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Construction Bulletin

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Amendments to the Home Building Act 1989

It is now 5 months since the **Home Building Amendment Act 2011** was passed, introducing a number of substantive changes to the **Home Building Act 1989 (NSW)** (**HBA**). Those amendments came into effect in 2 stages in October 2011 and February 2012.

Changes effective from 25 October 2011

The first of 2 stages of amendments to the HBA commenced on 25 October 2011. The significant changes to the HBA and Regulations from that date include:

+ an extended definition of "*Developer*" to include the owner of land on which a development is carried out even if the work is done on behalf of another person;
+ a new statutory period for completion of residential building work which will apply in the absence of a contractual definition;
+ an extension to the statutory warranty to provide that work done on behalf of a developer is also taken to have been done by the developer;
+ amendments allowing a contractor to notify the Director General of a dispute (previously disputes could not be notified under the relevant provisions by contractors); and
+ amendments to the statutory home owners' warranty scheme in relation to time limits for making of claims, including a new 10 year long stop time limit for any claim.

Amendments have also been made to the **Civil Liability Act 2002 (NSW)** (**CLA**) such that the proportionate liability provisions appearing in Part 4 of the CLA do not apply to claims commenced on or after 25 October 2011 arising from breach of statutory warranty under the HBA. The principles of proportionate liability continue to apply to proceedings commenced prior to that date.

Changes effective from 1 February 2012

The second phase of amendments to the HBA commenced on 1 February 2012. Changes effective from that date include:

+ new provisions limiting the application of strict contracting requirements to contracts where the price exceeds a prescribed amount of $5,000 plus a new category of "*small jobs*" for works costing between $1,000 and $5,000;
+ a new 5 day cooling off period under contracts for work exceeding $20,000 in value;
+ amendments to the limitation period in which to bring proceedings for breach of statutory warranty. The new limits will be 6 years for structural defects and 2 years in any other case. The amendments now identify when the statutory warranty period commences;
+ an increase in the minimum required insurance cover from $200,000 to $340,000; and
+ an increase in the prescribed value of work for which homeowners warranty insurance is required from $12,000 to $20,000.

Allocation of Risk – Who holds the money?

Redline Contracting Pty Ltd v MCC Mining (Western Australia) Pty Ltd **(No 2)** [2012] FCA 1 involved the interpretation of a security of payment clause in a construction contract between Redline Contracting Pty Ltd (**Redline**) and MCC Mining (Western Australia) Pty Ltd (**MCC**) for the construction of a pipeline for MCC's iron ore project.

The contract required Redline to provide MCC with security of 4 unconditional payment undertakings from Swiss Re International SE (**Swiss Re**) in favour of MCC for 10% of the contract value.

MCC made demands to Redline for payment, claiming to be owed amounts for rectification works and re-tendering contracts. Redline did not pay the amounts demanded and instead sought an injunction to restrain MCC from seeking payment under the undertakings, arguing that the contract contained an "*implied negative stipulation*" that the undertakings would not be called upon and that, as much of the amounts claimed were unliquidated damages, it would be unconscionable to do so.

Relevantly, clause 5.2 of the contract provided:

> "*5.2 Recourse*
>
> *Security shall be subject to recourse by a party who remains unpaid after the time for payment where at least 5 days have elapsed since that party notified the other party of an intention to have recourse.*"

Redline argued that the words "*time for payment*" in Clause 5.2 referred to the time for payment of a sum which is *due and payable* and that as unliquidated damages are not due and payable the clause did not enable MCC to call upon the undertakings.

MCC argued that the commercial purpose of Clause 5.2 was to provide for the *allocation of risk* between the parties in the event of a dispute and to identify which party was to bear the risk of being out-of-pocket while a dispute was resolved. MCC contended that, because it had a *bona fide* claim to the security money and had made a demand for payment which was not satisfied within the time required, it was entitled to be paid funds secured by the undertakings pending resolution of the dispute.

In rejecting the application for an injunction, the Court found that Clause 5.2 was likely to be determined, at final hearing, to be a risk allocation provision and that, having made a demand that was not satisfied by Redline, MCC was entitled to payment of security funds pending final resolution. In so finding the Court considered the actual form of words used in clause 5.2 which made no reference to liquidated claims or amounts that were due and payable. The words "*time for payment*" referred to satisfaction of a demand, not to a legal entitlement.

This case again illustrates that courts will seek to interpret the actual form of words used by parties in their agreements and will not attempt to re-write or improve the bargain struck by the parties because it is inconvenient to one of them. It is therefore important for parties to consider the possible effects of the terms of their contracts.

Clearly state your intention

The recent case of ***State of New South Wales -v- UXC Limited*** [2011] NSWSC 530 provides a reminder of the care that needs to be taken in drafting contractual terms so that they have the effect intended by both parties. The case involved an expert determination under a contract and whether it was binding on the parties.

The contract provided that an expert's determination would be final and binding upon them unless the amount assessed as payable under the contract by the expert exceeded the amount prescribed in the "*Agreement Details*" schedule of the contract. The parties did not specify any amount in the "*Agreement Details*" of the contract and instead simply left that section blank.

In accordance with the terms of their contract, the parties referred their dispute to an expert for determination. The expert determined that the State was entitled to terminate the contract and

an award of damages of more than $2.5 million.

UXC argued that the sum, having not been identified in the "*Agreement Details*", should be assessed as $0. In contrast, the State argued that in the absence of a specified limit in the "*Agreement Details*" there was no limit on the sum for which an expert determination would be final and binding upon the parties.

In the NSW Supreme Court, Justice Ball determined that there was no limit to the sum that could be determined as payable by the expert because no limit had been specified in "*Agreement Details*" of the contract. The Court held "*it does not matter whether the parties overlooked specifying the amount...or made a deliberate decision not to do so. The reason is the same.*"

UXC also contented that the expert determination clause was invalid because it sought to exclude the jurisdiction of the Court. The Court rejected the argument finding that:

+ a decision of a third party that is not a Court will be valid provided it complies with the terms of the contract;

+ parties are free to contract to specify preconditions to the accrual of rights and liabilities under the contract; and

+ a referral to an expert as a condition precedent to accrual of rights under a contract was acceptable provided the terms of the contract were complied with.

Implications

Failure to identify monetary limits, typically included in schedules to a contract, is likely to give an expert authority to make determinations for payment of unlimited sums. The same may be true of other items, e.g. the nature of disputes that may be referred for expert determination.

It is necessary to ensure that clauses providing for expert determination provide a sufficiently detailed process for appointment of the expert and for the expert's determination. It is also important to ensure that the power granted to an expert does not amount to an arbitration which may attract the application of the **Commercial Arbitration Act 2010 (NSW)**, a scheme which contains strict procedural rules which should not restrict the ability of an expert to appropriately determine the outcome of a dispute.

Don't count on your expert determination being set aside

In ***Shoalhaven City Council v Firedam Civil Engineering Pty Ltd*** [2011] HCA 38 the High Court has provided guidance on the issue of setting aside expert determinations. When conducted in accordance with binding contracts, expert determinations will only be set aside in very limited circumstances.

A dispute arose between the Council and Firedam over Firedam's claims for variations and extension of time to undertake works under the contract. The Council also claimed damages due to delayed completion of the project. In accordance with the contract, an expert was appointed to determine the dispute, the outcome of which was to be "*final and binding*" unless a party had a right to commence proceedings. The contract required the expert to provide reasons for any determination.

The expert declined to grant Firedam an extension of time because Firedam had "*not provided any reasoned support*" for the extension claimed and failed to comply with notice procedures that were a pre-condition of obtaining an extension of time. In contrast, when assessing the Council's claim for damages, the expert used a contractual discretion available to the Council to extend the time for completion of works. The relevant provision provided:

> "*The* [Council] *may in its absolute discretion for the benefit of the* [Council] *extend the time for completion at any time and for any reason, whether or not the contractor has claimed an extension of time.*"

The expert determined that the Council had contributed to the delay in completion of the project and, for that reason, exercised the contractual discretion to extend time for completion of the project.

In the ensuing litigation, Firedam argued that the expert's reasoning was inconsistent and unexplained, such that the determination did not accord with the requirements of the contract and was therefore not binding. Firedam was unsuccessful at first instance but successfully appealed to the NSW Court of Appeal. The Council appealed to the High Court.

The High Court unanimously allowed the appeal and reinstated the expert's determination. The Court held that there was no inconsistency between the expert's finding of delay attributable to the Council, and thereby his exercise of the contractual discretion on the one hand, and his rejection of Firedam's substantive claims for an extension of time in relation to variations claimed by it on the other.

The High Court considered that the expert's rejection of those claims because Firedam had "*not provided any reasoned support*" was sufficient in the circumstances. Further, Firedam had not complied with other contractual requirements that were preconditions to obtaining an extension of time. Having failed to overcome these difficulties, Firedam had "*failed to establish a basis for substantiation of its claim*".

Implications

Courts are generally reluctant to interfere with determinations made by experts appointed under contracts where such determinations are contractually agreed to be final and binding. The High Court reasoning indicates that expert's reasons for a determination do not need to be extensive. The standard of reasons required of an expert is not that required of a Court or an arbitrator, but only that imposed by the terms of the contract.

A Court will only set aside an expert determination where the expert has acted outside the powers provided to him or her under the contract or where the determination is otherwise improper or tainted by some illegality. Allegations of insufficient reasoning will not be sufficient grounds for setting aside an expert determination.

Privilege in Adjudications

In ***Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd*** [2011] VSC 477, a question arose whether documents produced for the purpose of adjudication proceedings (rather than for court proceedings) would attract litigation privilege.

What is litigation privilege?

The general concept of legal privilege is to protect the confidentiality of communications between a legal adviser and client. Litigation privilege is a specific type of legal privilege designed to protect the confidentiality of client/lawyer/third party communications made in respect of legal proceedings.

Section119 of the **Evidence Act 1995 (Cth)** governs that litigation privilege applies to:

+ confidential communications between a client and third parties or between a legal adviser acting for the client and third parties; and

+ the contents of any documents prepared;

for the dominant purpose of a client being provided with legal services relating to a current or anticipated "*Australian or overseas proceeding*".

Litigation privilege is an important mechanism because as a general rule, parties are obliged to produce (discover) to their opponent all documents, including documents or communications, relevant to the proceeding, whether helpful or detrimental to their respective case. Any documents that are legally privileged however are exempt from these discovery requirements. This means that a party to a proceeding need not discover, for example, details of discussions with his or her legal adviser about litigation tactics or the prospects of success in the proceeding.

Does litigation privilege apply to adjudications?

In ***Dura Constructions*** Macaulay J held that the meaning of "*Australian or overseas proceeding*" in section 119 of the Evidence Act should extend to adjudication and not just court proceedings. In other words, litigation privilege can apply to documents brought into existence for the dominant purpose of the provision of legal advice in relation to an adjudication.

The decision should provide comfort to parties participating in an adjudication that the documents prepared for the purposes of such proceedings can attract litigation privilege in any subsequent Court proceedings.

Whilst the case was decided in the Supreme Court of Victoria, the decision is likely to be followed in NSW.

Draft Regulations for Reporting Payments to Contractors

On 14 December 2011 the Commonwealth Treasury released draft Regulations to apply under section 405-5 of Schedule 1 to the **Taxation Administration Act 1953 (Cth)**. The Regulations will require businesses that operate "*primarily in the building and construction industry*" to provide quarterly reports to the ATO with details of payments made or owing to contractors that provide "*building and construction services*".

The quarterly report will require the business to provide details of the name of the contractor, the contractor's ABN if known, and the total payments made to the contractor or for which the business is liable during the relevant quarter.

A business is required to provide quarterly reports where:

+ the business of the purchaser is "*primarily in the building and construction industry*";
+ both the supplier and purchaser have an ABN; and
+ the contractor supplies to the purchaser *building and construction services,* or a combination of goods and building and construction services if the supply of services is not incidental to the supply of goods.

A report is not required if the supplier and the purchaser are both members of the same consolidated group or the same MEC group, or if tax is required to be withheld under the withholding provisions of the **Income Tax Assessment Act 1997 (Cth)**.

The definition of "*building and construction services*" is extremely broad and is likely to encompass any form of activity that might be construction related.

Further a purchaser is taken to be a business *primarily in the building and construction industry* if in either the current financial year or in at least one of the 2 prior financial years more than 50% of the purchaser's business income was derived from providing building and construction services.

The explanatory memorandum released by Treasury with the draft Regulations indicates that the new measures are aimed at reducing non-compliance with taxation obligations among contractors in the building and construction industry. This includes consideration by the ATO of whether suppliers identified by purchasers as "*contractors*" are so regarded at law.

A relevant consideration would be the level of income derived from a particular purchaser in a financial year. Where individuals or small company contractors receive substantial components of their income from single purchasers additional ATO scrutiny may be likely in the future.

The window for submissions in relation to the draft Regulations closed on 20 January 2012. The Regulations are presently intended to come into effect on 1 July 2012.

The Regulations impose a new level of reporting compliance on businesses involved in the building and construction industry. Additional vigilance will be required to ensure that reporting requirements are met and that parties appropriately identify the true nature of the relationship between purchaser and the supplier.

For further information on any of these articles please contact:

Paul Spezza, Partner
P 02 8273 9909
E paul.spezza@wottonkearney.com.au

Andrew Moore, Partner
P 02 8273 9943
E andrew.moore@wottonkearney.com.au

Nick Lux, Partner
P 03 9604 7902
E nick.lux@wottonkearney.com.au

Contributors:

Gemma Houghton, Senior Associate
Mark Hughes, Senior Associate
Timothy O'Ryan, Solicitor

wotton kearney
insurance lawyer