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Newsletter February 2016

Welcome to the February edition of the Doyles Construction Lawyers newsletter.

We hope you enjoy the articles.

Cost Plus – Nirvana or Hedes?

Often a contractor celebrates when a customer agrees to contract with him on a cost plus arrangement. A cost plus arrangement can either be a simple cost plus contract or a more complex cost plus deal like a guaranteed maximum price with share of savings.

However, contractors should realise that the cost plus type of contract contemplates an approach to payment which is substantially different to that in a fixed price lump sum contract.

LUMP SUM

In a fixed price lump sum contract the builder is entitled to spend whatever money he wishes to carry out the works. He is then to be paid the value of the works under the contract and whether or not he makes a profit or has been inefficient is a matter for himself.

Any expenses he incurs while undertaking a fixed price contract are a matter for the builder. He can employ an accounting system or a management style and culture to his satisfaction. If the work is done competently in accordance with the contract he is entitled to be paid and entitled to take whatever profit he has made from that project.

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COST PLUS

In contrast a cost plus arrangement makes the builder responsible for the justification of each and every item of the costs claimed and demonstrating the necessity and reasonableness of every cost to the owner. The owner often complains that costs have been incurred unnecessarily and have not been properly proved and cost too much, and the goods or services might have been used on other projects of the builder. Tight adherence to detailed budgets is essential

Additionally, if the builder has accounting processes do which not allow him to physically trace each invoice to its use on the owner's project then the owner may lose confidence in the builder's honesty.

MECHANICS

Further all cost plus contracts should include specific provisions to ensure that the parties identify and agree the costs on a regular basis and either approve or disapprove of the costs progressively. This avoids a major dispute at the end of the project when one or two years of cost claims have to be reviewed in detail.

Further the charges for builder's preliminaries and builder supplied labour or equipment should be agreed up front and the quantity to be used budgeted in advance each month.

THE SWINGS AND ROUNDABOUTS MAY BALANCE

Additionally, of course in a lump sum contract the builder benefits by the cost savings in some sections of the work and bears the cost over runs in others.

In the cost plus contract he has no savings to take care of any cost over runs. Accordingly, his efficiency in one area will reduce the cost for which he will receive no benefit whereas his inefficiency in other areas might increase the costs where those costs may not be paid by the owner.

PLUS PLUS

Additionally, the contractor should be careful to ensure that his margin is accurately defined as either including profit only, profit plus head office over heads, profit plus head office overheads, plus site office overheads and/or site resources. The clear definition of what is covered by the margin is vitally important to the overall success of the project to the builder.

DEFECTS

The question of defects needs to be considered carefully. Is the builder to be paid for pursuing subcontractors who do defective work or is the builder out of his margin expected to rectify the defects of any disappearing or bankrupt subcontractor? The risk allocation should make a substantial change to the margin in the contract.

HEAVEN OR HELL

Until a builder ensures that the contract protects him from an unnecessary and usually acrimonious dispute, he may expect nirvana and end up in hedes.

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Why litigants should carefully choose expert witnesses

Expert evidence has been identified as one of the principal sources of expense, complexity and delay in civil proceedings. In this article we l outline the consequences that can happen to one of the parties when an “expert” is found to less than objective and not an expert.

The moral of the story is to ensure your expert is expert and objective too.

A recent Building Case highlights the consequences for litigants

This is an extract from a recent VCAT decision *Dwell v Nava Homes Pty Ltd* where the Tribunal made very clear findings about the role of experts.

<u>The Brief Facts</u>

Mrs Dwell (Owner) entered into a contract with Nava Homes Pty Ltd (Builder) for the construction of a new home in Williamstown.

The construction of the home included the supply and laying of approximately 100 square metres of internal ceramic tiling. The Owner contends the laying of the tiling is defective and claims $16,469.50 for its removal and replacement.

The tiling was laid as a stack bond pattern using approximately 2.5 mm to 3.00 mm width grout joints straight and true in both directions.

<u>The Issues</u>

There are two issues to be determined:

- Was the installation of the tiling defective or non-compliant with the relevant Australian Standard and/or the 2007 Building Commission Guide to Standards and Tolerances?
- If so, what is the appropriate method and reasonable cost of rectification?

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Was the installation of the tiles defective or non-compliant?

The owners expert inspected the tiling on 19 July 2014 and provided a report to the Owner dated 28 July 2014.

At the commencement of the hearing, the builders experts report was produced, which was undated but was said to comprise: "*First Response 30/10/2014 – Second Response after Inspection 03/02/2015".*

Although the report claims to comply with the Practice Note, but it did not comply with paragraphs 8 (*An expert has a paramount duty to the Tribunal and not to the party retaining the expert)*, 9 (*An expert witness has an overriding duty to assist the Tribunal on matter relevant to the expert's expertise)*, 10 (*An expert is not an advocate for a party to a proceeding)* 11(*What must be included in the report of an expert witness*), 16 (*The format of an expert witness report*), and 24 (*When must an expert witness report be filed and served)*.

In his report and oral evidence to the Tribunal, the expert appeared not to assist the Tribunal but was seen as an advocate for Nova Homes Pty Ltd. The report was dated 28 October 2014, contains photographs that do not have any accompanying explanatory notes and was not filed with the Tribunal until the day of the hearing or served on The Owner at all. Addendum A to the report was headed *Rectification Cost Estimate,* the value of which was shown as $0.00.

Not only was the expert's response to the owners expert report initially prepared before he himself had inspected the tiling, his response to paragraphs 28-41was simply an attack on the owners expert credibility. For example -

> *"The CTS report writer has made assumptions that are not within his area of expertise. I have read through the owner's expert resume and found no formal qualifications that he has any conference to make these statements other than personal opinion. (sic) He is not noted as an engineer in either structural or thermal and his opinions are not fact. The owner's expert has taken a position of foretelling some future event that has not at this point occurred.*
>
> *The owner's expert alarmist approach to suggest Critical failure may well cause the home owners to seek a costly legal assistance as they have taken the owners expert's word for the near pending disaster that he would suggest is about to happen.*
>
> *I caution all parties to seek qualified professional opinions that are based on solid engineering facts, rather than gut feel and pending gloom." [sic]*

The expert evidence findings

The outcome of this proceeding was determined by the evidence of the respective experts called by each party.

The tribunal preferred the evidence of the owner's expert for the following reasons:

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- The Owners expert has had 48 years' experience in the tiling industry, 30 of which were in the employ of a major tiling company and subsequently as a private consultant to the tiling industry;
- Although he does not have any formal academic qualifications, he has accreditation under AS/ISO 9001 (Quality Management Systems) achieved in 1987, and upgraded in 1994;
- He has held a number of senior positions in the tile and stone, and construction industries and I find that he is qualified to offer an opinion on the quality of the tiling works.
- Before compiling his report, he inspected the tiling at the subject property;
- His report complies with Practice Note PNVCAT 2: Expert Evidence;
- His report and evidence demonstrates a detailed knowledge of the causes of defective tiling works.

On the other hand, the builder's expert:

- Has academic qualifications in building surveying only;
- Claims to be qualified to teach Australian Standard 3958.1 – Tile Installation, but his report did not identify the institution from where he has obtained this qualification;
- Has no qualifications as an engineer although he criticises the owners expert for a similar lack of engineering qualifications;
- Has practical experience as a carpenter, an owner-builder and a site manager on residential and commercial projects;
- Does not have specific experience in the practical aspects of tiling;
- Responded to the owner's expert's report before he inspected the tiling; and
- In his report in reply to the owner's expert report, failed to adequately respond to the owner's expert's opinion as to the causes of the defective tiling works.

Therefore the tribunal did not have regard to the builder's expert's reports or evidence.

Summary

The effective and fair use of expert evidence is one of the most significant issues which the courts now face and this case serves a warning to experts and parties and illustrates the desirability of using experts who are truly expert as well as exercising objectivity.

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A Costly Case of Slab Heave

A recent VCAT decision highlights the need for builders to carefully follow engineering drawings when undertaking site excavation and to ensure that proper drainage is installed to stop water reaching the foundation of the slab to prevent the possibility of slab heave.

Background to the Dispute

Ms Watson was the Owner of a house located in West Melton, Victoria. Richwall Pty Ltd ("the Builder") was engaged by the Owner under a building contract dated 7 July 2007 to construct a house for the Owner for an agreed price of $224,650.00.

The house was constructed on a waffle pod raft slab designed by McFarlane and Partners Pty Ltd ("McFarlane"). McFarlane were initially joined to the proceedings but were removed prior to the commencement of the hearing.

Construction of the house commenced in early August 2007 and possession of the completed house was given to the Owner on 6 December 2007.

Complaints

The Owner gave evidence that approximately 3 months after moving into the house she noticed cracks in the lounge room and front bedroom. After that time further cracks appeared in the en suite bathroom, the kitchen and along a wall in the family room. The Builder was notified and carried out repairs in April 2009 as well as additional repairs from time to time thereafter.

Despite the repairs the cracking continued to worsen. The Owner also noticed that during periods of high wind a creaking noise could be heard in the roof space. The Builder refused to undertake further rectification work and the Owner commenced proceedings in November 2013.

Slab Heave

The main issue considered by VCAT related to the movement of the slab upon which the House was constructed.

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Upon examination it was found that there was a significant amount of subsidence in the slab with a difference of some 66mm between the base point of the slab and the north east corner of the house which was the highest point of the slab.

The difference in slab height was compounded by the fact that the fall between the highest and lowest points of the slab was uneven with a noticeable heave present half way along the back wall of the house resulting from a separated articulation joint. This had left a 30mm rise relative to the base point. An additional rise in the slab was also noted in the garage floor area where a rise of over 40mm was noted.

What Went Wrong and Why?

The primary questions considered by VACT were why had the slab deformed in the way it did and was the slab heave in some way caused by poor workmanship on the part of the Builder? Some additional building defects were also considered although not all defects related to the slab heave problem.

The Onus of Proof

VCAT found that in order for the Owner to be successful it was insufficient for the Owner simply to prove because the onus of proof rested with the Owner to show that the slab heave and movement was caused by the Builder's faulty workmanship.

Relevant Considerations

The question of whether the geotechnical engineer had correctly assessed the soil classification was considered and a general consensus was reached that the classification of "H" indicating a highly reactive soil was correct.

From a number of photographs taken by the Owner during construction a conclusion was reached that the Builder had not included any spoon drain even though an early draft floor plan prepared by the Builder's designer indicated the need for such drainage.

Although this document was not a contractual document and had no binding force on the Builder, expert evidence suggested that the direct consequence of failing to put in place proper drainage was that water pooled next to the footprint of the slab. It was suggested that the pooled water then soaked into the soil and caused the slab heave to occur.

Additionally, during the hearing it came to light that the Builder had not installed sealed clay around the edge of the slab footprint with the effect that moisture content was not consistent for the entirety of the slab.

What Caused the Slab Heave?

Photographs taken during construction showed that the slab was left open while the frame was constructed. These photographs also appeared to confirm the lack of a spoon drain or grading of the soil away from the slab during construction.

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During the hearing it also became apparent that following construction of the roof and guttering, no temporary downpipes were attached to direct water away from the footprint of the slab. Further photographs taken during construction suggested that even at the time the brickwork for the house was largely completed downpipes had still not been installed.

In the Builder's favour VCAT found that problems with the alfresco area of the house were not caused by any defective workmanship on the part of the Builder but had been caused by the reactive nature of the soil coupled with a variation requested by the Owner, being the construction of a timber deck rather than the concrete covered area provided for in the drawings as well as the later construction of the Owner of a roof to protect the adjacent area from rainwater.

Taking into account all of the expert and factual evidence it was found that the slab heave problems arose because the Builder failed to prepare the site as directed in the engineering drawings by grading the soil away from the building footprint and then by placing uncompacted fill up to the level of the rebate.

The effect of this was that any water that entered the fill and reached the level of excavation was not directed away from the house but continued to affect the foundation of the slab. As the clay at the level of the base of slab was not sloped away from the footprint, as was required in the design, water was still able to reach the slab though the soil that the Builder had deposited around the edge of the slab.

The Cost of Rectification

The Builder was ordered to pay the Owner the sum of $62,066.67 being the sum calculated for rectification works to the slab as well as the repair of consequential damage caused by the slab heave such as re-tiling in the en suite bathroom.

The rectification costs ordered to be paid by the Builder were equivalent to almost 28% (over a quarter) of the original contract price and would almost certainly have wiped out most if not all of the profit earned by the Builder on this particular job.

The question of costs was reserved. However, given the length of the hearing and the number of expert witnesses called, in our experience costs would have well exceeded the rectification costs which would be a further sting in the tail for the Builder.

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The benefits of mediation in a commercial dispute

Court cases are expensive and that legal costs could escalate to an intolerable level. Lawyers will often recommend alternative dispute resolution options - mediation being one.

Mediation allows parties to remain in control of their own disputes and outcome while facilitating parties to tell their side of the story to the other party and the mediator.

What exactly is mediation?

Mediation is one form of alternative dispute resolution while others available include Early Neutral Evaluation, Expert Determination and Arbitration.

In essence mediation is an informal conflict resolution process brought before an independent, neutral third party. Mediation gives the parties the opportunity to discuss their issues, clear up misunderstandings, and find areas of agreement in a way that would never be possible in a court case.

Mediation is often voluntary. Typically, the mediator has no authority to make a binding decision *unless* both parties agree to give the mediator that power which is dealt with in advance of the mediation commencing.

When parties should consider mediation

In practical terms mediation is likely to be quicker and more cost-effective than the more formal processes of arbitration or litigation (in Court). Mediation should be considered as early as possible after a dispute has arisen. It is particularly appropriate where a dispute involves complex issues and/or multiple parties.

In addition, mediation can be implemented prior to, or in conjunction with, other forms of dispute resolution such as arbitration or court proceedings.

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In circumstances where privacy and confidentiality are important, mediation enables parties to preserve these rights without public disclosure. This often leads to more satisfactory outcomes for both parties.

Advantages of mediation

There are many advantages, in summary these can be described as:

- **You get to decide:**
  The responsibility and authority for coming to an agreement remain with the people who have the conflict. The dispute is viewed as a problem to be solved. The mediator doesn't make the decisions, and you don't need to "take your chances" in the courtroom.

  In doing this however, naturally you need to understand your legal rights so that you can make decisions that are in your own best interests.

- **The focus is on needs and interests:**
  Mediation examines the underlying causes of the problem and looks at what solutions best suit *your* unique needs and to satisfy *your* interests.

- **For a continuing relationship:**
  Colleagues, business partners, and family members have to continue to deal with each other co-operatively. Going to court can divide people and increase hostility. Mediation looks to the future. It helps end the problem, not the relationship.

- **Mediation deals with feelings:**
  Each person is encouraged to tell their own story in their own way. Discussing both legal and personal issues can help you develop a new understanding of yourself and the other person. You are encouraged to see things from the other person's perspective.

- **Higher satisfaction:**
  Participants in mediation report higher satisfaction rates than people who go to Court. Because of their active involvement, they have a higher commitment to upholding the settlement than people who have a judge decide for them. Mediations end in agreement about 80% of the time and have high rates of compliance.

- **Informality:**
  Mediation can be a less intimidating process than going to Court. Since there are no strict rules of procedure, this flexibility allows the people involved to find the best path to agreement. Although it is normal for any dispute resolution to be taxing emotionally, mediation is a process that is much less confronting and is conducted in a much more comfortable environment than litigation.

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- **Faster than going to court:**
  Time can pass before a case comes to trial, while a mediated agreement may be obtained in a couple of hours or in sessions over a few weeks.

- **Lower cost:**
  The Court process is expensive, and costs can exceed benefits. It may be more important to apply that money to solving the problem, to repairing damages, or to paying someone back. If you can't agree, other legal options are still possible. Even a partial settlement can lessen later litigation fees.

- **Privacy:**
  Unlike most Court cases, which are matters of public record, most mediations are confidential.

Where mediation is not the solution

With mediation a resolution is not guaranteed. There is the potential that parties may invest time and money in trying to resolve a dispute out of Court, and still end up having to go to Court. Ultimately it is a call that should be made in consultation with an experienced lawyer.

Mediation should not be a solution in circumstances where it is not appropriate. For example, where a Court remedy is necessary such as an injunction or seeking specific urgent Court orders.

It must also be remembered that the mediator has no power to impose a binding decision on the parties. Therefore, even after the mediation the matter may be unresolved and you may still need to go to Court.

Fundamentally, mediation rarely produces a satisfactory resolution **unless** both parties to a dispute are committed to a resolution.

Conclusion

Mediation is an alternative to using the Court system. It is suitable for people who are willing to communicate with the other party and attempt to better understand and settle their dispute with the help of a trained third party.

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