

## **CONTRACT ADMINISTRATION BASICS**

**J McMullan, 1996**

### **1. INTRODUCTION**

This topic is directed to the key features of engineering contracts.

The major criteria which impact on any engineering contract are time, cost and quality. Those three criteria form the substantive part of this discussion.

Each of the issues considered in this topic is necessarily brief. The topic is set out as follows:-

1. Contract Documentation
2. Parties to the Contract
3. The Superintendent
4. Time Under the Contract
5. Payment Under the Contract
6. Quality
7. Insurance
8. Security
9. Default/Termination

There are many types of engineering contracts, and engineering contracts can differ dramatically in nature.

Engineering contracts, for example, differ fundamentally in nature from sales contracts, in that engineering contracts impose obligations of performance over a prolonged period of time whereas sales contracts, by comparison, could, theoretically, be performed instantaneously. (In this respect, however, a true "turnkey construction contract" is more akin to a sales contract than to a traditional construction contract.)

Some engineering contracts involve aspects of sales contracts, for example in an equipment supply and installation contract.

This topic attempts to discuss some features which are typically a part of engineering contracts.

## **2. THE CONTRACT DOCUMENTS**

The Contract Documents, in theory (there is usually an express term of the Contract that the written contract contains the whole of the agreement, though in fact, in addition to every such contract, there will always be a number of terms implied into such contracts) include all of the terms of the Contract.

The Contract Documents should usually include all of the following (at least):-

### **Formal Instrument of Agreement**

This document should simply set out all of the documents which comprise the Contract Documents, and the execution clauses.

### **Conditions of Contract**

The Conditions of Contract (which may or may not be based on a standard form document) set out the detailed contractual terms.

Specifications

Drawings

Post-tender Correspondence (if any to be incorporated)

From time to time, usually through inadvertence, the Contract Documents are not clearly defined, or are not finalised before the work begins. In such circumstances, the terms of the Contract may need to be identified later by a Court or an arbitrator.

From time to time, though the Contract Documents are adequately defined, disputes may arise as to whether particular work forms part of the Contract, or whether the work is, in fact, a Variation.

In either case, the adequacy of the Contract Documents will be contractors to perform parts of the works

he will be required to repair or re-perform defective works

he will be required to bring the Works to Practical Completion by the Date for Practical Completion

he will be required to return to the site, after he has handed back the site at practical completion, during the Defects Liability Period, to rectify defects during that period

The terms of the Contract will vary project to project.

The key issue is that the Principal and the Contractor are the only parties to the Contract.

### **3. THE SUPERINTENDENT**

#### **3.1 Dual Role of the Superintendent**

The Superintendent is not a party to the contract; he is a person named in the contract by the two parties to the contract (the Proprietor and the Contractor) and given certain functions under that contract by those two parties.

The role of the Superintendent would usually include:-

- assessment of progress claims and issue of progress certificates;
- assessment of claims for extra payment for variations to the contract;
- assessment of claims for extension of time;
- assessment of quality of materials and workmanship in accordance with the contract documents;
- and
- assessment of claims for extra payment (such as claims under the latent conditions provisions) under the contract.

Accordingly, though the Superintendent is usually appointed by and paid by the Proprietor (and may sometimes be the Proprietor's original design consultant), the Superintendent's role is principally to decide major issues of potential dispute under the contract between the Proprietor and the Contractor.

In such contracts there is (at least) an implied term that the Superintendent will act fairly. There is a strong contractual argument that if the Superintendent does not act fairly towards the Contractor, this constitutes a breach of contract by the Proprietor.

(Interestingly, in AS2124-1992, following on from AS2124-1986, clause 23 expressly provides that the Proprietor is to ensure that the Superintendent acts fairly at all times.)

The dual role of the Superintendent (on one hand he is retained and paid by the Proprietor, yet on the other hand he has a quasi-certifier role between the two parties to the contract) has been the subject of judicial comment.

The Institution of Engineers Australia Code of Ethics requires, in clause 5 (b):-

"...in our capacity as Superintendent administering a Contract, we must be impartial in our interpretation of the Contract..."

The role of the Superintendent is complex. It requires substantial engineering skills, a sound understanding of the law of contract, and in particular the provisions of the particular project documents.

The Contract will usually provide expressly that the Principal's agreement to allow subcontracting, or approval of particular subcontractors, does not affect the position of the Head Contractor.

In recent years, as result of a number of major contractors going into liquidation leaving unfinished projects, some principals have chosen to require collateral warranties (separate direct contracts) to be entered into between the principal and certain of the key subcontractors on a particular project.

The position remains, however, even where this occurs, that the Head Contractor is responsible for the delivery of the Works.

The Superintendent has two distinct roles under a traditional form of construction contract.

On one hand he has a number of functions in which he acts, either expressly or impliedly, as the agent of the Proprietor. On the other hand, the two parties to the contract agree, at the time of entering into the contract, that the Superintendent is to perform certain assessment/certifier functions under the contract. Those functions are quite distinct.

In most instances, the Superintendent will be either an employee of the Principal (typically on major public sector contracts the Superintendent is a senior person from that public sector organisation) or a paid consultant of the Proprietor (usually, a senior engineer from a private engineering consulting firm). Accordingly, where there is a dispute under the Contract, the Contractor, if dissatisfied with the decision of the Superintendent, will usually assert that the Superintendent is biased in favour of the Proprietor.

The **dual** role of the Superintendent under such construction contracts has been recognised by the Courts. The leading case in this area is a decision of the New South Wales Supreme Court (Macfarlan J) in **Perini Corporation v. Commonwealth of Australia** [1969] 2 NSW 530.

In the **Perini** case, Perini Corporation had contracted with the Department of the Postmaster-General to construct the Redfern Mail Exchange. During the project, the Contractor claimed a number of extensions of time, some of which were granted, some of which were refused, and some of which were granted but not to the full extent claimed. As was common at the time, the work was undertaken on behalf of the Commonwealth of Australia by the Department of Works. The Superintendent under the contract was the Director of Works.

The Court had to consider the role of the Superintendent.

It was asserted by the Contractor that the Director of Works was obliged to exercise his own discretion in considering whether there was an entitlement to an extension of time and that, in fact, the Director had been guided by "Departmental policies". Effectively, the Contractor was saying that the Director of Works had acted as a rubber stamp of the Proprietor.

The Court made the following observations in relation to the role of the Director of Works:-

"The second matter on which I will speak generally concerns the position of the Director of Works. This gentleman is undoubtedly an important officer in the Commonwealth Public Service. Unlike other senior Commonwealth public servants, there is not any provision made by statute for his appointment or duties. However, his position appears to be fairly clear. At the head of the permanent administrative staff of the Department of Works is the Director-General of Works who is charged with the general supervision of the Department and its activities throughout the Commonwealth. In each State there is a Director of Works who, in relation to the State for which

he is appointed, discharges the same general duties as the Director-General does for the Commonwealth...

The fundamental basis upon which the plaintiff sought to litigate its case against the defendant was that the defendant was in breach of certain terms implied in the agreement... the plaintiff's argument was that in the discharge of the duties imposed upon him by clause 35, the Director of Works, with the encouragement and support of the defendant, acted in a manner that was outside his mandate."

The Contractor argued that the Departmental was liable for damage suffered by it, in consequence of the error of the Director of Works, on three different bases:-

- (i) the Department was vicariously liable for anything that the Director did wrongly;
- (ii) the Director of Works, in relation to his functions under clause 35 was a certifier and, as such, the Department was obliged under the contract to ensure that the Director performed his role as a certifier properly or, at least, was required to refrain from taking any action or course of conduct which would oblige or influence the Director to act otherwise than in accordance with his duties as certifier; and/or
- (iii) the Director of Works was an arbitrator and, accordingly, was obliged to act judicially.

The Court concluded (without much trouble) that there was no basis for interpreting that the Director of Works was to act as an arbitrator (this was not pressed in the trial).

The Court then considered the issue of vicarious liability and, in particular, the position of the Director of Works having regard to his public service obligations. In this respect the Court said, at page 536:-

"In my opinion the cases make plain that throughout the period of performance of all these duties, the senior officer remains an employee of the government or semi-government body, but that in addition and while he continues as such an employee he becomes vested with duties which oblige him to act fairly and justly and with skill to both parties to the contract. The essence of such a relationship in my opinion is that the parties by the contract have agreed that this officer shall hold these dual functions and they have agreed to accept his opinion or certificate on the matters which he is required to decide... " .

The Court then went on to consider the particular duties of the Director of Works, at page 536:-

"It is now necessary to consider the duties of the Director of Works. He, of course, has not bound himself by contract with either the plaintiff or the defendant. The plaintiff and the defendant are the only parties to the agreement but in it they have agreed that the Director of Works shall have the powers and duties stated in it. Many of these powers and duties are administrative and supervisory in their character and are performed by the Director of Works as a servant and agent of the Commonwealth. I have already expressed the opinion that in respect of the duties imposed upon him by clause 35 of the general conditions that he is a certifier. The word "certifier" does not have an exact meaning but is used to describe a function which is somewhere between those of a servant and those of an arbitrator."

The Court then concluded that in the present case the terms of the contract required the Director of Works to exercise his own discretion in relation to certain functions. At page 538, the Court said:-

"On behalf of the plaintiff it was said that if a decision with respect to a particular application were decided by reference to "Departmental policy" that indicated that the Director was not making a personal decision but was bowing to the established policy of the Department. A similar criticism to the one I have just mentioned was that the Director was not entitled, if he were to make a proper decision, simply to "rubber stamp" the opinion of another officer, or even to adopt the recommendations of a subordinate. This, it was argued was to surrender his duty to somebody else and he was not permitted to do it....

I have formed the opinion that subclause (2) does confer a discretion upon the Director. The operation of subclauses (1) and (2) in my opinion is that if there shall be a delay "in the execution of the works" and that delay has been caused by some relevant factor, then sub-clause (2) confers a discretion upon the Director to say whether the cause is sufficient or not to justify an extension of time. Considerable discussion occurred during argument about the true limits of this discretion and learned counsel for the defendant submitted that the limits were confined within a range of matters that were relevant to the interest of both parties under the contract. In a sense I am of the opinion that this is correct but that the interest to which the Director must pay attention is not simply a desire by the plaintiff for financial convenience or reasons of its own, to have an extension or, on the other hand, desire by the defendant to have the building completed within the time originally specified in the contract, or in an ulterior sense, the desire of those representing the Postmaster General to be given occupation at the earliest possible date. The kind of interest which must govern the exercise of the Director's discretion is the interest of each party as it appears from all the provisions of the agreement."

In summary, the Court concluded:-

1. the Director of Works was a certifier under the Contract and as such had certain duties imposed on him by the Contract;
2. the Director of Works had a discretion as to whether or not he would grant an extension of time;
3. in making his decision, the Director was entitled to consider departmental policy but would be acting wrongfully if he were to consider himself as controlled by departmental policy;
4. there was an implied term in the Contract that the Commonwealth would not interfere with the Director of Works' duties as certifier; and
5. there was an implied term of the contract that the Commonwealth would ensure that the Director of Works properly performed his duty as certifier.

This, it is suggested, is the current law on the status of the dual role of the Superintendent under a traditional form of construction contract.

Finally, it may be convenient to briefly mention clause 23 of AS2124-1992. That clause provides, so far as relevant, as follows:-

"The Principal **shall ensure** that at all times there is a Superintendent and that in the exercise of the functions of the Superintendent under the Contract, the Superintendent -

- (a) acts honestly and fairly;
- (b) acts within the time prescribed under the Contract or when no time is prescribed, within a reasonable time; and
- (c) arrives at a reasonable measure of value of work, quantities or time."

[emphasis added].

Clause 23, in the 1992 edition and in the 1986 edition, imposes a **direct contractual obligation** on the Principal to **ensure** that the Superintendent acts in a manner consistent with honesty, fairness and reasonableness. (It also imposes a contractual warranty on the Principal that the Superintendent's measure of work, quantities or time is, itself, reasonable.)

### **3.2 Functions of the Superintendent**

#### ***(i) as assessor/certifier under the Contract***

The Superintendent is appointed by both parties to the Contract to perform certain functions as assessor/certifier. Those functions will include, principally:-

- certification of progress claims;
- assessment of variations;
- assessment of extensions of time;
- assessment of quality of workmanship and materials; and
- assessment of claims under the contract (for example, latent conditions claims).

The critical considerations in respect of these functions are as follows:-

1. in his role as a certifier/assessor, the Superintendent has a duty to act fairly/impartially;
2. the Superintendent must exercise this role independently; and
3. the precise nature of this role will vary from case to case depending on the terms of the Contract.

With this background, we now turn to the primary functions of the Superintendent in his certifier/assessor role:-

### *Progress Claims*

In all traditional standard form contracts, the Contractor is required to periodically deliver, to the Superintendent, progress claims for payment under the contract.

The Superintendent is usually required to assess those progress claims (by reference to the degree of completeness and the quality of the materials and workmanship). The Superintendent must calculate the amount due, at that time, having regard to:-

- work carried out by the Contractor in performance of the contract; and
- claims for breach of contract.

The Superintendent has to make more than a complex technical assessment. He is also be required to make a legal assessment of complex legal causes of action upon which a Contractor might base a claim for additional payment.

(This process is referred to in more detail in Topic 5.)

### *Variations*

The Superintendent is required to regularly exercise legal judgments under the Contract in the authorisation and valuation of variations.

There are two separate issues.

The Contractor may assert from time to time that particular works which he has been required to perform (either in accordance with the contract documents, or alternatively pursuant to a direction of the Superintendent) constitute a Variation. The test applied by the Courts is, in substance, that particular work constitutes a variation if it is work outside the works upon which the Contractor tendered/contracted, having regard to the terms of the Contract

The second complex area of assessment for the Superintendent in relation to variations is in the **valuation of variations**.

(Again this issue is considered further in Topic 5.)

### *Extension of Time Claims*

The assessment of claims for extension of time is extremely complex.

Typically, under a traditional form of construction contract, the Contractor would be entitled to extensions of time in the following circumstances:-

1. where delays are caused by the Proprietor (for example, if the Proprietor fails to deliver the site on the agreed date, or the design drawings/specifications are wrong requiring further work to remedy the error);
2. where delays are caused through events beyond the parties' control (for example, inclement weather or industrial strife).

The first task of the Superintendent in assessing claims for extension of time by the Contractor is to determine whether, having regard to the express terms of the contract, the Contractor is entitled to an extension of time at all.

In each case, it will be a complex analysis for the Superintendent to determine whether an extension of time is due to the Contractor at all.

The more complex calculation, however, comes in relation to the quantification of extensions of time. A delay might occur because of two days rain....but the effect of the two days rain may be to delay work commencing on the site for a further three days. Alternatively, a delay may occur to one part of the works which is non-critical to practical completion of the total project.

The Superintendent is required to assess claims for extension of time and grant such extensions as are due to the Contractor under the Contract.

(A more detailed discussion of extensions of time is set out in Topic 4.)

### ***Quality***

The parties define the works to be performed under the contract, in the contract documents.

Those documents consist, typically, of the drawings and specifications, but may also include, in certain circumstances, post-tender correspondence, and other technical descriptions of the proposed works.

The parties, at the time of entering into the contract, appoint the Superintendent to check the quality of materials and workmanship against the contract documents and to take such steps as are set out in the contract to effect the requisite quality standards.

The Superintendent's role is, traditionally, to watch over the works, to give directions to remedy work which is not in accordance with the provisions of the contract, and where that direction is not complied with, to take the steps provided in the Contract to remove part of the work from the Contractor and to have that work remedied by others at the cost of the Contractor.

(A more detailed discussion of quality issues is contained in Topic 6.)

### ***(ii) as agent of the Principal***

The Superintendent has a dual role. This paper has discussed, above, some of the instances where the Superintendent is required to act as a certifier/assessor. In performing that role there is, clearly emerging

from the cases, an obligation to act fairly, impartially and not at the direction of one or other of the parties (usually the Proprietor).

The other part of the Superintendents role, however is completely different.

The Superintendent is also required to act as the agent/adviser of the principal in respect of certain other functions.

There are a number of functions which the Superintendent will be likely to be required to perform in this role, including:-

- notification of successful and unsuccessful tenderers;
- arrangements for execution of contract documents;
- vetting of Contractors' insurances;
- vetting of security deposits;
- approvals and clearances by statutory authorities;
- advice on rate of progress and expenditure;
- recommendations on contractual actions to be taken by the Proprietor; and
- management of site staff.

In addition to the above, the JCC Standard Form Contracts set out, in clause 5.02, a listing of functions of the Architect when acting as the agent of the Proprietor (in addition to a similar listing of functions when acting as an assessor, valuer or certifier). That list of functions in which the Architect is to act as the agent of the Proprietor sets out the matters in relation to which the Architect should issue instructions, to the Contractor, principally:-

- performance of the works;
- variations;
- site conditions;
- nominated sub-contractors and suppliers;
- substitution of materials and workmanship;
- postponement of work;

- making good of defects in the works; and
- the removal, re-execution, replacement of works executed by the Contractor.

Each of these functions (the list is far more extensive than the items referred to above), are examples of the types of function upon which the Proprietor usually relies on its professional advisers for advice, before, during and after the performance of the works by the Contractor under the contract.

In relation to this role, the Superintendent must:-

- (i) comply with the instructions of the Proprietor (irrespective of whether those instructions are reasonable, fair or contrary to the interests of the Contractor); and
- (ii) the Superintendent owes a duty of care to the Proprietor in the performance of those functions.

If the Superintendent fails to perform those functions in accordance with paragraphs (i) and (ii) above, the Superintendent may be liable to the Proprietor for breach of contract and/or in negligence.

### **3.2.3 Liability of the Superintendent**

#### ***(i) to the Proprietor***

The Superintendent is in a contractual relationship with the Proprietor to perform his functions (all of his functions whether as agent of the Proprietor or as an assessor/certifier under the construction contract).

This liability will arise, potentially, both in contract and in tort. (See *Brickhill v. Cooke* [1984] 6 BCLRS 47 in which the New South Wales Supreme Court, Court of Appeal, held that a client could sue an engineer in tort as well as in contract.)

The Contract of the Superintendent to the Proprietor may be in writing, oral, and/or implied.

In many instances, there will be a written contract between the Proprietor and the Superintendent. Those terms of engagement may or may not include provisions relating to the services to be performed, the payment to be made in respect of those services, and, possibly, limitation of liability and extent of professional indemnity insurance cover.

In other cases, there may be no written engagement. In that case the contractual obligation arises through the conduct of the parties in the Proprietor requesting the Superintendent to do certain work and the Superintendent being entitled to be paid a reasonable sum for those works.

Where the Superintendent is an employee of the Proprietor, there will be an employment contract whether in writing or otherwise between the Proprietor and the Superintendent.

The terms of such a professional engagement contract are, again, beyond the scope of discussion in this Unit.

In addition to their contractual relationship, the Superintendent will owe the Proprietor a duty of care in the performance of his functions.

Until 1974, there was a view that certifiers were somehow immune from liability (to anyone) in the performance of their certification functions. As late as 1973 this "immunity" was still thought to exist.

In **Sutcliffe v. Thackrah**, the House of Lords considered the earlier cases, including **Arenson v. Arenson**, and held that there was no such immunity.

The Superintendent, therefore, in the performance of his functions under the contract, both as agent of the Proprietor, and as an assessor/certifier under the contract, is potentially liable to the Proprietor if he fails to perform the obligations either in accordance with the terms of his contract with the Proprietor, or alternatively, if he fails to perform his task to the requisite standard of care.

**(ii) to the Contractor**

The Superintendent has no contractual relationship with the Contractor. Accordingly, to the extent that he may have potential liability to the Contractor at all it will only be in tort.

We have already seen, above, that the Superintendent is not immune in tort in relation to his performance of his role as assessor/certifier.

The Superintendent's potential liability to the Contractor, depends on whether he owes a duty of care to that Contractor in all the circumstances and whether, in the performance of those functions, he has performed those functions to the requisite degree of care and skill.

On first principles, there seems little doubt that the Superintendent and the Contractor are in a sufficiently proximate relationship that the Superintendent ought to owe a duty of care to the Contractor

One notes, however, in the final analysis that there have not been many cases (if any) in which a Contractor has succeeded in negligence against the Superintendent in relation to performance of his functions.

In **Junior Books v. Veitchi** which has been limited to its factual situation (nominated sub-contract heavily relied on for its expertise) the House of Lords concluded that a nominated sub-contractor (no contract with the owner) could owe a duty of care to an owner in relation to the construction of a tiled floor by the nominated subcontract.

It seems, to me, that various parties likely to be involved on construction contracts, albeit that there is no contractual relationship between the particular parties, nevertheless have those other parties in mind when they are performing their particular roles on the project. It seems to me that it would be likely, in 1994, that a Contractor could establish a sufficiently proximate relationship in an action in negligence against the Superintendent.

There are, however, obvious strategic difficulties with bringing such a claim, in particular:-

- (i) the Proprietor would usually be a better defendant for the Contractor where the conduct complained of is a failure by the Superintendent to perform his assessor/certifier role. (Although, conceivably, such an action against a Proprietor might be time-barred, yet an action in negligence against a Superintendent might still be available...);
- (ii) in performing an assessor/certifier role, a subjective assessment is likely to involve exercise of discretion by professional men, accordingly it is unlikely to be the type of decision which would easily be established as having been negligent (although, again, one might conceive actions where, through perhaps mere inadvertence error had occurred...); and
- (iii) the failure by a Contractor to explore his remedies through to arbitration/litigation (where the Superintendent's decision would be re-visited in any event) would usually be a complete answer to a claim in negligence against the Superintendent by the Contractor.

On balance, therefore, it seems to me that an action in negligence is available to a Contractor against the Superintendent but practical reasons make it unlikely that such an action would usually be pursued.

#### **4. TIME UNDER THE CONTRACT**

##### **4.1. PRACTICAL COMPLETION**

The obligation of the Contractor under the Contract is to bring the Works to practical completion by the Date for Practical Completion.

"Practical Completion" has no meaning other than the meaning defined in a particular Contract. It is not a term of art.

The usual elements of practical completion are:-

- (a) the completion of the Works except for minor omissions and minor defects –
  - (i) which do not prevent the works from being reasonably capable of being used for their intended purposes;
  - (ii) in relation to which there are reasonable grounds for not promptly rectifying them;
  - (iii) the rectification of which omissions or defects will not prejudice the convenient use of the Works; and
- (b) all tests required under the Contract have been completed; and
- (c) any other particular requirements (for example, the completion of "as completed" drawings) have been completed.

The requirements set out above are generally to be found in this form in such major standard form contracts as AS2124, JCC, NPWC3 and others.

From time to time, particularly in project - specific contract documentation, the Principal will define a number of further pre-requisites to Practical Completion (for example, the obtaining of certificates from the Fire Insurance Council of Australia...).

The obligation on the Contractor, therefore, is not to bring the Works to "perfect" completion by any particular date, but to bring the works to "Practical Completion" by the "Date for Practical Completion".

Where the Contractor fails to bring the Works to Practical Completion by that Date for Practical Completion, the Contract will usually provide for the payment of "liquidated damages" by the Contractor to the Principal (we refer to this further below). Those damages represent the damages for breach of contract which the Principal will be entitled to recover from the Contractor because the Contractor has breached the Contract, namely by failing to bring the works to Practical Completion by the required date under the Contract.

### **Separable Portions**

From time to time, in particular contracts, there may be several stages and/or several relevant parts of the Works which are required by the Principal to be brought to Practical Completion by a particular date.

In such circumstances, the Works are divided into "separable portions" (alternatively referred to, from time to time, as "Separable Parts").

In such circumstances, the separable portions are expressly defined in the Contract and there will be a separate regime of Dates for Practical Completion in respect of each separable portion, and liquidated damages in respect of each separable portion.

## **4.2 EXTENSION OF TIME**

### **4.2.1 Delays**

The Contractor's obligations to bring the Works to practical completion by the Date for Practical Completion.

A failure to bring the Works to practical completion by that date will usually expose the Contractor to a claim for damages (usually "liquidated damages") by the Principal.

Accordingly, where the Principal somehow acts so as to prevent the Contractor from achieving practical completion of the Works by the Date for Practical Completion, or where certain circumstances arise which are expressly provided for in the Contract which have the effect of delaying the Contract in achieving practical completion by the Date for Practical Completion, the Contractor will usually be expressly entitled to an extension of time of the Date for Practical Completion.

Delays enabling the Contractor to claim an extension of time under the Contract could usually characterise as follows:-

***(i) Delays caused by the Principal***

Certain delays under a construction contract are caused by the Principal. Such delays might include, for example, delays in providing clear access to the site, delays in providing detailed drawings and specifications, errors in the drawings and specifications, or failure to provide certain matters to be provided under the Contract by the Principal (for example, water, electricity, gas...).

Where the Principal delays the Contractor in the performance of the Works, the Contract should expressly provide that the Contractor is to be entitled to an extension of time. (The Contract also should provide that the Contractor is expressly entitled to payment for the costs associated with that delay, usually referred to as "delay costs", in the absence of such an express provision the Contractor will have a claim for damages for breach of contract in any event).

There is a substantial body of law as to the effect of such delays where the Contract does not expressly provide the Contractor with a right to an extension of time and/or delay costs. A discussions of those cases is beyond the scope of this topic. The "prevention principle", however, is to the effect that the Principal, if he prevents the Contractor from performing his contractual obligations, is unable to enforce his contractual remedies against the Contractor in respect of any failure to perform those obligations.

Accordingly, modern construction contracts usually expressly provide an entitlement in the Contractor to both an extension of time and to delay costs where delays are caused by the Principal to the Contractor in the performance of the Works.

***(ii) Delays caused by the Contractor***

Certain delays are caused by the Contractor.

For example, the Contractor might be late in arriving on site. Alternatively he might perform the Works at too slow a rate to complete the Works by the Date for Practical Completion. Alternatively, he might perform the Works but perform them in a defective manner or in the wrong location.

In such circumstances, the Contract should not (and rarely does) provide that the Contractor is entitled to an extension of time and/or additional payment in respect of those delays.

These are all matters for which the Contractor is contractually responsible.

***(iii) Neutral delays/force majeure***

Certain delays which occur on major engineering contracts are not caused through the fault of either party but are referred to, from time to time as "force majeure" delays or events.

Such delays might include, for example, inclement weather, nationwide industrial stoppages, civil wars...

It is a matter for the parties, at the time of entering into the Contract as to whether particular force majeure events will or will not entitle the Contractor to an extension of time and/or an adjustment of the Contract Sum.

Where the Contract expressly provides that the Contractor is to be entitled to an extension of time for such events, one might expect lower tender prices. Where the Contract does not expressly provide for an extension of time in such events, one might expect higher tender prices.

Similar reasoning applies in relation to the express provision in the Contract of an entitlement to delay costs where such delays occur.

The nature of delays, and the assessment of claims for extension of time, are one of the major areas for potential dispute under engineering contracts.

#### **4.2.2 Procedure**

Where delays occur under a construction contract and the Contractor intends to claim an extension of time (and/or delay costs) the Contract usually expressly provides for a notification regime for the notification of and assessment for default such claims.

The usual requirements of such a Contract are:-

##### ***(i) Notification of a Claim***

The Contractor is usually expressly required to give notice of circumstances which might lead to a delay of any kind, immediately the Contractor becomes aware of such circumstances. This provision usually applies not only to circumstances out of which the Contractor might ultimately claim an extension of time, but to all circumstances where the Contractor is likely to be delayed in achieving practical completion by the Date for Practical Completion (even where, for example, the delay was caused through the Contractor's own fault and the Contractor is not entitled to such an extension of time).

In some contracts, there is a two-tier notification requirement, namely that the Contractor notify the Superintendent (or the Principal as the case may be) immediately upon becoming aware of the likely occurrence of a delay, and again, providing details of the extent of the delay and other such matters, within a reasonable time of the Contractor being able to calculate the extent and likely cost and effect on the construction program of that delay.

##### ***(ii) Time Bars***

The Contract will usually provide that where the Contractor fails to give the necessary notice (or as the case may be, either of the necessary two notices), the Contractor will be barred under the Contract from bringing a claim for an extension of time and/or delay costs.

There is a substantial body of law as to the effect of such time bar clauses. From time to time, the Courts have declined to give effect to such time bar clauses for various reasons. In each case it will depend on the circumstances. The Contractor who wishes to make such a claim should strictly comply, however, with such time bar notice provisions.

##### ***(iii) Criticality/float***

A pre-requisite to claiming an extension of time, often expressly included in the Contract, is that the Contractor will, in fact, be delayed in achieving practical completion by the Date for Practical Completion.

In effect, the Contract will usually provide that even though a delay might occur, unless that delay occurs to a critical activity (namely, an activity which, if delayed, will consequently delay the Works from being brought to practical completion by the Date for Practical Completion), the Contractor is not to be entitled to an extension of time.

This has been referred, from time to time, as the issue as to "Who Owns the Float?".

On one view, where a Contractor has carefully arranged his affairs (or "husbanded" his time) so as to make certain activities non-critical, then delays which are caused to the Contractor, for which the Contract provides an extension of time, should result in an extension of time (thereby, in fact, giving the Contractor even more time "up his sleeve"). The opposite view is that the Contractor, where delayed on a non-critical activity, should not be entitled to an extension of time because he will not, in fact, be delayed under the Contract.

Contract provisions usually expressly provide for the latter (namely, that the Contractor is not entitled to an extension of time unless that delay is likely to delay him in achieving practical completion, i.e. that the delay occurs to a critical activity only). Despite this, the Courts have tended towards a view that the Contractor, where he has carefully husbanded his time in a particular way, should not be penalised by being denied an extension of time in such circumstances.

Such issues will need to be resolved in each case depending on the particular provisions of the Contract. The likelihood is, however, that a Court would prefer to find in favour of a Contractor where a delay is caused by the Principal (albeit to a non-critical activity) where such an interpretation is available to it.

### **4.3 LIQUIDATED DAMAGES**

The Contractual obligation on the Contractor, in respect of time under the Contract, is to bring the Works to practical completion by the Date for Practical Completion.

Where the Contractor breaches the Contract by failing to bring the Works to practical completion by the Date for Practical Completion, the Principal would, in the absence of any other provision, have a contractual entitlement to sue for general damages.

The convention has evolved, for the common convenience of the parties, that such damages are pre-agreed at the time of entering into the Contract. For this purposes, such damages are usually referred to as "liquidated damages" (in this context, the use of the word "liquidated" means, a specific amount rather than an amount to be determined by the Courts).

In fact, though such liquidated damages are to be paid by the Contractor to the Principal (usually, in fact, they are deducted by the Principal from monies due to the Contractor, where the Principal decides to deduct such liquidated damages at all), the liquidated damages provision is in fact, primarily for the benefit of the Contractor.

The operation of a liquidated damages clause effectively limits the potential exposure of the Contractor to damages for late completion.

There are a number of issues which arise in respect of liquidated damages as follows:-

The Courts have generally declined to enforce "penalty" clauses. For this reason, it is usual to make the liquidated damages a genuine pre-estimate of the damages likely to be suffered by the Principal in the event of late completion (albeit that this pre-estimate is made at the time of entering into the Contract rather than when the delay occurs, at the end of the construction period). The nature of such penalty clauses is beyond the scope of this topic. It may suffice to say, however, that a daily estimate of damages is rarely (if ever) treated as a penalty clause by the Courts. Penalty clauses usually take the nature of an amount unrelated to the actual damage suffered, and which penalty only comes into effect on a particular date.

The quantum of liquidated damages is usually estimated by the parties at the time of entering into the Contract, based on the damages likely to be suffered by the Principal if in fact the Contractor is late in completing the Works. Accordingly, as a matter of contractual negotiation, the amount of damages is typically a "genuine pre-estimate" of those damages. In the absence, however, of agreement on that amount, the parties are open to leave out the liquidated damages clause altogether. In such circumstances, the Principal could sue the Contractor for general damages if the Contractor was late in completing the Works. (The usual reason why the Contractor will insist on a liquidated damages clause is for the reason set out above, namely to limit his potential exposure in such circumstances.)

#### **4.4 DELAY COSTS**

Where the Contractor is delayed in completing the Works, he will usually be exposed to additional costs, irrespective of who caused the delay.

Such "delay costs" will usually arise out of the continuing costs to be borne by the Contractor (for example, crane hire, site shed hire, foreman salaries, other continuing costs including the contribution which the particular project is required to make to the head office overheads...).

Where, therefore, the delay is caused by a breach of contract on the part of the Principal (for example, delay in providing access to the site, or in the provision of drawings and specifications, or through a failure by the Principal to perform activities required of the Principal...) the Contractor will suffer financial loss in addition to the mere loss of time. The Contractor will therefore wish to claim an adjustment to the Contract Sum, or "delay costs", in addition to claiming an extension of time to the Date for Practical Completion.

The best drawn Contracts will usually expressly provide for the Principal to pay such "delay costs" to the Contractor (on the reasoning that in the absence of such an express clause the Contractor will nevertheless have an entitlement to damages against the Principal). Further, the clause will usually expressly limit the Contractor's entitlement in such circumstances.

Interestingly, in AS2124-1981, the delay cost provisions of the Contract referred to the entitlement of the Contractor to claim "extra costs necessarily incurred". On one view, this entitlement somehow limited the

Contractor's entitlement (for example, when compared to the similar provisions in the JCC Contract which referred to "loss ,damage or expenses"). This (effective) clause disappeared in the 1986 revision!

Accordingly, not only will the best drawn Contracts usually expressly provide the Contractor's entitlement to delay costs in particular circumstances, but may seek to limit the extent of that recovery.

## **5. PAYMENT**

### **5.1 PROGRESS CLAIMS/PROGRESS CERTIFICATES/PROGRESS PAYMENTS**

In all traditional standard form contracts, the Contractor is required to periodically deliver, to the Superintendent, progress claims for payment under the contract.

The Superintendent is usually required to assess those progress claims (by reference to the degree of completeness and the quality of the materials and workmanship).

For example, in AS2124-1986, clause 42.1 provides, in part, as follows:-

"42.1 Payment Claims, Certificates and Time for Payment.

At the times for payment claims stated in the Annexure...the Contractor shall deliver to the Superintendent claims for payments supported by evidence of the amount due to the Contractor and such information as the Superintendent may reasonably require. Claims for payment shall include all amounts then due to the Contractor under the Contract or for breach thereof"  
[emphasis added]

Accordingly the Superintendent must calculate the amount due, at that time, having regard to:-

- (i) work carried out by the Contractor in performance of the contract; and
- (ii) claims for breach of contract.

This is a complex calculation.

It might be said that the value of works to be assessed in relation to paragraph (i) could be performed by a quantity surveyor. (In fact, on a number of major projects in the late 1980's, project financiers often preferred quantity surveyors, rather than engineers/architects/superintendents, to assess progress claims...this, possibly, was a preference of project financiers rather than Proprietors.) The difficulty with this type of assessment, however, is that it is necessarily linked to an assessment of quality of materials and workmanship. It is necessary to ensure that the works as completed are in accordance with the technical requirements of the drawings and specifications, and are free of defects. This assessment, in itself, may ultimately become the subject of technical debate.

But perhaps the more complex area is the assessment of payment claims for "breach" of contract.

Claims for breach of contract might include, for example:-

additional payment to the Contractor for latent conditions;

claims for delay costs arising out of extensions of time which were the fault of the Proprietor;

claims for variations which arose out of the Proprietor's failure to give access to the site, or additional work caused by faulty design documentation;

claims for variations arising out of directions by the Superintendent relating to works not included in the contract/tender documents.

In addition, in recent times, the Superintendent might expect from time to time to receive even more complex claims, such as:-

restitution/quantum meruit claims (where the works as constructed are so different from that tendered on, that the contract sum is no longer applicable);

claims for negligence (for example, for additional works caused by negligent preparation of the design drawings specifications);

claims under the Trade Practices Act and/or Fair Trading Act.

Interestingly, this type of claim has traditionally, at least under AS2124-1986, not been required to be assessed by the Superintendent in assessing a progress claim. However, under AS2124-1992, this provision was amended to expand the nature of claims which were to be assessed by the Superintendent. The provision now reads as follows:-

"Claims for payment shall include the value of work carried out by the Contractor in the performance of the Contract to that time **together with all amounts then due to the Contractor arising out of or in connection with the Contract** or for any alleged breach thereof"

[emphasis added].

The additional words (highlighted) seem to include the negligence/quantum meruit/TPA type claims.

In every case, the ambit of the Superintendent's assessment of progress claims will depend on the language of the Contract.

When the Superintendent has assessed the progress claim he would issue the Progress Certificate.

The Progress Certificate is provided to both the Principal and the Contractor. To the extent that either party disputes that Progress Certificate, they are required under the Contract to take certain steps within a particular number of days to dispute that Progress Certificate.

Failing any dispute arising in relation to the Progress Certificate, the Principal then becomes contractually obliged to make the Progress Payment to the Contractor, in accordance with that Progress Certificate, within the number of days as set out in the Contract.

## **5.2 CASH RETENTION/SECURITY**

### **(i) Up to Practical Completion**

The Superintendent, in issuing the Progress Certificate, will calculate the cash retention, if any which is to be taken into account in making any progress payment. (We refer to cash retention and security in more detail in Topic 7.)

The convention historically was for the Contractor to provide security for the performance of his obligations to the Principal by the Principal deducting cash retention from progress payments, usually of the order of 5% of the value of work completed to any point up to the Date of Practical Completion.

The typical provisions for cash retention were to permit the Principal to deduct 5% of the value of works completed up to the point of Practical Completion to enable the Principal, should the need arise, to use those funds to pay others (if necessary) to complete the Contract Works in part or in total as the case required.

In recent times, in fact, the cash retention security has been replaced by bank guarantee security (again, this is referred to in more detail in Topic 7).

From the time of commencing the work up until practical completion, therefore, when issuing Progress Certificates, the Superintendent will usually note the amount of cash retention to be deducted, or not, from such Progress Payments.

The Contract will usually provide that such cash retention or security is to be returned, in part (usually 50%) at Practical Completion.

### **(ii) Defects Liability Period**

The Contract will usually expressly provide for a Defects Liability Period.

Typically such a period might be of the order of 12 months on a major construction contract, could be as little as 3 months on a minor construction contract, or could conceivably be for 2 years or more on a complex industrial project requiring lengthy commissioning periods for equipment. In practice, however, on major works, the Defects Liability Period would usually be of the order of 12 months.

During that Defects Liability Period, the Contractor will usually be expressly obliged to return to the site and rectify defects which become apparent. (We refer to the defects liability provisions in more detail in Topic 6).

Accordingly, at practical completion, part of the cash retention or bank guarantees will usually be returned to the Contractor, and the balance of the cash retention or bank guarantees will be retained throughout the Defects Liability Period. That security which is retained throughout that period is retained for the purpose of, should the need arise, the Principal rectifying such defects.

### **(iii) Final Certificate**

At the end of the Defects Liability Period the Contractor will receive the Final Certificate.

The Final Certificate will usually expressly exclude any further claims being made by the Contractor under the Contract. At that time, the balance of any cash retention or security monies will be returned to the Contractor (with deductions as may be necessary for uncompleted work, if any).

In some instances, the terms of the Final Certificate, and the relevant provisions of the Contract, may exclude any further claim under the contract by the Contractor.

## **5.3 VALUATION OF PROGRESS CLAIMS**

### **5.3.1 Value of Completed Work/Value to Complete**

The nature of a construction contract is that payment is to be made progressively throughout the completion of the Works until practical completion.

The Contractor's entitlement to payment, however, will be in accordance with the Contract Sum, not the actual value of work. All being equal the two amounts (the Contract Sum, and the actual value of the work), should be reasonably similar. The Contract Sum, however, is a matter for the tenderers to compete on and, accordingly, one could imagine that the Contract Sum could be greater than or less than the actual value of the work.

Accordingly, when the Superintendent comes to value the progress claims, he will usually be more interested in the pro-rata percent completion of the Works relative to the Contract Sum than the actual value of work completed.

The Superintendent, in assessing progress claims, will usually make an assessment based on a pro-rata percentage of completed work as against Contract Sum.

There are, however, a number of possible alternative methods for valuation which would include:-

- (i) the value of the completed work on a pure valuation basis;
- (ii) the value of the work still to be completed under the Contract,  
deducted from the total Contract Sum.

Where financiers are involved in the funding of construction work, the latter method of valuation has tended to be adopted from time to time, the financiers being concerned to ensure, for the purposes of their security, that there are at all times sufficient funds left in the finance facility to complete the work if necessary. Accordingly, in certain cases, the Superintendent in assessing the progress claims may be interested in the calculation of the value of the work to be completed, as opposed to the percentage of work completed on a pro-rata basis.

The Contract provisions usually require progress claims to be valued on the basis of the value of work done and will rarely provide for any valuation on the basis of value of work completed or otherwise.

### **5.3.2 Bill of Quantities/Fixed Price/Schedule of Rates**

The Contract Sum which is included in the tenders is a matter for competition between the respective tenderers.

The Contract Sum will usually be a fixed price. From time to time, however, the Principal may prefer to seek tenders based on a Schedule of Rates rather than a fixed price (for example, where the rough quantities are known, but for flexibility and/or difficulty of calculation reasons, the exact final quantities are not known and the Principal prefers to compare the tenderers on the basis of their unit rates rather than a total fixed price).

The Contract Sum may be calculated on a number of different bases, depending on the nature of the particular Contract:-

- Fixed Price

The tenderers will all bid a single price to be the Contract Sum. The price (subject to variations and other such matters expressly provided for in the Contract) will not vary, irrespective of the quantities ultimately encountered on the Contract.

- Schedule of Rates

The tenderers all submit a price based on unit rates. Those prices are, however, submitted pursuant to a schedule containing quantities, usually prepared by the Principal, which indicates quantities within a certain limit of accuracy. Where the quantities, however, are ultimately outside that limit of accuracy (whether or not that limit of accuracy is expressly provided in the Contract) those rates may ultimately be inapplicable under the Contract.

- Bill of Quantities

From time to time, the tenderers will be asked to bid on a fixed price basis but subject, however, to a bill of quantities. In such circumstances, the fixed price is to be applicable only so far as the bill of quantities is accurate within certain limits (whether or not those limits are expressly provided within the Contract itself).

In assessing progress claims, therefore, the Superintendent will sometimes be required to have regard to whether certain quantities for particular items are within a limit of accuracy expressly or impliedly included for particular items in either a schedule of rates or a bill of quantities.

Where such items are outside such a limit of accuracy (whether an express limit of accuracy or an implied limit of accuracy) the Contractor will potentially be entitled to claim payment based on a reasonable sum for the work performed (usually referred to as a "quantum meruit" claim, to which we refer further in Part 5.4.3 below and generally in Topic 10).

### **5.3.3 Payment for Offsite Goods**

The Contract will usually expressly provide whether the Contractor is entitled to include, in progress claims, an amount for goods which have been either ordered, or supplied, but for particular reasons not yet delivered to the site.

Such items might include, for example, bulk steel where that steel has to be purchased and then shipped to a fabrication site prior to delivery to the construction site. The Principal is potentially exposed to loss where goods are to be paid for which have not yet been delivered to the site (for example, if the goods are lost, stolen, or damaged while offsite and out of the Principal's control, or alternatively if the goods are not adequately identified and the Contractor, having received payment for the goods, then goes into liquidation, thereby exposing the Principal to a potential dispute over ownership of the goods).

The Contract should always expressly provide for, at the minimum, the following where payment is to be made for offsite goods:-

- (i) adequate written evidence of the passing of title in the goods to the Principal, upon payment for those goods;
- (ii) adequate identification of the particular goods, appropriate labelling, and separation of those goods from other goods not within the ownership of the Principal, at all times;
- (iii) adequate insurance of those goods while out of the control of the Principal, so as, in the event of their loss, to enable the Principal at all times to have, at a minimum, a good claim against an insurer for the cost of those goods.

In the absence of any of the above, the Superintendent should never certify for payment of goods which have not yet been delivered to the site.

## **5.4 VARIATIONS**

### **5.4.1 Whether Work Constitutes a Variation**

The usual area in which the Superintendent is required to regularly exercise legal judgments under the Contract is in the authorisation and valuation of variations.

These are two separate issues.

The Contractor may assert from time to time that particular works which he has been required to perform (either in accordance with the contract documents, or alternatively pursuant to a direction of the Superintendent) constitute a Variation. The test applied by the Courts is, in substance, that particular work constitutes a variation if it is work outside the works upon which the Contractor tendered/contracted, having regard to the terms of the Contract. (A full discussion of what constitutes a variation is beyond the scope of this paper.)

A number of issues regularly arise in relation to whether or not work constitutes a variation, including:-

- whether work subsequently performed by the Contractor is or is not included in the contract documents;
- whether particular work to be performed by the Contractor is, in accordance with the terms of the Contract, to be inferred from the contract documents; and
- whether the circumstances in which work properly described in the contract documents is to be performed are different from the circumstances described in the tender/contract documents.

These types of variations differ from the easy to understand type of variation, namely where the Proprietor wishes to change the work described in the original contract documents and seeks a quotation from the Contractor prior to that work being performed, which quotation the Proprietor then accepts and orders the variation or not.

The Superintendent's assessment of whether or not work constitutes a variation is more than a technical assessment. It requires skills in interpreting contract documents, a judicial impartiality in listening to the views of the Proprietor and the Contractor, and an ability to interpret documents which often are non-specific in relation to the subject matter of the asserted variation.

As was the case in relation to the assessment of complex claims under the contract in certification of progress claims, the Superintendent is appointed by both parties to the contract to make this assessment. The choice of the Superintendent is, in theory, a matter for the parties at the time of entering into the contract, but is, in practice, a matter which is usually decided solely by the Proprietor.

#### **5.4.2 Valuation of Variations**

The second complex area of assessment for the Superintendent in relation to variations is in the **valuation of variations**.

The common contract regime for valuing variations is, generally, as follows:-

1. the Proprietor (usually through the Superintendent acting as agent of the Proprietor) and the Contractor attempt to agree on the value of the approved variation;
2. failing such agreement, the Superintendent assesses the value of the variation in accordance with any pre-agreed (at the time of entering into the contract) rates which may be applicable for such variations;
3. where there is no such applicable pre-agreement, the Superintendent determines a "reasonable sum", including an amount for the builders oncosts and profit (but, depending in all circumstances, on the express language of the contract).

This regime cannot be avoided.

Effectively, the Superintendent is being asked to put a valuation on works which, by definition, was not agreed between the parties at the time of entering into the contract. It is work which the Contractor is obliged to perform (the Contractor bound himself to do this by entering into a contract which included a

variation clause). The parties did not agree, at the time of entering into the contract, on how much the Contractor would be paid for such work. They merely agreed on the valuation regime.

It is a contractual term, therefore, between the parties, decided upon at the time of entering into the contract, that the Superintendent is to have the last word on the valuation of variations.

### **5.4.3 "Quantum Meruit" Claims**

In certain circumstances, the Contractor will be entitled to claim payment for Works performed for goods provided, outside the terms of the payment provisions of the Contract.

Where, for some reason, the Contractor provides services or goods but the Contract has somehow become inapplicable (for example, the rates for a particular item in a schedule of rates contract being based on particular quantities, those quantities have become widely inaccurate), the Contractor will be entitled to a claim in restitution, colloquially referred to in the construction industry as a "quantum meruit" claim. (We refer to the legal basis for this type of claim, in general, in Topic 10.)

Quantum Meruit claims can arise on construction contracts in a number of ways:-

- Where pursuant to a schedule of rates contract, the quantities for any particular item have become grossly different to the items specified in the original schedule (or are outside the limit of accuracy expressly provided for in the Contract);
- Where the nature of the work performed pursuant to a fixed price contract is fundamentally or dramatically different from that which was tendered for.

In such circumstances, the Contractor will be entitled, as a matter of restitution, in the absence of an applicable contractual entitlement, to be paid a reasonable sum for the goods provided all services performed.

The nature of a Quantum Meruit claim is such that, typically, the entitlement in the Contractor to claim the Quantum Meruit "sneaks up" on the Principal without the claim ever having been foreseen.

The basis for such claim is that, the Contract being no longer applicable, the Contractor is required to a reasonable sum.

## **6. QUALITY**

### **6.1 REQUIREMENTS UNDER THE CONTRACT**

#### **6.1.1 Quality Requirements in Contract Documents**

The provisions, historically, which set out the quality requirements imposed on a Contractor are non-comprehensive, the provisions generally relying on the subject if assessment of a person such as the Superintendent.

Accordingly, when one looks at the standard form such as, for example, AS2124-1992, there is little or no guidance as to what is to be suitable in defining the standard of quality.

There is a comprehensive regime, however, of assessment as to quality by, for example, the Superintendent, and then the giving of directions to rectify defective work.

In recent times, this position has been changed by the introduction of quality assurance systems.

The substantive content of a quality assurance system relates to procedures whereby quality of work is checked, discussed, certain certificates are required to be completed by particular parties, and generally the procedures are set out which will ensure the delivery of appropriate quality on a contract.

Essentially, therefore, the determination of quality remains a subjective assessment by particular persons nominated under the particular contract.

### 6.1.2 Implied Terms

Most contracts will expressly provide that works are to be performed to achieve certain performance criteria, in particular that the work is to be:-

- (i) fit for the purpose for which it was intended;
- (ii) merchantable quality;
- (iii) unless otherwise specified, new;
- (iv) performed with reasonable care and skill...

These pre-requisites, usually expressly included in the contract, are common to many contracts, not merely engineering contracts.

In fact, were these requirements not to be expressly included in the contract, it would be likely that they would be implied into the contract in any event.

You will recall that we discussed, in Topic 1, the issue of implied terms.

There are a number of reasons why such terms as set out above are usually implied, (if not expressly included) in engineering contracts, including:-

such terms are likely to pass the implied term tests set out in detail in Topic 1 (collectively referred to as the "oh, of course" test);

such terms are, from time to time implied into such contracts by reason of legislation (for example, the **Goods Act** 1958 the **Trade Practices Act** 1974 (Cth), **Fair Trading Act...**);

common usage (it is usual, in such engineering contracts, that such terms are accepted amongst members of the industry, though, in particular cases, depending on the nature of the particular work to be performed, one could imagine circumstances where the terms would not be implied...)

Accordingly, in most engineering contracts, in addition to the express specification of the works required to be performed and set out in detail in the Drawings and Specifications, there will usually be a number of implied terms that the works be fit for the purpose for which are intended, that the goods be of merchantable quality, that the materials, unless otherwise specified, be new, and that the workmanship be performed to a standard of reasonable care and skill.

### **6.1.3 Codes**

The nature of engineering contracts is such that a number of SAA (Standards Association of Australia) Codes and usually be expressly included in the specification, or where no express inclusion is made, may be implied into the contract.

For example, where structural steel work is required, one would expect that the code on structural steel work would be either expressly referred to in the specification, or if not expressly included, that there would be an implied term that all work conform to that Code.

A difficulty arises from time to time in preparing those contracts. On one hand, the natural intention of draftsman of such contracts, when preparing the Drawings and Specifications, is to expressly refer to particular SAA Codes, particularly related to the area of work to be performed under the contract. (For example, if there is to be structural steel work, the tenancy is to expressly refer to the SAA Code on structural steel work.)

On the other hand, however, there is an interesting contract interpretation issue, namely that where particular codes are expressly referred to in the specification, one could infer that other codes, not expressly included, do not need to be complied with.

The likelihood is, however, that in the absence of expressly excluding an obligation to comply with any particular code, that a Court if it ever needed to do so, would interpret any contract as to include an implied term, at least, that Codes, were relevant, were to be complied with.

There is a view (which is wrong), expressed from time to time, that it is a matter of law that all Codes be complied with. In fact an examination of the Codes in most instances, indicates an obligation to exercise an engineering judgment. Further, there is, in fact, rarely any express obligation pursuant to legislation and/or any building regulations that particular SAA Codes be complied with.

In all those circumstances, therefore, it is unlikely that one could simply presume that, as a matter of law, all SAA Codes must be complied with. They do not have the force of legislation.

Having regard to the common usage of such Codes, however, and the usual practice of requiring, as a minimum, compliance with particular codes in relation to particular such work, it is likely, it seems to me, that the engineering contracts would usually be interpreted as including, at least, an implied term that codes were generally to be complied with.

## **6.2 DEFECTIVE WORK**

### **6.2.1 Judgment of the Superintendent**

In most engineering contracts there is a person in the role of the Superintendent (whether it be a Superintendent or the principal himself performing the same role).

The test on quality, historically, in engineering contracts, is exercised by that person subjectively.

The identification of defects in engineering works can be complex. It will usually require a personal engineering skill on the part of the person making the assessment. Further, such judgments are often the subject of bitter disputes. For example, a contractor may take the view that work has been satisfactorily completed, albeit that some minor defects are apparent (for example rough fabrication on steel work, or for example inaccuracies in fabrication elements), those minor defects being capable of easy rectification.

Accordingly, therefore, the Superintendent when making an assessment as to quality, we usually be required to exercise engineering judgment, and contract judgment. The determination by a Superintendent that work is "defective" will usually have serious consequences and it is likely, perhaps, that this will colour the Superintendent's subjective engineering judgment.

The test remains, however, under most engineering contracts, as to whether work meets the relevant quality standards, a subjective assessment by the Superintendent.

### **6.2.2 Direction to Remedy**

Where the Superintendent concludes that work is defective, there is a usual regime which the Superintendent can follow to procure compliance by the Contractor with the quality standards under the contract.

The first step which the Superintendent should follow is to give the Contractor formal notice, in writing, that particular work is defective, and that such work is to be remedied.

For example, in AS2124-1992, Clause 30.1 provides that the Superintendent may give the Contractor a notice to rectify defective work, at the contractor's expense.

The effect of that notice is to require the contractor to rectify those works within a reasonable time. Failing this, the Superintendent may choose to give a further notice threatening to take those works out of the contractor's hands and rectified, at the contractor's expense, by others.

The notice requiring that rectification should be clear and should expressly refer to the clause pursuant to which the notice is being made.

In particular, the Superintendent should be careful to ensure that the direction is clear that the works are required because the contractor has failed to comply with the contract. There is a common dispute where the Superintendent gives such a direction. The contractor will usually assert that the work is either not defective, or that he will carry out the necessary rectification at a more convenient time, that necessary rectification being minor and more conveniently performed as a final clean up.

Further, in some cases, the notice if not clearly given might be construed (usually wrongly) as a direction to perform additional works as a variation.

To complicate matters further, from time to time, the contractor might conclude that the works may require rectification, but that the performance of that rectification would be outside the terms of the contract upon which he tendered. Again, in that circumstance, even if the Superintendent clearly required the works to be rectified, those works would be performed as a variation.

## **6.3 QUALITY ASSURANCE PROGRAMS**

### **6.3.1 Nature of Programs**

In recent years, major construction contract works have tended to be performed pursuant to, amongst other things, Quality Assurance Programs.

Quality Assurance Programs are, by nature, a structured method of the parties agreeing on procedures to test, record, certify, and if necessary, rectify, all relevant aspects of quality on a particular contract.

Accordingly, programs usually require matters such as:-

- the provision of particular forms recording test results;
- the completion of such forms and signing off of test result forms by each of the parties;
- the preparation of lists of items requiring rectifications;
- the preparation of such defect if works;
- schedules of items requiring signing off by the Superintendent/Principal (as the case may require).

Such programs are, by their nature, preventative measures aimed at preventing the works being completed with defects. They are pro-active in nature.

### **6.3.2 Contractual Requirement to Comply**

Quality Assurance Programs have only been used in Australia, substantively, in recent years.

For this reason, the major standard form contracts in Australia have, as yet, failed to embrace Quality Assurance Programs completely. To the extent that such major standard forms currently envisage the use of Quality Assurance Programs, they tend towards requirements to the effect that Quality Assurance Programs shall be complied with "if" such programs are provided for in the contract documents (i.e. the major standard forms do not require Quality Assurance Programs, merely compliance with such programs if they are provided elsewhere).

In addition, the major standard forms have tended to expressly provide that the mere compliance with a Quality Assurance Program does not, in itself, satisfy totally the Contractor's obligations of vis-a-vis quality under the Contract.

To date, therefore, the compliance with the quality requirements of the Contract still remains a subjective assessment for the Superintendent albeit that the likelihood of achieving such quality objectives is enhanced by reason of complying with any required Quality Assurance Programs.

## **6.4 DEFECTS LIABILITY PERIOD**

### **6.4.1 Right and Privilege of the Contractor**

Once the Contractor achieves practical completion, the Defects Liability Period will commence.

Typically, on major engineering contracts, there will be a 12 months Defects Liability Period within which defects which become apparent are to be rectified, upon the Contractor being given reasonable notice, by the Contractor at his expense.

The Defects Liability Period may extend for any time, that being a matter for the parties to negotiate under the Contract, however the convention is for the Defects Liability Period on major works to be of the order of 12 months. The period might be as little as, for example, 12 weeks on a minor residential building contract, or long as several years on a major industrial equipment contract.

The critical obligation throughout the Defects Liability Period on the Contractor is that upon being given reasonable notice he attends the site (remembering that by this time he has left the site), within a reasonable period, and rectifies the defect.

There is a fundamental misconception as to the nature of this obligation. In fact, the Defects Liability Period provisions constitute **both a right** and an **obligation**.

It is the privilege of the Contractor to be entitled to return to the site and rectify defects as they appear during the Defects Liability Period. The alternative would be for the Principal to have the defects rectified by others, at the Contractor's expense, and to deduct the costs of that rectification from the security money still being withheld by the Principal throughout the Defects Liability Period. It would be substantially cheaper, as a rule, for the Contractor to attend the site and rectify the Works himself.

In addition, it is also the obligation of the Contractor to return to the site within the period specified under the Contract (or where such a period is not specified, within a reasonable period) to rectify those defects. In this respect, the provisions constitute an obligation on the Contractor to attend and rectify.

### **6.4.2 Failure to Rectify/Rectification by Principal**

In the same manner that the Contract usually provides that, where the Contractor fails to rectify defects, the Principal may take those works out of the hands of the Contractor and perform those Works at the Contractor's expense, similar provisions apply to a failure by the Contractor to rectify defects throughout the Defects Liability Period.

Where the Contractor fails to attend within a reasonable time throughout the Defects Liability Period and rectify such defects, the Principal becomes entitled to have those works rectified by others, and to deduct the cost of that rectification from the monies presently held by the Principal as security for that purpose.

#### **6.4.3 Liability for Defects after Defects Liability Period**

The Contract will usually expressly provide that, upon the completion of the Defects Liability Period, and upon the issue of the Final Certificate, the Contractor shall make no further claim under the Contract against the Principal.

The rationale for this limitation is that, by that time, the Contractor will have had time to sufficiently calculate any entitlement to which he claims to be entitled and to give notice of such a claim, and for the Superintendent to deal with all such claims under the Contract.

In some cases, where the parties so negotiate, a similar exclusion on making claims may be imposed on the Principal. This, however, is rare and there is no logical reason why this should be so.

## **7. INSURANCE**

### **7.1 Types of Construction Insurance**

There are three major construction insurances on a major engineering project:-

#### Contractors All Risk

Contractors all risk insurance covers loss caused to the works which may occur between the commencement of the project and the handing over of the works by the Contractor to the Principal at practical completion.

Such losses might include, for example,:-

- damage caused to part completed works by severe weather conditions
- damage caused by accidents on site

The insurance of such risks is usually required under the Contract to be effected by either the Principal or the Contractor.

The loss covered, on its face, is one which would normally be borne by the Contractor. The Contractor is given access (usually, for all practical purposes, exclusive access) of the site at the commencement of the works. From that moment the Contractor, under the Contract, has the "care and responsibility" for the Works.

Accordingly, if, for example, part completed works are damaged by severe weather conditions, the Contractor would usually be required to restore the works to that condition without entitlement to payment from the Principal.

This, however, would be a hollow remedy for the Principal if, for example, after such damage, the Contractor did not have sufficient funds to complete that respiration work.

For that reason, it is equally critical for the Principal and the Contractor that such potential losses be covered by the Contractors All Risk Insurance.

#### Public Liability/Third Party Liability

The Contract will usually also require the Principal or the Contractor to effect public liability/third party insurance.

The losses which might usually be covered by such insurance include claims by persons who suffer injury or property loss because of defective equipment on the site or defective works (for example, a brick wall falling onto the footpath and damaging parked cars in the street)

The Contractor has the care and responsibility for the works. He also has the control of the Site.

If, for example, a crane was to tip over while working on the site and fall across the fence onto parked cars in the adjacent street, those property owners might typically sue either the Contractor or the Principal or both.

The Contractor would be sued, in negligence, for his failure to properly secure the site, ensure that the equipment did not fall onto adjoining land...the Principal might be sued in negligence (in previous years this might have been generally referred to as "occupiers liability") on the basis that a danger associated with his occupation of the land has caused damage to people on adjoining land.

Again, the Contractor will typically have given an indemnity to the Principal in respect of such losses caused by the negligence of the Contractor or those for whom the Contractor is responsible. For the same reasons as above, however, this may be a hollow remedy for the Principal if, in fact, the Contractor does not have sufficient funds to meet any such claims.

Further, some events will not be caused by the negligence of any person (for example, accidental damage).

In those circumstances, it will be necessary for both the Principal and the Contractor to have such potential claims and/or losses covered by insurance.

#### Workers Compensation

The Contract will usually require that the Contractor effect all necessary and relevant workers compensation insurances.

In recent times, this provision has been a mere contractual obligation imposed on the Contractor to

comply with the relevant workcare legislation.

To the extent that any workman employed on the site is injured or becomes ill the workman would usually have his normal remedies under the workcare legislation against his employer.

Again, however, in the event that the Contractor fail to effect the relevant workcare insurances, there is a potential claim made by a workman employed on the site against the Principal in negligence (although, under the workcare legislation itself, it would be a failure by the Contractor to effect necessary insurances would not necessary dis-entitle such workman).

The Principal is usually satisfied, therefore, with merely imposing the obligation on the Contractor and, from time to time making cursory checks that this has, in fact, been complied with by the Contractor.

In addition to these three major insurances, from time to time the Contract may impose an obligation on either the Principal or the Contractor to effect other insurances including, possibly:-

- motor vehicle insurance

- marine insurance (where goods are to be supplied from overseas)

- environmental insurance (although, in fact, the environmental insurance

- market in Australia is extremely limited)

## **7.2 Who Effects the Insurance? - Principal or Contractor**

The Contract will usually provide **either** that the Principal is to effect the Contractors all risk and/or the public liability insurance, and the Contractor is to effect the workers compensation insurance **or** that the Contractor is to effect all of those insurances.

Where the Principal is to effect those insurances, of course, one would expect lower tender prices (to reflect the cost of that insurance).

Accordingly, therefore, it is a cost neutral issue to the Principal as to whether the Principal effects the insurance or the Contractor effects the insurance.

The modern trend has been for Principals to effect a project insurance on major projects. In that way, the Principal can have the benefit of potential cost economies for its insurance requirements on the projects, and the Principal can be comfortable that the insurances have, in fact, being effected.

The Contractor would usually, however, be required under the Contract to do all of the work of arranging the relevant insurances and providing evidence to the Principal that those insurances have been effected.

On first principles, one would expect the Contractor to effect the insurances. The Principal, typically, will be less - resourced then the Contractor, the Contractor will be aware of the dates proposed for the construction works, the nature of those works, details such as the number of men to be employed on site,

the machinery involves, and the nature of the work, all of which will be relevant to one or other of the insurances to be effected.

Nevertheless, under the Contract, it is either the Principal or the Contractor who will usually be required to effect the above insurances.

### **7.3 Project Insurance**

In recent years, on major projects, the trend has been for the Principal to effect projects insurance to cover all of the various kinds of insurance over the entire project.

Such project insurances are usually placed with one insurer and include:-

- Contractors All Risk
- Public Liability
- Workcare Compensation
- Motor Vehicle Insurance
- Any other insurances relevant to the particular project

The rationale for this has been economy of scale and the desire to ensure, for the Principal, that all relevant insurances have been effected and that no particular losses might fall between the gaps of the respective insurances.

### **7.4 Professional Indemnity Insurance?**

A more complex issue relates to whether the Principal should require professional indemnity insurance to be effected by the Contractor and/or others.

Historically, the Contractor did not carry professional indemnity insurance, the Contractor has been a construction Contractor rather than a professional adviser.

In recent years, however, major construction contractors have tended to include, on their staff, a number of professional people, including engineers, architects, project managers and other such professionals.

Further, such Contractors have tended to become involved in design and construct contracts whereas, in previous times, their role related to construction only.

In all of those circumstances, therefore, the service has been provided by major contractors have included in recent years from time to time, professional services. Accordingly, professional indemnity insurance has become a regular requirement of Principals of such Contractors on projects where professional services are being provided by the Contractor.

This is an extremely expensive type of insurance. It is not an insurance which Principals will necessarily wish to pay for in the absence of a good reason to do so. On balance, however, wherever the Principal is relying on the professional expertise of the Contractor in addition to his contracting obligations, the Principal may choose to require (as it would do normally in respect of its own professional consultants) the Contractor to effect and provide evidence of professional indemnity insurance for the project.

From time to time, the Principal will, in effecting a project insurance, include professional indemnity insurance in respect of all of the professional consultants employed on the project.

## **8. SECURITY**

### **8.1 Cash Retention/Bank Guarantee Alternative**

On major engineering projects, the Contractor will universally be required to provide security for the performance of its obligations under the Contract.

That security, traditionally, was provided by cash retention. The Principal would deduct an amount (usually of the order of 5% of the value of the works completed) from each progressive progress claim from the commencement of the works up until practical completion. At practical completion, usually, part of that cash retention would be returned to the Contractor if it was not required for any reason under the Contract). Typically, the Principal would retain, say, 2.5% of the total Contract sum throughout the Defects Liability Period.

In recent years, an alternative style of security has tended to be preferred by Contractors, namely the provision of bank guarantees in lieu of cash retention.

The attraction of providing a bank guarantee, for the Contract, is that (providing the Contractor has security at its bank for the relevant amount) the cost of the bank guarantee to the Contractor (typically of the order of 0-2% of the sum involved) is negligible in comparison with having the access to the relevant amount of cash flow.

The amount usually provided by way of bank guarantee should mirror the amount which would otherwise be provided by way of cash retention. For example, it is a typical amount to be provided by way of bank guarantee for amount equal to 2.5% of the Contract sum provided at commencement of the works, a second bank guarantee for 2.5% of the Contract sum provided half way through the completion of the works, the first bank guarantee being returned at practical completion, the second bank guarantee being returned at the end of the Defects Liability Period.

The purpose of the Contractor providing this security is to put the Principal in the position, at all times, of being able to step in and complete all or part of the works, as necessary, where the Contractor fails to do so under the Contract.

The critical issue in relation to the form of a bank guarantee is that the bank guarantee (so far as the Principal is concerned) be as good as cash. (I refer to the ability to convert the bank guarantee to cash below.)

## **8.2 Security by Principal?**

The convention has always been to require the Contractor to provide security to the Principal.

In fact, the Principal always has the advantage of the Contractor having completed part of the works prior to becoming entitled to receive payment for that work. (For example, where the Contract commences at the start of month one, submits its progress claim at the end of that month one, receives that progress payment towards the end of month two, then, at all times, the Contractor has completed at least 1-2 months of work for which he has not yet been paid.)

From time to time, however, the Principal has been required to give security to the Contractor.

This is not usual. (In fact, the annexure to AS2124 includes a place for the parties to indicate whether the Principal is to provide security or not.)

Where the Principal is to provide security, again, that security will usually be provided by way of bank guarantee.

One could envisage circumstances in which the Principal might provide security (where, for example, the company with which the Contractor was contracting was **not** the registered proprietor of the land).

Alternatively, there may be some issue about the financial security of the Principal. Alternatively, the Principal might be a foreign corporation and there may be concerns as to the ability of the Contractor to obtain payment where enforcement proceedings ultimately became necessary.

The convention, however, is that the Principal does not usually provide security to the Contractor.

## **8.3 Protection for Principal**

The Principal has substantial security under the Contract to protect it from any failure to complete the works by the Contractor.

That security consists of any or all of the following:-

- the value of the works completed by the Contractor, for which the Contractor has not yet been paid (this will, typically, at any time, be of the order of 1-2 months of works completed by the Contractor);
- the value of any cash retention or bank guarantee provided by way of security by the Contractor to the Principal.

Accordingly, at any time, if the Contractor fails to complete the works, the Principal will have a substantial amount of money with which to step into the shoes of the Contractor and complete the works.

Such circumstances might arise when, for example:-

- the Contractor goes into liquidation during the progress of the works;

- the Contractor, because of a contractual dispute with the Principal, terminates the Contractor and leaves the site;
- the Contractor, for reasons of the Principal, is terminated by the Principal.

In each of these circumstances, irrespective of the Contractor's right to sue for damages if it has a claim against the Principal, the Contractor will in fact typically be holding sufficient funds to re-start the work with another Contractor and complete the works at the Contractors expense.

#### **8.4 Security to Remedy Defective Work**

The Principal, at any time, is holding substantial security to enforce the rectification of defective work..

Where the Contractor performs defective work, and fails upon the Principals or the Superintendents instruction to rectify that defective work, at some point the Principal will become entitled to step into the shoes of the Contractor, rectify that defective work at the Contractor's expense, and deduct the cost of that rectification from monies otherwise due to the Contractor.

Accordingly, where defective works is not remedied by the Contractor, the Principal will usually deduct the cost of that rectification from the next progress payment or, failing that, from subsequent progress payments and any cash retention or bank guarantee security as presently held by the Principal.

#### **8.5 Presentation of Bank Guarantees**

##### **8.5.1 Ability to Convert to Cash: Form of Guarantee**

The rationale for providing security to the Principal is to put the Principal in the position where, irrespective of any contractual entitlement, it can complete the works if necessary, or rectify defective works if necessary, using funds provided by the Contractor.

The recent use of bank guarantees as an alternative to cash retention should have simply substituted a form of security which was equivalent to cash for that cash retention. For various reasons, however, the form of bank guarantee has tended to include, on occasion, certain restrictions on the Principal's ability to present that bank guarantee and convert it to cash.

For example, typical conditions might include:-

- notification of the Contractor with sufficient time, if necessary, for the Contractor to be able to commence Court proceedings to restrain the presentation of the guarantee;
- the need to obtain a judgment from a Court or an Arbitrator entitling the Principal to convert the bank guarantee to cash.

These conditions will, potentially, have the effect of removing the efficacy on the bank guarantee altogether.

The obligation to give notice of ones intention to present a bank guarantee could, conceivably, be seen as preventing a mad scramble to the Courts by a Contractor where it simply guest that the bank guarantee was to be presented. Accordingly, one could possibly justify the inclusion of a condition requiring formal notice to be given a certain number of days prior to presentation of a bank guarantee. Even that, however, will seemingly introduce the additional legal hurdle of, in appropriate circumstances, having to defend a Supreme Court injunction application prior to the Principal's ability to complete the project using the Contractors security monies.

The second condition, however completely removes the advantage of the security. The obligation to obtain a judgment from a Court or an Arbitrator will, typically, involve the Principal in many months of protracted and expensive litigation as a pre-condition to being able to complete the works using the Contractor's money. This seems an unnecessarily expensive condition to impose on the security to be provided by the Contractor to the Principal.

In fact, the more common convention is that where cash retention is not to be provided by the Contractor, the form of bank guarantee is to be a condition-free irrevocable direction to the bank requiring the bank to pay the funds to the Principal without reference to the Contractor.

### **8.5.2 Right to Convert to Cash**

The Principal will, under the Contract, become entitle to take the cash retention monies and/or convert a bank guarantee to cash and use those funds in limited circumstances only.

Such circumstances might include:-

- the Contractor failing to comply with a notice to rectify defective work and the Principal taking those defective works out of the hands of the Contractor;
- the Contractor having the whole of the works remaining to be performed under the Contract taking out of its hands, and the Principal completing those works;
- the Principal becoming entitled to claim, as a debt due, from the Contractor, sums of money relating to the Contractors failure to complete the works by the Date for Practical Completion (including, where provided, the deduction of liquidated damages).

Typically, the Contract will expressly provide those circumstances in which the Principal may have recourse to the security including the conversion of bank guarantees to cash.

### **8.5.3 Injunction to Restrain Presentation of Guarantee**

The presentation of a bank guarantee at a Contractors bank is a serious financial step for the Contractor.

Accordingly, where the Contractor becomes concerned that the Principal is about to present such a bank guarantee at the Contractor's bank, the Contractor will consider whether it would be in his interest to attempt to have the Courts restrain the Principal from presenting the bank guarantee, by way of injunction.

The Principal, in theory, in holding the bank guarantee, is in the same position as if it were holding cash. In theory, the Principal merely needed to present the bank guarantee at the bank named on the guarantee and the bank, without contacting the Contractor, will simply exchange the bank guarantee for the relevant amount of cash.

In practice, however, the Contractor has, from time to time disputed the right of the Principal to convert the bank guarantee to cash under the Contract (for example, the Contractor and the Principal may be in dispute as to whether the Principal has wrongfully terminated the Contract).

On one view, the Contractor should usually be successful in an injunction application where it can establish a prima face case to be argued in the Courts and a lack of commercial inconvenience being caused to the Principal if the injunction is granted (typically, the Contractor will be required to give an undertaking as to damages should the Contractor ultimately fail in any proceedings against the Principal and the Principal suffer loss as a result of being restrained from presenting the bank guarantee).

On balance, however, the Principal will usually be inconvenienced by being able to have recourse to the cash (for example, it will need to arrange alternative funds).

The Courts have tended to decide such applications on the balance of convenience. Contract disputes can be complexed and the rights of the parties are not always clear at first (they will be necessarily subjected to substantial pre-trial preparation on the documents and the facts relied upon by the parties will often vary). In those circumstances, where the Contractor is prepared to provide an undertaking as to damages, and where the Principal will not in fact be substantially inconvenienced by the inability to have recourse to the security (for the present), the Contractor will typically obtain an injunction, at least for a short period, restraining the Principal from presenting the bank guarantee while the issues are sorted out in the proceedings.

For this reason, where the Contractor becomes concerned that the Principal is about to present the bank guarantee, there is often a mad scramble to the Courts to obtain that injunction **before** the Principal in fact presents the bank guarantee at the Contractor's bank.

## **9. DEFAULT/TERMINATION**

### **9.1 Nature of Default**

#### **9.1.1 by the Contractor**

The nature of default under a construction contract is complex.

A Contractor can be in default in a number of ways. For example:-

- by performing work in a poor manner
- by completing work which is defective

- by being late in completing the work.

Those "defaults" comprise failures by the Contractor to perform the works in accordance with his obligations under the Contract. It is often a difficult matter to identify when a Contractor is in default.

### **(i) Delayed Progress**

The Contractor's primary obligation, in relation to time, is to bring the works to practical completion by the Date for Practical Completion.

In theory, if he so desired, the Contractor could leave the works until near the end of the Contract and then bring extra resources onto the works so as to complete by the Date for Practical Completion.

In practice, however, the Contract will usually provide that **after** the execution of the Contract, the Contractor is provide, to the superintendent, a programme for the performance of the works, and then to comply with that programme.

The significance of providing the programme **after** execution of the Contract, is that the programme itself is **not** a Contract document. A minor failure to comply with the programme will not usually, in itself, either put the Contractor in default, or entitle the Principal to sue for damages and/or terminate the Contract.

The provisions of the Contract, however, usually provide that the works are to be performed generally in accordance with the programme prepared by the Contractor.

The primary purpose of the programme is to provide a benchmark to measure the progress of the Contractor during the Contract but prior to the Date for Practical Completion.

The failure of the Contractor to bring the works to practical completion by the Date for Practical Completion is easy to establish. Such a failure (to bring the works to practical completion by the Date for Practical Completion) will usually entitle the Principal to take steps towards termination of the Contract, and will certainly entitle the Contractor to sue for damages, (usually pre-agreed damages, referred to as "liquidated damages").

It is substantially more complex to establish that the Contractor is late in the progress of the works, prior to the Date for Practical Completion.

The consequence of such a lack of progress, or "delayed progress", where it occurs, is, again, complex.

If a Contractor has provided a programme, and is failing to perform the works in accordance with that programme, he will usually be instructed by the principal/superintendent to bring the works back into compliance with that programme. If he fails to do so, he would usually be directed to provide a new programme showing how the works will, ultimately, be brought to practical completion by the Date for Practical Completion.

If the Contractor is substantially behind the programme, then, in theory, he will be in default under the Contract, which could lead to the Principal becoming entitled to exercise the remedies of taking part of or all of the works out of his hands, or terminating the Contract.

The consequences of a wrongful termination, (where termination is not in accordance with the Contract), are extremely serious. Further, there is usually substantial difficulty in identifying whether the Contractor is in fact, so behind in his performance of the works as to put in doubt his ability to bring the works to practical completion by the Date for Practical Completion. In combination, these factors tend to discourage the Principal from exercising contractual remedies based on delayed progress.

Delayed progress alone, therefore, though potentially a serious default, is rarely the basis for termination unless the delayed progress is so substantial as to make it obvious that the Contractor will be unable to complete the works by the Date for Practical Completion.

#### **(ii) Defective Work/Failure to Rectify**

Where the principal/superintendent conclude that the works, as completed are defective, they will usually direct the Contractor to repair, remove, and rectify those defective works. Where the Contractor fails to rectify those works, in accordance with that direction, he will be in default, and serious consequences may follow.

Defective work might include any or all the following:-

- in providing works to a lesser quality than that specified in the Contract documents;
- completing works in accordance with the specification, but which have defects (for example, cracks or corrosion in components);
- completing works intended to have a particular function, but which do not ultimately perform that function (for example, supplying equipment/machinery which does not operate, or does not operate in accordance with the required performance specifications).

The Contractor will usually, where work is obviously defective, prefer to remedy that work, rather than face the potential consequences of such defective work.

In fact, the Contractor has the **right**, as well as the **obligation**, to rectify defective work, rather than have the Principal simply rectify the defective work and deduct the cost of that rectification.

The usual regime available to the principal/superintendent under the Contract, where work is defective, is as follows:

- (a) direct the Contractor, in writing, to rectify the defective work within a specified period;
- (b) where the Contractor fails to rectify that work, direct the Contractor to rectify the work within a specified period, failing which the Principal will take all or part of that defective work out of the

hands of the Contractor, rectify that work himself, and deduct the cost of that rectification from the Contractor's entitlements under the Contract;

- (c) remove all or part of the defective work from the Contractor's hands, have it rectified himself, and deduct the cost of that rectification from the monies owing to the Contractor under the Contract.

Where the defective work is serious enough, and where the Principal has been through the regime set out above but this is still not adequate, such a default would be sufficient potentially for the Principal to terminate the Contract (subject to the Principal acting strictly in accordance with the termination provisions of the Contract).

### **9.1.2 by the Principal**

The Principal is usually only in default where he fails to make a payment due under the Contract by the due date.

In theory, the Principal can be in default in a number of other ways, for example:-

- failing to provide the access to the site on the specified date;
- failing to provide the necessary Contract drawings/specifications by the date required under the Contract;
- failing to provide some matter (for example, water/electricity) as required under the Contract;
- failure to make a payment by the due date.

In practice, wherever there is any failure by the Principal, the Contractor will simply make a claim for additional payment/time and be satisfied with that claim.

The most critical default, therefore, which a Principal can make is a failure to make a payment by the date due under the Contract.

Where the Principal fails to make such a payment by the date due under the Contract, the Contractor will usually have serious remedies available to him, in order:-

- the right to suspend the works, with all necessary adjustments on time and cost which flow from that suspension, until the payment is made;
- the right to terminate the Contract.

## **9.2 Remedies**

### **9.2.1 Notice to Comply**

Where the Contractor is in default, the Contract will usually provide that the Principal may give a notice to the Contractor setting out the default and requiring the Contractor to comply.

For example, in AS2124-1992, the Superintendent may give a direction to the Contractor pursuant to Clause 30.1 to repair defective work. That Contract provides that where such a notice is given, the Contractor is to comply with that notice, failing which he will be in "substantial default" for the purpose of the provisions of Clause 44.

The procedure, therefore, for the principal/superintendent where the Contractors in default is to give the Contractor a Notice to Comply. The failure to comply with such a notice is, itself, a default under the Contract.

### **9.2.2 Take Works Out of the Contractor's Hands**

The failure of the Contractor to comply with a notice to comply will usually entitle the Principal, under the Contract, to remove that part of the works which are the subject of the notice from the Contractor's hands, to have those works performed by others at the Contractor's expense, and to deduct that cost from monies otherwise due to the Contractor under the Contract.

Further, if necessary, the Contract will usually provide that the Principal may deduct such costs from the securities held under the Contract (if the monies owing to the Contractor under the Contract are not sufficient).

This is an extremely serious remedy for the Contractor.

It is a pre-cursor to termination of the Contract. Further, it will usually be substantially more expensive for the Contractor to have such works rectified by others at his expense, then it would have been had the Contractor himself been able to go back and re-perform that defective work.

### **9.2.3 Termination**

Where the Contractor is in default, in a manner expressly set out in the Contract, the Principal may obtain the right to terminate the Contract altogether.

(In addition to the express rights of termination provided in the Contract, the parties both have their common law rights of termination.)

For example, in Clause 44 of AS2124-1992, the Contract expressly defines "substantial default", sets out the express notice provisions which must be given to the Contractor, and brings up a show cause notice procedure which must be followed, prior to the Principal obtaining the right of termination.

The **consequences** of termination are extremely severe.

For example, again in AS2124-1992, those consequences include:-

- (a) removing the Contractor from the site;

- (b) making no further payment to the Contractor (until the notice as to the final cost of the works referred to below);
- (c) retaining any constructional plant which may be on the site which may be necessary for the principal to complete the works;
- (d) having the works completed by others;
- (e) upon the superintendent, the works having been completed, providing a notice as to the final cost of the works, setting out any surplus or shortfall owing to the Contractor, the Contractor then may or may not become entitled to payment of any surplus, or (more usually) the principal becomes entitled to claim as a debt due the amount of any shortfall from the Contractor.

Accordingly, once the Contract has been terminated, the Contractor will receive no further money and, in fact, usually, becomes liable at the end of the job for a shortfall.

In practice, therefore, termination is usually hotly contested.

Where the Principal terminates the Contract, on the basis of the default of the Contractor, the Contractor will usually dispute that it is in default and/or will dispute that the Principal has correctly followed the procedure set out in the termination provisions.

Should the Contractor be correct in such an assertion, namely that he has been wrongly terminated under the Contract, the potential damages which the Contractor might obtain against the Principal in a Court action are substantial.

For this reason, the consequences of wrongful termination being so severe for the Principal, such a remedy is usually taken only as a last resort and must be taken strictly in accordance with the express termination provisions of the Contract.

### **9.3 Conversion of Security to Cash**

The Contractor would usually provide security to the Principal under the Contract.

In recent times, the usual form of security provided is by way of Bank Guarantee for approximately 5% of the Contract Sum. The security could, however, be by way of cash retention or some other form.

Where the Principal terminates the Contract, the Contract would usually expressly provide that, so far as is necessary to give effect to the termination provisions, the Principal may convert the security to cash and use those funds to perform the works.

This is a key right of the Principal and, again, will usually result in the Contractor disputing, in Court if necessary, the right of the principal to convert the security to cash.

### **9.4 Wrongful Termination**

For the reasons set out above, the Contractor will usually dispute the termination of the Contract by the Principal on the grounds that the Contractor is in default.

Where the Principal terminates the Contract, the Contractor if he wishes to contest this will usually say that the Principal has unlawfully terminated the Contract and, by the Principal's conduct, has evidenced an intention to repudiate the Contract and to no longer be bound by it.

The effect of this is that the Contractor will not attempt to stay on the site but will leave the site and sue for damages.