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Construction Matters

June 2022

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Injunctions to Prevent a Call on a Bank Guarantee – A Matter of Good Faith

Authors: Melissa Koo, Joseph Perkins

In the recent case of *Lanskey Constructions Pty Ltd v Westrac Pty Ltd* [2022] WASC 90, the Western Australian Supreme Court reiterated the two-limbed test that must be satisfied in order for courts to grant an application for an injunction to prevent and restrain a call on a bank guarantee.

Here, the contractor (Lanskey) and the principal (Westrac) entered into an amended AS 4902-2000 design and construct contract (Contract). Pursuant to the terms of the Contract, Lanskey provided Westrac with security in the form of six unconditional irrevocable bank guarantees. Westrac was entitled to recourse to the security in limited circumstances, including to satisfy any outstanding debts or *bona fide* claims.

Lanskey did not achieve practical completion by the required date. Westrac claimed liquidated damages from Lanksey.

However, Lanskey sought immediate injunctive relief to prevent Westrac from having recourse to the bank guarantees, in part, on the basis of a purported oral agreement from a Westrac employee that Westrac would not levy liquidated damages against Lanksey if Lanskey did not claim delay damages from its entitlements to extensions of time. Westrac disputed the allegation that it waived its entitlement to liquidated damages.

The court refused to grant an injunction preventing Westrac from having recourse to the security. In doing so, the court reiterated two broad principles governing the grant of an interlocutory injunction, namely whether:

- There is a serious question to be tried.
- The balance of convenience favours the grant of an injunction.

In determining the first limb, the court considered whether there was *bona fide* claim in accordance with the relevant security clause under the Contract. Notably, Hill J held that the phrase "*bona fide* claim" to mean "a demand that is made in good faith" and which required Westrac, to "honestly and genuinely believe it is entitled to recover the amount claimed". Such a belief must also not be fraudulent or untenable.

On the facts of the case, Her Honour was not satisfied that Lanksey had established that Westrac did not have a *bona fide* claim and, noting the limited evidence surrounding the terms of the disputed oral agreement, it could not be said that Westrac's claim was unarguable, specious or not made in good faith.

Notwithstanding the Court's findings in respect of the first limb, Her Honour also noted in relation to the balance of convenience, that the plaintiff assumed the risk of a call on the bank guarantees when it agreed to provide them on the terms of the Contract, such that it did not favour the grant of an injunction in the present circumstances.

Key Takeaway

Parties should note that the effect of security clauses requiring the provision of bank guarantees is to allocate cash flow risk to the contractor and not the principal pending resolution of disputes between them.

Generally, where an application is to restrain a call on a bank guarantee, a court will not restrain payment under an unconditional obligation where the underlying claim is *bona fide*. The basis being that bank guarantees are essential in trade and commerce, particularly in the construction industry and, therefore, parties should have limited recourse to relief in circumstances where the parties previously allocated risk under the terms of their contracts.

Inclement Weather Risks in Construction – Considerations for Your Contracts

Authors: Brent Henderson, Hao Zhou

Following the disruption of the intense weather in March, Sydney continues to brace itself for a "wetter than average" winter.[1] The impact of extreme weather events has become more unpredictable and the new norm brought about by unprecedented climate change. The 2020 Global Risk Report (published each year by the World Economic Forum) has warned that natural disasters are becoming more intense and more frequent and we can expect more unprecedented extreme weather throughout the world. Extreme weather events are part of the Australian experience and have also been ranked since 2017 as the top global risk in terms of likelihood or impact in the Global Risk Report, beyond the risk of infectious diseases.

The construction industry is one of the most vulnerable sectors to the delay and disruption impact of inclement weather. However, parties often fail to recognise the risks to their project that should be managed effectively under their construction contracts, including those risks that impact on safety, programme and management of the project budget.

So why is the construction sector often not adequately prepared to address a foreseeable current risk that continues to be both extreme and unpredictable? In truth, the answer likely lies both in the way contracts are drafted with ambiguous entitlement to relief and claim requirements, the hyper competitive dynamic of the Australian construction market and the unfortunate fact that climate change is still a relative newcomer to the risks identified during the planning stage of construction projects and is given relatively little attention despite the increasing impact.

In construction contracts, entitlements and process are usually dealt with under the extension of time (EOT) clauses and potentially as latent conditions. The concept of "inclement weather" is often not clearly defined with reference to available data and records (if at all), nor are specific weather events expressly included as examples (or flooding as a result). Indeed, often construction contracts do not contain an express entitlement for inclement weather or its effects and even those that do may only allow for an EOT but not delay costs.

Accordingly it is recommended that the parties expressly specify the types of inclement weather that relief is to be available for (wind, temperature, rain, etc.) and whether such events give rise to time only, or both time and delay costs relief. As a compromise, the parties might agree an allowance for inclement weather delays, after which the risks might either be shared or borne by the contractor.

Other considerations include:

- Whether the contractor should be entitled to extra money and/or time in the event that some construction work has to be rectified because it has been damaged as a result of an adverse weather event (assuming that it has already been claimed for by the contractor)?
- Should the contractor be entitled to extra time and/or extra money in the event that the physical work is damaged? What if the work is not damaged but if the site becomes completely or partially inaccessible due to the impacts of an adverse weather event?

Unsurprisingly, a principal's default position will often be that no extra time or money should be payable and the contractor's position is the reverse. Ultimately, there is no universally correct answer and these are matters for negotiation between the parties based on their own commercial interests.

Where a particular building is part of a wider project, a principal will also need to answer the above questions with an eye to the project as a whole.

In a practical sense, industry participants should ensure that they have a close working relationship with their insurance broker, as this will assist them to select appropriate insurers and policies of insurance. While most insurers are proactive, that is not always the case. Nor can it be said that all insurers appreciate the impact that delay can have upon a construction project. In the case of a large project, the cost of delay could prove to be significant.

1 https://www.smh.com.au/national/nsw/sydney-set-for-several-sunny-days-before-cool-change-and-wetter-than-average-may-20220501-p5ahjf.html

Finally, leaving aside the contract, we generally recommend that the industry participants adopt a practical approach to issues such as adverse weather events. Even if a contractor were to sign a contract that prevented the contractor from claiming extra time and/or extra money in circumstances where (for example) it became more difficult to get labour or materials to site, we would generally question the logic of a principal seeking to hold strictly to those rights. Put simply, what advantage does the principal wish to gain (particularly if the contractor cannot complete the project)? The same attitude should (ideally) be adopted when the proverbial shoe is on the other foot.

Last but not least, it should be noted that contractors will usually still need to prove that the delay was on the critical path to the date for practical completion or at the very least that there has been an impact; mitigation measures have been taken; and the EOT claim has not otherwise been-barred pursuant to the claim requirements of the contract.

Takeaways

- Do not rely on old or standard form template documents for either contracts or insurance cover. Changed conditions call for adaptive strategies, and proper consideration of the likelihood and impact of inclement weather on the project and safety.
- Focus on clearly defining entitlements in the event of inclement weather events, and the limits of the entitlement. If claims need to be made in prescribed time frames, be aware of those requirements and follow them.
- Balancing the rights of the parties in a way that is equitable and sustainable is often "best for project", promotes harmony and lowers the risk of the parties getting bogged down in protracted claims disputes that ultimately further erode trust and the relationship.
- A practical approach to the challenges of weather impacts need not be inconsistent with effective administration of the construction contract – both should be aligned.

Spotlight on SOPA – Part 3: Unfair Time Bars

Authors: Donna Charlesworth, Tenille Kearney and Zayna Abu-Geras

What You Need to Know

Disputes concerning notice-based time bars may be set for a sharp increase in light of one of the new and novel changes to be introduced by the Building and Construction Industry (Security of Payment) Act 2021 (WA) (SOPA).

Under section 16 of the SOPA, adjudicators, arbitrators and courts alike will have the power to declare notice-based time bar provisions in construction contracts entered into after 1 August 2022 unfair, the impact of which will be the relevant noticed-based time bar will have no effect in the case of the particular entitlement that is the subject of the proceedings in which it was declared unfair.[1]

This represents a significant development in the law in Western Australia regarding notice-based time bars. In this article, we discuss what you need to know about section 16 of the SOPA.

Notice-based Time Bars

Notice-based time bars are common in construction contracts. They typically require a party to serve detailed notice of an event within a strict timeframe following its occurrence, as a precondition to claiming time or costs. The rationale for such provisions are that they seek to ensure the contract parties and Superintendent are aware of any issues and potential cost and time impacts on the project as soon as practicable, so the issues can be investigated, and steps can be taken to reduce their impact on the performance of the contract.

However, in practice, notice-based time bars are not only used as a risk management tool, but have been seen to be a "weapon" in the arsenals of Principals and Head Contractors to defeat claims from subcontractors. That may be so because notice-based time bars have traditionally been strictly enforced even if they appear to be harsh or onerous, provided such provisions have been clearly stated and expressed in the contract.[2]

All of this may be set to change when section 16 of the SOPA applies. This is because parties to new contraction contracts entered into after 1 August 2022 must be aware that adjudicators, arbitrators and courts alike will be empowered under section 16 the SOPA to declare a notice-based time bar provision unfair. If a notice-based time bar provision is deemed unfair, it will have no effect in the instance of the particular entitlement that is the subject of the proceedings in which it was declared unfair, but will continue to apply in other circumstances or in the context of other challenges arising under the same or related contracts.[3]

Section 16 of the SOPA is not just new to Western Australia, it is also new to Australia as a similar section does not exist in any other states' or Territories' security of payment legislation. It appears to have been introduced in the SOPA in response to recommendations in the 2017 Review of Security of Payment Laws[4] and the 2018 Review on Security of Payment Reform in the WA Building and Construction Industry (Fiocco Review),[5] that steps be taken to address the use of unfair time bars in construction contracts. The Fiocco Review stated in section 6.11.2:

> "Due to the significant level of stakeholder support for the proposal, I recommend that legislation prohibits unreasonable time bar clauses in WA. I agree with the reasons outlined by Mr Murray – curtailing freedom of contract to relieve parties in the contractual chain from the "harsh consequences of failing to give a required notice" is warranted. If one accepts that parties higher in the contractual chain present contracts to subcontractors on a 'take it or leave it' basis, then government intervention is warranted to 'protect the weak from the strong'."

1 Section 16(3) and 16(4) Building and Construction Industry (Security of Payment) Bill 2021 (WA) (SOPA).

2 *CMA Assets Pty Ltd Formerly Known as CMA Contracting Pty Ltd v John Holland Pty Ltd [No 6]* [2015] WASC 217, at [272] and [375].

3 Section 16(4) SOPA.

4 https://www.ag.gov.au/sites/default/files/2020-03/review_of_security_of_payment_laws_-_final_report_published.pdf

5 https://www.commerce.wa.gov.au/sites/default/files/atoms/files/final_report_-_security_of_payment_reform_in_the_wa_building_and_construction_industry.pdf

Key Features of Section 16 of the SOPA

The party who alleges that a notice-based time bar provision is unfair bears the onus of establishing that.[6] A notice-based time bar provision of a construction contract may be declared unfair in circumstances where compliance with the provision:

- Is not reasonably possible.[7]
- Would be unreasonably onerous.[8]

The decision-maker (adjudicator, arbitrator or court, for example) must consider the following factors before declaring a notice-based time bar unfair:[9]

- When and how notice was required to be given.
- When the party required to give notice would reasonably have become aware of the relevant event or circumstance, having regard to the last day on which notice could have been given.
- The relative bargaining power of each party in entering the construction contract.
- The irrebuttable presumption that the parties have read and understood the terms of the construction contract.
- The rebuttable presumption that the party required to give notice possesses the commercial and technical competence of a reasonably competent contractor.
- If compliance with the provision is alleged to be unreasonably onerous — whether the matters set out in the notice are final and binding.

However, the decision maker cannot take into account the provisions of any related contract or the things that occurred under any related contract, in deciding to declare a notice-based time bar unfair.[10] There is also no guidance in the SOPA as to what weight is to be attributed to the six factors above, what other factors (if any) might be relevant to whether a notice-based time bar is unfair, and what commercial and technical competence is reflective of a "reasonably competent contractor". In the circumstances, one can envisage situations where the same notice-based time bar provision will be declared "unfair" in one contract by one decision-maker, but upheld as "fair" when challenged in similar circumstances under another contract by a different decision maker. Accordingly, we expect many construction industry participants will be eagerly awaiting Court decisions on the operation of section 16 of the SOPA to understand how this section will operate in practice, and what sorts of notice-based time bars will be generally be considered "unfair" or "fair".

Conclusion

Section 16 of the SOPA is a new and novel feature of the SOPA legislation. Time will tell what impact this will have on the construction industry and construction contracts entered in Western Australia after 1 August 2022.

In the meantime, all construction industry participants should review, and if necessary, consider amending any notice-based time bar provisions that they suspect may be susceptible to being challenged and declared as "unfair".

If you need assistance reviewing or amending your construction contracts, please contact a member of our team.

6 Section 16(5) SOPA.

7 Section 16(2)(a) SOPA.

8 Section 16(2)(b) SOPA.

9 Section 16(6) SOPA.

10 Section 16(7) SOPA.

Inflation and Price Escalation Clauses

Author: Robert O'Brien

Over the last two years, COVID-19 has affected the construction sector in an unprecedented manner. Closed borders created havoc with local labour and material supply chains, giving rise to what many thought to be artificial inflation that would ease as the industry emerged from COVID-19.

The reality has been something very different. The global backlog in supply and the shortage of skilled labour in a heated economy has been exacerbated by increasing commodity prices. Rather than improving, the turmoil in Europe is only set to make matters worse. With the Australian federal government's recent 10-year plan for infrastructure investment increased to an unprecedented AU$120 billion, that pressure does not show signs of abating.

While the Reserve Bank has recently announced what everyone knew – inflation is on the rise – those in the construction sector will be only too well aware that cost increases of some staple materials are running at multiples of the official figures. Construction costs are now rising at a rate not seen in decades.

Notwithstanding the booming construction market, thanks largely to government incentives to counter COVID-19 effects, recent years have seen these financial pressures take their toll on contractors with rising insolvencies in the sector. It would be naive to put the demise of these firms down to one issue but construction inflation is a key factor in undermining the profitability of projects and the ability of contractors to maintain a positive cash flow.

A project tendered in 2020 would, as of today, be experiencing inflation in the order of 14%. If that project had only a modest margin, it would almost certainly be loss-making now.

The most recent heavyweight contractor to fall into insolvency was Probuild, despite a hefty tender book and significant projects underway, including AU$5 billion worth of major building projects in Victoria alone. Probuild is unlikely to be the last. Probuild's owner, South Africa's WBHO, put some of the blame on COVID-19 restrictions in Australia and significant material increases. Many of Probuild's projects had a two-to-three-year construction period that, when coupled with an average 12-month tender period, would have seen significant inflation in costs between tender and completion.

What this means in a practical sense to principals and contractors is that it is becoming harder to forecast costs over the medium to long term. In turn, contractors are unwilling, or simply unable, to take the risk on lump sum compensation models or commit to rates and prices for extended periods. We are already seeing contractors refusing to hold their tendered rates and prices beyond two or three months.

It is now more essential than ever that contractors and principals are well versed on the risks and mitigation of risks associated with inflation and supply chain disruption and consider, at the outset, how the risk of cost escalation can be minimised or shared on a project.

The traditional approach to risk allocation, identifying who is better placed to manage the risk, does not apply neatly to questions around inflation as wider economic factors bear upon the industry. While inflation has not been an issue the industry has had to grapple with for over a decade, seasoned principals and contractors will be familiar with the safeguards adopted in previous high inflationary periods in the form of price escalation clauses.

Price escalation clauses allow contractors and principals to establish thresholds for price movements within which one party bears the risk and outside of which the other party bears the risk. The common feature of price escalation clauses are the identification of an index or benchmark against which to measure movement and a limitation or percentage guideline as to when a cost increase will be considered significant enough to trigger relief.

While contractors may find some principals unwilling to consider a price escalation clause in their contracts, the flipside is that principals may be faced with a scenario in which their contractor becomes insolvent, which carries greater risks and costs for a principal and a project generally.

We have seen a steady increase in interest from stakeholders on projects to the use of price escalation clauses and managing the risks associated with price increases and supply of materials generally.

Please contact our team for further information or assistance with managing price escalation risks under your construction contracts.

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51828/06/22