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## Report suggests NZS Conditions of Contract overdue for an overhaul

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In September 2019 the Government passed legislation creating the New Zealand Infrastructure Commission, Te Waihanga (*Commission*). The Commission seeks to lift infrastructure planning and delivery to a more strategic level and by doing so, improve New Zealand's long-term economic performance and social wellbeing.

In August 2019 the Commission (then the Infrastructure Transactions Unit of Treasury) published a report by Urban Outcomes entitled '*An examination of issues associated with the use of NZS Conditions of Contract*' (*Report*). The Report found that the standard form contract governing many of these infrastructure projects is not operating as effectively or efficiently as intended.

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The New Zealand Standard Conditions of Contract for Building and Civil Engineering Construction (*NZS Conditions of Contract*) is designed to provide comprehensive, balanced and readable contract forms that are widely understood by industry players and can be used for a variety of projects. NZS 3910:2013 is the most widely used construction contract in the New Zealand market.

While NZS 3910 has benefited from 'limited scope reviews' in 2003 and 2013, the contract has not undergone significant revision since 1987. The Report indicates that further significant revision may be required or, at the very least, that a change in the broader contracting culture surrounding the contract needs to take place.

The overarching finding of the Report is that there exists a 'culture of mistrust' between the public and private sectors. The Report identifies several issues with public sector procurement and contracting of major infrastructure projects that have led to this, namely:

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that a skills gap is evident within most public sector agencies;

- the perception that the public sector prioritises lowest price over value for money;
- that special contract conditions are difficult to read and understand;
- that time bars are being used as a means for the public sector to get “something for nothing”;
- that there is no provision in the NZS Conditions of Contract for caps on contractors’ liability;
- the impartiality of the Engineer to the Contract; and
- that use of risk transfer is unsustainable and aggressive.

### **Skills Gap within the Public Sector**

Given that the primary role of most public sector agencies is to deliver services to the public, infrastructure investment takes on a subsidiary role. As a result, there is a lack of experience and expertise in construction at an executive level within the public sector which inhibits the potential for informed and proactive approaches to the resolution of issues during construction projects. The Report suggests that ‘unworkable bureaucracy’ is then required to get a project complete.

The Report recommends that executive level governance is encouraged to call on independent industry experts to advise on project dynamics alongside legal advisors. Such support would assist executive members’ understanding of key success and risk factors as well as advising on the feasibility of project timelines.

### **Lowest Price Procurement Practices**

There is a view within industry that the Government follows a ‘lowest-price-wins’ culture. The fourth edition of the Government Procurement Rules (*Rules*), which came into force on 1 October 2019 (after the Report was released), aims to change this perception. The Rules require public sector agencies to undertake a holistic assessment of the public value of a tender during the procurement process. Whether the Rules result in a change to this culture will be known in time. Ultimately, poor procurement processes can lead to poor documentation, poor supply chain performance, and an increased risk of contractor failures.

In order to rebuild confidence in public sector processes, the Report proposes agencies strive for greater transparency, publish high quality tender documentation, and actively pursue and resolve examples of poor internal procurement processes.

### **Difficult to Understand Special Conditions**

Special conditions are often added to the NZS Conditions of Contract to provide contractual flexibility for different operating environments. Accordingly, contracts can become long and highly technical. General, specific and special conditions, as well as schedules and often annexures together form contracts consisting of multiple documents that need to be pieced together.

The Report recommends following other international standards by allowing the tracking of changes into the general conditions of contract. This would allow parties to create one succinct but comprehensive document.

### **Unreasonableness of Time Bars**

Time bars are a common special condition that provide the public sector with cost and time certainty in relation to variations. Time bars disentitle the contractor from claiming for the cost and time impact of variations that are instructed and completed on site, if the contractor has not submitted its claim within a set time.

The contractual timeframe is often limited to 10 working days. If a contractor fails to meet the timeframe or fails to provide the level of detail required, it may be ineligible for payment despite still having to complete the works required by the variation. This conduct heightens the culture of mistrust between parties and creates an expectation that the condition will be used as a disentitlement regime.

Among its proposals, the Report recommends time bars be adjusted to a minimum of one month or, alternatively, fixed for the final account and linked to the retention release.

### **Lack of Contractors' Liability Caps**

Clients and contractors have starkly contrasting views on the inclusion of liability caps and, if included, how they should operate.

An apprehension to bearing all liability is based on the industry's perception that such liability may extend far beyond what could otherwise be earned for the work. Clearly an unsustainable approach. Conversely, principals face a potential risk highlighted in the Report where, if a project is going badly, and the contractor is approaching a liability cap, it may decide to walk away rather than completing the project.

There is opportunity to contribute to a sustainable construction sector by providing guidance to public sector agencies outlining when a liability cap is appropriate and what that limitation might look like.

### **Impartiality of the Engineer to the Contract**

The Engineer to the Contract (*Engineer*) is expected to act, simultaneously, as an impartial intermediary between parties, an independent certifier and expert advisor and representative of the principal, giving directions to the contractor on the

principal's behalf. The Engineer undertakes all of these roles while generally being on the principal's payroll. The potential for conflict issues to arise is clear.

The role of the Engineer is critical for both parties under a construction contract, which is why it is vital that the actual independence (as well as the perceived independence) of the role remains. The Report advocates for the establishment of a panel of individual experts who can be procured by the public sector for a specific project. These panel members would be agreed on upfront by public sector agencies and industry.

### **Unsustainable Risk Transfer**

The transfer of specific risk should only occur if the recipient is best placed to manage the risk and its cost. In some cases, the Report found risks that were entirely out of the contractor's control were nonetheless transferred despite the contractor having no viable means to mitigate that risk. In other cases, where risk has not been transferred, contractors have been unwilling to assist in managing risks because they were not directly affected by them.

The Report suggests that guidance be issued in relation to risk transfer, detailing the purpose of risk, as well as the potential impacts of misplaced risk. Business cases should include a transparent risk transfer table together with cost and time implications so that informed decisions can be made as to whether a risk is retained, shared, or transferred.

*New Zealand's public sector spends up to \$10 billion annually on the procurement of infrastructure.*

The Report concludes that addressing the highlighted issues will enable the NZS Conditions of Contract to function as intended and provide a contractual foundation for infrastructure where both the public and private sectors feel that their interests are protected. This in turn will increase the performance of the sectors in procuring and delivering infrastructure projects.

Our Construction team prepares a number of NZS 3910 contracts for infrastructure projects throughout New Zealand and we are dedicated to developing and maintaining strong partnerships between the public and private sectors. We contributed to the Report (through a client) and participated in a subsequent workshop led by the Infrastructure Transactions Unit to discuss its findings.

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