SQUIRE PATTON BOGGS

Construction Matters

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Can Parties to a Construction Contract Limit Liability to Misleading or Deceptive Conduct?

In our experience, it is quite common in contractual disputes for parties to accompany or supplement contractual claims with claims for misleading or deceptive conduct under the Section 18 of the Australian Consumer Law (ACL) (previously Section 52 of the Trade Practices Act).

Misleading or deceptive conduct claims are attractive to plaintiffs, because, among other things, these claims:

- Are not fettered by or reliant on the contract (and thereby "ex" the contract)
- Can relate to conduct before, during or after the formation of contract
- Can "open up" a flexible range of remedies under the ACL

One pertinent issue is whether the party to the construction contract having the benefit of a limitation of liability clause (generally the contractor) can rely on that clause as against a misleading or deceptive conduct claim by the principal.

The obvious risk to the contractor, assuming all elements to the cause of action of misleading or deceptive conduct claim are satisfied, is that they may potentially be faced with unlimited liability to the principal if the limitation clause is ineffective.

There are broadly two issues that need to be answered:

- Whether as a matter of contractual interpretation of the words of the limitation of liability clause, the clause, on its proper interpretation, applies to claims for misleading or deceptive conduct?
- Whether even if on a proper interpretation, the clause applies to misleading or deceptive conduct claims, would a court allow the clause to stand?

In relation to the first issue, assuming, that the limitation of liability clause, on its proper interpretation, applies to misleading or deceptive conduct, we turn to the second issue.

On the second issue, it has been consistently determined by courts, since the 1980s, that a clause that purports to exclude (as opposed to limit) any liability for contraventions of Section 18 of the ACL is unenforceable.

However, while it is clear that a clause that seeks to exclude liability is unenforceable, there is some (limited) good news for contractors seeking to limit (as opposed to exclude) their liability. Relatively recently, there have been a small collection of single-judge decisions in NSW which have allowed clauses that impose a monetary limit or temporal limit on the extent of the remedy flowing from a misleading or deceptive conduct claim. Given that these were single judge decisions, they are persuasive, but not binding upon state courts.

From a policy perspective, it seems to us that such decisions accord with freedom of contract by giving effect to attempts by parties to limit liability to misleading or deceptive conduct claims. Additionally, these decisions provide greater certainty to contractual parties by allowing them to agree on this important aspect of risk allocation by contract. These policy issues may well be at the forefront of the mind of relevant judges at some stage in the future, as and when this issue will fall to be authoritatively decided by a superior Australian Court.

Defects Obligations Under Construction Contracts

Some contractors have the misapprehension that liability for defects ends at the conclusion of the defect liability period. Defects can technically classify as breaches of contract or amount to negligence. The provision of a defects liability period gives the principal more rights than at common law. Therefore, the end of a defects liability period is not necessarily the end of a contractor's obligations with respect to defects found in works under the contract. If defects arise under a construction contract, the principal has a common law right to rectify defects that exist notwithstanding the parties have contractually agreed to include a defects liability period, unless there is a specific exclusion.

In very general terms, a "defect" is the "falling short" of some standard an item was required to meet, usually in accordance with requirements prescribed in a contract.

Usually, construction defects are classified fall into the following categories:

- Design defects
- Material defects
- Specification defects
- Workmanship defects

Most construction contracts feature a defects liability or defects correction period. This is a set period of time after a construction project is finished, during which the contractor is responsible for remedying defects arising with respect to the works. Typically, a defects liability period lasts between 12 and 24 months.

However, the expiry of this period does not release the contractor from liability for defects whatsoever. The end of such a period merely signifies the end of a period during which the contractor is obliged to remedy defects pursuant to an express contractual obligation. Unless express words are used to the contrary, a defects liability clause will not extinguish remedies the principal has under common law.

If faults appear after the defects liability period lapses, the principal would have a common law right to sue the contractor for breach of contract (for example, where construction work does not meet an express specification, quality requirement or industry standard) or negligence (for instance, if the defect causes damage to people or property).

Actions relating to defects must be brought within the relevant statutory limitation period for bringing a claim. Generally, for breach of contract, the limitation period runs from when the breach occurred, that is, when the defective work was performed as opposed to when loss is suffered. Often, for defective work, the limitation period will commence from the date of practical completion. In Western Australia, the general limitation period to pursue a claim for breach of contract or negligence is six years. In the Northern Territory the limitation period is three years pursuant to the Limitation Act 2008.

Notably, the law in the Northern Territory is generous to principals. The Building Act 2007 modifies the Limitation Act by providing that a cause of action arising from a "structure" (as defined under the Building Act) is 10 years from the issue of the occupancy permit. Unfortunately, this is invariably longer than what most contractors or consultants are required to maintain professional indemnity policies of insurance for under construction contracts.

Limitation periods become especially important for principals if there are latent defects. Such defects occur where the damage only becomes apparent several years after the work is completed. When latent defects arise, the principal should promptly conduct an assessment to determine when the limitation period will expire. This will ensure the principal is not time barred from making a claim.

The Importance of Properly Drafted Security Provisions in Construction Contracts

Best Tech & Engineering Ltd v Samsung C&T Corporation [No 2] [2015] WASC 447

Overview

The recent decision of *Best Tech & Engineering Ltd v Samsung C&T Corporation* highlights the importance of properly drafted security provisions in construction contracts. Poorly drafted clauses may prevent a call upon bank guarantees. Further clarification has been given to claims for overpayment, which are capable of forming the basis for a call on security.

Facts

Samsung C&T Corporation (Samsung) is a party to a head contract with Roy Hill Holdings Pty Ltd, under which Samsung is responsible for the delivery of engineering, procurement, construction, commissioning and performance testing in relation to the Roy Hill Iron Ore Project (Project). Samsung subcontracted Best Tech & Engineering Ltd (Best Tech) as a supplier of modular steel for these operations (Supply Contract).

Clause 3.2 of the Supply Contract entitled Samsung to call upon the Australia and New Zealand Banking Group (ANZ) for payment of up to US$1.5 million in guarantees in circumstances of defective workmanship or incurred costs that Best Tech was responsible for under the Supply Contract.

- On 10 September 2015, Samsung gave notice to Best Tech that it proposed to have recourse to the security under the Supply Contract (Recourse Notice). In the Notice, Samsung referred to numerous breaches of the Supply Contract by Best Tech, including:
- Failure to provide manufacturers' data reports
- Failure to comply with the Supply Contract schedules, which caused loss and damageThe supply of materials that required defect rectification
- Best Tech wrongfully purporting to suspend the Supply Contract

Samsung further asserted that it had made an overpayment of approximately AU$2.5 million which Samsung believed it was entitled to reconcile. Importantly, it was this overpayment which Samsung justified as a sufficient basis to call upon the security. Although the Recourse Notice constituted a formal notification pursuant to clause 3.2, Samsung chose not to rely upon Best Tech's alleged breaches under the Supply Contract.

Best Tech applied for an urgent interlocutory injunction to prevent Samsung from calling on the security, which was granted on 18 September 2015. Best Tech claimed that Samsung breached the Supply Contract by failing to pay for works undertaken pursuant to the Supply Contract, as well as asserting its entitlement to call upon the guarantees.

On 1 October 2015, Samsung wrote to Best Tech, enclosing a revised progress certificate which brought to account three alleged overpayments totalling approximately AU$3 million. When set off against amounts Samsung deemed payable to Best Tech, the resulting figure was approximately US$1.6 million. Samsung's letter demanded Best Tech make payment of this amount within 10 days of receiving the revised progress certificate.

Held

The main issues for Chaney J to consider concerned the proper construction of clause 3.2 of the Supply Contract, which was "poorly drafted".

Recourse Notice

In particular, an issue of construction arose over the following expression in clause 3.2:

'*Security* shall be subject to recourse by the *Purchaser* where at least 10 days have elapsed since the *Purchaser* notified the *Supplier* of its intention to have recourse subject to the purchaser showing any losses, damages or substantial breaches…'

The question arose as to whether:

- Samsung was able to demonstrate losses or damages at any time, either before or after the 10 days' notice of intention was provided, or
- Demonstrating losses after the notice of intention was given would provide for an additional 10 days before the security is called uponThe court considered that the requirement for 10 days' notice was to enable Best Tech to consider its position in light of the claim being made against it. If the basis of the claim was not apparent at the time the notice was given, then the purpose of the requisite notice was defeated.

It was held that a proper construction of clause 3.2 required Samsung to show its losses, damages or substantial breaches no later than the time upon which it gives 10 days' notice of intention to have recourse to the security.

Overpayments

The court also considered whether a claim for reimbursement for money overpaid could be sufficiently characterised as "money owing due to costs caused by the supplier to the purchaser that fall into the responsibility of the supplier". If so, this would give rise to an entitlement for Samsung to call upon the security pursuant to clause 3.2 of the Supply Contract.

Best Tech argued that the expression "money owing due to costs" applied only to situations where Samsung had incurred costs in the context of having an existing debt to some third party. This view was not accepted by the court. Chaney J read "money owing" as a reference to money owing by the supplier to the purchaser, which suited the commercial purpose of the contract. Further, overpayments were capable of being "costs", as it was classified as expenditure undertaken by Samsung under the Supply Contract. If overpayments were made, repayment could reasonably be said to "fall into the responsibility of the supplier".

As it was asserted that the claim for overpayment was capable of forming a basis to call upon the security, the court did not consider that Best Tech had established a "serious issue to be tried' as to Samsung's entitlement to give proper notice under clause 3.2. While an interim injunction was granted, it was restricted from its initial wide terms. Samsung was open to issue a further 10 days' notice of intention to have recourse to the security due to the asserted overpayments.

Implications

Where a party (in whose favour security has been given) has entered into a contract containing provisions that restrict it from calling upon a security, breach of its contractual promise may provide the basis for injunctive relief by the other party.[1] To this end, proper drafting of security clauses in construction contracts is crucial in obtaining clarity of the specific obligations imposed, and the exact circumstances in which breaches of those obligations will occur.

Certainly, if a period of notice is provided for, a party in breach of its obligations should be informed of the basis of that breach at the time that notice is given, in order for the party to consider the claim. Additionally, claims for overpayment are capable of forming the basis for a call on security.

The purpose of security provisions is to restrict a party's otherwise unrestricted capacity to call upon guarantees. Hastily and poorly drafted clauses may further restrict a party's capacity to call upon security for a legitimate claim. Clauses should impose clear requirements that leave no room for ambiguity.

1 *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158, 164.

Upcoming Events

Construction Breakfast Briefing

Adjudications On the Rise How to Protect and Advance Your Position
Wednesday, 30 March at 7:30am – 9:00am
Squire Patton Boggs Level 21, 300 Murray Street Perth WA 6000

For further details please contact Isla Rollason on +61 8 9429 7624 or isla.rollason@squirepb.com.

Contacts

Cris Cureton
Partner, Darwin
T +61 8 9429 7460
E cris.cureton@squirepb.com

Brendan Reilly
Partner, Perth
T +61 8 9429 761
E brendan.reilly@squirepb.com

Avendra Singh
Partner, Sydney
T +61 2 8248 7810
E avendra.singh@squirepb.com

Greg Steinepreis
Partner, Perth
T +61 8 9429 7505
E greg.steinepreis@squirepb.com