IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA449/2017
[2018] NZCA 132

BETWEEN	RICHINA PACIFIC LIMITED First Appellant	
	AAI LIMITED (FORMERLY VERO INSURANCE LIMITED) Second Appellant	
AND	SAMSON CORPORATION LIMITED Respondent	

Hearing:	21 March 2018
Court:	Kós P, Miller and Gilbert JJ
Counsel:	D J Chisholm QC and DAC Bullock for First Appellant S Stokes for Second Appellant G J Christie and JRJ Knight for Respondent
Judgment:	1 May 2018 at 3.00 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The respondent is entitled to one set of costs, payable by both appellants, for a standard appeal on a band B basis and usual disbursements. We certify for second counsel.

REASONS OF THE COURT

(Given by Miller J)

[1] The principal question in this appeal is whether a performance bond given by AAI Ltd (the second appellant) to secure the performance of a building contractor, Mainzeal Property & Construction Ltd, was discharged when Mainzeal and the building owner, Samson Corporation Ltd (the respondent), agreed to allow the contract engineer to certify practical completion on terms that expressly excluded part of the contract works, an automated car stacker.

[2] The bond provided that it would be "null and void" if Mainzeal "duly carries out and fulfils all the obligations imposed on [it] by the Contract Documents prior to commencement of the period of Defects Liability".

[3] Mainzeal went into receivership on 6 February 2013 without completing its obligations under the construction contract. In particular, the car stacker never met the contractual performance standard. The appellants do not dispute this, but they argue that AAI is not liable to pay out under the bond. The case for AAI is as follows: the period of defects liability commenced when the engineer to the contract certified practical completion; the certificate, which was given on 25 September 2012, could not and did not have partial effect, so the bond was discharged at that point; or alternatively that the parties instead varied the contract by agreeing to treat the car stacker as a deferred work to which no practical completion requirement attached.

[4] Richina Pacific Ltd (the first appellant) was the parent company of Mainzeal, and it agreed to indemnify AAI for any payments the latter made pursuant to the bond. It contends, in the alternative to AAI's argument, that the bond was discharged because AAI was disadvantaged; the arrangement between Samson and Mainzeal allowed Samson into possession prematurely and resulted in Samson paying retentions prematurely. It is said that the construction contract did not provide for these things. The bond contained an indulgence clause stating that it was not discharged by, among other events, any alteration in the terms of the construction contract, but Richina says this clause does not apply. In its written submissions AAI itself did not advance this

argument, which presumes that the practical completion certificate did not discharge the bond, but when asked Mr Stokes (who appeared for AAI) adopted it before us.[1]

[5] Samson succeeded before Hinton J, who found on the facts that Samson and Mainzeal agreed to partial practical completion and behaved accordingly; and further that the indulgence clause applied and in any event AAI was not prejudiced by what had happened.[2]

[6] We agree in the result and our reasons may be expressed relatively shortly. In particular, reference should be made to the judgment below for a fuller account of the facts.

The construction contract

[7] In 2010 Samson engaged Mainzeal to erect the Geyser Building at 100 Parnell Rd, Auckland. It was a complex of five buildings around a common courtyard with shared basement parking. The contract price of approximately $37m included a provisional $5.1m for the car stacker, a machine which was to shuttle vehicles from central garages to 165 parking spaces over four basement virtual garages via turntables, transfer shuttles, lifts, and rails, all using an automated control system. Mainzeal subcontracted the stacker to International Parking Systems Ltd (IPS).

[8] The contract employed New Zealand Standards conditions of contract NZS 3910:2003 and incorporated, among other documents, a number of special and general conditions together with the specifications. These included performance tests for the stacker, which must process a vehicle every 36 seconds, equating to 92 inbound movements and nine outbound in one hour for morning traffic and 18 inbound and 110 outbound in one hour for evening traffic. It is common ground that practical completion required that the stacker pass those tests, which were set to meet a condition of the building's resource consent designed to avoid queues on the site and in the street outside.

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1 We were told that Richina has paid AAI, which in turn has paid Samson subject to this appeal.
2 *Richina Pacific Ltd v AAI Ltd* [2017] NZHC 1686.

[9] Jeremy Hay of Resource Coordination Partners Ltd was appointed engineer to the contract. It was his duty, among other things, to certify practical completion, which was defined as:

> 10.4.1 … that stage in the execution of the work under the contract when the Contract Works or any Separable Portion are complete except for minor omissions and minor defects:
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> (a) Which in the opinion of the Engineer the Contractor has reasonable grounds for not promptly correcting; and
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> (b) Which do not prevent the Contract Works or Separable Portion from being used for their intended purpose; and
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> (c) Rectification of which will not prejudice the convenient use of the Contract Works or any Separable Portion.

Special conditions extended this definition to require evidence that, among other things, a code compliance certificate had been sought and the works had been completed to the satisfaction of the territorial authority such that a code compliance certificate would issue in due course.

[10] It will be seen that practical completion was achieved when the works were complete except for minor omissions and minor defects. A "Separable Portion" was defined as any part of the works which the parties agreed would be completed and handed over separately from the rest of the works. Such portion might attract its own practical completion requirement.

[11] The contract also provided that with Mainzeal's agreement Samson was entitled, before practical completion, to occupy any separable portion of the works that was sufficiently completed to allow such occupancy or use without unduly interfering with Mainzeal's work:

> 10.7.2 The Principal shall be entitled prior to the issue of a certificate of Practical Completion to the occupancy or use by itself or its nominee of any portion of the Contract Works which is sufficiently completed to allow such occupancy or use without undue interference with the work of the Contactor. Such occupancy or use shall be subject to the consent of the Contractor and to the agreement of the Principal and the Contractor that the portion of the Contract Works shall be a Separable Portion.

[12] Mainzeal was liable for liquidated damages for delay past the scheduled completion date of 29 March 2012, at $6,450 per calendar day.

The bond

[13] The contract required that the contractor provide a bond to secure its performance. Mainzeal procured AAI to issue the bond, securing it with an indemnity supported by Richina's guarantee.

[14] The bond specified that Mainzeal and AAI were jointly and severally bound to Samson in the sum of $2m and provided that it was to remain in full force and effect except as provided in cl 2, which stated relevantly that the bond shall be "null and void" if:

> (a) [Mainzeal] duly carries out and fulfills all the obligations imposed on [it] by the Contract Documents prior to commencement of period of Defects Liability referred to in the Contract Documents.

The contract provided that the period of defects liability commenced on the date of practical completion of the contract works or separable portion. So commencement of the period of defects liability under the bond was synonymous with practical completion of the works or any separable portion under the construction contract. The bond would be discharged if, upon practical completion, Mainzeal had performed all its obligations under the construction contract.

[15] The indulgence clause provided:

> 4. THE Surety shall not be released from any liability under this bond:
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> (a) By any alteration in the terms of the contract between the Principal and the Contractor;
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> (b) By any alteration in the extent or nature of the Contract Works to be completed, delivered and maintained;
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> (c) By any allowance of time by the Principal or by the Engineer appointed by the Principal under the Contract Documents;
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> (d) By any forbearance or waiver by the Principal or by the Engineer in respect of any of the Contractor's obligations or in respect of any default on the part of the Contractor.

[16] The bond was given on 27 May 2010, and the premium was calculated on the basis that it would expire on 17 August 2012.

The proceedings

[17] The proceeding was commenced by Richina, which sought a declaratory judgment that AAI was not liable to Samson under the bond. Samson did not accept that Richina had standing or that the declaratory judgment procedure was appropriate, but we need not concern ourselves with that, for Samson filed a cross-claim against AAI, pleading that it was liable under the bond, and AAI denied liability, joining cause with Richina. The decision on Samson's cross-claim accordingly disposes of the proceeding, except as to costs in the High Court, which remain to be fixed there. We decline Richina's invitation to interfere with an indication given by the Judge as to her likely approach to costs.[3]

[18] Richina and AAI pleaded that Mainzeal's obligations had been completed when practical completion was certified, no separable portions having been agreed. They pleaded in the alternative that the bond was discharged for several reasons, of which some were abandoned before us, leaving only the two mentioned above (allowing Samson into possession and paying retentions). An appeal as to quantum was also not pursued.

[19] A single notice of appeal was filed for Richina and AAI, though they were separately represented before us.

Practical completion

[20] Mainzeal experienced construction delays which began with the foundations and eventually triggered its liability for liquidated damages. By 1 July 2012 the amount payable had risen to more than $600,000. Mainzeal was anxious to mitigate this liability. For its part, Samson had agreed to let parts of the complex to tenants from 31 August and was anxious to take possession.

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3 At [152] and [161].

[21] On 23 August 2012 Mainzeal applied to the engineer for practical completion, listing a significant number of items which it wanted the parties to agree to treat as deferred works (we discuss this term at [31] below). The list did not include the car stacker. Mr Hay declined, listing a number of items which must be completed or altered to qualify for practical completion.

[22] He refused to treat the listed works, or any works, as deferred works. A contract instruction issued on 24 August following an inspection stated that "[w]ith consideration of the items highlighted within your letter as 'deferred works' and the works inspected, we advise that we are unable to issue Practical Completion of the Works at this time".

[23] On 24 August 2012 performance tests were attempted but aborted when the stacker broke down. On or about the same date, Mainzeal agreed to allow Samson into possession of three of the two buildings and the car stacker, in return for a pro rata reduction in liquidated damages. The parties later extended this agreement to reflect Samson entering into possession of a third building.

[24] On 31 August Samson took possession of the three buildings and began to use the car stacker. By 5 September it had taken possession of all five buildings, and by agreement liquidated damages ceased to run.

[25] At this time the stacker still could not achieve the performance standard and it was unreliable. IPS remained on site and its technicians operated the machine manually.

[26] Mainzeal reapplied for practical completion on 18 September, again asking that listed items be treated as deferred works and again omitting the car stacker.

[27] On 25 September 2012 Mr Hay issued a certificate of practical completion stating that "with the exception of the car stacker machine" the contract works had reached practical completion as at 14 September 2012. Practical completion was "granted with the exception of" certain listed items which were to be completed no later than 31 October 2012. One of those items was:

> Car Stacker Performance to be demonstrated in accordance with our letter dated 1st July 2010 and Contract Instruction 59 issued 22 September 2010.

The certificate added that the bond would not be released until the listed items were completed.

[28] At no time did Mainzeal suggest that the stacker met the performance standard or resist its exclusion from the practical completion certificate or assert that the certificate discharged the bond. On the contrary, it agreed at a meeting on 25 September to defer the car stacker performance tests until the machine was running more reliably. It then set about achieving practical completion for the stacker and acknowledged at a series of close-out meetings that practical completion had not been achieved. This continued until 21 December 2012, when Mainzeal advised the engineer that following a demonstration the previous day the machine "is now at a required position to achieve Practical Completion". It also secured from AAI a series of extensions for the bond, beginning on 28 September 2012.

Was the bond discharged on issue of the practical completion certificate?

[29] We have summarised AAI's argument at [3] above. It was put in various ways, all of which proceeded on the premise that the 25 September certificate of practical completion brought Mainzeal's obligations to an end.

[30] We do not accept the premise. Under clause 2(a) the bond was discharged only if at the date of practical completion Mainzeal had duly carried out and fulfilled all obligations imposed on it under the contract documents. At no material time did Mainzeal ever complete those obligations. It certainly had not done so when the certificate was given. Accordingly, the giving of the certificate did not discharge Mainzeal.

[31] We need not go further, but in deference to counsel we briefly address Mr Stokes's argument that the engineer was obliged to certify practical completion, or that the certificate should be deemed unconditional, because the stacker was treated as "deferred works", meaning, to use the definition that Mr Hemi, Mainzeal's regional manager, later adopted in evidence, parts of the contract works that have no significant

effect on use of the building and can be done after practical completion, that the parties agree to complete later, and that attract no separate practical completion requirement. In Mr Hemi's opinion such items are usually minor.

[32] We make two points about this. First, we observe that Mr Hay had a different understanding of the term. He described deferred works as "major incomplete or defective items" which the parties agree to defer to a later date. Mr Hay's understanding is more plausible, since the definition of practical completion already excludes minor defects and omissions that do not affect use and which the engineer finds excusable. We are not prepared to accept that an agreement to treat part of a building as a deferred work necessarily excuses that part from practical completion; whether it does so must be a question of fact.

[33] Second, the argument fails on the facts. We have noted that the engineer refused Mainzeal's request to treat a number of items as deferred works. The certificate which followed was quite clear that it excluded the stacker, which had still to meet the performance tests and must do so by a fixed date. Hinton J found that the parties proceeded accordingly.[4] We agree. Most importantly, the claim that the stacker was somehow excused compliance with practical completion requirements is untenable. The stacker was no minor part of the works; as Mr Hay explained, it was "fundamental" that the machine achieve the performance criteria. No agreement to treat it as a deferred work can be inferred from the exchange of schedules before practical completion; it was not even in Mainzeal's proposed list of deferred works and the engineer refused to treat anything as a deferred work. The evidence shows rather that the parties agreed the stacker must pass the performance tests and far from disputing the engineer's certificate, Mainzeal set to work on the stacker so that it could have practical completion certified.

[34] Hinton J characterised this arrangement as a variation, reasoning that the contract did not provide for partial practical completion and there was insufficient evidence of the stacker having been treated as a separable portion.[5]

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4 *Richina Pacific Ltd v AAI Ltd*, above n 2, at [81]–[89].
5 At [81]–[82].

[35] We respectfully differ from the Judge's characterisation of the arrangement. First, the Judge recognised that there is very little difference between a partial certificate and a certificate for a separable portion.[6] So far as this case is concerned, we think there is no difference at all. That is so because either way the stacker remained subject to practical completion.

[36] Second, under the terms of contract the principal and contractor must be party to a separable portion agreement but there are no process requirements. The evidence plainly sustains the Judge's conclusion that in September Samson and Mainzeal agreed for immediate mutual benefit to defer practical completion for the stacker and authorise it for the balance of the works. That being so, they treated the two as separable portions under the contract.[7]

[37] We consider that the evidence supports this conclusion. Mr Creemers accepted that the term "separable portion" was not used but explained that "we would just talk about parts of the building". Mr Hay said in his reply brief that he carved the stacker out of the practical completion certificate, so effectively treating it as a separable portion. And while Mr Chisholm QC, (who appeared for Richina, and who represented both appellants in the High Court) had him concede in cross-examination that "at a technical level" there was probably no agreement to create a separable portion, Mr Hay rejected the alternative explanations that the stacker was treated as a deferred work or included in practical completion. When it was put to him that in substance he was saying that there were separable portions he agreed, saying that what creates a separable portion is an agreement between the parties that certain works are not practically complete and adding that to accommodate Samson's desire for access and Mainzeal's for diminution of liquidated damages "we were trying break the contract into parcels" amounting to separate portions. In our opinion, that is what he achieved by excluding the stacker from the practical completion certificate, and the parties concurred in that course of action.

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6 At [78].

7 The stacker was not the only item reserved, but nothing turns on this point.

Was the bond discharged on Samson being allowed into possession?

[38] We now turn to Richina's alternative argument that AAI was discharged because the agreement between Samson and Mainzeal was beyond the scope of the indulgence clause and adverse to AAI.[8] As noted, this argument focused on two actions. The first was the decision to allow Samson into possession of the entire contract works; and the second, the voluntary decision to release retentions to Mainzeal.

[39] The indulgence clause encompassed any alteration in the contract terms, or the extent and nature of the contract works (it is set out above at [15]). It also covered the giving of time by the engineer. If the parties agreed to vary the contract by allowing for partial practical completion, as Hinton J found, their agreement would be captured as an alteration in the contract terms. On the view we prefer, however, the parties merely did that which the contract expressly allowed by treating the stacker and the rest of the works as separable portions and allowing Samson into possession of the latter. As between Samson and AAI, this is properly characterised not as a variation of the contract but a behaviour expressly permitted by it.

[40] As noted, Samson was also permitted to use the car stacker although it had yet to achieve practical completion. The contract expressly envisaged that with Mainzeal's consent possession of a separable portion might precede practical completion. We have held that the stacker was a separable portion and Mainzeal unquestionably agreed to Samson using it. It is debateable whether Samson actually took possession of the stacker; IPS technicians remained on site to work on it and operate it. But if Samson did take possession, it did so pursuant to the construction contract and not by way of variation.

[41] If contrary to the view we have just expressed, it was an alteration of the terms of the contract to allow Samson into possession of the stacker, we are satisfied that it was covered by cl 4(a) of the bond. We reject Mr Chisholm's submission that although

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8 *Trade Indemnity Company Ltd v Workington Harbour and Dock Board* [1937] AC 1 (PC) at 21 per Lord Atkin; *Triodos Bank NV v Dobbs* [2005] EWCA Civ 630, [2005] 2 CLC 95 at [14]–[18] per Longmore LJ; and *Samson Corporation Ltd v Macrennie Commercial Construction Ltd* [2014] NZHC 1203 at [99].

within the plain language, this action was beyond the bond's purview and so excluded. The purview doctrine holds that an indulgence clause is confined to acts of indulgence within the general purview of a guarantee, unless such acts are contemplated by the principal contract which is the subject of the guarantee.[9] The contract expressly contemplated that Mainzeal might allow Samson into possession before practical completion.

[42] On this analysis the question of prejudice to AAI does not arise. That would fall for consideration only if the construction contract had been altered, or the parties to it had behaved, in a manner not contemplated by the bond.

Was the bond discharged on Samson paying retentions for the car stacker?

[43] Mainzeal submitted a claim for payment in connection with its 18 September application for practical completion. Under the general terms of contract, it fell to the engineer to evaluate the claim and issue a provisional payment certificate certifying the amount that he considered payable. Samson might protest, but in the event that it did not, the contract specified that it must then pay that sum.

[44] The special conditions provided that 20 per cent of total retentions must be released following practical completion and lodgment of an application for code compliance. Where there was a separable portion, cl 12.3.1 of the general conditions provided that the amount to be retained was to be reduced by such percentage as the engineer considered equitable:

> 12.3.1 The Principal shall, in accordance with the Progress Payment Schedule, retain out of the amount which would otherwise be payable such retention monies as are required under the Special Conditions in respect of the whole of the Contract Works or any Separable Portion. The amount to be retained in respect to the Contract Works shall be reduced upon the completion of any Separable Portion under 10.7.2 by such percentage as shall be equitable. The percentage reduction shall be determined by the Engineer.

[45] Mr Hay certified Mainzeal's claim without any deduction from retentions for the car stacker, and Samson paid the certified amount. It is evident that Mr Hay

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9 *Trade Indemnity Company Ltd v Workington Harbour and Dock Board*, above n 11, at 21; and *CIMC Raffles Offshore Singapore Ltd v Schahin Holding SA* [2013] EWCA Civ 644, [2013] 2 All ER (Comm) 760 at [34]–[36].

considered the payment of retentions equitable. He explained in evidence that he felt at the time that the remaining retentions would suffice to protect Samson during the defects period. The total retentions paid to Mainzeal came to $100,000, and Hinton J found that any deduction from that sum for the car stacker would have amounted to $13,000—14,000, which she considered de minimis.[10]

[46] Richina's attack on the payment rests on two premises. The first, which we have rejected, is that the stacker was not a separable portion. The second, which we also reject, is that practical completion never occurred. The argument is that for these reasons Samson was under no legal obligation to pay any of the the retentions. So, for example, Mr Chishom submitted that the payment was voluntary if there was no complete certificate of practical completion issued, and emphasised that in cross-examination Mr Creemers accepted that Samson's payment was voluntary.

[47] We do not accept that the retentions payment was voluntary. Samson was obliged to pay what the engineer certified following his decision to certify practical completion for a separable portion of the works. It was entitled to be heard on the matter but that did not make the payment voluntary once the engineer exercised his contractual authority to certify it. It appears from his evidence that Mr Creemers lacked an expert's familiarity with the conditions of contract, and his attention was not drawn to the relevant provisions before he was invited to accept that the payment was voluntary. In the circumstances we attach no weight to his opinion. As we have noted above, it was also within Mr Hay's power, if he found it equitable, to allow a nil deduction from the retentions payment on account of the stacker.

[48] We conclude that retentions were paid in performance of Samson's obligations under the contract and so the act of payment could not discharge the bond. We need not address Hinton J's conclusions that there was a waiver for purposes of the indulgence clause and that insofar as the payment included retentions for the stacker it caused AAI no prejudice.[11]

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10 *Richina Pacific Ltd v AAI Ltd*, above n 2, at [105].
11 At [104]–[105] and [108].

Result

[49] The appeal is dismissed.

[50] The respondent is entitled to one set of costs, payable by both appellants, for a standard appeal on a band B basis and usual disbursements. We certify for second counsel.

Solicitors:
Lee Salmon Long, Auckland for First Appellant
Dawson Harford, Auckland for Second Appellant
Simpson Grierson, Auckland for Respondent