the novation agreement provides sufficient comfort in the form of warranties from the specialist contractor being novated, and if necessary indemnities from the Principal, that the design already performed has been undertaken to an appropriate standard.
- 12.7 As the first contract is extinguished and is replaced by a second contract it is important for the specialist contractor who is being novated to understand that their role changes. Conflicts of interest must be managed. A designer will cease to have obligations to the Principal for its design, and instead will owe obligations to the Contractor. This change will see different priorities emerge - for example a Contractor will wish to save money on design, where earlier a Principal may have wished to maximise quality.
- 12.8 Overseas caselaw indicates that because the first contract has been extinguished a novation agreement may not work as intended if the Principal attempts to reserve itself rights under the novation agreement. For this reason novation agreements are best kept simple.

13. Indemnities

- 13.1 An indemnity is an enforceable promise by one party to keep another party harmless from loss or damage incurred. They are usually drafted so as to require the indemnifier to make good on losses suffered by the indemnified consequent on a breach of the indemnity.
- 13.2 A recovery under an indemnity only requires the indemnified party to show that there has been a breach of the indemnity. Once a breach of indemnity has been committed then losses that arise become a debt due from the indemnifier to the indemnified party.
- 13.3 In an action for breach of contract a party needs to show that it has taken reasonable steps to mitigate its loss and that its loss is not too remote (ie that the loss is sufficiently connected with the breach of contract). If there has been a breach of an indemnity then normally the indemnified party does not need to concern itself with a failure to mitigate or remoteness of damage.
- 13.4 This means that indemnities provide a wider scope for the indemnified to recover against the indemnifier.
- 13.5 Indemnities provided in standard form contracts are usually balanced and go both ways, that is there will be indemnities from the Contractor to the Principal and from the Principal to the Contractor. Such indemnities normally govern matters that parties would consider fairly represent the need for an indemnity such as losses incurred by the Principal in the Contractor undertaking the construction or remedying defects in the works, or losses incurred by the Contractor in occupying the site.
- 13.6 If standard forms contain indemnities that have not been amended in any way then it is generally reasonable to assume that they have been drafted in a way that is fair and balanced.
- 13.7 Issues arise when Principals seek indemnities which are far wider than called for in a standard form. For example a Principal that requires a Contractor provide an indemnity for “*any breach of Contract*” is significantly widening the liability risk that a Contractor faces. Any amendments or additional indemnities included in a contract on top of the standard indemnities that they provide should be carefully considered for the additional risk that they will impose on the Contractor.

14. Records of Work/Producer Statements

- 14.1 In a traditional build only contract the only producer statement that a Contractor should be required to produce is a “PS3”, which is a statement that the Contractor considers it has constructed the works in accordance with the building contract. An example is Schedule 6 in NZS3910:2013.
- 14.2 In a design and build contract the Contractor may also be contractually required to provide a PS1 for its design, a PS2 by design review by peer review and a PS4 being a construction review.
- 14.3 Producer statements are sometimes required because a Principal considers that they will be necessary to assist it with obtaining a code compliance certificate from the territorial authority.

- 14.4 The building contract will set out what producer statements the Contractor is required to provide. If the contract is silent on this then the Contractor is not required to provide any producer statements.
- 14.5 Producer statements are to be contrasted with records of work under the Building Act 2004. Licensed Building Practitioners are required to provide records of work under s88 of the Building Act when restricted building work is undertaken (critical work on a residential property). These are not the same as producer statements, and they are required when requested even if the contract is silent on the matter.
- 14.6 Standard form contracts do not make practical completion dependent upon obtaining a code compliance certificate and normally obtaining consents and code compliance certificates is a Principal's obligation. If the special conditions put the obligation to obtain a code compliance certificate (or a certificate of public use) on the Contractor, consider the implications of this, particularly for matters outside of a Contractor's control such as performance by third parties eg the territorial authority and others not engaged by the Contractor.
15. **The Construction Contracts Act 2002 (Act)**
- 15.1 The Act has been in force for nearly 15 years now and Contractors have no excuse for not being familiar with its provisions. A copy can be found here:
<http://www.legislation.govt.nz/act/public/2002/0046/34.0/DLM163059.html>
- 15.2 Parties cannot contract out of the Act (Section 12). That means that, where applicable, the regime of the Act applies in addition to anything included within the Contract.
- 15.3 All standard forms contain detailed provisions for claiming payment and assessing payment which Principals and Contractors need to follow. Therefore the default payment provisions of the Act will not apply as between Principals and Contractors. If a Contractor's subcontracts do not contain provisions for claiming and assessing payment the default provisions of the Act will apply to those subcontracts.
- 15.4 There are some broad issues that Contractors need to remember:
- (a) Conditional payment agreements are invalid (Section 13).
 - (b) Retention provisions need to be complied with by Principals holding retentions on Contractors, and Contractors holding retentions on subcontractors (Section 18A onwards).
 - (c) All payment claims must conform with the requirements of the Act (Section 20) if the full benefit of the Act is to be obtained by a Contractor. This includes submitting Form 1 of the Construction Contract Regulations with every payment claim. A copy can be found here:
<https://www.building.govt.nz/assets/Uploads/projects-and-consents/forms/Form-1-Information-that-must-accompany-all-payment-claims.pdf>

(d) A payee (Contractor or Subcontractor) can suspend works under the Act if an amount due under the provisions of Section 24A of the Act is not paid.

(e) Adjudication provisions (Subpart 1).

16. Subcontracts

16.1 The most widely used form of subcontract is SA-2017 which is endorsed by both the Registered Master Builders Association and the Specialist Trade Contractors Federation.

16.2 Contractors must detail their subcontractor relationships with precision. It is common for subcontract documentation to be poorly assembled leading to arguments over interpretation if disputes arise. A Contractor should know with certainty the legal identity of the subcontractor (check on the Companies Register here: <https://companies-register.companiesoffice.govt.nz/>) and the documents that comprise the subcontract.

16.3 SA-2017 should be properly completed, compiled and executed with relevant documents attached (for example drawings, specifications, head conditions of contract, pre-let minutes etc.). This places a Contractor in a far better position than having to analyse a trail of emails and document transfers once work has already commenced and usually once a dispute has occurred.

17. Some Tendering Do's and Don'ts.

17.1 Read the contract documents. Contractors should, at the very least, have a good working knowledge of both New Zealand Standard and NZIA documentation. Read the special conditions very carefully.

17.2 Every condition inserted into a contract means something. So why insert a special condition? A special condition should only be necessary or acceptable if the risk allocation in the standard form being used is not appropriate.

17.3 How does the special condition alter the risk allocation?

17.4 Beware of lazy drafting. For example requiring a Contractor to *provide all warranties required by the Specification*. Such a clause puts the onus on the Contractor to trawl through the Specification to identify what warranties are required and does not set out with any particularity what form of warranty is required. The Principal, through its consultants, should be able to list what warranties it requires and the form of those. It is not unreasonable to expect a Principal to list what it requires and provide the forms that it is requiring parties to enter into.

17.5 Is the new risk allocation acceptable to the Contractor?

17.6 If it is not acceptable is it negotiable? Consider submitting a tender tagging a special condition by altering it or deleting it.

17.7 If it is acceptable does it affect the Contractor's pricing?

17.8 Consider submitting two prices - one if an onerous special condition is included, and one if it is excluded.

- 17.9 Principals should understand that if they redistribute risk as allocated in a standard form, so that a Contractor takes more risk, that either comes at an increased cost or at the risk of the Contractor breaching the Contract and at worst being unable to complete it which in turn has significant issues for the Principal.
- 17.10 If a tender with a list of tags is submitted make sure those tags are incorporated into the final form of contract, and that if there is any ambiguity or conflict between documents that the tagged tender prevails. That means if there is an order of precedence of documents in the Contract ensuring that the tagged tender is high on the list of that order, or that the need for the tags has been removed by amending the Contract so that the tags are no longer necessary.
18. **Disclaimer:**

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