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Court ruling could have serious impact on construction contracts

A High Court ruling just released could have serious impact on engineers and construction owners when it comes to construction contracts.

Faced with reconciling aspects of a standard form contract with additional provisions of the Construction Contracts Act (CCA), the court has treated certificates issued by the engineer under NZS3910:1998 as being made **on behalf of the owner** – despite the contract expressly requiring the engineer to act independently of either party when issuing certificates.

This puts the engineer in a difficult position. If they issue a payment certificate on behalf of the owner, they could come under fire from the contractor. However, if the engineer acts independently of the owner, they might end up binding the owner without the owner's authority.

And for the owner, they may find themselves stuck with a certificate issued by the engineer (purporting to act on the owner's behalf) with which they disagree, but are still considered to have "made".

In this article, we discuss the background giving rise to the case, the court's considerations and the implications of the case.

The Act and the New Zealand Standard

One of the most commonly used standard form contracts in the construction industry has been the New Zealand Standard NZS3910 series of Conditions of Contract for Building and Civil Engineering Construction. The latest version (NZS3910:2003) came after the CCA 2002.

However, the situation gets tricky because an earlier version (NZS3910:1998) was not only used in the period between the CCA coming into force and the 2003 version becoming available, but has also continued to be used by contractors and engineers who – being very familiar with the 1998 edition – resisted change. Pre-dating the CCA by a good number of years, it unsurprisingly contains no reference to the CCA, nor to payment claims and payment schedules.

CCA default provisions vs contracts

Although it is not possible to contract out of the CCA, certain aspects of it only apply if not already dealt with in the contract. In particular, default provisions of the CCA which can be overridden by contract are:

- The number, frequency and value of progress payments claimable under the contract, and the due date for such

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payments; and

- The period within which a payment schedule is to be served following receipt of a payment claim.

A liberal approach has been taken in determining what constitutes a payment claim or payment schedule. And likewise, the court has upheld contractual provisions over the CCA’s default provisions, where the contract covers the above matters in substance (even if not using the precise same terminology as the CCA).

NZS3910:1998 and the case in question

Last month the High Court delivered its judgment in *Marsden Villas Limited v Wooding Construction Limited* – in which the court sought to reconcile the payment claim and certificate contractual provisions of NZS3910:1998 with the CCA’s default provisions.

In this case, the contractor had issued payment claims. It said that payment schedules had not been issued in time and it was owed \$2.9million payable immediately. On that basis, the contractor suspended all work.

Two key issues arose:

Claims to be submitted for work carried out “during periods of not less than one month”

A clause in the standard NZS:3910:1998 terms allows payment claims to be made for work carried out “during periods of not less than one month”. This is unchanged in the 2003 version.

However, it appears that the contractor in the *Marsden* case issued a payment claim for works carried out for 1 to 27 February – but not 28 February. The 28th was a working day so the period claimed was held to be shorter than one month.

The owner argued that this meant that the payment claim was defective. The court disagreed, and confirmed that such a technicality did **not** invalidate the payment claim. Even though the payment claim was for a lesser period than one month, the contractor could still rely on it.

Payment schedule to be provided within 10 working days per the contract

The second issue was whether the CCA’s 20 working day default period for a payment schedule applied, or whether NZS3910:1998 shortened the period to 10 working days.

The court held the latter – but in doing so, it appears to have treated the contract’s terms about the issue of engineer’s progress payment certificates as being equivalent to terms about the provision of payment schedules.

Was the court right?

With respect, the court may be mistaken in its approach to NZS3910:1998’s payment provisions.

The role of the engineer under NZS3910:1998

The CCA requires payment claims to be served on the owner (which the CCA calls the “payer”). Likewise, payment schedules are to be served by a owner. In either case, the owner/payer can authorise a person to receive or serve the claim or schedule on its behalf.

However, NZS3910:1998 provides that the engineer has a dual role. Although usually the engineer acts as the **owner’s agent** (e.g giving the contractor directions on behalf of the owner), when it comes to valuing work and/or issuing certificates the engineer is expressly required by the contract to act **independently**.

How does that fit in with the CCA?

What this means is that when a contractor applies to the engineer for a payment certificate, the engineer does not receive the contractor's claim as an agent of the owner. So when the engineer issues a payment certificate, again they are not doing so as the owner's agent. Nor can the owner direct the engineer over the certificate contents – if the owner disagrees with the certificate, then it must have recourse to the dispute provisions set out in section 13 of NZS3910:1998.

The key difference is that:

- **an engineer's certificate** sets out the amount which **an independent party** (as the engineer is to be, in providing such certificates) considers to be properly payable; whereas
- **a payment schedule** sets out the amount which **the owner** proposes to pay, and the owner's reasons for any difference between that and the claimed amount.

In light of that, it is difficult to see how NZS3910:1998's provisions for the engineer's certification of payment can be treated as equating to the provision of a payment schedule by the owner. And if that is the case, then NZS3910:1998 does not provide for any timing of a payment schedule being issued by or on behalf of the owner – and the CCA's default 20 working day period should apply.

How does the post-CCA NZS3910:2003 fit in with this?

The 2003 version deals with claims and payment certificates differently to 1998, in the following ways:

- The contractor sends the original of its claim for payment to the owner, and a copy to the engineer;
- Within seven working days later, the engineer assesses the claim and issues

the original of its certificate (a provisional Progress Payment Schedule) to the owner, and a copy to the contractor. At this stage the engineer is acting in an **independent role**;

- Within three working days later, the owner notifies the engineer of any changes it requires the engineer to make to that provisional schedule; and
- Within two working days later (and no later than 12 working days from receipt of the contractor's payment claim) the engineer is to issue – on behalf of the owner – a payment schedule to the contractor (and copied to the owner). In other words, at this stage the engineer is acting **on behalf of the owner**.

The difference here is that, as per the CCA, the payment claim is from the contractor to the owner and the payment schedule is from the owner (through its agent) to the contractor – with the engineer's role as independent administrator.

What about where the engineer has purported to issue payment schedules in NZS3910:1998?

From the *Marsden* judgment it seems, as a matter of practice during the contract, the engineer had been issuing to the contractor documents expressly purporting to be payment schedules on behalf of the owner.

There is nothing to stop a person (including the engineer) issuing payment schedules on behalf of a owner, so long as they either have the owner's authority to do so (and if they don't, then they may be personally liable to the owner and/or the contractor). But that does not change the fact that under the agreement – as set out in NZS3910:1998 – the engineer is not the owner's agent when it comes to payment claims and/or schedules.

Where the owner's post-contractual conduct (or that of its agent) differs from the terms of

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the contract, that is unlikely to constitute a variation of the contract. This means that even if the owner (or its agent) has in the past provided its payment schedules within 10 working days of receipt of the payment claim, this would not normally amount to an agreement – and the owner could subsequently revert to the actual contract provisions (or the CCA’s default provisions if the contract is silent).

What does the *Marsden* judgment mean for engineers and owners?

If the court’s approach to NZS3910:1998 is followed then this has serious impact on both engineers and owners.

For engineers

The judgment means that an engineer administering a NZS3910:1998 contract now faces a real conflict. In issuing the payment certificate they must somehow both act independently and as the owner’s representative – the two roles will not easily marry. An engineer who issues a certificate without the owner’s authorisation (or in a form with which the owner disagrees) may face a claim for breach of authority or agency by the owner, as may an engineer who fails to issue a certificate within the 10 working day period.

The safest practice for an engineer may well now be to issue a single document that both certifies (independently) what the engineer considers to be the proper amount payable and then set out any further owner-directed amendments to indicate a scheduled amount that the owner proposes to pay. That last part is important – the court has previously held that an engineer’s assessment alone does not constitute a payment schedule because it does not set out an amount which the owner proposes to pay.

For owners

The judgment means that owners will need to have a proactive role in production of the engineer’s certificate. Otherwise, even if the owner disagrees with the engineer’s certificate, it will need to pay the amount set out in it anyway.

The safest practice for a owner would be to expressly require the engineer to include certain deductions in the engineer’s certificate – and if the engineer refuses to do so, then to consider whether either it is possible to pursue the engineer for breach of agency and/or whether the owner should send its own payment schedule to the contractor within the 10 working day period. In doing so, the owner should state that the engineer is not authorised to purport to issue any payment schedules on the owner’s behalf.

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