The Construction Verdict - March 2022

Construction Verdict highlights some of the most important legal developments during the last few months relating to the building and construction sectors.

Construction supply chain woes continue, EBOSS reports

The demand for construction materials has escalated drastically over the last 12 months and forecasts from EBOSS suggest that it will only continue to rise until Q3 2022 at the very least. Couple this with a constrained supply chain as a flow-on effect from the pandemic and you have the recipe for continual increases to prices and lead times of construction materials.

Starting with the supply issue, the problem largely stems from the New Zealand industry's reliance on freight. The report found that 90% of all construction product sold in New Zealand is either imported or contains imported components. This dependence on imports was never an issue until the market experienced rapid change over the last year. New Zealand is currently experiencing a significant increase in its construction workload (which include the measures taken to address the housing crisis). Globally, other countries are having the same idea. The United States is experiencing a 15-year housing boom, and both China and India are anticipating construction demand to grow at least 12%. New Zealand is struggling to get access to both materials and freight in the face of this. In fact, EBOSS' survey found that four out of five domestic suppliers are experiencing issues relating to either:

- increased freight costs;
- access to worldwide shipping;
- the lead times for freight getting out of ports;
- delays at NZ ports; or
- freight availability.

These problems are being aggravated by the domestic demand for materials – building consents issued hit an all-time high in the year to July 2021 in New Zealand, eclipsing the previous record set way back in 1974.

Given that supply issues are looking like they're here to stay, parties considering a development project should:

- plan ahead and discuss areas where delays or additional costs can be expected (and ensure these are factored into project budgets and programmes);
- consider mitigation measures available;
- consider whether fixed prices are the best option for the project; and
- consider the financial health of each party and ability of each to continue to perform their obligations if either party takes the risk on cost escalation throughout the life of a project

(including insolvency risk).

You can read the full report here.

Green Star compliance required for Government builds from 2022

In pursuit of its plan for a carbon neutral public sector by 2025, the Government is rolling out a standard which will ensure new buildings over a certain value meet a minimum Green Star rating of five.

From 1 April 2022 this standard will apply to all non-residential government buildings with a capital value over $25m and from 21 April 2023 the standard will apply to all non-residential government buildings with a capital value over $9m.

The Green Star standard evaluates the environmental attributes and performance of a building using a suite of rating tools developed to be applicable to each industry sector. For a five-star rating (or higher), a building must score at least 60 out of a possible 100 points. The system is administered by the NZ Green Building Council and has been adapted to apply to a New Zealand context.

Case Law

Misrepresentation, implied terms: *Davies v Smith [2021] NZHC 2865*

In 2014 the Davies entered into a contract with Mr Smith in his capacity as director of KM Smith Builder Limited (*KM Smith*) to build a house on a property owned by the Davies. The Davies claimed that Mr Smith made representations regarding his ability to manage the project, the cost of the project, and the date of completion which induced them to enter into the contract. The Davies further claimed that the contract contained the following implied terms:

1. The cost estimate was between $2.5 and $2.8m;
2. Mr Smith would ensure costs would be reasonable and in accordance with the contract; and
3. KM Smith would ensure the subcontractor costs were reasonable.

In response to the misrepresentation claims, the Court found that Mr Smith had sufficiently outlined KM Smith's general modus operandi to the Davies in respect of project management and performing work on a cost reimbursement basis. On the date of completion, Doogue J found that, while Mr Smith did provide an indicative date, he qualified that indication heavily so as to fall short of a misrepresentation.

As a result of this finding, the alleged implied terms based on these alleged representations could not be read into the contract. However, the Judge addressed the Davies' submissions all the same.

An implied term as to the price would clearly and unequivocally change the entire nature of the contract which was on a cost reimbursement basis and therefore could not be read in.

The parties were not in dispute about the existence of an implied term that the cost of construction would be reasonable, but the Court found that the Davies failed to establish that the cost expended was not reasonable.

On the subcontractor issue, Doogue J stated that while KM Smith has a contractual duty to keep subcontractor costs to a reasonable level, the Davies were unable to point to any loss occasioned by KM Smith's failure to seek competitive quotes.

Waivers, estoppel: *Valmont Interiors Pty Ltd v Giorgio Armani Australia Pty Ltd (No 2) [2021] NSWCA 93*

This recent decision by the New South Wales Court of Appeal (*NSWCA*) highlights the risk of informal arrangements made to keep projects moving being seen as contractual waivers without express communication otherwise.

Valmont Interiors (*Valmont*) was engaged by Giorgio Armani (*Armani*) for construction and fit-out works of a store at the Sydney Kingsford Smith Airport under a construction contract (*Contract*). Joinery work was to be provided by a separate contractor however, when it became clear that it would not be ready in time, Armani instead directed Valmont to supply the remaining joinery items. Valmont completed the work and sought payment.

Armani refused to pay Valmont for the joinery items on the basis that Valmont had failed to notify Armani of the variation in accordance with the time bar in the Contract.

In the District Court Armani was estopped from relying on the time bar in the Contract because of its own failure to follow the variation procedure when approving and paying for variations. The judge held that the estoppel only applied to work performed up to the date of the email in which Armani made it clear to Valmont that it would rely on the variation procedure going forward. This decision was to Valmont's detriment as most costs had been incurred after the date of the email and Valmont appealed.

On appeal, the NSWCA held that the estoppel had effect both before and after the email. Armani's email did not displace the assumption that Valmont would be compensated for the cost of supplying the joinery. Further, Armani's statement that "there are not variations" suggested that the direction to supply joinery was not a variation, but rather an extra-contractual request by Armani. In the circumstances, the NSWCA found it was unconscionable for Armani to resist payment for the joinery.

This case demonstrates the need for contracting parties to take particular care to familiarise themselves and comply with variation procedures. Informal arrangements made to expedite projects need to be clearly expressed as a one-off if there is a risk they can be viewed as a waiver. Finally, if you believe another party is acting on the false assumption that a waiver exists, the onus is on you correct this assumption.

Please contact our Construction team for more information.

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