

# The Prevention Principle and Implied Duty of Good Faith in Construction Contracts

The recent decision of *Probuild Constructions (Aust) Pty Ltd v DDI Group Pty Ltd* [2017] NSWCA 151 emphasises the ongoing importance of the “prevention principle” in the New South Wales and broader Australian construction industry and found that an implied term of good faith can govern the unilateral power to extend time commonly found in standard form construction contracts.

## Key Findings

- Probuild directed its contractor, DDI, to perform variations after the date for practical completion.
- DDI did not within the contractual time frames claim an extension of time to the date for practical completion for delays arising out of the variations.
- Probuild was nevertheless obliged to grant DDI an extension of time because of a discretionary contractual clause which permitted Probuild to grant extensions of time even where no claim had been made.
- The court found that Probuild was obliged to exercise its discretion because the requirements of honesty and fairness in the context of the prevention principle dictated as much and, separately, because it was operating under an implied duty of good faith to do so.

## Background

The appellant, Probuild Constructions (Aust) Pty Ltd (Probuild), was the head contractor for the refurbishment of the popular Tank Stream Hotel in Sydney. On 19 May 2014, Probuild subcontracted with DDI Group Pty Ltd (DDI), pursuant to an amended form of the General Conditions of Subcontract for Design and Construct (AS4303-1995) (the “Subcontract”).

The date for practical completion of the works was 5 January 2015, with the date of practical completion being the date certified by the head contractor, or some other date as allowed by clause 41 of the Subcontract. Clause 41 of the Subcontract provided a mechanism by which DDI could seek an extension of time in the event that it envisaged a delay in carrying out the works, including delay caused by a variation to the Subcontract works. Importantly, clause 41.9 also conferred on Probuild a discretionary power to extend time, notwithstanding that DDI was not entitled to or had not claimed an extension of time.

Despite the intended application of clause 41 for use in circumstances such as those that materialised before Probuild and DDI, neither party sought to employ its function, meaning that when the actual Date of Practical Completion was reached on 28 May 2015 – some 144 days after the intended Date for Practical Completion – the seed for what would soon become a source of dispute between the parties had already been sown.

## The Dispute

On 27 July 2015, DDI lodged a payment claim in the amount of AU\$2,175,267 (including GST) (the “Payment Claim”), pursuant to s13 of the *Building and Construction Industry Security of Payment Act 1999* (NSW) (**SOP Act**), to recover monies it said were due under the Subcontract. Relevantly, a large component of the Payment Claim was in respect of variations that DDI said Probuild directed it to undertake *after* the Date for Practical Completion.

In opposition, pursuant to s14 of the SOP Act, Probuild provided DDI with a payment schedule which scheduled an amount of AU\$nil by reason of a set-off for liquidated damages in the amount of AU\$2,328,998, based on DDI’s failure to complete the work by the Date for Practical Completion.

## Adjudication

On 15 October 2015, DDI made an application for adjudication of its Payment Claim pursuant to s17 of the SOP Act, asserting that it was Probuild that instructed it to depart from the Subcontract construction program and that Probuild was clearly aware of the delays by reason of the revised construction programs that it issued. To this end, DDI argued that Probuild’s liquidated damages claim was unreasonable and merely an “invention of convenience”.

The adjudicator dismissed Probuild’s claim for liquidated damages, noting that 80% of the contract variations being directed by Probuild and submitted for approval by DDI came after the Date for Practical Completion. Accordingly, it was determined that it would be “totally inconsistent and unreasonable” for Probuild to be directing DDI to perform significant additional work under the Subcontract after the intended Date for Practical Completion and then claim for liquidated damages against DDI after it had followed Probuild’s express directions. In reaching this decision, the adjudicator explained that whilst there may have been some DDI-caused delays, he was not satisfied that Probuild was entitled to a liquidated damages claim for the total 144 days. Accordingly, the adjudicator determined that Probuild was liable to DDI for payment of an amount of AU\$475,716.20 (including GST), plus interest.

## Primary Judgment

On 10 December 2015, Probuild commenced proceedings in the Equity Division of the Supreme Court of NSW seeking an order to quash the adjudicator's purported determination on the basis that the determination had been infected by a denial of natural justice, namely, procedural fairness. Specifically, Probuild contended that the adjudicator had rejected its liquidated damages claim on bases which neither party had contended for, and which the adjudicator had not notified the parties of. To this end, Probuild asserted that, had the adjudicator intended to so act, he should have invited the parties to make further submissions pursuant to s21(4) of the SOP Act.

The primary judge dismissed Probuild's summons, stating that there had been no denial of procedural fairness and that the adjudicator had dealt with Probuild's argument "as made".

## Court of Appeal

On appeal, Probuild contended that the primary judge had erred in his decision because underpinning the adjudicator's rejection of the liquidated damages claim was the application of the prevention principle which had not been argued. Subsequently, the primary issue on appeal was whether the adjudicator had applied the prevention principle and, if so, whether he had denied Probuild procedural fairness.

## Decision

The Court of Appeal found that Probuild had not been denied procedural fairness because, in the circumstances of the arguments put before the adjudicator, it "should not have come as a surprise" to Probuild that the adjudicator would apply the prevention principle.

McColl JA delivered the leading judgment and, in so doing, embarked upon a useful discussion of the prevention principle, which we discuss below. Her Honour also highlighted the commercial function of the SOP Act; that being to ensure that any person who undertakes to carry out construction work under a construction contract is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work and the supplying of those goods and services.

## Application of the Prevention Principle

Her Honour identified that the premise of the prevention principle is that a party cannot insist on the performance of a contractual obligation by the other party if it itself is that cause of the other party's non-performance.<sup>1</sup> By reference to the present case, the prevention principle applies to delays in practical completion caused by variations that result from the act or default of the principal.

Ordering variations after the due date that substantially delays completion will, unless the contract provides otherwise, and in the absence of an applicable extension of time clause, disable the proprietor from recovering or retaining liquidated damages which might otherwise have accrued after the giving of the order.<sup>2</sup>

Therefore, in the context of variations to construction works, whether ordered before or after the due date for completion, the prevention principle "is grounded upon considerations of fairness and reasonableness".<sup>3</sup>

Where the prevention principle is employed in extension of time cases, the contractual date for practical completion ceases to be the proper date for the completion of the works and if there is no contractual mechanism for the substitution of a new date, then there is no date from which liquidated damages can run and the right to liquidated damages is lost.<sup>4</sup> Accordingly, the time for performance is set "at large"<sup>5</sup> and the time for completion of the work is then to be undertaken within a reasonable time.<sup>6</sup>

The implied operation of the prevention principle can be modified or excluded by contract,<sup>7</sup> including by way of extension of time provisions such as those at clause 41.5 – 41.6 of the Subcontract, which provided DDI with the opportunity to claim an extension of time for delay. Probuild argued that DDI's failure to exercise its contractual right meant that the prevention principle ought not to have been a relevant consideration of the adjudicator.<sup>8</sup>

However, Her Honour McColl JA held, by reference to Probuild's own submissions, that the inferential application of the prevention principle by the adjudicator could not, or should not, have come as a surprise to Probuild.

Further, pursuant to the operation of clause 41.9 of the Subcontract, the Court of Appeal extended the principles espoused in *Peninsula Balmain Pty Ltd v Abigroup Contractors Pty Ltd* [2002] NSWCA 211, holding that Probuild ought to have exercised its reserve power to grant extensions of time, both honestly and fairly, having regard to the underlying rationale of the prevention principle.

Notably, the contract in this case did not contain the usual amendments that modern construction contracts generally contain to counter the effects of *Peninsula Balmain*, namely that the unilateral power to extend time is for the benefit of the principal (or in this case, the head contractor) only and that the power need not be exercised for the benefit of the contractor. If such a provision had been included, it would have been more difficult for DDI to ultimately succeed, although it is questionable whether the outcome in the immediate appeal would have been any different given it was dealing with an application to set aside an adjudication determination under the notoriously "rough and ready" regime provided by the SOP Act.

1 *Spiers Earthworks Pty Ltd v Landtec Projects Corp Pty Ltd (No 2)* [2012] WASCA 53 at [47].

2 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 397-398); *app Turner Corp Pty Ltd (recv & mgr apptd) v Austotel Pty Ltd* (1997) 13 BCL 378 (at 384) per Cole J (as his Honour then was).

3 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 397-398).

4 *Spiers Earthworks Pty Ltd v Landtec Projects Corp Pty Ltd (No 2)* [2012] WASCA 53 at [49].

5 *Holme v Guppy* (1838) 150 ER 1195 (at 1196); 3 M&W 387 (at 389) per Parke B; Hudson's Building and Engineering Contracts (13th ed, 2015, *Sweet & Maxwell*) (at [6-028]).

6 *Multiplex Constructions (UK) Ltd v Honeywell Control Systems Ltd (No 2)* [2007] EWHC 447 (at [61]); Hudson's Building and Engineering Contracts (13th ed, 2015, *Sweet & Maxwell*) (at [6-028]).

7 *SMK Cabinets v Hili Modern Electrics Pty Ltd* [1984] VR 391 (at 395).

8 *app Turner Corp Pty Ltd (recv & mgr apptd) v Austotel Pty Ltd* (1997) 13 BCL 378 (at 384-385) per Cole J (as his Honour then was).

## Application of the Implied Duty of Good Faith

Separate to the rationale of the prevention principle, and by reference to *Alcatel Australia Ltd v Scarcella*,<sup>9</sup> which followed the seminal case of *Renard Constructions (ME) Pty Ltd v Minister for Public Works*,<sup>10</sup> Justice McColl held, and Beazley ACJ and Macfarlan JA agreed, that “if necessary” there was an implied duty on Probuild to act in good faith in exercising the unilateral power to extend time.

Good faith contemplates good standards of both commercial morality and practice. In particular, it requires contracting parties to exercise their rights in such a way that the parties in question may enjoy the benefits anticipated to come from the contract. As previously established, this duty is founded upon the broad doctrines of contract law and forms a general duty to cooperate and limit unconscionable behaviour so as to maintain loyalty to the contract and builds upon fundamental expectations between contracting parties, such as:

- To act reasonably, honestly and fairly
- To do all things necessary as to co-operate in achieving the contractual aim
- Not to prevent, impede, fetter or hinder the other party in the performance of the contract

The exact scope of the duty of good faith in commercial contracts in Australia is an unsettled and developing area of law. This present case, and particularly the manner in which her Honour referred to the implied duty of good faith as essentially being a matter of course, tends to suggest that the courts, or at least the NSW Court of Appeal, is prepared to find a duty to act in good faith in the exercise of contractual discretions. This is quite a development and ought to be borne in mind when drafting such discretions.

On one view, this implied duty compelled Probuild to perform its contractual obligations and to exercise the discretion conferred on it by clause 41.9 of the Subcontract because it was beneficial towards the overall performance of the bargain to do so.

Probuild’s appeal was unanimously dismissed with costs.

## Contacts

### Brendan Reilly

Partner, Perth  
T +61 8 9429 7611  
E [brendan.reilly@squirepb.com](mailto:brendan.reilly@squirepb.com)

### Jeremy Munce

Senior Associate, Sydney  
T + 61 2 8248 7831  
E [jeremy.munce@squirepb.com](mailto:jeremy.munce@squirepb.com)

### Tim O’Shannassy

Associate, Perth  
T + 61 8 9429 7602  
E [tim.o’shannassy@squirepb.com](mailto:tim.o’shannassy@squirepb.com)

<sup>9</sup> *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 (at 369) per Sheller JA (Powell and Beazley JJA agreeing).

<sup>10</sup> (1992) 26 NSWLR 234.