Contractors' right(s) to terminate for non-payment


STUART ROBERTSON, PARTNER, AND **SAM McCUTCHEON,** SOLICITOR,
KENSINGTON SWAN'S CONSTRUCTION TEAM

THE COURT OF APPEAL has recently released its judgment in Custom Street Hotel Ltd v Plus Construction NZ Ltd [2017] NZCA 36. This has clarified the contractor's right to terminate an NZS 3910 contract where there has been failure to pay by the principal.

The disputes between Custom Street and Plus Contracting were the subject of adjudications and then an arbitration. The arbitral award was appealed, on points of law, to the High Court. The High Court judgment was subsequently appealed to the Court of Appeal. We have previously written two separate articles discussing certain aspects of the High Court decision:

- The relationship between a contractor's right to suspend work under the Construction Contracts Act 2002 and the right to suspend under NZS 3910 (Right to suspend left dangling – October 2016); and
- The application of the Contractual Remedies Act 1979 to termination for non-payment under NZS 3910 (Who's heard of the Contractual Remedies Act 1979? – November 2016).

The Court of Appeal has recently released its judgment, finding in the contractor's favour on all points. This article focuses on when a contractor will have a right to terminate following non-payment by a principal.

Summary of events

Custom Street was the principal under a NZS 3910:2003 contract with Plus Construction. Plus was experiencing significant delays in its work and had ceased work completely by 23 July 2014. A series of disputes were referred by Plus to adjudication under the CCA. The result of one determination was to render 'time at large', meaning Plus had a reasonable time to complete the contract works.

The engineer subsequently certified that Plus had either abandoned the contract or was persistently, flagrantly, or wilfully neglecting to carry out its contractual obligations. Plus did not remedy these defaults and Custom Street moved to terminate the contract. Plus issued a notice of default under clause 14.3.3 before Custom Street could terminate, asserting Custom Street was in default by failing to pay amounts owing to Plus. Plus issued a notice requiring the engineer to suspend the whole of the contract works before the 10 working days under clause 14.3.3 had expired, and purported to terminate the contract before the engineer had ordered a suspension.

Plus proceeded to arbitration, the result of which was appealed to the High Court on five points of law. The High Court found in Plus' favour on all points and subsequently Custom Street was granted leave to appeal four of those points to the Court of Appeal.

Termination for non-payment

One question every contractor should be asking if they are not receiving payment is "When am I entitled to terminate this contract?".This was one of the questions on appeal in Custom Street and the Court of Appeal has set out two separate options to terminate in that circumstance:

- under clause 14 of NZS 3910 (the relevant provisions are the same in both the 2003 and 2013 editions of NZS 3910); or
- under the Contract and Commercial Law Act 2017 (CCL Act) (which has now superseded the Contractual Remedies Act 1979).

Overall this is good news for contractors. We discuss each of the grounds for termination below but also note that we have some reservations around whether the CCL Act will apply in circumstances where NZS 3910 already provides a remedy.

Termination under clause 14.3.3

In Custom Street, Plus terminated the contract under clause 14.3.3. The literal wording of clause 14.3.3 provides that if the non-payment has not been remedied within 10 working days of the contractor providing notice (of non-payment), the contractor may require the engineer to suspend the whole of the contract works, and that:

Following such suspension the Contractor shall be entitled without prejudice to any other rights and remedies to terminate the Contract by giving notice in writing to the Principal. (emphasis ours)

Plus sent an email requiring the engineer to suspend the contract works but the engineer did not issue a suspension notice as the works had already been suspended for other reasons.

The arbitrator found that the suspension was merely a procedural step and not a prerequisite to termination and the fact that an engineer may have not suspended the contract works should not rob the contractor of the right they would otherwise have to terminate the contract. Although the High Court took a different approach to termination (see below), the Court of Appeal largely affirmed the arbitrator's approach.

The Court of Appeal adopted what, in our view, is a strained interpretation of clause 14.3.3; ignoring the words 'Following such suspension' (being of the whole of the contract works) and finding that upon expiry of the 10 working day period a contractor has two independent rights; a right to suspend the contract works, and a separate right to terminate the contract.

The problem with this finding is that it goes against the clear reading of the clause. Rightly or wrongly clause 14.3.3 expressly states that suspension of the whole of the contract works by the engineer is a prerequisite to termination. There is no ambiguity in these words and the Court's decision

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to simply ignore them in the circumstances goes against freedom of contract.

This is a positive finding for contractors who can now move to terminate a contract immediately upon the expiry of the 10 working day period. However, due to the reservations we have noted above, we recommend that that you separately request a suspension before terminating. If the NZ Standards committee were reviewing NZS 3910 in the future, we would encourage it to also address clause 14.3.3.

Termination under the CCL Act

Although it was not expressly raised in argument, the High Court held that Plus was entitled to terminate under the Contractual Remedies Act 1979. The Contractual Remedies Act has since been superseded by the CCL Act although the effect of the relevant provisions has not been changed. We refer to the current CCL Act for the purposes of discussion in this article.

The remedies under the CCL Act are intended to apply where a contract is silent on the effect of a particular breach and a remedy for it. We discussed the High Court's reasoning in our earlier article, *Who's heard of the Contractual Remedies Act 1979? (*Contractor *November 2016)* and queried whether the CRA should apply to non-payment given NZS 3910 adequately covers this position.

While we still have reservations on this issue, the Court of Appeal expressly confirmed that in circumstances of non-payment under NZS 3910 a contractor will have a right to cancel under both the CCL Act and separately under the contract. In reaching this finding there was no detailed discussion on the interface between the CCL Act and the provisions of NZS 3910 and we are of the view that this is an area that warrants further consideration in the future.

Positive outcome for contractors

Despite the concerns over the legal merits of the judgment, the outcome is nothing but positive for contractors. Where a principal has failed to pay amounts due a contractor now has two separate options to terminate, either:

- under clause 14.3.3 where payment has not been received within the 10 working day notice period under clause 14.3.3 (regardless of whether suspension has been instructed by the engineer); and
- under the CCL Act where there has been misrepresentation, repudiation or material breach.

Although this is a beneficial judgment for contractors, given the complexities discussed above we recommend that you always seek legal advice before seeking to terminate a contract using either (or both) of NZS 3910 or the CCL Act. A wrongful termination will leave you open to a damages claim by the innocent party.

NB: The content of this article is not legal advice.

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